International Journal of Management and Commerce Innovations ISSN 2348-7585 (Online)
Vol. 14, Issue 2, pp: (71-76), Month: October 2026 - March 2027, Available at: www.researchpublish.com

Malaysia's Economic Transformation: Growth, Fiscal Reform, Digital Industries and Inclusive Prosperity

Dr. Chong Kuan Git[1], Dr. P. Ravindran Pathmanathan[2], Dr. Venkatesh Karanam[3]

[1,2,3] UNIES Business School

DOI: https://doi.org/10.5281/zenodo.23686978

Published Date: 21-October-2026, Amendment Date: 27-October-2026

Abstract: **Malaysia's economy in 2026 combines resilient domestic demand, strong export-oriented manufacturing and rapid investment in digital infrastructure with continuing exposure to external shocks. Official data show that real gross domestic product (GDP) grew by 6.0% year-on-year in the second quarter of 2026, led by services, manufacturing, exports and investment, while headline inflation rose to 1.9% as fuel costs linked to the Middle East conflict fed through. The government's fiscal planning for 2027 must balance household protection, energy security, development spending and medium-term fiscal consolidation. This conceptual review examines Malaysia's economic transformation through five themes: the composition of growth, fiscal sustainability, productivity and wages, digital and high-value industries, and inclusive development. Drawing on research on the middle-income trap, foreign direct investment spillovers, subsidy targeting and global value chains, it argues that headline growth must be judged alongside productivity, real wage progression, regional opportunity, business dynamism and environmental sustainability. The paper proposes a seven-part policy framework that links investment attraction to domestic supplier development, skills formation, innovation diffusion, targeted social protection and transparent public finance. It also sets out research priorities on the quality of digital investment, the distribution of productivity gains and the long-term effects of subsidy and tax reform. The paper is a policy-oriented conceptual review and does not estimate original econometric relationships.**

Keywords: **Malaysia; economic transformation; fiscal reform; productivity; digital economy; semiconductors; inclusive growth; labour market.**

I. INTRODUCTION

Malaysia's development strategy has reached a stage at which the quality of growth matters as much as its rate. The economy has benefited from strong demand for electrical and electronics (E&E) exports, a growing services sector and heavy investment in digital infrastructure. Bank Negara Malaysia (BNM, 2026) reported that real GDP grew by 6.0% in the second quarter of 2026, up from 5.4% in the first quarter, supported by domestic demand and robust exports, particularly E&E products benefiting from "strong artificial intelligence (AI)-related demand". Approved investment reached a record RM431.1 billion in 2025 (Ministry of Finance Malaysia, 2026).

These encouraging indicators coexist with longer-standing structural challenges. Malaysia has been an upper-middle-income economy for several decades, and Doner and Schneider (2016) cite it as an example of a country whose transition to high income has been slowed less by economic constraints than by the political difficulty of building the institutions needed for upgrading. The country must sustain productivity growth, increase the value captured by domestic firms, improve wage progression, manage demographic and skills transitions, and preserve fiscal space for future shocks. The Pre-Budget Statement 2027 recognises the need to shield households from energy and living-cost pressures while laying foundations for a higher-value economy through productivity, innovation, digitalisation, AI, energy transition and food security (Ministry of Finance Malaysia, 2026).

This paper analyses Malaysia's economic transformation by examining how macroeconomic performance relates to structural change. It asks how the country can turn investment and export growth into higher productivity, better jobs and more inclusive prosperity. The discussion is conceptual and policy-oriented and uses official data and published analysis available up to 13 October 2026. It does not present original survey data or econometric estimates.

II. MACROECONOMIC PERFORMANCE AND GROWTH COMPOSITION

A. Growth and Sectoral Contributions

According to the Department of Statistics Malaysia (DOSM, 2026), the economy grew by 6.0% year-on-year in the second quarter of 2026. Growth was broad-based but uneven: mining and quarrying expanded by 9.2%, manufacturing by 7.3%, construction by 6.5% and services by 5.9%, while agriculture contracted by 3.7% (Table 1). BNM (2026) attributed part of the strength in services to information and communication technology (ICT) activity associated with the expanding operation of data centres. These differences matter because an aggregate growth figure can conceal uneven performance across sectors, regions and forms of employment. The contraction in agriculture is significant for rural incomes and for the government's food-security objectives.

