MALAYSIA ECONOMIC MONITOR

DECEMBER 2020

Sowing the Seeds

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Abbreviations

ASEAN	Association of Southeast Asian Nations
B40	Bottom 40 percent (of the population)
BNM	Bank Negara Malaysia
BPN	National Caring Aid (Bantuan Prihatin Nasional)
BSH	Cost of Living Aid (Bantuan Sara Hidup Rakyat)
CAGR	Compound Annual Growth Rate
CMCO	Conditional Movement Control Order
COVID-19	Coronavirus Disease 2019
CPI	Consumer Price Index
CPTPP	Comprehensive and Progressive Trans-Pacific Partnership
DE	Development Expenditure
DFI	Development Finance Institution
DOSM	Department of Statistics Malaysia
E&E	Electricals and Electronics
EAP	East Asia and Pacific
EMCO	Enhanced Movement Control Order
EMDEs	Emerging Market and Developing Economies
EPF	Employees Provident Fund
FBM KLCI	FTSE Bursa Malaysia Index
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GFCF	Gross Fixed Capital Formation
GLC	Government Linked Corporation
GNI	Gross National Income
GST	Goods and Services Tax
GVCs	Global Value Chains
HIES	Household Income and Expenditure Survey
IMF	International Monetary Fund
IPI	Industrial Production Index
LCR	Liquidity Coverage Ratio
LFPR	Labor Force Participation Rate
LHDN	Inland Revenue Board (Lembaga Hasil Dalam Negeri Malaysia)
LPI	Logistics Performance Index
LTGM	Long Term Growth Model
M40	Middle 40 percent (of the population)
MADA	Muda Agricultural Development Authority
MCO	Movement Control Order
MEM	Malaysia Economic Monitor
METS	Malaysia External Trade Statistics
MGII	Malaysia Government Investment Issues
MGS	Malaysian Government Securities
MITB	Malaysian Islamic Treasury Bills
MOF	Ministry of Finance Malaysia
MPC	Monetary Policy Committee
MTFF	Medium-Term Fiscal Framework
MTRS	Medium-Term Revenue Strategy
NCD	Noncommunicable Disease
OE	Operating Expenditure
OPR	Overnight Policy Rate
PLI	Poverty Line Income
PPP	Public Private Partnership
PPTS	Percentage Points
RCEP	Regional Comprehensive Economic Partnership
RMCO	Recovery Movement Control Order
RMK12	12th Malaysia Plan
SOEs	State Owned Enterprises
SOPs	Standard Operating Procedures
SMEs	Small and Medium Sized Enterprises
SRR	Statutory Reserve Requirement
SST	Sales and Services Tax
T20	Top 20 percent (of the population)
TEMCO	Temporary Enhanced Movement Control Order
TFP	Total Factor Productivity
Y/Y	Year-on-Year


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Summary

The COVID-19 pandemic has exacted a heavy toll on Malaysia's economy

In 2020, the country experienced its sharpest recession in twenty years due to the impact of a triple shock related to the direct health impact of the pandemic; the economic impact of domestic restrictions on movement; and the impact of a synchronized global recession on Malaysia's tradeable sectors.

Malaysia's economy is projected to grow by 6.7 percent in 2021, after contracting by 5.8 percent in 2020. However, the rebound in economic activity is subject to numerous uncertainties such as the deployment of an effective vaccine and the robustness of a rebound in global growth. Notwithstanding a growth rebound in 2021, Malaysia is not expected to recover fully from the shock of COVID-19 within the next few years.

The Malaysian government has delivered a series of economic response packages to mitigate the impact of the crisis. Public policies, including cash transfers, wage subsidies and loan moratoria, have helped reduce the impact of the pandemic on vulnerable households and firms.

While these measures have been vitally necessary, they have been implemented at a time when the government is experiencing a dramatic decline in revenues, creating a challenge to the medium-term fiscal outlook. Like governments across the world, Malaysia has depleted much of its available fiscal space and will exit the crisis with a larger burden of debt and contingent liabilities. This has resulted in difficult intertemporal constraints for the government to further expand expenditures on relief measures and consumption-supporting stimulus today, which may leave the government less equipped to invest in lasting recovery and growth tomorrow without the support of a stronger revenue base.

> The rebound in economic activity is subject to numerous uncertainties such as the deployment of an effective vaccine and the robustness of a recovery in global growth

When the current situation stabilizes and recovery becomes more entrenched, the government should refocus its fiscal policy to rebuild buffers against future shocks and to sustain public financing for inclusive, long-term growth. Addressing the fiscal

legacies of the present crisis and the pre-existing structural weaknesses constraining the government's ability to counter economic shocks and sustainably finance shared prosperity will require comprehensive medium-term plans to enhance revenue mobilization.

Looking to the future, to seize new growth opportunities and to overcome potentially long-lasting challenges brought on by the COVID-19 crisis, the government will need to consider bold structural reforms intended to ensure more durable, inclusive growth in a post-pandemic environment. Beyond its short-term consequences, the unique nature of the pandemic and its exceptional severity are also likely to have profound effects on long-term growth prospects. These effects may arise from various interlinked factors that will exacerbate the demand and supply shocks that the economy is facing.

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 food and agricultural sector and the role it can play in supporting a resilient recovery and future growth. The COVID-19 crisis has drawn attention to the food system and the continued relevance of food security as well as the need for food policy to focus on a wider range of risks and opportunities.

With Malaysia on the cusp of achieving high-income status, its current policy orientations have left it with a two-speed agricultural economy. By modernizing and diversifying its agrofood sector and better integrating it with its more dynamic "farm-to-fork" food economy, Malaysia could help advance other national priorities.

The structure and performance of these sectors have broad relevance to Malaysia's achievement of higher levels of inclusion, resilience, competitiveness, jobs growth, long-term economic growth, and sustainability. With the writing of the 12th Malaysia Plan and the rewriting of food security policy at hand, Malaysia faces at least two immediate opportunities to lay out a higher vision for its agrofood sector and adopt a befitting set of policies.

Recent economic developments

In the third quarter, with the easing of pandemic-related movement restrictions following the implementation of the Recovery Movement Control Order (RMCO), Malaysia's economy continued to contract, albeit at a much lower rate than in the previous quarter, at -2.7 percent (Q2 2020: -17.1 percent). The improvement in economic activity was broad-based across all sectors, led by the manufacturing sector which recorded a positive growth of 3.3 percent during the quarter (Q2 2020: -18.3 percent). Services, construction and mining sectors recorded smaller declines as movement restrictions were relaxed. The agriculture sector posted a small decline of 0.7 percent (Q2 2020: 1.0 percent), following slower growth of fishing, forestry and logging, rubber and the oil palm segments, which offset the gains recorded in the aquaculture and livestock segments.

Domestic demand also improved following the transition to the RMCO. Private consumption recovered to a considerable degree, with a much smaller contraction of 2.1 percent during Q3 2020 from -18.5 percent in Q2 2020. Various income support measures such as the *Bantuan Prihatin Nasional* cash transfers, wage subsidies and the *i-Lestari* Employees Provident Fund withdrawals boosted household spending during the quarter. Meanwhile, growth in public consumption rose from 2.3 percent in Q2 2020 to 6.9 percent in Q3 2020 from higher spending in supplies and services, and in emoluments.

Over this period, while aggregate investments continued to contract, the rate of contraction declined. Gross fixed capital formation contracted 11.6 percent in Q3 2020 (Q2 2020: -28.9 percent). The lower contraction in investments were driven by resumption in both private and public investments.

A number of other selected indicators suggest that there has been a gradual pick-up in economic activity. These include the manufacturing PMI and industrial production index for the manufacturing cluster which have been on an upward trend since April. Nevertheless, the recent re-imposition of CMCO following a surge in the number of new COVID-19 cases could dampen the pace of recovery in the near term.

Headline inflation remained negative in recent months. Headline inflation stood at -1.4 percent during Q3 2020 (Q2 2020: -2.6 percent) driven by lower

transportation costs as retail fuel prices remained below their levels last year. Core inflation moderated slightly to 1.0 percent (Q2 2020: 1.2 percent) due mainly to lower rental and accommodation prices.

Malaysia is currently experiencing a third wave of COVID-19 infections. After successfully managing the pandemic and bringing the number of daily cases to single digits in July, there has been a surge in infections since mid-September, with the number of new cases hovering between 1,000 and 2,000 at the national level.

Following the emergence of this third wave, the government re-introduced a stricter CMCO in most parts of the country. As a result, mobility in public places, including commercial spaces, has been restricted. Despite the imposition of these restrictions, the number of daily cases remain elevated. Both the resurgence of COVID-19 infections and containment efforts have dampened Malaysia's near-term economic recovery.

Malaysia's exports improved over the quarter, largely due to improved external demand. Gross exports expanded at the rate of 4.4 percent (Q2 2020: -15.1 percent), with the increase in the exports of manufactured and agriculture goods driving this recovery. The increase in manufactured exports was due to a rebound in E&E exports, especially to major trading partners such as China and the US; by firms fulfilling a large backlog of orders; and by an increase in the demand for work-from-home appliances, servers and medical devices. Over the same period, the contraction in gross imports eased (Q3 2020: -6.3 percent vs. Q2 2020: -15.1 percent) mainly due to the decelerating contraction in intermediate imports. The current account surplus increased considerably, from 2.5 percent of GDP in Q2 2020 to 7.1 percent in Q3 2020, due to higher goods surplus and secondary income balance. The conclusion of RCEP negotiations in November 2020, which will lead to the formation of the world's largest preferential trade area, is expected to be supportive of Malaysia's exports in the years ahead.

With the gradual re-opening of the economy, the unemployment rate has declined slightly from its peak of 5.1 percent in Q2 2020 to 4.7 percent in Q3 2020. At the same time, the implementation of movement restrictions since Q1 2020 has contributed to relatively high skills- and time-related underemployment rates.

The financial sector has remained resilient. The Central Bank of Malaysia (BNM) kept the Overnight Policy Rate (OPR) at 1.75 percent since July 2020. Despite pressure on earnings, banks maintained healthy capital and liquidity positions throughout H1 2020. The deferment of all loan and financing repayments has given businesses and households breathing space, although impairment ratios edged upwards to 1.43 percent overall in October 2020, albeit from historically low levels, driven by the household segment. These rates are expected to increase once the moratorium period ends.

The fiscal deficit is expected to widen to 6.0 percent of GDP in 2020 due to the economic downturn and the government stimulus measures. The fiscal deficit for 2020, initially projected in the Budget 2020 to stand at 3.2 percent of GDP, is now expected to widen to 6 percent of GDP (RM86.5 billion), compared to 3.4 percent in 2019. Expenditure is expected to increase by 3.4 percent of GDP, while revenue is expected to increase only by 0.6 percent of GDP, resulting in a 2.8 percent increase in the fiscal deficit.

The wider fiscal deficit resulted in a rise in federal government debt. Following the increase in government borrowing, government debt had risen to 60.7 percent of GDP by the end of September 2020. In order to expand fiscal space in response to the crisis, parliament passed the Temporary Measures for Reducing the Impact of COVID-19 Act 2020, which allows the government to temporarily raise the statutory limit on government debt from 55 percent GDP until 2023. The Act sets the domestic debt limit at 60 percent of GDP and at the end of September it stood at 56.6

percent of GDP. Federal government borrowings have continued to be mostly ringgit-denominated with a wide range of maturities, limiting exposure to exchange rate and rollover risks.

Budget 2021 aims to provide support to lives and livelihoods, and introduces various measures to facilitate an economic recovery. The budget includes various measures that would enhance social protection for vulnerable groups by increasing the benefit level and expanding the beneficiary coverage of cash transfer programs. And to support economic recovery, the budget introduces new measures for upskilling and reskilling, with particular emphasis on specific groups of workers including the youth, the long-term unemployed, the disable and those who have lost their jobs during the crisis.

While the government is expecting a nominal increase in revenue collection in 2021; in proportion to GDP, revenue is projected to continue to decline. Federal government revenue is expected to decline further to 15.1 percent of GDP in 2021, almost one-third lower than its level in 2009 and well below the averages for upper-middle-income and high-income countries. Malaysia's declining trend in revenue collection will increasingly constrain the government's ability to counter future shocks and sustainability finance its longer-term inclusive growth agenda.

The fiscal deficit in 2021 is projected to narrow to 5.4 percent, mainly driven by an increase in output. Although government expenditure is projected to rise in 2021, the expected increase in aggregate GDP and government revenue collection is likely to lead to a narrower budget deficit. The primary deficit is also projected to shrink to 2.9 percent of GDP in 2021, down from 3.6 percent in 2020.

The government's Medium-Term Fiscal Framework (MTFF) targets a fiscal consolidation path to reach a budget deficit averaging at around 4.5 percent of GDP over the period 2021-2023. The MTFF assumes an average GDP growth rate of 4.5 to 5.5 percent over the next three years. Furthermore, it assumes an average crude oil price of USD45 to 55 per barrel coupled with a projected daily production of 580,000 barrels. A new Medium-Term Revenue Strategy (MTRS) aims to broaden the revenue base, identify new sources of tax, reduce leakages (including via the informal sector) and enhance targeting of tax incentives.

Economic outlook

While the global economy is expected to improve going into 2021, output is not expected to return to pre-pandemic levels in the near term. The global economy is projected to grow at the rate of 4.2 percent in 2021, after contracting by 5.2 percent in 2020. This recovery is predicated on a gradual improvement in confidence, consumption, and trade, assuming the rollout of an effective vaccine starting in early 2021. In the East Asia Pacific region, growth is expected to strengthen to 6.6 percent in 2021 (2020f: 0.5 percent), led by a strong rebound in China.

Malaysia's economy is projected to grow by 6.7 percent in 2021. This rebound can be attributed to a low base in 2020, continued improvements in exports and a gradual build-up of momentum in private consumption and investment.

The strength and timing of Malaysia's economic recovery will depend largely on the timely availability of an effective mass vaccination program. Malaysia is expected to receive its vaccine supply in stages, with the first batch of COVID-19 vaccines expected to arrive in Q1 2021, which would allow the vaccination of at least 20 percent of the Malaysian population by the end of 2021. The vaccine rollout is likely to boost consumer and business confidence, contributing to a gradual strengthening of private sector activity.

Consumption and investment are expected to see a return to growth. As the key driver of growth, private consumption is expected to rebound to 7.4 percent growth (2020f: -4.8 percent), benefitting from better management of COVID-19, prospects of improved labor market conditions, continued support from pandemic related stimulus measures including personal income tax reductions and tax reliefs, cash transfers and targeted repayment assistance provided by BNM. Gross fixed capital formation is projected to turnaround and grow by 7.2 percent (2020f: -13.4 percent), supported by expansions in public and private investment.

Exports will likely gain momentum on the back of recovering global demand. In the absence of another wave of infections, exports will likely register stronger growth of 8.9 percent in 2021 (2020f: -9.3 percent) as global demand firms. The recovery in economic activities in regional countries, led by China, will also contribute to improvements in goods exports.

Headline inflation is projected to increase modestly in 2021. The average consumer price inflation rate is projected to increase to 0.8 percent next year (2020f: -1.0 percent). Underlying inflation is expected to be broadly contained into 2021 in the absence of immediate domestic cost pressures.

Despite the rebound in growth in 2021, it is anticipated that in the medium term, the Malaysian economy's output will only gradually return to its pre-pandemic levels. With the pandemic leaving indelible scars on productivity through its effects on investment, labor supply and human capital, this is expected to generate substantial headwinds in the recovery process and see the economy modestly progress toward the path of economic activity projected before the COVID-19 pandemic.

The growth outlook is subject to considerable downside risks. On the external front, unexpected delay in the global rollout and distribution of vaccine could lead to "on-and-off" lockdowns in advanced economies and amplify downside risks to growth. Domestically, a prolonged and ineffective containment of the third wave of outbreak in Malaysia could see the current CMCO in high-risk areas be extended and the number of vulnerable households without adequate support remain elevated. Furthermore, ongoing domestic political uncertainty could continue to dampen private investment sentiment.

In the near term, containing the COVID-19 outbreak and protecting the most vulnerable remain the topmost priorities to prevent a more protracted downturn. This requires sustained efforts to ensure smart containment through appropriate mitigation and control measures, including targeted CMCO and EMCO in high-risk areas; large-scale testing; and contact tracing to limit the spread of the virus. Lack of certainty regarding the extent, duration and severity of the renewed outbreak and its economic consequences suggest that additional targeted social spending may be required.

As health risks diminish and economic recovery is underway, the policy focus will need to shift towards facilitating necessary economic adjustments to enable new growth in the post-pandemic environment. This implies that temporary fiscal support to preserve existing jobs and firms should be gradually phased out as conditions improve, while measures to incentivize job creation and investment in expanding sectors and facilitate upskilling and reskilling of workers could be expanded.

As the recovery becomes more entrenched, fiscal policy should refocus on rebuilding buffers to counter future shocks and on sustaining public financing to ensure higher levels of inclusive, long-term growth. Fiscal policy should strive towards raising revenue and enhancing spending efficiency. In terms of revenue, the government may consider strategies that prioritize increasing the progressivity of the personal income tax framework; removing exemptions from consumption taxes on non-essential items; expanding capital gains tax; exploring other forms of progressive taxes, including wealth taxes; maximizing gains from tax expenditures; and enhancing revenue administration. In terms of expenditure, the government may focus on containing the rising costs of public wage bill and pensions; improving the targeting of social spending; phasing out generalized subsidies; and strengthening public investment project selection and management.

Sowing the seeds

Malaysia's agricultural sector has been a key enabler of the country's economic transformation over the past fifty years. The sector has played a critical role in Malaysia's development by supplying food to an urbanizing population, releasing labor to the non-primary sectors, providing inputs used in agro-processing and other forms of manufacturing, generating investible capital, and earning foreign exchange. Today, the agricultural sector is the smallest economic sector, behind services and industry, accounting for approximately 11 percent of employment and 7 percent of GDP.

Yet the COVID-19 crisis has highlighted the continued importance of the agricultural sector to the country going forward; and this edition of the MEM looks at the potential role of a strengthened agrofood economy in achieving shared prosperity, sustainable long-term economic growth, and other national priorities. When it first struck, the pandemic brought food into focus because a situation involving economic shutdowns of such unprecedented scale necessarily raised concerns about the security and dependability of food access and supply. And while worst-case scenarios have not played out, the crisis has indeed had ripple effects on the food economy with impacts on food security and welfare that have yet to be fully assessed.

The pandemic has brought attention to the multifaceted and interconnected nature of Malaysia's food system, with increased focus on issues related to food security and agrofood policy in broader terms. Today, food insecurity often relates more to problems of diet quality, healthy food affordability, and food choices, than to shortages of staple food availability. And this has continued to be true during the pandemic as food insecurity has been fueled more by the loss of income than by the initial short-lived disruptions that affected food supply. Meanwhile, it is not just the crisis that invites renewed interest in and a new perspective on agriculture.

Just as COVID-19 has brought the food system into national focus together with new perspectives on food security, accession to high-income status will also offer a new lens through which Malaysia will view its agrofood sector. In high-income contexts in which the day-to-day concerns about the adequacy of staple food supply are largely allayed, societies tend to start expecting more of their food systems. Better performance comes to be expected across a widening set of domains as growing attention is paid to value addition, the quality of diets, the environmental footprint of food across its lifecycle, labor protections for food chain workers, animal welfare, and the vibrance of food culture.

From either standpoint, despite obvious strengths, Malaysia's current agricultural policy seems to have some "blind spots:" under-appreciated and under-addressed risks and opportunities for food security and agrofood system development. In particular, despite the declining place of rice in Malaysians' diets or the agro-economy, Malaysia spends more public resources on rice than on any other agricultural product. Furthermore, resources supporting the rice sector are mostly channeled through instruments of a highly protectionist and market-distorting kind. These aspects of agricultural policy have seemingly contributed to Malaysia having a two-speed agricultural economy in which the agrofood side of the sector—as distinct from the plantation side—has significant unfulfilled potential.

> By modernizing and diversifying its agrofood sector and better integrating it with its "farm-to-fork" food economy, Malaysia could help advance other national priorities

Malaysia has huge underexploited potential to serve the varied demands of a modern agrofood economy, both domestically and regionally. While national agrofood policies have remained focused on target levels of rice self-sufficiency, Malaysia has become increasingly reliant on net imports of much of the higher-value foods it eats; and it has not become a major exporter of fruits and vegetables as its own consumption of these products has risen. Malaysian households already spend about three times more on fruits and vegetables and more than twice as much on breads and other cereals than on rice. Not only domestically but across Asia, ongoing demographic shifts are changing how much consumers spend on food, how and where they shop for it, what and where they eat, and even what they value in food. Malaysia is nearly 80 percent urbanized and its middle class is expanding; and the entire Asian middle class could expand to 3 billion people within a decade.

These demographic, socioeconomic, and cultural changes point to significant growth possibilities for private businesses and jobs to develop up and down food supply chains. They lie not only in the production of more diverse and higher-value food products but also in the development of advanced farm technology and service industries, food processing, logistics and wholesale, and further downstream, a diversity of food services and retail formats addressing both consumer and post-consumer needs. In the upstream segments of food supply chains (that is, for the agricultural sector), the name of the game will be to better respond to, link, or even help shape food sector changes. And as it does so, the fact that the agricultural sector has been a latecomer to the digital economy only points to further growth potential. In this and other domains, Malaysia will benefit from investing in human and social capital, innovation, quality infrastructure, and risk management.

Doing so could help Malaysia to more fully leverage its rich food culture and agricultural potential to dynamize its urban economy and brand itself globally. To date, Malaysia has not used its food sector as much as possible to market itself to investors or global talent, to cultivate familiarity or an image of modernity, safety, or stability—as Thailand has to its advantage. Malaysia can still do more to differentiate itself, through its agrofood exports, as a purveyor of superior products in terms of flavor, variety, sustainability, safety, Halal-compliance, labor protections, or any number of other aspects of quality—thereby creating a "halo effect" of potential benefit to other sectors of the economy.

Meanwhile, Malaysia's rice-centric agricultural policy has inadequately addressed a number of existing and emerging challenges of the agrofood economy, including inequity, health, and environmental ones. In particular, while extreme poverty is nearly a reality of the past in Malaysia, including in rural areas, farming has largely remained synonymous with poverty of the relative kind. A large majority of the farmers growing the national staple food, rice, are among the poorest members of society (the B40). Malaysia also faces several dietary health challenges, including nutritional ones. Over one-fifth of its young children face diminished life prospects because they are stunted; and rates of chronic conditions like diabetes and high body mass have generally risen over the past decade. Malaysian agriculture is also contending with a widely shared rise in environmental stressors, climate change, and biosecurity risk. Notably, over 70 percent of emerging infectious diseases in humans have their source in animals and animal agriculture is one of their major vectors.

Although agriculture cannot "solve" poverty, chronic disease, or biosecurity challenges on its own, making health a key driver of agricultural policies will help make doing so more attainable. Malaysia has already adopted progressive policies including a sugar-sweetened beverage tax and a sodium reduction strategy to improve diet quality at the consumer level; but Malaysian agriculture is still lacking in nutrition-sensitivity. In addition to remedying that, Malaysia will also need robust strategies to mitigate various sector risks ranging from zoonosis to resource competition, pollution, and climate change. A focus on supplying a diversity of minimally processed, and multiply valuable plant-based foods will generally be helpful across all of these endeavors, including in attenuating nutritional, food safety, biosecurity, and environmental hazards, and in raising incomes.

Malaysia can expect more from its agrofood economy and should be deploying public resources accordingly. Today, the orientation and quality of public spending in agriculture needs to be re-assessed—both because of what it is doing, and what it is not. The problem is not that Malaysia cannot afford what it is spending on the agrofood sector. For a soon to be high-income country, the core issue to address is how to "spend better" in ways that align better with evolving food system aspirations. For example, Malaysia could be building an agricultural sector that is more responsive to the country's contemporary food economy, including by developing the capacity to supply more of the high-value foods that the region and Malaysia consume—including fragrant rice varieties. It could be developing a modern periurban farm sector connected to urban markets with advanced logistics. It could position itself to lead in the supply of "healthy and safe" produce to the region. It could be training and attracting a next generation of agrofood system entrepreneurs across a wide variety of disciplines. An agricultural sector vested with the belief that it can modernize and "change the world" will become one that Malaysia's youth and best minds want to join and work to build. If not that, the agricultural sector will likely continue to be a purveyor of low-quality and informal employment, and a magnet for economic precariousness, transience, and social instability.

Opportunities for new directions in agrofood policy are at hand: Malaysia has at least two major and immediate platforms to update its agrofood sector policies, better calibrating its objectives and means to higher standards and aspirations. In particular, the RMK12 will give Malaysia the chance to sustain its existing level of commitment to but redouble its belief in the potential of the agricultural and food

economy. In this context, to strategically increase the efficacy and efficiency of agricultural public expenditure, Malaysia can, first, shift the strategic focus from increasing (paddy) production and (rice) self-sufficiency to policies that reflect a more holistic view of food security, agricultural growth and competitiveness, and rural development. In all of these areas, farm profitability, diet quality, food safety, environmental sustainability, and biosecurity would become central concerns. Second, Malaysia can intensify efforts to modernize and diversify the agrofood sector to boost the incomes of rural households. This will involve more balanced investment in the agrofood sector and policy reforms that enable and stimulate the private sector to develop in new and more rewarding directions. Third, it can focus spending more on public goods and provide private goods only to overcome well-defined market failures—with a view to stimulating productivity- and innovation-led as opposed to input-led growth.

In parallel to the RMK12, the rethinking of national food security strategy that is underway is an opportunity to bring appropriate balance to this area of policy. A better balance between ensuring a stable supply of rice on the one hand, and access to a diversity of healthy foods on the other, will be more effective, as will a rebalancing that accounts for the determinants of both urban and rural food insecurity. In light of persistent nutritional deficiencies and a rising burden of chronic disease, food security policy also needs to take a wider range of dietary health outcomes into consideration. For the agricultural sector, the overarching implication is to put less policy focus on paddy production and rice self-sufficiency. "Right-sizing" the place of rice in agricultural policy will, over time, enable Malaysia to produce and market a wider range of foods more affordably, while boosting access to them by supporting higher agricultural incomes.

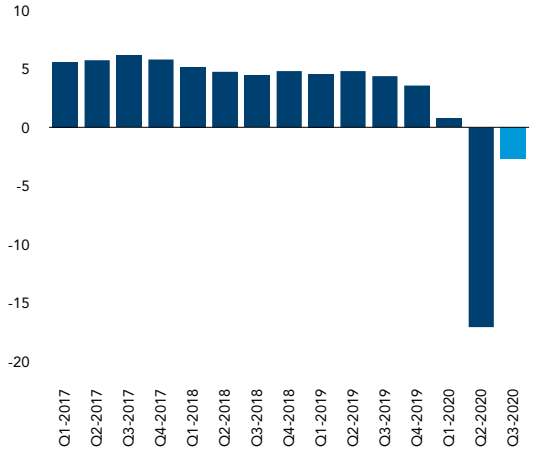
Beyond the two entry points for reform already flagged, the opportunity exists to introduce an agrofood system perspective in other national policy initiatives and strategies. Those would include ones relating to developing the digital economy, combatting non-communicable diseases, planning for pandemic prevention and response, guaranteeing consumer protection (or food safety), adapting to climate change, expanding and enhancing higher education, designing smart cities, and other themes.

In the coming years, Malaysia will want to make every effort to modernize and diversify its agrofood sector and integrate it into its more dynamic "farm-to-fork" economy. Doing so will help it advance several national priorities; indeed, the food system, agriculture included, has broad relevance to inclusion, resilience, competitiveness, jobs, long-term economic growth, and sustainability. The needed reorientation of the aims and means of policy will also help the agrofood sector better align with what comes to be expected in a high-income country.

Recent trends in Malaysia's economy

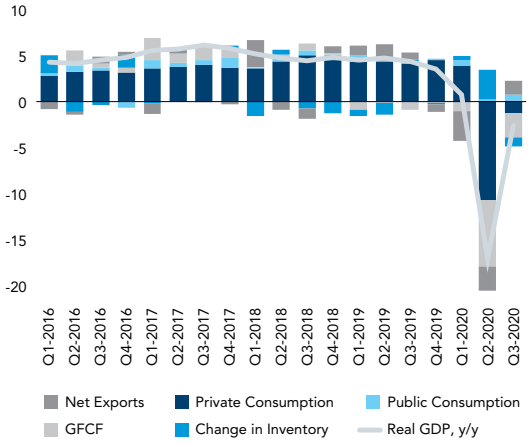
Malaysia's economy posted a smaller contraction of 2.7 percent in Q3 2020...

