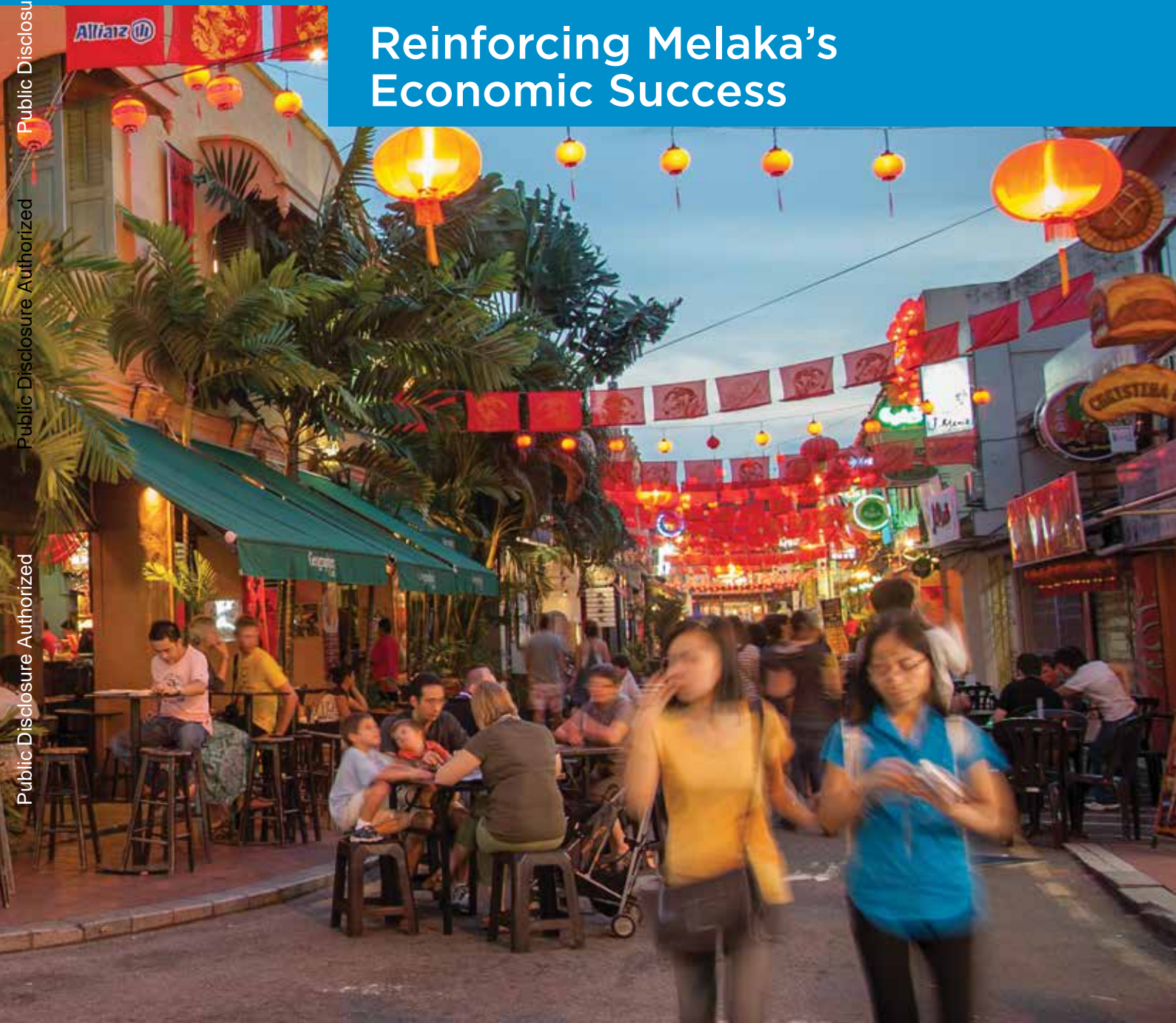


MELAKA

Reinforcing Melaka's Economic Success



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Sustainability Outlook Diagnostic
Supporting Report 1

MELAKA

Reinforcing Melaka's Economic Success

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Abbreviations

FDI	foreign direct investment
GDP	gross domestic product
GVA	gross value added
HSR	high-speed rail
R&D	research and development
SMEs	small and medium enterprises
SWOT	strengths, weaknesses, opportunities, and threats
UNESCO	United Nations Educational, Scientific and Cultural Organization
UPEN	Unit Perancang Ekonomi Negeri

Melaka's Weekend Market



Source: “Weekend Market” by Daniel Pietzsch [CC BY-NC 2.0](#).

Introduction

Despite Melaka State's rapid economic growth in recent years, its future prosperity is not predetermined. Recent growth in the tourism industry has set the region on a path of extremely fast economic expansion. However, it is unclear whether this growth model has been delivering broad social benefits; also unclear is whether it has caused excessive strain on local infrastructure, services, and historical heritage. Very ambitious development plans and large-scale infrastructure investment projects have been shaping government priorities, but some persistent challenges might need further consideration in Melaka's long-term plans.

This supporting report offers a detailed analysis of recent economic development trends in Melaka City and Melaka State and compares Melaka's performance with other similar locations in Malaysia and internationally. The report begins with a SWOT (strengths, weaknesses, opportunities, and threats) analysis (box 1) and then elaborates the following key message regarding Melaka's economic competitiveness:

- 1-1 Leverage competitive advantages and create conditions for the key sectors of tourism and manufacturing to thrive.

The report proposes the following key policy adjustments that the city and state might consider to increase their economic competitiveness:

- 1-A** Reassess large infrastructure projects and create strategies to leverage their opportunities.
- 1-B** Rethink strategic priorities and link them with opportunities for economic development.
- 1-C** Build a more inclusive and collaborative model of economic decision making.
- 1-D** Support development of major sectors.

The report utilizes a range of comparator cities for the purposes of horizontal analysis. These cities include peers (based on size, economic structure, and region) as well as aspirational comparators enabling Melaka to identify policies that will help it achieve its stated development objectives. The key indicators utilized for the assessment are included in annex A.

Box 1 Economic Competitiveness: SWOT Assessment

A SWOT assessment was carried out for the economic competitiveness of Melaka State. The underlying message is that for Melaka to make the most of its growth potential in the context of tough regional competition, it needs to intensify its effort to strategically differentiate itself. Further elaboration of the assessment is included in annex B.

<p>Strengths</p> <ol style="list-style-type: none"> 1. Dynamically growing and well-educated population 2. Internationally recognized historic and cultural assets with UNESCO status 3. Access to the large markets of Kuala Lumpur and Singapore 	<p>Weaknesses</p> <ol style="list-style-type: none"> 1. Tough national competition facing the state 2. Transport connectivity and congestion issues that could become a major obstacle for growth 3. Lack of support from the national government
<p>Opportunities</p> <ol style="list-style-type: none"> 1. External connectivity improvements through major infrastructure projects 2. Dynamic and globally engaged government 	<p>Threats</p> <ol style="list-style-type: none"> 1. Wide policy focus 2. Capacity shortages 3. Deterioration of core assets

Melaka Achieved Rapid Economic Growth Driven by Heritage and Health Tourism, yet Productivity Gains Have Been More Modest

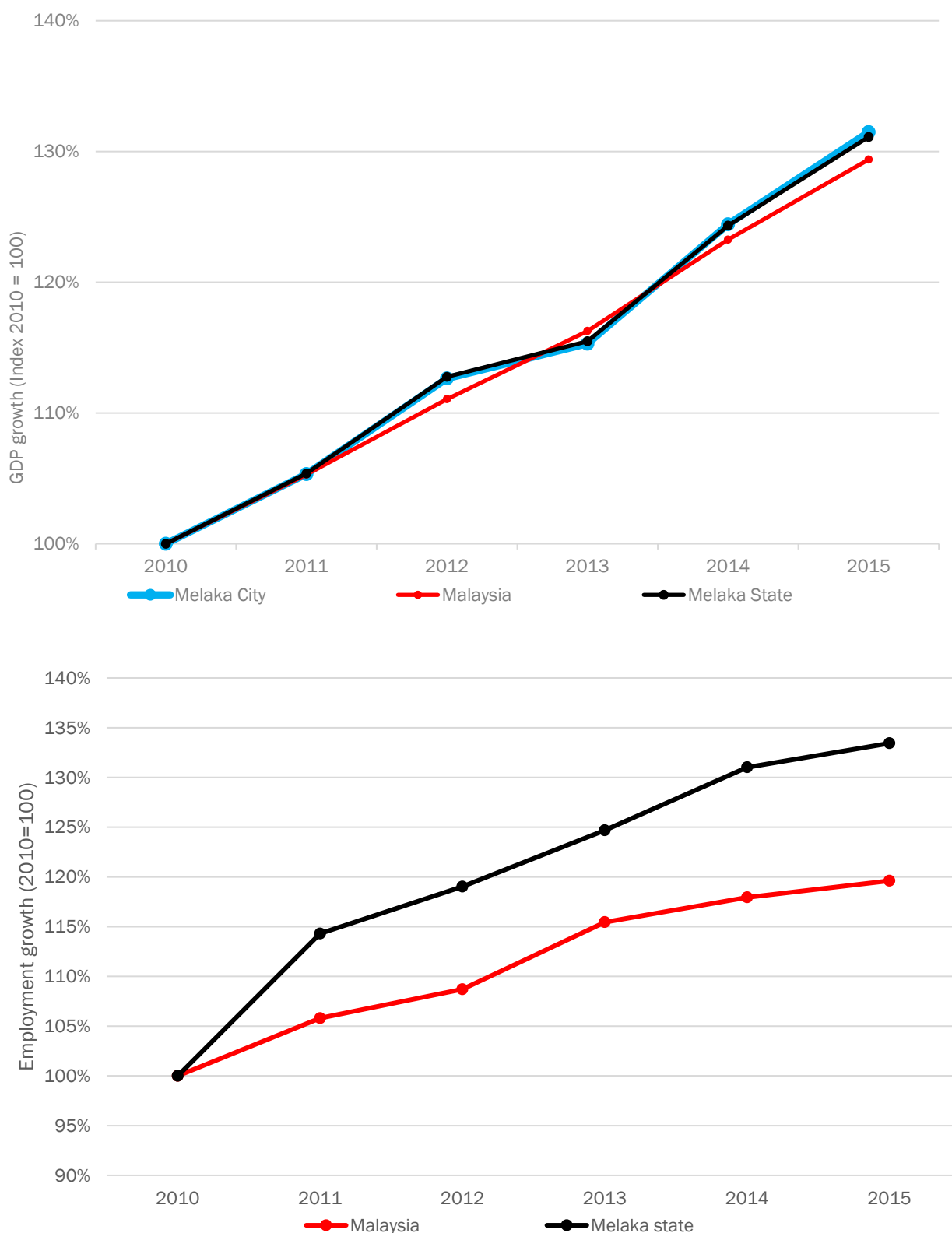
The Economic Dynamics of Melaka State

Melaka has experienced outstanding economic growth over the last 18 years. However, during that time span two very different economic periods can be determined. Initially, between 2000 and 2010, the rapid expansion of tourism led to an unusual reverse structural transformation. Contrary to the prevailing global pattern of economic development in similar countries (and as explained more fully below), Melaka transitioned from a mainly manufacturing-based economy to a mainly consumer services-focused economy. This process doesn't imply a post-industrial decline for Melaka, but rather a shift in the growth trajectory as a rapidly expanding tourism industry overtook manufacturing as the predominate driver of growth. Since 2011, the start of the second period, the pattern of growth has changed, with stabilization of the structural transition and the public sector making the biggest contribution to the economy. Consistent growth during this period has been an important achievement. Yet an overall reliance on tourism as the driver of growth, rather than manufacturing and advanced services, is the possible cause for the sluggish growth in labor productivity. Melaka State also has an extremely low unemployment rate, which suggests on the one hand that the quality of jobs might be an issue, and on the other hand that without an increase in productivity, the state's outstanding economic growth may be hard to sustain in the long run.

In recent years, Melaka State's economy has grown consistently, an impressive achievement given wider regional economic volatility over the period. Between 2011 and 2015, the economy grew at an average rate of 5.6 percent, above the national average of 5.3 percent (see figure 1). Within the state, Melaka City is the most important economic contributor in terms of GDP and employment. Its GDP per capita was 5 percent higher than the national figure in 2015. From 2010 to 2015, the total number of jobs in the state grew by 33 percent, ahead of the national growth rate of 20 percent. Job creation between 2010 and 2015 also outpaced population growth by 8 percent. Moreover, Melaka State's per capita income has been consistently higher than national levels since 2009; the state's mean monthly per capita income in 2016 was RM 1,756, compared to RM 1,687 for Malaysia (DOSM 2012b, 2014b, 2015b, 2017b).¹

¹ Mean monthly per capita income was calculated from mean monthly household income and the average household size published by the Department of Statistics Malaysia for years 2009, 2014, 2015, and 2017.

