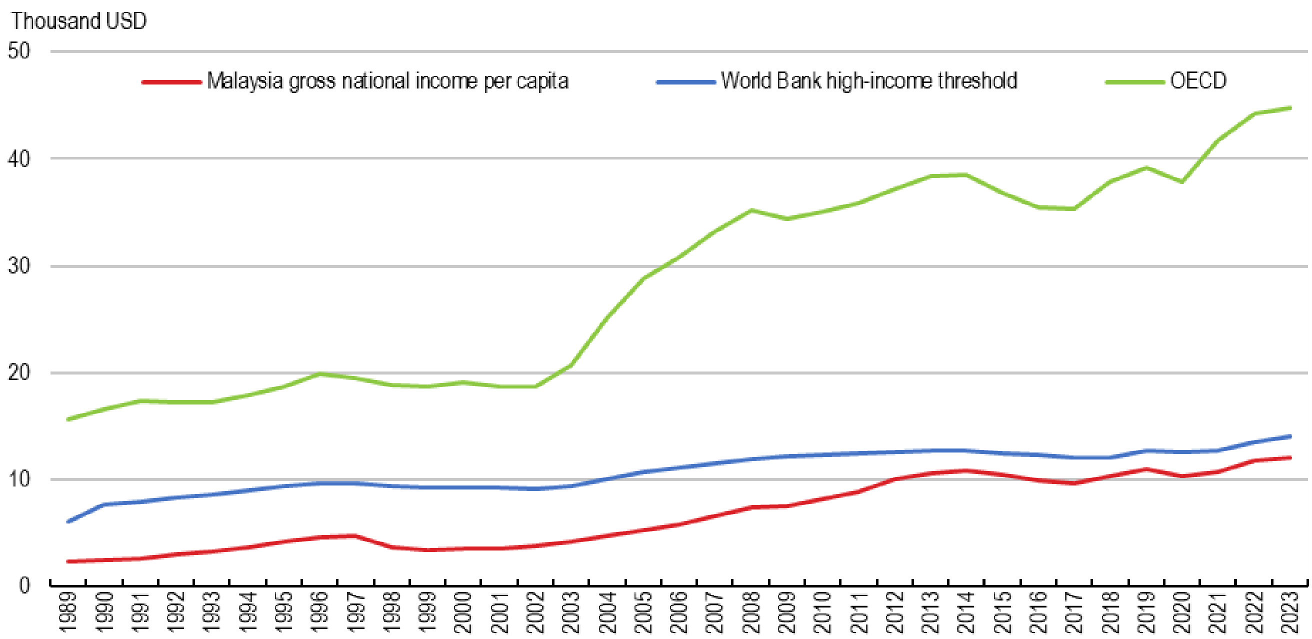
Paving the way towards prosperity in Malaysia

Category: Malaysia,Uncategorized
written by oecdecoscope | August 27, 2024

by Jens Arnold and Ken Nibayashi

Malaysia's economy has achieved an impressive growth since the 1960s, with average yearly growth of over 6%. It has been ahead of regional peers in terms of per capita incomes and has been able to consolidate this lead. While incomes were only one-third of the World Bank's threshold for high-income countries in 1989, it has approached and is set to surpass that threshold by 2028 (Figure 1).

Figure 1. Rapid economic development has boosted Malaysia close to high-income status



Source: World Bank, GNI, Atlas method (current USD).

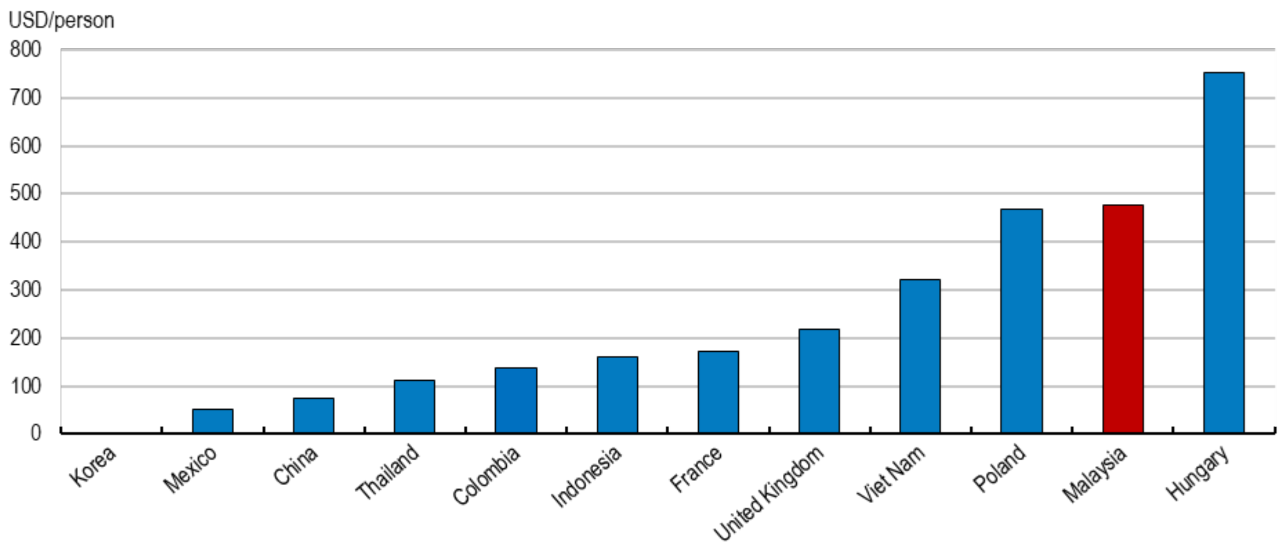
Strong growth has also propelled impressive social progress. Poverty has declined consistently over the last decades, and poverty rates have narrowed across different ethnic groups. Income inequality has also fallen, and labour force participation has trended upwards. At the same time, more could be done to create better and more equal opportunities in Malaysia, as highlighted in the recent *OECD Economic Survey of Malaysia* (**OECD, 2024**). Income inequality remains higher than in regional peers, and labour force participation among women remains some 26 percentage points lower than among men, partly related to difficulties of accessing affordable childcare. As incomes rise, Malaysians are likely to demand better public services and better opportunities, and this may require different policies from those that were successful in the past.

Pension coverage, for example, is narrow and inadequate. More than 60% of the population are not covered by any old-age pension scheme, and those who are often fail to receive a decent pension. As the population ages, more and more elderly Malaysians will reach retirement age without any type of old-age pension to rely on. Non-contributory social assistance pensions could help fill current coverage gaps in the future, but their current coverage and benefit levels are very low.

In the same vein, social assistance programmes could do more to support those in need. Different programmes are fragmented and poorly targeted, managed by multiple agencies at different levels of government. Benefit levels are generally too low to make a real difference for vulnerable households. Even for the lowest income decile, cash transfers augment market incomes by only around 13%, and overall spending on social assistance amounted to only 1% of GDP in 2023.

By contrast, Malaysia spent 3.5% of GDP on fossil fuel subsidies in 2023, which are counted as social assistance in its public accounts. But these subsidies are particularly ineffective as a social policy tool. Estimates suggest that the most affluent 10% of income earners receive almost three times more in fuel subsidies than the decile with the lowest incomes. Fossil fuel subsidies also provide the wrong price signal for reducing greenhouse gas emissions, and Malaysia's fuel subsidies are particularly high in international comparison (Figure 2). Shifting spending from subsidies to pensions and well-targeted, unified social assistance benefits could support substantial improvements in social inclusion.

