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**GEOPOLITICS
AND
STAGFLATION :**
IMPLICATIONS ON THE
LOW-INCOME GROUP
IN MALAYSIA

**SPEAKER**

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GEOPOLITICS AND STAGFLATION : IMPLICATIONS ON THE LOW - INCOME GROUPS IN MALAYSIA

“Stagflation may be global in origin, but solutions must be local in response”

EXECUTIVE SUMMARY

This MSIA Reading Series features a Hard Talk presentation by renowned political economist Professor Jomo Kwame Sundaram. The discourse provides an exhaustive critical evaluation of Malaysia's contemporary macroeconomic structure and structural bottlenecks in industrial growth, labor market rigidities, and necessary fiscal realignments.

Over the course of the session, Jomo articulated a systematic critique of contemporary orthodox economic planning, urging policy planners to move beyond superficial reform toward deep structural transformation. The proceeding breaks down the deliberation into key thematic domains:

- The theoretical roots of Malaysia's middle-income trap.
 - The phenomenon of premature deindustrialization.
 - The structural underpinnings of wage suppression and human capital drain.
 - External geopolitical shocks in a multipolar global order.
 - Geopolitical uncertainties and domestic stagnation pressures
 - Concrete policy paradigms required to steer the national economy toward high-value, equitable growth.
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1. INTRODUCTION

The phenomenon of simultaneous economic stagnation, high inflation and high unemployment of the 1970s has re-emerged today as a central global risk, driven not by domestic policy failures alone, but by intensifying geopolitics. This Hard Talk by Jomo Kwame Sundram examines a critical question: How do geopolitical uncertainties translate into domestic stagflation pressures, and why do the low-income groups in Malaysia bear disproportionate burden.

The current geopolitical landscape has fundamentally shifted. The US-China strategic rivalry, the protracted war in Ukraine, the conflict in the Middle East and the trade, technology and financial war fares have fragmented the global economy. As the Speaker has consistently argued, this deglobalization is not merely political rhetoric, it has material consequences. Supply chains are being re-routed for security rather than efficiency, sanctions and export controls disrupt commodity flows and logistic costs due to conflicts in strategic points such as the Red Sea and the Straits of Hormuz. For a highly open, trade-dependent country like Malaysia, these external shocks are directly imported and lead to the classic stagflation pressures.

2. THEORETICAL FRAMEWORK & POLITICAL ECONOMY LANDSCAPE

2.1 Structuralism vs. Neoliberal Policy Paradigms

Jomo's analysis is fundamentally situated at the intersection of developmentalist structuralism and classical political economy. He contends that post-1980s market-led deregulation, while effective at attracting foreign investment in assembly-level manufacturing, systematically undermined the state's capacity to build domestic technological capability. **Market Failure in Capability Building:** Free market mechanisms left to themselves prioritize immediate comparative advantage—in Malaysia's case, low labor costs and tax incentives—rather than cultivating dynamic long-term competitive advantage. This subsequently leads to erosion of the country's capacity. The reduction of targeted state industrial intervention led to an industrial ecosystem characterized by foreign technology dominance and weak domestic backward/forward linkages.

Malaysia faced current economic stagnation within the broader context of global political economy. Jomo argued that the policy frameworks adopted across Southeast Asia following the 1997–1998 Asian Financial Crisis (AFC) leaned too heavily on neoliberal market deregulation, fiscal conservatism, and a retreat of state industrial leadership.

"The fundamental error of post-1990s policy planning in Malaysia was the uncritical belief that market forces alone would automatically transition our industrial base from low-cost assembly to high-value innovation. Market forces prioritize short-term comparative advantage—which for Malaysia meant cheap labor and tax concessions—rather than intentionally building long-term technological capacity." (Jomo Kwame Sundaram)

Jomo contrasted this with the developmental state frameworks of East Asia (South Korea, Taiwan, Japan), where the state actively conditioned subsidies, governed finance, and directed investment toward the domestic economy.

