CONNECT WITH US

wbg.org/Malaysia

@WorldBankMalaysia

@WB_AsiaPacific

# Table of Contents

Summary ........................................................................................................................................... 2

PART ONE
Recent economic developments ........................................................................................................ 5
Economic outlook ............................................................................................................................ 9

PART TWO
Surviving the storm ....................................................................................................................... 38
Summary

Malaysia’s economy has been severely affected by the COVID-19 pandemic

In 2020, Malaysia’s economy is projected to contract by 3.1 percent. In Q1 2020, growth slowed to just 0.7 percent with efforts to flatten the curve of the pandemic through a series of movement control orders and with deep uncertainty regarding growth prospects severely constraining economic activity. A pronounced output contraction of around 10 percent in Q2 2020 is envisioned, reflecting the significant impact of the economic disruptions resulting from the MCO imposed during the quarter. This is expected to be followed by a partial recovery in the second half of the year, as the outbreak eases and mobility restrictions are gradually lifted. This forecast assumes that the spread of pandemic is broadly contained at the global level and that the massive fiscal and monetary policy support measures implemented by governments around the world limit the depth of contraction in global economic activity. With all these factors, the near-term outlook for Malaysia’s economy is unusually uncertain at present.

The COVID-19 pandemic has resulted in an unprecedented crisis that requires large-scale and unconventional policy responses by governments everywhere. With the crisis severely affecting private demand and causing supply shocks, the government is tasked with the responsibility of facilitating economic recovery in the near term.

Malaysia’s economy remains resilient and rests on strong fundamentals. Its diversified economic structure, sound financial system, effective public health response and proactive macroeconomic policy support suggest that Malaysia will be able to ride out the storm better than many other countries.

The crisis has demonstrated the importance of having an enhanced social protection system that provides minimum protection to all those in need.
In the near term, Malaysia’s fiscal strategy should be re-prioritized to create additional policy space. This will require efforts to re-allocate expenditures towards priority areas, identify new sources of non-tax revenue, as well as legislative amendments to temporarily increase available fiscal space.

The Prihatin stimulus package, and more recently the Penjana plan, have provided important support to households and firms affected by the crisis. However, efficiency could be improved, and the quantum of financial assistance provided may need to be increased to adequately protect the welfare of vulnerable households and to ensure the sustainability of affected firms.

Over the medium term, the government should establish policies to prepare Malaysia’s economy for a post-COVID-19 recovery in the context of ‘new normal’ conditions. While to some extent, the COVID-19 crisis has required the temporary suspension of Malaysia’s medium and long-term economic plans, it also creates an opportunity to accelerate necessary structural reforms. First, it will be necessary to rebuild fiscal buffers and to ensure spending efficiency; second, to re-invigorate foreign and domestic private investment; third, to upskill and redeploy human capital; and fourth, to accelerate the digitalization agenda.

The Malaysia Economic Monitor (MEM) consists of two parts. Part 1 presents a review of recent economic developments and a macroeconomic outlook. Part 2 focuses on a selected special topic that is key to Malaysia’s medium-term development prospects and to the achievement of shared prosperity.

In this edition, the focus of the special topic is on Malaysia’s social protection system and how it can be improved and leveraged to better address the needs of the Malaysian population within a rapidly changing economic context. This altering economic environment flows from the shock of the global COVID-19 pandemic and the changing world of work induced by growing digitalization and automation.

With Malaysia set to achieve high-income country status and with its new emphasis on ensuring shared prosperity, it will need to ensure that its social protection framework is fit-for-purpose. At present, the thin provision of social assistance provides very limited support to enable the population to absorb shocks. To establish an adequate social insurance system, Malaysia needs both to improve the adequacy of financial protection for those already contributing to existing systems and to expand coverage to reach almost 40 percent of the labor force outside the current net.

The need for these measures will become even more acute as disruptive technologies and evolving demographics change the nature of work. The special topic in this MEM presents an analysis of issues related to the framework for social protection, with a series of policy recommendations to enable Malaysia to address the ongoing impacts of the COVID-19 crisis and other challenges into the future.
PART ONE

Recent Economic Developments and Outlook
Recent economic developments

The COVID-19 crisis has triggered a global economic shock of historic magnitude, causing a synchronized collapse in economic activity across the world during H1 2020. In particular, economic conditions in East Asia and the Pacific (EAP) deteriorated sharply as the impact of pandemic-related lockdowns rippled through the region.

Malaysia’s economy has been dramatically affected by COVID-19 and the subsequent movement restrictions implemented to flatten the curve of the pandemic. The health and human toll of the crisis on Malaysia has been enormous, with more than 8,000 confirmed cases and 121 deaths recorded to date, and many more suffering from economic hardship and diminished prospects. The MCO announced in mid-March led to a sudden decline in mobility in public places and severely interrupted economic activity. It was later replaced by the Conditional Movement Control Order (CMCO) and then the Recovery Movement Control Order (RMCO) that allowed progressively greater mobility and resumption of economic activity.

In this context, Malaysia’s economy expanded at the rate of 0.7 percent in Q1 2020. This represented a sharp deceleration from the rate of 3.6 percent recorded in Q4 2019, which itself was significantly lower than in the preceding quarters of 2019.

While private consumption remained the largest contributor to economic growth in the first quarter, its growth moderated to 6.7 percent in Q1 2020, down from 8.1 percent in Q4 2019. In particular, the MCO weighed heavily on retail, travel, leisure and recreational spending and on spending on durable goods. However, solid consumption expenditure in January and February and the continued operation of online platforms and delivery services throughout the MCO period helped to support private consumption during the quarter.

Aggregate investment contracted for the fifth consecutive quarter, with declines in both private and public investment. Gross fixed capital formation shrank by -4.6 percent in Q1 2020 (Q4 2019: -0.7 percent). Over the quarter, private investment was deeply affected by uncertainty related to the pandemic and the change in government. Over the same period, public investment registered its tenth consecutive quarter of negative growth.

Exports of goods and services shrank for the third consecutive quarter in Q1 2020 due to weak external demand and heightened uncertainty. Exports of goods and services declined by -7.1 percent in Q1 2020 (Q4 2020: -3.4 percent), the largest decline since the 2009 Global Financial Crisis. Over the same period, imports shrank by -2.5 percent (Q4 2019: -2.4 percent) due to a fall in capital goods imports,
especially machines and transport equipment. The current account surplus narrowed to 2.9 percent of GDP (Q4 2019: 3.4 percent), based on four-quarter rolling averages.

Exports of goods and services recorded its largest decline since the 2009 Global Financial Crisis

On the supply side, manufacturing and services were the main drivers of growth in Q1 2020, with agriculture, construction and mining all contracting. The decline in growth of services can be attributed to the direct impact of the pandemic on tourism and travel, which in turn weighed on retail, food services and accommodation. Meanwhile, other services that could be delivered through internet-based platforms and that were thus better able to weather the impact of movement restrictions, recorded increased activity. The manufacturing sector was impacted first by disrupted international supply chains and then by the MCO-related restrictions, which severely reduced operational capacity. In the mining sector, ongoing maintenance led to contraction in the production of oil and gas. In agriculture, weather conditions were not favorable to palm oil production, leading to a decline in production. Of all the sectors, the construction sector contracted the most (-7.9 percent), with the MCO leading to the closure of all constructions sites.

Headline inflation stood at just 0.9 percent in Q1 2020 (Q4 2019: 1 percent), with this low rate mostly due to falling fuel prices. While the inflation rate was positive in January and February, at 1.6 percent and 1.3 percent respectively, the decline in fuel prices resulting from a significant decrease in global oil prices caused inflation to turn negative in March (-0.2 percent) and April (-2.9 percent).