The expenditure side shows the importance of both domestic and external demand. Exports grew by 17.0% and imports by 13.9%, government consumption by 7.6%, private consumption by 4.8% and gross fixed capital formation by 4.6% (DOSM, 2026). These figures are year-on-year changes in each component. They should not be read as contributions to GDP growth, which require a separate national-accounts calculation that weights each component by its share of output.

Table 1: Malaysia: Real GDP Growth by Sector and Expenditure Component, Q2 2026 (% Year-on-Year)

Supply side (sector)	Growth	Demand side (component)	Growth
Mining and quarrying	9.2	Exports of goods and services	17.0
Manufacturing	7.3	Imports of goods and services	13.9
Construction	6.5	Government final consumption	7.6
Services	5.9	Private final consumption	4.8
Agriculture	−3.7	Gross fixed capital formation	4.6
Real GDP	**6.0**		

Note. Data from DOSM (2026).

B. Inflation, Household Costs and Economic Confidence

BNM (2026) reported headline inflation of 1.9% in the second quarter of 2026, up from 1.6% in the first quarter, while core inflation eased from 2.1% to 1.9%. The central bank linked the rise in headline inflation to external cost pressures from the Middle East conflict; fuel inflation rose to 5.0% from −1.5% in the previous quarter as RON97 and diesel prices increased. Although the national rate remains moderate, households experience inflation differently depending on income, location, housing costs, transport needs and consumption patterns. Policy evaluation should therefore look at purchasing power and spending on essentials, not only at the national average.

III. FISCAL REFORM AND PUBLIC FINANCE SUSTAINABILITY

Fiscal policy must reconcile competing claims: social protection, infrastructure, education, healthcare, security, investment and debt management. The Ministry of Finance identifies the Public Finance and Fiscal Responsibility Act 2023 [Act 850] and the targeting of subsidies as key elements of its fiscal-governance agenda (Ministry of Finance Malaysia, 2026). The Act sets medium-term targets including a fiscal deficit of 3% of GDP and a debt ceiling of 60% of GDP (Lee, 2026). Lee (2026) also cautions that global uncertainty, cost-of-living pressures and the electoral calendar could delay consolidation, and that higher oil prices had already raised the cost of the BUDI95 petrol subsidy. Budget 2027, tabled on 9 October 2026, allocated RM459.8 billion and projected a narrower deficit of 3.3% of GDP for 2027 (Reuters, 2026; The Star, 2026).

A. Subsidy Targeting and Distributional Effects

Broad subsidies lower prices for every consumer, including many who do not need help, and they can be costly and encourage inefficient consumption. Coady et al. (2017) estimate that fossil-fuel subsidies worldwide are very large once environmental and health costs are included. Targeted assistance can improve fiscal efficiency, but eligibility errors, administrative burdens and coverage gaps may exclude households in genuine need. Coady et al. (2004) show that the

effectiveness of targeting varies widely with the method used and the quality of implementation. In Malaysia, the government reports that targeting electricity, diesel and RON95 subsidies saves about RM15.5 billion a year, savings that are partly absorbed by a fuel-subsidy bill that could reach RM40 billion in 2026 (Ministry of Finance Malaysia, 2026). A credible transition requires reliable data governance, accessible appeals, clear communication and regular assessment of actual household effects. Savings should be transparently linked to priority spending or to deficit reduction.

B. Revenue, Expenditure Quality and Fiscal Credibility

A sustainable fiscal strategy needs attention to both revenue and the quality of expenditure. Revenue measures should be assessed for their effects on investment, consumption, compliance costs and distribution. Spending should be evaluated through project selection, procurement integrity, maintenance obligations and measurable public outcomes. Fiscal rules can make policy more predictable, but they work only when supported by credible forecasts, transparent reporting and accountability for any deviation from the agreed path.

