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Acknowledgements

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<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
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<td>B40</td>
<td>Bottom 40 percent (of the population)</td>
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<td>BID</td>
<td>Brought-in-dead</td>
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<td>BNM</td>
<td>Bank Negara Malaysia</td>
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<td>BPN</td>
<td>National Caring Aid (Bantuan Prihatin Nasional)</td>
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<td>BPS</td>
<td>Business Pulse Survey</td>
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<td>BSH</td>
<td>Cost of Living Aid (Bantuan Sara Hidup Rakyat)</td>
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<td>CAGR</td>
<td>Compound Annual Growth Rate</td>
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<td>CMCO</td>
<td>Conditional Movement Control Order</td>
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<td>COVID-19</td>
<td>Coronavirus Disease 2019</td>
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<td>CPI</td>
<td>Consumer Price Index</td>
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<td>CPTPP</td>
<td>Comprehensive and Progressive Trans-Pacific Partnership</td>
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<td>DE</td>
<td>Development Expenditure</td>
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<td>DFI</td>
<td>Development Finance Institution</td>
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<td>DOSM</td>
<td>Department of Statistics Malaysia</td>
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<td>E&amp;E</td>
<td>Electricals and Electronics</td>
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<tr>
<td>EAP</td>
<td>East Asia and Pacific</td>
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<tr>
<td>EMCO</td>
<td>Enhanced Movement Control Order</td>
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<td>EMDEs</td>
<td>Emerging Market and Developing Economies</td>
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<td>EPF</td>
<td>Employees Provident Fund</td>
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<td>FBM KLCI</td>
<td>FTSE Bursa Malaysia Index</td>
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<td>FDI</td>
<td>Foreign Direct Investment</td>
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<td>FIRE</td>
<td>Finance, Insurance and Real Estate Sector</td>
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<td>GDP</td>
<td>Gross Domestic Product</td>
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<td>GFCF</td>
<td>Gross Fixed Capital Formation</td>
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<td>GIC</td>
<td>Global Investment Competitiveness</td>
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<td>GLC</td>
<td>Government Linked Corporation</td>
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<td>GNI</td>
<td>Gross National Income</td>
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<td>GST</td>
<td>Goods and Services Tax</td>
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<td>GVCs</td>
<td>Global Value Chains</td>
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<td>HIC</td>
<td>High-income Countries</td>
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<td>ILO</td>
<td>International Labor Organization</td>
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<td>IMF</td>
<td>International Monetary Fund</td>
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<td>IPA</td>
<td>Investment Promotion Agencies</td>
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<td>IPI</td>
<td>Industrial Production Index</td>
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<tr>
<td>LCR</td>
<td>Liquidity Coverage Ratio</td>
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<td>LFPR</td>
<td>Labor Force Participation Rate</td>
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<tr>
<td>LHDN</td>
<td>Inland Revenue Board (Lembaga Hasil Dalam Negeri Malaysia)</td>
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<td>LTGM</td>
<td>Long Term Growth Model</td>
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<td>M40</td>
<td>Middle 40 percent (of the population)</td>
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<td>MCO</td>
<td>Movement Control Order</td>
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<td>MEM</td>
<td>Malaysia Economic Monitor</td>
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<td>MGII</td>
<td>Malaysian Government Investment Issues</td>
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<td>MGS</td>
<td>Malaysian Government Securities</td>
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<td>MITB</td>
<td>Malaysian Islamic Treasury Bills</td>
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<td>MNC</td>
<td>Multinational Corporations</td>
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<td>MOF</td>
<td>Ministry of Finance Malaysia</td>
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<td>MPC</td>
<td>Monetary Policy Committee</td>
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<td>MTFF</td>
<td>Medium-Term Fiscal Framework</td>
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<td>MTRS</td>
<td>Medium-Term Revenue Strategy</td>
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<td>MSME</td>
<td>Micro, Small and Medium Enterprises</td>
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<td>NIA</td>
<td>National Investment Aspirations</td>
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<td>NPL</td>
<td>Non-performing Loans</td>
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<td>OE</td>
<td>Operating Expenditure</td>
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<td>OPR</td>
<td>Overnight Policy Rate</td>
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<td>PMR</td>
<td>Product Market Regulations</td>
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<td>PPP</td>
<td>Public Private Partnership</td>
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<td>PPTS</td>
<td>Percentage Points</td>
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<td>R&amp;D</td>
<td>Research and Development</td>
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<td>RCEP</td>
<td>Regional Comprehensive Economic Partnership</td>
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<td>RMCO</td>
<td>Recovery Movement Control Order</td>
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<td>RPGT</td>
<td>Real Property Gains Tax</td>
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<td>SOEs</td>
<td>State Owned Enterprises</td>
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<td>SMEs</td>
<td>Small and Medium Sized Enterprises</td>
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<td>SRR</td>
<td>Statutory Reserve Requirement</td>
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<td>SST</td>
<td>Sales and Services Tax</td>
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<tr>
<td>T20</td>
<td>Top 20 percent (of the population)</td>
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<td>TEMCO</td>
<td>Temporary Enhanced Movement Control Order</td>
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<td>TFP</td>
<td>Total Factor Productivity</td>
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<td>UMIC</td>
<td>Upper-middle Income Countries</td>
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<td>WHO</td>
<td>World Health Organization</td>
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<td>Y/Y</td>
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In recent months, there has been a steep increase in the number of daily new cases and, more disturbingly, in the number of deaths. While it took almost one year for Malaysia to record its first 100,000 cases, the increase in the number of new cases between April to May 2021 alone amounted to more than 100,000. Similarly, while it took about one year for cumulative deaths to reach 500, the cumulative number of deaths in the first two weeks of June alone was more than 500. Even more worryingly, the number of brought-in dead (BID) cases also rose sharply; in May 2021, BID cases accounted for nearly one-third of total deaths.

The severity of the current wave has raised concerns regarding the overall capacity of the health system. With the number of new cases and death rates continuing to climb at a rapid rate, the health system has been operating at close to its maximum capacity, with most intensive care units (ICUs) running at nearly 100 percent capacity. At the same time, key containment measures, including mass testing and contact tracing, have not been fully or effectively implemented. In addition, the rollout of the country’s vaccination program is being affected by delayed vaccine supply and high vaccine hesitancy, although there are some signs that the pace has picked up recently.

To curb the spread of the pandemic and to ease the burden on the health system, the government has reimposed the movement control order (MCO). Initially, the terms of the MCO allowed for most economic sectors to continue to operate. However, with the number of cases remaining high and with no signs of abatement, the government subsequently announced a full lockdown, with only key essential services allowed to operate. The Ministry of Health has indicated that it may take between 3-4 months to flatten the curve of the pandemic.

These latest developments will continue to adversely affect Malaysia’s economy in the near term. The continuous cycle of “on-and-off” closures and re-openings will have negative spillovers on the economy. In addition, the number of vulnerable households is likely to increase. A slower-than-expected rollout of the vaccination program or further increases in case numbers and death rates would further exacerbate this situation.