Labor market conditions deteriorated over the course of the first quarter. Strong employment growth (2.1 percent) helped to keep unemployment stable at 3.3 percent in January and February. However, a decrease in tourism-related activities and the enactment of the MCO resulted in employment growth decelerating to 1.6 percent over the quarter. In March, unemployment was estimated to stand at 3.9 percent, and in April it rose to 5 percent, its highest rate since monthly data has been available.

Bank Negara Malaysia (BNM) lowered the Overnight Policy Rate (OPR) from 3 to 2 percent in the period from January to May. In addition to lowering the OPR, BNM boosted liquidity in the financial system by lowering the Statutory Reserve Requirement (SRR) from 3 to 2 percent and by allowing financial institutions to use their holding of Malaysian government bonds to comply with the SRR.

The financial sector remained resilient in Q1 2020. The banking sector’s overall return on equity stood at 11.1 percent in Q1 2020 (Q4 2019: 13 percent), while return on assets was estimated at 1.3 percent (Q4 2019: 1.5 percent). Financial institutions’ capital and liquidity ratios remained well above the minimum statutory requirements.
Heightened uncertainty caused a decline in performance in the domestic financial market. Increased investors’ demand for safe assets has led to substantial non-resident outflows from domestic equity and bond markets in February and March, with the ringgit depreciating against the US dollar in line with most regional currencies.

Responding to the impact of the MCO on vulnerable households and businesses, the government unveiled two rounds of the Prihatin Rakyat Economic Stimulus Package in Q1 2020. The package was designed with the aim of addressing three broad objectives: (1) to protect Malaysian households, including through one-off cash assistance programs; (2) to support businesses, including through a wage subsidy program for employees; and (3) to ensure that the structure of the economy remains in place, through measures to preserve jobs and support domestic investment activities with strong multiplier effects. More recently, the government has announced the Penjana short-term economic recovery plan, which outlined measures to help stimulate the economy. The Penjana plan focuses on three key thrusts, which is to empower people, to empower businesses and to stimulate the economy.

Higher government spending to cushion the pandemic’s impact coupled with declines in revenue have led to a narrowing of fiscal space. While the cost of the overall Prihatin Rakyat package amounts to a total of RM260 billion, or 17 percent of GDP, the direct fiscal injection is fairly modest, amounting to RM35 billion (or 2.3 percent of GDP), with the bulk of the expenditure on the one-off Bantuan Prihatin Nasional (BPN) cash assistance program. Meanwhile, the Penjana plan increases the government expenditure by another RM10 billion, of which the bulk is allocated for the extension of the wage subsidy program and upskilling and re-skilling programs. The heavy reliance on non-fiscal mechanisms to finance the bulk of both the Prihatin package and Penjana plan reflects the limited fiscal space available to government at the outset of the COVID-19 crisis.

Falling global oil prices have placed additional downward pressure on already declining federal government revenues. Global commodity prices have declined sharply, with crude oil prices expected to average at US$32 per barrel in 2020, half the US$62 per barrel assumed by the government in its budget.

With projected increases to expenditure and downward pressures on revenue, the fiscal deficit is expected to widen in 2020, with a consequent erosion to fiscal policy space. Malaysia entered the crisis with a relatively elevated level of federal government debt (2019: 52.5 percent of GDP) and a low level of revenue (2019:15.4 percent of GDP). World Bank estimates suggest that the fiscal deficit could widen to as high as 7 percent of GDP if measures to reduce non-core spending or to secure additional non-tax revenue are not adopted. The government’s options to finance any additional fiscal measures are constrained by statutory limits, which can only be amended through a parliamentary sitting.

---

1 Excluding the one-off Petronas special dividend of RM30 billion.
Economic outlook

World Bank projections suggest that the global recession in 2020 will be the deepest in eight decades, despite the unprecedented policy response. Growth in the EAP region is expected to slow sharply in 2020 to its lowest rate since 1967.

Malaysia’s GDP is projected to decline by 3.1 percent this year (2019: 4.3 percent), mainly reflecting a sharp slowdown in economic activity in H1 2020. The near-term outlook for Malaysia’s economy is unusually uncertain at present. The baseline projection envisions a pronounced output contraction of around 10 percent in Q2 2020, reflecting the significant impact of economic disruptions from the MCO imposed during the quarter, followed by a partial recovery in the second half of the year as the outbreak eases and mobility restrictions are gradually lifted. It also assumes that the spread of pandemic is broadly contained at the global level, and the sizable fiscal and monetary policy support measures implemented by major economies limit potential structural damage to global economic activity.

While household expenditure and business investment spending are expected to improve gradually, they are likely to remain subdued throughout the year due to the high levels of uncertainty. Private consumption and aggregate investment growth are projected to fall to 1.2 and -4.9 percent respectively in 2020 (2019: 7.6 and -2.1 percent). Despite large-scale support through the Prihatin Rakyat and Penjana stimulus packages, private sector activity is likely to recover modestly as restrictions on social interactions are gradually scaled back, and will remain below its pre-crisis level over the foreseeable future.

The recovery of the external sector is likely to be relatively slow, consistent with the projected path of recovery in global trade. This year, Malaysia’s exports and imports are projected to contract sharply, by 12.9 and 9.2 percent respectively (2019: -1.1 and -2.3 percent) in the context of the dramatic collapse in global trade activity. A gradual recovery in Malaysia’s external sector is expected to begin in H2 2020 as the impact of the pandemic fades, and gain momentum next year as global trade activity begins to normalize.

Consumer price inflation will likely be muted over the near term due to the marked decline in global oil prices and overall demand since March. Inflation is expected to be close to 0 percent on average this year (2019: 0.7 percent), primarily reflecting the steep fall in oil prices and the broad-based weaknesses in demand.

On the external front, the global pandemic has amplified existing downside risks. A further weakening of global growth would pose downside risks to Malaysia’s external demand. Furthermore, with ongoing uncertainty and increased risk aversion, this could lead to heightened volatility in the domestic financial markets and to higher portfolio outflows.
PART ONE - Recent Economic Developments and Outlook

With the outcome of the pandemic remaining uncertain, there is a risk that it will lead to an increase in the number of vulnerable households. While necessary to curb the virus outbreak, the implementation of the MCO has weighed heavily on domestic demand, jeopardizing the sustainability of many businesses and leading to higher unemployment.

Particularly with existing statutory limits, any further narrowing of fiscal policy space could constrain the government’s ability to provide adequate economic support, especially in the near term. The marked reduction in fiscal space presents a potential risk should the economic impact of the initial MCO be greater than anticipated, thus requiring additional fiscal injections, particularly to provide support to vulnerable households and businesses. These risks would be amplified by the occurrence of a second wave of the pandemic that could require the re-imposition of the MCO.

The collapse of the Pakatan Harapan government in February 2020 and its replacement with a new coalition, known as Perikatan Nasional, has also contributed to uncertainty surrounding Malaysia’s economic policy. In the near term, this includes the ability to table the necessary legislative amendments and emergency bills in parliament, and subsequently to gain sufficient support from the Dewan Rakyat (lower house) to pass them.

On the upside, the containment of the spread of COVID-19 and the various government support measures could be more effective than anticipated. This would lead to higher pent-up consumer demand, greater investor confidence, and consequently a more robust recovery in domestic economic activity in H2 2020. A breakthrough in the development of effective treatments and vaccines against the new disease is also possible, which would bring an earlier-than-expected end to the global pandemic and contribute to a more sustained resumption in global economic activity, with considerable positive spillovers to Malaysia’s economy.

The crisis also presents an opportunity to accelerate a number of much needed structural reforms.