Figure 2. Fossil fuel subsidies per capita in selected countries, 2022

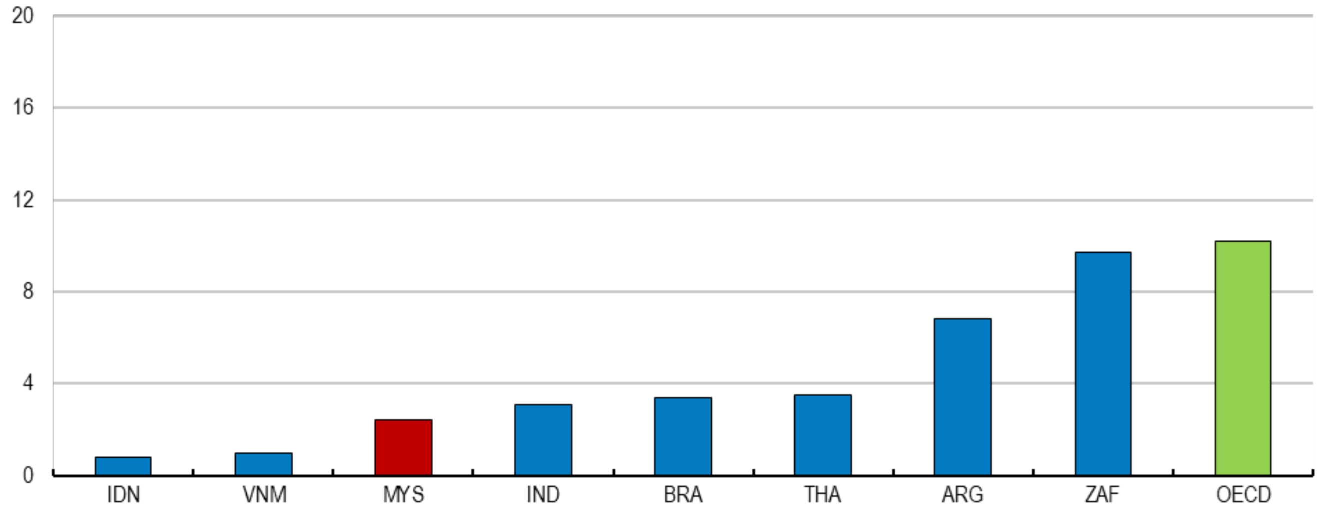


Source: IEA Fossil Fuel database.

These kind of reforms could boost the effectiveness of taxes and transfers for reducing inequalities. Currently, public policies reduce income inequality by 2.4 points of the Gini coefficient, a widely used inequality measure (Figure 3). This reduction in inequality is more than what Indonesia and Viet Nam achieve, but it falls short of the 3.5 points in inequality reduction that taxes and transfers generate in Thailand, and is much less than in the average OECD country where taxes and transfers reduce inequalities by more than 10 points of the Gini coefficient.

Figure 3. Inequality reductions are small

Impact of public policies on income inequality



Source: World Bank (2023); Commitment to Equity Institute (2023), OECD Income Distribution Database (2024).

Better labour market policies could also help Malaysia to make further progress towards higher material living standards. More than one in four workers in Malaysia work in informal jobs, particularly older and less educated ones. Incentives for formal job creation could be improved through less rigid labour market regulations and by exempting low-wage workers from mandatory contributions to the pension fund, especially as non-contributory basic pensions are expanded. Even for those with higher skills, labour market reforms could improve job quality and strengthen productivity. Many people, particularly recent tertiary graduates, work in occupations that do not match their skills. Better alignment of tertiary education with labour market needs, a reorganisation of vocational education and training and more investment into adult education could help to reduce skills mismatches.

Delivering better public services and creating better opportunities will also call for substantial reforms on the fiscal side. Spending existing public resources in a more effective way should be a first step, for example by phasing out fossil fuel subsidies, but also through a better coordination of fragmented policy programmes in areas such as social protection or support to small and medium enterprises. Beyond these improvements in spending efficiency, there may also be a case for raising additional public revenues. Current tax revenues remain below 12% of GDP, which is low even in a regional comparison, and places tight limits on what Malaysia's public sector can deliver. Establishing a well-designed value added tax, broadening the tax base of personal income taxes and improvements in tax administration would be ways to expand the resources available. Providing solid financing for future spending needs that will arise as Malaysia becomes a high-income country is likely to be one of the major challenges in coming years.

Malaysia's ascent towards a high-income economy is remarkable, with robust and resilient growth and visible improvements across many dimensions. The analysis and policy recommendations presented in the newly launched *OECD Economic Survey of Malaysia* (**OECD, 2024**) are aimed to help the country build on its past achievements and maintain a strong performance in the years to come.

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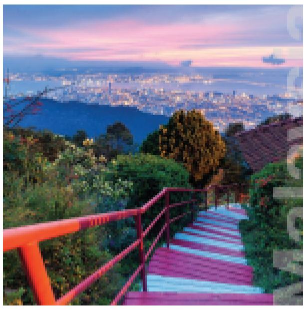
Malaysia: Five takeaways from the new OECD Economic Survey

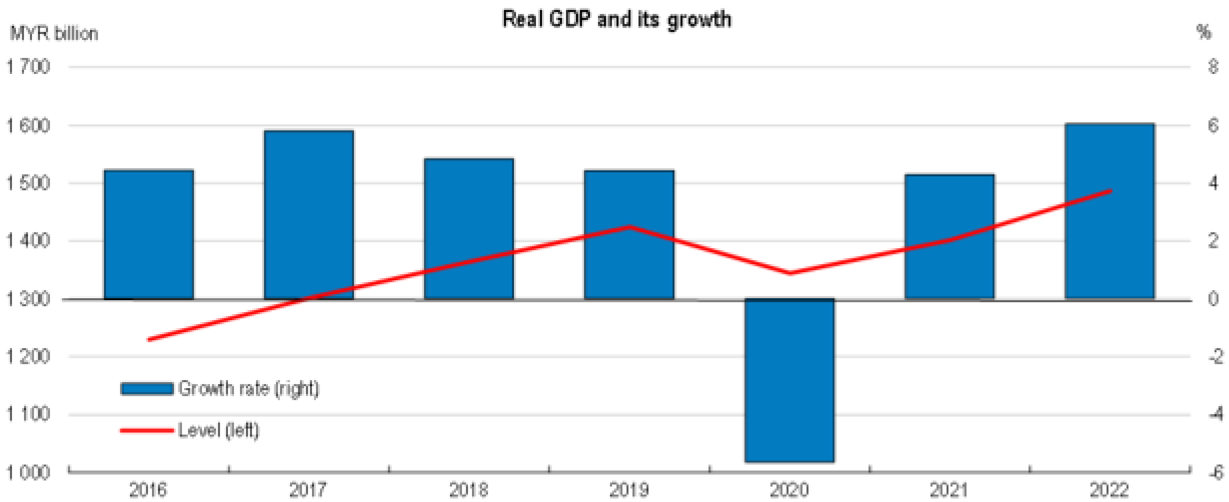
Category: Malaysia
written by oecdecoscope | August 27, 2024



By Patrick Lenain and Kosuke Suzuki, OECD Economics Department

Like many countries around the world, Malaysia has been hit hard by COVID-19. Stringent restrictions have constrained consumer spending, while the global recession have reduced exports. The Malaysian government reacted swiftly to support growth. Since February 2020, it has rolled out nine fiscal stimulus packages, amounting to more than 35% of GDP. Monetary policy has also been eased, and measures introduced to restore credit flows. Moreover, the government has made great progress with its vaccination campaign, and this should remain the priority. Thanks to these policies, the economy is projected to resume fast economic growth (Figure 1). The *OECD Economic Survey of Malaysia 2021* says that Malaysia should continue its reforms to remain a business-friendly country and achieve strong, inclusive and clean growth.