IV. PRODUCTIVITY, WAGES AND HUMAN CAPITAL

Long-term prosperity depends on productivity growth rather than on output expansion alone. A move to higher-value production requires firms to adopt advanced technologies, improve management practices, invest in research and development and develop skilled workers. Bloom and Van Reenen (2007) show that differences in management practices explain a substantial part of productivity differences between firms and countries, which suggests that managerial capability deserves as much policy attention as technology. Rodrik (2016) adds that many developing economies are reaching their peak share of manufacturing employment at lower income levels than earlier industrialisers, which raises the stakes for productivity growth in services. The government's 2027 priorities include highly skilled talent and innovation-led growth (Ministry of Finance Malaysia, 2026), objectives that require coordination among schools, universities, technical and vocational education and training (TVET) institutions, employers and professional bodies.

A. Wage Progression and Job Quality

Wage policy should be considered together with productivity, business margins, labour-market conditions and the cost of living. A statutory minimum wage sets a floor, but sustained gains in earnings require stronger firm productivity, career progression, worker bargaining capacity and effective enforcement. Budget 2027 proposed raising the monthly minimum wage from RM1,700 to RM2,000 from June 2027, with micro, small and medium enterprises with annual sales below RM50 million exempted for the time being, and raising the individual tax-relief limit from RM9,000 to RM12,000 (Reuters, 2026; The Star, 2026). These are announced future measures and should not be described as implemented. International evidence suggests that carefully calibrated minimum-wage increases can raise pay without large job losses; Cengiz et al. (2019), for example, find little change in the number of low-wage jobs following state-level increases in the United States. Malaysia's labour market differs in important ways, however, including its reliance on foreign workers and its large informal sector, so the effects of the 2027 increase should be monitored closely.

B. Skills and Lifelong Learning

Skills policy must respond to occupational change in manufacturing, logistics, financial services, healthcare, education and digital industries. Short courses can help workers adapt, but training quality should be judged by verified competencies, job placement, wage progression and employer satisfaction. Employers should take part in curriculum design and provide structured workplace learning. Public funding should favour programmes that report outcomes transparently rather than those that simply maximise enrolment.

V. DIGITAL ECONOMY, SEMICONDUCTORS AND HIGH-VALUE INVESTMENT

Malaysia's digital and manufacturing prospects are closely tied to global investment in data centres, cloud services, AI and semiconductors. BNM (2026) identified the expansion of data-centre operations and strong AI-related demand for E&E exports as important contributors to second-quarter performance. This creates an opportunity to deepen Malaysia's role in regional technology value chains. Budget 2027 includes several targeted instruments, among them a RM100 million fund established by Khazanah Nasional and InvestPenang for early-stage semiconductor and advanced-manufacturing firms (The Star, 2026).

Investment volume, however, is not the same as domestic economic value. Data-centre development should be assessed against its use of electricity and water, grid capacity, local employment, technology transfer, domestic procurement and environmental impact. Masanet et al. (2020) show that efficiency gains have so far moderated growth in global data-centre

energy use, but the rapid expansion of AI workloads makes local grid and water planning a pressing concern. Semiconductor investment should be judged by the sophistication of the activities undertaken locally, including design, advanced packaging, testing, equipment, materials, research and supplier development. Rasiah (2010) found only limited upgrading by electronics firms in Malaysia towards research-intensive activities, a finding that underscores the importance of linking incentives to measurable spillovers and reviewing them periodically. The governance of global value chains also shapes how much learning reaches local firms (Gereffi et al., 2005).

A. Strengthening Domestic Firms

Large multinational investments may produce limited local spillovers if domestic firms lack the capabilities or certifications needed to enter supply chains. Javorcik (2004) shows that productivity spillovers from foreign investment tend to flow mainly through backward linkages, that is, through local firms that supply multinationals. Policy should therefore support supplier upgrading, quality standards, export readiness, management capability and access to patient finance. Universities and research institutions can contribute through industry-linked research, commercialisation and specialist talent development. Measures of this kind help turn foreign investment from an isolated capital inflow into a platform for domestic productivity growth.