The COVID-19 pandemic is an unprecedented situation that requires the government to implement large-scale and unconventional policy responses. While the outcome of the pandemic remains uncertain, and until more effective means to manage it emerge, the economy can be expected to operate under a set of new norms, characterized by social distancing, temporary movement restrictions to contain local outbreaks, and limited international travel. With the crisis severely affecting both private demand and supply, it falls upon the government to do most of the heavy lifting to support the economy in the near term.
The quantum of the financial assistance in the Prihatin package and Penjana plan may need to be increased. While the measures included in the Prihatin package could help lessen the near-term disruptions on vulnerable households and businesses, the package implicitly assumes that the crisis will pass within a few months. Given that it could take at least another 1-2 years for the economy to return to pre-COVID-19 conditions, additional financial assistance may be needed to protect the welfare of vulnerable households and to ensure the sustainability of SMEs.

In the near term, fiscal strategy should be re-prioritized to create additional policy space through legislative amendments. This would entail placing fiscal consolidation efforts temporarily on hold and increasing the government’s fiscal space to enable it to better manage larger-than-expected impacts from the pandemic. Without legislative changes, the government’s immediate options are limited to either reallocating some expenditure items or increasing its reliance on government linked corporations (GLCs) such as Petronas. However, these options may not provide sufficient resources to adequately respond to the crisis if a deeper stimulus is required. Thus, the government could also consider pursuing legislative amendments to existing laws through an emergency bill, as other countries have done.

Over the medium term, policies should aim to prepare the economy for post-COVID-19 recovery, in the context of a “new normal” environment. While the COVID-19 crisis has to some extent resulted in the temporary suspension of measures mandated by Malaysia’s medium and long-term economic plans, it also presents opportunities to accelerate a number of structural reforms. Looking ahead, policies in the medium term should have four broad areas of focus. They should facilitate the intensive rebuilding of fiscal buffers and ensure spending efficiency; the re-invigoration of foreign and domestic private investment; the upskilling and redeployment of human capital; and the promotion of the digitalization agenda. The reform agenda on strengthening institutions, governance, and the capacity of the administration remains an important complement to these efforts and should be maintained.

Finally, the COVID-19 crisis has emphasized the importance of having an enhanced social protection system that provides minimum protection to all those in need. Enhancing Malaysia’s existing social protection system will entail the implementation of both short- and long-term policies. In the near term, the focus would necessarily be on support to the COVID-19 recovery efforts through continued cash transfers to the B40. There are also short- and medium-term opportunities for deepening social assistance, improving the delivery of social protection programs, and promoting a jobs recovery. Over the long term, policies on both the revenue and the expenditure side would be needed to support the combined achievement of a guaranteed minimum of protection for all those in need and a broader and more progressive tax framework.
The COVID-19 pandemic has triggered a collapse in global and regional economic activity

The COVID-19 pandemic has resulted in a synchronized collapse of global economic activity

Economic conditions in East Asia and Pacific have also deteriorated sharply

Falling global demand has resulted in significant declines in commodity prices, with particularly sharp falls in energy prices.

Commodity prices have declined in recent months...

Changes in Nominal Price Indexes, May over January 2020, Percentage

<table>
<thead>
<tr>
<th>Category</th>
<th>Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>Energy</td>
<td>-50</td>
</tr>
<tr>
<td>Metals &amp; Minerals</td>
<td>-40</td>
</tr>
<tr>
<td>Food</td>
<td>-30</td>
</tr>
<tr>
<td>Non-energy</td>
<td>-20</td>
</tr>
<tr>
<td>Agriculture</td>
<td>-10</td>
</tr>
<tr>
<td>Raw Materials</td>
<td>0</td>
</tr>
<tr>
<td>Fertilizers</td>
<td>10</td>
</tr>
<tr>
<td>Beverages</td>
<td>20</td>
</tr>
<tr>
<td>Precious Metals</td>
<td>30</td>
</tr>
</tbody>
</table>

...with particularly sharp falls in energy prices.

Major Commodity Price Indexes, US$ (2010=100)

Source: World Bank Group
Malaysia’s economy has been dramatically affected by restrictions on movement to flatten the pandemic curve

The MCO has been effective in flattening the curve of the COVID-19 outbreak...

...through a significant decline of mobility in public places

Source: World Bank staff calculations based on European Centre for Disease Prevention and Control data

Source: World Bank staff calculations based on Google data
Economic activity slowed down markedly in recent months

Malaysia’s economic growth weakened sharply in Q1 2020...

GDP, y/y, Percentage

...weighed down by negative investment and net export growth

Contribution to GDP, y/y, Percentage

Source: DOSM

Source: World Bank staff calculations based on DOSM data
Exports have continued to see negative growth due to weak external demand

Negative export growth continued amid plunging external demand

A smaller goods surplus and a larger deficit in services led to a narrower current account surplus
Foreign direct investment and global value chains in the wake of COVID-19

The COVID-19 pandemic has created unprecedented challenges to global value chains (GVCs), hampering the flows of intermediate inputs, final goods, services and people. Governments around the world have been scrambling to mitigate the impact of the pandemic on major GVC network hubs, including China, Europe, and the United States (see Figure 13). With multinational corporations having continued to adapt their supply networks to balance efficiency and resilience, their investment decisions will shape the evolution of GVCs in the years to come. Governments from developing countries could further open their economies to foreign investment, seizing opportunities stemming from the reconfiguration of GVCs, and strengthening global collaboration to expedite recovery and to boost longer-term growth.

Multinational corporations are at the epicenter of the current turmoil, with these corporations being required to make investment decisions to fragment and relocate production in a process that will have an ongoing impact on the geography of global value chains. These enterprises account for about 22 percent of global output and contribute to about 70 percent of total trade, particularly in sectors heavily involved in global value chains, such as electrical and electronics, motor vehicles and chemicals (see Figure 14). Around the world, multinationals also contribute to a substantial share of employment, with U.S. multinationals alone employing 42.3 million workers worldwide in 2016 and representing 22 percent of total private industry employment in the United States. As a result of the immediate supply restrictions, the demand shock, and general decline in investor confidence, the COVID-19 pandemic is expected to reduce FDI by 30 to 40 percent this year. Already, the top 5,000 multinational corporations have reduced their earnings estimates by around 30 percent for the year. This could cause lasting damage to supply chains, with more than half of foreign direct investment consisting of reinvested earnings by these corporations and with their inextricable links to numerous suppliers.

Multinationals have a long history of managing GVC disruptions resulting from crises, with these enterprises having learnt to constantly adapt to risks and opportunities by reconfiguring production networks. The 2008 Japanese earthquake and the 2011 Thailand Chao Phraya river floods both shaped the evolution of GVCs, in many ways making them more resilient. No consensus has emerged on how GVCs will look like after the current pandemic subsides. Some economists hold the view that there will be little significant change and that adjustments will concentrate in health-related industries, as the economic rationale for most GVCs continues to hold (Baldwin 2020; Freund 2020; Miroudot 2020). Others believe that the pandemic is a major wake-up call, requiring a new balance between risk and
PART ONE - Recent Economic Developments and Outlook

FIGURE 13
The emergence of global value chains has made trade more complex...

Source: Authors’ calculations using UNCTAD-EORA database

FIGURE 14
...with multi-national corporations dominating trade in the largest sectors

MNCs’ Share of Export, Percentage

100

80

60

40

20

0

Log Average Annual Export

Commodity KIG KIS LIG LIS RP

Source: Authors’ calculations using OECD AMNE database
reward for GVCs, as pandemics, climate change, natural disasters and manmade crises may expose the world to increasingly frequent crises (Goldberg 2020; Javorcik 2020).