2.2 Historical Analysis of Industrial Policies

To understand the current economic bottleneck, Jomo traces the trajectory of Malaysia's economic evolution across four distinct policy phases;

Era / Policy Phase	Primary Growth Paradigm	Industrial Structure Target	Structural Limitations & Outcomes
1960s – Early 1970s Import Substitution	Domestic market protection, state enterprise setup	Light consumer goods, basic agricultural processing	Market size constraints; limited export competitiveness
1970s – 1980s Export-Oriented Takeoff	Export Processing Zones (EPZs), FDI incentives	Electronics assembly, textiles, resource processing	Dual economy creation; enclave development with minimal local spillover
1990s – 2000s Heavy Industry & Services	State-led heavy industrialization (HICOM), privatization	Automotive, steel, financial services, ICT	Efficiency deficits in state-protected firms; Asian Financial Crisis setbacks
2010s – Present Services Shift & Automation	Service-sector expansion, high-value tech drivers	Digital economy, advanced E&E, green energy	Premature deindustrialization; persistent wage stagnation & skill mismatches

3. STRUCTURAL ECONOMIC ANALYSIS & INDUSTRIAL TRAJECTORY

3.1 Premature Deindustrialization in Malaysia

A central pillar of Jomo's presentation is the diagnostic proof of premature deindustrialization. Historically, advanced economies transitioned from agriculture to manufacturing, achieving high income levels before shifting toward services. In contrast, Malaysia experienced a declining share of manufacturing in GDP and employment prior to achieving high-income status.

This premature shift toward low-productivity non-tradable services (e.g., retail, food and beverage, gig economy platforms) has diminished national productivity growth potential. He emphasized that without a robust, technologically sophisticated manufacturing core, service sector growth remains largely non-scalable and incapable of driving sustained real wage increases.

3.2 Electronics & Electrical (E&E) Sector Analysis

While the E&E sector continues to account for a significant portion of total exports, Jomo highlighted critical structural vulnerabilities:

- i **Assembly and Testing Dominance:** The bulk of domestic E&E activities remain concentrated in lower-value Outsourced Semiconductor Assembly and Test (OSAT) functions rather than integrated circuit (IC) design, wafer fabrication, or original IP generation.
- ii **Foreign OEM Dependence:** Foreign Original Equipment Manufacturers (OEMs) retain control over core research and global supply networks, limiting the absorption of knowledge by local firms.
- iii **Inadequate R&D Spillovers:** Fiscal incentives granted to foreign investors have not been sufficiently conditional on mandatory technology transfer or local supplier development mandates.

4. LABOR MARKET DYNAMICS, WAGES, AND HUMAN CAPITAL

4.1 The Low-Wage Equilibrium Trap

The discussion extensively addressed the institutional and economic causes of persistent wage suppression in Malaysia. Prof. Jomo argued that the country has fallen

into a "low-wage equilibrium trap," where low wages disincentivize industrial upgrade, and the lack of industrial upgrade prevents wage expansion.

"When businesses can easily access underpaid, low-skilled labor, the commercial incentive to invest in capital automation, worker training, and process innovation vanishes. We have effectively subsidized inefficiency by keeping labor artificially cheap." (Jomo Kwame Sundaram)

4.2 Impact of Unskilled Labor Dependence

The systemic dependence on low-cost migrant labor across construction, plantation, and low-tier manufacturing sectors was identified as a primary mechanism of wage distortion. The speaker outlined the structural consequences of this policy framework:

- **Wage Compression:** The continuous inflow of low-wage labor compresses the baseline floor for entry-level domestic workers.
- **Productivity-Compensation Divergence:** Data over recent decades indicates that real wage growth has systematically lagged behind labor productivity gains.
- **Youth Underemployment and Brain Drain:** Educated Malaysian graduates face severe wage penalties at home, causing significant talent emigration to regional hubs offering higher real returns on human capital.

5. MACROECONOMIC STABILITY, FISCAL REFORM, AND GLOBAL HEADWINDS

5.1 Fiscal Policy & Tax Base Limitations

Addressing national fiscal health, Jomo delivered a sharp critique of Malaysia's narrow tax revenue base. With government revenue as a percentage of GDP trending lower compared to regional peers, state capacity to fund education, healthcare, and infrastructure is severely constrained.

He highlighted the necessity of comprehensive tax reform, arguing for progressive tax structures—such as capital gains taxation, environmental carbon taxes, and direct wealth assessments—rather than relying excessively on regressive consumption-based taxes that disproportionately burden lower-income households.