Figure 1 GDP Growth 2010–2015 (top) and Employment Growth 2011–2015 (bottom)

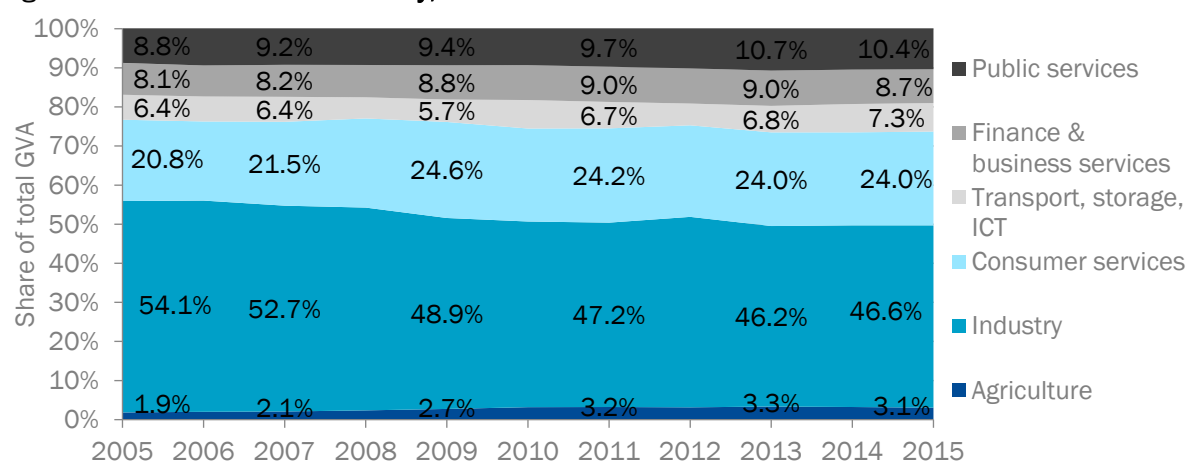


Sources: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a (for Melaka State); Oxford Economics Database 2017 (for others).

Note: 2010 = 100 percent.

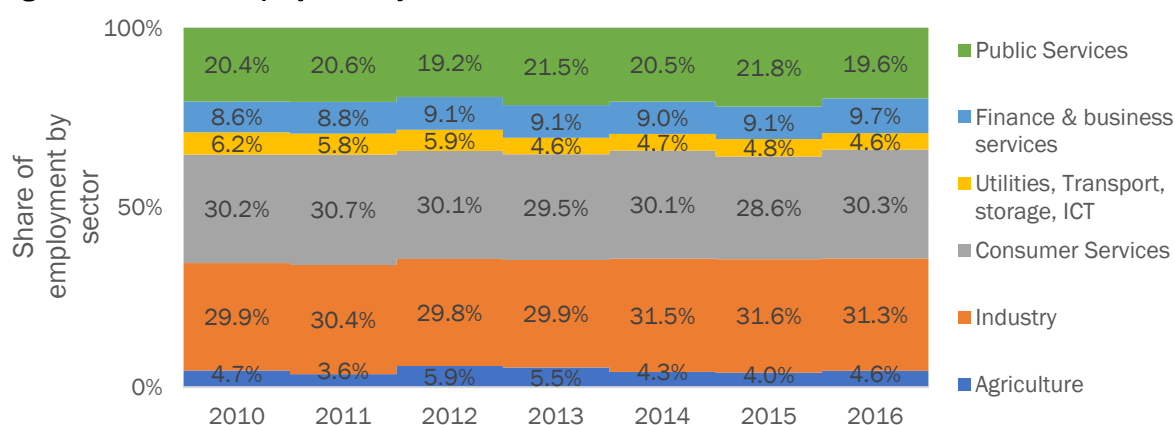
Between 2005 and 2011, the structure of output for Melaka's economy shifted from the industrial sector (which includes mining and quarrying, construction, and manufacturing) to consumer services.² This trend is particularly clear for Melaka City (see figure 2), where the share of Gross Value Added (GVA) of the industrial sector decreased from 54.1 percent to 47.2 percent between 2005 and 2011, while consumer services increased from 20.8 percent to 24.0 percent. This shift was not a result of deindustrialization, but rather a result of explosive growth experienced in the tourism sector. Between 2005 and 2011, the nominal output of manufacturing in Melaka City grew by 57 percent, while nominal output in consumer services grew by 153 percent (Oxford Economics Database 2017). This trend represents a rather unusual dynamic, because the prevailing global trend in city and regional economic restructuring is associated with moving from a specialization in consumer services to manufacturing, and then from manufacturing to high-value-added tradable knowledge services (World Bank Group 2015). In 2005–2011 Melaka followed a different path: as the role of manufacturing declined, tourism and tourism-related services expanded. However, over the last six years the structure of the city and state economy has been stable—in terms of output, employment, and growth in major economic sectors (figures 3 and 4).

Figure 2 Share of GVA: Melaka City, 2005–2015



Source: Oxford Economics Database 2017.

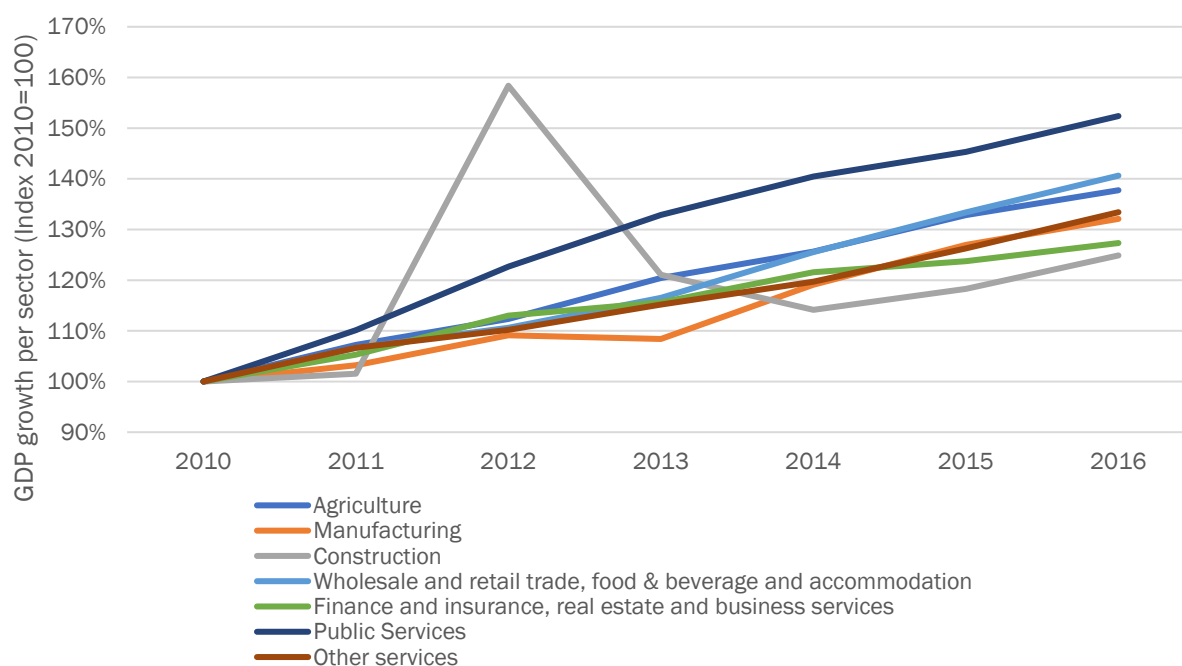
Figure 3 Share of Employment by Sector: Melaka State, 2010–2016



Sources: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a.

² Data is not available before 2005.

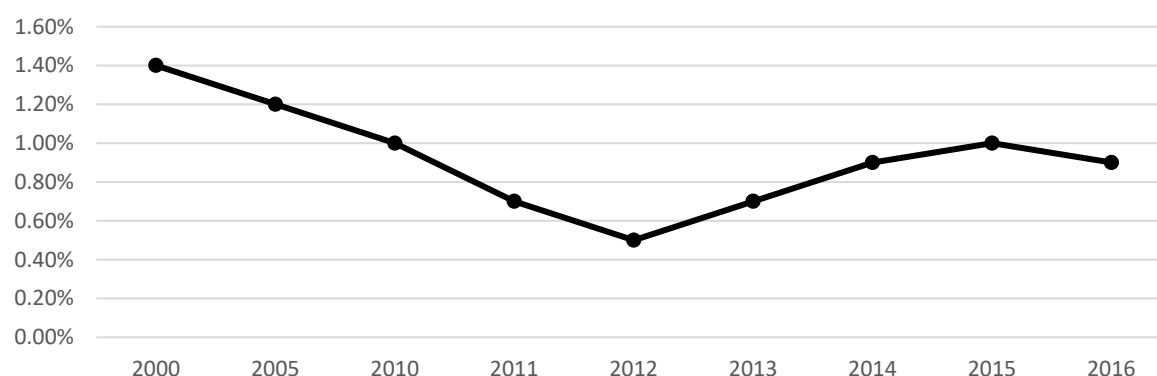
Figure 4 GDP Growth by Sector: Melaka State, 2010–2016



Source: DOSM 2017c.

Melaka has an unusually high employment rate, in a context of high employment across Malaysia. Melaka State's employment rate is 99.1 percent compared to the national average of 96.6 percent. Traditionally, an unemployment rate of 3 percent is considered to signify full employment in an economy (Beveridge 2014); however, this percentage varies by country and period. A 3 percent rate is considered frictional unemployment, which is necessary for economic dynamism (i.e., there are always some people changing jobs and careers). An unemployment rate of 0.9 percent (if national statistics are accurate) may suggest either labor shortages or the prevalence of underemployment, for instance in the tourism sector. Data suggests that the unemployment rate has not been below 1.4 percent in the last 17 years, which indicates a persistent structural phenomenon that requires further investigation (figure 5). Melaka's high rate of employment may suggest that many of the jobs are of poor quality. One potential reason for this is that many jobs in Melaka are part-time service jobs that are linked to surges of tourist inflow. This may be confirmed by the fact that the fall of the unemployment rate coincided with the fast growth of tourism from 2000 to 2012. Part-time contracts may allow those working under them not to be considered unemployed, but this type of work raises other concerns, such as a lack of social protection for the employees (i.e., health care) and the possibility that pay cannot consistently cover basic needs.

Figure 5 Evolution of Unemployment Rate in Melaka State, 2000–2016



Sources: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a.

Stagnating productivity partially reflects an overreliance on tourism and suggests potential limitations in the existing growth model. From 2010 to 2016, Melaka State's labor productivity was stagnant (DOSM 2017c; see also DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a). When looking at the two main contributors of GVA in Melaka State, there is a clear gap. Manufacturing has had higher levels of labor productivity than the state as a whole, while the productivity of the tourism sector is significantly below the state's average. The public sector, which includes health care services (the fastest-growing subindustry of recent years), also has low productivity and hasn't shown substantial productivity improvements. Labor productivity is critically important as an indicator most closely correlated with level of income. It is particularly important in Melaka because with relatively low population growth and an extremely low unemployment rate, improving labor productivity will likely be the main avenue for economic growth. The state then needs to be concerned with retaining and growing high-productivity sectors (discussed in more detail in the section on manufacturing), as well as with supporting the increase of labor productivity of tourism (discussed in more detail in the section on tourism).

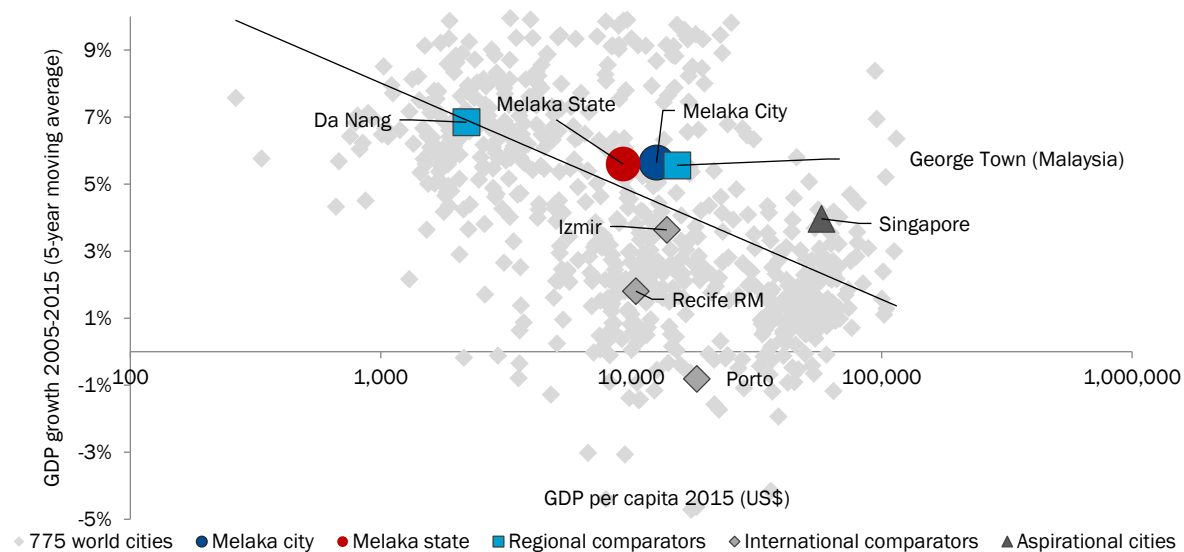
Horizontal Analysis

Melaka's economy has been growing faster than most of its comparator cities, at a similar or slightly higher level of development. However, its labor productivity remains behind most comparators, partially due to the prevalence of employment in lower-productivity sectors and partially due to a lower level of productivity in manufacturing and advanced services. Melaka's productivity growth has not been higher than that of its peers, which confirms the earlier hypothesis about the challenges of the industrial transformation ongoing in Melaka and points at possible structural constraints that impede the development of the local economy.