GDP, y/y, Percentage



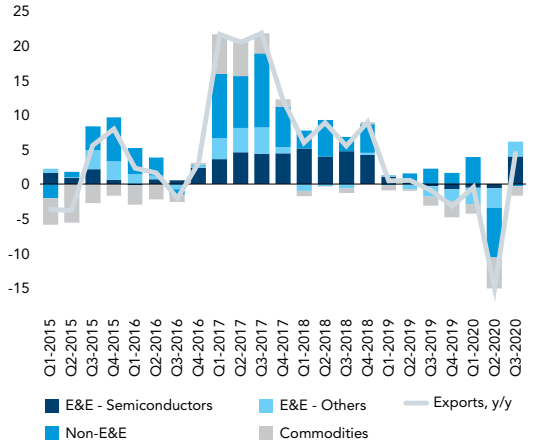
...driven by an improvement in both domestic and external demand

Contribution to GDP, y/y, Percentage



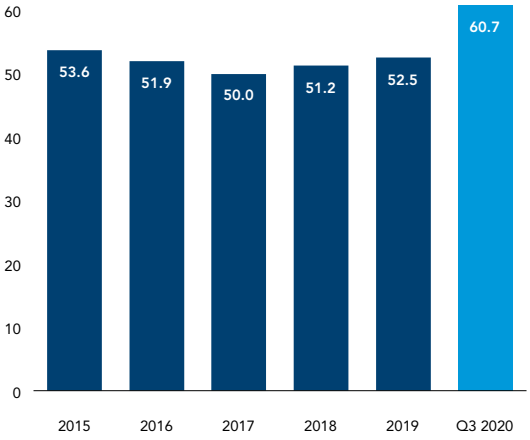
The export recovery has been led by the E&E sector

Contribution to Export Growth, y/y, Percentage



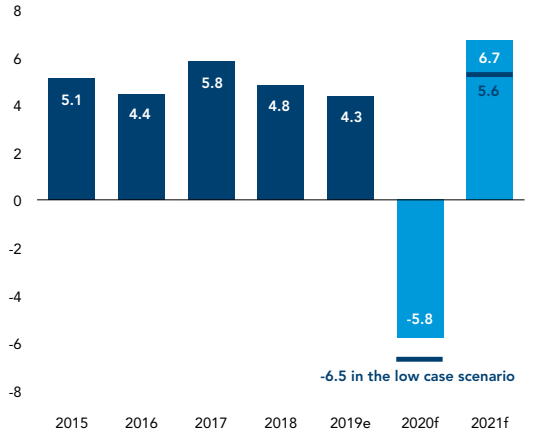
In line with the wider budget deficit, government debt rose in 2020

Federal Government Debt, Percentage of GDP



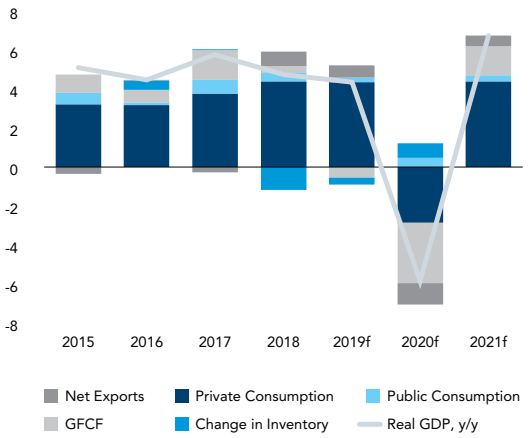
Malaysia's economy is forecast to grow by 6.7 percent in 2021, after contracting by 5.8 percent in 2020...

GDP, y/y, Percentage



...reflecting a broad-based rebound in consumption, investment and exports

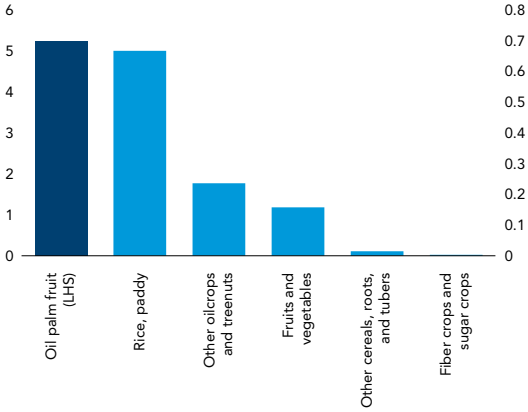
Contribution to GDP, y/y, Percentage



Sowing the seeds

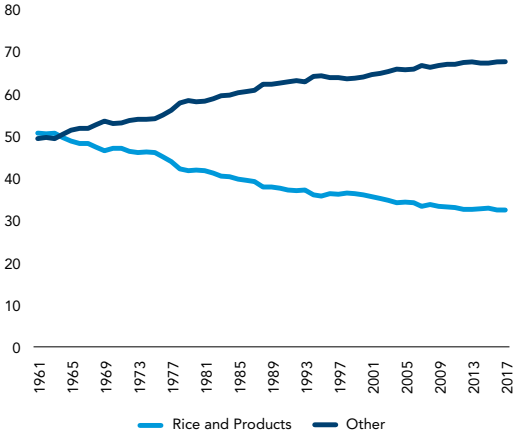
Malaysia has remained focused on producing few crops...

Malaysia's Crop Mix, 2018, Millions of Hectares



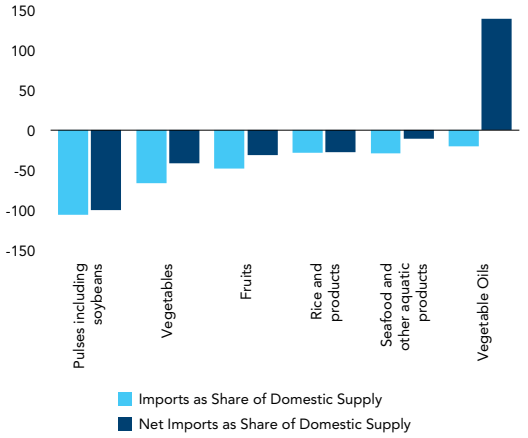
...while what it and the region consumes has greatly diversified

Food Supply in 15 Eastern and Southeast Asian Countries, 1961-2017, Percentage



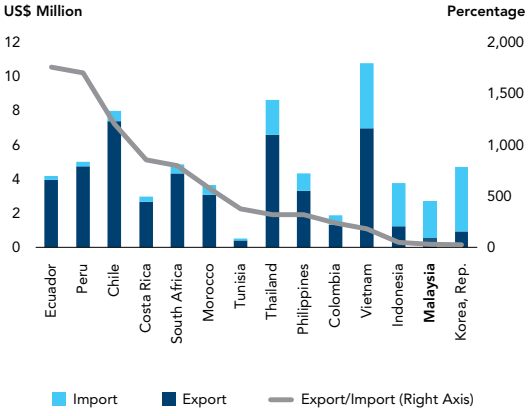
Malaysia has become a net-importer of some of the higher-value foods it consumes

Imports and Net-Imports as a Share of Domestic Supply of Selected Food Groups, 2017, Percentage



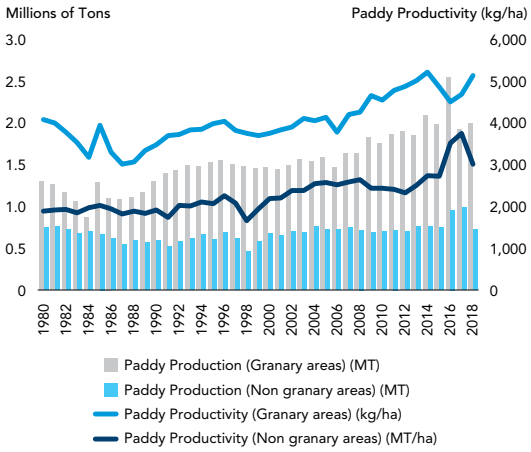
Malaysia's exports of fruits and vegetables have not increased commensurately with imports as much as in other countries

Fruit and Vegetable Trade in Selected Countries, 2019



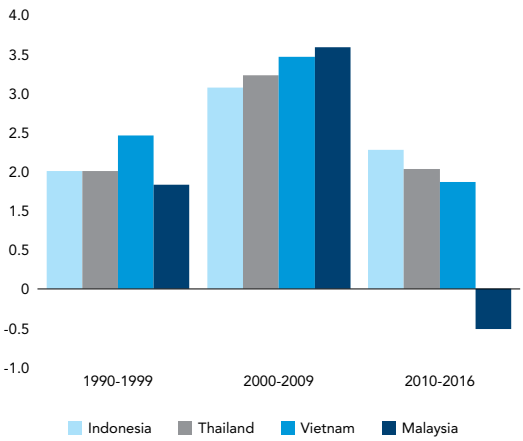
Paddy output and yields have not been highly responsive to supportive policies

Paddy Production and Yields in Granary and Non-granary Areas in Millions of Tons and Tons Per Hectare, 1980-2018



Malaysia's agricultural total factor productivity may be running out of steam

Agriculture Total Factor Productivity, Growth by Decade, in Selected Countries,1990-2016, Percentage

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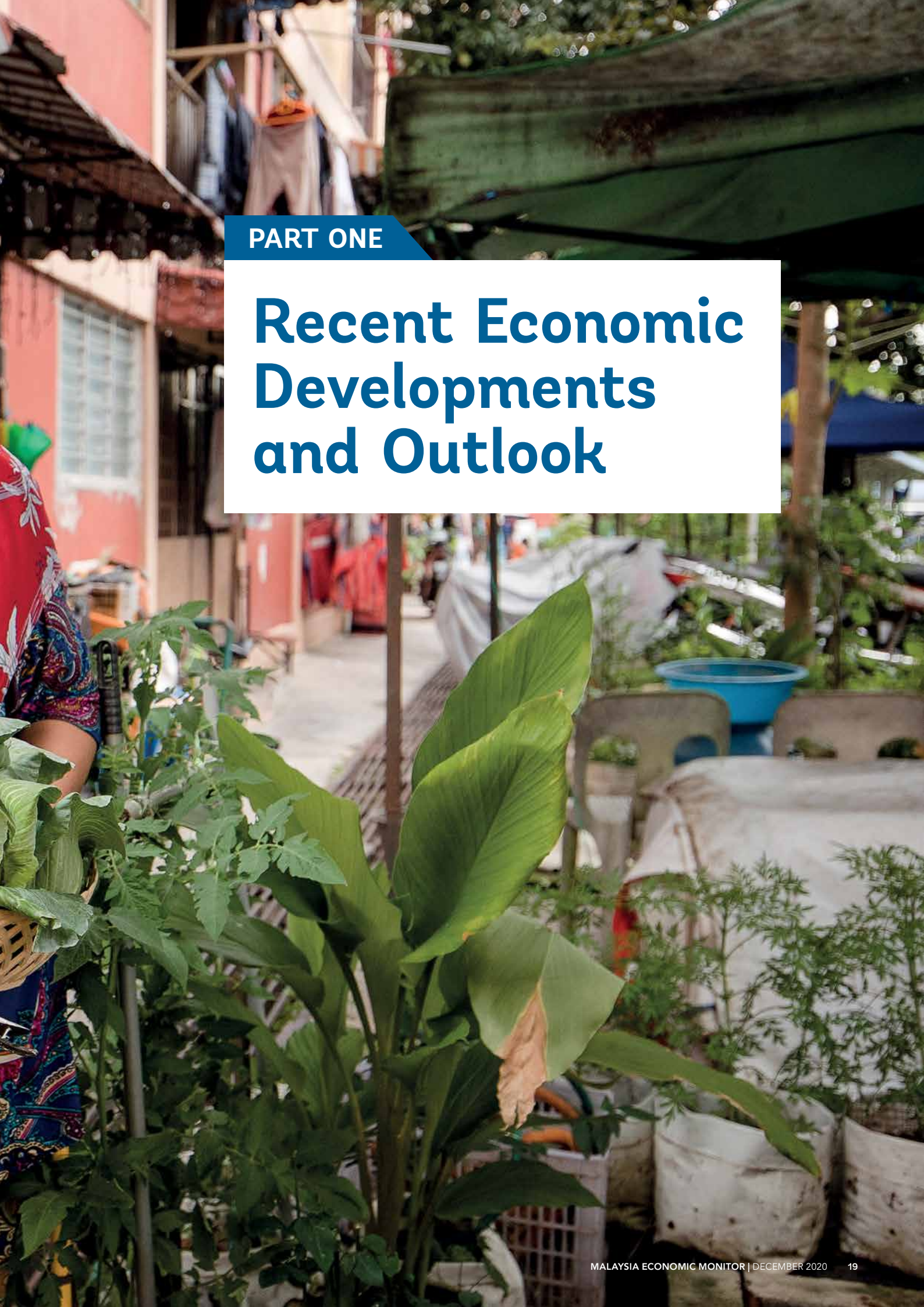


PART ONE

Recent Economic Developments and Outlook

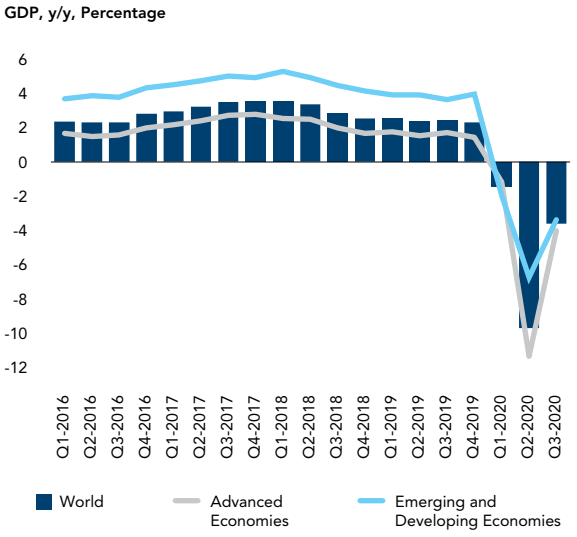
Recent economic developments

Global economic recovery has slowed in recent months, with COVID-19 surging in several major economies

After an initial rebound in Q3 2020, the global economic recovery has decelerated in recent months (see Figure 1). Following a sharp contraction in H1 2020, global economic activity rebounded strongly in Q3 2020, with the gradual easing of stringent pandemic-related restrictions across most economies. However, a rapid resurgence of COVID-19 in several major economies in recent months, and the containment measures re-imposed to rein in its spread, have resulted in a slowdown in the pace of the nascent recovery. Recent data suggest that while global manufacturing activity has continued to recover strongly, the rebound in the services sector appears to have slowed. Global financial conditions have remained loose, reflecting exceptional monetary policy accommodation in most economies, but underlying financial vulnerabilities have continued to increase, with rising debt levels and weakening bank balance sheets.

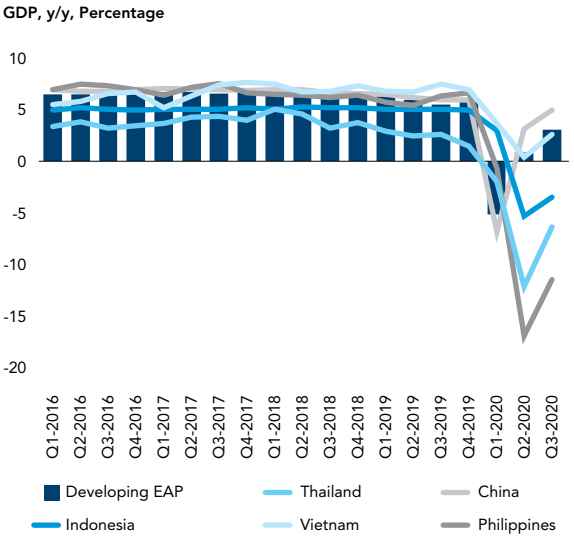
While economic activity in the developing East Asia and Pacific (EAP) region has also picked up since Q2 2020, the pace of recovery has varied considerably across countries (see Figure 2). In China and Vietnam, which were both relatively successful at containing the pandemic in the period following Q1 2020, economic growth has rebounded sooner than

FIGURE 1
The global economic activity picked up considerably in Q3 2020



Source: World Bank Global Economic Prospects

FIGURE 2
Economic conditions in the developing EAP region have also improved, with significant cross-country differences



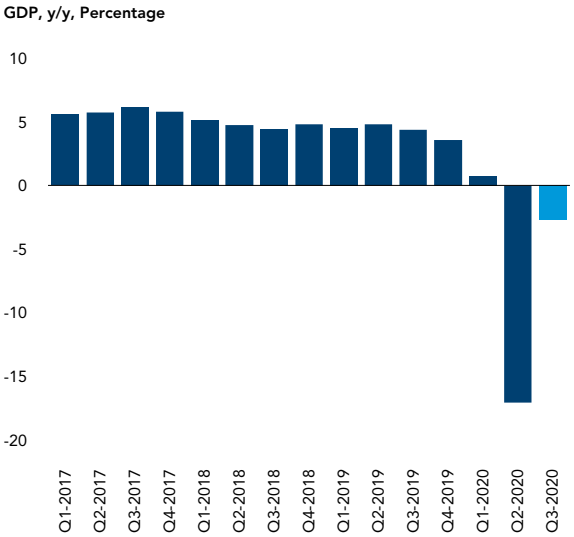
Source: World Bank Global Economic Prospects

expected, supported by a sustained resumption of production and trade; considerable stimulus-fueled public investment; and relatively strong levels of foreign direct investment (Vietnam). While the sharp contraction in other developing EAP countries bottomed out in Q2 2020, the recovery has been dampened by sustained increases in COVID-19 infections and the re-imposition of pandemic-control measures in a number of regional economies, including Indonesia, the Philippines and Myanmar.

In Q3 2020, Malaysia's economy recorded a smaller contraction as movement restrictions were eased

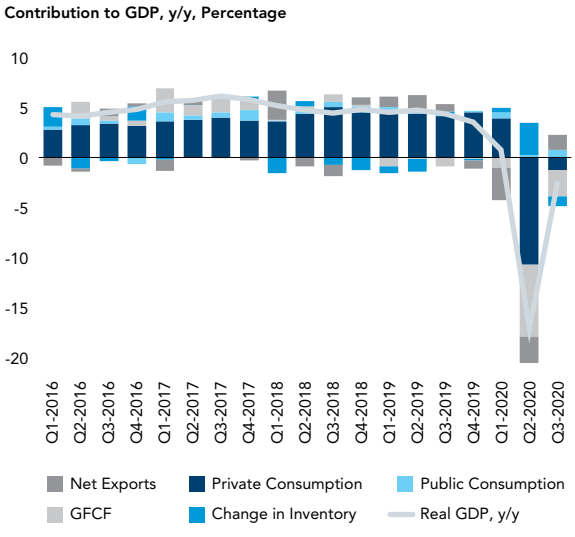
With the easing of pandemic-related movement restrictions following the implementation of the Recovery Movement Control Order (RMCO), Malaysia's economy posted a smaller contraction of -2.7 percent in Q3 2020 than in the previous quarter (Q2 2020: -17.1 percent) (see Figure 3). Malaysia experienced a broad-based improvement across all sectors, with the manufacturing sector recording a positive growth of 3.3 percent (Q2 2020: -18.3 percent). This improvement was driven by a strong rebound in the electricals and electronics (E&E) segment amid a high backlog of orders. With the relaxation of movement restrictions, the services, construction and mining sectors declined at significantly lower rates than in the previous quarter. The gain in the services sector was attributed to the improved performance of the retail segment, in part reflecting an increase in vehicle sales stimulated by an exemption from Sales and Services Tax (SST). Nevertheless, the overall performance of the sector continued to be negatively impacted by weak tourism activity due to travel restrictions. Improvements in the construction sector were driven by the resumption of large-scale transportation projects, while improvements in the mining sector were driven by a gradual recovery in external demand. The agriculture sector declined slightly, by -0.7 percent (Q2 2020: -1.0 percent), following slower growth of fishing, forestry and logging, rubber and the oil palm segments, which offset the gains recorded in the aquaculture and livestock segments.

FIGURE 3
Malaysia's economy posted a smaller contraction in Q3 2020...



Source: DOSM

FIGURE 4
...driven by an improvement in both domestic and external demand



Source: World Bank staff calculations based on DOSM data

Domestic demand also increased following the implementation of the RMCO (see Figure 4). Private consumption recovered to a considerable degree, with a much smaller contraction in Q3 2020, at -2.1 percent (Q2 2020: -18.5 percent). A number of income support measures, including *Bantuan Prihatin Nasional* (BPN) cash transfers, wage subsidies and the *i-Lestari* Employees Provident Fund (EPF) withdrawals, stimulated household spending during the quarter. Over the same period, public consumption growth increased from 2.3 percent in Q2 2020 to 6.9 percent in Q3 2020, largely due to increased expenditure on supplies and services and emoluments.

Over these periods, while aggregate investments continued to contract, the rate of contraction has declined. In particular, gross fixed capital formation (GFCF) contracted by -11.6 percent in Q3 2020 (Q2 2020: -28.9 percent). Overall, the decelerating contraction in investments was driven by a resumption in both private and public investments. The recovery in private investment (Q3 2020: -9.3 percent vs. Q2 2020: -26.4 percent) was supported by the revival of construction activity resulting from the gradual reopening of the economy. In addition, there was an increase in capital spending in the E&E and healthcare-related segments. Higher capital spending by the government also contributed to a lower rate of contraction in public investments, at -18.6 percent in the third quarter (Q2 2020: -38.7 percent).

A number of other selected indicators suggest that there has been a gradual pick-up in economic activity since April. In November, the manufacturing purchasing managers' index (PMI) stood at 48.4, a considerable increase from its low point of 31.3 in April. The industrial production index (IPI) also rebounded from its low point in April for manufacturing (from 73.1 to 127.5 in October). Nevertheless, the recent re-imposition of the stricter Conditional Movement Control Order (CMCO) following a surge in the number of new COVID-19 cases could dampen the pace of recovery in the near term.

TABLE 1
GDP growth decomposition

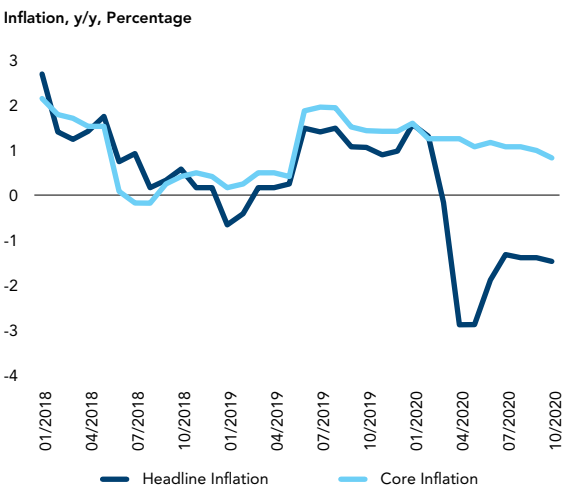
GDP, y/y, Percentage

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	2019	Q1 2020	Q2 2020	Q3 2020
GDP	5.2	4.7	4.4	4.8	**4.8**	4.5	4.8	4.4	3.6	**4.3**	0.7	-17.1	-2.7
Consumption													
Private Sector	6.5	7.9	8.9	8.4	**8.0**	7.7	7.8	7.0	8.1	**7.6**	6.7	-18.5	-2.1
Public Sector	0.2	2.9	5.0	3.9	**3.2**	6.3	0.3	1.0	1.3	**2.0**	5.0	2.3	6.9
Gross Fixed Capital Formation	0.4	1.6	2.8	0.6	**1.4**	-3.5	-0.6	-3.7	-0.7	**-2.1**	-4.6	-28.9	-11.6
Exports of Goods & Services	2.3	2.0	0.5	2.9	**1.9**	0.1	0.5	-2.1	-3.4	**-1.3**	-7.1	-21.7	-4.7
Imports of Goods & Services	-2.0	3.7	2.3	2.0	**1.5**	-1.6	-2.3	-3.5	-2.4	**-2.5**	-2.5	-19.7	-7.8
Sectoral													
Agriculture	3.1	-1.5	-1.2	0.2	**0.1**	5.8	4.3	4.0	-5.7	**2.0**	-8.7	1.0	-0.7
Mining	-2.5	-1.3	-5.1	-0.1	**-2.2**	-1.5	0.9	-4.1	-3.4	**-2.0**	-2.0	-20.0	-6.8
Manufacturing	5.2	4.9	5.0	4.7	**5.0**	4.1	4.3	3.6	3.0	**3.8**	1.5	-18.3	3.3
Construction	4.9	4.8	4.7	2.5	**4.2**	0.4	0.5	-1.4	1.0	**0.1**	-7.9	-44.5	-12.4
Services	6.5	6.6	7.3	6.9	**6.8**	6.4	6.1	5.8	6.2	**6.1**	3.1	-16.2	-4.0

Source: World Bank staff calculations based on DOSM data

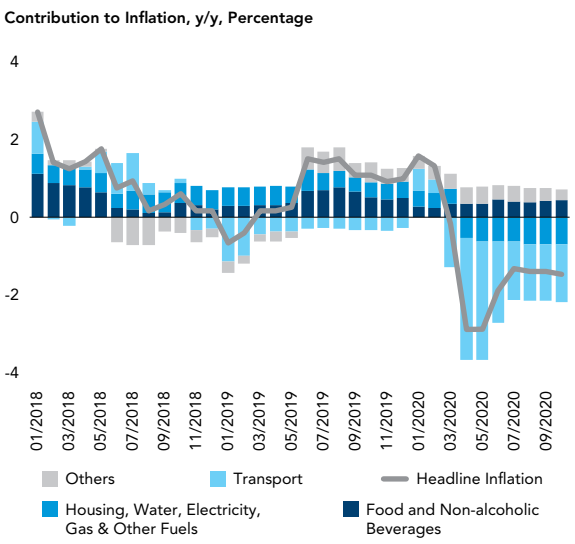
Headline inflation remained negative in recent months, while underlying inflation remained benign (see Figure 5 and 6). The headline inflation rate stood at -1.4 percent in Q3 2020 (Q2 2020: -2.6 percent), with a negative rate driven largely by low retail fuel prices. The lower energy prices were partially offset by modest price increases in food and non-alcoholic beverages. Core inflation moderated slightly to 1.0 percent (Q2 2020: 1.2 percent), mainly due to lower rental and accommodation prices.

FIGURE 5
Headline inflation remained negative in recent months...



Source: World Bank staff calculations based on DOSM data

FIGURE 6
...driven by lower retail fuel prices



Source: World Bank staff calculations based on DOSM data

New surges in COVID-19 cases have led to the resumption of stricter movement control measures

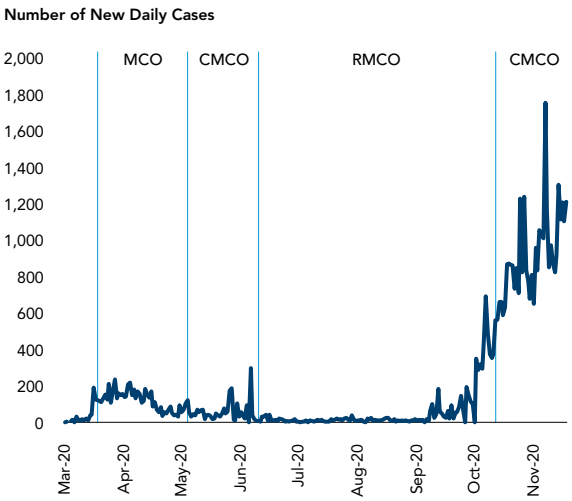
Malaysia is currently experiencing a third wave of COVID-19 infections (see Figure 7). After successfully managing the pandemic and bringing the number of daily cases to single digits in July, there has been a surge in infections since mid-September, with the number of new cases hovering between 1,000 and 2,000 at the national level. The new wave, which began in the eastern state of Sabah, has since spread throughout the country, with the central region of Kuala Lumpur, Selangor and Negeri Sembilan being particularly affected. While the surge in new cases is mainly concentrated in specific, confined areas, such as prisons and workers' hostels, the number of cases involving community transmission has also been increasing. On December 12, the number of active COVID-19 cases stood at 13,751, accounting for 16.7 percent of total number of cases in Malaysia to date.

The government re-introduced the CMCO across most parts of the country following the emergence of this third wave. The re-introduction of the CMCO entailed a number of restrictions, including the closure of schools and universities until next year; the wider enforcement of work-from-home rules for most firms and businesses; limited inter-state travels; restricted operating hours for businesses; and prohibitions on large social gatherings and other activities. In addition, the government implemented the Temporary Enhanced Movement Control Order (TEMCO) in specific localities or neighborhoods where the spike in the number of cases has been particularly severe. The CMCO has been lifted for most states from December 7 except Kuala Lumpur, Sabah and most Selangor districts as the daily infections remained high in these areas.