The immediate focus should be on effectively containing the pandemic and saving lives. Increasing the capacity for smart containment, including the adoption of an effective testing and tracing strategy, is essential to ensure a safe and gradual reopening of the economy. In parallel, the vaccination rollout must be accelerated, to help slow down the spread of the pandemic.
Recent economic developments

The Malaysian economy contracted by 0.5 percent in Q1 2021, moderating from the 3.4 percent decline in Q4 2020. While negative spillovers from the pandemic continued to weigh on the economy in the first quarter, the impact was cushioned by less restrictive movement restrictions during that period. The strengthening of global trade activity also supported improved economic performance, as did a number of policy measures implemented by the government through its various stimulus packages.

Domestic demand continued to decline but at a slower rate (Q1 2021: -1.0 percent; Q4 2020: -4.5 percent). Domestic demand benefited from a deceleration in the decline in private consumption as household activity resumed following the easing of movement restrictions. Measures such as the Employee Provident Fund (EPF) withdrawal scheme also had a positive impact on private consumption. Private investment also increased, driven mainly by higher capital expenditure in the manufacturing sector.

Increasing the capacity for smart containment, including the adoption of an effective testing and tracing strategy, is essential to ensure a safe and gradual reopening of the economy.

On the sectoral front, improvement was broad-based, led by the manufacturing sector. This growth was supported by strong global demand for E&E products and rubber gloves. The services, mining and construction sectors all contracted at a more moderate pace than in Q1 2021.

Malaysia’s exports accelerated in Q1 2021, following stronger global economic activity. Much of the recent export growth momentum mirrored the

The government must also protect the welfare of vulnerable groups through adequate financial support. In particular, it must move to protect those in the bottom 40 percent (B40) income group and those most affected by the movement restrictions. This includes informal workers who are not adequately covered by social safety nets; those who have lost their jobs, been placed on unpaid leave, or experienced pay cuts; and those with limited assets or savings to fall back on.

In the short term, the government’s fiscal policy should prioritise ensuring the well-being of the people. It urgently needs additional fiscal space both to strengthen the health sector and to provide sustainable support to vulnerable groups.

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 special topic that is key to Malaysia’s medium-term development prospects and to the achievement of shared prosperity.

The special topic for this edition is on the impact of COVID-19 on the private sector and how in the longer term it can help to re-build the economy. The COVID-19 pandemic has exposed the gaps and exacerbated the vulnerabilities in Malaysia’s private sector. This is especially the case for small and medium enterprises (SMEs), which have been hard hit by both demand and supply shocks.

The post-pandemic recovery will need to be largely driven by the private sector. The productivity of firms in Malaysia especially the SMEs are found to be underperforming compared to its global peers. In the context of the current uncertain global situation, it is particularly important for Malaysia to make the transition to a productivity led growth model.

Over the medium term, deep structural reforms are needed to achieve higher rates of more inclusive and sustainable growth. While in the near term, focus will be to weather the surge; to reduce poverty and ensure shared prosperity, growth that creates a greater number of more productive jobs is needed. Economic transformation through deeper structural changes and market integration that catalyze business opportunities is needed to create an environment in which workers are able to shift into higher productivity activities, resulting in higher incomes as they generate greater returns on their labor and other assets.

On the sectoral front, improvement was broad-based, led by the manufacturing sector. This growth was supported by strong global demand for E&E products and rubber gloves. The services, mining and construction sectors all contracted at a more moderate pace than in Q1 2021.

Malaysia’s exports accelerated in Q1 2021, following stronger global economic activity. Much of the recent export growth momentum mirrored the
pick-up in manufacturing sector, on increased global demand for electronics as well as continued strong demand for rubber gloves.

**Headline inflation has trended upwards, partly due to higher fuel prices.** The uptick in fuel inflation stemmed from a base effect from the same period last year. The normalization of electricity tariffs following rebates between April and December 2020 also contributed to the higher headline inflation.

Despite initial signs of a gradual recovery in the labor market, the unemployment rate remained elevated. The unemployment rate continued to be driven by relatively high unemployment rates for the 15-24 age group. Private sector wages registered a smaller contraction in Q1 2021. Meanwhile, underemployment rates remained elevated in Q1 2021.

The domestic financial sector remained stable in Q1 2021. During the quarter banks maintained adequate capital and liquidity positions. Nevertheless, overall loan impairment ratio remained stable at 1.6 percent in March 2021 (February 2021: 1.6 percent), despite higher impairments from households amid continued pressure on household income.

So far this year, the government has announced three stimulus packages, to mitigate the impact of the pandemic. Collectively, these three packages amount to a value of RM75 billion (5.5 percent of GDP), with the amount of direct fiscal injection standing at 1.2 percent of GDP.

**The fiscal deficit is expected to increase in 2021.** Following the announcement of the three economic stimulus packages, the government now expects Malaysia’s fiscal deficit to rise to 6 percent of GDP in 2021, higher than the earlier target of 5.4 percent. At the end of 2020, Malaysia’s fiscal deficit stood at 6.2 percent of GDP due to sharp revenue losses and increased stimulus spending.

The government recently withdrew RM5 billion from the National Trust Fund (KWAN) to finance the procurement of COVID-19 vaccines and related expenses. The withdrawal was made following amendments to the National Trust Fund Act 1988, or the Emergency (National Trust Fund) (Amendment) Ordinance 2021, published in the Federal Government Gazette in April 2021. This has led to calls for greater transparency and accountability over the government’s use of emergency financing during the COVID-19 crisis.

**Economic outlook**

The global economy is projected to expand by 5.6 percent in 2021, its strongest post-recession growth rate in 80 years. This recovery, however, is uneven and largely reflects sharp rebounds in some major economies, most notably the United States (U.S.), owing to its large fiscal support. Nevertheless, global GDP is expected to remain 1.9 percent below pre-pandemic projections.

The ongoing pandemic and movement restrictions will affect Malaysia’s economy in the near term. The economy is projected to grow by 4.5 percent in 2021. This latest projection is 1.5 percentage points lower than the earlier forecast of 6.0 percent. The revision reflects the slower pathway towards suppression of the pandemic and the slower-than-expected vaccine rollout. The trajectory and pace of growth will depend on the duration and severity of movement restrictions, the containment of the pandemic, and the pace of the vaccine rollout.

The worsening COVID-19 situation and the re-imposition of the MCO is expected to have considerable impact on private consumption. The movement restrictions coupled with increased precautionary behavior and subdued wage growth is expected to affect household spending activity (2021f: 4.2 percent; 2020: -4.3 percent). This is especially...
so for services-related sectors. Meanwhile, public consumption is expected to continue to expand over the near term, albeit at a slower rate.

**With recovering global demand, export growth is likely to gain momentum.** Given the acceleration of advanced nations’ vaccination programs and the reopening of their economies, global demand is expected to continue to recover in the near term. The growth rate for Malaysia’s exports of goods and services is projected to rebound to 13.1 percent in 2021 (2020: -8.9 percent) as global demand picks up. Import growth is projected to rise by 13.6 percent (2020: -8.4 percent), with the growth of intermediate and capital imports regaining some momentum due to improvements in exports and investment.

**It is projected that investment activities will be driven by continued improvement in export-related activities.** Gross fixed capital formation is projected to rebound to 6.7 percent (2020: -14.5 percent), supported by increased capital expenditure in the private sector. Increased production in the manufacturing and trade-related sectors, particularly in the E&E as well as oil and gas subsectors, will support this growth.

**Headline inflation is projected to be higher in 2021.** The average consumer price inflation rate is projected to increase to 3.0 percent, (2020: -1.2 percent), mainly due to the gradual improvement to domestic demand and higher fuel prices.