In recent years, Melaka State's (and Melaka City's) economy has been growing faster than most selected comparators. The benchmarking of Melaka's economic dynamics against selected Malaysian and international comparators shows that the output of Melaka City and Melaka State has been growing faster than predicted for their level of development given global trends (see figure 6).⁴ Both total output and total employment in Melaka State have been growing faster than in comparator cities at similar or slightly higher levels of development (Recife, Izmir, Porto), and faster than in its slightly more developed neighbor, Penang (see table 1).

⁴ For a description of the comparator selection methodology, see the introduction in *Melaka Sustainability Outlook Diagnostic: Overview Report*.

Figure 6 GDP per Capita 2015, and GDP Growth 2011–2015: Melaka and Comparators



Sources: DOSM 2017c (for Melaka State); Oxford Economics Database, 2017 (for all others).

Table 1 Descriptive Data on Melaka and Comparators

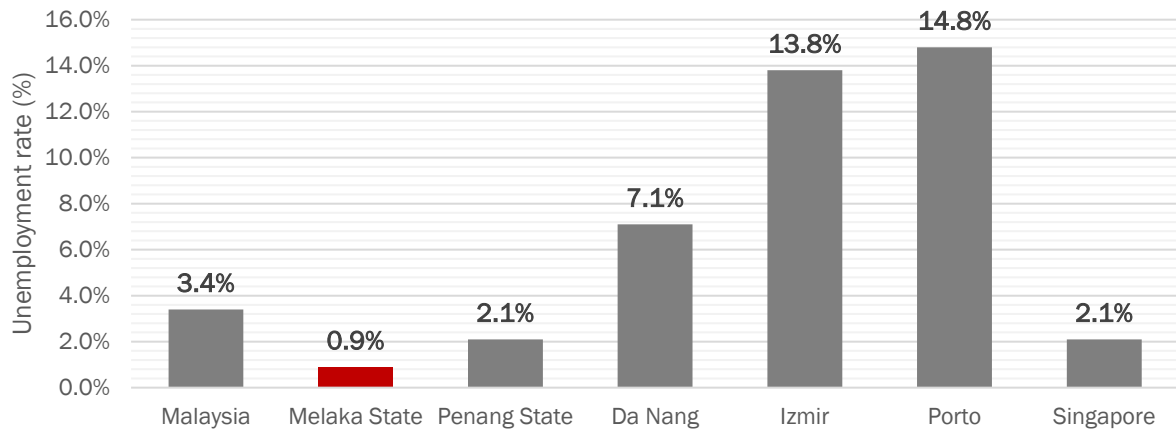
		Population (million)	GDP per capita (US\$)	Share of national GDP (%)	Average GDP growth, 2005– 2015 (%)	Average employment growth, 2005–2015 (%)
Melaka	Melaka State	0.9	9,507	2.6	5.6 ^a	5.0 ^a
	Melaka City	0.5	12,600	1.9	6.2	4.2
Regional direct comparators	George Town	0.6	15,300	2.3	5.6	3.0
	Da Nang	1.0	2,200	1.2	6.3	3.7
International direct comparators	Recife RM	3.9	10,400	1.7	4.0	1.9
	Izmir	3.1	13,900	4.8	3.9	4.3
	Porto	2.3	18,300	19.1	0.1	-0.9
Aspirational comparators	Singapore	5.5	57,500	100.0	6.2	4.8

Sources: DOSM 2017c (for Melaka State); Oxford Economics Database 2017 (for all others).

a. Average from 2011 to 2015.

Lower unemployment rates than in comparator cities are a cause for concern rather than celebration. In 2016 Melaka had an unemployment rate less than half of George Town and Singapore, both of which are seen as dynamically developing economies (figure 7). As suggested earlier, the low unemployment rate might be a result of the poor quality of jobs, which is confirmed by the fact that disposable income in Melaka is lower than in most of the comparator cities (figure 8).

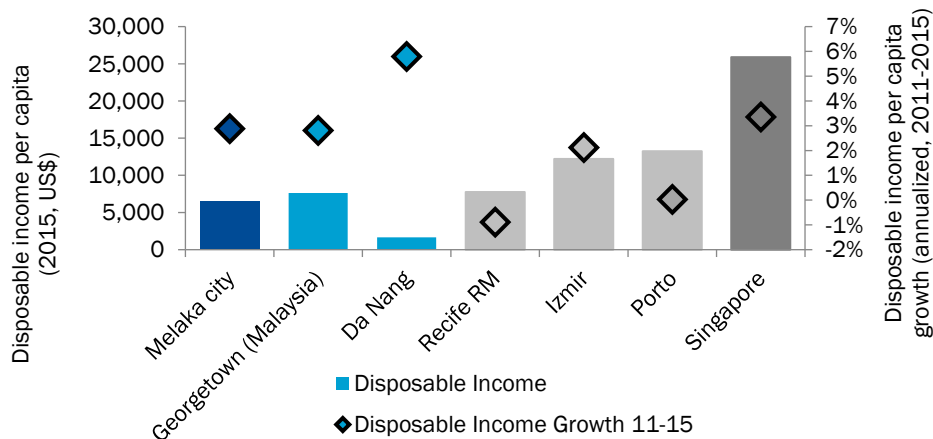
Figure 7 Unemployment Rate 2016: Melaka and Comparators



Sources: DOSM 2017a (for Melaka State); Oxford Economics Database 2017 (for all others).

The labor productivity of Melaka State is lower than in most comparators. This difference is driven both by the difference in the industrial structure of the economy in Melaka and comparators (figure 9), and by the difference in the labor productivity in individual sectors (table 2). On the one hand, Melaka has a lower share of employment in the usually highly productive sectors of financial and business services than most comparators, and a higher share of employment in public services, usually a relatively low-productivity sector. On the other hand, there is also a substantial difference in productivity within sectors. Manufacturing in Melaka is less productive than in George Town, which reflects the difference in the type of manufacturing activities that both cities host (discussed in the next section), while business and financial services are far less productive than in places like Izmir and Porto. The productivity differences within each of the industrial groups can be explained by multiple factors—first, the specific types of activities that represent these industries, and second, the multiple local conditions that shape the performance of the industry, including quality of infrastructure, skills of the population, business environment, and others.

Figure 8 Disposable Income per Capita 2015 and Growth Trend 2011–2015: Melaka and Comparators



Source: Oxford Economics Database 2017.

Note: Data not available for Melaka State.

Table 2 Value Added per Worker, 2015: Melaka and Comparators (US\$)

Melaka and comparators	Total	Agriculture	Industry	Transport and communications	Financial and business services	Consumer services	Public services
Melaka State	18,491	49,491	25,469	36,230 ^a	13,981	13,557	7,093
Melaka City	25,055	70,000	39,222	45,000	19,700	20,210	10,697
George Town (Malaysia)	27,379	53,000	35,272	40,200	29,351	20,875	14,260
Da Nang	3,943	1,342	3,772	1,167	31,455	2,497	2,210
Recife RM	21,815	7,278	34,363	22,571	35,222	12,156	18,798
Izmir	34,699	18,375	29,370	89,278	62,693	21,947	24,884
Porto	37,363	5,289	32,025	53,778	72,917	33,697	37,223
Singapore	79,242	-	70,189	91,453	113,134	89,538	31,340

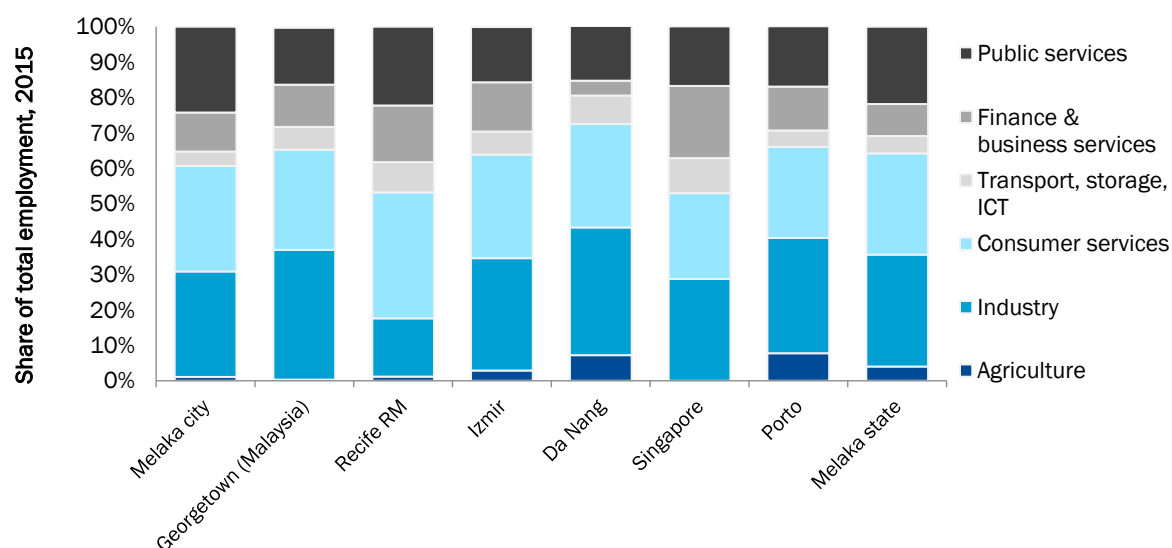
Source: DOSM 2017c (for Melaka State); Oxford Economics Database 2017 (for all others).

Note: Values for Melaka State were converted to U.S. dollars using the 2015 end-of-year exchange rate at <http://www.xe.com/currencycharts/?from=USD&to=MYR&view=5Y>.

a. Transport and communications sector includes utilities in Melaka State.

Note: “-” = data not available.

Figure 9 Share of Total Employment, 2015: Melaka and Comparators

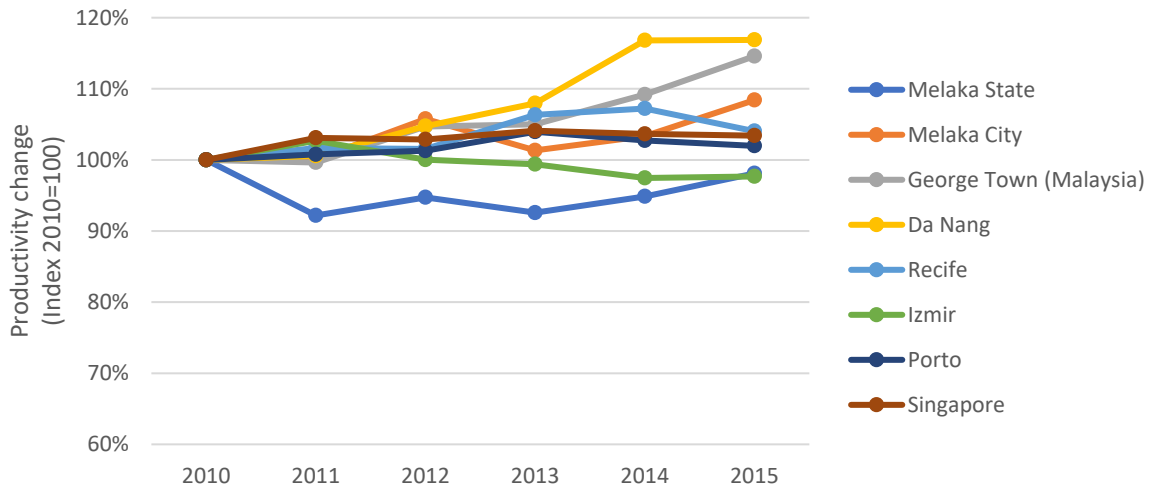


Source: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a (for Melaka State); Oxford Economics Database 2017 (for all others).

Over time, labor productivity in Melaka has grown at a slower rate than in the comparator cities (figure 10). This confirms two of the earlier observations: 1) the form of structural transformation observed in Melaka makes it difficult to achieve productivity growth, and 2) there are potentially other structural conditions that are holding back productivity growth in Melaka. The next sections attempt to address these questions through a more detailed discussion of the two main sectors of

specialization in Melaka, manufacturing and tourism, and through a discussion of key challenges facing the economy.

Figure 10 Productivity Change, 2010–2016: Melaka and Comparators



Sources: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a (for Melaka State); Oxford Economics Database 2017 (for all others).

