

# **An Overview On The Growth and Development Of The Malaysian Construction Industry**

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## **Abstract**

*The Malaysian economy enjoyed a period of sustained economic growth up until the mid-1997 East Asian economic crisis. As a result of the government's economic recovery measures, official government statistics estimate that by the end of 2004 GDP growth will increase by 8%. Malaysia's high level of economic growth and the aspiration of becoming a developed and industrialized nation has created the environment for growth, and stimulated changes in construction industry. This paper overviews how the Malaysian construction industry responded to the country's rapid economic development. The paper focuses on Malaysia's rapid economic development and the impact on the growth and changes in construction output. This provides an understanding of the past and present scenario of the construction industry in the economy*

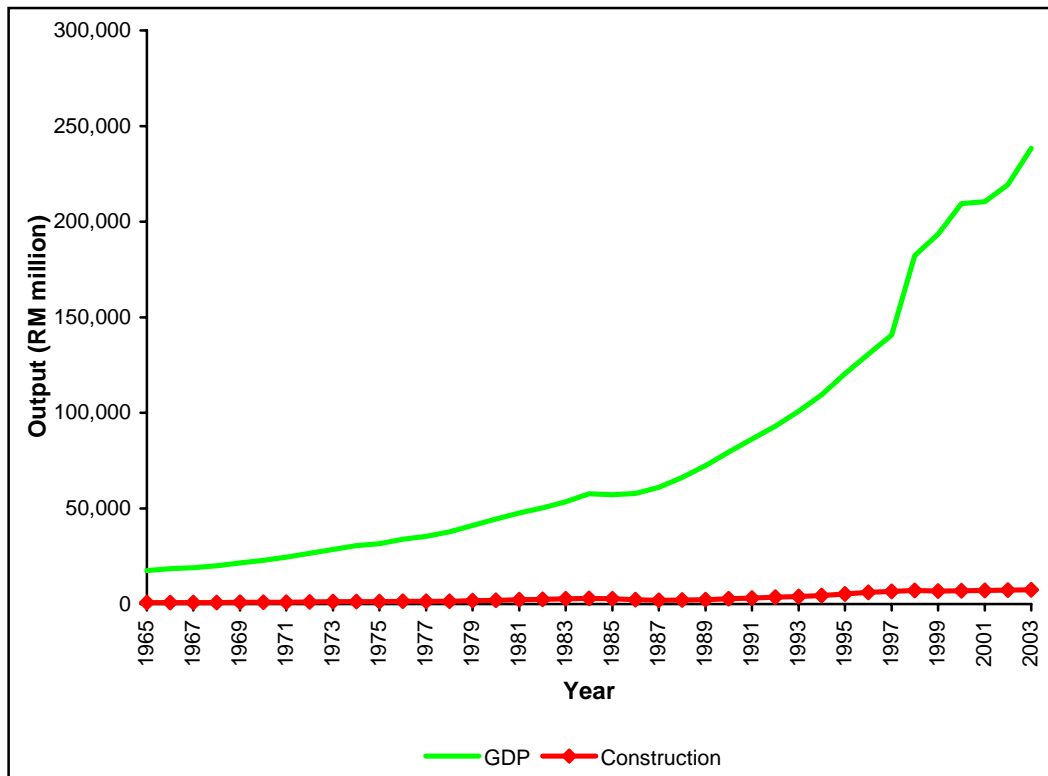
## **Introduction**

The construction industry plays an important role in any country's economic development. It establishes the infrastructure required for socioeconomic development while being a major contributor to overall economic growth. Construction output is referred to as growth-initiating and growth-dependent (Drewer, 1980). As development progresses, the construction industry needs to satisfy the expansion and changes in construction demand.

The most significant factor that affect all construction demand is the general economic situation and expectations about how it will change (Hillebrandt, 1993). In a buoyant economy with high and growing gross domestic product, a satisfactory balance of payments and a reasonable level of employment and with expectations of a continuation of this situation, then generally standards of living will be rising, consumer expenditure increasing and government will feel able to spend on improving services to the community. In a depressed situation, the whole position is reversed and less demand for construction will be created. As Malaysia moves from developing country status towards a developed and industrialized nation as envisaged in Vision 2020, its construction industry will need to respond to the changes in construction demand. Any attempt to formulate strategies for fulfilling future demand would require a reliable understanding of the past and present scenario of the industry.