**The economy faces several downside risks.** An ineffective containment of the outbreak could see Malaysia remain in an ongoing cycle of movement controls, posing a further drag on the economy. Further delays in Malaysia’s vaccine rollout could also affect the planned reopening of the economy. The current slow pace of Malaysia’s vaccine rollout and any further delay could also affect a more certain reopening of the economy. In addition, the number of vulnerable households could remain elevated and the ongoing domestic political uncertainty could continue to hinder the progress of the recovery effort in the near term.

**In the near term, containing the current wave of the COVID-19 pandemic should remain the government’s topmost priority.** Protecting the lives and health of citizens is vital to lessen strains on the health system, ensure a safe resumption of economic activities and prevent a more protracted downturn. An effective find-test-trace-isolate-support (FTTIS) strategy is essential to ensure a safe and gradual reopening of the economy and an easing of movement restrictions.

**The pace of the vaccine rollout plan also has to be accelerated.** The government could enact more proactive measures, including extending the opening hours of vaccination centers (including on weekends) and redeploying volunteers at these centers to reach remote areas where access may be more constrained. In addition, a sustained, effective public communication campaign should be implemented to reduce vaccine hesitancy amongst the public.

**With movement restrictions expected to remain in place, continued financial support is essential.** As the number of cases remain high and movement restriction measures remain in place, additional financial support for vulnerable groups particularly those in the B40 is still needed to ensure that the welfare of these groups is protected.

**In the current context, fiscal policy should prioritise the welfare of the people over medium-term fiscal consolidation.** It is necessary to create additional fiscal space to strengthen the health system as well as to provide additional financial support for the vulnerable groups. Given this, it may be necessary to revisit the debt limit soon.

**Efforts to rebuild fiscal buffers should remain the key policy priority in the medium term.** In the case of Malaysia, efforts to increase revenue collection through a more progressive tax framework needs to be accelerated. Measures to improve spending efficiency should also be introduced alongside revenue-enhancing measures.

**Malaysia also needs to enhance its social protection system.** The crisis has highlighted the importance of a strong social protection system to provide a guaranteed minimum standard of living for all and improve the resilience of the vulnerable against income shocks, including those resulting from events such as the COVID-19 pandemic.

**Looking further ahead, structural reforms should be anchored on ensuring that Malaysia’s transition into a high-income country translates to an improvement in living standards for all Malaysians.** Productivity growth and private-sector innovation will be the primary drivers of future growth. Deep structural reforms will be needed to remove distortions, encourage innovation, strengthen competition in markets, improve the investment climate, and facilitate deeper regional integration. These issues and policies are explored in greater detail in Part 2 of this edition of the MEM, titled Resilient Recovery for the Private Sector.
Resilient recovery for the private sector

The COVID-19 pandemic has exposed the gaps and exacerbated the vulnerabilities in Malaysia’s private sector. This is especially the case for SMEs, which have been hard hit by both demand and supply shocks. Real time surveys implemented during the crisis, show that Malaysian firms are more vulnerable than their peers, with less cash in hand to withstand the crisis. These shocks have exacerbated the issues that the Malaysian private sector faced pre-pandemic. Malaysian firms especially SMEs lag behind their global peers on productivity measures and have lower rates of technology adoption and were less likely to provide training and to invest in innovative activity.

While the top policy priority will be on saving lives and livelihoods, it is essential for the government to focus on increasing the resilience of the private sector. The sharp increase in the number of COVID-19 cases and the subsequent re-imposition of the MCO increases the uncertainty around Malaysia’s economic recovery. The fallout of the pandemic presents considerable fiscal challenges for Malaysia, implying that the post-pandemic recovery will need to be largely driven by the private sector.

To achieve higher rates of more inclusive and sustainable growth, Malaysia will need to implement deep structural reforms. To reduce poverty and ensure shared prosperity, economic growth that creates a greater number of more productive jobs is needed. Economic transformation through deeper structural changes and market integration that catalyze business opportunities is needed to create an environment in which workers are able to shift into higher productivity activities. These measures would aim to increase productivity led growth and will include encouraging firm level innovation, having open and contestable markets, improving the business environment and facilitating deeper regional integration through greater liberalization of services industry.

The private sector adjusted to the crisis through various mechanisms. Affected by demand and supply shocks, firms are adjusting employment and are experiencing pressing liquidity constraints. The pandemic has also exacerbated issues related to access to finance, which could constrain private sector recovery and future growth. On the upside, a majority of firms continue to respond to the challenges brought on by the pandemic through the increased use of digital tools. However, despite the high proportion of firms adopting digital technology, the vast majority of firms are interested in government assistance for the adoption of digital solutions to deal with COVID-19 crisis.

Uncertain trade and investment prospects have given Malaysia a renewed sense of urgency to strengthen its competitiveness. Beyond the pandemic, Malaysia faces a considerably less benign global environment amid heightened policy uncertainty and shifting patterns of international trade. Additionally, the country also faces the acceleration of disruptive technologies that will alter the nature of comparative advantage. In Malaysia, private investment fell by 11.9 percent last year, with FDI contracting by 55 percent, a greater decline than in many other regional economies. Even before the current crisis, Malaysia had experienced a decade-long decline in private investment growth. Productivity driven growth will rely on reversing this secular decline in private investment growth. Productivity driven growth will rely on reversing this secular decline in private investments that are an important source of new technology and firm-level process innovations and improvements in management practices.

To reduce poverty and ensure shared prosperity, economic growth that creates a greater number of more productive jobs is needed.

It is necessary to address regulations and practices that restrict business entry and market competition. While being generally open to trade and investment, Malaysia has retained a number of exclusions on foreign suppliers in certain key sectors. Similarly, the government has also liberalized foreign participation in the services sector in 2009, but retained restrictions in sectors such as transport services, finance and professional services. Finally, mainstreaming an economic growth strategy that incorporates green and environmental sustainability will play a positive role in improving private sector competitiveness.
Investments in innovative activity and skilled workforce will be pivotal to productivity led growth for Malaysia. While great emphasis has been placed on the enhancement of the quantity of R&D and innovation in Malaysia, less emphasis has been placed on its quality and its links with industry. Moreover, the gross expenditure on R&D, which is an important gauge to an economy’s investment in innovative activities has declined in 2018. Analyses across three Productivity and Investment Climate Surveys for Malaysia have shown that skills shortages are a major constraint for firms operating in Malaysia. With the trend toward increased digitization and automation in the current context, the availability of an adequately skilled workforce has become even more critical.

In the immediate term, clear and accessible support programs will be critical to provide relief to firms. This includes the extension of conditional wage subsidies, improving predictability of SOP regulations and expediting approvals and disbursements for existing loans. To facilitate private sector recovery, short-term policies to recalibrate existing programs towards current firm needs such as increasing digital capabilities and skills, in addition to developing an enabling framework that provides more efficient and inclusive financial services, especially for SMEs are crucial.