Key Message 1-1: Leverage Competitive Advantages and Create Conditions for the Key Sectors of Tourism and Manufacturing to Thrive

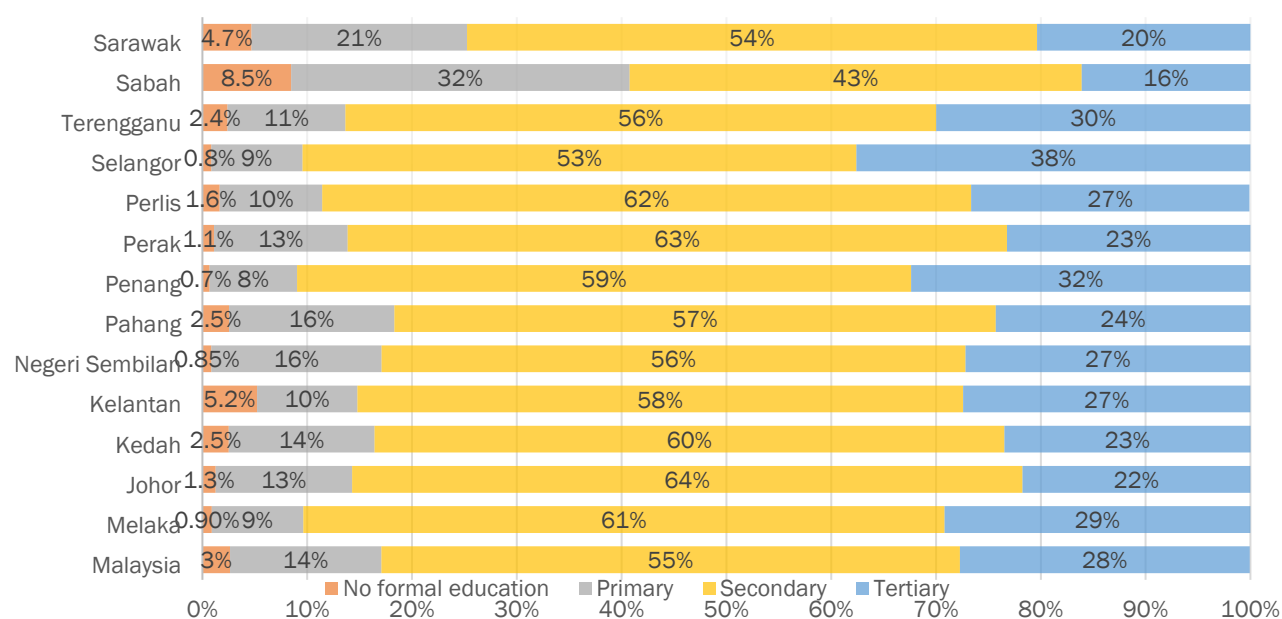
Enabling Conditions and Constraints for Economic Growth

The first step to improving economic development outcomes is an understanding of the conditions that shape them by enabling or constraining growth. Melaka stands out for its positive demographic dynamics, relatively high skill levels, and favorable business location. However, it is not clear whether these positive characteristics are leveraged effectively or to their full potential. While the state has committed to large-scale infrastructure investments to address connectivity constraints, other pathways may also allow the government to support the development of the economy.

Population growth and skilled labor force

The region's dynamic population growth enhances labor resources, but this does not necessarily mean that the region can successfully attract and retain the most skilled. Melaka State experienced the second highest positive net migration from 2010 to 2015 (52,000 people) in Malaysia, after Selangor (27,400 people). During the same period, the working age population (aged 15–64) in its capital, Melaka City, increased by 147 percent. Moreover, Melaka City's growth rates are higher than those in its peer capital city, George Town (Penang), at 136 percent and higher than national growth levels at 143% (Oxford Economics Database 2017). However, local officials suggest that young and well-educated Melakans typically move away to seek better economic opportunities in Kuala Lumpur or Singapore. In order to retain talent, Melaka needs to combine a good quality of life with better job prospects in highly productive sectors.

Figure 11 Share of Labor Force by Education Attainment in Malaysian States, 2016



Source: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a.

A skilled population and strong educational institutions make human capital an important resource for growth, yet currently these positive attributes do not appear to be fully utilized. In 2016, Melaka's labor force had a higher percentage of people with secondary education than did the country as a whole (70.4 percent versus 67.8 percent) (figure 11). Melaka's overall skill profile is one of the best among all Malaysian states. According to a recent ranking by UniRank, Technical University of Malaysia is among the top 20 universities in the country.⁵ But Selangor, Penang, and Terengganu have more universities at the top of the rankings and relatively stronger skills profiles. While the overall skill profile of Melaka's population shows high potential, further investigation is required to understand whether it meets the needs of Melaka's firms and potential investors.

⁵ UniRank, "Technical University of Malaysia, Melaka," <https://www.4icu.org/reviews/universities-english/10520.html> (accessed December 10, 2017).

University Students in Malaysia



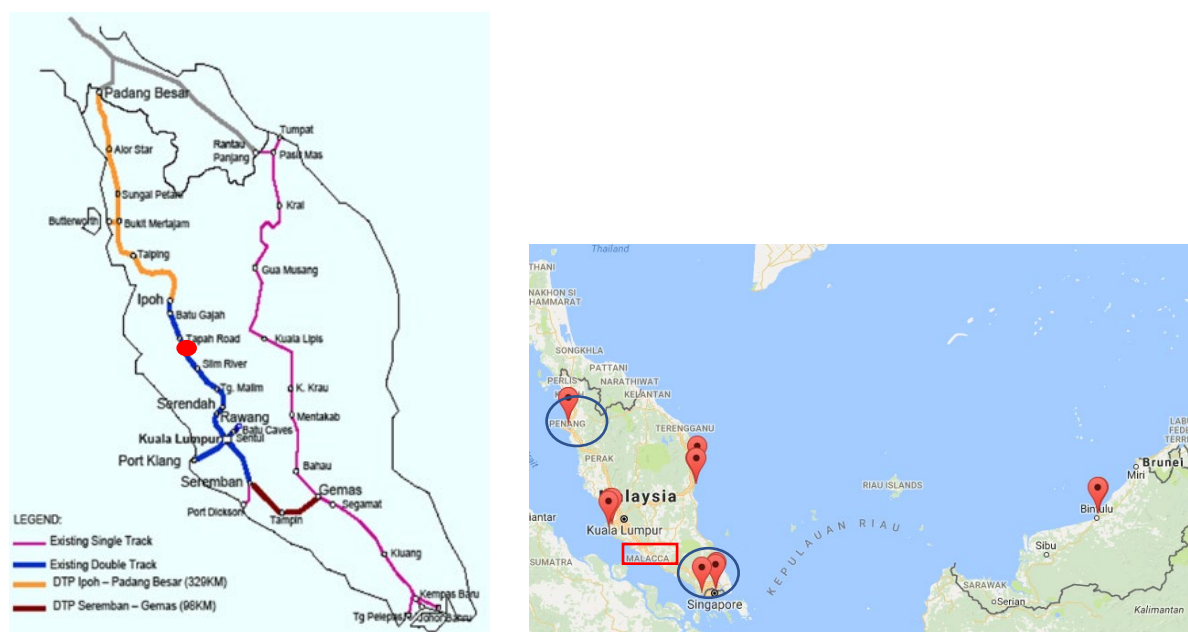
Source: Nafise Motlaq/World Bank.

Connectivity

The city's proximity to large economic centers is a mixed blessing for Melaka. Melaka is located close to Johor Bahru, Kuala Lumpur, and Singapore (all can be reached in three hours or under by car), and relatively near to George Town (six hours by car). These cities have a combined population of 16.3 million. On the one hand, these regions offer a large market for local products and the tourism sector; and proximity to major economic hubs like Singapore and Kuala Lumpur also means having access to multiple advanced universities, research institutions, and specialized service providers that can boost Melaka's potential for innovation. On the other hand, being in the neighborhood of highly developed cities and regions means that Melaka faces tough competition. Against many comparison criteria, Melaka is at a disadvantage. Selangor and Negeri Sembilan are located closer to Kuala Lumpur. Penang, just like Melaka, has a popular UNESCO World Heritage site and is better connected by rail and air. Johor Bahru is located across the narrow gulf from Singapore and has been successfully competing with its neighbor (in the petrochemical industry) and leveraging its proximity (by attracting entertainment parks that Singapore hasn't dedicated land to).

Relatively poor transport connectivity further impedes Melaka's potential. Regions like Penang, in the north of Malaysia, or Johor, in the south, are significantly closer to two of the main ports in the country. Moreover, Melaka City is currently bypassed by the major rail network (figure 12). Low connectivity prevents the state from integrating into value chains either regionally or globally, undermining the efficiency of local and foreign firms located in Melaka. Moreover, low connectivity may discourage enterprises from locating in the state.

Figure 12 Rail Lines (left) and Location of Ports (right) in Malaysia



Sources: Ministry of Transport Malaysia, “Rail Transport: Rail Land Development,” <http://www.mot.gov.my/en/lands/rail-transport/rail-land-development> (left); Ministry of Transport Malaysia, “Location of Ports,” <http://www.mot.gov.my/en/maritime/ports-in-malaysia/location> (right).

Note: In right map, Melaka State is outlined in red.

There are several ambitious new infrastructure projects planned that seek to address connectivity challenges, but it is unproven to what extent they will be beneficial to the region’s economy:

- **High-speed rail (HSR) connection to Kuala Lumpur and Singapore.** Melaka is planned as one of the stops on the HSR between Kuala Lumpur and Singapore, which will dramatically cut the travel time from Melaka to either city. The HSR station is planned to integrate public transportation and other services, such as bicycles and rickshaws, and is expected to be completed by 2031 (Straits Times 2018). Melaka is expecting increased tourism visits from Singapore and an alleviation of car congestion during weekends. However, the real impacts of the HSR are not straightforward. On the one hand, it may bring more tourists and make Melaka more attractive as a business location; on the other hand, it may reduce the length of tourist stay (as weekend trips will be replaced by day trips). International experience confirms that high speed rail connections do not necessarily boost economies of secondary cities (see box 2).
- **One Belt One Road initiative.** Construction of a major deep-sea port in Melaka aiming to compete with Singapore is included as one of the possible projects under One Belt One Road, the Chinese government’s ambitious global connectivity initiative. Some One Belt One Road projects have been canceled, but as of August 2018 Melaka’s Gateway port appeared to be going forward (Berger 2018). The proposed Melaka Gateway project may bring RM 43 billion (US\$10.3 billion) of Chinese and Malaysian investment to the region (Jaipragas 2017). The initiative includes construction of seven seaports meant to have different specializations: mineral products, oil, gas, petroleum, fishing, tourism, and major trading. Local exporting firms could be expected to benefit from proximity to the port. However, the initiative seems to be part of a strategic Chinese master plan to compete with Singapore and may not be designed to maximize the benefit of the local economy (Jaipragas 2017). There is skepticism about whether the ports will be successful and make

it possible to pay back the huge loans that their construction will require (Maresca 2017). This skepticism is consistent with the international evidence on local economic benefits of major port investments, which suggests that such projects do not guarantee achieving higher levels of prosperity (see box 3).

Business environment

The business environment in Melaka offers limited opportunities for growth. This is the finding of an online survey of Melaka enterprises conducted in November and December of 2017.⁷ While businesses think that there is a growing demand in the region, they identify business regulations as bureaucratic and a constraint on the growth of firms. While a number of surveyed firms report having benefited from state support, they also suggested that there is room for closer collaboration with the government and more business support programs.

A number of other local conditions have specific relevance to the performance of key industries and an important effect on economic outcomes. The following sections discuss the performance of tourism and manufacturing sectors.

Box 2 Investing in High-Speed Rail for Competitiveness: City Examples

International experience shows that the impact of HSR investments on economies of secondary cities and regions is not very clear. France, Spain, and Japan are some examples of countries that have implemented high-speed rail projects. However, the outcomes differ case by case, and among different cities connected by the new transport infrastructure. The following three examples of HSR initiatives suggest the diversity of outcomes.

- France's high-speed TGV Sud Est resulted in an overall reduction of congestion and accident costs, and it enhanced the image and increased the accessibility of cities (Vickerman 1997). Substantial economic growth was witnessed around stations such as Valence, where a major urban regeneration effort was undertaken along with the construction of the new train line. Lyon, which was the final destination on one of the high-speed lines from Paris, experienced substantial growth, manifested in higher demand for office space and increased investment in real estate. But other stations on the Paris-Lyon line, such as Le Creusot and Macon, captured little to no benefit (Banister and Berechman 2000).
- In the case of Spain, AVE Madrid-Sevilla was expected to increase mobility between the capital of the country, Madrid, and the region of Andalucía, where Seville is located, to boost tourism in the south of the country (Sánchez-Ollero, García-Pozo, and Marchante-Mera 2014). However, the line ended up being used far less than expected, and is mainly a way to go from smaller cities in the south to Madrid. Overall, the line enhanced the centrality of Madrid rather than dispersing economic activity to the periphery.
- The effect of the Shinkansen HSR between Tokyo and Osaka on the economies of the connected regions has been rather hard to evaluate (Givoni 2006). It has been observed that regions served directly by the Shinkansen experienced higher population and employment growth rates than those not served by it. Nevertheless, it is less clear if the high-speed train led to economic growth or if the train was originally located where the growth was already occurring. It is argued that where existing stations were enhanced to accommodate the train services, development around the stations was marginal; where new stations were built, development around the stations was generated if local strategies linked the station to economic opportunities in the region (e.g., through good transportation links to the HSR station).