Since the condition, the performance and the prospects for the economy have implications for the industry, construction industry development should be considered in the context of a country's economic development.

## Construction Output And GDP



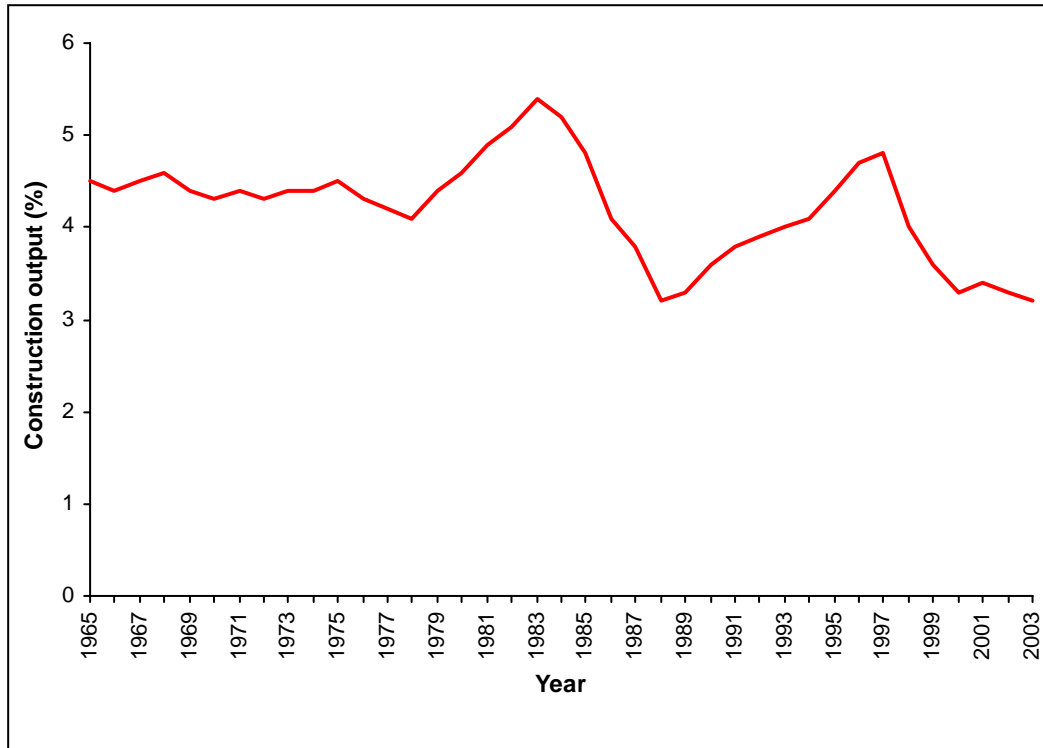
**Figure 1: Construction output and GDP, 1965 – 2003 (Data for 1965 – 1991 in 1978 constant price; data for 1992 onwards in 1987 constant prices)**

**Data source: Economic Reports-various issues**

Figure 1 shows that construction output grew from RM801 million in 1965 to RM 7.58 billion in 2003. The GDP grew from RM17,582 million in 1965 to RM238.4 billion in 2003. This reflects the industry's important role in providing the infrastructure to satisfy development needs and facilitate investment in other economic sectors.