In the medium to long term, deep structural reforms are needed to ensure a resilient recovery for the private sector. An early ratification of the Comprehensive and Progressive Agreement of Trans-Pacific Partnership (CPTPP) and the swift entry into force of the Regional Comprehensive Economic Partnership (RCEP) should be prioritized. The commitments implied by these agreements could have significant positive impacts in terms of attracting investments, including investments that spur innovation and technological upgrading. Malaysia also needs to modernize its investment ecosystem to attract more quality investments, encourage deeper linkages between public research institutions and industry, strengthen firms’ technological and skills readiness, and mainstream environment sustainability into economic policy making. These reforms will be critical in ensuring Malaysia’s post pandemic recovery is led by the private sector.
Recent trends in Malaysia’s economy

Malaysia’s economy posted a smaller contraction in Q1 2021...

...driven by improvements in domestic and external demand

Daily COVID-19 cases have been rising at a faster pace...

...and with a higher number of fatalities

Current momentum in exports is expected to provide continued support to the economy

Malaysia’s economy is projected to grow by 4.5 percent in 2021

Malaysia’s economy posted a smaller contraction in Q1 2021...

Malaysia’s economy is projected to grow by 4.5 percent in 2021
**Resilient recovery for the private sector**

**Firms were on the path to recovery at the end of Q3 2020, but this trend has since reversed**

Firm Operational Status, Percentage

![Graph showing operational status of firms](image)

**Malaysia has been experiencing a decade-long decline in private investment growth**

Real Private Gross Fixed Capital Formation, y/y, Percentage

![Graph showing real private gross fixed capital formation](image)

**On the positive side, a majority of firms responded to the pandemic with increased use of digital tools**

Share Among Firms that Started or Increased Use in Digital Platforms, Percentage

![Graph showing share among firms using digital tools](image)

**Even before the pandemic, Malaysia had lower TFP levels than its aspirational and transitional peers**

Relative TFP of Comparator Groups to Malaysia, Percentage (2019)

![Graph showing relative TFP](image)

**Malaysian firms are less likely to invest in upskilling and innovation**

Share of Firms Investing in Training and R&D, Percentage (2019)

![Graph showing share of firms investing](image)

**The topmost priorities for firms continue to be improving predictability of SOPs**

Most Beneficial Government Policy Improvements, Percentage of Firms

![Graph showing most beneficial policy improvements](image)
Near-term measures should focus toward saving the lives and livelihoods of all Malaysians

Immediate measures to provide relief to businesses and short-term measures to increase firm efficiency

Implement clear and accessible support programs
Extend conditional wage subsidies
Improve SOP regulations
Recalibrate programs
Develop more efficient and inclusive financial services

Protecting the lives and livelihoods of all Malaysians

Source: World Bank staff elaboration
PART ONE

Recent Economic Developments and Outlook
Recent economic developments

Global economic conditions have improved

Global economic activity has gained significant momentum after marked contraction caused by the COVID-19 pandemic (see Figure 1). Nevertheless, global economic growth remained well below pre-pandemic projections. The pandemic continues to weigh on growth in many countries. The epicenter of the pandemic has now moved to some emerging market and developing economies (EMDEs), where more transmissible and virulent variants are spreading and where access to vaccines remains limited. In general, while some advanced economies have recorded significant progress with their vaccination programs, the vaccination rates in poorer countries remain low.

The recovery pattern is also expected to be uneven, passing over many poorer countries, and there is considerable uncertainty about its sustainability going forward. With their successful vaccination programs, economic performance has also improved in the major advanced economies, particularly in the United States, where the recovery is being powered by substantial fiscal support. Among the developing economies in the East Asia Pacific region, there has been a general improvement to economic performance, albeit with significant variations between countries (see Figure 2). While growth in China remains strong, it has moderated recently, with authorities focusing

FIGURE 1
Global economic activity has picked up considerably since Q3 2020

FIGURE 2
Regional economic activities have also improved, but at an uneven pace

Malaysia’s economy contracted by 0.5 percent in Q1 2021, moderating from the 3.4 percent decline in the previous quarter (see Figure 3). While negative spillover effects from the pandemic continued to weigh on the economy in Q1 2021, these effects were cushioned by less restrictive movement control measures. Overall activity also benefited from the rebound in major economies and the general strengthening in global trade activity. A number of policies outlined in the government’s stimulus packages also provided crucial support to the economy during the quarter. Nonetheless, while the decline in growth narrowed during the quarter, Malaysia’s economic growth remained below its pre-pandemic levels, with the speed and timing of an entrenched recovery remaining uncertain.

Domestic economic activity continues to be weighed down by the pandemic

Malaysia’s economy contracted by 0.5 percent in Q1 2021, moderating from the 3.4 percent decline in the previous quarter (see Figure 3). While negative spillover effects from the pandemic continued to weigh on the economy in Q1 2021, these effects were cushioned by less restrictive movement control measures. Overall activity also benefited from the rebound in major economies and the general strengthening in global trade activity. A number of policies outlined in the government’s stimulus packages also provided crucial support to the economy during the quarter. Nonetheless, while the decline in growth narrowed during the quarter, Malaysia’s economic growth remained below its pre-pandemic levels, with the speed and timing of an entrenched recovery remaining uncertain.

While negative spillover effects from the pandemic continued to weigh on the economy in Q1 2021, these effects were cushioned by less restrictive movement control measures.

Domestic demand registered a smaller contraction of 1.0 percent in Q1 2021 (Q4 2020: -4.5 percent) (see Figure 4). Domestic demand benefited from a relatively smaller decline in private consumption...
compared to the previous quarter (Q1 2021: -1.5 percent; Q4 2020: -3.5 percent). This was largely driven by a gradual resumption in household activity, following the easing of movement restrictions in February. Measures such as the Employee Provident Fund (EPF) withdrawal scheme also had a positive impact on private consumption. Growth in public consumption accelerated (Q1 2021: 5.9 percent; Q4 2020: 2.4 percent), mainly due to increased expenditure on emoluments, and supplies and services. Private investment also increased (Q1 2021: 1.3 percent; Q4 2020: -6.6 percent), driven by increased capital expenditure in the services and manufacturing sectors. Public investment declined at a slower pace than in the previous quarter (Q1 2021: -18.6 percent; Q4 2020: -20.4 percent) due to increased expenditures on fixed assets. Nonetheless, while significant improvements were recorded in the most recent quarter, the overall level of domestic demand remained below its pre-COVID-19 peak in Q4 2019.

On the sectoral front, the improvement was broad-based, with growth led by the manufacturing sector. The manufacturing sector grew at the robust rate of 6.6 percent during the quarter (Q4 2020: 3.0 percent), supported by strong global demand for E&E products and rubber gloves. The output of the agriculture sector also increased (Q1 2021: 0.4 percent; Q4 2020: -1.0 percent) due mainly to higher output in other agriculture and livestock sub-sectors. The services, mining and construction sectors all contracted at a more moderate pace than in Q1 2021, owing to an increase in the range of permissible activities across many economic sectors.

In April 2021, headline inflation increased to 4.7 percent (March 2021: 1.7 percent) (see Figure 5). The increase in headline inflation was mainly due to fuel price increases stemming from a base effect from the same period last year (see Figure 6). The normalization of electricity tariffs following the ending of rebates in December 2020 also contributed to the increase in the headline inflation. Meanwhile, core inflation remained constant at 0.7 percent during the quarter. The Producer Price Index (PPI) of local production recorded a marked increase of 10.6 percent in April 2021 (March 2021: 6.7 percent). The sharp rise was mainly due to a low base effect and continued rise in commodity and raw material prices.