As a result of the re-imposition of the CMCO, mobility in public places has been restricted (see Figure 8). The CMCO resulted in movement restrictions in high-density public places, including retail and recreational outlets, transit stations, workplaces, public parks, groceries and pharmacies. Mobility restrictions have been relatively severe in the Klang Valley region, which includes Malaysia's major economic centers (i.e. Kuala Lumpur and Selangor), with the CMCO being implemented in these areas earlier than in the other states. Despite the imposition of these restrictions, the number of daily cases remain elevated. Both the resurgence of COVID-19 infections and containment efforts have dampened Malaysia's near-term economic recovery.

FIGURE 7

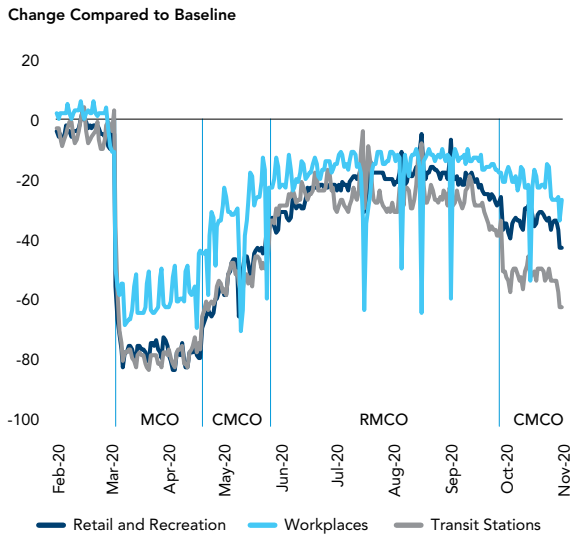
The CMCO was re-introduced following the third wave of the pandemic...



Source: Oxford University's Our World in Data

FIGURE 8

...leading to a decline of mobility in public places compared to Q3 2020



Source: Google Mobility Data

Improved external demand contributed to higher exports

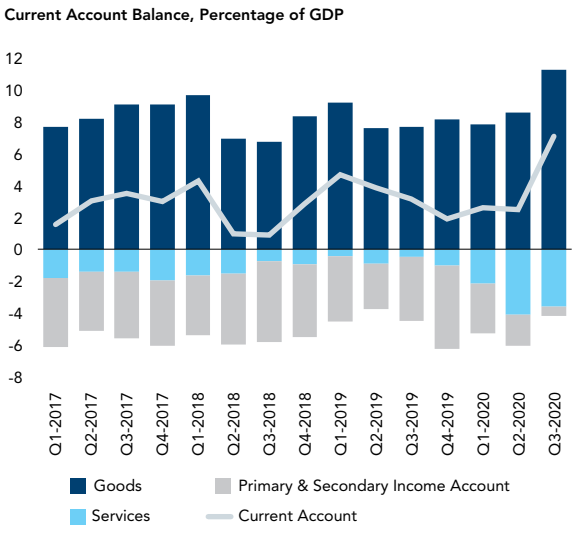
Malaysia's exports improved over the quarter, largely due to the increase in E&E manufacturing (see Figure 9). Gross exports expanded at the rate of 4.4 percent (Q2 2020: -15.1 percent), with the increase in the exports of manufactured goods driving this recovery. Growth in exports of manufactured goods recovered after contracting at the rate of 12.6 percent in Q2 2020 to reach 6.8 percent in Q3 2020. This was driven by a rebound in E&E exports, especially to major trading partners such as China and the US; by firms fulfilling a large backlog of orders; and by an increase in the demand for work-from-home appliances, servers and medical devices. While both non-E&E exports and commodities exports continued to contract, they did so at a lower rate than in the previous quarter (Q3 2020: -0.7 percent and -7.2 percent respectively, vs Q2 2020: -15.1 percent and -26.4 percent). The conclusion of the Regional Comprehensive Economic Partnership (RCEP) negotiations in November 2020, which will lead to the formation of the world's largest preferential trade area, is expected to be supportive of Malaysia's exports in the years ahead (see Box 1).

Over the same period, the contraction in gross imports also declined (Q3 2020: -6.3 percent vs. Q2 2020: -15.1 percent). This was due to the decelerating contraction in intermediate imports and the positive growth in consumption imports. The contraction in intermediate imports eased from -23.4 percent in Q2 2020 to -13.5 percent in Q3 2020, due to increased imports of industrial supplies and fuel lubricants. Over the same period, consumption imports increased by 4.6 percent (Q2 2020: -9.5 percent), with higher household spending leading to increased imports of consumer durable goods.

The conclusion of the RCEP negotiations is expected to be supportive of Malaysia's exports in the years ahead

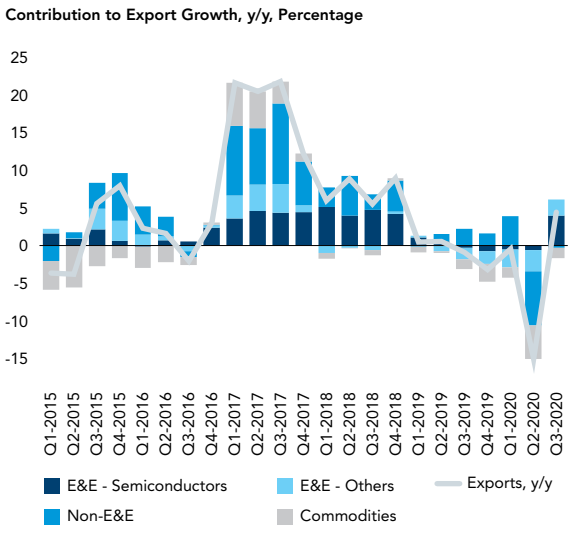
The current account surplus increased considerably, from 2.5 percent of GDP in Q2 2020 to 7.1 percent in Q3 2020, due to a higher goods surplus and a positive secondary income balance (see Figure 10). With the increase in exports outstripping the increase in imports, this contributed to a higher goods surplus, which rose to RM41.5 billion during the quarter (Q2 2020: RM25.9 billion). The services deficit widened to RM13.3 billion (Q2 2020: -RM12.5 billion) due to

FIGURE 9
Export recovery has been led by the E&E sector



Source: World Bank staff calculations based on BNM and DOSM data

FIGURE 10
The current account surplus increased considerably due to a higher goods surplus and a positive secondary income balance



Source: World Bank staff calculations based on DOSM data

increased expenditure on transportation services arising from the increase in trade activity during the quarter. With international travel restrictions remaining in place, the travel account remained in deficit. Over the same period, the financial account recorded a net outflow, with the bulk of the outflows driven by portfolio investment. There was an increase in residents' portfolio investments abroad during the quarter, driven by institutional investors' purchases of financial assets. The direct investment account registered a higher net outflow, largely due to a small net foreign direct investment (FDI) outflow.

TABLE 2
Selected external sector indicators

	Q1 2018	Q2 2018	Q3 2018	Q4 2018	Q1 2019	Q2 2019	Q3 2019	Q4 2019	Q1 2020	Q2 2020	Q3 2020
Balance of Goods & Services (% of GDP)	8.0	5.4	6.0	7.4	8.8	6.7	7.2	7.1	5.7	4.5	7.7
Current Account Balance (% of GDP)	4.3	1.0	0.9	2.8	4.7	3.9	3.2	1.9	2.6	2.5	7.1
Total Exports (% of GDP)	68.8	69.6	68.5	70.4	66.2	66.7	65.3	65.2	65.0	69.7	70.8
Total Imports (% of GDP)	59.0	61.7	61.6	60.8	55.0	58.0	55.9	55.9	54.9	60.5	54.4
Net Portfolio Investment (RM billion)	-3.5	-40.2	0.9	-6.5	6.5	-10.6	-23.6	-1.3	-41.3	22.2	-23.1
Gross Official Reserves (RM billion)	416.4	423.4	427.0	419.6	420.2	425.4	431.3	424.1	440.1	443.1	436.5
(US$ billion)	107.8	104.7	103.0	101.4	103.0	102.7	103.0	103.6	101.7	103.4	105.0

Source: World Bank staff calculations based on DOSM data

BOX 1

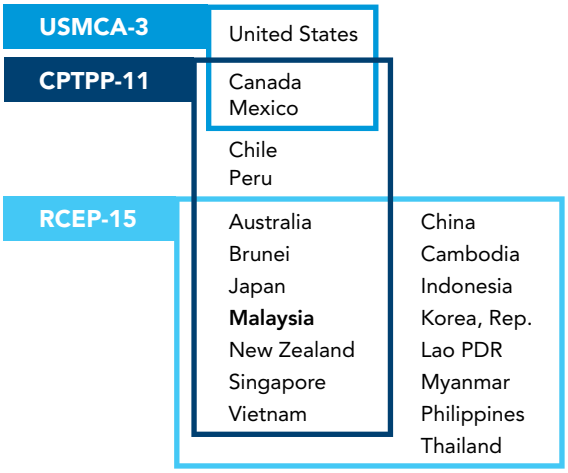
The Regional Comprehensive Economic Partnership: A welcome boost to investor confidence and international integration

The Regional Comprehensive Economic Partnership (RCEP) was signed on November 15, 2020 by representatives of 15 Asia-Pacific countries including China, resulting in the establishment of the world's largest trading bloc (see Figure 11). The group accounts for 30 percent of global GDP; 27 percent of global merchandise trade; 18 percent of services trade; and 19 percent of FDI outflows. With the RCEP negotiations commencing between ASEAN member states and dialogue partners in 2013, their conclusion with the promulgation of the treaty provides a welcome boost to international integration at a time when protectionism has been on the rise.

The agreement will deepen trade and investment relations between member countries mainly through reductions in non-tariff barriers on goods and services trade. It harmonizes the provisions

FIGURE 11
Malaysia is at the center of new regional integration initiatives

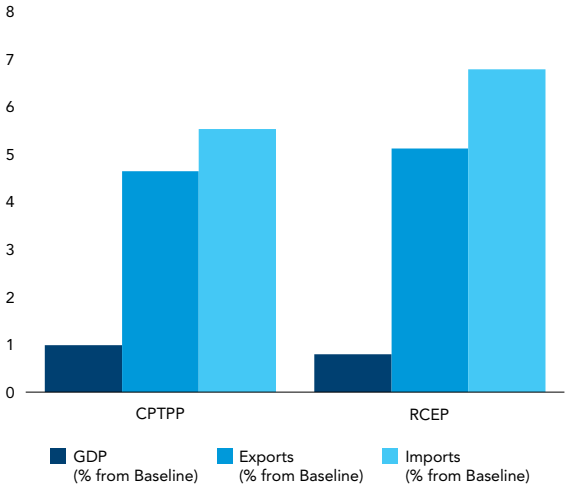
Trade Agreement Membership in the Asia-Pacific Region



Source: World Bank staff illustration

FIGURE 12
Malaysia is expected to see a net gain of around 1 percent of GDP from the RCEP

Model Simulations of Cumulative Percentage Changes to GDP, Exports and Imports for Malaysia in 2030



Source: World Bank staff estimates

imposed by countries on the trade in goods, thus providing more certainty for traders and investors. For example, it encourages importing countries to accept the product standards of other member countries from where the good originates if those countries provide the same level of consumer protection.

> The RCEP harmonizes the provisions imposed by countries on the trade in goods, thus providing more certainty for traders and investors

Importantly, the agreement aligns rules of origin for all 15 countries, allowing RCEP participants to integrate into the same production network or regional value chain. RCEP contains relatively strong provisions to protect intellectual property. It requires commitments by each member to refrain from discriminating against other members' investors in several service sectors. It also facilitates the temporary movement of individuals for investment and trade activities.

Preliminary modelling estimates suggest that Malaysia is expected to see gains of about 1 percent of GDP as a result of its participation in the RCEP (see Figure 12). Exports are projected to rise by approximately 5 percent and imports by 7 percent. The gains may be higher under an alternative scenario that factors in potential productivity gains resulting from increased openness. The GDP impact of RCEP for Malaysia is broadly equivalent to that from the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) (without the US). The equivalence reflects the relative breath of the RCEP (covering 30 percent of global GDP, compared to 14 percent for the CPTPP), with the greater depth of commitments under the CPTPP. The RCEP is expected to come into force towards the end of 2021. Malaysia has still yet to ratify the CPTPP.

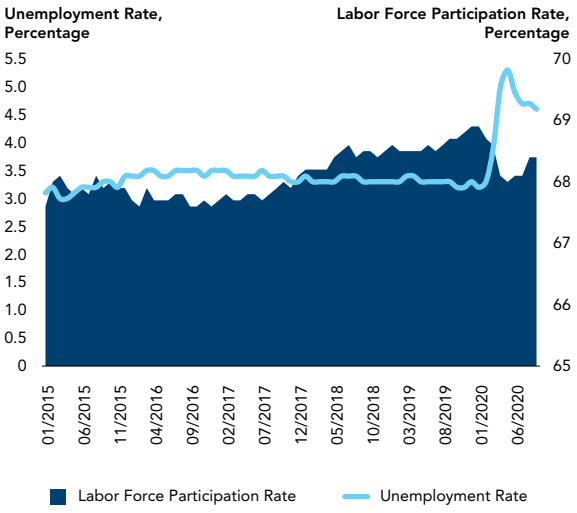
While unemployment has moderated slightly, under-employment remains elevated

With the gradual re-opening of the economy, the unemployment rate has declined slightly from its peak of 5.1 percent in Q2 2020 to 4.7 percent in Q3 2020 (see Figure 13). In Q3 2020, there was a small improvement in labor market conditions, with a decline in the contraction rate for employment growth (Q3 2020: -0.4 percent vs. Q2 2020: -1.3 percent), supported by an increase in rehiring activities. The labor force participation rate (LFPR) increased slightly over the same period, up from 68.1 percent in Q2 2020 to 68.4 percent in Q3 2020. The unemployment rate continued to be driven by relatively high unemployment rates for the 15-24 age group, which have remained in the double-digit range, standing at 12.6 percent in Q3 2020. In the third quarter, private sector wage growth recorded a lower rate of decline than in the previous quarter (Q3 2020: -2.6 percent vs. Q2 2020: -5.6 percent). Wages for the services sector also declined at a lower rate, at -2.5 percent (Q2 2020: -6.4 percent) while in the manufacturing sector, the rate stood at -2.7 percent (Q2 2020: -4.0 percent).

The implementation of movement restrictions since Q1 2020 has contributed to relatively high underemployment rates (see Figure 14). In terms of skills-related underemployment indicators, which capture the number of people with tertiary qualification who work in semi-skilled or low-skilled jobs, the rate increased from 34.3 percent in Q3 2019 to 36.8 percent in Q3 2020. Meanwhile, time-related underemployment, which captures those who are employed for less than 30 hours per week due to the nature of their work or to the insufficient availability of work, also increased from 1.2 percent in Q3 2019 to 2.0 percent in Q3 2020. If left unaddressed, these trends could lead to higher levels of underemployment and unemployment relative to the pre-crisis period. Further, a large share of Malaysians on low incomes are employed in sectors that make working from home difficult (see Box 2).

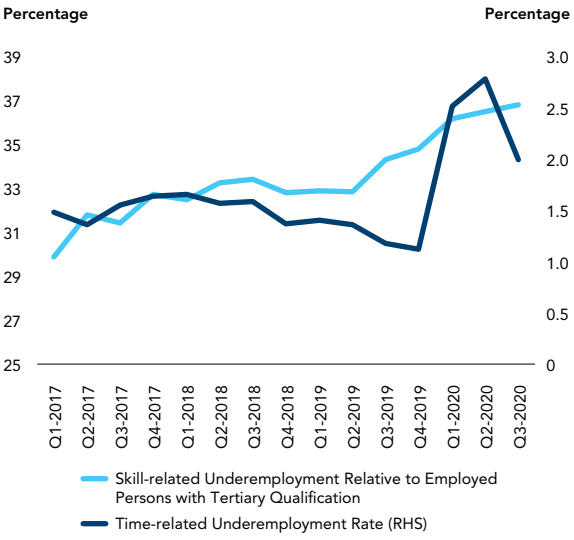
> The unemployment rate continued to be driven by relatively high unemployment rates for the 15-24 age group

FIGURE 13
Unemployment rate moderated slightly from its peak in Q2 2020



Source: World Bank staff calculations based on DOSM data

FIGURE 14
Movement restrictions contributed to relatively high underemployment rates



Source: World Bank staff calculations based on DOSM data

Overall, the financial sector has remained resilient

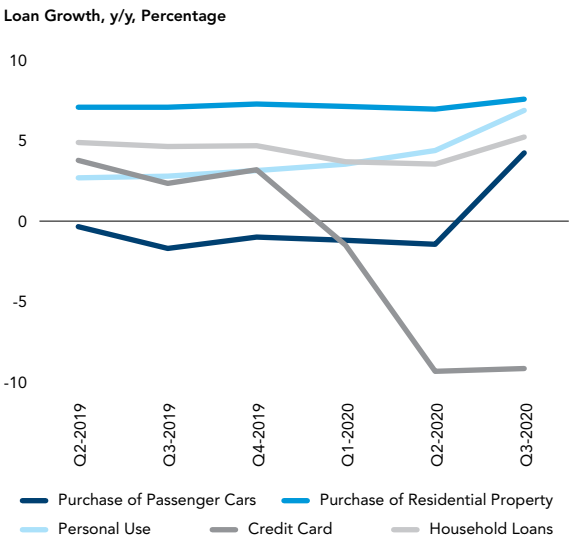
Malaysia's central bank, Bank Negara Malaysia (BNM), has kept the Overnight Policy Rate (OPR) at 1.75 percent since July. BNM expects the economic growth rate for 2020 to be within the earlier forecasted range of -3.5 to -5.5 percent. Looking ahead to 2021, economic activity is projected to improve further, driven by a projected recovery in global demand and a turnaround in public and private sector expenditure. However, the trajectory is expected to be uneven across sectors, with economic activity in some industries remaining below pre-pandemic levels, and with improvements in the labor market lagging.

The financial sector remained resilient through Q3 2020. Despite pressure on earnings, banks maintained healthy capital and liquidity positions throughout this period. As of June 2020, the banking sector's overall return on equity was estimated to stand at 10.0 percent (Dec 2019: 13 percent), with return on asset estimated at 1.2 percent (Dec 2019: 1.5 percent). In addition, the banking system's liquidity coverage ratio remained at 153 percent, well above the minimum statutory requirement of 100 percent, with banks continuing to maintain an adequate capital buffer, with the tier 1 capital ratio at 15.1 percent in October 2020. The deferment of all loan and financing repayments has given businesses and households breathing space, although impairment ratios edged upwards to 1.43 percent overall in October 2020, albeit from historically low levels, driven by the household segment. These rates are expected to increase once the moratorium period ends.

Household loan growth picked up in Q3 2020, largely reflecting an increase in loan growth for the purchase of passenger cars and for personal use (see Figure 15). Household loan growth increased to 5.6 percent in Q3 2020 (Q2 2020: 2.7 percent), in large part reflecting higher loan growth for the purchase of passenger cars and residential properties incentivized by the SST exemption and Home Ownership Campaign respectively. Outstanding loans to businesses grew at the more modest pace of 2.9 percent in Q3 2020 (Q2 2020: 3.9 percent), due to the slower disbursement of loans for working capital purposes. Overall, net financing expanded by 4.6 percent in Q3 2020 (Q2 2020: 3.7 percent) (see Figure 16).

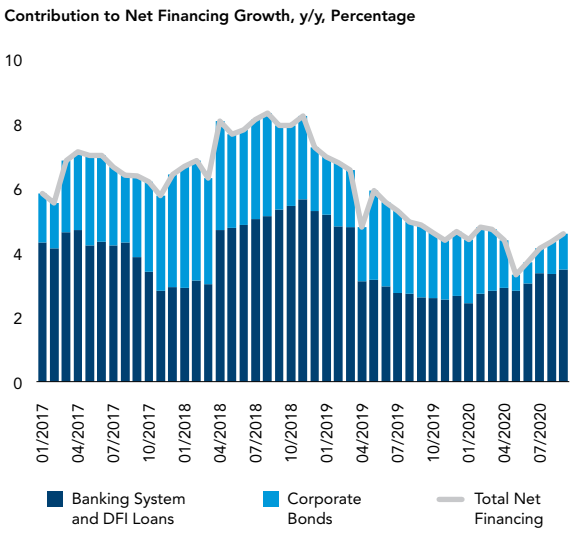
The performance of Malaysia's domestic financial markets was mixed during the quarter. The domestic bond market experienced relatively high non-resident portfolio inflows in Q3 2020 (see Figure 20), which led

FIGURE 15
Household loans grew at a faster pace on higher car purchase loans and personal loans



Source: World Bank staff calculations based on BNM data

FIGURE 16
Net financing expanded by 4.6 percent in Q3 2020



Source: World Bank staff calculations based on BNM data

BOX 2

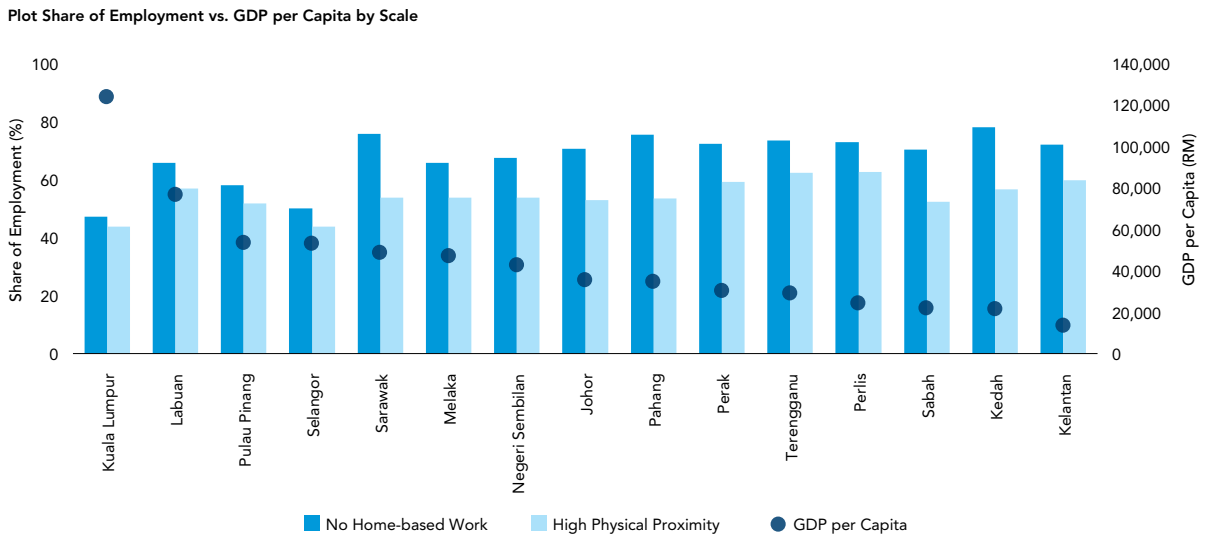
How many Malaysians can work from home?

Mobility restrictions imposed to curb the health impact of the COVID-19 pandemic has adversely affected many workers, particularly those with jobs that cannot be performed from home and require high levels of physical proximity. As long as COVID-19 remains a health risk, the ability to work from home provides an indication of vulnerability to job loss with mobility restrictions in place, while the degree of physical proximity is an indicator of the likelihood that a worker can return to work, even if mobility restrictions are gradually lifted. Estimates for Malaysia suggest that 64.5 percent of jobs cannot be performed from home, after adjusting for internet access, while about 50.9 percent of jobs require high levels of physical proximity (see Abdur Rahman, Jasmin and Schmillen 2020).

Workers in less developed states are more vulnerable to job losses during the COVID-19 crisis. In Putrajaya, the state or federal territory with the lowest share of jobs vulnerable to COVID-19, only 29.3 percent of jobs cannot be performed from home, and only 32.1 percent of jobs require high levels of physical proximity. Workers in Kuala Lumpur are also relatively less vulnerable, where 47.1 percent of jobs cannot be performed from home and 43.7 percent of jobs require high levels of physical proximity, as shown in Figure 17. In contrast, 78.1 percent of jobs in Kedah cannot be performed from home, while 56.6 percent of jobs require high levels of physical proximity. In Perlis, 62.6 percent of jobs require high levels of physical proximity, the highest in the nation. Additionally, there are negative correlations both between GDP per capita and the share of jobs that are not conducive to home-based work, and between GDP per capita and the share of jobs that involve high levels of physical proximity. The correlation coefficients for the two relationships are -0.77 and -0.65 respectively, suggesting that workers in less developed states are more vulnerable to job losses during the COVID-19 crisis.

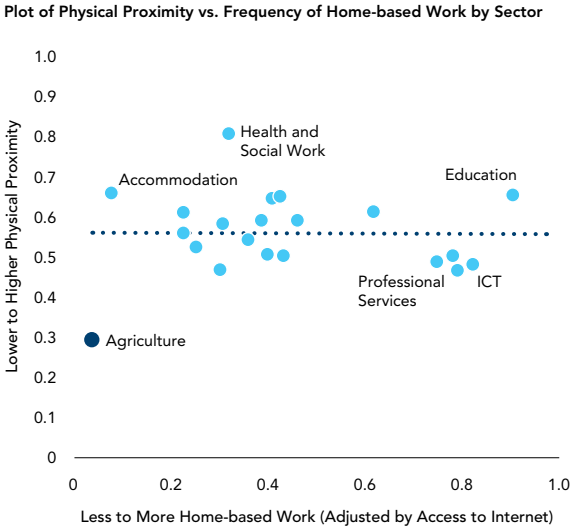
Vulnerability is highest among those already more economically at risk prior to the crisis, including workers with relatively low levels of income and education, and the self-employed. Less than one fifth of workers in the lowest income decile are able to work from home, compared to more than three fifths

FIGURE 17
Workers in less-developed states are more likely to have jobs that cannot be performed from home and require high levels of physical proximity



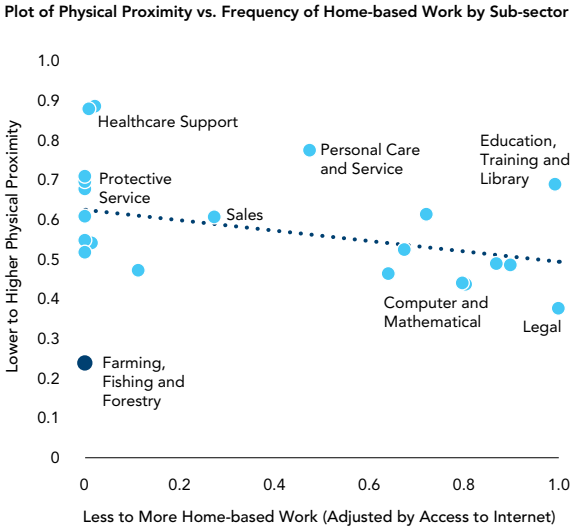
Source: World Bank staff calculations based on Dingel and Neiman (2020), Garrote Sanchez et al. (2020), O*NET and Department of Statistics Malaysia
Note: GDP per capita for W.P. Kuala Lumpur includes that for W.P. Putrajaya.

FIGURE 18
Workers in the agriculture sector are least likely to be able to work from home...



Source: World Bank staff calculations based on Dingel and Neiman (2020), Garrote Sanchez et al. (2020), O*NET and Department of Statistics Malaysia

FIGURE 19
...many of whom are involved in farming, fishing and forestry related occupations



Source: World Bank staff calculations based on Dingel and Neiman (2020), Garrote Sanchez et al. (2020), O*NET and Department of Statistics Malaysia

of workers in the highest income decile. Similarly, only one out of ten workers without a formal education are able to work from home, compared to eight out of ten workers with tertiary education. Own account workers and unpaid family workers are also more likely to have jobs that cannot be performed from home compared to employees. Workers from rural areas and women are similarly likely to have jobs that cannot be performed from home, or that require high levels of physical proximity. Compared to prime-aged workers age 25 to 54, youth and older workers are also at greater risk of losing their jobs.

As expected, workers in the agriculture sector and workers involved in farming, fishery and forestry related occupations have the least ability to work from home. Figure 18 and Figure 19 visualize the relationship between the ability to work from home and the level of proximity involved in different sectors and occupations, and show that while work in agriculture requires relatively low levels of physical proximity, it also—for obvious reasons—cannot be performed from home.[1] These findings place agricultural workers highly vulnerable to job and income loss when strict mobility restrictions and work-at-home orders are in place.