Given evolving tolerances for risk as a result of the pandemic, while some multinationals may be willing to lose some efficiency gains to diversify suppliers, the relationship between production length and GVC resilience is more complicated than it may first appear. There is no correlation between supply chain complexity and the severity of the economic impact of COVID-19 (Miroudot 2020). Production localization, or shorter supply chains, would not necessarily result in greater resilience. On the contrary, some previous crises and disasters have led to more offshoring to diversify suppliers and to integrate with a production network spread across a range of countries. Even during the current pandemic, countries have still relied on global production networks to meet higher domestic demand for essential medical and other goods.

Over time, traditional supply chains have also evolved into supply networks, making it difficult to relocate, whether back to an enterprise’s own country or elsewhere. The challenge relates to a number of factors, including how modern supply networks are structured and how lead firms choose to engage with their suppliers (Willy Shih 2020). For example, a foreign affiliate manufacturing T-shirts in Rwanda may source coloring material, textiles, textile machinery from at least three tiers of domestic suppliers, while importing fabrics, chemicals and machines from hundreds of firms around the world (see Figure 15). As the example shows, the supplier networks are so interconnected that building them somewhere else would incur considerable costs, thus

FIGURE 15
Networks between MNCs and their suppliers are now incredibly complex

Source: Author’s calculation using transaction level data from Rwanda
As lead firms seek to stay abreast of the evolution of GVCs in the recovery phase, one sure strategy for multinationals is to accelerate technology adoption. COVID-19 could create opportunities to embrace digital transformation to enhance efficiency and to reduce risks. Multinationals could use artificial intelligence, machine learning, and big data to monitor supply networks, to develop and oversee production remotely, to connect to customers, and to fulfill orders. Toyota has efficiently implemented this approach since the 2011 Japanese earthquake, enabling it to track components and replace them relatively easily during the pandemic. About 70 percent of companies surveyed in Europe are speeding up digital transformation in response to the pandemic, with banks, health care providers, and retailers moving to digital channels and using e-commerce platforms to expand their customer base (MGI, 2020).

The pandemic has also exacerbated already increasing protectionist sentiment, encouraging more nationalist policies. In particular, the United States and the European Union have enacted strict screenings of foreign acquisitions in response to perceived risks to national or economic security. In 2019, restrictions on FDI had already reached the highest level in 20 years. Another worrying development is that some governments are now conditioning state support on shifting production back home. US lawmakers are crafting proposals to push American companies to move operations or key suppliers out of China by offering tax breaks, new regulatory incentives, and carefully structured subsidies, while Japan has set aside a record US$ 2.2 billion support package to subsidize manufacturers who move their production out of China. Such interventions are often not supported by economic rationale. In particular, not only does reshoring not necessarily reduce supply chain risks, the increased production costs could undermine national competitiveness and lower long-term growth across the world. These policies could also hurt low-income countries that are increasingly reliant on GVCs to stimulate economic growth.

Even during the current pandemic, countries have still relied on global production networks to meet higher domestic demand for essential medical and other goods

risking a loss of competitiveness. Even if production facilities could be relocated, it would require a whole ecosystem of talent, infrastructure as well as nearby upstream and downstream industries to scale up production in a new location.
What can countries do in the recovery phase and the ‘new normal’ of GVC to counter prevailing global headwinds and uncertainty related to national economic sovereignty measures? World Bank research suggests a three-part policy response, as follows³:

- **Opening up the economy and ensuring that it is ready for a post-crisis start:** The crisis has exposed a number of structural challenges that may impact developing countries, including dependence on a small number of vulnerable sectors. By its nature, FDI strengthens the resilience of an economy and enables it to absorb future shocks through economic diversification and enhanced productivity. To attract additional investment, countries could counter the global protectionist trend by further easing entry and reducing operational FDI restrictions as part of their structural reforms. Becoming relatively more open to foreign investors can significantly help attract investment. For example, China and India both recently announced the removal of caps on foreign equity ownership of securities and defense and allowing foreign ownership of fund management firms.

- **Seizing opportunities created by the evolving structure of GVCs:** Recent trade tensions between the US and China have prompted a diversification of American production facilities to other East Asian countries. The push to diversify supply chains may intensify, with regional supply chains gaining more momentum in the context of the pandemic. Policymakers may also respond to changes in sectoral dynamics, including the rise in e-commerce and digital health or the decline in fossil fuels. These changes may create new opportunities for some developing countries, according to their respective comparative advantages. Policymakers should reflect on the possible shifts and let business realities guide their response, building on economic fundamentals. These will entail realigning investment incentives to the new national development priorities that are likely to emerge following the pandemic, such as job creation. Reforms may also be needed to phase out of crisis-related investment screening and approval mechanisms for FDI entry.

- **Strengthening global collaboration:** The COVID-19 pandemic has resulted in an increased awareness of the shared public health and economic vulnerabilities faced by countries and of the importance of collaboration to resolve crises. It has also highlighted the critical importance of a commitment to enabling the exchange of data, the sharing of information on good practices, and strengthening collaboration. Recent history has shown that global integration through trade and investment has brought peace and prosperity to many countries. Global leaders need to work together to secure the hard-earned gains from participation in global value chains.

Inflation turned negative in recent months, reflecting a marked decline in fuel prices

Headline inflation turned negative in recent months... 

...due primarily to sharp declines in petrol prices

Source: DOSM

Source: World Bank staff calculations based on DOSM data.
Labor market conditions softened noticeably in recent months

Unemployment rose to its highest rate in March... ...driven by a rise in unemployment for the 15-24 age group

Source: DOSM

Source: World Bank staff calculations based on DOSM data
Heightened uncertainty has caused a decline in the performance of the domestic financial markets

Increased investor demand for safe assets led to large portfolio outflows...

...and the ringgit depreciated against the US dollar, in line with regional currencies

Source: BNM and Bursa Malaysia

Source: World Bank staff calculations based on BNM data
BOX 2

Foreign workers in Malaysia during the COVID-19 pandemic

The COVID-19 pandemic has hit foreign workers particularly hard. While the pandemic and MCO have affected practically everyone in Malaysia, foreign workers—both regular foreign workers that entered Malaysia using the Visit Pass (Temporary Employment) system and comparable irregular foreign workers—are likely to have been hit particularly hard for several reasons. First, foreign workers are a vulnerable population, with low salaries and limited savings and support. Second, the MCO negatively impacted non-essential businesses that require physical interactions or presence—such as in hospitality and retail services, manufacturing and construction sectors—that are likely to have laid off at least some of their employees. Third, foreign workers are for the most part not covered by measures announced in the economic support packages and plans. Finally, regulations like those that prevent foreign workers to change employers within Malaysia could aggravate the adverse impacts.

Mitigating the effects of the pandemic on foreign workers could benefit not only these workers but also businesses and Malaysia more broadly. Even though foreign workers are not Malaysian citizens, there are humanitarian grounds to support them during the extraordinary crisis caused by the COVID-19 pandemic. Support to foreign workers can also help any business with continuing labor shortages to survive the crisis. In addition, support to foreign workers can also benefit Malaysia more broadly. Support will mean that a larger share of foreign workers will be willing and able to remain properly documented, to comply with the RMCO, and to avail themselves of COVID-19 testing and treatment offered by the health care system. In turn, this will likely limit the spread of COVID-19 across Malaysia.

Malaysia has taken some positive steps to accommodate the needs of foreign workers. Access to tests and treatment for COVID-19 has been extended to both regular and irregular foreign workers. This is essential both for the well-being of foreign workers, who often live in communal housing that does not permit social distancing, and to prevent the wider spread of COVID-19. The government has also moved to improve the housing conditions of foreign workers and introduced a 25 percent discount on the levy imposed on the extension of work permits for foreign workers with permits expiring between April 1 and December 31, 2020, which acts as an incentive for employers to retain these workers.