### TABLE 1
GDP growth decomposition

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Source: World Bank staff calculations based on DOSM data
Exports have expanded strongly, led by robust demand for manufactured goods

Malaysia’s exports accelerated to 18.2 percent in Q1 2021 (Q4 2020: 5.1 percent). This was largely driven by increased external demand due to stronger global economic activity and the low base in Q1 2020 when the country first entered into a nationwide lockdown. Much of the recent export growth momentum was driven by manufacturing exports, which grew by 21.9 percent during the quarter (Q4 2020: 7.6 percent) on the back of increased global demand for E&E products and rubber gloves (see Figure 7). Export growth was also supported by a narrower contraction in commodities exports (Q1 2021: -5.4 percent, Q4 2020: -7.8 percent), mainly due to higher LNG prices.

Imports also rebounded as the pickup in manufacturing and investment led to increased demand for capital and intermediate imports. Malaysia’s gross imports grew by 10.8 percent in Q1 2021 (Q4 2020: -4.5 percent), with much of this increase attributable to the strong growth in capital imports (Q1 2021: 32.7 percent; Q4 2020: -15 percent), consistent with the recent pickup in investment activity. Intermediate imports also expanded (Q1 2021: 4.6 percent; Q4 2020: -7.2 percent), reflecting the increased demand for manufactured goods.

In Q1 2021, the current account surplus narrowed to 3.3 percent of GDP (Q4 2020: 4.9 percent). This reflects a smaller goods surplus and wider deficit in the services and secondary income accounts (see Figure 8). During the quarter, the goods surplus narrowed to RM36.6 billion (Q4 2020: RM42.6 billion), with imports growing at a faster pace than exports. The services account registered a larger deficit of -RM15 billion (Q4 2020: -RM14 billion) due to continued weakness in travel activity and higher payments for foreign transportation services and other business services. The deficit in the secondary income account also increased (Q1 2021: -RM3.6 billion; Q4 2020: -RM2.7 billion), with outflows from workers’ remittances outpacing receipts. The increased deficit in the secondary income account more than offset the narrower deficit in the primary income account, which stood at -RM5.7 billion in Q1 2021 (Q4 2020: -RM7.2 billion).
The financial account rebounded, with a net inflow of RM16 billion in Q1 2021 (Q4 2020: -RM10.2 billion). This was driven by net inflows in direct investment, portfolio investment, financial derivatives and other investments. The greatest inflow was recorded in the Other Investment category, with the value standing at RM13.9 billion (Q4 2020: -RM3.7 billion), mainly due to an increase in interbank borrowings from abroad.

**FIGURE 7**
Export growth was led by strong global demand for E&E products and rubber gloves

**FIGURE 8**
The current account surplus narrowed due to a smaller goods surplus

### TABLE 2
Selected external sector indicators

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Source: World Bank staff calculations based on DOSM data
Despite initial signs of a gradual recovery in the labor market, Malaysia’s unemployment rate remained elevated. In the first quarter, there were some indications of gradual improvements in the labor market. These improvements were characterized by a lower rate of contraction in employment growth (Q1 2021: -0.05 percent; Q4 2020: -0.6 percent) and a greater increase in the labor force (Q1 2021: 1.4 percent; Q4 2020: 1 percent). Nonetheless, despite these signs of recovery, the unemployment rate remained elevated at 4.8 percent during Q1 2021 (see Figure 9). Underlying the overall unemployment rate is the high rates for the 15-24 age group, which remained elevated at 12.1 percent in Q1 2021, although it declined from the 12.8 percent recorded in Q4 2020. Meanwhile, the unemployment rates for other age groups rose during the period. Due to improvements in the manufacturing and services sectors, private sector wages contracted at a lower rate in Q1 2021 than in the previous quarter (Manufacturing wage: -0.6 percent; Q4 2020: -3.4 percent. Services wage: -3.1 percent; Q4 2020: -4.6 percent).

Despite signs of recovery, the unemployment rate remained elevated at 4.8 percent during Q1 2021

Underemployment rates remained high in Q1 2021 (see Figure 10). Skill-related underemployment has risen since the onset of the COVID-19 pandemic and stood at 13.1 percent at the end of March 2021. Time-related underemployment declined to 2.0 percent in Q1 2021, down from 2.4 percent in Q4 2020, but nevertheless remained elevated at above pre-pandemic levels.¹

¹ Skill-related underemployment rate is the fraction of the labor force with tertiary qualification who work in semi-skilled or low-skilled jobs. Time-related underemployment rate is the share of the labor force employed for less than 30 hours per week due to the nature of their work or to the insufficient availability of work.
Malaysia is facing a rapid rise in COVID-19 infections, putting the health system under strain

After a gradual decline trend in new daily COVID-19 cases between February and March, daily cases have been on the rise again, and at a much faster pace since mid-April (see Figure 11). The increase in the number of daily cases began in late March, following further relaxations to the movement controls and the re-opening of schools, which together contributed to many outbreaks and clusters linked to workplaces, communities, and educational institutions. In the last week of May, the number of daily new infections averaged at 7,000 cases, with a record high in the number of daily fatalities (see Figure 12), surpassing even India, which was the epicenter of the pandemic earlier during the year. In addition, the pandemic has become increasingly widespread, with most districts in the country now falling into the red zone category. The health ministry has also expressed concern regarding the emergence of new variants of concern (VOCs), which may spread at a faster pace and result in higher fatality rates than previously identified strains. Health experts have also expressed concerns regarding Malaysia’s positivity rate, which stands above the five per cent threshold that is considered to be indicative of inadequate testing.

The severity of the most recent wave of the pandemic has placed significant strains on Malaysia’s public health system. Most hospitals that manage COVID-19 patients are currently operating at maximum capacity, with intensive care units (ICUs) dedicated to treating COVID-19 patients operating at above 90 percent of their capacity. In addition, the COVID-19 Integrated Quarantine and Treatment Centers (PKRCs), which are used to treat and isolate asymptomatic and low-risk patients, are also operating close to their limits. The government has implemented temporary measures to alleviate the pressure, including the establishment of field ICUs at military facilities in selected areas and the opening of additional PKRCs nationwide.

2 Red zones are districts that have seen more than 41 new cases within the last 14 days.
3 A high percent positivity rate means that more testing should probably be done, as it suggests high coronavirus infection rates due to high transmission in the community (https://www.jhsph.edu/covid-19/articles/covid-19-testing-understanding-the-percent-positive.html)
To curb further accelerations in the number of infections and to ease the pressure on the health system, the government has reimposed a nationwide movement control order (MCO). In response to the increase in the number of infections throughout the country, a nationwide MCO was imposed on May 12, although most economic sectors continued to be allowed to operate. The restrictions included limitations on movement across state lines; prohibitions on dine-ins and social gatherings; the closure of schools and a shift back to remote schooling across the country; and a return to work from home arrangements. These restrictions were further tightened on 25 May, with the operating hours of businesses further restricted and a 60 percent staff capacity limit imposed on workplaces. With the number of cases continuing to increase, the government announced a full lockdown on 1 June, with only essential services being allowed to operate.