⁷ The conclusions derived from the survey are based on the responses of 26 enterprises located in the state of Melaka. The results of the survey are not representative.

Lessons

- HSR does not necessarily guarantee positive effects for a secondary city. Beneficial impacts highly depend on local strategies. Melaka needs to have clarity on what objectives it wants to address. For instance, Melaka can aim to reduce congestion and boost train-related economic activities around the new station, as happened in some stations of the TGV.
- HSR alone is not enough to boost the economic development of a region. Complementary development strategies need to be coupled with the transport investment, such as local links to the station (Japan) or urban redevelopment plans (France), to have a beneficial impact on the region.
- Improved connectivity wouldn't necessarily benefit tourism, as shown by the Andalucía example.

Box 3 Lessons from Large Port Investment Initiatives

International experience shows that investment in ports can be transformational for local economies. But based on experiences from Morocco, Turkey, and Italy, success depends on clear market potential, comprehensive planning, and policy support.

Tangier, Morocco. The northern peninsula of Morocco, where Tangier is located, had been marginalized and underdeveloped for decades (Houpin 2010), and its strategic location for shipping routes along the Strait of Gibraltar had been neglected. However, the area's high potential and lack of regional competition was obvious (Klaric 2013).

To activate the peninsula's economy, the central government decided to build the Tangier Mediterranean Port in 2002. The opening of the port instantly brought a boost to the manufacturing sector, resulting in 28 percent employment growth from 2002 to 2004 and an annual increase of investment of 13.2 percent (Kulenovic et al. 2015). This project was not done in isolation, but rather as part of an integrated framework with five key aspects:

- Improvements in roads and rail in the northern part of Morocco
- Development of industrial and logistics free-trade zones
- Specific training and high-quality education of the local workforce
- Strong collaboration between national, regional, and local governments to alleviate the obstacles of implementation
- Establishment of a specific agency to create bridges between global investors and Tangier

Mersin, Turkey. Mersin gained its prominence as a port in the late 19th century, after the construction of a railway in the south of Turkey connected it to Adana. However, as the volume of shipments increased, port facilities in Mersin became inadequate and port congestion became a major constraint (MIP 2015).

The government decided to build the Mersin International Port in the 1950s. The objective of the port was to enhance access to foreign markets in southern Turkey and enable growth of trade (Merk and Bagis 2013). However, the impact of the port was limited due to an overestimation of its potential and a lack of coordination with other local development efforts (Merk and Bagis 2013). In retrospect, the following points are clear:

- The port didn't generate the expected volume of traffic. It is not often included in intercontinental routes, and its maritime connections are less diverse than most Mediterranean ports (Merk and Bagis 2013).
- There seems to be a disconnection between the port's activities, which are now handled solely by the private sector, and the needs of local businesses and regional development.

For instance, the port uses its local monopoly to charge higher rates and thus impedes the competitiveness of local firms.

Gioia Tauro, Italy. The Italian province of Reggio Calabria, on the Tyrrhenian coast of the southern region of Calabria, was for many years one of the least developed territories in the country. Back in the 1960s, to solve political disputes and to bring economic development to this part of the region, the central government was looking for comprehensive solutions that would bring economic opportunities (Genco, Sirtori, and Vignetti 2013).

In the early 1970s, the national government decided to build a port in Gioia Tauro, a commune in the province of Reggio Calabria, as part of a package that would involve a steel plant and a railroad. However, the demand for shipping was overestimated, and port facilities remained unused for two decades. The planning effort did not account for the fact that the mostly agricultural economy of Calabria would gain little from the port, and the local constituency would not support the project. The steel plant was also unsuccessful due to lack of demand and failure to compete with importers. In the 1990s, private investors took over the port with the aim of transforming it into a global hub. The new management was better able to account for the needs of the region and breathed new life into the port. However, issues related to poor original planning (weak inland connectivity) continue to impede the port's development and still impact the region.

Lessons

- Identifying a clear gap in the maritime market is a key condition for the implementation of a port. In the case of Tangier, its strategic location was key for the success of the port. In the case of Mersin, the port was established and the demand for larger port capacity was evident. Melaka needs to assess whether in a region with many globally competitive ports there is still a market niche that is unaddressed.
- To be successful, a port requires comprehensive strategic planning at regional scale. Tangier's success is underlined by a holistic regional development strategy linked to the development of the port—the element that was missing in Mersin and Calabria. Melaka would need to identify the right set of activities to support the development of the port, and leverage its success for the benefit of the local economy. The areas of intervention to be considered should include internal connectivity, international trade agreements, deals with key shipping companies, skills of the workforce, and support of the national authorities.

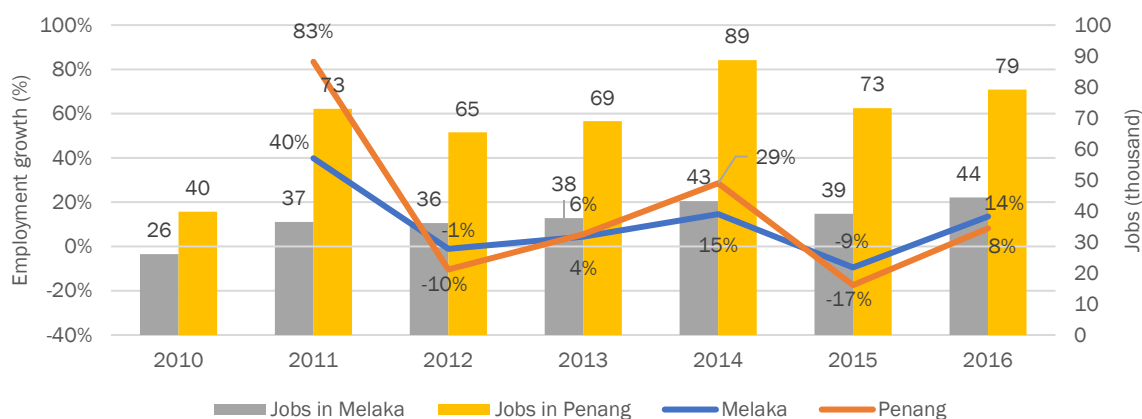
Economic Structure

Tourism

Tourism is a major source of growth and future development potential in Melaka, but further expansion of the industry will depend on expanding tourism offerings and ensuring the sustainability of the core assets and adequacy of urban infrastructure.

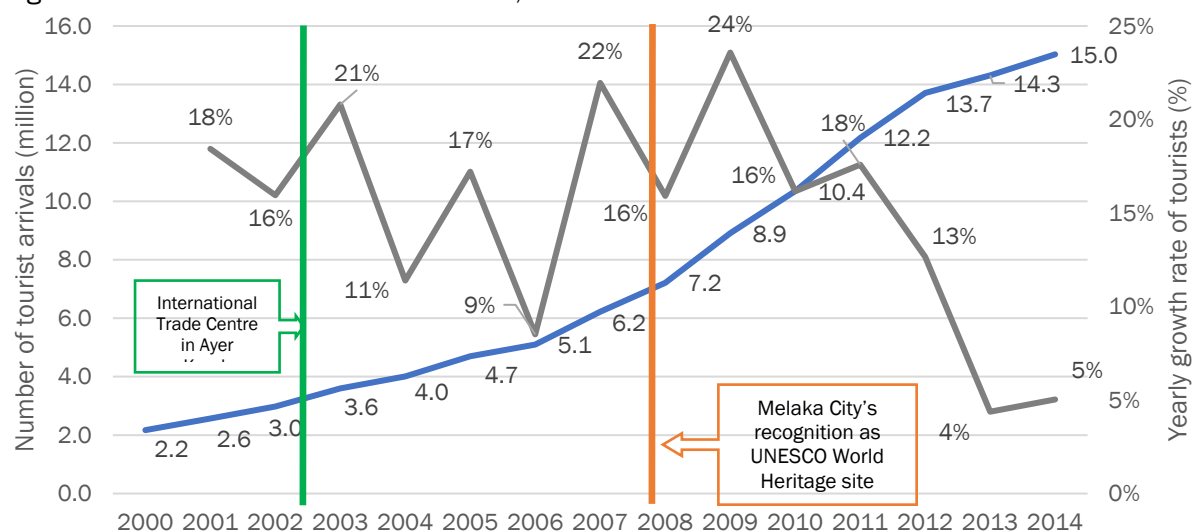
The growth of the tourism economy has brought a lot of employment opportunities to residents of Melaka. Between 2010 and 2016, 18,300 jobs were created in the “accommodation and food services activities” subsector, while the state’s share of total employment grew from 8.7 percent to 11.2 percent. This makes this subsector the third largest in Melaka in terms of job contribution. For comparison, the share of employment in this sector in neighboring Penang went from 5.6 percent to 9.6 percent in the same period, creating 39,400 jobs—two times more than in Melaka. It is also important to highlight that growth in employment tends to follow the same behavior in both states, with Penang experiencing greater fluctuations in industry dynamics (figure 13). These patterns suggest that national and macro conditions play a rather important role in performance of the industry.

Figure 13 Employment in Accommodation and Food Services Activities, 2010–2016: Melaka State and Penang State



Source: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a.

Figure 14 Tourist Arrivals in Melaka State, 2000–2014

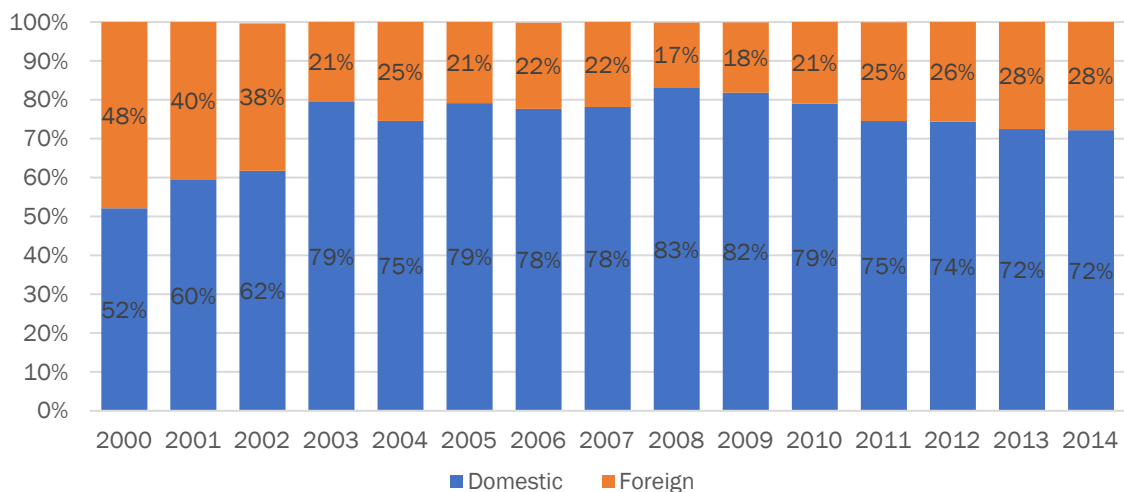


Sources: Tourism Malaysia 2015; Melaka Tourism Promotion Division 2015.

The number of tourists visiting Melaka State has increased dramatically since the early 2000s. From 2000 to 2014, the number of tourists grew from just above 2 million people to more than 15 million (figure 14). The opening of Melaka's International Trade Centre in Ayer Keroh was an important contribution to the growth spike seen in 2003. Additionally, Melaka's recognition as a UNESCO World Heritage site in 2008 caused high growth in the number of visitors the following year. However, despite continuing growth in the absolute number of visitors, the rate of growth has declined in recent years.

Melaka's tourists are mainly visiting from other states in Malaysia. In 2014, 72 percent of the total visitors to the state were domestic, mainly visiting from Selangor, Kuala Lumpur, and Johor. Since 2001, the number of domestic visitors has grown by over 10 percent a year, and the share of domestic visitors has gone up from one half a percent to a significant 72 percent. However, over the last few years the number of foreign visitors has been growing faster. In 2014, 67 percent of foreign visitors came from only five East Asian countries/ economies: Singapore, Japan, and Taiwan, China accounted for 37 percent of the total foreign tourists, China accounted for 18 percent, and Indonesia for 12 percent. Recently, the growth of foreign visitor numbers has also slowed down, from rates of around 30 percent in 2009 and 2010, to 6 percent in 2014 (figure 15).

Figure 15 Share of Domestic and Foreign Tourists Visiting Melaka State, 2000–2014



Source: Melaka Tourism Promotion Division 2015.

Tourist visits to Melaka are short, usually a weekend long. The average length of stay of visitors in Melaka State is two days (Melaka Tourism Promotion Division 2015), far less than in Penang, where a 2014–2015 tourist survey found the average to be eight days (Omar and Mohamed 2016). If we consider only the years after UNESCO's declaration of Melaka and George Town as a joint World Heritage Site in 2008, the average length of stay in Melaka increased slightly, to 2.1, but the average stay of a foreign tourist in Malaysia overall increased from 7.2 to 7.9 days, which suggests that Melaka is lagging.