However, more can be done to mitigate the adverse effects of COVID-19 on foreign workers and their employers. Based on international best practices and Malaysia’s unique country context, recommended measures include continued provision of access to healthcare and improvements both to the clarity and scope of outreach efforts to the foreign worker community. Testing and treatment needs
to become part of daily business until a COVID-19 vaccine becomes readily available. In addition, it should be assured that all foreign workers remain with proper lodging and food. Finally, it would be worth considering allowing and facilitating changes of foreign workers’ employers, extending expiring visas, and temporarily suspending the foreign worker levy.

Even though foreign workers are not Malaysian citizens, there are humanitarian grounds to support them during the extraordinary crisis caused by the pandemic.

As far as feasible, all foreign workers should be treated equally. Based on an estimate by World Bank (2020), irregular foreign workers make up more than 40 percent of the total foreign worker population in Malaysia. Irregular foreign workers arguably face more adverse conditions than their regular counterparts, due to the lack of social protection benefits, contracts, and workplace protections. In this time of crisis, as far as feasible any support that is being provided for regular foreign workers should be extended to the more vulnerable communities of irregular foreign workers to limit the adverse effects of COVID-19 on the total foreign worker population in Malaysia and the spread of the pandemic.
The financial sector remained resilient in Q1 2020 despite the turmoil caused by the outbreak

In the period from January to May, BNM lowered the OPR by a total of 1 percent, from 3 percent to 2 percent. It also lowered the Statutory Reserve Requirement from 3 percent to 2 percent to ensure ample liquidity in the financial system.

Financial institutions have remained profitable, and capital and liquidity ratios were well above the minimum statutory requirements. But impaired loans have grown faster in Q1 2020, indicating deteriorating debt service capacities of households and businesses.
Higher government spending to cushion the impact of COVID-19 coupled with declines in revenue have led to a narrowing of fiscal space.

Costs associated with the Prihatin package and the Penjana plan are expected to result in an increase to government expenditure of RM35 billion in 2020.

Falling global oil prices have placed additional downward pressure on already declining federal government revenues.

With projected increases in expenditure and downward pressures on revenue, the fiscal deficit is expected to widen considerably in 2020.

- The fiscal deficit could widen to as high as 7 percent of GDP if measures to reduce non-core spending or to raise additional non-tax revenue are not adopted.
- The government’s options to finance additional fiscal measures are constrained by statutory limits, which can only be lifted through legislative amendments.
The global economy is projected to experience a major contraction this year

Global GDP is projected to contract sharply in 2020... ...with growth in Developing EAP projected at its lowest rate since 1967

Malaysia’s economy is expected to contract sharply in 2020

Malaysia’s economy is forecast to contract by 3.1 percent in 2020...

...reflecting a broad-based decline in private sector activity

GDP, y/y, Percentage

<table>
<thead>
<tr>
<th>Year</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
<th>2019e</th>
<th>2020f</th>
<th>2021f</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP</td>
<td>5.1</td>
<td>4.4</td>
<td>5.7</td>
<td>4.7</td>
<td>4.3</td>
<td>-3.1</td>
<td>6.9</td>
</tr>
</tbody>
</table>

Source: World Bank staff projections
The COVID-19 pandemic has exacerbated downside risks to growth

1. Global economic downturn
   - Many advanced and developing economies are facing the prospect of a sharp economic downturn, affecting Malaysia’s external demand

2. Second wave
   - The occurrence of a second wave could lead to the return of stricter movement restrictions

3. Modest roll-out of response packages
   - An insufficient economic response by the government could lead to a slower-than-expected pace of recovery

4. Higher number of vulnerable households
   - The pandemic’s outcome remains uncertain; hence there is a risk that the number of vulnerable households could increase

5. Narrowing fiscal policy space
   - Further narrowing of fiscal space given existing statutory limits could restrict further economic recovery measures

6. Domestic political uncertainty
   - Ongoing political uncertainty could complicate policy implementation and dampen investor confidence

7. Upside risk on effective containment
   - Effective containment and pent-up demand could lead to faster-than-expected recovery in consumer confidence

Source: World Bank staff elaboration
Policy considerations in the short, medium, and long term

**Short-term:**
Protecting vulnerable households and businesses

- Containing the risk of another outbreak.
- Creating temporary fiscal space through legislative amendments.
- Increasing the quantum and delivery of financial assistance to the vulnerable in the *Prihatin* package.

**Medium-term:**
Preparing the economy under a 'new normal'

- Restoring fiscal buffers through a more progressive tax framework, improving spending efficiency, and reducing fragmentation in social protection programs.
- Upskilling and retraining of the workforce.
- Enhancing competitiveness in attracting quality investments.
- Accelerating the digital agenda and bridging the digital divide.

**Long-term:**
Laying the foundations for transition to high-income status

- Implementing structural reforms in six broad areas including raising female labor force participation, improving human capital, boosting competitiveness, creating quality jobs, modernizing institutions, and promoting inclusion.

Source: World Bank staff elaboration
Strengthening public trust through effective communication, especially in times of crisis

The global shock of the COVID-19 pandemic has brought attention to the importance of public trust not only in responding to public health emergencies but also in reopening economies and planning for economic recovery. Governments, international organizations like the World Health Organization (WHO), and experts in medicine and public health rely on public trust to gain cooperation for health advisories, movement control orders or community quarantines, and social distancing. On the economic front, businesses and workers will need to trust that authorities are in control of the situation to restart enterprises that were put on hold. As such, high levels of collaboration between governments and citizens are essential to defeating the pandemic.\textsuperscript{17}

Trust between citizens and institutions is sustained by effective communication characterized by transparency and openness, both during the health crisis and in the reopening of markets and economies. Good communication engages with numerous audiences, tailored to their respective contexts, via suitable channels and outputs, and over a period of time. An effective and strategic communication is one that is integrated with operations, with the ability to explain and expound upon policies and their future path, playing a key part in any successful outcome.

Surveys of trust in government institutions, private sector, and of other citizens illustrate important differences in levels of interpersonal and institutional trust across countries\textsuperscript{18}. The Ipsos Global Advisor Trustworthiness Monitor, launched early 2020, revealed that professions such as doctors, scientists and teachers enjoy high levels of trust among Malaysians (see Figure 39). The Ipsos Malaysia study further revealed that public services, such as education, healthcare/medicine, and the armed forces tend to receive comparatively higher trust ratings from the public. Another survey, the YouGov COVID-19 perception tracker of government handling of the crisis, sees Malaysia second only to Vietnam in terms of citizen confidence with which the COVID-19 crisis is being handled (see Figure 40).

\textsuperscript{17} We’re all in this together: Collective action and trust in the age of coronavirus. (2020, April 20). Retrieved from https://blogs.worldbank.org/governance/were-all-together-collective-action-and-trust-age-coronavirus

FIGURE 39
Citizens have the greatest trust in teachers and doctors...