As long as mobility restrictions are in place to curb COVID-19 infections, income support in the form of direct cash transfers should be continued to support vulnerable workers. Further rounds of cash transfers targeted at the B40 – the group that needs the most support – will remain vitally important. These transfers provide short-term relief to mitigate acute financial strains, they support medium-term recovery efforts, and they support consumption and human capital development at a time of economic downturn. In addition, there is an increased and urgent need for skills-building programs that can enhance workers' skills, focusing on those less susceptible to automation in the advent of rapid technological change that has been accelerated by the current crisis, such as digital and socioemotional skills (see World Bank 2018 and Chernoff and Warman 2020). In this current environment, these skills are also required to obtain jobs that can be performed from home. The government has already made steps in the right direction by providing incentives for the upskilling and reskilling of workers in Malaysia's short-term economic recovery plan, *Penjana*, and by the inclusion of similar initiatives in Budget 2021. It is important for efforts to continue in this direction as Malaysia pursues economic recovery.

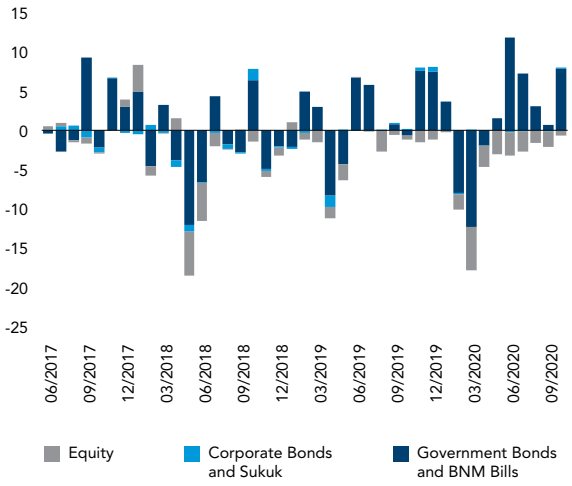
[1] 83 percent of workers in the agriculture sector are employed in farming, fishing and forestry related occupations.

Source: Adapted from Abdur Rahman, Jasmin and Schmillen (2020)

to a decline in government bond yields. As a result, the 3-year, 5-year and 10-year Malaysian Government Securities (MGS) yields declined by 25.4, 22.1 and 20.6 basis points, respectively. Conversely, the domestic equity market was affected by a global equity market correction in September, triggered by concerns over the possible implementation of new rounds of movement restrictions in Europe and the failure to pass a new US fiscal stimulus bill. The announcement by selected large companies on the main board of subdued second quarter corporate earnings also affected the performance of the domestic equity markets. As at end-September, the FBM KLCI had increased by 0.3 percent to close at 1,504.8 points. The ringgit appreciated by 3.00 percent against the US dollar during the quarter, largely reflecting the non-resident inflows into the domestic bond market and the weakness of US dollar amid slower demand for US dollar-denominated assets. Relative to other major currencies, the ringgit depreciated against the British pound by 1.4 percent, and against the euro by 1.3 percent (see Figure 21).

FIGURE 20
The domestic bond market experienced non-resident portfolio inflows...

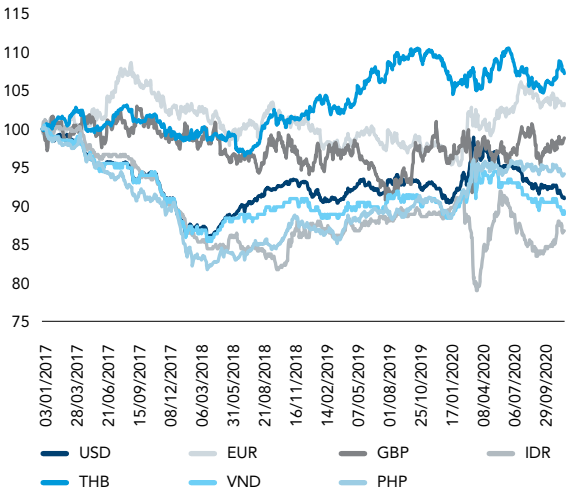
Non-resident Portfolio Flows, RM Billion



Source: BNM and Bursa Malaysia

FIGURE 21
...which contributed to the ringgit's appreciation against the US dollar

MYR/Currency, January 2017=100
(Upward Trend Indicates MYR Depreciation)



Source: World Bank staff calculations based on BNM data

The economic downturn and the government's response have led to a wider fiscal deficit in 2020

The fiscal deficit is expected to widen to 6 percent of GDP in 2020, largely due to the economic downturn and the government stimulus measures. The fiscal deficit for 2020, initially projected in Budget 2020 to stand at 3.2 percent of GDP, is now expected to widen to 6 percent of GDP (RM86.5 billion), compared to 3.4 percent in 2019. Expenditure is expected to increase by 3.4 percent of GDP, while revenue is expected to increase only by 0.6 percent of GDP, resulting in a 2.8 percent increase in the fiscal deficit (see Figures 22-24). Similarly, the primary deficit is expected to widen to 3.6 percent of GDP in 2020, compared to 1.2 percent in 2019.

The government implemented a series of stimulus packages that contributed to the wider fiscal deficit. To mitigate the economic impact of the pandemic, the government announced a series of stimulus packages worth 21.2 percent of GDP (RM305 billion) (see Table 3). The direct fiscal injection was estimated at RM55 billion, or 3.8 percent of GDP. Initially, the budget allocation for overall expenditure in 2020 stood at RM297 billion (18.5 percent of GDP). Under the revised budget, this is now expected to reach RM314.7 billion (21.9 percent of GDP), a 6 percent increase. The increase in expenditure due to the stimulus spending was partially offset by expenditure savings of about RM20.3 billion after existing programs were revised or rescheduled. Development expenditure savings amounted to RM11 billion, while operating expenditure savings were estimated at RM9.3 billion, generated from reduced operating expenditure, such as savings on fuel subsidies.

Government expenditure for 2020 was revised upward due to stimulus spending (see Figure 22). Following the revision of the budget for 2020, the government's allocation for operating and development expenditures were lowered, but allocation to fund stimulus spending led to an increase in total expenditure. Operating expenditure is now expected to stand at 15.8 percent of GDP. A decrease in allocations for grants and spending on goods and services and the reallocation of some funds to development expenses has contributed to the decrease in projected operating expenses. Similarly, development expenditure is projected to be lower because of the rescheduling of a number of infrastructure projects following the implementation of the movement control order. It is now expected to stand at around 3.5 percent of GDP. The COVID-19 fund established by the government to finance stimulus spending and recovery efforts is estimated to result in expenditure of RM38 billion.

The expected shortfall in overall government revenue over the course of 2020 results from the combined impact of the decline in economic activities and lower oil prices. Under the initial 2020 budget, revenues were projected to stand at RM244.5 billion (15.2 percent of GDP) (see Figure 23). However, under the revised budget, it is now projected that these revenues will stand at RM227.3 billion (15.8

TABLE 3
The total value of the government's stimulus packages is estimated at RM305 billion or 21.2 percent of GDP

	Total Value		Direct Fiscal Injection	
	RM Billion	Percentage of GDP	RM Billion	Percentage of GDP
Prihatin	250	17.4	25	1.7
Prihatin SME+	10	0.7	10	0.7
Penjana	35	2.4	10	0.7
Kita Prihatin	10	0.7	10	0.7
Total	**305**	**21.2**	**55**	**3.8**

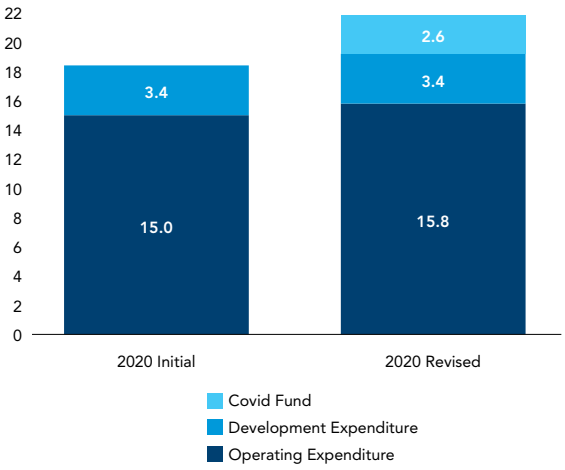
Source: World Bank staff calculations based on MOF data

percent of GDP). The shortfall was due to the decline in economic activities that led to lower direct and indirect tax revenues this year. The sharp decline in global oil prices also contributed to the revenue shortfall, with the initial budget for 2020 assuming average annual prices of USD62 per barrel, a figure that has now been revised downward to USD40 per barrel. Additionally, forgone revenue due to the provision of tax measures has also contributed to the expected decline in overall revenue. The revenue shortfall will be partially offset by transfers from government-owned entities (Petronas, BNM, KWAP and Khazanah).

FIGURE 22

Expenditure for 2020 was revised upward due to COVID-19 related spending...

Federal Government Expenditure, Percentage of GDP

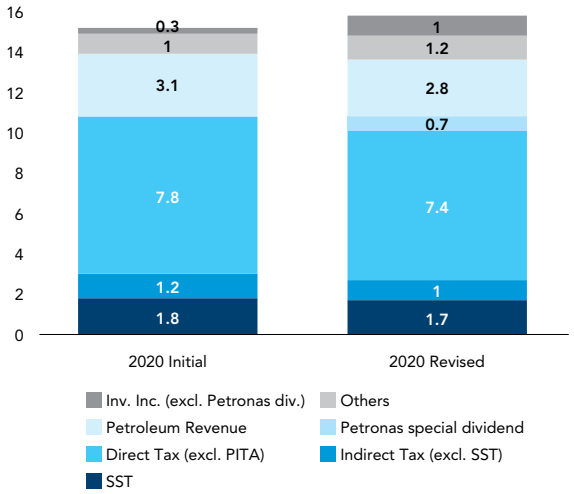


Source: World Bank staff calculations based on MOF data

FIGURE 23

...while revenue as a share of GDP is expected to rise in 2020 due to non-tax revenue

Federal Government Revenue, Percentage of GDP

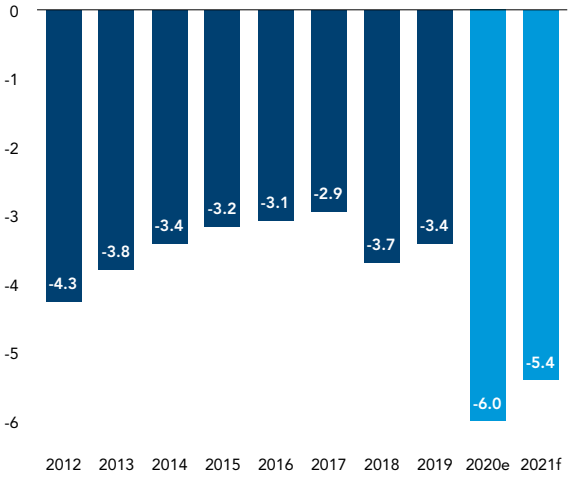


Source: World Bank staff calculations based on MOF data

FIGURE 24

The budget deficit is expected to reach 6 percent of GDP in 2020

Federal Government Fiscal Balance, Percentage of GDP

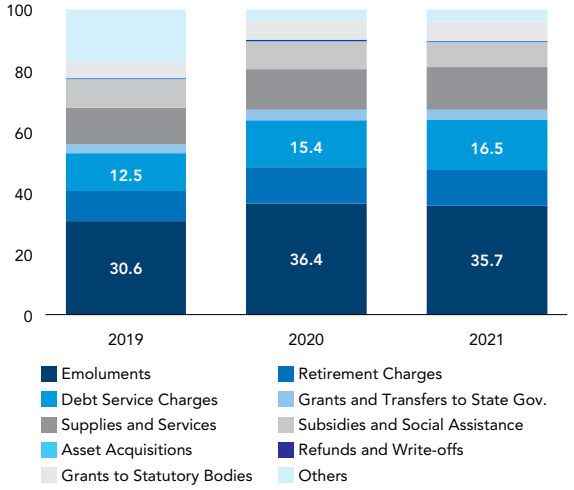


Source: World Bank staff calculations based on MOF data

FIGURE 25

Debt service charges are expected to rise in 2020 and 2021

Federal Government Expenditure, Percentage of Operating Expenditure



Source: World Bank staff calculations based on MOF data

With the economic contraction, federal government revenue is expected to decline by 14 percent in 2020, driven by broad-based contractions in all revenue sources. The contraction in tax revenue is expected to contribute 10.3 percentage points to the overall decline in revenue. Following the drastic decline in oil prices due to the global economic slowdown, petroleum income tax is expected to register the largest contraction estimated at about 59 percent. This will contribute more than 4 percentage points to the overall decline in revenue. Personal income tax and corporate income tax are expected to decline by 7.2 percent and 6.8 percent respectively. Due to the slowdown in international trade, import and export duties have been severely impacted, with revenues from these sources estimated to contract by 25.5 and 28.8 percent respectively. The projected contraction in non-tax revenue is expected to contribute about 3.7 percentage points to the overall decline in revenue, driven mainly by a decline in investment income

The wider fiscal deficit led to an increase in federal government debt. With the initial deficit target of 3.2 percent of GDP, federal government debt was projected to reach around 53 percent of GDP at the end of 2020. However, following the increase in government borrowing to finance the budget deficit, government debt had risen to 60.7 percent of GDP (RM874.3 billion) by the end of September 2020. Domestic Debt stood at RM845 billion, constituting 96.6 percent of total government debt. To accommodate this increased government debt, parliament passed the emergency COVID-19 bill (Temporary Measures for Reducing the Impact of COVID-19 Act 2020), which allowed the government to raise the statutory limit on government debt from 55 percent to 60 percent of GDP. The Act stipulates a domestic debt limit of 60 percent of GDP; by the end of September, it stood at 56.6 percent of GDP.

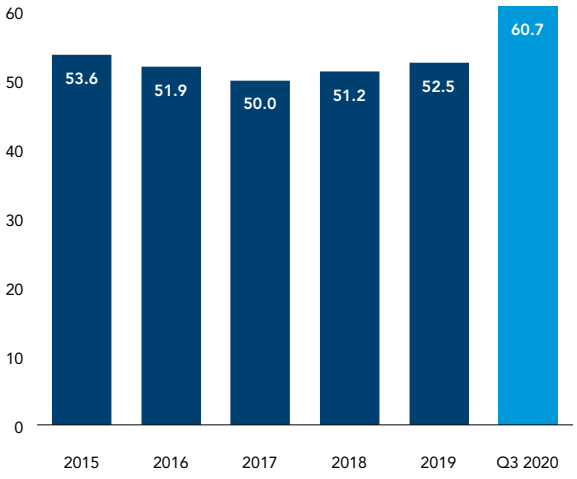
With the wider fiscal deficit, federal government debt rose to over 60 percent of GDP

Higher government borrowing is expected in 2020. Government borrowing is expected to reach RM181.5 billion (12.6 percent of GDP), a 31.5 percent increase from the initial estimate under the 2020 budget. Almost all (99.9 percent) of the government borrowing was financed through domestic sources. The government has issued RM73 billion worth of MGS and RM 76.5 billion worth of MGII. Additionally, RM32 billion worth of treasury bills were issued to implement cash and liquidity management. While the maturity of the issued securities is spread across the short term (17.6 percent of total issuance), medium term (32.6 percent of total issuance) and long term (50 percent of total issuance), heightened uncertainty related to COVID-19 caused an uptake in short-term issuance.

FIGURE 26

In line with a wider budget deficit, government debt rose in 2020...

Federal Government Debt, Percentage of GDP

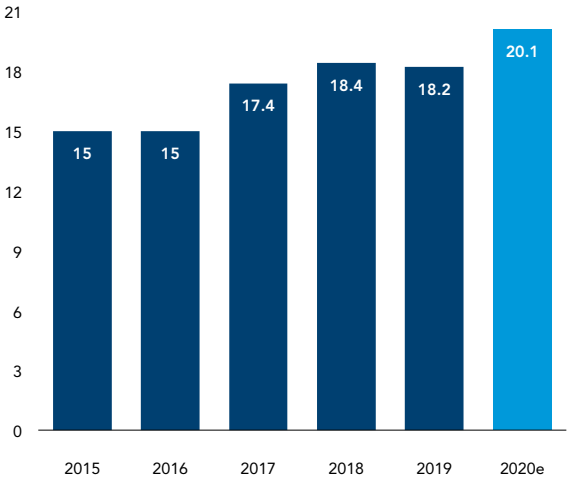


Source: World Bank staff calculations based on MOF data

FIGURE 27

...along with higher government guarantees due to increased borrowing by GLCs

Government Guarantees, Percentage of GDP



Source: World Bank staff calculations based on MOF data

Government guarantees also rose in 2020, due to increased borrowing by a number of Government Linked Companies (GLCs). Government guarantees increased to reach 20.1 percent of GDP (RM289.8 billion) at the end of September, up from 18.2 percent of GDP (RM275.4 billion) in 2019. Committed guarantees (loan guarantees that require government financing) was estimated to stand at 12.3 percent of GDP (RM177 billion) at the end of September. The increase was mainly due to borrowing by DanaInfra and Prasarana to finance the development and maintenance of public transportation infrastructure and by the Public Sector Home Financing Board to fund housing loan facilities for civil servants. The majority of the government guarantees were financing for infrastructure (53.7 percent of total government guarantees) and services (24.3 percent).

The fiscal implications of the government's various stimulus and relief measures, coupled with recent political developments, have led to a downgrade in Malaysia's sovereign credit rating. In December 2020, Fitch Ratings downgraded Malaysia's sovereign rating from A- to BBB+, citing rising fiscal burden and lingering political uncertainty which could have an impact on Malaysia's prospects for further improvement in governance standards. Earlier in June, Standard & Poor's lowered Malaysia's sovereign rating outlook from 'Stable' to 'Negative' on downside risks to the government's fiscal metrics. Although Malaysia's fundamentals remain strong with the economy being well-diversified and having a deep financial market, these rating actions underscore the need to strengthen governance and modernize institutions.

The proposed budget for 2021 aims to provide support for lives and livelihoods

On December 6th, the government unveiled its proposed budget for 2021, estimated at RM322.5 billion (20.5 percent of GDP). Of this, RM236.5 billion has been allocated for operating expenditure; RM69 billion for development expenditure; and RM17 billion for the special COVID-19 fund. Under the proposed budget, debt services charges and emoluments are projected to reach 52.2 percent of the operating budget, compared to 43.1 percent in 2019 and 51.8 percent in 2020 (see Figure 25). The bulk of the development budget has been allocated to the economic sector (56.4 percent) and the social sector (26.6 percent). The development expenditures have been earmarked primarily for the implementation of public transportation projects (Mass Rapid Transit 2, Pan Borneo Highway); connectivity projects (National Digital Network); and other infrastructure projects (including the repair of rundown schools and the construction of medical laboratories).

The proposed budget for 2021 aims to provide much-needed support for lives and livelihoods and introduces a range of measures to facilitate economic recovery. The economic crisis has put large segments of the population under immense economic stress, especially those in the bottom 40 percent income group (B40). The proposed budget includes a range of measures intended to enhance social protection for vulnerable groups by increasing benefit levels and expanding the beneficiary coverage of a number of existing cash transfer programs. The budget also introduces a new cash transfer program, the *Bantuan Prihatin Rakyat* (BPR), which is an expanded version of the previous *Bantuan Sara Hidup* (BSH) program. To support economic recovery, the budget introduces funding for new measures for upskilling and reskilling, with particular emphasis on specific groups of workers, including youth, the long-term unemployed, the disables and those who have lost their jobs as a result of the crisis. Budget 2021 also marked the first annual budget that is aligned with the United Nations' sustainable development goals (SDGs). In addition, as part of the government's goal of establishing Malaysia as a sustainable finance hub, the government also announced in the budget that it will issue its first Sustainability Bond in Malaysia for environmental and social initiatives in 2021.

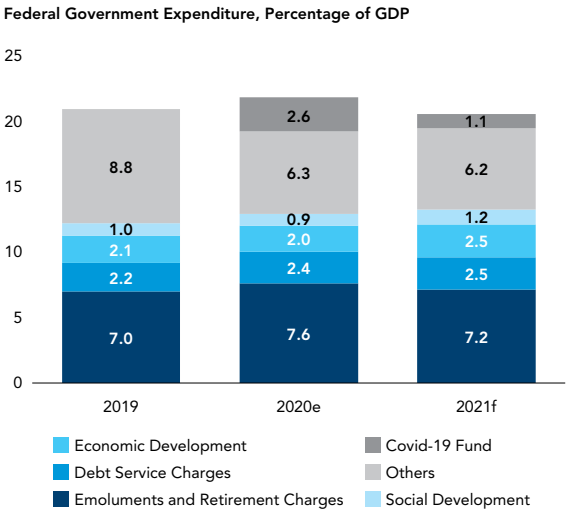
With the expected economic recovery in 2021, the government is expecting increased revenue collection. Government revenues are projected to rise to RM236.9 billion (15.1 percent of GDP), a 4.2 percent

increase over expected revenue in 2020. This is based on the government's GDP growth forecast of 6.5 to 7.5 percent and the assumption of a higher crude oil price at USD42 per barrel. The projected increase is expected to derive from increased tax revenues, which are estimated to reach RM174.4 billion (2020: RM153.2 billion). This expected increase will be partially offset by an expected decline in non-tax revenues, down to RM62.5 billion (2020: RM74 billion). The expected expansion in tax revenue will likely be driven by a rebound in direct tax revenue, which is projected to increase to more than 66 percent of total tax revenue. SST is expected to contribute 11.8 percent of the projected overall tax revenue. However, in proportion to GDP, revenue is projected to decline further to 15.1 percent in 2021, almost one-third lower than its level in 2009 and well below the averages for upper-middle-income and high-income countries. The declining trend in revenue has been driven by broad-based declines in oil-related revenues, consumption taxes and direct taxes.

The fiscal deficit in 2021 is projected to narrow to 5.4 percent of GDP, mainly driven by an increase in output and revenue. Although government expenditure is projected to rise in 2021, the expected increase in aggregate GDP and government revenue is likely to lead to a narrower budget deficit. The primary deficit is also projected to shrink to 2.9 percent of GDP in 2021, down from a deficit of 3.6 percent in 2020.

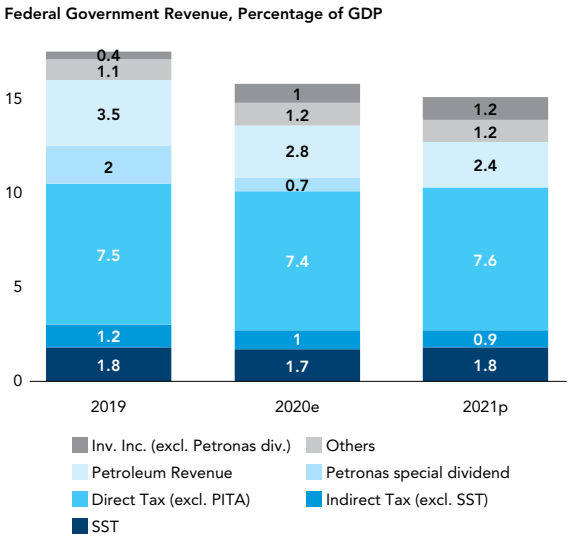
The government's medium-term fiscal framework (MTFF) sets out a path for fiscal consolidation, projecting a budget deficit averaging at around 4.5 percent of GDP over the period 2021-2023. The MTFF projects that government revenue will reach 14.7 percent of GDP; that total expenditures will stand at around 19.2 percent of GDP; and that the average GDP growth rate will range between 4.5 to 5.5 percent over the next three years. Furthermore, it assumes an average crude oil price of USD45 to 55 per barrel and a projected daily production of 580,000 barrels. The government also expects to identify new sources of revenue by adopting the Medium-Term Revenue Strategy (MTRS), which includes broadening the revenue base, reducing tax leakages, increasing tax collection from the informal sector and enhancing targeting of tax incentives.

FIGURE 28
2021 expenditure projections assume a smaller COVID-19 fund...



Source: World Bank staff calculations based on MOF data

FIGURE 29
...along with higher tax revenues



Source: World Bank staff calculations based on MOF data

Economic outlook

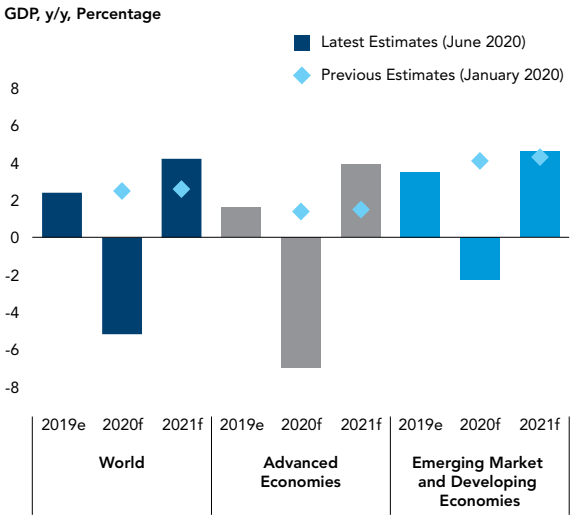
Global growth is projected to improve in 2021, but output is not expected to return to pre-pandemic levels in the near term

While the global economy is expected to continue to improve into 2021, output is not expected to return to pre-pandemic levels in the near term. The global economy is projected to grow at the rate of 4.2 percent in 2021, after contracting by 5.2 percent in 2020 (see Figure 30). This recovery is predicated on a gradual improvement in confidence, consumption, and trade, assuming the rollout of an effective vaccine starting in early 2021. Nevertheless, due to the severity of economic damage from the pandemic on investment, labor supply and human capital in most countries, levels of economic activity are not expected to return to pre-pandemic levels in the near term.

Output in advanced economies is set to improve in 2021, with accommodative policy measures gaining traction. After contracting by -7.0 percent in 2020, the growth rate in advanced economies is projected to improve to 3.9 percent in 2021. Growth in EMDEs is also expected to recover next year. This projection is based on the assumption of a rebound in several large EMDEs, with the positive spillover effects from large-scale policy support taking hold in the economies and with a recovery in consumer and investor confidence.

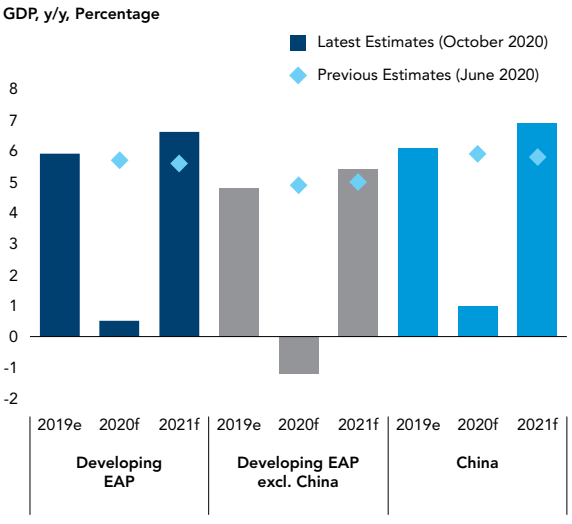
Growth in the East Asia Pacific region is projected to improve. Regional growth is expected to strengthen to 6.6 percent in 2021 (2020f: 0.5 percent), with a stabilization in global activities and trade (see Figure 31). In China, growth is projected to increase to 7.9 percent in 2021, partly reflecting a projected recovery in global demand and continued strengthening in consumption and investment. Growth in other major economies in the region is also likely to improve in 2021, with private consumption and exports expected to remain the key drivers of growth.

FIGURE 30
Global GDP is projected to improve in 2021 as confidence, consumption, and trade gradually strengthen



Source: World Bank staff projections

FIGURE 31
Regional growth is projected to accelerate in 2021, led by a strong rebound in China



Source: World Bank staff projections

Malaysia's economy is expected to return to growth in 2021

In this global and regional context, Malaysia's economy is projected to grow by 6.7 percent in 2021 (see Table 4). This recovery can be attributed to a rebound from a low base in 2020; to continued improvements in exports; and to a gradual build-up of momentum in private consumption and investment. Nevertheless, the strength and timing of this recovery will depend largely on the timely availability of an effective mass vaccination program and on the robustness of recovery in global growth and external demand.