To extend the length of visitor stays, Melaka needs to diversify its offerings. Tourists in Melaka spend the most on accommodation and shopping; they spend a smaller share on food/beverage and transportation, and an even smaller share on exploration, sightseeing, and other activities (figure 16). These results are consistent with the findings from the interviews with public officials and tourist surveys that suggest that Melaka is predominantly a weekend destination famous for heritage, shopping, and restaurants but with rather limited offerings beyond that. To keep tourists in the city for longer, Melaka needs to develop other activities and attractions for them. However, the lack of beaches (like those in Penang) puts Melaka at a natural disadvantage, and perhaps

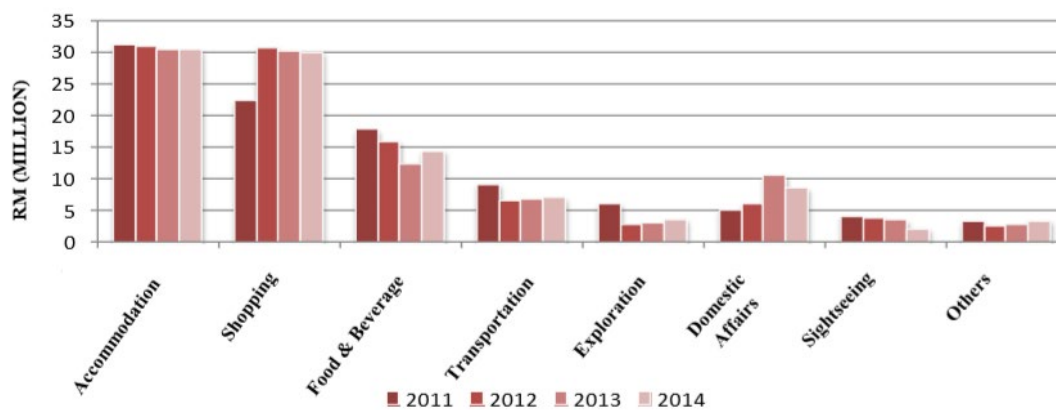
suggests that weekend tourism is the niche the city should continue to explore, while still improving diversity and the quality of the offering, and thus increasing tourist expenditures and visitor numbers.

Image 3 Melaka Duck Tours



Source: “Tourist tank!” by gordontour CC BY-NC-ND 2.0.

Figure 16 Distribution of Tourists’ Expenditure in Melaka State, 2011–2014



Source: Melaka Tourism Promotion Division 2015.

The nature of tourism activity in Melaka explains both the state’s challenge regarding achieving higher levels of productivity and the concerns about the quality of jobs. The dominance of short visits and high weekly fluctuations all contribute to the fact that the fastest-growing industry in Melaka is probably creating a lot of low-paid part-time jobs. These factors contribute to an incredibly high employment rate, but also create relatively low productivity growth.

Local services and infrastructure are stretched during the peak inflows of visitors, which creates sustainability challenges. Despite the short average length of visits, the Melaka tourist accommodation occupancy rate is higher than that of Malaysia as a whole. In 2013, Melaka’s occupancy rate was 70.11 percent, while Malaysia’s was 62.6 percent (Melaka Tourism Promotion Division 2015). This suggests that during its peaks, Melaka is likely operating at full capacity. For the hotel industry, this data suggests the possibility of further expansion. For the state however, it

points at an extreme and highly time-concentrated pressure on urban infrastructure. This includes pressure on roads (congestion is reported to be very high on weekends), water and sewerage systems, public spaces, etc. The development process, if mismanaged, could potentially lead to an uncontrolled increase in tourism infrastructure (hotels and restaurants), without an appropriate investment in the capacity of urban infrastructure, urban services, or core tourism attractions. Failure to appropriately maintain and develop infrastructure and services may result in the gradual deterioration of core tourism assets and subsequent reduction in attractiveness of the city, which will directly damage the rapidly growing tourism economy. Box 4 offers an example of how Barcelona is trying to overcome similar challenges in the tourism sector.

Box 4 Barcelona's Approach to Attracting Tourism while Reducing Disruptive Impacts

Barcelona is ranked number 12 in the "Global Top 20 Destination Cities by International Overnight Visitors" (Hedrick-Wong and Choong 2016). The number of visitors to Barcelona has been increasing steadily in the last decades. This has fueled the local economy, but also increased congestion, tested the capacity of local housing and services, and had a substantial effect on the lives of the locals.

To support further tourism growth while alleviating its negative impacts, the government launched the Turisme 2020 Barcelona strategic plan in 2015 (Ayuntament de Barcelona 2017). The strategy included the following targets: 1) strengthening relations between visitors and local businesses to better understand preferences and keep diversifying local offerings; 2) making services more accessible for people with disabilities; 3) establishing a monitoring system to maximize social returns of tourism investments; 4) introducing certification in the tourism industry to enhance quality of services; 5) pushing for innovative projects that would introduce new products and use new spaces; and 6) developing new tourism products such as large-scale events, local cuisine, and heritage-linked activities.

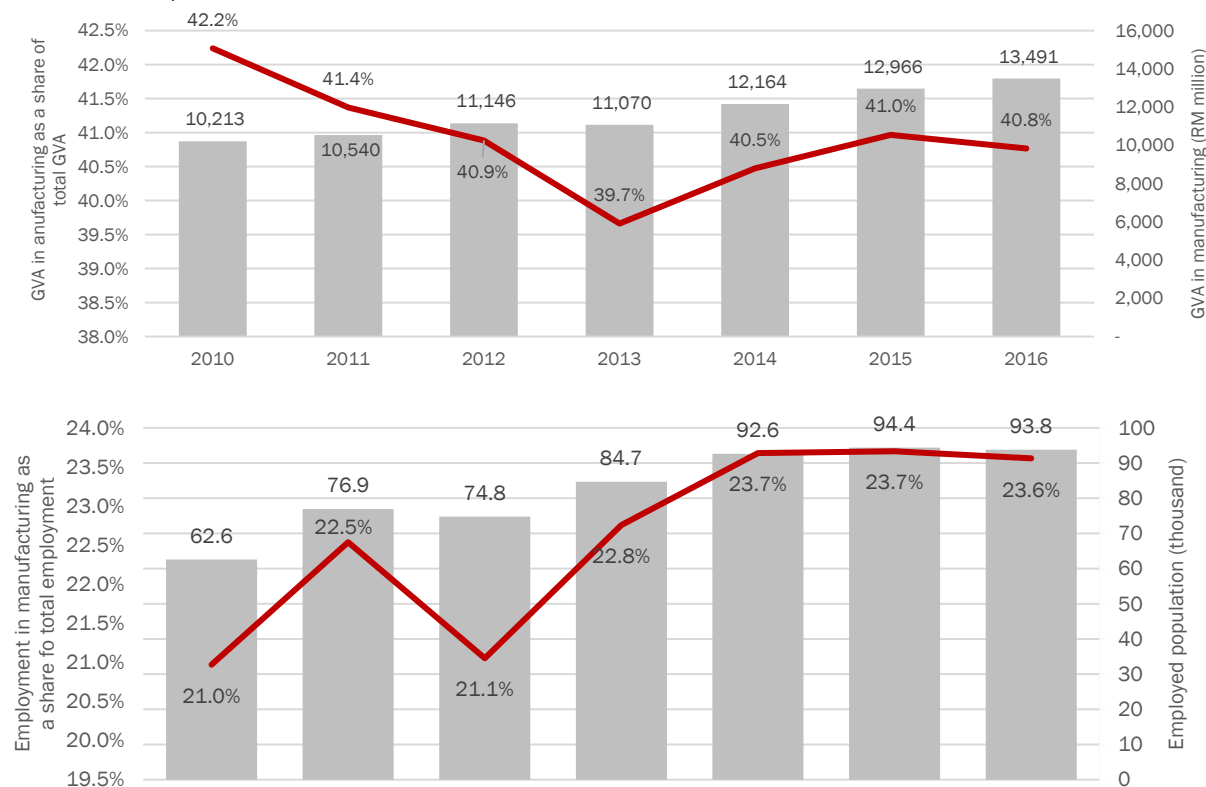
Some of the specific activities implemented under the strategy include 1) promoting attractions are not oversubscribed; 2) fighting illegal tourist accommodation rentals, which put pressure on the housing market; 3) implementing comprehensive management plans for the most visited and crowded places, with a detailed spatial understanding of tourism activities; 4) having a tourist mobility plan that reduces the impact for regular public transport and specific transport for tourists; 5) coordinating territorial strategies among involved authorities; 6) integrating visitors in local urban planning strategies; and 7) finding mechanisms, such as taxes, to compensate negative externalities.

Manufacturing

Manufacturing makes a big contribution to Melaka's economy, and it should therefore be a focus for policy makers. Further analysis of the conditions that attracted investors such as Honda and CTRM (Composite Technology Research Malaysia) could help the state define a policy strategy promoting subsector specialization in higher-tech forms of production.

Manufacturing is one of the main economic activities in Melaka State. Malaysians and Melakans mostly think of Melaka as a tourism destination, but Melaka City is fourth on the list of major Malaysian cities that are most specialized in the industrial sector (which includes construction, mining, and quarrying, alongside manufacturing). Even through its relative contribution to total GVA in the state has been decreasing, manufacturing still makes up 41 percent of economic output, and it accounts for 24 percent of employment in Melaka State (figure 17). In 2010–2016, it added 31,200 jobs; this is the fifth largest number among Malaysian states and an impressive achievement for one of the smallest states.

Figure 17 Manufacturing Sector Contribution to GVA (top) and to Total Employment (bottom) in Melaka State, 2010–2016



Source: DOSM 2011, 2012a, 2013, 2014a, 2015a, 2016a, 2017a, 2017c.

Foreign investment is the main driver of growth in the manufacturing sector of Melaka. While the total number of manufacturing plants in Melaka decreased by 10 percent from 2013 to 2015, the number of foreign-owned manufacturing plants increased by 3 percent. Over these three years, foreign investment flows in manufacturing grew by 20 percent, and employment in foreign-owned factories grew by 24 percent. Leading origins of investment include the following economies: Singapore; Taiwan, China; Japan; and the United States. Examples of large foreign direct investment (FDI) projects in manufacturing include major projects in the car and aerospace industries (see box 5).

Box 5 Manufacturing Enterprises Located in Melaka

Honda Malaysia. The multinational car company Honda established one of its plants in Alor Gajah, assembling the first car in Melaka in 2003 (Honda 2017). Honda Malaysia's Pegoh plant was built in Pegoh's industrial park, where the main activity is assembling parts of automobiles, such as the CR-V. This first investment brought Melaka RM 382 million (The Star 2014) and led to a second plant and further investments of RM 40.12 million (including land acquisition) (Motor Trader 2012). According to LinkedIn, these plants have between 51 and 200 employees, with a 20 percent increase in the last two years.

CTRM. CTRM is a public manufacturing company located in Batu Berendam, Melaka, that specializes in producing high-quality components and equipment for use in the defense and aerospace sectors (such as parts for wings, engines, tails, and fuselages) and in carrying out research and development. It currently has projects with international enterprises such as Airbus and Boeing (Boeing 2011). According to LinkedIn, the company has between 1,000 and 5,000 employees, with 5 percent growth in employment in the last two years.