Trust Levels Based on Profession Among Citizens of Malaysia, Percentage, 2020

- Politicians
- Government Ministers
- Ad Executives
- Ordinary People
- Journalists
- Business Leaders
- Bankers
- Civil Servants
- Pollsters
- TV News Readers
- Lawyers
- Police
- Judges
- Religious Leaders
- Armed Forces
- Scientists
- Doctors
- Teachers

Source: Ipsos survey

FIGURE 40
...and Malaysia scores well on measures of handling the COVID-19 crisis

Perceptions of Government Handling of COVID-19, Score for Selected Countries, 2020

Source: YouGov survey
Ensuring widespread compliance with public health measures requires trust in those who are in authority to instruct their populations to engage in social distancing. The daily health updates provided by Dr. Noor Hisham Abdullah, the Director-General of the Ministry of Health, Malaysia exemplifies a key communications strategy by the government to position the top public health official to strengthen public trust and support for government instructions and enforcement. The daily updates, which utilize a methodical and evidence-led approach, have garnered a popular following and raised public compliance levels to the MCO imposed nationwide to curb the pandemic. This had shown signs of early success and had enabled the government to allow the economy to reopen with the announcement of a Conditional MCO in early May, increasing the focus on facilitating economic recovery, while maintaining public health as an urgent priority.

The same principles of trust apply to manage economic crises. A 2018 study explored how increasing government accountability to citizens across Asia would in turn increase policy capacity to respond to an economic crisis (Yap 2018). Evidence from the study shows that “the dynamic exchange between government and citizens underlie the successful rehabilitation of the Asian economies (from the 1997/98 Asian Financial Crisis)” and that when “government demonstrates accountability to its citizens; this spurs citizens’ support for the government and cooperation on policies, which directly broaden the government’s policy capacity to facilitate economic recovery or success”. The study cites the experience of Singapore which adopted clear, transparent, and consultatory approaches in dealing with the crisis. Their citizens responded by providing further political and economic support. When Singapore presented its budget statement in February 1998, there was an acknowledgement that the financial crisis was not fully over, and the country had to deal with much economic uncertainty. The government expressed commitment to “keep in close touch with the private sector” regarding economic developments.

With trust, the ability of public officials to restore confidence will also increase. One well-known example was during the eurozone crisis. In July 2012, the eurozone was on the verge of collapse. Speaking at a bankers’ forum in London was then-President of the European Central Bank Mario Draghi who pledged to do “whatever it takes” to preserve the Euro. This statement resonated across the European markets and led to calmer conditions and subsequently helped to restore financial confidence (Stankova 2019).

In this crisis, as in others before it, there is an opportunity to build trust in bureaucracies and in the capability of the public service to protect the citizenry and quickly steer the country to economic recovery. While building trust takes time, features of transparency, open communication, and increased government accountability can bring governments closer to solutions and, more importantly, to citizens.

PART TWO

Surviving the Storm
Surviving the storm

The COVID-19 pandemic and the associated economic slowdown underscore the need to better protect individuals and households in Malaysia, both during the recovery period and into the medium- and long-term future. With the impact of the COVID-19 pandemic on Malaysia, it faces a battle to defend the welfare and livelihoods of its people, especially those in the B40. The crisis is expected to accelerate major changes around the world, ushering in what has been described as a “new normal.”

To survive the storm and thrive in the “new normal”, Malaysia needs a mixture of expenditure and revenue measures, including an enhanced social protection system that provides minimum protection for all those in need. Ideally, the guaranteed minimum of protection to all those in need will be set at adequate benefit levels and regardless of specific work arrangements. In addition, the social protection system would incentivize work, be responsive to changing circumstances, and be fiscally sustainable. On the expenditure side, it would cover publicly financed social assistance programs such as cash transfers, contributory social insurance programs such as retirement savings, and active labor market programs such as skills-building initiatives. An enhanced social protection system would imply a strong role for the government and additional fiscal expenditures. Thus, it would also require policy measures on the revenue side, such as the introduction a broader and more progressive tax framework.

Structurally, Malaysia faces challenges related to the changing nature of work and its aging population. Rapid technological transformation has been changing the way people work, leading to some degree of job displacement and a growing prevalence of forms of jobs that do not involve “standard” employment relationships, such as own-account work and gig economy jobs. In addition, Malaysia’s population is aging rapidly, with the proportion of the population aged 65 and above expected to double from seven percent to 14 percent within only 24 years. This puts increasing pressure on the
social protection system, particularly on components based on “standard” employment relationships.

In Malaysia, social assistance programs have only a modest impact on poverty reduction and on promoting productive employment. While the coverage of Malaysia’s non-contributory social assistance programs is high (encompassing 76 percent of all individuals and 98 percent of those in the B20 as per the distribution of income per capita), the level of benefits is generally insufficient to achieve a reduction in the poverty gap similar to that of the average upper middle-income and high-income countries. At about 1 percent of GDP, spending on social assistance is also low by international standards. There are also few policies that link the beneficiaries of social assistance programs to efforts to build their human capital or to improve their productive inclusion in the labor market. In addition to a lack of specific support measures and incentives for participating in those measures for beneficiaries with the capacity to work, there is also a lack of coordination between social assistance, education and labor market programs.

With Malaysia’s economy operating in a “new normal” context, it is vital to improve the performance of the social protection system and to ensure that it is integrated with wider economic policy. Throughout the recovery from the COVID-19 crisis, cash transfers to the B40 will remain vitally important to provide short-term relief mitigating acute financial strains, to support medium-term recovery efforts, and to support consumption and human capital development at a time of economic downturn. Also, there is significant potential to achieve better outcomes through both the flagship Bantuan Sara Hidup (BSH) program and the core social assistance programs implemented by the Department of Social Welfare (Jabatan Kebajikan Masyarakat, JKM). Key to forming a more consistent systemic approach will be to improve and better harmonize the objectives, design and implementation of BSH and JKM programs. This would include improving the coverage and adequacy of some of the well-targeted JKM programs and to put more emphasis on productive welfare for beneficiaries with work capacity. It would also include clarifying the objectives and improving the targeting performance of BSH. More generally, there is potential to improve the equity and efficiency of social assistance programs by better coordinating targeting approaches, information systems, and front-end service delivery.

Participation in retirement savings institutions is low, especially among the B40 and women, and the majority of participants will only receive very low benefits in retirement. With about 7.6 million active members, the EPF is the retirement savings institution with the largest coverage in Malaysia, although coverage is slightly lower than would be expected given the country’s level of development. Coverage is especially low among lower income households, with less than half of the B40 being active EPF contributors. Average contributions per worker are also relatively low because participation in “standard” employment is intermittent and the minimum withdrawal age is low relative to global benchmarks. As a result, average balances are inadequate, with more than half of workers at age 54 having balances of under RM150,000 and almost three
quarters having balances under RM250,000. Average balances for women are even lower.

Several measures could increase the proportion of workers actively contributing to the EPF and ensure that retirement savings could be sustained for a longer period of time. To increase coverage, oversight could be improved, including through a requirement for the registration of all workers as a condition for the granting of business licenses and/or government contracts. To raise average balances, the minimum withdrawal age for EPF could gradually be increased to 65 through a well-considered transition process. For instance, the increase could be implemented over a period of 20 years. In addition, consideration could be given to converting all contributions to EPF wholly into retirement savings, to mandating phased withdrawals of EPF balances, and to exploring longevity insurance and annuitization options. Over time, the EPF contribution rate could be reduced as the benefit eligibility age increases, provided that there is an observed increase in coverage and adequacy. With the changing nature of work, it is unlikely that EPF can ever reach full coverage of the labor force even with all these measures. Thus, a modest, broadly targeted social pension may also be required.

There is a significant degree of duplication and fragmentation in Malaysia’s labor market programs. While the country has long emphasized the importance of human capital development and productive participation in the labor market, relevant efforts have been constrained by the multiplicity of implementing agencies and programs. This has made it difficult to obtain accurate data on program effectiveness; made programs costly to administer; and created a lack of clarity among beneficiaries.