Malaysia's COVID-19 vaccination program is expected to start in Q1 2021. The government is currently in an ongoing process of acquiring the supply of COVID-19 vaccines. To date, the government had negotiated two deals with vaccine developers, which would allow the vaccination of at least 20 percent of the Malaysian population by the end of 2021. Malaysia is expected to receive its vaccine supply in stages, with the first batch of COVID-19 vaccines arriving in Q1 2021. The vaccination program would prioritize medical frontliners, senior citizens, and those with non-communicable diseases, such as heart diseases and diabetes.

Consumption growth is expected to gradually gather momentum. Consumption activities are expected to be driven by continued expansion in both private and public consumption, with private consumption remaining the key driver of growth. Private consumption is expected to increase to 7.4 percent (2020f: -4.8 percent), benefitting from a gradual strengthening of consumer confidence arising from better COVID-19 management and reduced health risks, prospects of improved labor market conditions, continued support from pandemic related stimulus measures including personal income tax reductions and tax reliefs, cash transfers and targeted repayment assistance provided by BNM. Meanwhile, public consumption is expected to continue to expand over the near term, albeit at a slower rate (2021f: 2.1 percent; 2020f: 3.7 percent). This growth will be supported by ongoing government expenditure on emoluments and on measures to improve public service delivery.

Investment activities are anticipated to progressively gain traction. Gross fixed capital formation is projected to grow by 7.2 percent (2020f: -13.4 percent), supported by increased private and public investment. Private investment is expected

TABLE 4
GDP growth and contribution to growth

Annual Growth, y/y, Percentage					Contribution to Annual GDP Growth (Percentage Point)				
	2019	2020f	2021f	2022f		2019	2020f	2021f	2022f
GDP	**4.3**	**-5.8**	**6.7**	**4.8**					
Domestic Demand (including stocks)	3.9	-5.1	6.6	4.8	Domestic Demand (including stocks)	3.7	-4.8	6.2	4.4
Private Consumption	7.6	-4.8	7.4	6.1	Private Consumption	4.3	-2.8	4.4	3.6
Public Consumption	2.0	3.7	2.1	1.5	Public Consumption	0.3	0.5	0.3	0.2
Gross Fixed Capital Formation	-2.1	-13.4	7.2	2.8	Gross Fixed Capital Formation	-0.5	-3.1	1.5	0.6
					Change in Stocks	-0.4	0.7	0.0	0.0
External Demand					External Demand				
Exports of Goods & Services	-1.3	-9.3	8.9	5.5	Exports of Goods & Services	-0.9	-6.0	5.5	3.4
Imports of Goods & Services	-2.5	-8.6	9.1	5.4	Imports of Goods & Services	-1.5	-4.9	5.0	3.0

Source: World Bank staff calculations and projections

to grow next year, supported accommodative policy and measures such as investment tax incentives and additional funds for micro Small Medium Enterprises (SMEs) that will spur new investments and relocation of operations into Malaysia. Nevertheless, the degree of this growth is highly conditional on the strength of private sector balance sheets and on the economic outlook more generally. Public investment is also expected to gather pace, supported by the 2021 budget which continues to be expansionary. Allocation for development expenditure is expected to increase to RM69 billion (2020: RM50 billion) for the implementation of major infrastructure projects, including the construction of the electrified and double-tracked railway network between Gemas and Johor Bahru, the Pan Borneo Highway, and the Klang Valley Double Track project, and to enhance national security and public service delivery.

With recovering demand, export growth is likely to gather pace. Export growth is projected to increase to 8.9 percent next year (2020f: -9.3 percent) as global demand gradually improves. The recovery in economic activities in a number of countries throughout the region,

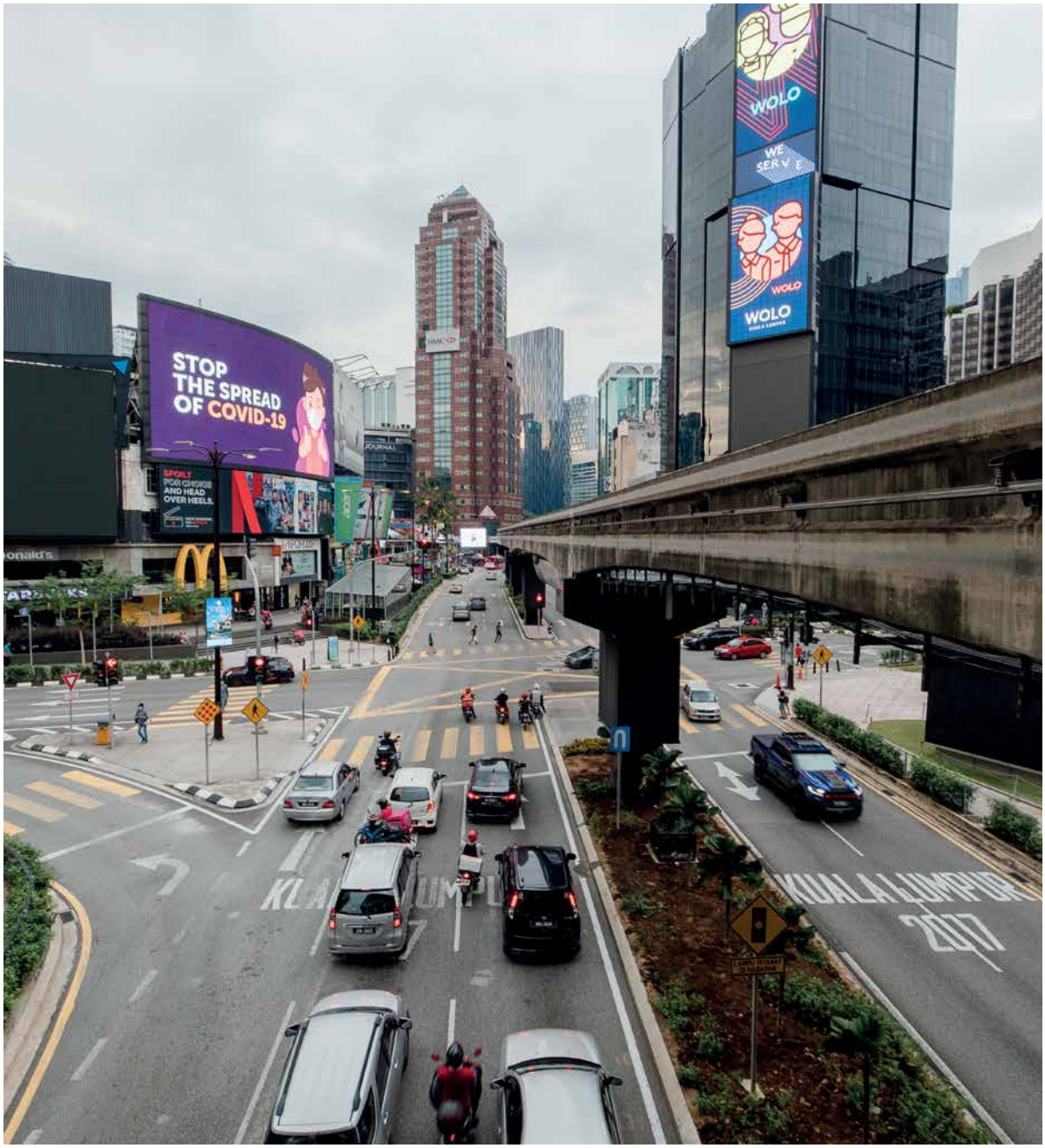
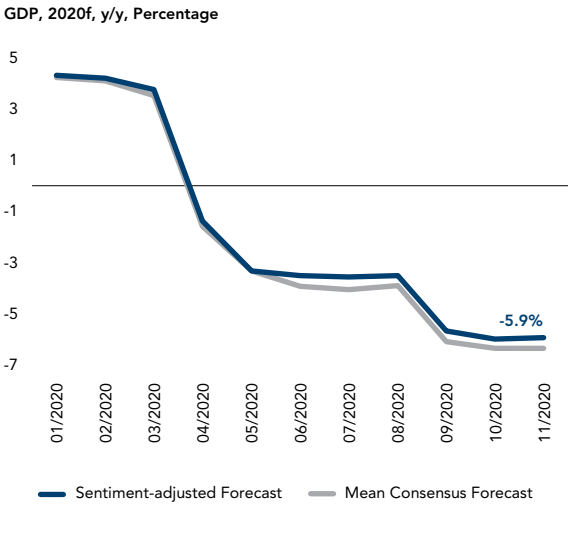
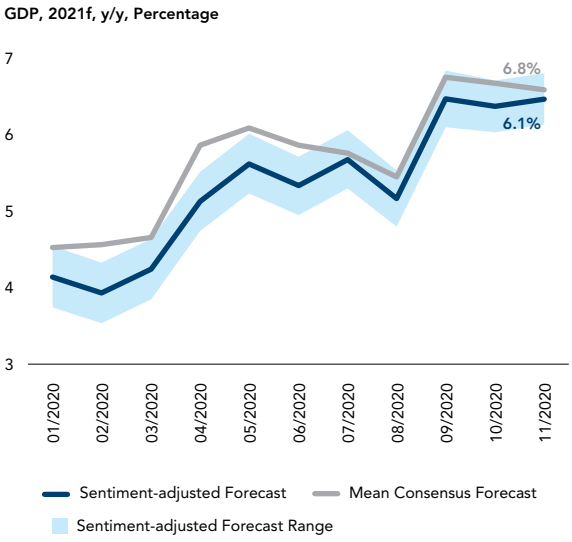


FIGURE 32
News-based measures of economic sentiment points towards a slightly smaller GDP contraction in 2020...



Source: World Bank staff calculations and projections

FIGURE 33
...but lower growth prospects next year compared to those of professional forecasters



Source: World Bank staff calculations and projections

including China, will also contribute to improvements in goods exports. Similarly, import growth is projected to increase by 9.1 percent (2020f: -8.6 percent), with the growth of intermediate and capital imports regaining momentum due to improvements in export and investment activity. See Box 3 for further details on Malaysia's trade performance during the COVID-19 pandemic.

News-based measures of economic sentiment[2] suggest that the near-term growth prospects for Malaysia could be lower than the consensus forecast. Complementary news-based measures of economic sentiment suggest that the GDP growth for 2020 could be 0.4 percent higher than estimated by the consensus forecast. However, the sentiment-adjusted growth forecast for 2021 has been on average 0.4 percent lower than the consensus forecasts since January, with the latest forecast predicting 6.5 percent GDP growth for 2021 (see Figure 32 and Figure 33).

Despite the rebound in growth in 2021, it is anticipated that output for the Malaysian economy will only return to the pre-pandemic level at a modest pace over the medium term. With the pandemic leaving indelible scars on productivity through its effects on investment, labor supply and human capital, this is expected to generate substantial headwinds in the recovery process and see the economy modestly progress toward the path of economic activity projected before the COVID-19 pandemic.[3]

Headline inflation is projected to increase modestly in 2021. The average consumer price inflation rate is projected to increase to 0.8 percent next year (2020f: -1.0 percent), driven by a gradual improvement in domestic demand and the continued implementation of stimulus measures. Underlying inflation is expected to be broadly contained into 2021 in the absence of immediate domestic cost pressures.

[2] The news-based sentiment index is derived by the staff of the World Bank through an analysis of the proportion of positive words ("gain", "improve", "agreement", etc.) relative to the proportion of negative words ("concern", "fear", "decline", etc.) present in a vast collection of news articles on Malaysia's economy. Information derived from media reports has two main advantages compared to official statistics. First, measurements of economic conditions can be calculated in real-time, at a daily frequency. Second, this information enables the measurement of economic forces that might not be easily captured by traditional data sources, providing complementary insight into factors such as the collective sentiment regarding economic prospects. A study based on historical data in 25 countries between 1991 and 2017 suggests that including news-based measures of sentiment reduces the forecast errors of GDP growth by 12 percent on average relative to the consensus forecast.

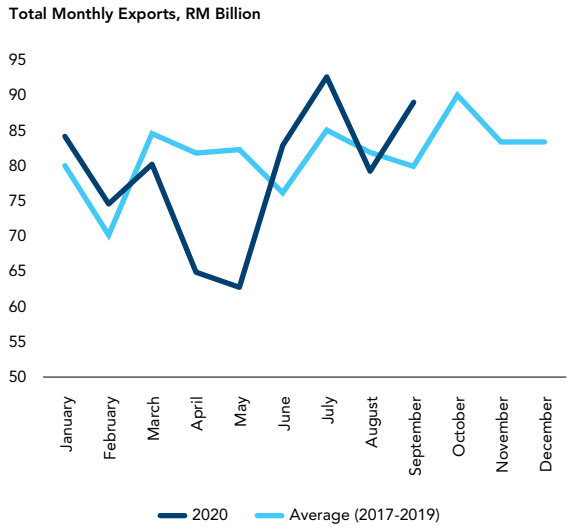
[3] World Bank estimates in the latest East Asia and Pacific Economic Update (October 2020) "From Containment to Recovery" indicated that output for several East Asian countries, including Malaysia, is unlikely to return to the pre-crisis trend by end-2022.

BOX 3

How is the COVID-19 shock expected to affect Malaysia's trade?

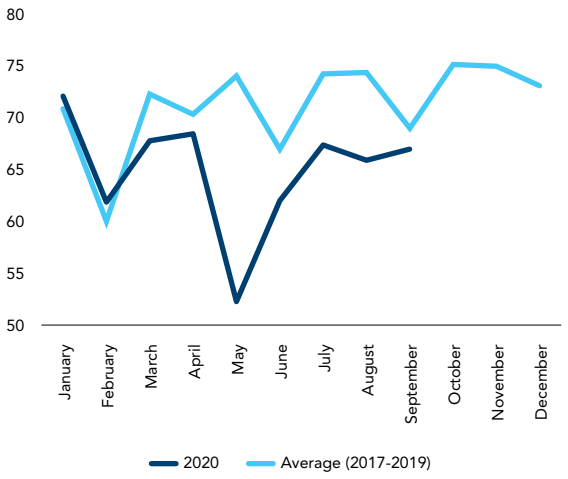
The COVID-19 pandemic and the increase in the incidence protectionist policies around the world could pose a threat to Malaysia's transition to a high-income status. Trade has been an important engine for Malaysia's growth since the early 1970s. In particular, over recent decades Malaysia was highly successful in entering and rising up through in the E&E global value chain (GVC), which accounted for around 40 percent of exports in 2019. Malaysia's deep integration into GVCs, that benefited the country for half of a century, makes its economy more sensitive to any restructuring of production networks. As a response to the COVID-19 shock, there is a possibility that in the future multinational corporations might opt for greater geographical diversification in terms of suppliers, to limit their exposure to country specific shocks, at the expense of greater efficiencies achieved through economies of scale.

FIGURE 34
Malaysia's monthly exports have bounced back to trend levels after the MCO...



Source: World Bank staff calculations based on METS data

FIGURE 35
...but monthly imports have remained well below trend throughout 2020



Source: World Bank staff calculations based on METS data

Countries resilience to future COVID-like shocks will also depend on the ability of workers to perform tasks remotely

Malaysia's merchandise trade fell sharply in April and May 2020, but rebounded in June, exceeding average 2017-2019 exports by 9 percent, and have remained strong since. The COVID-19 containment and closure policies introduced in mid-March via the initial MCO had an immediate impact on exports, which dropped in April by 21 percent compared to previous years (see Figure 34 and Figure 35). Exports recovered to previous years' levels in June when some restrictions to internal movements were lifted and economic sectors were re-opened. Imports were initially more resilient and rebounded after a decrease in May, although since then they have remained at a lower level than previous years. As the Malaysian government continues to respond to the pandemic with measures to contain the spread of infections, we expect a decrease in trade throughout 2020. Despite their short-term economic costs, early and tight lockdowns may lead to a faster recovery in exports as seen in the first half of the year (Caselli et al., 2020).

In September 2020, exports of electronics and electrical equipment increased by 33 percent compared to 2019 (see Figure 36). Electronics and electrical equipment (HS chapters 84-85) is the most important industry in terms of trade. It accounted for 50 percent of exports in September and around 40 percent of imports. Other important export industries that expanded are plastic and rubber products (HS chapters 39-40) and vegetables (HS chapters 6-15) which increased by 40 and 35 percent, respectively, compared to September 2019. Industries that contracted both in terms of exports and imports are minerals (HS chapters 25-27) and transportation (HS chapters 86-89) which declined by over than 20 percent. The latest export numbers from September suggest a strong recovery with exports of industrial supplies and parts and accessories 20 percent higher compared to the previous year. The recovery in imports of these categories was much slower and reached the 2019 level

only in September (see Figure 37). This trend might be explained by companies running down their inventories which were accumulated during the first months of the pandemic, as well as due to weaker investment and domestic demand. As the number of COVID-19 cases is increasing globally and many countries are reintroducing some of the restrictive measures, there is a risk that trade might contract again in the following months. However, China's recovery continues to gather pace providing a key source of demand for Malaysia's exports.

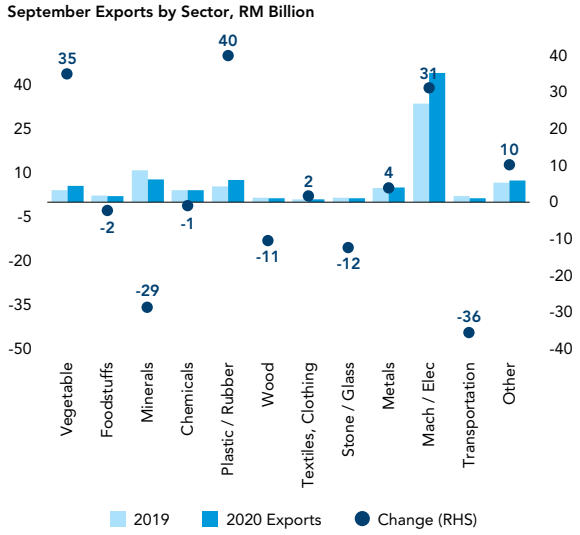
The COVID-19 pandemic has exposed the risks associated with the interconnected nature of global value chains. The pandemic might also accelerate the diversification of some manufacturing activities out of China that had started as Chinese manufacturing wages increased and the US-China trade war unfolded. Demographic change and growth in China were already leading to a shift of some manufacturing activity to other countries (World Bank 2020).

An analysis of past shocks suggests that importers do not bring production home but tend to reduce excessive dependence on any single foreign source. Freund et al. (2020) studied the 2011 earthquake in Japan and document that the shock did not lead to reshoring, nearshoring, or diversification, but found that the earthquake led importers of components to move away from Japan, and towards lower cost suppliers in developing countries. Although, these results cannot be directly applied to the COVID-19 pandemic as the nature of the shock is different in many respects, this evidence may be informative of the type of reshuffling in trade patterns to come. The current shock will bring both challenges and opportunities for Malaysian exporters as they are deeply integrated in both Chinese and US-centric GVCs.

The pandemic is also accelerating the adoption of new technologies that can stimulate productivity growth. Both firms and households are investing in computers, software, and skills to cope with social distancing constraints. The current crisis could push some firms to adopt new technologies such as industrial robots and 3D printing to increase the resilience of their supply chains. These technologies might also facilitate the movement of production closer to consumers as the importance of wage differentials become less important in the choice of production locations. Recent evidence by Espitia et al. (2020) show that the possibility of remote work can buffer the negative effect of restrictive measures as it allowed some production to be carried out during the pandemic. Thus, countries resilience to future COVID-like shocks will also depend on the ability of workers to perform tasks remotely. This requires governments to invest in the creation of broadband networks that need to be complemented by firms' intangible investments in training and reorganization of internal operations.

FIGURE 36

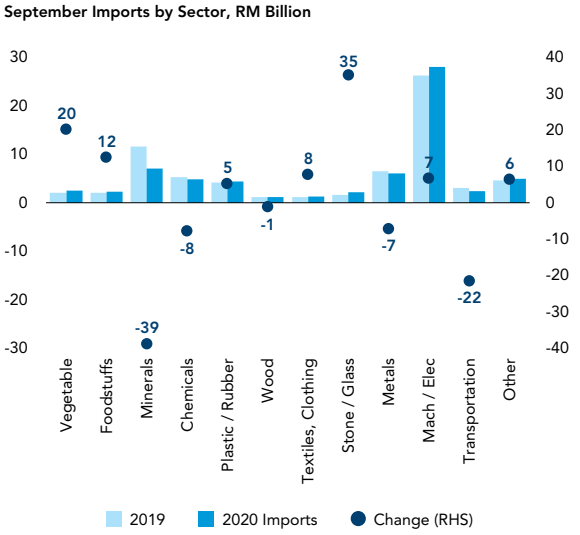
September export data points to a strong rebound in E&E exports...



Source: World Bank staff calculations based on METS data

FIGURE 37

...although the rebound in import growth in the same period has been weaker



Source: World Bank staff calculations based on METS data

The growth outlook is subject to considerable downside risks

On the external front, unexpected delays in the rollout of vaccination programs could lead to "on-and-off" lockdowns in advanced economies, amplifying downside risks to growth. Currently, it is assumed that vaccination programs will begin rolling out in early 2021. The successful rollout of these programs at this stage would contribute to global economic recovery and restore overall confidence. However, delays or interruptions to the implementation of these programs could act as a drag on recovery, subsequently affecting global demand and investments. While many governments are now considering easing movement restrictions, it is also recognized that there may be periodical needs to reimplement such restrictions to control the spread of the virus. The resulting uncertainty may continue to have negative spillover effects on domestic financial markets.

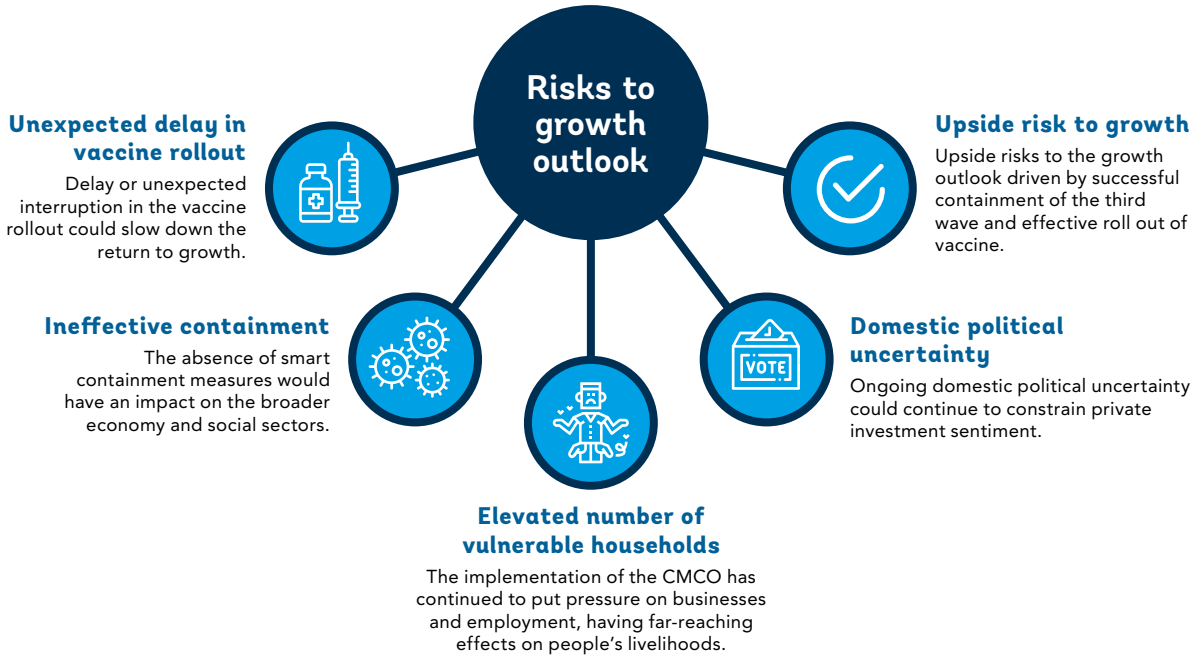
With the outcome of the pandemic remaining uncertain in the near term, the number of vulnerable households without adequate support could remain elevated. The implementation of the CMCO has continued to put pressure on businesses and employment, having far-reaching effects on people's livelihoods, especially those who are already in the vulnerable groups. These include those with little or no assets or savings to fall back on, informal workers who are not covered by social safety nets, and those who have lost their jobs, been placed on unpaid leave, or experienced pay cuts because of the movement restrictions (see Box 4). A survey conducted by DOSM at the beginning of the MCO in March showed that the share of workers with savings duration beyond four months is fairly low and a large share of working adults, especially those earning below RM4,000, feel under pressure with their current financial position.[4]

Ongoing domestic political uncertainty could continue to dampen private investment sentiment. Lingering speculation regarding the future of the current coalition, and the possibility of a general election in the near term, may continue to contribute to uncertainty surrounding Malaysia's political stability and the overall direction of economic policies.

The successful implementation of vaccination programs could contribute to a more rapid re-opening of the economy

Nevertheless, there are also upside risks to the growth outlook, predicated on the successful containment of the third wave and the effective roll out and implementation of vaccination programs. This could lead to a faster-than-expected recovery in consumer demand, greater investor confidence, and consequently a more robust recovery in domestic economic activity in 2021. The successful implementation of vaccination programs, at both the national and global levels, could contribute to a more robust resumption in economic activity; and a sharper recovery in international trade and investment (see Figure 38).

FIGURE 38
Risks to growth outlook



Source: World Bank staff illustration

[4] See December 2019 Malaysia Economic Monitor, "Making Ends Meet".

Containing the COVID-19 outbreak and protecting the most vulnerable remain the topmost priorities over the near term

In the near term, containing the current wave of the COVID-19 pandemic remains vital to ensure a safe resumption of economic activity and to prevent a more protracted downturn. This requires sustained efforts to ensure smart containment through appropriate mitigation and control measures, including targeted mobility restrictions in high-risk areas; large-scale testing; and contact tracing to limit the spread of the virus. It will also require sustained, effective public communication campaigns to maintain public support for these measures and to prevent the onset of pandemic fatigue. Additional funding allocations on healthcare may also be required to meet the increased needs of domestic health and emergency services and to facilitate the timely and equitable distribution of COVID-19 vaccines when they become available.

Lack of certainty regarding the duration and severity of the renewed outbreak and its economic consequences suggest that additional targeted social spending (through a larger COVID-19 fund or a reallocation of expenditure) may be required. Available data suggest the impact of the crisis has already had a dramatic adverse impact, particularly on the B40, who are most vulnerable to the effect of income and job losses. Members of this group have relatively limited support from savings and social insurances to enable them to weather further shocks. While a range of fiscal measures have been implemented through the *Kita Prihatin* Stimulus Package to support both vulnerable households and micro traders through the latest outbreak, these measures rest on an implicit assumption that the pandemic will be successfully

BOX 4

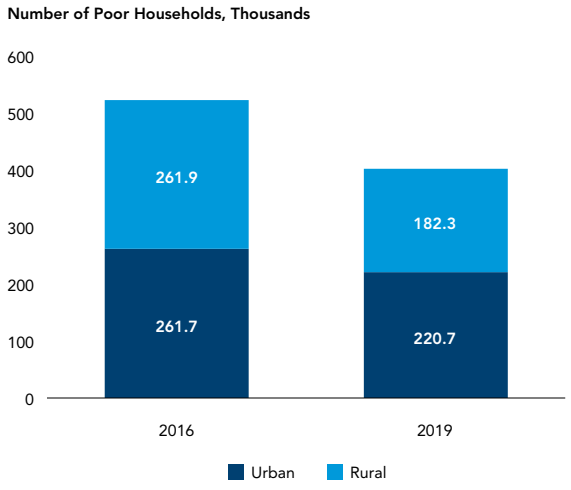
Malaysia's upgraded poverty line and the implications for policy

In July 2020 the government announced that it had revised its official poverty standard, or "poverty line income" (PLI). The announcement of this revision coincided with the release of results from the 2019 Household Income and Expenditure Survey (HIES). This was the first revision to the poverty line methodology since 2005. More importantly, it was the first time that the poverty line had been revised in real terms (that is, after adjusting for inflation) since the PLI was first established in 1977. Since then, prior to the current revision, while Malaysia's GDP per capita at more than quadrupled, with dramatic increases in general living standards, there had been no revision to the poverty threshold. While the previous PLI may have been appropriately set for a lower-middle income country, as Malaysia was in 1977, the new PLI is more closely aligned with citizens current needs and expectations.