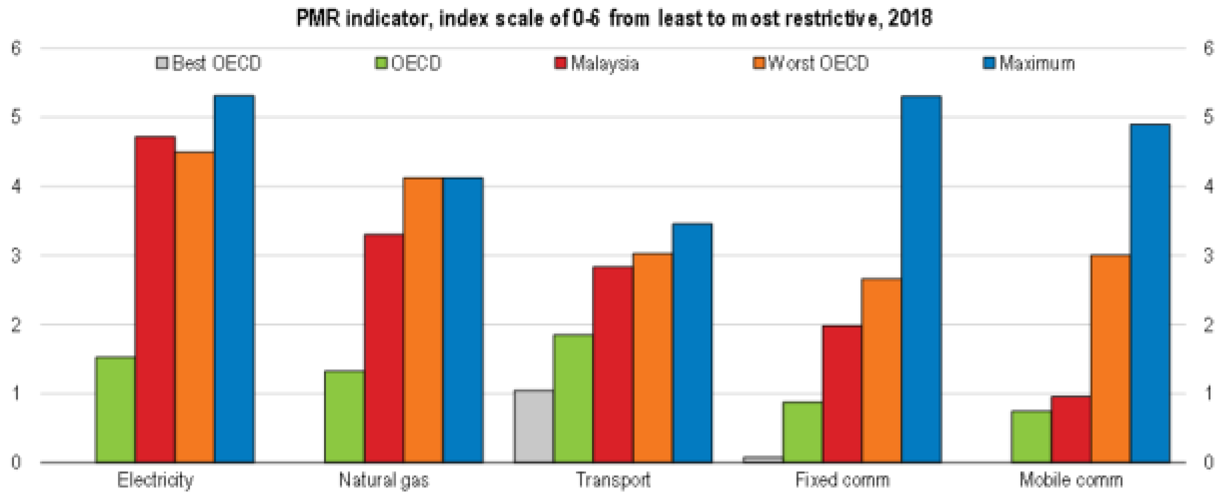
Figure 1. Activity is projected to return to its pre-pandemic level in 2022



Source: Department of Statistics Malaysia, and OECD (2021), *OECD Economic Surveys: Malaysia 2021*.

After the pandemic, well-functioning markets will be crucial to boost the economy. Malaysia is open to investment and entrepreneurship, but new data collected for the *Economic Survey* points to regulation that impede several activities. The new OECD Product Market Regulation Indicators for Malaysia show that barriers to competition hinder market entry in the sectors of energy and transport (Figure 2), professional services and retail trade. Moreover, starting a new business remains challenging due to the multiple licenses and permits required by various levels of government. Easing these regulations would spur productivity growth, business dynamism and innovation in Malaysia.

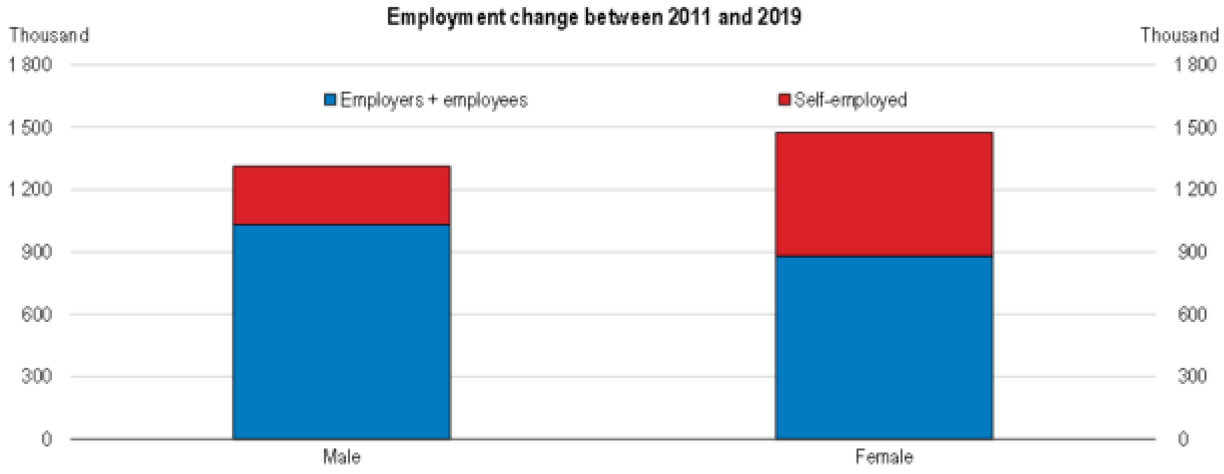
Figure 2. Competition needs to be enhanced in some sectors



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). Best OECD/worst OECD represents the OECD best/worst performing country, while maximum corresponds to the most restrictive country among those in the PMR database. For electricity, natural gas and mobile communications, the OECD best scores are zero.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

To make growth more inclusive after the pandemic, social policies will also be crucial. Many workers have been affected by the crisis and unemployment remains high. Government support to affected households should thus remain in place until the recovery is well established. Government policies should focus especially on women, young people, and lower-skilled workers. Women often have no other choice than to join the labour market as self-employed (Figure 3), and they have been hit by the tight restrictions in the sectors of tourism and retail trade, putting them at risk of poverty. Platform workers, whose number is increasing fast with the spread of digitalisation, are generally self-employed and also in a precarious position. Therefore, strengthening social protection is of utmost importance.

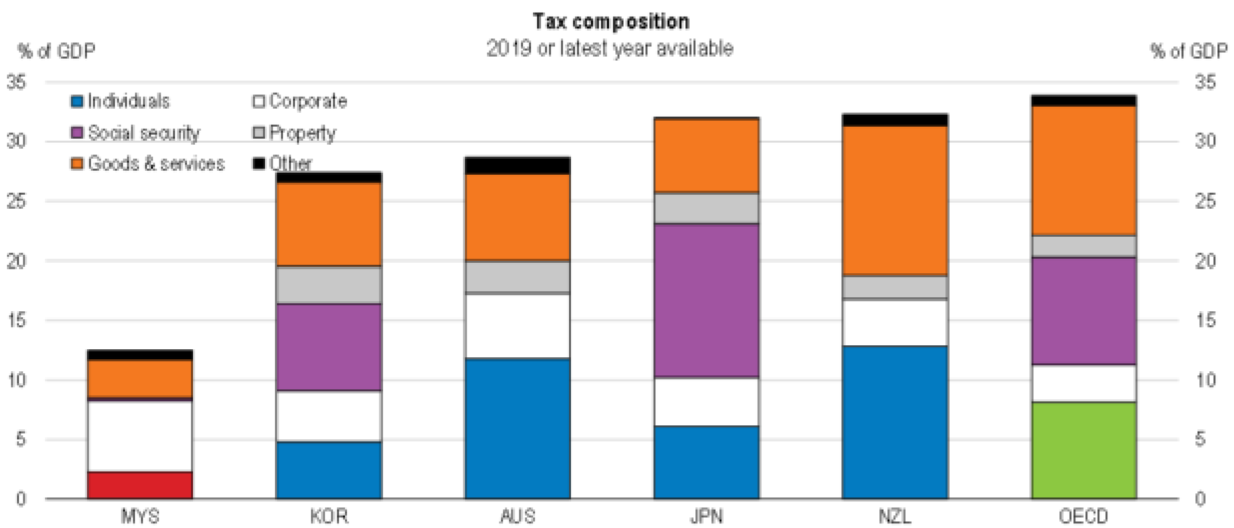
Figure 3. More women are working, but many of them are self-employed



Source: DOSM, Labour Force Surveys.