In the near future, the COVID-19 pandemic increases the need for further wage subsidies as well for effective labor market programs to address rising unemployment and underemployment. Over time, the focus of wage subsidies should shift from job retention to job creation, largely consistent with what was announced as part of the Penjana plan. Again, broadly consistent with the Penjana plan, skills-building initiatives will be vital to facilitate workers’ access to jobs that will be in demand during the recovery, such as those necessitating digital or socio-emotional skills. More in the medium and long term, measures to reduce duplication and fragmentation of labor market programs are needed. A deeper culture of program evaluation could produce significant benefits; flagship labor market programs that have been credibly evaluated could be strengthened and others discontinued.

The development of an enhanced social protection system implies a strong role for the government, likely entailing additional fiscal expenditures financed by higher, progressive taxes. Even a gradual expansion of the social protection system may be challenging in the context of the downward trend in government revenues and the fiscal shock resulting from the COVID-19 pandemic. There is a critical need to diversify the revenue base and to increase collection through more progressive taxation. Thus, an enhanced social protection system will require a mixture of public policy measures on both the expenditure and the revenue sides.
Against the backdrop of the COVID-19 pandemic and the changing world of work, Malaysia needs an enhanced social protection system

In the short run, most cash transfer recipients indicated that they need additional support...

<table>
<thead>
<tr>
<th>Share of Respondents Who Need Additional BPN Beyond MCO Phase 1, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Yes</td>
</tr>
<tr>
<td>82%</td>
</tr>
<tr>
<td>No</td>
</tr>
<tr>
<td>18%</td>
</tr>
</tbody>
</table>

Source: DOSM

...while aging is fast and non-standard jobs are becoming more common, especially among women

<table>
<thead>
<tr>
<th>Share of Own-Account Workers Among Women, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
</tr>
<tr>
<td>10</td>
</tr>
<tr>
<td>2011</td>
</tr>
<tr>
<td>11</td>
</tr>
<tr>
<td>2012</td>
</tr>
<tr>
<td>12</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>13</td>
</tr>
<tr>
<td>2014</td>
</tr>
<tr>
<td>14</td>
</tr>
<tr>
<td>2015</td>
</tr>
<tr>
<td>15</td>
</tr>
<tr>
<td>2016</td>
</tr>
<tr>
<td>16</td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>17</td>
</tr>
<tr>
<td>2018</td>
</tr>
<tr>
<td>18</td>
</tr>
<tr>
<td>2019</td>
</tr>
<tr>
<td>19</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Population Aged 65 and Above, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
</tr>
<tr>
<td>4</td>
</tr>
<tr>
<td>2011</td>
</tr>
<tr>
<td>5</td>
</tr>
<tr>
<td>2012</td>
</tr>
<tr>
<td>5.5</td>
</tr>
<tr>
<td>2013</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>2014</td>
</tr>
<tr>
<td>6.5</td>
</tr>
<tr>
<td>2015</td>
</tr>
<tr>
<td>7</td>
</tr>
<tr>
<td>2016</td>
</tr>
<tr>
<td>7.5</td>
</tr>
<tr>
<td>2017</td>
</tr>
<tr>
<td>8</td>
</tr>
<tr>
<td>2018</td>
</tr>
<tr>
<td>7.5</td>
</tr>
<tr>
<td>2019</td>
</tr>
<tr>
<td>8</td>
</tr>
</tbody>
</table>

Source: World Bank (2019a) and DOSM
Malaysia’s social protection response to COVID-19

Social assistance, social insurance and labor market measures have formed an integral part of Malaysia’s Prihatin package and Penjana plan in response to COVID-19. Measures that have been announced included one-off cash transfers, reduced contribution rates to and early withdrawal modalities from EPF savings, wage subsidies, and incentives for training.

The one-off cash transfer, BPN, was announced as part of the Prihatin package and targeted to B40 and M40 individuals and households with the benefit amount varying based on household income. More specifically, RM1,600 was disbursed to 4 million households with income less than RM4,000 per month, RM1,000 was disbursed to 1.1 million households with income between RM4,000 and RM8,000 per month, RM800 was disbursed to 3 million single individuals aged 21 and older with income less than RM2,000 per month, and RM500 was disbursed to 400,000 single individuals aged 21 and older with income between RM2,000 and RM4,000 per month. The transfers to single individuals and households were not exclusive, with single individuals with income below the eligibility threshold being eligible to receive the transfer while their households also remained eligible. Other than the BPN, a series of smaller one-off cash transfers were also made in response to COVID-19, including transfers of RM500 each to civil servants and e-hailing drivers and transfers of RM200 each to all students enrolled in institutes of higher learning. Moreover, BSH beneficiaries received an additional RM100 while all Malaysians were eligible to receive a deposit of RM50 into their mobile wallets.

Reduced contribution rates to and early withdrawal modalities from EPF accounts formed an important part of the response to COVID-19. EPF members were given the option to reduce their contribution from 11 percent to 7 percent of wages from April to December 2020. In parallel, members were also allowed to withdraw RM500 per month from April 2020 to March 2021. These measures were intended to increase households’ liquidity during the crisis, and are estimated to amount to RM50 billion.

Wage subsidies targeted to workers earning RM4,000 or less per month were introduced as part of the Prihatin package to encourage employee retention, initially for three months. The value of the wage subsidies was tied to the number of workers in a company. RM600 per worker per month was allocated for firms with more than 200 employees, RM800 per worker was allocated for firms with 76 to 200 employees, and RM1,200 per worker was allocated for firms with less than 76 employees. Firms with more than 76 employees had to demonstrate that their revenues had fallen by at least half since January 2020, and employers were disallowed from laying off workers covered by wage subsidies and from reducing their wages. The subsidy was only available to companies
certain other skills, and an increase in the training cost that is claimable through the EIS from RM4,000 to RM6,000 for affected sectors, as well as a daily training allowance of RM30 to EIS trainees.

As the economy moves toward recovery, Malaysia will be implementing further measures as part of the Penjana plan that are largely focused on the retention and hiring of workers. Announced on June 5 2020, the Penjana plan extends the existing wage subsidy program for a further three months. In addition, the plan supports firms with a reduced work week and introduces a separate wage subsidy program for the hiring of youth and unemployed workers. It also aims to strengthen job matching efforts particularly through SOCSO’s job portal and allocates funds for the training of unemployed workers including youth and gig economy workers. Moreover, it offers incentives to encourage flexible work arrangements including working from home.

Some measures related to social assistance and social insurance programs were also announced as part of the Penjana plan. Working parents are entitled to one-off e-vouchers of RM800 per household for mobile childcare services. In addition, a public transport subsidy offers discounted unlimited monthly travel passes costing RM30 for the main public transport lines in Kuala Lumpur from mid-June to December 2020. Further, a one-off transfer of RM300 will be made to specific vulnerable groups, primarily the disabled and single mothers. Finally, modest matching grants totaling of up to RM50 million will be given to gig economy platforms that make EPF and SOCSO contributions.

The government has also incentivized training. Measures introduced to this end as part of the initial support packages included double tax deductions on expenses incurred on approved tourism-related training, an allocation of RM50 million to subsidize short courses in digital and registered prior to 2020 and limited to Malaysian employees, and was expected to benefit 4.8 million workers.
An enhanced social protection system can foster equity, resilience, and opportunity

**Equity through protection against destitution**
- BSH cash transfers
- Social assistance benefits and services by JKM
- Education assistance
- ...

**Resilience through insurance against shocks**
- Private sector retirement savings by EPF
- Public sector pensions
- Disability, survivorship, and unemployment insurance
- ...

**Opportunity for all through investments in human capital and jobs**
- Publicly financed skills-building programs
- Levy-financed skills-building programs
- Employment services by JobsMalaysia and others
- ...