DOSM estimates that 5.6 percent of Malaysian households were living below the poverty line in 2019. While this is considerably higher than the 0.4 percent estimated in the 2016 HIES, it certainly does not indicate that poverty has increased in real terms. Rather, it reflects the fact that the minimum standard for acceptable standards of living has been increased. If the new PLI is applied to the 2016 data, it can be seen that according to the new standard, poverty has actually declined, with the poverty rate according to the new standard standing at 7.6 percent in 2016. As with the previous PLI, the revised PLI takes into consideration differences in prices between different states and between urban/rural areas. Therefore, the poverty lines in many of these states are lower than the national average of RM2,208 per month for an average household. For example, the average PLI in Perak is RM2,077.[5]

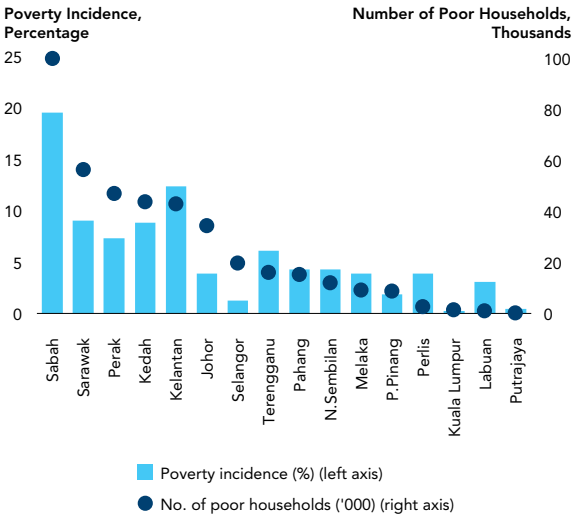
The revised PLI casts great lights on the true nature and extent of poverty in Malaysia, enabling policymakers to assess and manage it far more effectively. Under the previous PLI, the issue of poverty had almost disappeared from public view, with the proportion of those falling below the poverty line standing at less than one percent. As a result, the attention of policymakers turned more to a much larger group, the B40. While the needs of this group are also significant and worthy of policymakers' attention, the needs of the poorest group, the B10, are considerably

FIGURE 39
Most poor households live in urban areas



Source: World Bank staff calculations based on METS data

FIGURE 40
The largest numbers of poor households live in Sabah, Sarawak, Perak, Kedah and Kelantan



Source: World Bank staff calculations based on METS data

different from those in the 4th income decile (B31–B40). The new PLI can facilitate greater differentiation and the better targeting and formulation of policies and programs for the poorest Malaysians.

Some useful insights may be drawn from the geographic distribution of poverty, as measured by the revised PLI. For example, as in most countries, poverty rates in Malaysia are higher in rural areas than in urban areas, standing at 12.4 percent and 3.8 percent, respectively, in 2019. However, because Malaysia is highly urbanized, the majority of poor Malaysians (55 percent) live in urban areas (see Figure 39). Between 2016 and 2019, the number of urban poor households declined by only 16 percent as compared to the reduction in the number of rural poor households (approximately 30 percent). The discrepancy in poverty reduction rate in urban versus rural areas may be due to rapid urbanization across Malaysia as well as a strong government focus on alleviating rural poverty for many years. Therefore, this calls for a reassessment of the often-held view that poverty in Malaysia is largely a problem of remote and isolated areas.

Poverty is concentrated in a handful of states, with one in four Malaysians below the revised poverty line living in Sabah. Five states, Sabah, Sarawak, Perak, Kedah and Kelantan, account for more than 70 of poor households (see Figure 40). In particular, Sabah stands out for having both the highest poverty rate (19.5 percent) and the largest number of poor (more than 100,000 households). As discussed in Box 2, the least-developed states including Sarawak, Kedah, and Perlis have the highest share of workers vulnerable to movement restrictions and the pandemic. Workers in less-developed states are more likely to be affected with job losses as their jobs demand high levels of proximity and cannot be performed from home. Thus, there is a strong argument for concentrating poverty alleviation efforts and welfare-support policies in the most lagging states, while at the same time maintaining an awareness of the increasing share of the poor in urban areas.

Despite a lack of representative data, there can be no doubt that the poverty rate has increased as a result of the COVID-19 pandemic and the associated control measures. The limited data available (for example, online surveys with unrepresentative samples and highly localized surveys in PPRs in the Klang Valley) suggest that poorer households have been hit the hardest. Disproportionate numbers of the poor and vulnerable work in low-skilled occupations, with working from home not an option. Many others have had to face disproportionately high levels of risk, working in high-risk, low-paid essential service jobs. Informal workers and those who are self-employed were much more likely to suffer employment and income losses, with the long-known issue of insufficient savings buffers having become critical across a range of households. Evidence from other countries indicates that compared to those who were poor before the COVID-19 crisis, the "new poor" are more likely to be urban, to have higher levels of education, and to work in occupations outside of agriculture. In short, the crisis has altered the face of poverty, requiring adaptation on the part of policy makers.

[5] The figure RM2,208 is frequently cited as the new PLI. However, the PLI methodology calculates household-specific PLIs for each household in the HIES, taking into household needs as determined by the size and composition of the household, and the local prices for basic food and nonfood necessities. In 2016 cost of basic needs in Sabah was more than 60 percent higher than the costs for the same items in Kelantan (World Bank, 2020).

contained by early 2021 and that the economy will be on a firm path to recovery thereafter. Sustaining targeted and temporary relief to affected households and measures to preserve viable firms will be crucial to ensure that the impact of the crisis is not amplified and to avoid a deeper recession if it lasts longer than currently assumed.

As health risks diminish and as the economy recovers, policy focus will need to shift towards facilitating necessary economic adjustments to enable new growth in the post-pandemic environment. This implies that as conditions improve, measures to incentivize job creation and investment in growing sectors and to facilitate the upskilling and reskilling of workers should be expanded. Malaysia has made a number of steps in the right direction, with the extension of several programs to promote job creation and training by firms tabled in Budget 2021. A portion of the fiscal resources that become available following the policy shift could then be channeled towards scaling up quality public investment with strong multiplier effects to stimulate demand; to crowd in private investment; and to lay the foundation for a durable and more inclusive recovery.

Bold reforms are needed to facilitate durable and inclusive growth in a structurally different post-pandemic future

The COVID-19 crisis has emphasized the importance of striking a balance between the need to support near-term activity and facilitate longer-term growth. Confronted with the resurgence of COVID-19 infections, Malaysia's government has, with good justification, focused on sustaining the provision of near-term support to save lives and to preserve livelihoods during a period when Malaysians, especially those in the low-income segments, are facing enormous hardship. However, while this response has been vitally necessary, it has been implemented during a period of precipitous decline in government revenue, thus dramatically narrowing the government's fiscal space. This poses a dilemma for the government as further expenditures on near-term relief measures and consumption-supporting stimulus may leave it less well-equipped to facilitate subsequent recovery and longer-term growth. Thus, the government should take a dynamic view of policy to address the ongoing crisis, with a clear set of strategies for different phases of recovery to manage difficult trade-offs between providing relief today and supporting recovery and growth tomorrow.

As the recovery becomes more entrenched, fiscal policy should refocus on rebuilding buffers to counter future shocks and on sustaining public financing to ensure higher levels of inclusive, long-term growth. Reflecting this, fiscal policy should strive towards raising revenue and enhancing spending efficiency. In terms of revenue, the government may consider strategies that prioritize increasing the progressivity of the personal income tax framework; removing exemptions from consumption taxes on non-essential items; expanding capital gains tax; exploring other forms of progressive taxes, including wealth taxes; maximizing gains from tax expenditures; and enhancing revenue administration. In terms of expenditure, the government may focus on containing the rising costs of public wage bill and pensions; improving the targeting of social spending; phasing out generalized subsidies; and strengthening public investment project selection and management (see Figure 41). The government will need to give careful consideration to ensure that fiscal strategies are both sufficiently flexible and appropriately timed to avoid undue drag on growth.

Structural reforms should also expand beyond rebuilding fiscal buffers. In addition to its short-term consequences, the unique nature and the exceptional severity of the COVID-19 pandemic also likely to have profound effects on long-term growth prospects, both domestically and abroad. These effects may arise from a range of interlinked factors, including accelerated trends towards digitalization and automation; potential reconfigurations of global supply chains and shifting investment preferences; lasting shifts in consumer behavior and the composition of spending; weakened private and public sector balance sheets and loss of human capital from protracted unemployment and learning disruptions.

The 12th Malaysia Plan (RMK12) serves as a crucial platform for Malaysia to charter its development goals beyond the next five years. For the government to navigate Malaysia's post-pandemic recovery effectively and to realize its development aspirations, it will need to take a long-term view in the formulation of its upcoming RMK12, striking a balance between the need to address the immediate impact of the crisis and its commitment to implement the bold structural reforms required to seize new growth opportunities. The RMK12 is also a timely opportunity for the government to revisit the role of economic sectors beyond manufacturing and services, such as agriculture and, more specifically the agrofood sector. The COVID-19 pandemic has highlighted the importance of this sector, specifically in the area of food security and accelerating the shared prosperity agenda. These issues and policies are explored in greater detail in Part 2 of this edition of the MEM, titled Sowing the Seeds.

FIGURE 41
Rebuilding fiscal buffers

Source: World Bank staff illustration

PART TWO

Sowing the Seeds

Sowing the seeds: Revitalizing the agrofood sector

The COVID-19 crisis has highlighted the need to revamp agrofood strategy

Overall, Malaysia's economy has experienced extraordinary growth over recent decades, with the agricultural sector making a major contribution to this growth.[6] Malaysia's GDP grew by an average annual rate of 6.3 percent in the period from 1970 to 2019, with this rate standing at 5.3 percent over the past decade (2010–2019) (WDI 2020). These high rates of growth were made possible by the modernization, industrialization, and diversification of Malaysia's economy, with services and manufacturing contributing to about 80 percent of total GDP during this decade. By the mid-1990s, Malaysia had successfully made the transition from lower-middle-income to upper-middle-income status, with strong expectations that it will achieve high-income status by the mid-2020s.[7] Over the past two decades, extreme poverty has been all the eliminated from the country.

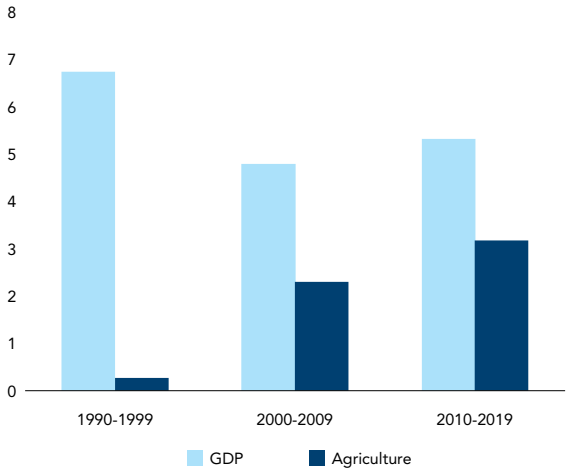
Although the growth of Malaysia's agricultural sector has been relatively moderate compared to that of services and manufacturing, it has nonetheless been a key enabler of the country's economic transformation over the past fifty years. While the growth of this sector has been relatively low compared to that of these others, it still recorded the impressive annual average rate of 2.8 percent in the period from 1970 to 2019, with this rate standing at 3.2 percent over the past decade (see Figure 42).[8] The agricultural sector has also played a critical role in facilitating growth by ensuring the supply of food to an urbanizing population; releasing labor to the non-primary sectors; providing inputs used in agro-processing and other forms of manufacturing; generating investible capital; and generating foreign exchange. As Malaysia moves towards the achievement of high-income status, it is poised to join numerous other countries that have transformed their economies, with its agricultural sector moving from prime position at an earlier stage of its development to third place, behind services and manufacturing, in terms of contributions to employment and GDP. As of 2019, Malaysia's agricultural sector accounted for approximately 11 percent of total employment and 7 percent of GDP (see Figure 43).[9]

The COVID-19 crisis has emphasized the importance of Malaysia's agricultural and food sectors to the achievement of food security, resilience and other matters. Initially, the pandemic and its unprecedented impact on the economy, with widespread shutdowns across all sectors, resulted in credible concerns related to the security and dependability of food access and supply. While Malaysia has not been among the most severely affected countries and worst-case scenarios have not manifested, loss of income at the household level and responses to uncertainty have nonetheless created a high degree of volatility in food markets. In addition, restrictions on the movement of goods and people have interfered with agricultural production, while at times, social distancing measures have disrupted food processing, marketing, and delivery. The

[6] Agriculture's role in Malaysia's economy is discussed at greater length in recent work carried out by the World Bank, including the report, "Agricultural Transformation and Inclusive Growth: The Malaysian Experience" (Taffesse and Tsakok 2019).
[7] In 2019, Malaysia had a GNI per capita of RM 45,924, or US$ 11,200 using the Atlas method (World Bank 2020).
[8] To put this average growth rate in regional perspective, it is similar to that achieved by Indonesia (3.9 percent) and China (3.8 percent), and a good deal higher than that recorded in Vietnam (2.6 percent) or the Philippines (2.6 percent) over the same period (WDI 2020).
[9] Malaysia in fact stands out in that the contributions of agriculture to the overall economy (GDP) have been more in line with the sector's share of employment than they have been in other countries in the region.

FIGURE 42
Agricultural growth has been substantial and has accelerated...

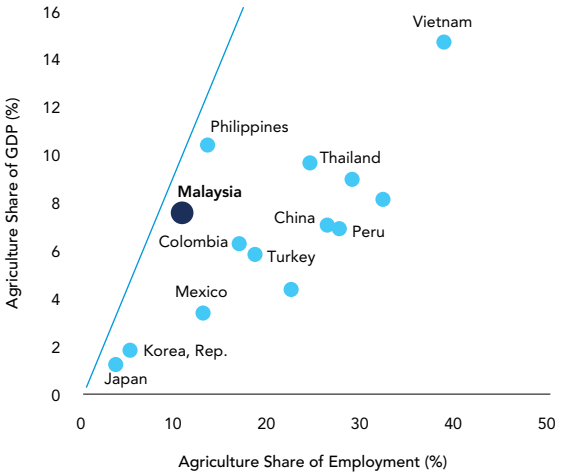
Growth in Agricultural Value Added and GDP, 1990-2019, Percentage



Source: WDI 2020

FIGURE 43
...and the sector's contributions to employment and GDP have remained fairly balanced in the course of transition

Agriculture Share of Employment and GDP in Selected Countries, 2018



Source: WDI 2020

crisis has had ripple effects across the food economy, with the impacts on food security and welfare still not able to be fully assessed.

Thus, the pandemic has brought attention to the multifaceted and interconnected nature of Malaysia's food system, with increased focus on issues related to food security and agrofood policy in broader terms. Today, food insecurity often relates more to problems of diet quality and affordability of nutritious foods than to lack of availability of staple foods . And this has continued to be true during the pandemic as food insecurity has probably been fueled more by the loss of income than by the initial short-lived disruptions that have affected food supply. Following the near-global economic shutdown that occurred during the pandemic, Malaysia's agricultural sector experienced a contraction . This was, however, caused to a considerable extent by severely dry weather conditions and cutbacks in fertilizer applications in the oil palm sector. From a food security standpoint, the significance of this contraction may lie particularly in the loss of livelihoods it implies, knowing that it will have affected some of Malaysia's poorest households. Meanwhile, it is not just the crisis that invites a new perspective on food and agriculture.

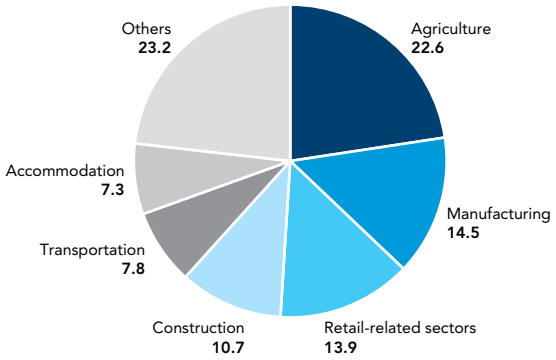
While the pandemic has resulted in increased focus on Malaysia's food system and on issues related to food security, it has also made it clear that the achievement of high-income status will be accompanied by socioeconomic transformations that will require a reassessment of the agrofood sector. In high-income contexts, in which day-to-day concerns regarding the adequacy of suppliers of staple foods are largely allayed, societies tend to start expecting more of their food systems. With the achievement of this status, expectations tend to increase and more attention is paid to issues such as value addition, the quality of diets, the environmental footprint of food across its lifecycle, the quality of food sector jobs, the welfare of workers and animals, and the vibrance of food culture. From this standpoint, despite its obvious strengths, Malaysia's current agrofood policy seems to have some blind spots, with a number of under-appreciated and under-addressed risks and opportunities.

As Malaysia makes the transition to higher levels of development, it will be better able to pursue other national priorities, including the achievement of shared prosperity, through measures to strengthen its agrofood system. Through measures designed to enhance farmers' incomes, agricultural jobs, and agro-exports, agriculture in Malaysia can be made a more powerful engine of for shared prosperity—more widely distributed and equitable growth. It is notable that farming households are a major "constituent" of the B40 (see Figure 44 and Figure 45); and that food insecurity remains a challenge among low-income households. Moreover, the trajectory of the agrofood sector—with its potential to influence public health

and productivity, the country's natural capital base, the quality of rural employment, and more—has broad relevance to national goals relating to the inclusion, resilience, competitiveness, jobs, sustainability, and long-term economic growth. The forthcoming preparation of the 12th Malaysia Plan (RMK12) as well as formulation of the national food security policy provide timely opportunities to lay out a higher vision for Malaysia's agrofood sector and to revamp the aims and means of agrofood policy.

FIGURE 44
A large portion of B40 households are smallholders employed in the agricultural sector

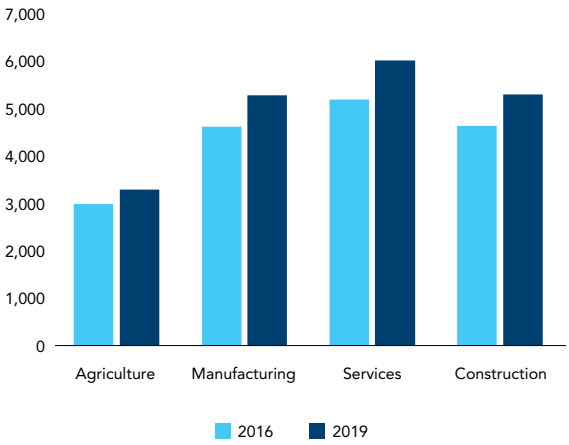
Distribution of B40 Households by Industry, 2014, Percentage



Source: Economic Planning Unit (EPU)

FIGURE 45
Households with heads working in the agricultural sector had the lowest median income

Median Disposable Income of Households in RM, 2016 and 2019



Source: DOSM 2019

Malaysia's agricultural strategy has produced a strong but two-speed agricultural economy

Malaysia's development of tree-crop commodities has been a major contributor to its economic growth and serves as an allegory of its economic development story, with a shift from primary production toward increasingly sophisticated economic activities. Specifically, the significance of the contribution of oil palm to the agricultural sector and to the wider economy can hardly be overstated. After overtaking Nigeria as the world's largest producer of raw oil palm fruit in 1975 (a position it ceded to Indonesia in the mid-to-late 2000s), over the next two decades, Malaysia became a leading global exporter of refined palm oil and a range of high-value added products derived mainly from oil palm, as well as other tree crops such as rubber (see Box 5).

That said, Malaysian agriculture has not diversified to the extent seen in many high-income countries around the world, nor has it yet become a top exporter of a diverse set of high-value food products. While Malaysia has demonstrated its cutting-edge capabilities in the transformation of palm oil production, it ranked in only 69th place out of 101 countries (below Mozambique, Egypt, Ethiopia, and Zimbabwe) in an agribusiness benchmarking exercise conducted by the World Bank in 2019;[10] with the food side of its agricultural sector experiencing attrition. Malaysia's tree crop sector also has room to improve in number of ways, most particularly in terms of closing persistent yield gaps and addressing ongoing social and environmental challenges.

[10] World Bank Enabling the Business of Agriculture 2019.

BOX 5

Malaysia's monocrops as a (paradoxical) source of diversification

As described in the World Bank's work on Malaysia's agricultural transformation (Taffesse and Tsakok 2019), the country has progressively reached a point where it adds a great deal of value to raw oil palm through manufacturing. In 1970, palm kernels were exported without further local processing; by the early 1980s, it was exporting large volumes of crude palm kernel oil; by 1991, nearly two-thirds of Malaysia's palm kernel oil exports (by volume) consisted of processed products. In one sense, this process of transforming raw material into a wide range of intermediate and consumer goods turned oil palm, a monocrop, into a major driver of the agro-based economy's diversification. At present, oil palm provides the raw material for four broad categories of processed food and nonfood products: (1) palm oil and palm kernel products; (2) oleochemicals used in soap, cosmetics, and other nonfood products; (3) biodiesel; and (4) palm biomass such as green plywood. Though just one crop, oil palm can be considered to be structurally diversified to a far greater degree than many other crops.

Meanwhile, in the wider tree crops subsector, Malaysia has successfully established itself as a major supplier of a diverse set of high-quality processed products, even as its production of their raw material declined. Malaysia's long-standing rubber plantations and other tree crop plantings has given way to the oil palm. However, in the development of downstream industries, Malaysia has forged ahead. In particular, Malaysia became a prominent supplier of a wide range of rubber products, including tires, gloves, thread, and footwear during the 1990s. Since then, it has achieved recognition as a supplier of increasingly sophisticated products, including catheters, surgical gloves, and other medical equipment. During the COVID-19 pandemic, there has been a surge in the demand for and production and export of rubber gloves, an essential component of the personal protection equipment required in the fight against the pandemic. Malaysia has also become one of the region's major processors of cocoa butter, with its capacity to grind raw material now exceeding what its own domestic plantations can supply.

The agrofood sector, however, has been considerably less dynamic

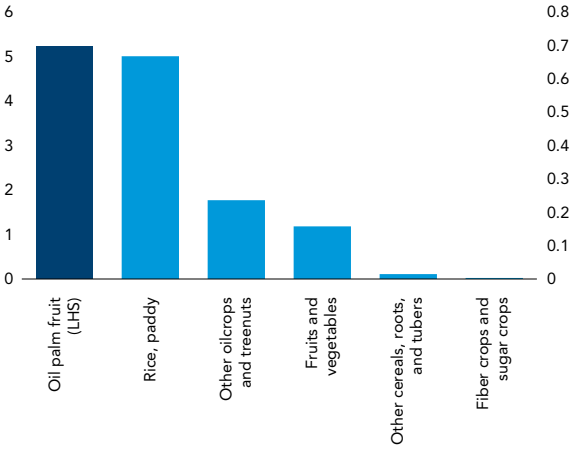
In comparison to its tree crops sector, Malaysia's agrofood sector[11] is at a surprisingly early stage of modernization and diversification. Although rice has benefited to the greatest extent from public support, it has not been Malaysia's fastest growing crop. In the period from 1990 to 2018, Malaysia's rice output increased by only 44 percent, compared to the rate of 61 percent for fruits and vegetables and 208 percent for oil crops. Despite these growth trends, Malaysia's crop mix has remained largely dominated by rice, if oil crops are excluded (see Figure 46). In addition, while domestic production has roughly kept up with the rising national demand for rice, Malaysia's crop mix has not mirrored the diversification of national and regional diets as the country achieved higher levels of economic development (see Figure 47). In other upper-middle-income countries, including Chile, Mexico, and Turkey, and even rice-centered countries such as China, Thailand, and Vietnam, agricultural production has demonstrated a greater degree of responsiveness to the realities of a growing, urbanizing, and more wealthy population that is increasingly dependent on purchased food and that has become increasingly demanding in terms of the quantity, diversity, and quality of its food supply.

> Malaysia is still at early stages in terms of exploring high-value rice markets, due among other factors to restrictions on land use and the marketing and export of rice

In the rice sector, Malaysia has performed relatively poorly in terms of productivity, profitability, and quality if the effects of subsidies are discounted. Malaysian paddy yields are, on average, comparable to those of other rice-importing Southeast Asian countries, although they have been growing more

FIGURE 46
Malaysia has remained focused on producing few crops...

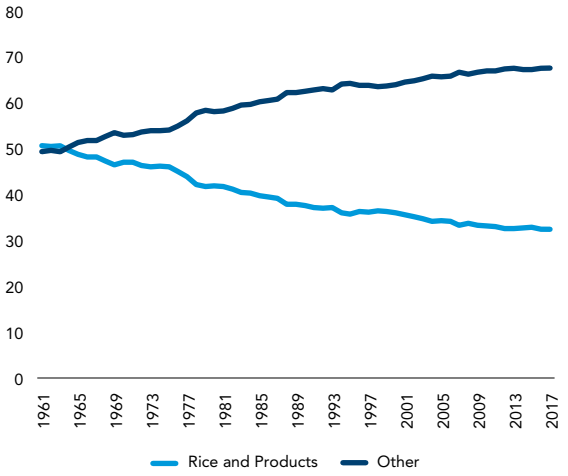
Malaysia's Crop Mix, 2018, Millions of Hectares



Source: FAOSTAT 2020

FIGURE 47
...while what it and the region consume has greatly diversified

Food Supply in 15 Eastern and Southeast Asian Countries, 1961-2017, Percentage



Source: FAOSTAT 2020

[11] The agrofood sector is defined here as the part of the wider agricultural sector that is devoted to producing and processing food, exclusive of plantation crop products, for both export and domestic consumption.

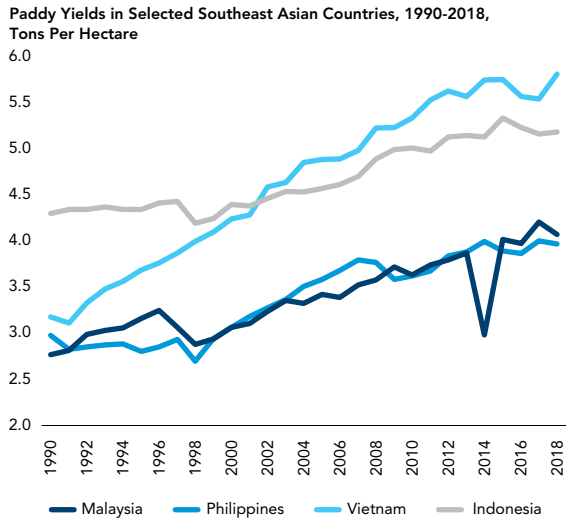
slowly (see Figure 48). And within the Muda Agricultural Development Authority (MADA),[12] Malaysia's largest rice granary, paddy farmers' production costs and net profits are actually some of the best in the region, the latter surpassing those of Indonesia, the Philippines, China and India (in comparable rice bowl areas). However, this advantage only holds if the effect of subsidies is not discounted. Without these subsidies, Malaysian farmers' net profits would be among the lowest of this group of comparators (see Figure 49). Notably, Malaysian rice costs more to produce than to import, despite generous levels of subsidization.

Malaysia's relatively high costs of rice production are driven by several factors. It has not helped that the private agricultural inputs and services sectors are underdeveloped, that varietal research and extension are slow-moving, or that milling has become highly concentrated (Omar, Shaharudin, and Tumin 2019). Malaysia's smallholder-dominated paddy sector has also made limited progress toward realizing economies of scale or mechanization despite facing increasing competition for labor. Due to aging milling technologies and supply chain constraints, its rice quality tends to be relatively low. Furthermore, Malaysia is still at early stages in terms of exploring high-value rice markets, due among other factors to restrictions on land use and the marketing and export of rice, and a lack of varietal or market research. These and other realities have harmed farmers' ability to compete in terms of either price or quality.

Malaysia has become increasingly dependent on net imports for much of the higher value foods its population eats. An examination of Malaysia's food balance sheets shows that in 2017, 66 percent of Malaysia's domestic supply of vegetables and all of its domestic supply of pulses were imported (FAOSTAT 2020).[13] For rice, 28 percent of the domestic supply was imported, still a remarkably high proportion. As a country moves towards higher levels of economic development, increased dependence on imports is not unexpected; in fact, it is typical of higher income countries. However, where Malaysia is exceptional is in terms of having less than commensurate exports of these products, especially higher value products (see Figure 50).