Additional government revenue will be needed to enhance social protection without further increasing public debt. Malaysia's tax revenue is low (Figure 4) and has declined for years, making tax reform essential. Tax revenue will also be required to protect Malaysia's fast-ageing population. According to a UN projection, the old-age dependency rate (+65/15-64) of Malaysia will reach 25% by 2050, more than twice the current 10%. Encouraging more elderly people to stay longer in the labour force would also be useful to help reduce old-age income poverty and raise government revenue.

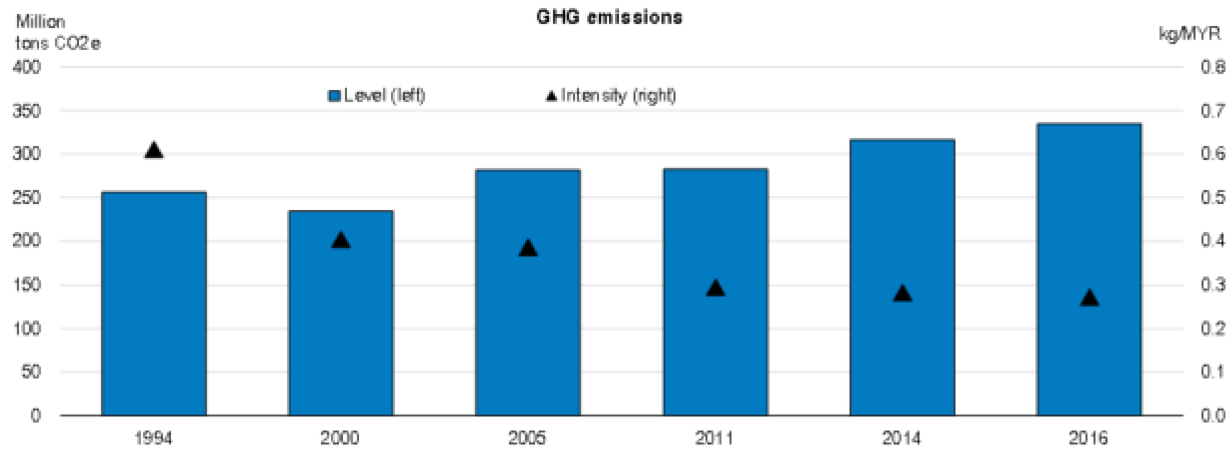
Figure 4. Malaysia's tax revenue is low



Source: OECD, Tax Revenue Statistics database.

The post-pandemic recovery also needs to focus on cleaner energy. As the latest IPCC report depicts, immediate, rapid and large-scale reductions in greenhouse gas emissions are now strongly called for at the global level. Malaysia has made steady progress in reducing its carbon emissions intensity during the past two decades. However, fast economic growth has translated into higher volumes of greenhouse gas emissions (Figure 5). The return to strong economic growth after the pandemic should not once again result in fast-rising carbon emissions. The *Economic Survey* encourages Malaysia to reduce the use of coal in electricity production, increase renewable energy production, increase domestic carbon prices, improve forest management, and support biodiversity. These objectives are all essential for Malaysia’s greener post-pandemic recovery.

Figure 5. Green House Gas emissions intensity is improving, but its volume is increasing



Note: GHG emissions include emissions from land use, land use change and forestry, but exclude removals.
Source: Ministry of Environment and Water (2020), *Malaysia - Third Biennial Update Report to the UNFCCC.*

Reference:

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Asia & Pacific economies are projected to rebound from COVID-19

Category: Australia,China,COVID-19,India,Indonesia,Japan,Korea,Malaysia, New Zealand,Thailand,Uncategorized
written by oecdecoscope | August 27, 2024

by Patrick Lenain and Kosuke Suzuki, OECD Economics Department

While the world is struggling to exit from the coronavirus crisis, the region Asia & Pacific is a notorious exception: many countries in the region have stopped the COVID-19 pandemic after the first wave, and they quickly returned on a path of growth in the second half of 2020 – a rare accomplishment. The OECD projects that the region's recovery will continue in 2021 and 2022 (Table 1).

Table 1: Strong growth projected in Asia & Pacific
(Real GDP growth, % year-on-year)

	2020	2021	2022
Australia	-3.8	3.2	3.1
China	1.8	8.0	4.9
India*	-9.9	7.9	4.8
Indonesia	-2.4	4.0	5.1
Japan	-5.3	2.3	1.5
Korea	-1.1	2.8	3.4
New Zealand	-4.8	2.7	2.6
Dynamic Asia**	-4.6	4.3	4.6
Asia & Pacific	**-1.5**	**5.9**	**4.1**
Rest of world	-5.7	3.2	3.4
World	**-4.2**	**4.2**	**3.7**

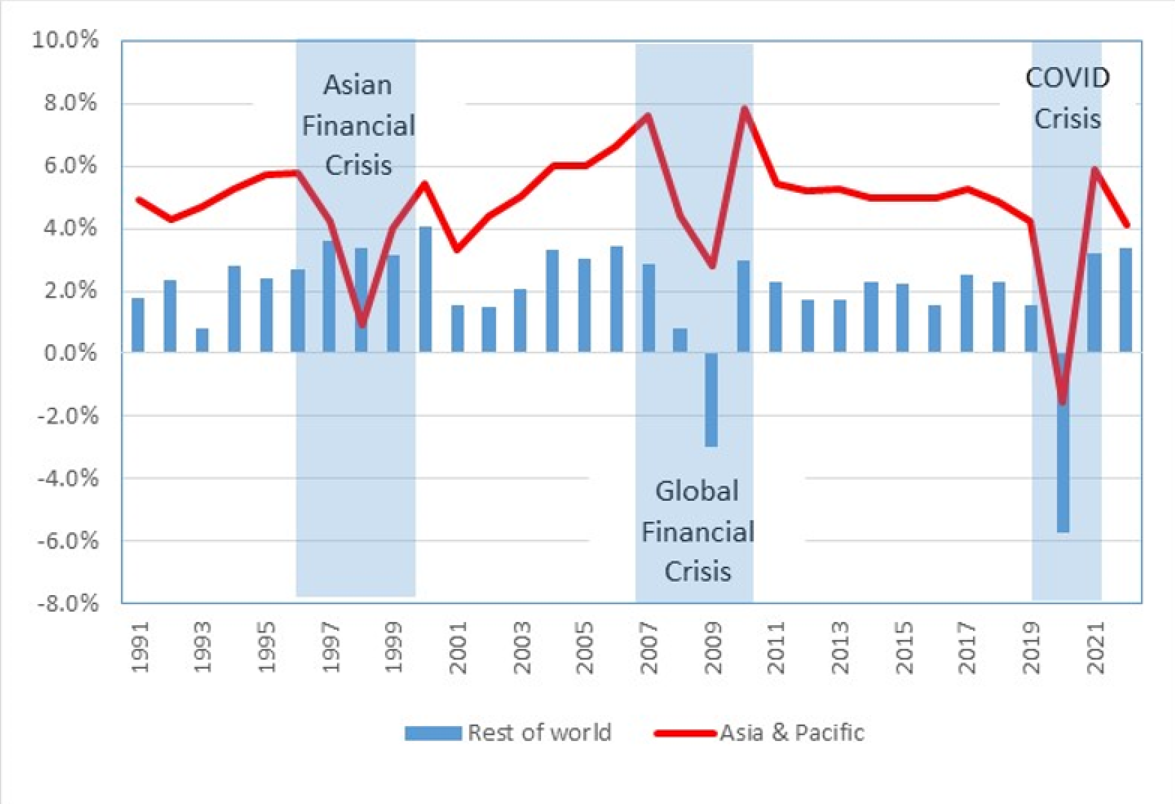
* Fiscal year starting in April.
** Dynamic Asia includes Chinese Taipei, Hong Kong, Malaysia, Philippines, Singapore, Thailand and Vietnam.