The current MCO is set against a greater set of challenges. The Ministry of Health expects that it may take between 3-4 months to flatten the curve, and this is similar to the first MCO implemented back in March 2020. Nevertheless, while the previous MCO was successful in bringing the number of new cases down to single digits, the current MCO faces greater challenges. First the number of daily cases during the first MCO was much lower, below 500 and the health system was not as constrained. The government recently announced the National Recovery Plan (NRP) which details a four-phased post-pandemic exit strategy and re-opening of the economy, based on a certain set of milestones i.e. number of daily new cases, ICUs capacity and vaccination rate. Although the Plan provides a structured plan for the phased re-opening of the economy, it was also suggested that it could be improved by including more detailed strategies to slow down the spread of infections.

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4 “Up to 4 months to flatten the curve” (https://themalaysianreserve.com/2021/05/31/up-to-4-months-to-flatten-the-curve/)
COVID-19 vaccinations are ongoing, but the national level of immunization remains low

While implementation of Malaysia’s National COVID-19 Immunization Program (NIP)\(^6\) is underway, it has been impacted by delayed vaccine supply and logistical challenges. While more than 14 million people have registered for the COVID-19 vaccine in Malaysia, only slightly more than 5 million (less than 20 percent of the population) have received at least one dose of a vaccine by mid-June (Figure 13). Although Phase 1 of the NIP got off to an encouraging start, with vaccinations progressing ahead of schedule, the progress of Phase 2 has been impacted by delays in vaccine supply. In addition, the vaccination rate has also been affected by logistical challenges in vaccine distribution as well as vaccine hesitancy among the public. The on-going global vaccine shortage has also led to the delay of Phase 3 of the NIP, which was initially scheduled to begin in May.

Despite these constraints, the inoculation drive gained some momentum in May and June (see Figure 14). This was largely due to the overwhelming positive response to the opening of a parallel vaccination channel that offered the AstraZeneca vaccine through a voluntary opt-in program, contributing to an increase in daily vaccination rate.\(^7\) In addition, the government has also set-up large scale vaccination centers as well as mobile vaccination units in the rural areas. An increase of vaccine deliveries in May and June has also contributed to an increase in the number of vaccines administered. Relatedly, data released by the government show that average daily vaccinations increased more than sixfold from March to June and have surpassed the 200,000 level for the first time on June 15. The government has also recently granted conditional approval for emergency use to the single-dose vaccines CanSino and Johnson & Johnson, and this could contribute to the acceleration of the vaccination program.

### FIGURE 13
Total vaccination rate and registration for vaccination remains low

<table>
<thead>
<tr>
<th>Number of People Registered and Vaccinated, Million</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total registration</td>
</tr>
<tr>
<td>Govt. target (Aug 2021: 10 million)</td>
</tr>
<tr>
<td>Vaccination rate</td>
</tr>
<tr>
<td>Completed 2 doses</td>
</tr>
<tr>
<td>At least 1 dose</td>
</tr>
<tr>
<td>0 5 10 15 20 25 30</td>
</tr>
</tbody>
</table>

Source: The Special Committee on COVID-19 Vaccine Supply (JKJAV)
Note: As at 18 June 2021

### FIGURE 14
Pick-up in vaccination rate in May and June

<table>
<thead>
<tr>
<th>Share of People Who Received at Least One Dose of Vaccine, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 2 4 6 8 10 12 14 16</td>
</tr>
</tbody>
</table>

Source: Oxford University’s Our World in Data
Note: As at 18 June 2021

---

\(^6\) The NIP is divided into three phases; phase 1 of the rollout is channeled towards healthcare personnel and essential workers, accounting for about 500,000 individuals, and would run between February to April 2021. Phase 2 includes senior citizens above the age of 60 as well as vulnerable groups with underlying health conditions, comprising about 9.4 million individuals and would take place between April to August 2021, while the third phase would be opened to the general public, running from May 2021 to February 2022 covering about 13.7 million individuals.

\(^7\) On 28th May 2021, the government announced that it will no longer run the parallel AstraZeneca vaccination program. Instead it will be re-introduced in the main vaccination program.
The financial sector remained stable, despite pressures on credit quality

Malaysia’s central bank, Bank Negara Malaysia (BNM), maintained the overnight policy rate (OPR) at 1.75 percent in H1 2021. The Monetary Policy Committee (MPC) considers the current monetary policy stance to be appropriate and accommodative, noting a better-than-expected economic performance in the first quarter of 2021. Nevertheless, the MPC also acknowledged that the reimposition of movement restrictions and challenges related to the vaccine rollout could dampen near-term growth prospects. Despite these constraints, the central bank expects Malaysia’s growth trajectory to improve due to strengthening global demand and increased public and private spending. Nonetheless, the MPC expects the balance of risks to the economy to remain tilted to the downside.

Malaysia’s domestic financial sector remained stable in Q1 2021, with banks maintaining adequate capital and liquidity positions during the quarter. In terms of profitability, the banking sector’s overall return on equity stood at 8.5 percent (Q4 2020: 9.2 percent), with return on assets estimated to stand at 1 percent (Q4 2020: 1.1 percent). Liquid assets held by the banking system remained adequate to support financial activity, with a coverage ratio of 145 percent in Q1 2021 (Q4 2020: 148 percent), well above the minimum statutory requirement of 100 percent. Furthermore, banks continued to maintain an adequate capital buffer, with the tier 1 capital ratio standing at 14.9 percent at the end of March 2021. Despite higher impairments from households amid continued pressure on household income, the overall loan impairment ratio was stable at 1.6 percent in March 2021 (February 2021: 1.6 percent).

Household loans expanded faster in Q1 2021, driven by strong growth in loans for the purchase of residential properties and passenger cars (see Figure 15). Outstanding household loan growth increased to 6 percent in Q1 2021 (Q4 2021: 5.4 percent), mainly driven by loans for the purchase of residential properties and passenger cars. In part, this was driven by the tax exemption measures announced by the government in its economic stimulus packages. Growth in credit card loans declined, suggesting a decline in overall spending activity during the pandemic. Outstanding loans to businesses also grew at a more rapid rate in the first quarter (1.6 percent;
Q4 2020: 0.9 percent), due to loans for the purpose of working capital. On balance, net financing expanded by 4.7 percent in Q1 2021 (Q4 2020: 4.4) (see Figure 16).

Outstanding household loan growth increased to 6 percent in Q1 2021, mainly driven by loans for the purchase of residential properties and passenger cars.

During the first quarter of 2021, Malaysia’s domestic financial markets recorded a mixed performance. Accommodative global liquidity conditions and improved investor sentiments, which was partly supported by the reinstatement of Malaysia in the FTSE World Government Bond Index (WGBI), led to an increase in non-resident holdings of outstanding government bonds (Q1 2021: 25 percent; Q4 2020: 24.2 percent) (see Figure 17). The yields for 3-year, 5-year, and 10-year Malaysian Government Securities (MGS) increased by 24.4, 54.1 and 61.9 basis points respectively during the quarter. The FBM KLCI declined by 3.3 percent at the end of March 2021, closing at 1573.5 points (end-December: 1627.2 points), largely due to pressure on corporate earnings following the resurgence of the pandemic and the reimposition of the MCO. In the foreign exchange market, improved US economic prospects led to increased investment flows into US financial assets, consequently strengthening the US Dollar. As a result, the Malaysian ringgit and other regional currencies depreciated against the US Dollar (see Figure 18). Although capital inflows have continued, increases in yields due to higher expected inflation in the US could lead to a reversal of capital flows in the future.