Figure 2 shows that construction output as a percentage of GDP fluctuates year on year. Between 1965 and 2003. Between 1965 and 1977, it fluctuated between 3.2% and 5.4% of GDP. The construction industry constitutes an important element of the Malaysian economy. Although it accounts for less than 5 per cent of GDP, the industry is a strong growth push because of its extensive linkages with the rest of the

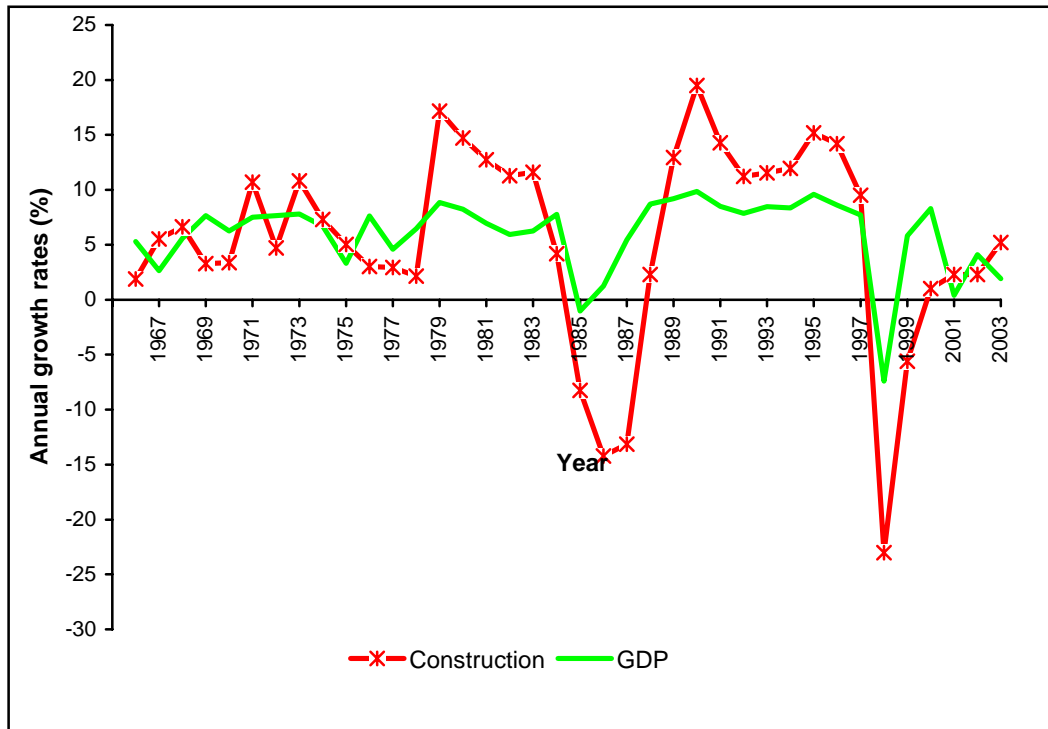
economy. In particular, the industry has extensive linkages with construction related manufacturing industries such as basic metal products and electrical machinery. In 1998, when the construction industry experiences a sharp downturn, basic metal industries incurred some 35.6 per cent drop in output.



**Figure 2 : Construction Output as a percentage of GDP, 1965 - 2003**

**Data source : Economic Reports- various issues**

## Fluctuations In Construction Output



**Figure 3 – Annual Growth Rates of GDP and Construction, 1965-2003**

**Data source : Economic Reports – various issues**

Figure 3 shows the changes in the annual growth rates of construction in relation to GDP between 1965 -2003. The growth of construction output generally follows the trend of the economy but the peaks and the troughs are more extreme. The output increase when economic growth strengthens and falls even lower when the economy weakens. The figure also shows that the construction industry grows at a faster rate than the economy during periods of rapid economic growth. During period of economic downturn the industry experience greater declines and remains in recession longer than the economy. This reflects the cumulative interaction of the multiplier and accelerated effects on demand for construction as a result of the changes in the economy. Hence, the construction industry’s annual growth rates generally follow the growth trend of the economy, reflecting a positive correlation between construction output and GDP.

## **The Growth And Nature Of Construction Output In Relation To The Different Phases Of The Country's Economic Development**

Malaysia's economic development can be divided into three major phases:

- Phase I: The early years of post-independence (the years immediately after independence up to the end of the 1960s)
- Phase II: The New Economic Policy (1970 –1990)
- Phase III: The New Development Policy and Vision 2020 (from 1991 onwards)

### **The early years of post-independence**

Construction output grew at an annual average rate of 4.1 percent between 1965 and 1970; construction output increased from RM801 million in 1965 to RM 980 million in 1970. Construction activity during the period was mainly brought about by economic development programmes in agriculture, infrastructure, rural development and the growth in capital expenditure on urban and rural housing.