Source: *OECD Economic Outlook*, December 2020.

The region's current resilience is in sharp contrast with the late 1990s, when the Asian Financial Crisis hit it very hard (Figure 1). Governments in the region drew lessons from this experience and were better prepared when the Global Financial Crisis arrived. They were also ready when the coronavirus struck: fiscal space was available, monetary policies were sound, exchange rates were flexible, foreign exchange reserves abundant, bank well capitalised, external indebtedness was low – and health systems had been re-organised.

Figure 1 – The economic performance of Asia & Pacific has improved

(Annual GDP growth in %)



Source: *OECD Economic Outlook*, December 2020.

Strong resilience in the face of crises contributes to long-term growth, especially in poor and emerging countries, as shown by a literature launched by Easterly et al. (1993). Thanks in large part to their growing resilience, the 15 countries and territories of Asia & Pacific doubled their share in world GDP from 19% in the early 1990s to 34% currently. The region has become an economic powerhouse and most likely will gain further ground. The Regional Comprehensive Economic Partnership (RCEP) recently signed will provide another boost to long-term growth, as discussed in the recent OECD Economic Survey of Thailand.

Of course, not all countries of the region have the same resilience. To throw light on this disparity, we use a hierarchical cluster analysis (Ward linkage), a statistical procedure that identifies homogenous groups of observations without making a difference between dependant and independent variables. We identify four groups of countries with common factors for each of the three crises. To group the region’s economies, we use the following indicators: 1) the depth of recession, 2) the speed of recovery, and 3) the post-recession scarring of growth. The first two indicators provide a contemporary measure of resilience when faced with a shock, while the third indicator is an ex-post measure of resilience. For the current crisis, we use the number of COVID-19 deaths as a proxy of ex-post resilience, in line with empirical findings that the spread of the coronavirus has damaged economic activity due a combination of government-imposed lockdowns and self-imposed lockdowns (Golsbee and Syverson, 2020).

Our cluster analysis reveals some diversity within the region. The resilience of individual economies has changed rapidly – in both directions (Table 2). Some key findings are:

- Australia has shown great resilience during the first two crises, but fell into a recession with the coronavirus.
- While China and India were resilient in the face of the first two crises, they have lost some ground with the COVID-19 pandemic, especially India.
- Korea and Thailand have seen their resilience improve after each crisis.
- Vietnam has consistently been the most resilient economy in the region.

Table 2 – Many Asian & Pacific economies are resilient in the face of shocks, though not all

Asian Financial Crisis (1997-99)			
Sharp recession, slow exit & scarring	Recession, rapid exit & scarring	Mild recession & rapid exit	Muted impact of crisis
IDN, THA	HKG, KOR, MYS, SGP	JPN, NZL, PHL	AUS, CHN, IND, MNG, TWN, VNM
Global Financial Crisis (2008-09)			
Sharp recession & slow exit	Sharp Recession, rapid exit & scarring	Recession & rapid exit	Muted impact of crisis
JPN	HKG, SGP, TWN	KOR, MNG, MYS, NZL, PHL, THA	AUS, CHN, IDN, IND, VNM
COVID-19 Crisis (2020-21)			
Sharp recession, slow exit & scarring	Recession, slow exit & scarring	Recession, slow exit	Recession, swift exit
IDN, IND, PHL	AUS	CHN, HKG, JPN, MYS, TWN	KOR, MNG, NZL SGP, THA, VNM

Rising resilience

Source: OECD estimates using a hierarchical cluster analysis procedure (Ward linkage).

Despite this diversity, the region displays overall a strong resilience and is placed to recover rapidly from the COVID-19 crisis, assuming that the pandemic is brought under control and that the large population can be vaccinated soon. If this happens, Asia & Pacific will confirm its new position as a global powerhouse. The return to economic growth should be an opportunity to address socioeconomic problems inherent in several countries, notably high informality and inequality, and make headways on a path of decarbonisation.

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Making growth more inclusive by enhancing social protection: the case of Malaysia

Category: Malaysia,Uncategorized
written by oecdecoscope | August 27, 2024

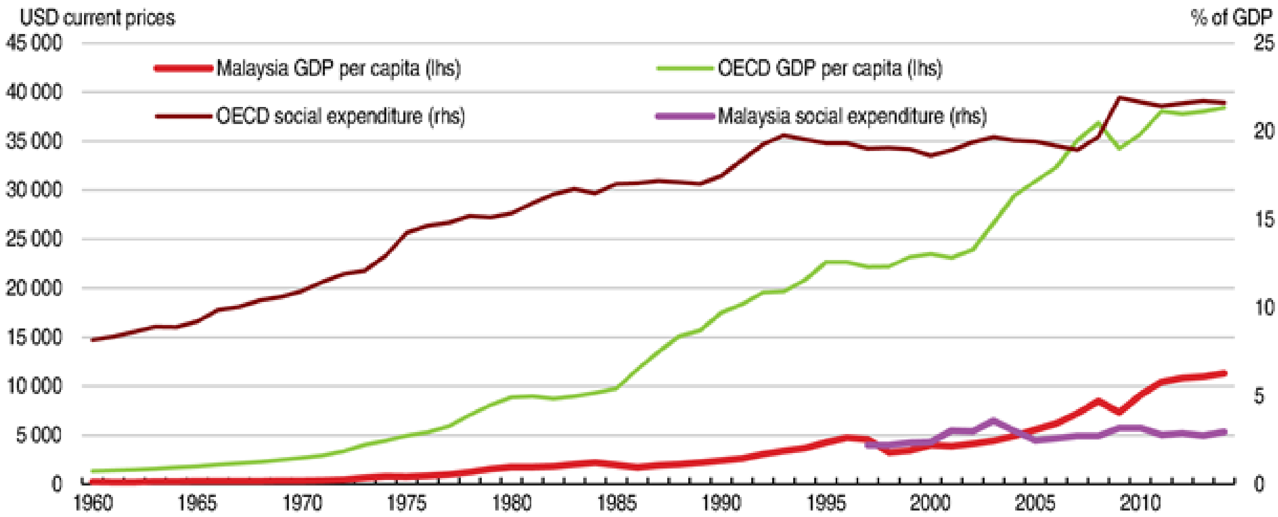
By Abu Zeid Mohd Arif, Economist, Country Studies Branch, OECD Economics Department

Growth can be more inclusive by pursuing policies that enable improvements in a country’s living standards while sharing gains more equitably across the population. Inclusive growth incorporates a focus on relative – not just absolute – income and wealth inequality, and on well-being, which depends on both monetary and non-monetary conditions, such as access to quality education, employment, housing and healthcare.