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The government has provided additional support to households and firms amid the COVID-19 surge

To date, the government has announced three additional stimulus packages, the PERMAI, PEMERKASA and PEMERKASA+, to mitigate the economic impact of the pandemic. Collectively, these three packages amounted to RM75 billion (5.3 percent of GDP), including direct fiscal spending of RM16 billion (1.1 percent of GDP) (see Figure 19). These packages included special allocation to the health sector and measures to support business continuity. The government also continued with the disbursement of the Bantuan Prihatin Nasional cash transfer program (BPN 2.0), with 460,000 additional recipients to about 11 million recipients.

The fiscal deficit widened in 2020 on higher stimulus spending

At the end of 2020, Malaysia’s fiscal deficit stood at 6.2 percent of GDP, reflecting sharp revenue losses and increased stimulus spending. Federal government revenue was estimated to stand at 15.3 percent of GDP in 2020, lower than the figure of 17.2 percent recorded in 2019. Federal government expenditure increased slightly to about 22.2 percent of GDP in 2020, up from 21 percent in 2019 (see Figure 20). Over the same period, operating and development expenditures combined were estimated to stand at 19.5 percent of GDP, with the COVID-19 Fund established to provide economic relief and to finance recovery amounting to 2.7 percent of GDP. Following the announcement of the three economic stimulus packages, the government now expects Malaysia’s fiscal deficit to rise to 6 percent of GDP in 2021, higher than the earlier target of 5.4 percent.

The government recently withdrew RM5 billion from the National Trust Fund (K WAN) to finance the procurement of COVID-19 vaccines and related expenses. The withdrawal, amounting to almost 25 percent of the fund or 0.4 percent of GDP, was made following amendments to the National Trust Fund Act 1988, or the Emergency (National Trust Fund) (Amendment) Ordinance 2021, published in the Federal Government Gazette in April 2021. The government stated that it needed to tap into the fund to ensure that its 6 percent budget deficit target remains achievable. The use of this fund has led to calls for greater transparency and accountability over the government’s emergency financing during the COVID-19 crisis.

The Federal government’s debt increased following a widening of the fiscal deficit in Q1 2021. At the end of March 2021, the federal government’s debt stood at 58.5 percent of GDP. The increase in federal government debt was driven by a decline in government revenues and an increase in expenditures. One of the measures included in the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020, adopted by parliament last year, to temporarily increase the limit in domestic debt (MGS, MGII, and MITB) from 55 percent of GDP to 60 percent. Meanwhile, the value of debt guaranteed by the federal government had increased to 20.8 percent of GDP by the end of December 2020, up from 18.2 percent of GDP a year earlier.

9 K WAN was established as the country’s natural resource fund to ensure that future generations will continue to benefit from a stable source of income from the country’s rich but finite wealth of natural resources. It is managed by BNM and to date, its sole contributor is PETRONAS and as at end-2019, the fund amounted RM19.2 billion.
10 MGS: Malaysian Government Securities; MGII: Malaysian Government Investment Issues; MITB: Malaysian Islamic Treasury Bills
In April 2021, the government issued the world’s first sovereign US Dollar Sustainability Sukuk (Islamic bond). The issuance consisted of US$ 800 million of 10-year Trust Certificates, and US$ 500 million of 30-year Trust Certificates. The Sukuk was oversubscribed by a factor of 6.4, indicating investors’ growing appetite for sustainable debt instruments (see Box 1).
The Rise of Sovereign Sustainable Bond Issuances

A Brief History of Sovereign Sustainable Bond Issuances

In December 2016, the Republic of Poland issued a EUR 750 million green bond, the first such bond from a sovereign state, to finance a range of climate-related projects. It had been eight years since the first green bond was issued by the World Bank, with this marking a significant development in the nascent sustainable bond market that foreshadowed the growing popularity of sovereign sustainable bond issuances.

Green bonds serve to channel funds into climate-related projects, while social bonds play a similar role for projects with a social agenda. Some projects have dual objectives, with a mix of climate and social agendas, with these bonds often labeled as sustainability bonds. Meanwhile, bonds with a specific marine and ocean focus have been labeled as blue bonds. Collectively, these thematic green, social, sustainability, and blue bonds are often referred to as sustainable bonds.

The COVID-19 pandemic has created a range of new challenges, resulting in new developments as governments strive to deal with the massive global economic and social disruption resulting from the pandemic. As a result, while the value of global social bond issuances stood around US$ 17 billion in 2019, the response to the pandemic resulted in a dramatic increase to US$ 141 billion in 2020 (see Figure 21).
What are governments using the funds for?

Funds raised through the issuance of sovereign sustainable bonds are earmarked for activities intended to promote sustainability, which are often activities that have long been financed by governments but that only now have been segregated and clearly identified as having climate, social or sustainability impacts. The World Bank Green Bond Proceeds Management and Reporting guide for public-sector issuers provides guidance on how this might be achieved.

In Poland, the issuance of green bonds has been used to fund several sectors with a heavy concentration in clean transportation and sustainable agriculture, while in Thailand, sustainability bond proceeds have been allocated to a Mass Rail Transit project (clean transportation, 60 percent) and employment generation (COVID-19 response, 40 percent).

How Malaysia could leverage sustainable issuances to fund development

Malaysia’s SDG Sukuk Framework, which provides a basis for the issuance of the inaugural sustainability sukuk, is aligned with major international guidelines and principles, such as those expressed through the International Capital Market Association’s (ICMA) Sustainability Bond Guidelines 2018, Green Bond Principles 2018, Social Bond Principles 2020, and the ASEAN Sustainability Bond Standards 2018. This reflects the Malaysian government’s commitment to utilize the proceeds of the sukuk issuance only on eligible projects that are either climate-friendly; have a clear social agenda; or both.11

Thus, this represents a pool of available funding for key sustainable developmental projects, including projects related to clean transportation, renewable energy, energy-efficient green buildings, the sustainable management of living natural resources, access to essential services such as healthcare and education, affordable basic infrastructure, and employment generation through support to small and medium enterprises.

As demand for sustainable investment assets such as Malaysia’s sustainability sukuk increases worldwide, the use of such instruments to tap the global and domestic capital markets could attract a wider group of investors than traditional sukuk or bond issuances. A larger pool of available investors usually means stronger demand and better pricing, both of which will be essential as Malaysia looks forward to a rebound from the pandemic crisis and to the achievement of more sustainable growth into the future.

Economic outlook

Global growth is projected to improve in 2021, but recovery is expected to be uneven across countries

The global economy is projected to expand by 5.6 percent in 2021, its strongest post-recession growth rate in 80 years (see Figure 22). Following a 3.5 percent contraction due to the impact of the COVID-19 pandemic in 2020, global economic activity has gained significant momentum. However, this recovery has been uneven across countries, largely reflecting sharp rebounds in some major economies, most particularly the U.S., where recovery has been driven by large fiscal support programs. Global recovery is expected to continue into 2022, with the growth rate moderating to 4.3 percent. Despite this, global GDP is expected to remain at 1.9 percent below pre-pandemic projections.

In advanced economies, progress towards control of the pandemic has been driven by an acceleration in the implementation of vaccination programs, which is expected to unlock significant pent-up demand. Growth in advanced economies is forecast to reach 5.4 percent in 2021, 2.1 percentage points higher than the projections made in January. This is driven by significant fiscal and monetary policy support; acceleration in the implementation of vaccination programs in several countries; the provision of additional fiscal support in the US; and the release of sizable pent-up demand.