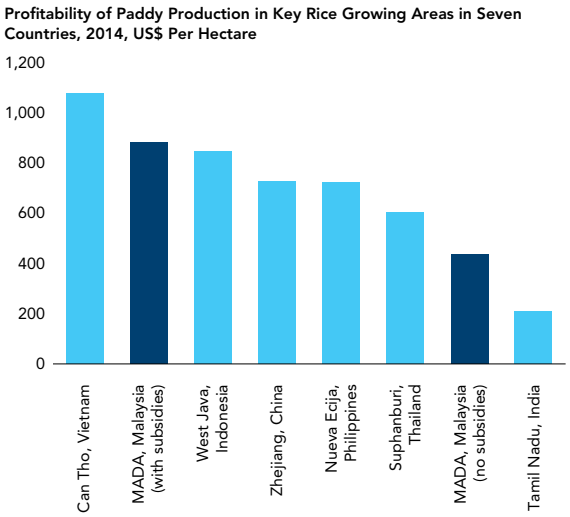
Despite its natural advantages, Malaysia has also not become a major exporter of fruits and vegetables, as many other countries have at similar points in their development trajectory. With their high market and nutritional value, fruits and vegetables are a significant category. Both domestic production and imports of fruits and vegetables have increased to satisfy consumers' rising demand for a year-round

FIGURE 48
Malaysian paddy yields are generally comparable to those of other rice-importing countries in the region



Source: FAOSTAT 2020

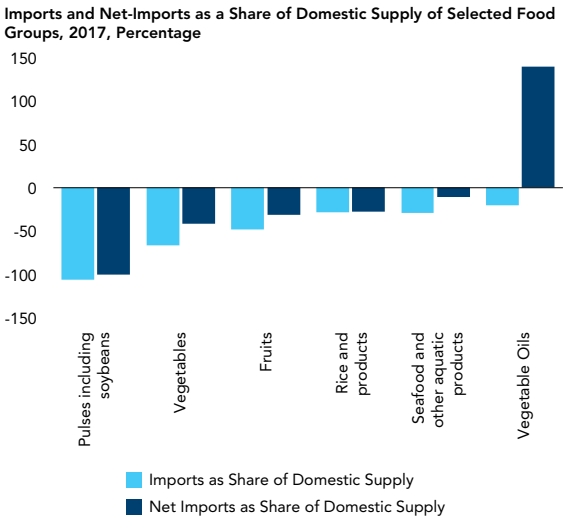
FIGURE 49
Malaysian paddy production is far less profitable when subsidies are not factored in



Source: Omar, Shaharudin, and Tumin 2019

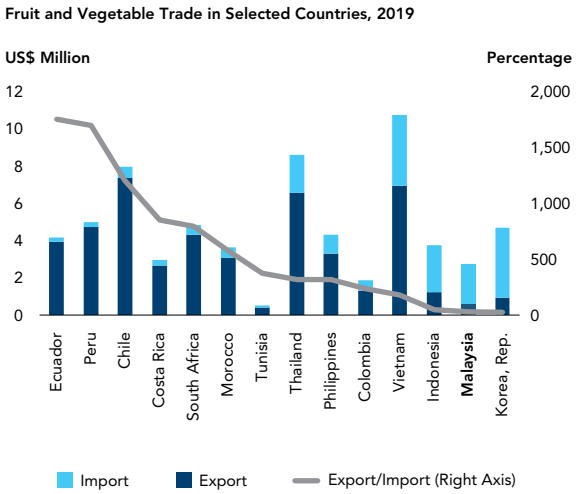
[12] MADA stands for the Muda Agricultural Development Authority
[13] Note that not all domestic supply is consumed as food.

FIGURE 50
Malaysia has become a net importer of some of the higher-value foods it consumes



Source: FAOSTAT 2020

FIGURE 51
Malaysia's exports of fruits and vegetables have not increased commensurately with imports as much as in other countries



Source: Comtrade 2020

supply of a diverse range of foods in these categories, as is typical when per capita income rises. Malaysia's consumption of fruits and vegetables has increased by more than two-and-a-half times since 1990.[14] Where Malaysia deviates from comparator countries is in having developed its exports of fruits and vegetables to a much lesser extent (see Figure 51).

In Malaysia, there is also significant potential to improve the regulatory environment governing the agrofood sector and to upgrade and modernize the food sector's core infrastructure, including beyond the farmgate. Malaysia's potential to improve the business regulatory environment in indicated by its low ranking under the World Bank Enabling the Business of Agriculture benchmarking exercise. As already noted, in 2019, Malaysia ranked in only 69th place out of 101 countries. Its overall score was evidently damaged by its grade of zero under "registering fertilizer," which relates to laws and regulations that help domestic farmers gain access to high-quality fertilizer. Separately, in the area of logistics, while Malaysia's performance is decent, there is still definitely room for improvement, with the same likely holding true in relation to food logistics. Under the Word Bank's (non-food-specific) Logistics Performance Index (LPI), which scores countries in relation to customs, infrastructure, international shipments, logistics competence, tracking and tracing, and timeliness, while Malaysia outperformed upper-middle-income countries and closely trailed or rivaled Vietnam in most categories, it lagged behind Thailand, China, and high-income OECD countries under every index component (World Bank 2018).

[14] Based on tons of "food supply" between 1990 and 2017 (FAOSTAT 2020). Note that the 2017 figure reflects the new Food Balance Sheet methodology.

BOX 6

The decisive role of the public sector in supporting the successful development of tree crops and oil palm complex

Malaysia's achievements in the area of tree crops have materialized in large part due to focused government intervention and leadership. In the case of oil palm, the government proactively "picked its winner" and invested heavily. And over time, it provided support not only for upstream production, but also downstream, in the palm oil and other value added industries. Moreover, through the government's interventions, it has contributed to building the industry's innovation capacity, its infrastructure and its institutions, and to drawing in private sector investment. Starting in 1956, the government established agencies (and raised taxes) dedicated to fostering the development of the industry. It also became involved in supporting oil palm estates, extension, processing, research and development, commercialization, and marketing. Early on, a palm oil export tax rebate and other forms of cross-subsidization encouraged producers to grow oil palm in preference to rubber. Later, various government programs enabled a major expansion of private sector milling and marketing capacities. By the late 2000s, the government helped establish five industrial clusters dedicated to different parts of the palm oil industry.

In parallel, the public sector has been relatively proactive in terms of managing the oil palm sector's social and environmental sustainability challenges, particularly important given the attention that these challenges are attracting from parts of civil society. Even though still at the initial stages of effective environmental and social achievement, Malaysia's push for the development of sustainable palm oil certification systems and its plans to halt the expansion of oil palm plantations also demonstrate a significant commitment to the managing of these sector threats. That said, given the sector's vulnerability to climate change and its association with labor and environmental challenges, it cannot afford to become complacent.

Existing approaches to agrofood policy have generated inefficiencies and distortions that are impeding growth

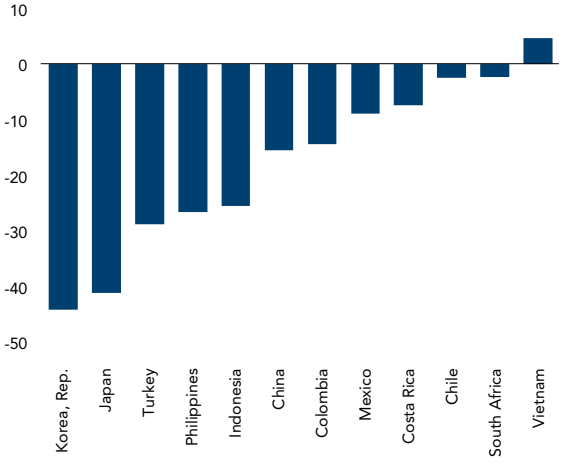
While the large public sector presence in Malaysia's agricultural sector has had a generally positive impact on tree crops, it has created challenges in the agrofood sector. Systematic and significant public sector intervention in the tree crops sector has been central to enabling it to achieve its outstanding performance (see Box 6). On the other hand, the same factors have had a very different impact on agrofood, particularly rice. Paradoxically, government policies to support farmers' livelihoods and national food supply have over time resulted in structural characteristics that limit the growth and dynamism of the agrofood economy.

The rice-centricity of the Malaysian government's policies has led to lopsided public support, with it allocating more public resources to rice[15] than to any other agricultural product (World Bank 2019a).[16] Much of this expenditure is driven by a desire to achieve goals that remain pertinent today, including ensuring food security and reducing rural poverty. At the same time, some of these measures, including measures to achieve self-sufficiency in terms of rice production, may seem out of step with contemporary realities. Those realities include the declining significance of rice in terms of the population's diets and incomes (see Box 7). They also include a disconnect between the achievement of food security and the production of rice, which is neither scarce nor generous in assuring economic access to adequate food supplies.

Furthermore, public support for the rice sector in particular has been provided largely through distortionary and protectionist instruments. Major instruments used to support paddy production and protect rice consumption include fertilizer subsidies, a guaranteed minimum price for paddy, an output-based (paddy price) subsidy, parastatal control over milling and trade, government leadership of varietal development and seed production, and a retail (rice) price ceiling. One

FIGURE 52
Implicit taxation of consumers: Where does Malaysia stand?

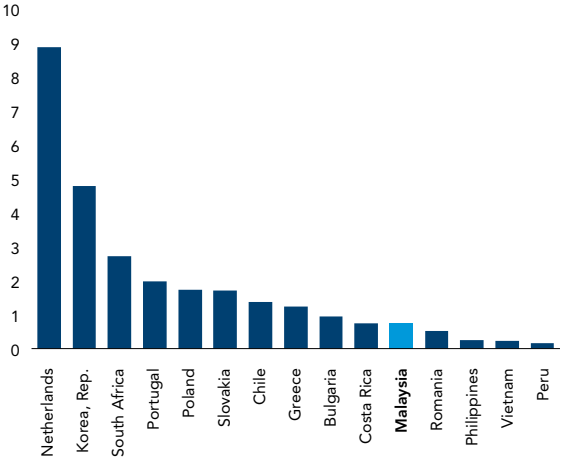
Agricultural Consumer Support Estimates as a Share of Gross Farm Receipts, 2016, Percentage



Source: OECD 2020
Note: Malaysia was not included in this OECD analysis.

FIGURE 53
Malaysia could be spending more on public goods like agricultural sciences, extension and R&D

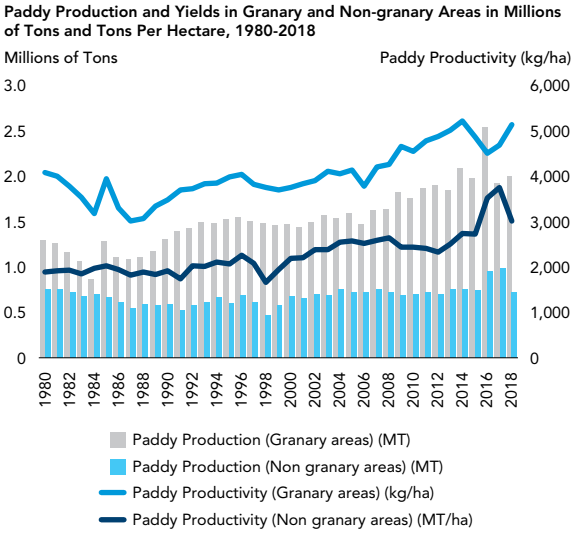
Gross Domestic Expenditure on R&D in Agriculture as Share of Agricultural GDP, Latest Year Available (2016 for Malaysia), Percentage



Source: UNESCO 2020, WDI 2020
Note: Based on current LCU. Accounts for public and private R&D spending.

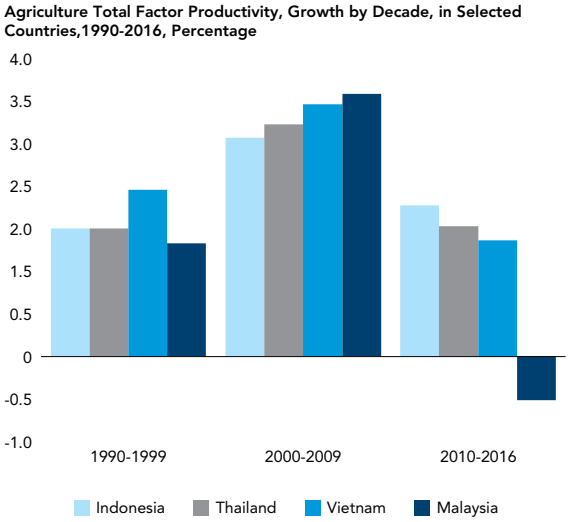
[15] Used here to designate the paddy production and rice milling and marketing complex.
[16] Overall, Malaysia spends quite generously on agriculture relative to other Southeast Asian countries, though not compared to OECD countries; in 2017, it spent the equivalent of 9.4 percent of agricultural GDP (World Bank 2019a).

FIGURE 54
Paddy output and yields have not been highly responsive to supportive policies



Source: Malaysia Department of Agriculture and estimates for paddy productivity

FIGURE 55
Malaysia's agricultural total factor productivity may be running out of steam



Source: USDA 2020

consequence of these distortionary support policies is a *de facto* tax on Malaysian consumers. In itself, in the global context, such taxes are not unusual (see Figure 52). However, the burden of these taxes is particularly high in Malaysia. In 2016, sub-sector policies indirectly cost consumers an estimated RM 3.5 billion (more than US$ 800 million) (Arshad, Arifin, and Tey 2019).

Public expenditure has also been heavily channeled towards the subsidization of private goods, including fertilizers and pesticides, farm equipment, irrigation and drainage hardware, and planting material. This pattern of public spending (World Bank 2019a) has entrenched an approach to agricultural growth that expects to generate returns on the ever more intensive application of inputs. While this has been a common approach across emerging economies, public expenditure is increasingly being used to promote new technologies, greater R&D, better extension, innovation, and agro-entrepreneurship (notably in Latin American countries like Mexico, Peru, and Chile) (Morris et al. 2020). In Malaysia, there is probably room for both public and private sector cooperation to enhance the extent and quality of spending on agrofood R&D (see Figure 53).

A number of studies have called the effectiveness of agricultural support policies in terms of boosting productivity and competitiveness into question. While these policies have likely helped to maintain rice self-sufficiency within the targeted range (usually 65–70 percent), these studies suggest low levels of responsiveness within the rice sector to government support, even in dimensions specifically targeted for improvement, such as income levels, output, import substitution, and yields. In particular, the relative rates of growth of paddy yields in granary and non-granary areas respectively appear to be similar, despite considerable the considerable expenditure on the former (see Figure 54).[17] More generally, after at least two decades of sustained growth, Malaysia's agricultural total factor productivity (TFP) may now be decelerating or declining (see Figure 55).

[17] Notwithstanding strong discrepancies in yield levels across granary and non-granary areas yields in non-granary being much lower.

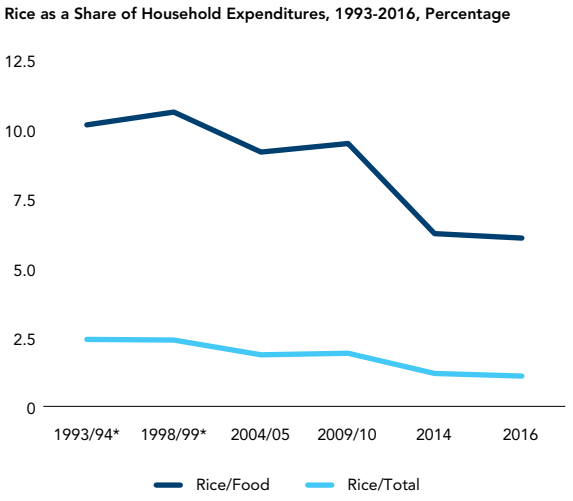
BOX 7

Rice-centricity of agricultural support policies

Over the past decades, rice has been playing a declining role in Malaysia's economy and the diets of its population. In 2018, rice production accounted for only 0.2 percent of national GDP and 2.4 percent of agricultural GDP, much lower proportions than in the past (DOSM 2019). By 2015, there were fewer than 150 thousand paddy farmers, down from more than 200 thousand in 1985. Although paddy production has continued to be supported by the public sector, it accounts for a steadily decreasing proportion of agricultural land use. In 1970, while paddy accounted for about one-fifth of agricultural land use, this had declined to less than 10 percent by 2017. And while national rice consumption has been increasing in terms of total volume, this is only because Malaysia's increasing population has more than offset its declining appetite for rice (Figure 56).[18] As of 2016, the average Malaysian household spent three times more on fruits and vegetables and more than twice as much on breads and other cereals as on rice (Omar, Shaharudin, and Tumin 2019). These trends suggest that the greater market opportunities lie in diversification.

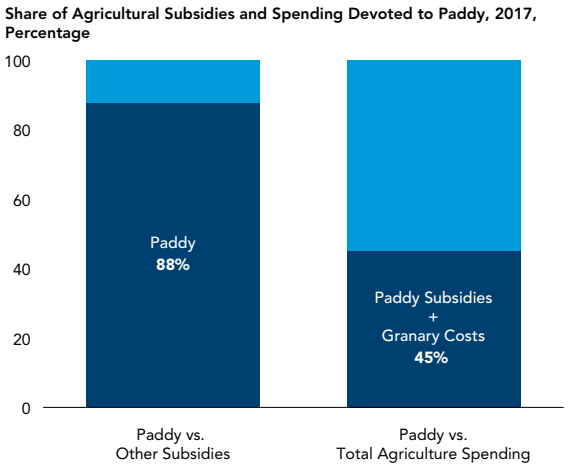
With these and other changes described, and also relative to international benchmarks, Malaysia's public expenditure on rice has been high, and continues to be so (see Figure 57). In 2017, direct budgetary spending alone accounted for about 45 percent of the Ministry of Agriculture and Agro-based Industry's annual budget. The proportion has been even higher in other recent years, reaching 57 percent in 2011. In fact, the transfer of public resources to farmers (through both higher consumer prices and spending of taxes) was higher in Malaysia than in almost any country, including Japan. In Malaysia, transfers accounted for 73 percent of gross farm receipts in 2017 (World Bank 2019a).

FIGURE 56
The place of rice has declined to about 1 percent of Malaysian households' expenditures...



Source: World Bank 2019a

FIGURE 57
...but its dominance of the agricultural budget has been steadfast



Source: Based on World Bank 2019a

[18] Between 1978 and 2018, Malaysia's overall population almost doubled, increasing by about 93 percent.

Key dietary and related health risks need to be better addressed

A significant proportion of Malaysia's population continues to face diet-related health issues. While inadequate calorie intake has now become almost completely a problem of the past, hidden hunger (which occurs when the quality of food people eat does not meet their nutrient requirements) has not (see Figure 58). In the current era, Malaysia faces low rates of undernutrition in terms of calorie intake, recording similar levels to Republic of Korea and Japan. However, while nutritional deficiencies are declining, they still drastically compromise the socioeconomic prospects of those affected, including the 21 percent of Malaysian children under 5 who were identified as stunted in 2016 (see Figure 59).[19] While Malaysia also records moderate levels of diet-related chronic disease compared to many peers, it still faces some health challenges related to

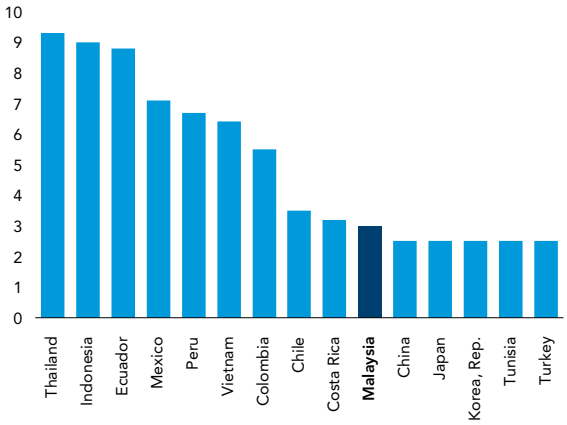
[19] Another 11.5 percent of young children were wasted.

poor diet quality. Rates of noncommunicable diseases (NCDs), most specifically diet-related conditions such as diabetes and kidney and cardiovascular disease, have been increasing steeply, as have risk factors such as high body mass (see Figure 60). In less than a decade, the proportion of the population affected by diabetes[20] rose by an incredible 44 percent, reaching 17 percent among 20–80-year-olds in 2016 (WDI 2020) (see Figure 61).

An increasing proportion of Malaysia's population is now overweight and thus at heightened risk of chronic disease.[21] As of 2016, 43 percent of its adults and 6 percent of its very young children (those under

FIGURE 58
Inadequate calorie intake is nearly a problem of the past...

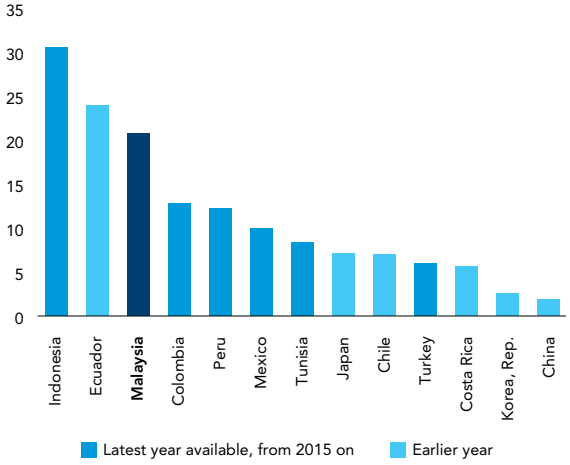
Undernutrition in Selected Countries, 2018, Percentage of Population



Source: HNP 2020

FIGURE 59
...but hidden hunger is not

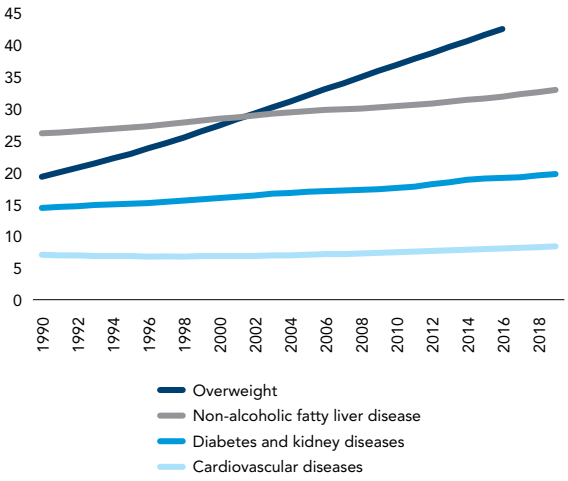
Stunting in Selected Countries, Percentage of Children Under 5, Latest Year Available



Source: HNP 2020, based on latest available data

FIGURE 60
Malaysia can still take *preventive* action to curb the progression of noncommunicable diseases...

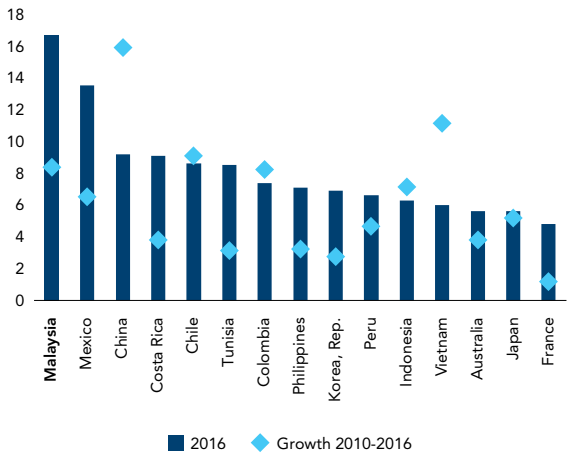
Prevalence of Selected NCDs in Malaysian Adults Age 20+, 1990-2019, Percentage



Source: GBD 2020 and HNP 2020

FIGURE 61
...provided that the country acts swiftly

Diabetes Prevalence in Adults Age 20 to 79, 2016, Percentage



Source: WDI 2020

[20] Type I and type II combined.
[21] In the current context, it also bears noting that diet-related disease has the potential to compound the public health effects of zoonosis, another food system risk that concerns the wider economy, noting that people affected by NCDs have sadly succumbed at greater rates to COVID-19.

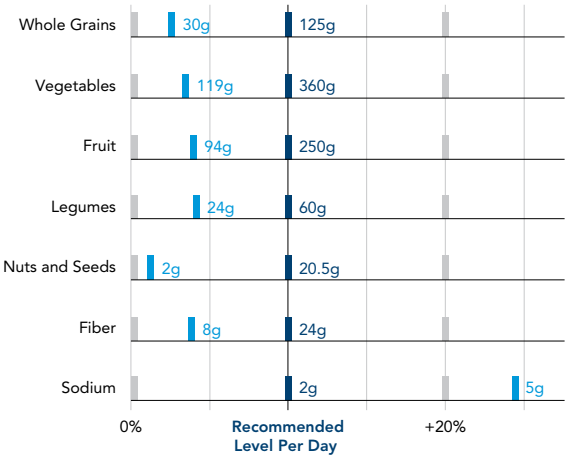
five) were overweight (WHO 2020; HMP 2020), with the percentage of overweight boys more than quintupling between 1990 and 2016, increasing from 6 to 30 percent (NCD Risk Factor Collaboration 2017).[22]

While in general, Malaysians enjoy diverse diets, these diets are significantly deficient in fresh produce, legumes, and fiber and excessive in sodium and unhealthy fats. Dietary diversity in Malaysia is high: in 2013, the diversity of the country's food supply was already at a similar level to that found in France, as measured by the Shannon diversity index. However, Malaysian consumption patterns deviate significantly from dietary recommendations (see Figure 62). In particular, the sale of ultra-processed foods has been increasing significantly (see Figure 63). These facts have ominous implications for Malaysia's public health and productivity going forward. To illustrate the potential magnitude of what it costs a nation to be sick with chronic disease, one study on the United States economy found that the total burden of NCDs (not specifically those which are food system–related) corresponds to an annual tax rate of near 11 percent on aggregate income (Chen et al. 2018).[23]

The composition of the population's diet is only one of several pathways linking agriculture to public health and productivity. Other health-related issues that could be impacted by agricultural policy include environmental pollution; animal-to-human disease transmissions; antimicrobial resistance; unsafe food; and in the long-run, even climate change. Over 70 percent of emerging infectious diseases in humans have their source in animals, with animal agriculture being one of their major vectors. Agriculture is a major source of zoonosis risk when it involves the confinement of animals in intensive livestock farming and/or incursions into wildlife habitat. In the current context, it is worth noting that chronic conditions, many of them diet-driven, significantly increase the risk of complications from COVID-19, which itself is a zoonotic disease. Agricultural and food system practices, particularly ones involving animal farming, are also associated with foodborne disease, which is estimated to cost Malaysia more than US$ 900 million in lost productivity annually (Jaffee et al. 2019, estimated on the basis of 2016 indicators). Environmental and equity aspects of agricultural growth also deserve more attention.

FIGURE 62
Malaysian consumption patterns deviate significantly from dietary recommendations...

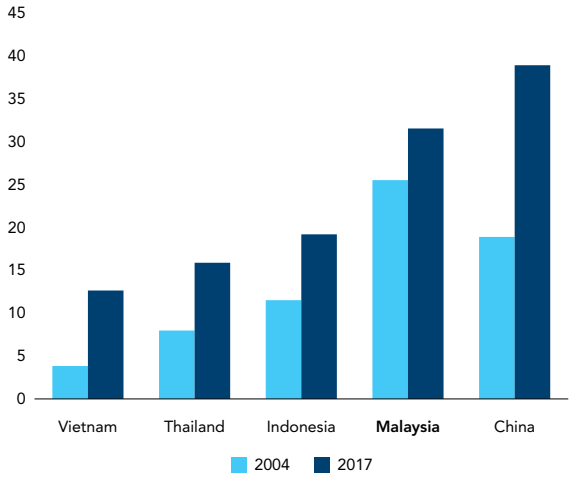
Consumption of Selected Food Groups and Components, 2017



Source: GBD 2018
Note: The "recommended level" label is the midpoint of the theoretical minimum risk exposure level (TMREL) range.

FIGURE 63
...and the consumption of ultra-processed foods is rising

Sales of Non-essential Junk Foods in Grams Per Person Per Day, 2004 and 2017



Source: Based on Euromonitor data reported in Popkin, Corvalan, and Grummer-Strawn 2019

[22] The latest (2020) Global Burden of Disease study suggests that increases in dietary risks, among others, may be driving the world to a turning point in terms of life expectancy gains (IHME 2020).
[23] In general, NCDs affect an economy when individuals die from them prematurely, when illness makes them work less or less well, or retire early, and when public or private resources must be spent to treat health conditions—or prevent them. The latter implies a loss of savings across the population and hampers economy-wide physical capital accumulation.