Malaysia’s success in alleviating poverty has been achieved despite the absence of an integrated and comprehensive social protection system. Households benefit from near-universal access to electricity, clean water, healthcare and transport, but income support for disadvantaged persons (such as the unemployed, single parents, disabled and elderly) remains ad hoc, insufficiently targeted and inadequate in providing basic living standards (OECD, 2016a).

Malaysia's social protection expenditure is lower than in all South East Asian countries for which data are available and than in all but a handful of countries in the Asia Pacific region. Public expenditure on social protection as a proportion of GDP typically rises in step with GDP per capita, as observed in OECD countries. Malaysia displays a different pattern (Figure 1). This would be the case even when adding in *zakat*, a compulsory Islamic charitable mechanism that in 2013 represented over one fifth of the level of government social spending excluding health.

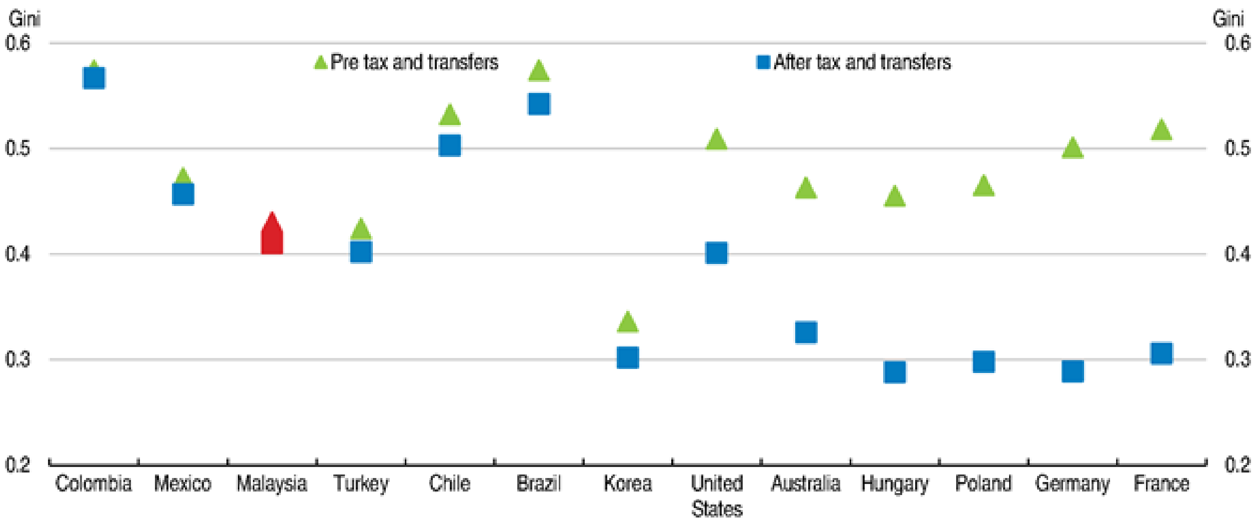
Figure 1. Social expenditure in Malaysia has not increased in step with GDP per capita



Source: OECD (2016), Social spending (indicator), http://dx.doi.org/10.1787/7497563b-en; ADB, Statistical Database System.

The low level of social protection expenditure is further reflected in the low redistributive power of the tax-and-transfer system: pre and post-tax and transfer Gini coefficients for income barely differ, like in Turkey (Figure 2).

Figure 2. Malaysia's tax-and-transfer system has little effect on income distribution



Notes:

1. 2013 for Korea and the United States and 2014 for Malaysia and Hungary, 2012 for all others.

2. The Gini coefficient has a range from zero (when everybody has identical incomes) to one (when all income goes to only one person). Increasing values of the Gini coefficient thus indicate higher inequality in the distribution of income.

Source: OECD (2016), OECD Income Distribution Database, http://dx.doi.org/10.1787/data-00654-en; *World Bank (2014), Malaysia Economic Monitor December 2014: Towards a Middle Class Society.*

Social expenditure is highly fragmented, being provided through a multitude of small-scale, specific-purpose programmes by a diverse range of ministries. It is essential that Malaysia develop a comprehensive social protection and income transfer system that provides targeted and timely support to those in need, while retaining strong incentives and facilitation mechanisms to maximise labour market participation. This calls for undertaking a comprehensive assessment of social protection needs and optimal strategies to meet them. Malaysia could utilise global best practice toolkits such as the Inter Agency Social Protection Assessments toolkit (ISPA, 2016) and draw lessons from the OECD Development Centre's work to develop social protection systems in the region (OECD, 2016b).

A key priority is the introduction of an employment insurance scheme that integrates job-matching services, reskilling and income smoothing to prevent a temporary setback from becoming an entrenched disadvantage. This scheme should also include temporary income smoothing payments to further reduce financial barriers to re-employment and overall income inequality.

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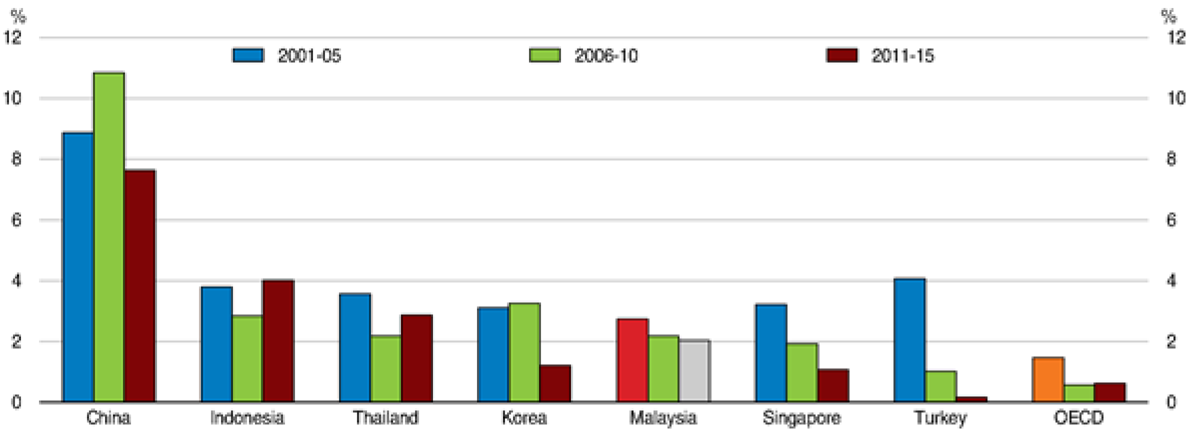
Boosting productivity is key for Malaysia to attain high-income-country status

Category: Malaysia,Productivity,Uncategorized
written by oecdecoscope | August 27, 2024
By Hidekatsu Asada, Head of the Southeast Asia desk, Country Studies Branch, OECD Economics Department

Productivity growth is essential for living standards to durably improve. Malaysia has reached a development stage where growth needs to be driven more by productivity gains than the sheer accumulation of capital and labour inputs. The 11th Malaysia Plan (2016-20) sets an ambitious labour productivity growth target of 3.7% per year, well above than the 2% average growth recorded from 2011 to 2015 (Figure 1). The first OECD Economic Assessment of Malaysia calls for coordinated structural reforms to achieve the productivity improvements needed for Malaysia to attain high-income-country status.