While most of the construction work took place in the public sector, there was increased private sector investment towards the end of the sixties, particularly non-residential construction with the establishment of industrial estates following the shift from inward-looking to outward-oriented industrial development. Expansion in private residential construction was facilitated by loans and advances from commercial banks that played a role in developing a culture of home ownership in the country. The public sector housing programmes focused on low-cost housing and housing for public employees, whereas the private sector concentrated on urban residential construction.

### **The New Economy Policy**

The New Economic Policy (NEP) was launched in 1970 and construction activities expanded with the acceleration of public sector development expenditure, mainly in infrastructure projects. There was increased demand for residential construction and a high growth in private investment. The expansion of private sector industrial growth and construction activities associated with manufacturing facilities continued from the late sixties. The development of new growth centres under the NEP led to an intense

process of urbanisation which increased the demand for housing the related infrastructure.

Figure 3 shows that the annual growth rates of the industry increased from 3.38 percent in 1970 to 10.71 in 1971 and 10.84 in 1973. However, the rapid expansion in construction activities led to an increase in imports of machinery and equipment, and shortages of building materials and labour towards the end of the seventies. This increased the price of residential, commercial and industrial buildings. On the other hand, increased speculative activities increased the stock of building premises. As a result, there was a stepped decline in the industry's annual growth rate between 1974 and 1978 as shown in Figure 3.

When oil became dominant in the late seventies, supporting construction facilities and buildings expanded the industry's activities. The expansion was compounded by the enhancement of foreign direct investment towards the end of the seventies. The industry's annual growth rate increased sharply from 2.13 percent in 1978 to 17.18 percent in 1979 as shown in Figure 3.

### **Second decade of the New Economic Policy**

The industry experienced extreme variations in its growth performance in the 1980s, ranging from strong growth during the first and last few years to negative growth during the mid-eighties' recession. The strong growth between 1981 and 1983 was sustained mainly by the public sector's expansion programmes in physical infrastructure and major policy transformations.

The shift towards heavy industrialization programmes led to an increase in the construction of industrial plants, industrial and commercial buildings, and the country's physical infrastructure. The government's policy on foreign direct investment, which continued from the seventies, led to the establishment of more free-trade zones. There was rapid development of oil installations and continuing strong demand for housing. The Hotel Investment Incentives which were introduced in the government's 1982 budget to promote tourism increased hotel construction for the private sector.

The industry grew at an annual average rate of 12.6 percent between 1980 and 1983, following the rapid expansion in construction activities. It was the fastest

growing sector of the economy during that period. However, construction activities contracted during the recessionary years of the mid-eighties and the industry's annual growth rate decelerated from 11.61 percent in 1983 to 4.18 percent in 1984.

### **The recessionary years of the mid-eighties**

Figure 3 shows that overall construction activities were dampened by the mid-eighties recession. Measures undertaken by the government to weather the impact of international recession which include the rationalisation of public development expenditure show growth of private investment, lightness in credit availability, higher cost of mortgage loans, and the temporary freeze on housing loans for the public sector employees, further weakened construction demand.

There was a significant slowdown in overall construction activities which led to negative annual growth rates for 1985, 1986 and 1987.

### **The recovery period**

In stimulating the economy and revitalising the construction industry, the government promoted private sector investment in low-cost housing and revive housing projects which had been abandoned by the private sector during the recession. The prevalence of more realistically and affordably-priced housing units and the more attractive end-financing packages offered by financial institutions, facilitated the recovery in the demand for private residential buildings.

Increased public sector expenditure on road works and the country's industrialization programmes, which were enhanced after the mid-eighties recession, have provided further relief to the contraction in the industry. The amendments to the National Land Code in 1986 which liberalised foreign ownership regulations on landed properties have attracted foreign capital. There was an influx of foreign investments on commercial and residential buildings.