5.2 External Economic Shocks & Global Dynamics

Jomo outlines several key external economic shocks and global dynamics—spanning geopolitical tech fragmentation, global rate differentials, and ESG-related trade mechanisms—alongside their transmission channels, domestic economic impacts, and corresponding mitigation strategies. Geopolitical tensions, particularly US-China semiconductor export restrictions, disrupt E&E supply chains and threaten export stability, prompting strategies focused on strategic non-alignment and supply chain diversification. Meanwhile, monetary policy divergence among major central banks drives capital outflows, currency volatility, and imported food inflation, which domestic authorities aim to counter through macroprudential controls and deepened domestic capital markets. Finally, stringent green trade regulations like the EU's Carbon Border Adjustment Mechanism (CBAM) pose market access hurdles for non-compliant exporters, driving the need for state-supported industrial greening initiatives and dedicated energy transition funding.

External Shock / Trend	Transmission Mechanism	Impact on Domestic Economy	Mitigation Strategy
Geopolitical Tech Fragmentation	US-China semiconductor restrictions, export controls	Supply chain disruptions; pressure on E&E export stability	Strategic non-alignment, supply chain diversification
Global Rate Differentials	Monetary policy divergence by major central banks	Capital outflow risks, currency volatility, imported food inflation	Targeted macroprudential controls, domestic market deepening
ESG & Carbon Tariffs	EU Border Adjustment Mechanisms (CBAM), scope 1-3 rules	Market access barriers for exporters lacking green compliance	State-supported industrial greening & energy transition funds

6. IMPLICATIONS ON THE LOW-INCOME GROUPS

In Malaysia, low-income is officially categorized as B40, households earning below RM5,250 a month. In reality, however, the vulnerable group extends to M40 who are now experiencing downward mobility due to stagflation. For the low-income groups, especially the B40 group, the stagflation impact is severe. Food takes 35-40 % of their income compared to 15% for higher-income groups. Hence, when prices of food rise, they are the worst hit. Stagnant wages, higher electricity bills and higher loan payment mean they must spend less on foods, delay healthcare or take on debt. Stagflation, therefore, does not only reduce purchasing power of the B40 group but it deepens inequality, with the poor paying the highest price for a crisis created outside Malaysia

Low -income workers spend 20-25 % on transport. Geopolitics in the Middle East raises diesel prices which affect goods transport. Even with RON95 subsidized, the cost of goods rise via increase in logistics cost. Removal of blanket diesel subsidy in 2024, while fiscally necessary, added RM200-400 per month for the small lorry drivers, e-hailing and taxi operators, all of which will be passed to low-income consumers or users .As ordinary citizens, the low -income groups face a shrinking fiscal space where the Malaysian economy , caught between rising subsidy bills and global financial pressures, offers targeted aid that merely compensates for inflation rather than lifting them out of poverty .

Stagflation do not cause mass job losses, but they make jobs among B40 weaker and less secure. Although unemployment is low at 3.0 % in mid-2026, B40 workers are mainly in jobs where wages do not rise with prices. When freight and food costs rise due to Middle East tensions and US-China trade frictions, employers face higher costs. Instead of hiring more staff, they cut working hours, freeze overtime and use more part-time workers. Real wages may grow 2.8% on average, but for B40 workers in informal jobs, income is unstable - they work the same hours but earn less in real value. Young B40 workers are most affected; with inflation at 1.9%, food price rising and fewer full-time jobs. The result is not unemployment on paper but hidden unemployment - people are employed but the jobs no longer pay enough to have a decent living.

The lesson from Jomo's political economy perspective is that the vulnerability of the B40 is not accidental but is the product of a development structure that prioritized low wages for competitiveness over living wages for resilience, and cheap food imports for efficiency over food sovereignty for security. When geopolitical disruptions destabilize that structure, vulnerable groups lack any buffer to absorb the shock. They have no savings to fall back on. Poor families are now buying cheaper consumer items, shop less often and cut basic food items. Even with government's aid like SARA and cheap petrol, life is still expensive. Official inflation may be 1.9 %, but for B40, the cost of living is much higher.