---

MALAYSIA ECONOMIC MONITOR | JUNE 2020
Today, the coverage of publicly financed social assistance is high but benefits amount to a small share of per capita income

The coverage of social assistance is high across all income groups, especially among the B20...

Social Assistance as Share of B20 Income, Latest Available Year, Percentage

<table>
<thead>
<tr>
<th>Income Level</th>
<th>Malaysia (2016)</th>
<th>Low Income</th>
<th>Lower Middle Income</th>
<th>Upper Middle Income</th>
<th>High Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low Income</td>
<td>7.8</td>
<td>10.1</td>
<td>13.0</td>
<td>21.2</td>
<td></td>
</tr>
<tr>
<td>Lower Income</td>
<td>34.6</td>
<td>56.8</td>
<td>65.9</td>
<td>66.2</td>
<td></td>
</tr>
<tr>
<td>Upper Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>High Income</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: World Bank staff calculations based on HIS (DOSM) and ASPIRE database
As the level of spending is low as well, impacts on poverty and equity are modest

Malaysia’s social assistance spending is low compared to other countries...

...resulting in modest impacts on the poverty headcount and inequality

Source: Ministry of Finance and ASPIRE Database

Source: World Bank staff calculations based on HIS (DOSM) and ASPIRE database
Coverage of contributory social insurance is far from complete

Malaysia’s coverage of retirement savings institutions is far from complete...

Coverage by Retirement Savings Institutions, 2019, Percentage of Labor Force

- EPF Contributors: 48.9%
- Civil Servants and Armed Forces: 11.9%
- Uncovered: 39.2%

...especially among lower income households

Coverage by EPF, 2016, Percentage of Working Age Population

Source: World Bank staff calculations based on LFS (DOSM), EPF and KWAP

Source: World Bank staff calculations based on HIS (DOSM)
Cash transfers, in-kind transfers and “temptation goods”

One contentious point in disbursing social assistance in the form of cash transfers is that beneficiary households may misuse the cash to purchase so-called “temptation goods.” This is one reason why some countries prefer in-kind transfer programs, even though cash transfers are, on average, more cost-effective in terms of delivering resources to households than in-kind alternatives, at least outside of extraordinary situations where markets break down (Gentilini 2016). In this context, “temptation goods” often refer to alcohol and tobacco, as in Evans and Popova (2017). There are, of course, other temptation goods that can potentially be purchased with cash, but alcohol and tobacco have been studied most extensively (Banerjee and Duflo 2007).

Evidence shows that, if anything, cash transfers reduce expenditure on temptation goods. In a meta-analysis of research on the impact of cash transfer programs on expenditures on temptation goods, Evans and Popova (2017) find that on average, cash transfers actually decrease total expenditure on these goods, irrespective of geography, program design, or program duration. This conclusion is based on the findings from 19 studies in ten countries in Latin America, Africa, and Asia that have used experimental or quasi-experimental design (in other words, studies that are methodologically robust). The finding by Evans and Popova (2017) is consistent across various specifications. While precise reasons behind a negative – as opposed to zero – impact of cash transfers on the purchase of temptation goods have yet to be established, one of the possible explanations mentioned by Evans and Popova (2017) is that cash transfers are often directed at women. They might therefore improve women’s within-household bargaining position, supporting their desire not to spend limited cash on temptation goods.

While the evidence on the impact of cash transfers on the purchase of temptation goods is clear, the effectiveness of cash versus in-kind transfers are dependent on program context and design. In another meta-analysis, Gentilini (2016) compares the effectiveness of cash transfers and food transfers. While he finds that cash transfers are, on average, more cost-effective than in-kind alternatives, context matters. Some of the specific context and design considerations that affect the effectiveness of cash and food transfers include the marginal propensity to consume food, the duration of the program, the frequency of transfers, and perceived risks (such as erosion of purchasing power), all of which affect purchasing and consumption.
behaviors. Further, Gentilini (2016) finds that both cash and food transfers improve a range of indicators related to income, poverty, and malnutrition. Even though the meta-analysis focuses on food transfers, one can expect that the effectiveness of cash transfers relative to other types of in-kind transfers to also be dependent on specific context and design. The key takeaway is that overall effectiveness cannot be generalized and is dependent on the objectives of each program and on the specific indicators used to measure those objectives.
Policies should support COVID-19 recovery efforts and the development of an enhanced social protection system

<table>
<thead>
<tr>
<th>Instrument</th>
<th>Short- and medium-term policies</th>
<th>Long-term policies</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>i. Continue to provide COVID-19 emergency cash transfers until income of B40 recovers</td>
<td>i. Formulate a Social Protection Masterplan based on a functional review of the social protection system</td>
</tr>
<tr>
<td></td>
<td>ii. Deepen social assistance:</td>
<td>ii. Further deepen social assistance:</td>
</tr>
<tr>
<td></td>
<td>• Use BSH/BR1M as a platform for human capital accumulation and productive welfare</td>
<td>• Strengthen core social assistance programs in line with fiscal space</td>
</tr>
<tr>
<td></td>
<td>• Reduce exclusion error through proactive outreach/enrolment</td>
<td>• Promote productive employment and the capacity of social/care workers</td>
</tr>
<tr>
<td></td>
<td>• Replace nontargeted fuel subsidies by a targeted allowance</td>
<td></td>
</tr>
<tr>
<td></td>
<td>iii. Improve the delivery of social protection programs:</td>
<td>iii. Address increasing demand for non-cash support services, especially for older persons</td>
</tr>
<tr>
<td></td>
<td>• Move toward a more standardized and commonly implemented targeting system</td>
<td>iv. Reverse the downward trend in government revenues:</td>
</tr>
<tr>
<td></td>
<td>• Achieve deeper integration or interoperability of information systems</td>
<td>• Increase the progressivity of the personal income tax framework</td>
</tr>
<tr>
<td></td>
<td>• Consolidate front-end service delivery</td>
<td>• Expand the capital gains tax</td>
</tr>
<tr>
<td></td>
<td>iv. Update benchmarks for monetary and non-monetary deprivation</td>
<td>• Restrict items that are SST zero rated or exempted</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Focus the use of tax incentives</td>
</tr>
<tr>
<td>Instrument</td>
<td>Short- and medium-term policies</td>
<td>Long-term policies</td>
</tr>
<tr>
<td>---------------------------</td>
<td>-------------------------------------------------------------------------------------------------</td>
<td>------------------------------------------------------------------------------------</td>
</tr>
</tbody>
</table>
| Contributory social insurance | **i. Strengthen the coverage of old-age income protection:**  
  • Broaden the scope of contributions to cover the self-employed, possibly with auto enrollment and an option to opt out  
  • Work with aggregators, like gig economy platforms  

  **ii. Strengthen the adequacy of old-age income protection:**  
  • Gradually increase the minimum withdrawal age to for EPF Account 1 balances to 65  
  • Convert contributions to EPF Account 2 to retirement savings  
  • Mandate a phased withdrawal for EPF balances  

  **iii. Improve social assistance for older persons through a modest, broadly targeted social pension** | **i. Further strengthen the coverage and adequacy of old-age income protection:**  
  • Unify registration requirements and contribution collection for EPF, SOCSO, and HRDF  
  • Further increase the EPF minimum withdrawal age with increased life expectancy  
  • Consider lowering EPF contribution rates and capping covered wages subject to mandatory contributions  
  • Offer age-based portfolios, longevity insurance, and annuitization options  

  **ii. Further improve social assistance for older persons through a higher coverage or adequacy of social pensions in line with fiscal space** |
MALAYSIA ECONOMIC MONITOR

JUNE 2020

Surviving the Storm

Download the complete MEM