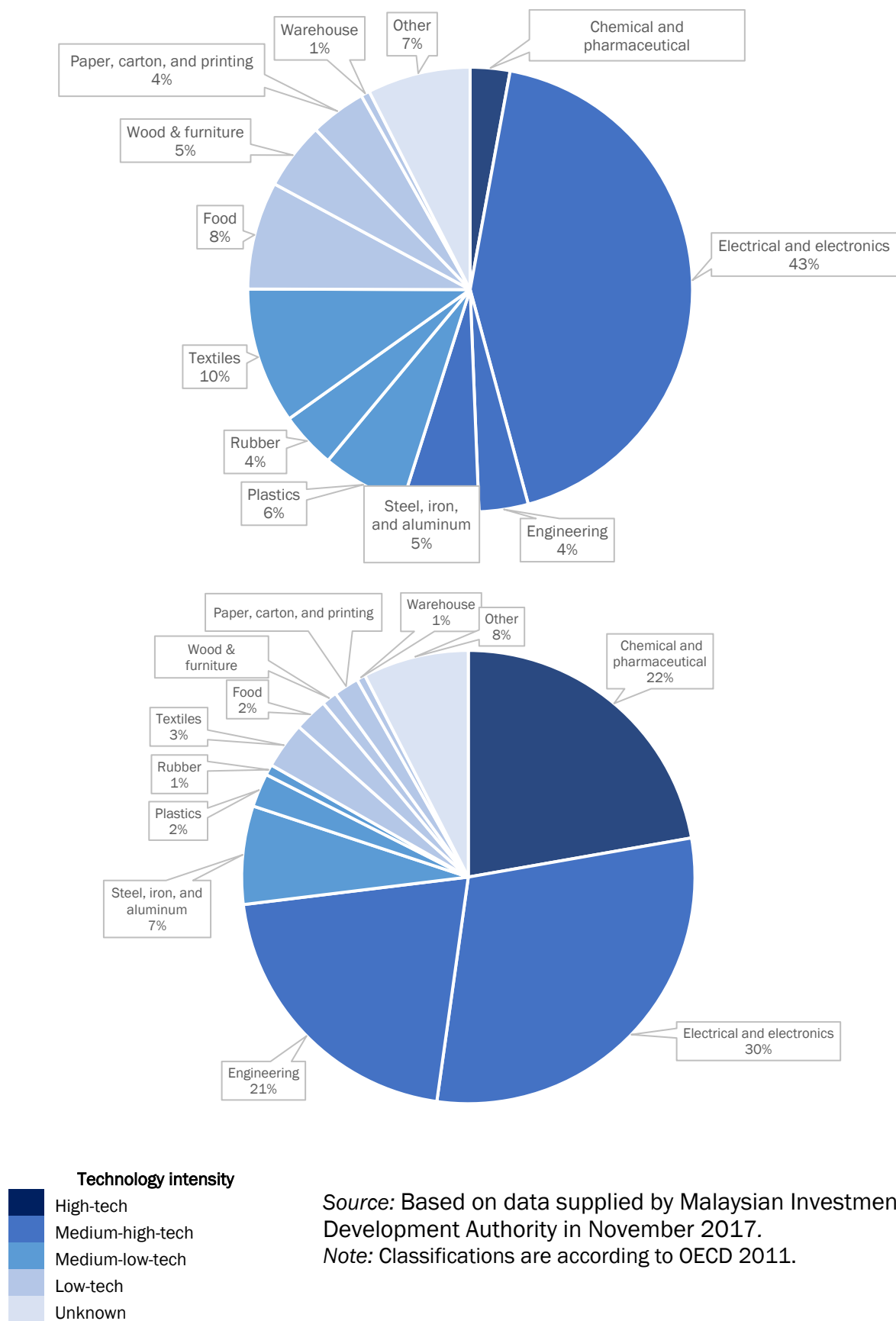
Melaka's manufacturing sector is diversified; while it is mostly focused on mid- and low-tech production, newer investment is more concentrated in more technologically complex industries. As of 2015, 60 percent of the factories in Melaka State focused on medium-low- or low- technology-intensity manufacturing sectors, such as “steel, iron, and aluminum,” and “paper, carton box, and printing” and employed 43 percent of the labor force in manufacturing. However, these sectors account for only 19 percent of the total investment flows in manufacturing. About half (51 percent) of the investment flows are concentrated in medium-high-tech sectors, specifically in “electrical and electronics” and “engineering,” which employ 49 percent of the labor force. The only high-tech sector represented in Melaka is “chemical and pharmaceutical” manufacturing, which accounts for 22 percent of investment, but only 3 percent of employment (figure 18). While high- and mid-high-tech manufacturing accounts for a small share of factories and employment in manufacturing, the fact that these industries are dominating investment is a positive sign for the state (particularly in light of labor productivity challenges).⁸

Melaka is not specialized in any of the manufacturing subsectors. While other states in Malaysia are specializing in electronics (Penang, described in box 6) or petrochemicals (Johor), Melaka's manufacturing profile is very diverse.⁹ In Melaka State, “electrical and electronics,” “steel, iron, and aluminum,” “food and food mill,” and “paper, carton box, and printing” account for 47 percent of the factories in the state, with almost equal share of firms between them. These four sectors are very different from each other in terms of technology intensity, requiring different labor skills and resources to succeed; thus colocation doesn't produce substantial productivity benefits for them. Lack of specialization means that the state is not developing localized supply chains, skills pools, or services that are characteristic of manufacturing clusters, which allow firms to increase their productivity and achieve higher levels of competitiveness that often are required for accessing international markets.

⁸ Based on data supplied by Malaysian Investment Development Authority in November 2017.

⁹ Based on data supplied by Malaysian Investment Development Authority in November 2017.

Figure 18 Employment in Manufacturing (top), and Total Value of Investment in Manufacturing (bottom) in Melaka State by Subsector and Technology Intensity, 2015



Source: Based on data supplied by Malaysian Investment Development Authority in November 2017.
 Note: Classifications are according to OECD 2011.

Box 6 Penang's Electrical and Electronics Sector

Penang State in Malaysia has the second highest concentration of manufacturing production in the country after Selangor, with 12.9 percent in 2016 (DOSM 2017c); in 2013 it attracted the most investments in manufacturing (MIDA 2014). Penang has established a comparative advantage over other states in Malaysia by focusing on technology-intensive goods such as semiconductors and hard disk drives (Hutchinson 2008). To develop such expertise, Penang has targeted specific international companies and offered them support services, such as handling of licenses, permits, and incentives locally to avoid having to go through the national government. Penang has been able to upgrade the skills of its labor force, through facilitating collaboration between local education institutions and the multinational enterprises. This has allowed the state to gradually move from high-labor-intensity manufacturing activities into specialization in high-tech manufacturing.

Melaka lacks support from Malaysian federal programs that have helped boost other regions in the country. Malaysia has implemented economic corridor development initiatives in different regions (ADB 2015). The regions covered by the program enjoy several benefits, including transport infrastructure investment, knowledge-sharing support for enterprises, and other forms of economic incentives for business. However, none of the five economic corridors include Melaka (MIDA 2017). In fact, it is the only state not covered by the corridor initiatives.

Further development of the manufacturing sector may be supported by better identification of the state's competitive advantages. Melaka unquestionably has a track record of success in manufacturing. The state has attracted large international investors, and these companies have chosen to locate in Melaka for a reason. However, such cases have not been replicated, partially because there is no clear understanding of the factors that allowed Melaka to attract large manufacturers in the past. Further analysis of conditions and local characteristics could offer insights regarding major past FDI deals. This information could help the state come up with a more targeted FDI strategy as well as targeted efforts to magnify its competitive advantages.

Policy and Governance for Economic Development

Melaka's State Structure Plan 2035 establishes economic development streams on which the state will focus in the coming years (State of Melaka 2018). The streams seek to improve areas of the state's economy and quality of life, strengthen economic potential, develop competitive industries, enhance the tourism sector, boost Melaka's retail sector, promote manufacturing, increase productivity and sustainability of the agricultural sector, make waste management more efficient, enhance accessibility to utilities, and develop a green economy. Box 7 presents an overview of the policy areas.

Melaka's current industrial strategy is potentially too broad and open ended, lacking focus on a few niche sectors of economic activity. Existing economic development priorities recognize the importance of developing core industries in the state (manufacturing and services related to tourism) and of building up the state's innovation potential through strengthening of R&D and development of industrial clusters. However, the vast range of proposed actions and investments does not provide a focused vision of the city's future. There are key unanswered questions regarding what the city should specialize in, and what form of economic transition it will undergo. Existing economic plans identify a number of strategic activities focusing on consumer services, tourism, agriculture, manufacturing, R&D, and logistics. Additionally, the state has a green economy strategy. While an ambitious economic development agenda is to be lauded, it is also important for the agenda to be focused and able to evolve over time, informed by an understanding of Melaka's competitive position: conditions that make the state stand out, the industries they will enable, and the conditions in which Melaka will struggle to compete.

While the government of Melaka is extremely proactive, limited inclusiveness and capacity shortages undermine the effectiveness of regional governance. Melaka’s state government is proactive and ambitious: it is engaged in multiple international networks and actively seeks support and funding for its projects. But representatives of Melaka State and Melaka City governments admit that some capacity shortages persist. The robustness of analytical work that informs decision making can be improved further. Additionally, the role of the private sector, civil society groups, and other nongovernment stakeholders in the strategic policy dialogue and decision-making process remains rather limited. This is an area that the both can quite easily rectify and improve upon.

Box 7 Summary of Melaka’s Economic Policy Priorities

Melaka’s State Structure Plan 2035 identifies ten priority areas of economic development:

1. Improve the state’s economy and quality of life.

- Promote spatial development policies to target development by territory, defining key development areas, such as **Melaka City, Alor Gajah, Bandar Jasin, Ayer Keroh**, and industrial zones, which would work internally and with the surrounding state to create links between firms. These areas can potentially form clusters and create a multiplier effect in the economy. Some of the policies include the creation of development corridors (such as Melaka Gateway), the construction of transport infrastructure to empower the state (such as the high-speed rail station in Ayer Keroh), construction of the seven maritime ports, an expansion of the airport, and a “tourism and agricultural zone” that could link cultural sites and agricultural areas.
- Increase dynamism in the two main sectors driving Melaka’s economy, **manufacturing and services**. This would be achieved by attracting FDI, promoting the creation of small and medium enterprises (SMEs), improving linkages with key international players (China; Indonesia-Malaysia-Thailand Triangle; Association of Southeast Asian Nations [ASEAN]), supporting the creation of high-tech industries, optimizing land transportation with the Express Rail Link and the HSR, improving public services and infrastructure in the industrial areas, and strengthening innovation through green technology and replacement of imports. Additionally, the idea is to attract high-tech industries, linking to local universities for the provision of skills. There is also a goal of reducing poverty to 0 percent, thus improving the quality of life for everyone.
- Create the Melaka International Technology Park.
- Provide access to broadband telecommunications in all areas of Melaka.
- Improve the infrastructure for tourism, such as the Gateway project, and strengthen transportation methods, like highways, bicycle paths, and water taxis routes.

2. Strengthen economic activity. The objective is to identify key industries with a potential to expand and to help them grow. For example, the plan is to encourage companies to invest in R&D, to support the formation of a knowledge-based economy, to develop clusters, and to ensure educational programs that link the workforce with enterprises.

3. Develop competitive industries. The plan is to attract and promote high-tech industries in the state while providing public services and needed infrastructure. The particular focus is fostering R&D (by facilitating land permits and offering tax incentives) in industries that support a reduction in greenhouse gas emissions.

4. Enhance the tourism sector. The goal is to revise a master tourism plan every five years in order to adapt the strategies to the most recent market. This plan would consider creating tourism corridors, upgrading the quality of existing recreational products in Ayer Keroh, strengthening the current tourism products available (such as museums, open spaces, sport activities, etc.), diversifying into new products (such as urban renewal, a

“Silk Road” along the Straits of Melaka, and green tourism), and promoting annual events. The objective is to reach 25 million tourists in 2035 through a sustainable strategy.

5. **Transform Melaka into a shopping center.** The plan is to develop corridors and bring together different retail producers, including SMEs, to attract visitors interested in this activity. The objective is to offer a great variety of products through an efficient allocation of space and producers in the zones.
6. **Improve the industrial base.** The goal is to identify small industrial areas that have a potential to grow, link tourism with manufacturing, increase women's participation in the labor force, strengthen the brand for the state, develop industrial heritage, and develop niche agricultural production industries such as flowers, herbs, and decorative tropical fish.
7. **Increase the productivity of agriculture.** The production of some agricultural products is underdeveloped, and Melaka suggests using technology that has been implemented in advanced economies, such as Japan, to improve their production. One example is agricultural greenhouses that use special technology and artificial light. Melaka also wants to promote good agricultural practices, begin offering agricultural certification accreditation, and implement vertical farming (which can be done indoors).
8. **Make waste management more efficient.** Better access to services and improvement of utilities is a key component of this goal, which seeks to better manage water supply and enhance sewage systems in the state. The industrial sector is one of the main producers of waste, which must be treated to ensure the sustainability of the sector and territory.
9. **Build up international connectivity.** One of the key proposals is the construction of an international airport that would better connect the state with the world. The government would first evaluate the possibility of this infrastructure project by conducting a study of feasibility and needs. There is also a plan to open a station for HSR in Ayer Keroh, which would better link Melaka with Singapore and Kuala Lumpur. Lastly, government officials are leveraging the construction of seven ports (part of the One Belt One Road initiative) to develop a major logistical hub in the state. The state is already starting major land reclamation efforts in order to provide a location for the ports. The government looks at potential Chinese investment as a once-in-a-lifetime opportunity.
10. **Development of a green economy.** There are seven main pillars to the states' effort to promote a green economy: improve water management (i.e., monitor activities that may pollute water); invest in renewable energy (i.e., implement carbon trading to reduce carbon emissions); implement green transport (i.e., promote public transport); target zero waste (i.e., develop recycling strategies); conserve natural resources (i.e., better manage the development of sensitive areas in the state); strengthen key green centers in the state (i.e., integrate planning between main cities); and implement new urban growth (i.e., build new housing based on “Green Neighborhood” concept and technology).

Recommended Actions

In order for Melaka to make the most of its vast growth potential, the state will need to intensify its efforts in the context of tough regional competition. This will include a particular focus on how the city can differentiate itself and identify target sectors for interventions. It will be important to fully utilize the institutions and enterprises present in the city in this process.

The recommendations presented here seek to tackle the specific challenges identified in Melaka. A suggested action plan is included in table 3.