Figure 1. Labour productivity growth has declined

Average of growth of real value added per employee per year



Note: The underlying employment data for Malaysia might underestimate the number of legal and undocumented foreign migrant workers.

Source: OECD calculations based on data provided by national statistical office and OECD (2016), Productivity Statistics (database), http://dx.doi.org/10.1787/data-00685-en.

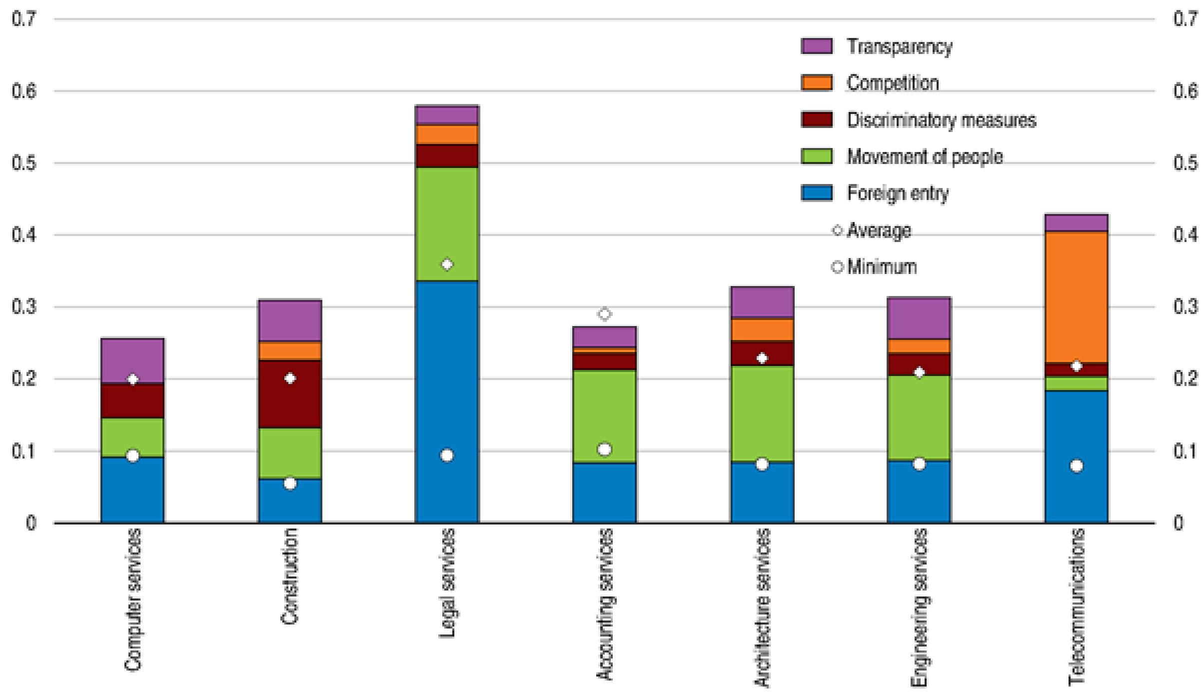
To boost productivity, three priority areas for further reform stand out.

First, enhancing the quality of education is critical to increase the availability of skilled workers and improve Malaysia's attractiveness for investment in higher value-added activities. Improvement in teachers' evaluation, training and upskilling is necessary to raise basic education outcomes. Enrolment in tertiary level education has expanded, but graduates often lack the skills required by industry. To narrow the skills mismatch in the labour market, more focus should be put on vocational education and training.

The second priority is improving the regulatory framework. Malaysia's efforts to create a more business-friendly environment through regulatory reform resulted in the country ranking 18th in the World Bank's Ease of Doing Business 2016. But observation of OECD best practice suggests Malaysia could do even better. Implementation of competition policy could be strengthened further by enhancing the independence and funding of the regulator. Productivity could be boosted by facilitating the entry of innovative firms and the exit of unproductive ones. With this in mind, a key recommendation is the reform of rigid bankruptcy laws in line with OECD standards.

Thirdly, further investment liberalisation will also boost growth in the services sector and enhance competitiveness. Indeed, a set of indicators measuring restrictions to services sector trade (the OECD's Services Trade Restrictiveness Index – STRI) was computed for the first time for Malaysia, revealing that the country has more restrictive regulations than the average of OECD member countries and major emerging economies (Figure 2).

Figure 2. The STRI for selected sectors



Note: The STRI indices take values between zero and one, one being the most restrictive. They are calculated on the basis of the STRI regulatory database which contains information on regulation for the 34 OECD Members, Brazil, China, Colombia, India, Indonesia, Latvia, Malaysia, Russia and South Africa. The STRI database records measures on a Most Favoured Nations basis. Preferential trade agreements are not taken into account.

Source: OECD (2016), Services Trade Restrictiveness Index.

Reference

OECD (2016), *OECD Economic Surveys: Malaysia 2016: Economic Assessment*, OECD Publishing, Paris.

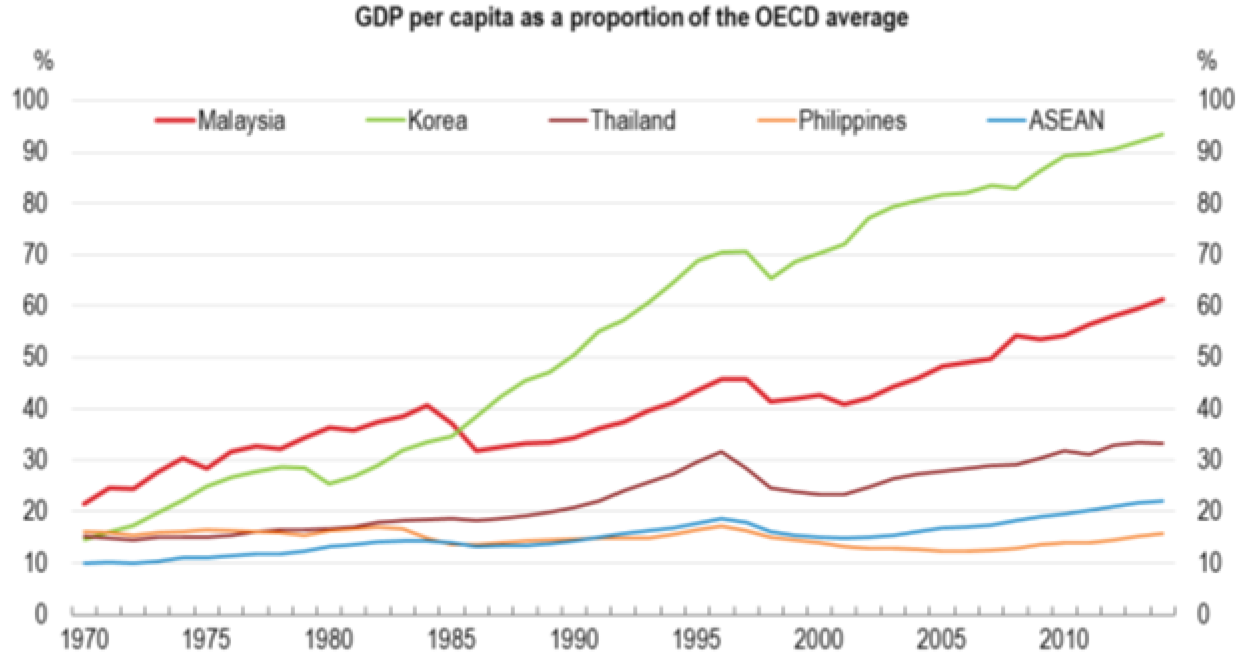
Successful macro transformation in Malaysia, but challenges remain