A significant impetus to the recovery of the construction industry was the privatization policy undertaken by the government to consolidate public sector finances

The recovery of the economy following an improved external environment and adjustment efforts undertaken by the government, have also resulted in increased

public and private investments and the recovery in construction demand. The industry's annual growth rate rose sharply from 2.28 percent in 1988 to 12.96 percent in 1989.

The economy's industrialization programmes after the mid-eighties' recession have changed the nature of major construction demand. Clients demand more complex building and civil engineering works, and faster construction times. In fulfilling the changes in construction demand, there was a gradual shift from low-productive, traditional construction techniques towards modern construction activities based on capital-intensive and high-technology construction techniques.

### **The 1990s and Vision 2020**

The rapid expansion of construction demand after recovering from the recession, continued into the 1990s. The industry's highest annual growth rate of 19.5 percent recorded in 1990 was higher than the growth of construction industries in the developed and other developing regions as shown in Table 1.

<b>Regions</b>	<b>Growth of the construction industry (%)</b>
<b>Developed Regions:</b>	
Northern America	2.3
Europe	2.9
European Economic Community	4.9
<b>Developing Regions:</b>	
Africa	1.8
Caribbean and Latin America	-1.2
Eastern, Southeastern and Southern Asia (exc.Japan)	9.1
Middle East	-3.7
Oceania	0.5

**Table 1: Annual growth rate of construction industry in the developed and developing regions, 1990**

**Data source: United Nations, Statistical Yearbook, 1989/90**

The growth of the industry was further enhanced by the implementation of Vision 2020 in 1991. This has resulted in rapid implementation of several large scale infrastructure projects, housing, schools, hospitals, commercial and industrial buildings enroute to realizing the goals envisaged in the Vision.



The expansion of tourism and the manufacturing industry have also contributed to the industry's growth momentum. The rapid industrialization programmes have intensified the urbanization process which further increased the demand for housing and related infrastructure facilities. The country's rapid industrialization has also created a new demand for large scale, complex, alternative energy production facilities. As the country's GNP per capita increases, there is an increasing demand for leisure facilities.

Between 1990 and 1996, the industry grew at an annual average rate of 14 percent. The growth of construction activities in the 1990s were propelled by the strong upsurge in private investment supported by large inflows of foreign investment, high domestic savings and extensive privatization of construction projects.

The slowdown of the country's economic growth following the East Asian economic crisis has impacted the growth of the construction industry. The growth of the construction industry fell from 14.2 percent in 1996 to 9.5 percent in 1997. Construction growth further fell to -24 percent in 1998. As a result of the government's economic recovery measures, official government statistics show that by the end of 1999 construction growth has increased by 20 percentage points to -4.4 percent. The implementation of privatized projects as well as the expansion of government fiscal spending particularly on infrastructure and residential projects has further supported the growth of the construction industry. Growth of the industry expanded at a rate of 1.0 and 2.3 percent in 2000 and 2001 respectively.

The slowdown in the civil engineering sub-sector following the completion of several major privatized projects in 2003 had sunk down the growth to a lower level. The construction industry registered of growth 2.3% and 1.9 % in 2002 and 2003 respectively. Official government statistics estimate overall GDP growth for 2004 to expand by 6.0% – 6.5% . Growth of the Malaysian economy is expected to resume, although growth will be slower than in the “ Miracle” days of the early 1990s. The economy will be on course to achieve the target set out in vision 2020 since the vision is the country's long-term goal. Hence, the future scenario of the Malaysian construction industry will be guided by the vision which aims to transform the country into a developed and industrialized nation by the year 2020.



## **Conclusion**

As Malaysia moves from developing country status towards a developed and industrialized nation as envisaged in vision 2020, most of the theories on the role of construction industry in economic development is supported by the experience of Malaysia. The country's transformation from an agriculture-based economy to industrialization has created the environment for the development of the construction industry. The construction industry has played an important role in establishing the infrastructure required for socioeconomic development and contributing directly to economic growth. There is a positive correlation between construction output and GDP. The industry's annual growth rates generally follow the growth trend of the economy. The most important factor that influenced the future growth of the industry is the economic situation and expectations about how it will change.

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