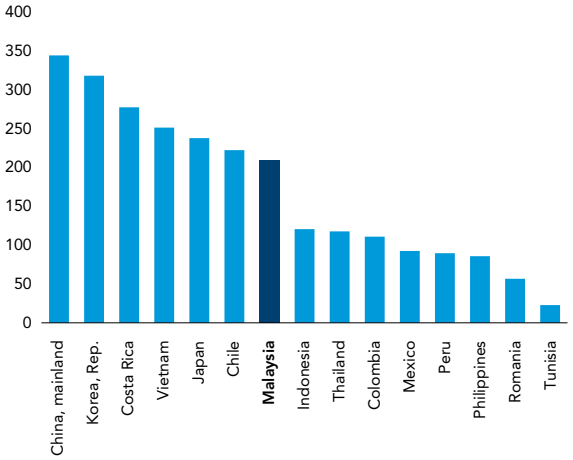
While Malaysia has taken steps to address environmental issues in its palm oil sector, it still has more ground to cover and it has been slow to take on mounting environmental challenges on the agrofood side. In relation to palm oil production, Malaysia has asserted leadership in committing to halt agriculture-driven tropical deforestation and biodiversity loss and pursuing sustainability certification, but it still has some way to go to realize the promise of the goals and frameworks it has put in place. Furthermore, aggressive agricultural adaptation strategies will be needed in a sector that exhibits particular vulnerability to temperature and rainfall pattern changes.[24] Malaysia is also quite a high user of fertilizer (see Figure 64), and at least in the rice sector, it is at an early stage of mainstreaming good environmental farming practice. Similarly, it still has progress to make in developing systems and incentives to manage mounting competition for freshwater resources.

In terms of equity, while farmer welfare has improved significantly over time, farmers are still among the poorest members of Malaysian society. While extreme poverty has all but been eliminated across Malaysia, including in rural areas, farming still remains associated with poverty, at least relative to average income levels. In spite of the subsidies paddy farmers receive, the vast majority of them are in the B40 income distribution group. Even amongst farmers participating in MADA, Malaysia's leading rice granary, an estimated 87 percent of these farmers had less land than it would take to generate net monthly incomes of RM 3,000 (assuming double-cropping) (Wong 2020). Growing the national staple food alone is insufficient to support a household in most cases (Omar, Shaharudin, and Tumin 2019).

Effective measures to modernize and otherwise transform Malaysia's agricultural sector would help to enable the country to achieve its stated goal of becoming an equitable high-income country. Existing policies, along with the small average size of land holdings, are likely contributing to making the agrofood sector's association with poverty a quasi-structural reality. In the agrofood-cum-rice sector, fifty-year-old policies that may have been justified at a previous point now constrain the potential of Malaysian farmers and would-be agro-entrepreneurs. At the farm level, government subsidies that were designed to enhance farmers' welfare and productivity effectively disincentivize rice farmers from growing higher-value crops, or even higher-value varieties of rice, or from leveraging technological advances (particularly in the use of inputs) to achieve higher levels of productivity. It is notable that despite the substantial subsidies available to smallholders, many farmers still abandon farmland earmarked for rice, especially in Sabah and Sarawak. In Sarawak, 40 percent of the cultivable land in state systems has been abandoned, with only 12 percent being utilized to plant paddy.

FIGURE 64
Malaysia can do more to green its farms

Fertilizer Consumption in Kilograms of Nitrogen Nutrients Per Hectare of Cropland in Selected Countries, 2018



Source: FAOSTAT 2020

[24] Preventive strategies to mitigate a rise in agrofood sector emissions (especially by avoiding a rise in livestock rearing) are also key at time when food system emissions alone preclude the possibility of avoiding two degrees of warming if they remain on the current trajectory (Clark et al. 2020).

Going forward, the agrofood sector faces broadening opportunities

Malaysia has huge, underexploited potential to serve the varied demands of a modern agrofood economy, both domestically and regionally. The continued rise of the middle classes across Asia is reshaping the continent's food markets, creating tremendous growth opportunities for those segments of the food sector that are in a position to cater to, or even to play a role in shaping, food demand. Malaysia is nearly 80 percent urbanized, with a rapidly expanding middle class. In the wider Southeast Asia region, the number of consuming class[25] households is set to double to 163 million households by 2030, according to projections by the McKinsey Global Institute (Tonby et al. 2019). At this rate, the entire Asian middle class population could increase by more than a billion people within a decade, growing to more than three billion (Kharas 2017). These demographic shifts are changing how much consumers spend on food, how and where they shop for it, what and where they eat, and even what they value in food.

In turn, these demographic, socioeconomic, and cultural changes point to significant growth possibilities for private businesses and jobs to develop up and down food supply chains. These possibilities lie not only in the production of a more diverse range of higher-value food products but also in the development of advanced farm technology and service industries, food processing, logistics and wholesale, and further downstream, a diversity of food services and retail formats addressing both consumer and post-consumer needs. The continued migration of value addition down the supply chain is apparent even in mature food economies such as that of the United States, where growth over the past two decades has been particularly pronounced in downstream food services and retail trade (USDA ERS 2020).

For the agricultural sector specifically, in the upstream segments of food supply chains, the challenge is to better respond to, or even to play a role in shaping, food sector changes. There are significant opportunities to be seized through product diversification; integration with new downstream business models and markets, including those mediated by e-commerce; and greater control over quality. In this context, quality refers to the ability of products to meet the demands of buyers, with opportunities relating to producers' ability to respond to volume, timing and other specifications of processors, including importers, marketers and consumers standards related to food safety, environmental, labor, animal welfare, and others.

For Malaysia's agricultural sector, the opportunity lies in supplying the diversity and quality of materials needed by industry and in developing integrated agrofood industries

Malaysia's food manufacturing sector is already growing at a rapid pace, indicating dynamism and excellent potential for increased backward integration. Malaysia's food manufacturing sector has averaged annual growth rates in excess of 6 percent over the past two decades, and in excess of 5 percent over the past three. This points to a level of dynamism that far exceeds that of the agricultural sector, or that of the food manufacturing sectors of countries such as Korea, Thailand, Australia, Japan or even, in the last decade, Vietnam. For Malaysia's agricultural sector, the opportunity lies in supplying the diversity and quality of materials needed by industry and in developing integrated agrofood industries (through the establishment of clusters or other means) that perform to high standards. However, to ensure positive overall impacts, it is also necessary to break with a pattern in which value is added to food through the manufacturing of formulated or ultra-processed food products that are convenient, affordable, and tasty, but that have deleterious health effects.

[25] McKinsey Global Institute defines consuming classes or consumers as individuals with per capita incomes (or consumption) of more than US$10 per day (Dobbs et al. 2012).

Embracing the digital economy will be game-changing

Given the limited level of integration of Malaysia's agricultural sector into the digital economy, improvements in this area offer great potential for enhancing competitiveness at every rung of food supply chains. In fact, this situation is not unique to Malaysia. Even so, even more than many places elsewhere, Malaysia has a strikingly high degree of connectivity: it has the same level of internet use adoption as the European Union (134 percent) and more mobile cellular subscriptions per 100 people than either the European Union or the average high-income country. Going forward, more emergent parts of Malaysia's food economy still have the potential to develop as digital economy "natives," intrinsically shaped by the possibilities created by increased access to data and higher levels of connectivity.

If the agrofood sector increased its level of participation in the digital economy, this could unleash great potential. The increased use of digital technologies could transform the delivery and capacity of extension services, as already indicated by the experiences of a number of other countries, including China. In parts of the sector, digital applications could deeply transform methods of production and marketing, with dramatic positive impacts on the business models that underpin or involve farming and on the types of work or jobs available in the sector. In the process, the increased use of these applications could usher in an age of precision agriculture, enhanced product differentiation, and more environmentally sustainable farming practices. These and other possibilities are already being explored by agro-entrepreneurs across the region, with the Vietnamese state particularly proactive in promoting them (see Box 8).

The increased use of digital technologies could transform the delivery and capacity of extension services

BOX 8

Embracing the digital economy: Experiences in the agrofood sector with extension and ag-tech

In the agrofood sector, China has been particularly proactive in the development of digital extension platforms. The increased use of digital technologies has gradually been making its mark on extension services across a growing number of countries, changing not only the way farmers access services but also what those services are and who is involved in delivering them. China is one case in which the government has been particularly proactive in developing multi-modal, one-stop-shop platforms, integrating these platforms into their extension systems and thereby providing farmers with a range of options to enable them to access information, technical support, and sometimes e-government services. Some of these platforms, such as Shanghai Province's One-Click Farmers' Service, allow farmers to connect to extensionists remotely, in real time, through videoconferencing facilities. Various other on-demand services involve farmers "pulling," or requesting information by calling, sending an SMS, setting up notifications on their device, or consulting an app. In China and elsewhere, it is hoped that these platforms will enable extension services to become more demand-responsive, with their propensity for customization, cost structure, and technical capacity to pool knowledge resources offering the potential for what could be referred to as "mass customization."

At the same time, Vietnam has adopted a proactive stance to support some of the most recent newcomers to the agricultural field – digital entrepreneurs. While their reach remains small and their approaches experimental, many of them have great ambitions. Indeed, many of these ambitions relate to using the internet-of-things, big data and artificial intelligence to transform farming into a more profitable and less environmentally impactful field of enterprise, with significant positive transformations for smallholders. Digital solutions are being used to support precise input use, risk- and market-informed crop planning, efficient marketing, and traceability. The government has provided support through means such as facilitating participation in accelerator-like programs, providing co-funding for ICT training for rural students, and investing in improvements to rural connectivity.

Enhanced quality and safety measures will strengthen the agrofood system

Malaysia has the potential to compete more effectively in the agrofood space by strengthening human and social capital, innovation, quality infrastructure, and risk management systems. A failure to do so creates the very real risk of stagnation, if not decline. In the area of risk management systems, Malaysia has already demonstrated a strong capacity to address emerging risks from zoonotic diseases and to manage food safety risks from animal source foods. According to assessments conducted by the OIE on national veterinary service capacities, Malaysia outperforms most other countries in Southeast Asia in these terms. However, if it is to achieve similar levels of performance in other areas, it must pay greater attention to dimensions of performance that have not been a primary focus to date, including quality, profitability, the environment, labor, nutrition, and animal welfare.

In order to maintain productivity in the context of a changing climate and to achieve higher levels of environmental sustainability, it is also necessary to address persistent yield gaps on both sides of the agricultural sector. To achieve this, a less intense focus on farm-level output may be fruitful. For example, there is still significant potential to achieve progress in relation to agricultural technology; inputs; and services provision; the mitigation of food loss along the supply chain; farm and supply chain coordination; technology absorption; quality infrastructure; soil and water management; crisis preparedness; and long-term risk surveillance and planning.

Although improvements to the agricultural sector in themselves cannot be expected to solve the problem of chronic disease, health-orientated agricultural policies may play a major role in facilitating the achievement of this objective. Malaysia has already adopted progressive policies, including the imposition of a sugar-sweetened beverage tax and the implementation of a sodium reduction strategy to improve diet quality at the consumer level. Compared to many of its peers, the risks related to its population's dietary practices are still relatively moderate. However, as discussed in a previous section, with increasing income levels and an increasingly ageing population, public health challenges related to diet are already nontrivial and likely to increase over time. With the current emphasis on the production of palm oil and white rice rather than a wide range of healthful foods, Malaysian agriculture still lacks nutrition-sensitivity.

With Malaysia's still significant room to improve the health of the population to improvements to their diet, its agricultural sector can contribute in two major ways. First, this sector could play a role in increasing the availability and reducing the cost of the healthiest and lowest-impact foods by producing more of a wide diversity of minimally processed plant-based foods. Second, it could play a role by increasing the purchasing power of farming households by growing in an inclusive manner. These two contributions need to be linked by treating the supply of healthier and more sustainable foods as an opportunity to increase the profitability and draw of the agro-enterprise sector.

Malaysia's agricultural sector can and should be creating a greater number of high-quality jobs and, in the process, revitalizing a sector experiencing attrition through aging and limited entry. For that matter, Malaysia's success in supporting "a next generation of farmers" could hinge less on the provision of direct support to farmers' income and entry and more on measures to redefine what it means to work in farming and the broader agro-economy. If Malaysia's agricultural sector is firmly committed to the achievement of modernization and transformation, it will become increasingly attractive to highly qualified individuals, including the young. Without this commitment, the agricultural sector is likely to continue to be provider of low-quality and informal employment, strongly associated with poverty, transience, and social instability.

Finally, Malaysia has not leveraged its rich food culture and agricultural potential to the fullest extent possible to dynamize its urban economy and to brand itself at the global level. It has not used its food sector to market itself as much as possible to investors or global talent, to cultivate familiarity or to establish image of modernity, safety, or stability, as Thailand has successfully managed. Malaysia can still do more to differentiate itself through its agrofood exports, establishing a reputation as a purveyor of superior products in terms of flavor, variety, sustainability, safety, Halal-compliance, labor rights, and any number of other aspects of quality, thereby creating a "halo effect" that may potentially benefit other sectors of the economy.

The COVID-19 wake-up call coincides with opportunities for policy change

At present, Malaysia has at least two major platforms that could be used immediately to update its agrofood sector policies, to better calibrate its objectives, and to establish higher standards and aspirations. The first and most important of these platforms is the RMK12, through which Malaysia could better articulate the potential and significance of the agricultural sector and the role it could play in relation to facilitating the achievement of the country's broader social and economic aspirations. The second platform through which a reassessment of agricultural policy could be implemented involves the newly established Executive Committee on National Food Security Policy, formed during the COVID-19 crisis to address medium-term and long-term food security concerns.

In addition to these two entry points for reform, there are also other means and opportunities to ensure the integration of the necessary reforms to the agrofood system perspective through other national policy initiatives and strategies. These could involve platforms and mechanisms to develop the digital economy; to combat non-communicable diseases (NCDs); to plan for pandemic prevention and response; to ensure consumer protection (or food safety); to adapt to climate change; to expand and enhance higher education; to design smart cities; and other themes. Appropriate recognition should be given to agrofood issues be given within a wider range of areas of national policy and among a wider range of policy makers, including those specializing in environmental, public health, climate, enterprise, private sector development and competitiveness, innovation, and urban policy. The integration and mainstreaming of a food system perspective into their agendas may result in increased recognition of the importance of agriculture to facilitating the achievement of a wide range of national priorities.

RMK12 provides an opportunity to re-assess the objectives and instruments of agrofood policy

With Malaysia poised to achieve high-income status, the core issue for the government is to determine how to spend better in ways that facilitate the achievement of its evolving food system aspirations. The RMK12 will provide Malaysia with an opportunity to realize the potential of the agricultural and food economy. To some extent, the focus of agricultural policy over the past 50 years on the need to provide indefinite protection and aid to rice and other food crop farmers has been somewhat self-fulfilling. To achieve its full potential, it must adopt a new paradigm.

Malaysia can expect far more from its agrofood economy and should be deploying public resources to achieve this goal. Malaysia could strive to develop an agricultural sector that is more responsive to the country's contemporary food economy, including by developing the capacity to supply a greater range and volume of the high-value foods that the populations of Malaysia and the broader region are increasingly consuming, including fragrant rice varieties. It could strive to develop a modern periurban farm sector connected to urban markets with advanced logistics. It could position itself to become a leading regional provider of healthy and safe produce. To achieve this, it may need to invest far greater resources to develop the human capital that will be required to transform Malaysia's agrofood complex, including through the provision of training and other measures to attract a new generation of agrofood system entrepreneurs across a wide variety of disciplines. To strategically increase the efficacy and efficiency of agricultural public expenditure, three broad directions for reform could be considered, as follows:

1. **Shift the strategic focus from increased (paddy) production and (rice) self-sufficiency to a more balanced consideration of food availability and affordability, nutritional adequacy, and**

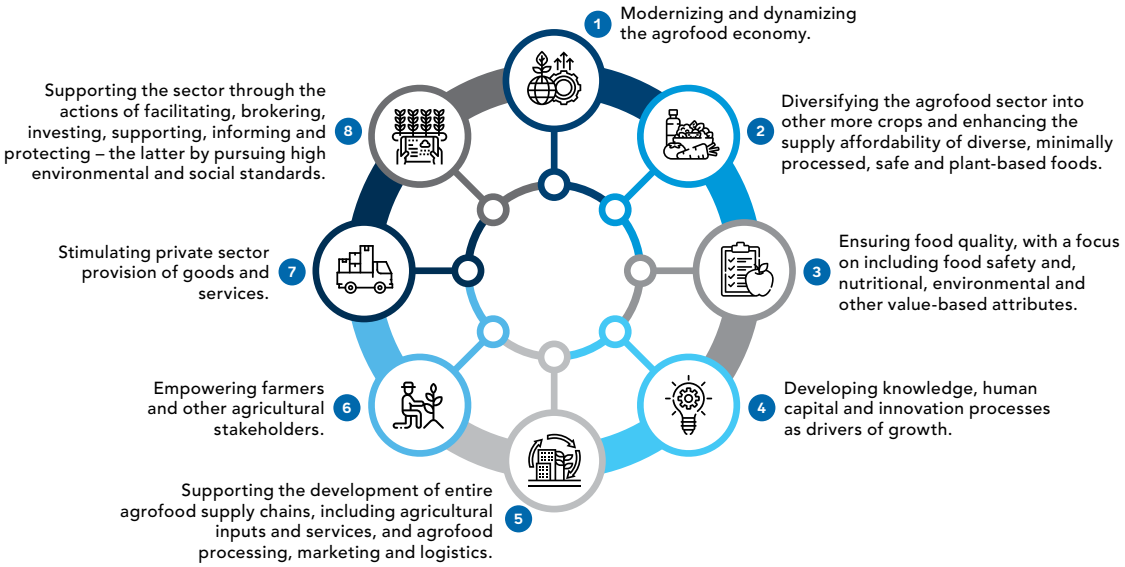
diet quality for all, especially for the poorest consumers. This shift would entail a number of strategic changes: (i) promoting diversification to increase the supply of nutritionally-important foods at reasonable prices; (ii) supporting not just primary production, but off-farm processing, logistics, and value addition; and (iii) focusing on the quality, not just quantity of food.

2. **Intensify efforts to modernize and diversify the agrofood sector to boost the incomes of rural households.** This will involve more balanced investment in the agrofood sector and policy reforms that enable and stimulate the private sector to develop in new and more rewarding directions. For example, agricultural policies and public investments can more powerfully incentivize the development and adoption of modern technologies and services including precision agriculture tools accessible to small farmers; innovations in processing and marketing; and efficiencies in storage and distribution including ones that help mitigate food loss. Mature granaries will continue to be the main rice-producing centers in Malaysia, but the development of new granaries with low productivity potential may need to be reconsidered since more diversified cropping patterns may be possible and more fruitful in these areas. Rice-growing areas might also "diversify" more into higher-value rice varieties. In addition, agricultural diversification efforts at large can more broadly encompass activities upstream and downstream of farming, including ones that leverage digital approaches.

3. **Focus spending more on public goods and provide private goods only to overcome well-defined market failures—with a view to stimulating productivity- and innovation-led as opposed to input-led growth.** Global evidence and experience show that public expenditure is generally most cost-effective when it purchases true public rather than private goods and services. Private goods include direct subsidies for farmers and agribusinesses, while public goods include hard and soft infrastructure like roads and information systems. Certainly, some market failures justify spending public money on private goods, but such spending should be of appropriate size to correct the problem, generally be temporary, and avoid crowding out private sector development in the market. Current input and price subsidy programs in the rice market do not seem to be of this nature.

The formulation of Malaysia's RMK12 creates an opportunity to assess and determine the potential of the agricultural sector and to define the role of government in facilitating its transformation. Policies should be formulated and implemented in order to improve food security; to enhance agricultural livelihoods; to modernize and dynamize the agrofood economy; and to ensure its resilience, competitiveness, growth, and sustainability (see Figure 65). Building on the RMK12, the effective implementation of measures to achieve these goals requires the appropriate alignment of resources and the provision of the appropriate incentives for policy professionals and agencies, including through the formulation and application of a new set of key performance indicators.

FIGURE 65
The agricultural sector's potential should be clearly laid out in the RMK12



Source: World Bank staff illustration

The Cabinet Committee on National Food Security Policy's convening opens the door to a rebalancing of food security policy

The Cabinet Committee on National Food Security Policy chaired by the Prime Minister of Malaysia was initiated in March 2020 amid of COVID-19 pandemic. This committee was established to attain a holistic and sustainable National Food Security Policy. As such, the Committee will be formulating a national strategy in ensuring a strong level of food security in Malaysia as well as enhancing food safety. The Cabinet Committee is supported by a coordinating committee, namely the Executive Committee on National Food Security Policy which is chaired by the Minister of Agriculture and Food Industries. This committee is responsible to propose and review the related strategies on national food security, by taking into account the food availability, accessibility, utilization, stability, and sustainability that is taken care of. Hence, in creating a resilient food system, areas such as productivity, resources optimization, sustainable consumption, foreign workers, climate change, water and land scarcity, health, disaster, mechanization and automation are to be addressed through a collective and thorough collaboration across ministries and agencies. To chart food security policy going forward, it recognizes that several issues need to be taken into consideration (see Figure 66).

Malaysia's food security policies could be more effective if they involved measures to achieve a better balance between ensuring a stable supply of rice, and access to a diversity of healthy foods. Evidence, including that emerging from the COVID-19 crisis, suggests that food insecurity often relates more to problems of diet quality, healthy food affordability, and choices, than to shortages of staple food availability. Taking this into account, Malaysia needs policies that will swiftly and decisively deal a significant blow to persistent childhood undernutrition, and that prepare it well to support households' access to nutritional needs in the event of shocks.

A rebalancing is also required to better account for the determinants of both urban and rural food security. In the context of the COVID-19 pandemic, the particular challenges faced by urban populations have highlighted the need to address these challenges through the formulation of food security policies that meet these populations needs, including through the formulation and implementation of supportive agricultural policies. For example, these policies could be designed to facilitate the development of modern periurban horticultural parks and intended to ensure

FIGURE 66
Key considerations for the Cabinet Committee on National Food Security Policy

Source: World Bank staff illustration

the continuity of supply of nutritious foods to cities, both in the context of a crisis and in normal times.

Food security policy should also be designed to recognize evolving dietary patterns and to ensure the health and productivity of Malaysia's population, particularly in the context of increasing income levels and an increasingly ageing population. An expansion of what is meant by food insecurity is needed to account not only for caloric inadequacy but also for multiple forms of malnutrition or dietary risk that exist despite a sufficiency of calories. More than undernutrition, contemporary food security efforts need to address diet-related nutritional deficiencies as well as various forms of diet-related chronic disease—the latter, in the context of the pandemic, being associated with higher rates of acute illness and mortality. Malaysia has already adopted progressive policies to stem the progression of diet-related chronic diseases and it is time that agriculture also embrace this orientation.

A major component of measures to rebalance food security policy will be a decreased emphasis on rice paddy. The degree of emphasis on paddy production in agricultural policy should be appropriately tuned to enable Malaysia to produce and market a wider range of foods at more affordable prices while increasing access to these foods through measures to increase agricultural incomes. This perspective could give purpose and life to Malaysia's overdue rice policy reforms. In short, food security policy needs to be reframed to facilitate the emergence of a healthier, more inclusive society, with full recognition of the role that the agricultural sector can play in achieving this goal.

The reforms to the rice sector required to facilitate the achievement of this goal will involve dismantling protectionist and commanding forms of support and replacing them with genuinely supportive measures. At a minimum, these reforms should strive to empower farmers to cultivate a wider range of crops, including healthier, higher value crops; to improve their soils to meet their needs through the application of the appropriate technologies and the use of the appropriate input; to venture into milling if they so choose; and to benefit from increased opportunities to earn adequate returns on their generally small landholdings. Amongst other measures, it may be necessary to reconsider the role of parastatal companies and their impact on rice markets and on the inputs and milling industries. Recent analysis supports the feasibility and potential benefits of even incremental reforms (see Box 9).

To support the implementation of these new paradigms, farmers and supply chain actors in the sector will still require high levels of support, although the nature of that support will differ considerably from that currently provided. Among other new areas, they will require significant support to develop more environmentally sustainable farming practices; to organize more efficient farming and marketing arrangements based on economies of scale; to effectively manage water resources in the context of increased competition; and to mitigate the costs associated with switching to new crops or engaging in other value addition activities.

BOX 9

Even incremental reforms of rice policy could be beneficial to farmers

An on-going World Bank analysis suggests that even incremental reforms to Malaysia's rice policy could be beneficial to farmers. The analysis points to the feasibility of incremental reforms to rice sector protections and subsidies to better align Malaysia's provision of farm support with international best practices. One such reform would involve replacing farm subsidies that are currently based on how much farmers produce (which greatly influence farmer decision making), with direct payments of equal value to incentivize them to become more responsive to markets and better agroecosystem stewards. Subsidies of this nature could also subsume rice fertilizer subsidies. These subsidies are not only poorly targeted and wasteful, but also support an industry whose current dysfunction is directly harmful to farm operations (with exceedingly long wait times to obtain a product of poor quality).

Similarly, even a partial liberalization of rice imports and prices, involving the lowering of import restrictions and the dismantling of price floors and ceilings, would leave farmers better off. In parallel, lifting restrictions on the production, marketing, and export of expensive fragrant rice varieties, far from jeopardizing rice stocks or food security, could also provide a means for some farmers in Sabah and Sarawak to enhance their livelihoods and food access by deriving value from the wealth of fragrant rice varieties that are unique to this part of the country and that have potentially high value on global markets. Meanwhile, given that Malaysia's rice supplies are robust, it seems that greater stockpiling at this point is not necessary to enhance food security.

Revitalizing the agrofood sector will help Malaysia respond to the demands of a high-income economy

At an earlier stage of its development, Malaysia successfully leveraged its agricultural assets to achieve a dramatic economic transformation that has made it one of Southeast Asia's leading success stories. However, with its transition to a highly developed, high-income nation, Malaysia must continue to strive to achieve progress in areas where it is still required if it is to maintain this trajectory. Malaysia's achievement of a dominant position in the global palm oil industry has won it recognition and acclaim around the world, shaping the country's reputation as an advanced, agro-industrial force. However, it has also drawn attention to the fragility of its biodiversity and to the need to economically empower those segments of its population that have yet to receive optimal benefits from this transformation. At present, Malaysia's food industry does not have the same global reputation for achievement and quality as neighboring Thailand, despite its relative socio-economic advantages. To improve its global standing, Malaysia may need to focus on addressing a number of key issues, including agro-environmental issues affecting the rice sector; the modernization of inputs and value chains; the excessive focus on the achievement of self-sufficiency in the area of rice production; and the weak representation of Malaysian goods in high-value food export markets.

Looking to the future, Malaysia has great potential to reap the benefits from the modernization and diversification of its agricultural sector, with the deeper integration of this sector into an increasingly dynamic global food economy. At the same time, with the increasing global focus on a post-modern quest for a broader food system transformation, a focus merely on the modernization of its existing agricultural systems will not enable Malaysia to reap optimal benefits. Rather, it must transform its vision and alter its perspective of what it can expect from this sector. As it achieves higher levels of economic development, not only will the performance of Malaysia's agricultural sector be benchmarked against a different set of peers, but the benchmarks themselves will change, shifting to dimensions that Malaysia has sometimes neglected for lack of aspirations relating to them. Malaysia's food system generally and its agrofood sector specifically will increasingly be assessed in terms of its contributions to climate stabilization and the achievement of environmental and social sustainability more generally. With the evolving aspirations and expectations of its own citizens, it will increasingly be required to leverage its food systems to ensure these citizens' long-term health and productivity, particularly by facilitating affordable access to a wider range of high quality food products. With the evolving expectations and conceptions regarding the ethics of agricultural practices, it may need to give greater consideration to reducing harm and cruelty to animals and to ensuring that workers in the sector operate in humane conditions. With advances in technology, these changes may be predicated on the use of new business solutions and technologies, requiring innovative approaches to developing and attracting new types of human resources and investors, often from new sources across the country and around the world.

To achieve this transformation, Malaysia will need to formulate an ambitious vision for its agrofood sector, with a clearly defined roadmap that outlines the appropriate policies and strategies to achieve this vision. In the past, much of Malaysia's successful transformation of the agricultural sector can be attributed to government interventions that facilitated the achievement of this transformation. However, in the rapidly evolving new context, the very interventions that ensured success at an earlier stage may now act as constraints. While this paradox underscores the need for reform, it also suggests that reform could be implemented to achieve great benefits for Malaysia's economy and for all its citizens. The formulation of a clear vision based on higher aspirations for its agrofood sector has great potential to enable Malaysia to achieve its broader national objectives in terms of enhancing competitiveness, creating a greater number of more highly productive jobs, and improving resilience to endogenous and exogenous shocks, thereby driving sustainable long-term economic growth and enabling Malaysia to achieve its vision of becoming an equitable, high-income economy.

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