7. POLICY RECOMMENDATIONS & STRATEGIC ROADMAP

7.1 Actionable Policy Framework

To break out of the middle-income trap and reverse premature deindustrialization, six strategic policy imperatives derived from this discourse session are provided below:

- i **Revitalize Mission-Oriented Industrial Policy:** Shift from general, sector-agnostic investment promotion to targeted, mission-oriented state initiatives focused on advanced technology, renewable energy manufacturing, and digital infrastructure.
- ii **Implement Conditional Fiscal Incentives:** Mandate performance-based criteria for foreign investment tax incentives, explicitly requiring technology transfer and integration of local suppliers.
- iii **Restructure Foreign Labor Management:** Replace fragmented foreign worker quotas with a transparent, tiered levy system designed to gradually increase the cost of low-skilled labor, encouraging automation.
- iv **Expand the Progressive Fiscal Base:** Broaden government revenue through progressive taxation mechanisms (e.g., capital gains tax, inheritances, carbon pricing) to rebuild state capacity for social investment.
- v **Institutional Integration & Streamlining:** Consolidate redundant economic development agencies, trade bodies, and innovation funds into an empowered, unified policy execution unit.
- vi **Strengthen Universal Social Safety Nets:** Transition from fragmented, discretionary cash transfers toward institutionalized, universal social protections, including robust healthcare financing and pension reform.

8. QUESTIONS & ANSWERS SESSION

Participant Question 1: *“Given political constraints and short electoral cycles, how can long-term structural reforms be sustained when short-term populist measures are preferred by politicians?”*

Jomo's Response: Structural reform must be communicated through tangible economic benefits—such as real wage growth, better public transport, and quality public health—rather than abstract macroeconomic metrics. Building cross-party consensus on foundational economic goals is essential to prevent policy reversals during political transitions.

Participant Question 2: *“What specific mechanisms should be attached to industrial incentives to ensure domestic firms actually benefit from foreign investments?”*

Jomo's Response: Tax breaks and pioneer status must be strictly conditional. Incentives should be granted on a phased basis, tied directly to verifiable targets in local supplier sourcing, joint R&D expenditure, and structured workforce upskilling programs.

9. CONCLUSION

This MSIA Hard Talk by Prof. Jomo Sundram session provides an invaluable analytical framework for understanding the political economy of contemporary Malaysia. The deliberations underlined an urgent message: incremental adjustments within the existing policy model are insufficient. To secure sustainable, equitable development, Malaysia must execute a coordinated, state-guided structural transformation focused on technological mastery, fair labor compensation, and progressive governance.

Geopolitics and stagflation are no longer distant macroeconomic concerns debated worldwide. They are lived realities especially amongst the low-income or B40 group in Malaysia. As Jomo contended, the current global disorder marks the end of the cheap globalization era that Malaysia benefitted for three decades. Trade, energy and financial war fares have created a new normal where external shocks are not cyclical but structural. For Malaysia, a small highly open economy, this means stagflation is imported, and its adversities affect the domestic economy. The lessons learned from this Hard Talk are: the low-income groups, as consumers, face inflation where food and transport consume almost two-third of their income; as workers, they face wage stagnation with no bargaining power to demand real wage increases; and as citizens, they face shrinking fiscal gap where the government caught between rising subsidy bills and global financial pressures, offers merely targeted aid that merely compensates for inflation rather than lifting them out of poverty.

Addressing stagflation for low-income or B40 Malaysians cannot be limited to monetary policy but requires structural readjustment through rebuilding its food sovereignty through support for small farmers; institutionalizing a living wage and stronger social protection beyond one-off handouts; and strengthening policy autonomy to shield the Malaysian Ringgit and domestic economy from geopolitical volatility. Ultimately, the test of the Malaysian economy is not GDP's growth alone, but whether growth can be decoupled from geopolitical vulnerability for the poorest 40 % of Malaysians. If geopolitics is about power among nations, then the true measure for Malaysia is whether it empowers the low-income groups with decent living, stable employment and a dignified future despite the turbulence outside.

Disclaimer

The contributions and deliberations of the panellist during the MSIA Hard Talk session are very much appreciated. The opinion expressed in this MSIA Reading Series are those of the panellist. They do not purport to reflect the opinions or views of MSIA and the editors.

Acknowledgement

We wish to express our sincere thank you to Professor Jomo Sundram for his insightful session and thought-provoking Hard Talk on today's global challenges and their local impacts on the Malaysian economy and the low-income groups in Malaysia. We thank all participants for the active participation, thoughtful questions and for taking time off to listen and engage in the Hard Talk. These involvements made the session meaningful and grounded in the Malaysian realities.