Category: Malaysia,Uncategorized
written by oecdecoscope | August 27, 2024

By Mohamed Rizwan Habeeb Rahuman, Economist, Southeast Asia Desk, Country Studies Branch, OECD Economics Department

Malaysia has sustained rapid and inclusive economic growth for close to half a century, as documented in the OECD's first Economic Assessment of Malaysia (OECD, 2016). Real GDP growth has averaged 6.4% per year since 1970, outperforming most of its regional peers (Figure 1). In the process, the Malaysian economy has undergone a dramatic transformation from dependence on agriculture and commodity exports to a more diversified and open economy with strong links to global value chains. Growth has been driven by a series of structural reforms that began in the 1970s. Malaysia harnessed its favourable geographical location on global trade routes to promote export-oriented industrialisation, encouraging regional integration through a relatively open environment to trade and investment. This has facilitated the development of manufacturing, boosting growth, employment and productivity by expanding access to global markets, capital, knowledge and technology. More recently, real GDP growth averaged 5.3% per year between 2011 and 2015, led mainly by domestic demand, with the services sector now representing more than half of GDP.

Figure 1. Convergence to OECD income levels has progressed

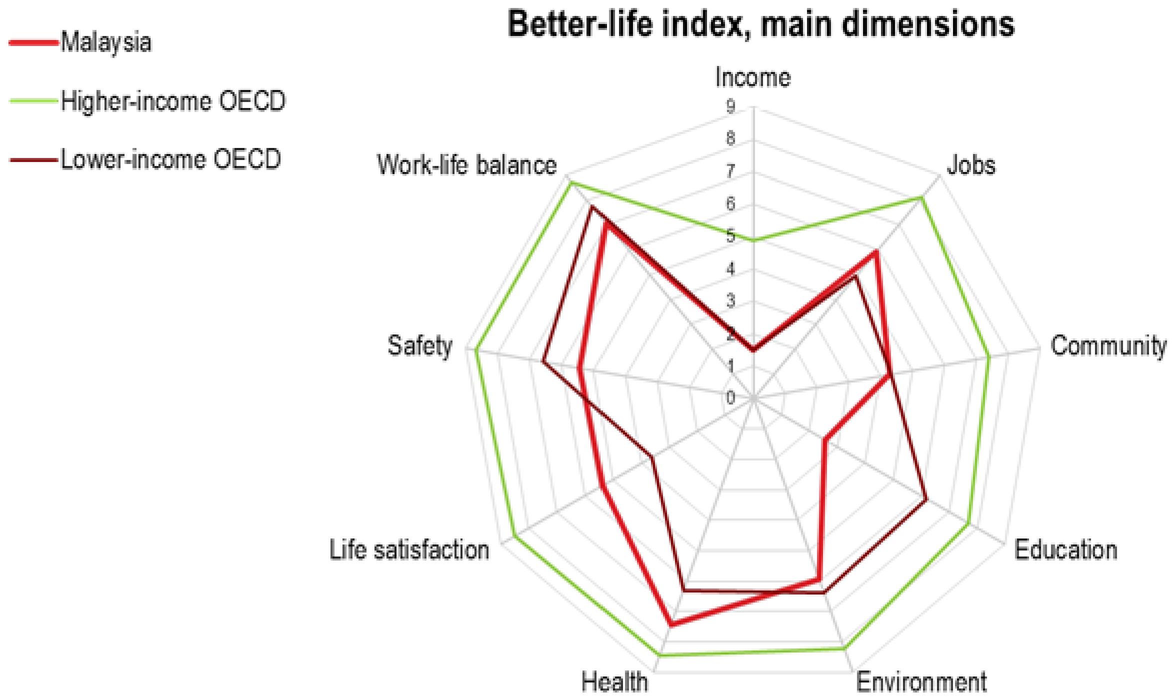


Note: GDP per capita is computed in real USD PPP terms; ASEAN excludes Myanmar; 1970-2011 data are from the Penn World Tables, 2012-14 data from the World Development Indicator database.

Source: World Bank, World Development Indicators; Penn World Tables 8.1 database and Economic Planning Unit, Malaysia.

Malaysia's aspiration to attain high-income country status involves striving for greater inclusiveness. It scores well on some indicators in the OECD *Better Life Index*, in particular long-term unemployment. However, the index illustrates relative weakness in areas such as educational attainment and skills, as well as personal earnings. It also highlights the need to further improve healthcare to increase healthy life expectancy (Figure 2).

Figure 2. Well-being indicators point to further opportunities to foster inclusive growth



1. Due to data availability, the indicators used in the OECD Better Life database are not necessarily identical with this exercise. Therefore, the higher and lower-income OECD data does not always correspond to the data in the OECD Better Life database.

2. Indicators are normalised to range between 10 (best) and 0 (worst) according to the following formula: (indicator value – minimum value) / (maximum value - minimum value) x 10.

3. OECD higher/lower income countries are countries belonging to the top/bottom 30% income quintiles of the OECD member countries.

Source: OECD calculations based on data provided by OECD, Better Life Index, national sources and UNESCO, UIS.stat (database).

In the face of external headwinds, growth slowed down to just over 4% year-on-year in the first half of 2016 but is projected to remain resilient at around this pace in the remainder of 2016 and in 2017 thanks to the continuing strength of domestic demand, even though momentum will be held back by the subdued pace of the global economy and still low commodity prices. Trade will continue to grow at a slower rate than GDP in line with slowing global trade, which affects the growth potential of trade-exposed emerging market economies like Malaysia (134% of GDP in 2015).

The balance of risks to growth is tilted to the downside and stems mainly from external factors. A more rapid than foreseen normalisation of United States monetary policy would entail a downside risk to the projections, as open emerging market economies such as Malaysia are vulnerable to capital outflows.

While Malaysia has diversified its economy and reduced its dependence on oil for government revenue, 19% of exports were agricultural and mining goods in 2015 and around 15% of government revenue is still oil-related in 2016. Thus, if commodity prices were to fall further, the trade balance, corporate profits and fiscal revenue would be negatively affected. On the upside, higher crude oil prices, accelerating inflows of tourists from Asia, or higher-than-forecast palm oil prices if unfavourable weather conditions continue to affect production, could see growth exceed projections.

Reference

OECD (2016), *OECD Economic Surveys: Malaysia 2016: Economic Assessment*, OECD Publishing, Paris.