VI. INCLUSIVE AND SUSTAINABLE DEVELOPMENT

Economic inclusion requires attention to differences in income, geography, gender, age, disability and access to opportunity. Rural communities and smaller towns do not automatically benefit from investment concentrated in major industrial corridors, and the second-quarter contraction in agriculture is a reminder of the pressures on rural livelihoods (DOSM, 2026). Connectivity, transport, affordable housing, healthcare, childcare and reliable digital access all shape whether people can take part in economic growth. The government's stated commitment to raising the floor and strengthening food security provides a policy basis for evaluating these dimensions (Ministry of Finance Malaysia, 2026).

Sustainability should be built into industrial and infrastructure decisions from the outset. Energy-transition policy must balance emissions reduction, reliability, affordability and industrial competitiveness. Food security requires attention to productivity, climate resilience, logistics, land use and the viability of farming livelihoods. Environmental targets should be accompanied by credible measurement and by transition support for workers and firms affected by structural change.

VII. A POLICY FRAMEWORK FOR HIGH-QUALITY GROWTH

Drawing on the preceding analysis, the paper proposes a seven-part framework for high-quality growth (Table 2). The elements reinforce one another: investment incentives are more effective when domestic suppliers and workers have the capabilities to benefit, and fiscal transparency strengthens public support for difficult reforms such as subsidy targeting.

Table 2: Policy Framework for High-Quality Growth in Malaysia

Element	Recommended actions
1. Link incentives to outcomes	Evaluate investment incentives against productivity, skilled employment, local sourcing, research collaboration, technology transfer and environmental performance.
2. Strengthen fiscal transparency	Publish medium-term fiscal assumptions, programme costs, procurement information and outcome evaluations in accessible formats.
3. Improve wage and skills pathways	Connect training to employer demand, recognised competencies, career progression and measurable wage outcomes.
4. Deepen domestic supply chains	Help SMEs meet quality, digital, financing and export requirements so they can supply higher-value industries (Javorcik, 2004).
5. Manage digital infrastructure sustainably	Assess data-centre and semiconductor projects for their energy, water, grid, workforce and local-value implications.
6. Target inclusion effectively	Use reliable eligibility systems, accessible appeals and transparent monitoring to protect vulnerable households (Coady et al., 2004).
7. Build resilience	Diversify export markets and critical inputs, strengthen food and energy security, and improve readiness for external shocks.

Note. Framework developed by the authors.

VIII. DISCUSSION AND FUTURE RESEARCH

Malaysia's economic performance in 2026 shows the value of export competitiveness and resilient domestic demand, but it also highlights the need to examine how growth is composed and distributed. Future research should investigate whether digital investment builds durable local supplier capabilities, how productivity gains are shared among firms and workers, and whether targeted subsidies improve household welfare relative to their fiscal cost. Sectoral studies should distinguish high-value manufacturing from lower-value assembly and examine the quality of the jobs that investment creates.

Firm-level data could be used to test the relationship between technology adoption, management practices and productivity, following the approach of Bloom and Van Reenen (2007). Household panel data could show how inflation and subsidy changes affect different income groups, and the effects of the 2027 minimum-wage increase on employment, hours and informality will deserve careful evaluation. Regional analysis could identify whether investment corridors generate spillovers for surrounding districts. These lines of research would help move policy evaluation beyond headline growth and investment totals towards measurable improvements in living standards and productive capacity.

IX. CONCLUSION

Malaysia's economic transformation calls for a shift from measuring success mainly through aggregate growth to assessing productivity, wage progression, domestic value creation, fiscal resilience and inclusion. The second-quarter data for 2026 show strong momentum, particularly in services, manufacturing and exports, while inflation and external energy pressures remain significant risks. Fiscal reform must protect vulnerable households without undermining long-term public investment or debt sustainability.

Digital and semiconductor opportunities can strengthen Malaysia's position in global value chains, but the benefits depend on domestic supplier development, skilled employment, technology transfer and sustainable infrastructure. The framework proposed in this paper connects investment quality, fiscal transparency, human capital, inclusion and resilience. Putting it into practice will require coordination across government, business, education and research institutions, supported by reliable data and independent evaluation. High-quality growth is ultimately achieved when investment and innovation translate into better opportunities, stronger firms, decent work and higher living standards across Malaysia.