- 1-A Reassess large infrastructure projects and create strategies to leverage their opportunities.** Neither the HSR nor the port development initiatives guarantee economic benefits for Melaka. Both will require complementary policy interventions in the local economy to maximize benefits: local transportation linkages, investment promotion efforts, urban regeneration, and other initiatives. The port investment is particularly risky—given high competition between ports in the state, it is not clear whether this development will generate large enough traffic—and thus it requires a thorough assessment.
- 1-B Rethink strategic priorities and link them with opportunities for economic development.** The economic agenda of Melaka’s State Structure Plan 2035 should be better grounded in the economic reality of Melaka today. It is not clear whether its ambitions—to attract high-tech industries and to become a logistics hub, the main tourist destination in Malaysia, and the green technology center—reflect its real competitive advantages and limitations. Additionally, the breadth of these ambitions might reduce the chances of successful implementation of any of them. Melaka could adjust its approach by building the state government’s analytical capacity and conducting deeper investigation into factors that supported Melaka’s success, attracted large investors, and helped local businesses in the past.
- 1-C Build a more inclusive and collaborative model of economic decision making.** Representatives of local governments confirm that collaboration with local businesses and the community is not particularly robust, and that their involvement in strategic decision making is limited. Building a broader development coalition will help further refine policy priorities by accounting for challenges experienced by businesses. It may also enhance local capacity by engaging the private sector in implementation of the strategy.
- 1-D Support development of major sectors.** Tourism and manufacturing will remain the main pillars of Melaka’s economy, but their challenges are very different, and each industry needs a well-tailored policy approach:
- Diversification of tourism offerings is already among the state’s priorities. This effort should prioritize attracting visitors during weekdays (for instance through further support to booming medical tourism, or development of conference or event tourism). The sustainability of urban infrastructure and core tourism assets should also be given a higher priority.
 - To boost the productivity of manufacturing, Melaka needs to learn from successful investment deals of the past and focus on enhancing and marketing the conditions that brought Honda and CTRM to the state. Long-term manufacturing development can include a selective investment attraction effort that targets high-tech producers, builds stronger links between universities and industry to ensure the appropriate skills pipeline, and continues a broad spectrum of innovation promotion initiatives that the region has already begun.

Table 3 Recommended Action Plan for Melaka's Municipal Sustainability

Item	0-4 Years	5-9 Years	10 or more Years
<p>1-A Reassess large infrastructure projects and create strategies to leverage their opportunities. Conduct an analysis of the impact and risk of big infrastructure projects and identify main local policies and investments that will help leverage them for the benefit of the state.</p> <p>Lead agency:</p> <ul style="list-style-type: none"> • Ministry and Departments of Transportation, Unit Perancang Ekonomi Negeri (UPEN) <p>Supporting agencies:</p> <ul style="list-style-type: none"> • Other ministries and departments related to complementary policies, including Plan Malaysia 	1 year		
<p>1-B Rethink strategic priorities and link them with opportunities for economic development. Melaka is advised to conduct a deep diagnosis of the state's competitive advantages, including market trends and opportunities presented by the external environment, e.g., national policy. Melaka should introduce changes to the regional strategy accordingly.</p> <p>Lead agency:</p> <ul style="list-style-type: none"> • Chief Minister's Department <p>Supporting agencies:</p> <ul style="list-style-type: none"> • Sectoral departments 	1 year		
<p>1-C Build a more inclusive and collaborative model of economic decision making. Initiate an inclusive public-private dialogue to create a broad coalition supporting and aiding in implementation of regional development strategy.</p> <p>Lead agency:</p> <ul style="list-style-type: none"> • Chief Minister's Department <p>Supporting agencies:</p> <ul style="list-style-type: none"> • Private sector representatives, civil society representatives, academia, other main actors at the municipal level 	3 years		
<p>1-D Support development of major sectors. Develop and implement a detailed support program for tourism and manufacturing focusing on specific constraints and opportunities that the industries experience.</p> <p>Lead agency:</p> <ul style="list-style-type: none"> • Tourism Malaysia, UPEN, Investment promotion departments at the state and municipal levels <p>Supporting agencies:</p> <ul style="list-style-type: none"> • Public entities responsible for infrastructure projects, education department, private sector, academia. 		5 years	

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Annex A: List of Indicators Analyzed

Table 4 Legend

Status	Description
OK	The current data is adequate to measure and monitor the urban economic dynamic observed.
Outdated	The current data and statistics date from five years ago or longer and need to be updated.
Missing	Statistics on the urban economic dynamic are currently unavailable.
Needs Revisiting	Information on the urban economic dynamic exists, but may no longer be adequate to measure the situation effectively. Revisiting the statistical definition of the indicator and the data collection is needed.
Longer Duration	Data is available for recent years; however, a longer history is needed.

Table 5 Summary of the Urban Sustainability Framework's Urban Economic Development Indicators

1.1 Economic Performance	Status
GDP per capita, including growth rate	OK
Employment growth rate/average income/wage growth rate	OK
GDP density (GDP/km ² of urban built-up area)	Missing
GDP energy intensity (Energy use/unit of GDP)	Missing
GDP carbon intensity (CO ₂ emissions/unit of GDP)	Missing
Level of unemployment and change over time	OK
1.2 Economic Structure	
Sectoral breakdown (GDP, employment) and evolution during the last two decades	Longer Duration
Location quotients of top-three city economic subsectors (share of subsector in city GDP compared to national share)	OK
Foreign direct investment per capita	Missing
Parameters of business demographics: start-up rate, business churn rate, growth of incumbents	Missing
Herfindahl index and evolution over time	Missing
1.3 Business Climate, Innovation, and Entrepreneurship	
Research and development expenditure as a proportion of GDP	Missing
Days to obtain a business license, and change over time	Missing
Number of days the city government takes to grant a construction license	Missing
Ease of access to finance (what share of business struggles to access finance, what are the interest rates, what financial tools are offered by banks and by other institutions)	Missing
Quality and accessibility of support for businesses	Missing
1.4 Labor Force	
Labor force participation rate, and changes over time	OK
Level of education of labor force	OK
% of foreign-born inhabitants	Missing
1.5 Livelihood Opportunities	
Unemployment rate (%), and changes over time	OK
Average hourly earnings of female and male employees, by occupation, age, and persons with disabilities	Missing

1.6 Income Equality	
Income Gini coefficient	Missing
Average income ratio between urban population and neighboring rural population, and changes over time	Missing
Income convergence/divergence across urban regions	Missing
Ratio of access to services between 90th and 50th percentile	Missing
1.7 Global Appeal	
Foreign investment as a % of total investment	Missing
Number of visitors from abroad and domestically	OK
Number of international students	Missing
Number of foreign residents	Missing
1.8 Connectivity	
Number of national and international routes from nearest airport	Missing
Average travel time to commute to work	Missing
Broadband Internet subscriptions per 100 inhabitants	Missing
Proportion of population covered by a mobile network, by technology market accessibility measure	Missing

Annex B: Additional SWOT Information

Strengths:

1. **Dynamically growing and well-educated population.** Melaka State's human capital is among its greatest assets. Its population is among the fastest growing in Malaysia (with the second largest absolute migration inflow), and its share of people with secondary and tertiary degrees in the workforce is higher than the national average. These characteristics speak to the ability of Melaka's educational institutions to produce skilled workers. However, limited information has been found on whether the skills profiles of the population meet the needs of the local businesses, or on whether the state offers sufficient opportunities for the young and ambitious, many of whom leave for Kuala Lumpur or Singapore.
2. **Internationally recognized historic and cultural assets with UNESCO status.** In Malaysia, there are two cultural and two natural sites declared as UNESCO World Heritage Sites. One of these attractions is jointly located in Melaka State and Penang State (UNESCO 2017). Melaka City was declared a UNESCO World Heritage Site on July 7, 2008 together with George Town (State of Melaka 2018). Additionally, some villages in the state have been gazetted by UNESCO as traditional villages for the preservation and conservation of their heritage. Recognition by UNESCO has been critical for the development of the tourism economy. It has also dramatically increased global recognition of the state, which can potentially be leveraged to other areas.
3. **Access to the large markets of Kuala Lumpur and Singapore.** These large urban areas are located within a six-hour drive from Melaka and have a combined population of 16.3 million, which represents both a large market for products and a driver for the local tourism industry. Proximity to these major economic hubs also means having proximity to multiple advanced universities, research institutions, and specialized service providers that can boost Melaka's potential for innovation.

Weaknesses:

1. **Tough national competition facing Melaka State.** Although Melaka's location close to other densely populated and rapidly developing states provides access to their markets, it also means that Melaka needs to compete with them for talent, for tourists, and for investors. In a number of areas, moreover—including transport links, proximity to major cities, existing industrial specializations, and strength of local universities—Melaka is behind states like Penang, Johor, and Selangor. This weakness highlights the importance of identifying and focusing on the region's unique competitive advantages.
2. **Transport connectivity and congestion issues that could become a major obstacle for growth if not addressed.** Overall, Melaka can't be seen as remote or poorly connected, as all modes of international transportation are within a short drive from the state. However, the state's current lack of railway connection, large international airport, or port puts it at a marginal disadvantage relative to some of the neighbors. Rail transportation connects cities from the neighboring states of Johor and Sembilan with the capital city Kuala Lumpur and other major urban areas, but existing tracks do not pass through cities in Melaka. Melaka has an international airport like Johor and Penang, but flights are limited and are often one-off charters for tourist groups. Melaka City is accessible to Kuala Lumpur International Airport (less than two hours by car), but the distance still puts it at relative disadvantage. Finally, Penang, Johor, and Kuala Lumpur all have major ports, which make them more attractive for logistics and manufacturing investors, while port access in Melaka would be reduced by poor rail connectivity.

Traffic congestion in Ayer Keroh and Melaka City, particularly during peak times for tourism, is reported as a major issue by representatives of both the private and public sectors. A comprehensive investment strategy is required to improve public transportation and reduce the use of private vehicles. Congestion can become a threat for both leading industries in the city: Tourism might be hurt by the declining quality of air and the perception that the city is overcrowded. For manufacturers, who rely on roads as the main route for delivering inputs and shipping outputs, congestion might mean extra costs (though manufacturers may be somewhat less effected by city center congestion).

- 3. Lack of support from the national government.** The fact that Melaka is the only state not included in any of the Malaysia corridor development initiatives puts it at a significant disadvantage.

Opportunities:

- 1. External connectivity improvements through major infrastructure projects.** The high-speed rail connection to Kuala Lumpur and Singapore and likely investment in major ports can both create major growth opportunities for Melaka, but neither of the two can guarantee success. HSR will bring Kuala Lumpur and Singapore even closer, enhancing opportunities for local businesses and possibly making Melaka a more attractive location for advanced services firms looking to cut costs while staying close to big markets. Yet it may also have opposite effects, and may cut the average length of stay for tourists. Similarly, the ports might bring in lots of FDI in manufacturing and logistics, but they could become a sunk cost if the demand for the new facility in an already extremely well serviced region is low. In order to maximize local economic benefits, the HSR and port projects require accurate planning, including complementary action plans that will help localize the benefits. The port investment specifically is extremely risky given the competition with Singapore, Johor, and Klang, and for that reason requires detailed analysis and weighted consideration before the final decision is made.
- 2. Dynamic and globally engaged government.** The Melaka State government is actively plugged into key global networks. It was a member of Rockefeller's 100 Resilient Cities program starting in 2016, and is part of the Global Platform for Sustainable Cities, whose members include 28 cities in 11 countries. Moreover, Melaka is considered within the One Belt One Road strategy, which would connect it to other countries in Asia and the world, facilitating trade and exchange of knowledge. This strength showcases the degree to which the state government is proactive and ready to benefit from international knowledge exchange and support.

Threats:

- 1. Wide policy focus.** Both the current strategic planning document for Melaka and interviews with public officials suggest that the state's strategic policy thinking might be insufficiently informed about some of the important constraints facing the state. The state has been enjoying tremendous growth in recent years as it has leveraged its core strengths and competitive advantages. However, the recent trends do not negate the challenges that persist. Secondary cities like Melaka succeed by focusing their limited resources on enhancing their competitive advantages and overcoming principal constraints. This approach implies being selective and realistic in pursuit of goals. While Melaka's ambition to compete with Singapore is admirable, the realism of this goal needs to be reassessed. Being selective is particularly critical when committing to large-scale projects like the seven-port initiative, which may produce benefits but also entails substantial challenges and very high opportunity costs. The same logic should apply to the state's investment promotion strategy, where each new deal could be selected to bring the state (which has limited land and labor resources) closer to its vision.

2. **Capacity shortages.** While the government of the state is extremely proactive and ambitious, capacity shortages that affect both the robustness of analytical work and policy implementation are a potential concern. The level of engagement by the private sector and community could also be increased to achieve greater ownership of policies implemented by the local and regional authorities. The experience of competitive cities and states around the world shows that broad public-private coalitions drive development. In Melaka's case, achieving a more robust collaboration between different stakeholders could be key to refining the state's strategic priorities.
3. **Deterioration of core assets.** There is a risk that Melaka's tourism growth could lag due to the deterioration of urban environment and services. Melaka aims to attract 25 million tourists by 2035; however, it is unclear whether the city understands the challenges of sustaining current infrastructure and urban environments with that volume of visitors, unless the tourism offering within the state is substantially diversified.

Melaka State in Malaysia has strong sustainability aspirations and is an important member of the Global Platform for Sustainable Cities (GPSC). To inform the next update to Melaka's State Structure Plan, GPSC performed a sustainability outlook diagnostic to holistically consider six dimensions of the state's urban sustainability. The diagnostic consists of an overview report—containing a policy brief, executive summary, and benchmarking assessment—and six supporting reports that cover each of the diagnostic's dimensions. Informed by a wide range of stakeholder consultations and by data, analyses, and the benchmarking assessment, the reports offer key messages and recommendations for action so that Melaka can chart its own pathway to urban sustainability.