ACKNOWLEDGEMENT

The authors thank the institutions and researchers whose official data and policy analyses informed this review. This research received no specific grant from any funding agency in the public, commercial or not-for-profit sectors. The authors declare no conflict of interest.

REFERENCES

[1] Bank Negara Malaysia. (2026, August 14). *Economic and financial developments in Malaysia in the second quarter of 2026* [Press release]. https://www.bnm.gov.my/-/gdp2q26pr

[2] Bloom, N., & Van Reenen, J. (2007). Measuring and explaining management practices across firms and countries. *The Quarterly Journal of Economics, 122*(4), 1351–1408. https://doi.org/10.1162/qjec.2007.122.4.1351

[3] Cengiz, D., Dube, A., Lindner, A., & Zipperer, B. (2019). The effect of minimum wages on low-wage jobs. *The Quarterly Journal of Economics, 134*(3), 1405–1454. https://doi.org/10.1093/qje/qjz014

[4] Coady, D., Grosh, M., & Hoddinott, J. (2004). Targeting outcomes redux. *The World Bank Research Observer, 19*(1), 61–85. https://doi.org/10.1093/wbro/lkh016

[5] Coady, D., Parry, I., Sears, L., & Shang, B. (2017). How large are global fossil fuel subsidies? *World Development, 91*, 11–27. https://doi.org/10.1016/j.worlddev.2016.10.004

[6] Department of Statistics Malaysia. (2026, August 14). *Gross domestic product second quarter 2026* [Press release]. https://www.dosm.gov.my/portal-main/release-content/gross-domestic-product-q22026

[7] Doner, R. F., & Schneider, B. R. (2016). The middle-income trap: More politics than economics. *World Politics, 68*(4), 608–644. https://doi.org/10.1017/S0043887116000095

[8] Gereffi, G., Humphrey, J., & Sturgeon, T. (2005). The governance of global value chains. *Review of International Political Economy, 12*(1), 78–104. https://doi.org/10.1080/09692290500049805

[9] Javorcik, B. S. (2004). Does foreign direct investment increase the productivity of domestic firms? In search of spillovers through backward linkages. *American Economic Review, 94*(3), 605–627. https://doi.org/10.1257/00028 28041464605

[10] Lee, C. (2026, May 25). *Malaysia's fiscal reforms: Clear commitments amidst cloudy conditions* (ISEAS Perspective No. 2026/39). ISEAS–Yusof Ishak Institute. https://www.iseas.edu.sg/articles-commentaries/iseas-perspective/2026-39-malaysias-fiscal-reforms-clear-commitments-amidst-cloudy-conditions-by-cassey-lee/

[11] Masanet, E., Shehabi, A., Lei, N., Smith, S., & Koomey, J. (2020). Recalibrating global data center energy-use estimates. *Science, 367*(6481), 984–986. https://doi.org/10.1126/science.aba3758

[12] Ministry of Finance Malaysia. (2026, August 18). *Pre-Budget Statement 2027* [Press release]. https://www.mof.gov.my/portal/en/news/press-release/pre-budget-statement-2027

[13] Rasiah, R. (2010). Are electronics firms in Malaysia catching up in the technology ladder? *Journal of the Asia Pacific Economy*, *15*(3), 301–319. https://doi.org/10.1080/13547860.2010.494910

[14] Reuters. (2026, October 9). *Malaysia to raise minimum wages, expand tax relief in $112.5 billion 2027 spending boost*.https://www.reuters.com/world/asia-pacific/malaysia-plans-1125-billion-budget-2027-ahead-possible-election-2026-10-09/

[15] Rodrik, D. (2016). Premature deindustrialization. *Journal of Economic Growth, 21*(1), 1–33. https://doi.org/10.1007/s10887-015-9122-3

[16] The Star. (2026, October 9). Highlights from Budget 2027. *The Star*. https://www.thestar.com.my/business/business-news/2026/10/09/highlights-from-budget-2027