While growth in the East Asia Pacific region is projected to improve, it is expected to do so at an uneven pace across different countries (see Figure 23). Overall growth in the region is projected to accelerate to 7.7 percent in 2021, largely reflecting a strong rebound in China. Nevertheless, output in two-thirds of the countries in the region is expected to remain below pre-pandemic levels at least until 2022. The pandemic is expected to dampen potential growth in many economies, especially those that suffered most from extended outbreaks of COVID-19 and the collapse of global tourism and trade. Major downside risks to

FIGURE 22
Global GDP is projected to improve in 2021...

GDP, y/y, Percentage

FIGURE 23
…with growth in Developing EAP projected to accelerate, but remain uneven across countries

GDP, y/y, Percentage

Source: World Bank staff projections

Source: World Bank staff projections
the ongoing pandemic and movement restrictions will continue to affect Malaysia’s economy in the near term

The current resurgence of the COVID-19 pandemic and the reimposition of the MCO is expected to have a significant impact on private consumption. The ongoing MCOs, increased precautionary behavior, and subdued wage growth are all expected to exert negative pressure on private consumption activity. This is especially so for services-related sectors, which will continue to be particularly impacted by movement restrictions. Expansion in consumption will crucially depend on the safe reopening of the economy, which is likely to be subdued in the near term given the severity of the current outbreak. With these factors, in 2021, private consumption growth is expected to reach 4.2 percent (2020: -4.3 percent). Meanwhile, public consumption is expected to continue to expand over the near term, albeit at a more moderate rate (2021f: 2.0 percent; 2020: 3.9 percent). This growth will be supported by ongoing government expenditure on emoluments and on measures to improve public service delivery.

With recovering global demand, export growth is likely to gain momentum. Given the acceleration of advanced nations’ vaccination programs and the reopening of their economies, global demand is expected to continue to recover in the near term. Assuming there are no new major waves of infections, the growth rate for exports for goods and services is projected to rebound to 13.1 percent in 2021 (2020: -8.9 percent) as global demand stabilizes. The recovery in economic activities in selected countries throughout the region, especially China, will also contribute to increases in trade activities. Import growth is projected to rise by 13.6 percent (2020: -8.4 percent), with the growth of intermediate and capital imports regaining some momentum due to improvements in exports and investment.

In the near term, it is projected that investment activities will be driven by these continuing increases in export-related activities. Gross fixed capital formation is projected to rebound to 5.5 percent (2020: -14.5 percent), supported by increased capital expenditure in the private sector. Increased production in the trade-related manufacturing sectors, particularly in the E&E as well as oil and gas subsectors, will support this growth. Public investment is expected to grow, albeit at a slower rate, supported by the range of programs implemented through the government’s stimulus packages and by the continued implementation of major infrastructure projects (e.g., ECRL, MRT2 and Pan-Borneo Highway).

Against this backdrop, Malaysia’s economy is projected to grow by 4.5 percent in 2021 (see Table 4). This latest projection is 1.5 percentage points lower than the earlier forecast of 6.0 percent. The revision reflects the slower-than-expected suppression of the pandemic and implementation of the vaccine rollout. Under this baseline scenario, growth can be attributed to a marked rebound from a low base in 2020 and to continued improvements in exports.

The pace and trajectory of growth will depend on a number of factors. This includes the length and severity of movement restrictions, the effectiveness of pandemic containment measures, and the pace of the rollout of the vaccination program. An ongoing cycle of on-and-off closures and re-openings of the economy levels, raises the possibility of more severe and longer-lasting effects from the pandemic, including subdued investments.
or any further unexpected disruptions or delays to the vaccination rollout could exert further negative pressure on growth. Furthermore, an increase in the number of vulnerable households could affect consumer spending, posing additional downside risk to the projection. On the upside, the effective management of the pandemic and increased vaccination rates could lead to higher-than-projected growth.

**TABLE 3**
GDP growth and contribution to growth

<table>
<thead>
<tr>
<th></th>
<th>Annual Growth, y/y, Percentage</th>
<th>Contribution to Annual GDP Growth (Percentage Point)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2020  2021f  2022f  2023f</td>
<td>2020  2021f  2022f  2023f</td>
</tr>
<tr>
<td>GDP</td>
<td>-5.6  4.5    5.0    4.8</td>
<td>-4.7  3.9    4.9    4.4</td>
</tr>
<tr>
<td>Domestic Demand (including stocks)</td>
<td>-5.1  3.9    4.8    4.5</td>
<td>-4.7  3.9    4.9    4.4</td>
</tr>
<tr>
<td>Private Consumption</td>
<td>-4.3  4.2    6.4    6.0</td>
<td>-2.5  2.5    3.8    3.6</td>
</tr>
<tr>
<td>Public Consumption</td>
<td>3.9   2.0     1.2    1.0</td>
<td>0.5   0.3     0.2    0.1</td>
</tr>
<tr>
<td>Gross Fixed Capital Formation</td>
<td>-14.5  5.5  4.2    3.5</td>
<td>-3.3  1.1    0.9    0.7</td>
</tr>
<tr>
<td>Change in Stocks</td>
<td>0.7   0.0     0.0    0.0</td>
<td>0.7   0.0     0.0    0.0</td>
</tr>
</tbody>
</table>

Source: World Bank staff calculations and projections

Headline inflation is projected to increase in 2021, with the average consumer price inflation rate projected to increase to 3.0 percent, (2020: -1.2 percent). This is mainly due to the projected gradual improvement to domestic demand and to higher fuel prices. Underlying inflation is expected to be broadly contained into 2021 in the absence of immediate domestic cost pressures.

**Ineffective containment and a slow vaccination rollout would be costly to the economy**

A prolonged and ineffective containment of the pandemic could see the number of cases and fatalities remain high (see Figure 24). Without a proper Find-Test-Trace-Isolate-Support (FTTIS) strategy, reopening the economy will come at the risk of another surge in case numbers and precipitate another phase of movement restriction. This would have negative spillovers to the economy. Businesses, particularly those in the services sectors and SMEs, would operate under more uncertainty, and investment activities would be deferred. Continuous use of these non-pharmaceutical interventions (NPIs), often coupled with other stringent control measures (e.g. lockdowns) have been found to be effective in breaking chains of transmission. Without this, mortality, morbidity, and incidence of COVID-19 cases is likely to remain high, and in turn overburden the health system.

With the current pace of Malaysia’s vaccine rollout, any further delays could also affect a safe reopening of the economy. To date, the pace of the rollout has been fairly slow, partly due to supply issues,
although it has picked up recently. The government has indicated that the third phase of the NIP may commence later than initially planned due to delays in receiving supplies. Other factors negatively affecting the implementation of the vaccination campaign include operational issues, such as weaknesses in the online registration system and logistical challenges. In addition, vaccine hesitancy among certain segments of the population has also led to a lower number of individuals registering for vaccination or failing to turn up at their appointments. Failure to accelerate the rollout could contribute to prolonged lockdowns and amplify downside risks to the economy.

The number of vulnerable households without adequate support could increase. While the government has introduced a number of financial support measures for households, many of them are either modest or short-term in nature. Furthermore, although most sectors in the economy are permitted to operate during the MCO, the gains have been fairly uneven, accruing mainly to the manufacturing sector. This could have a number of negative implications, particularly for those in lower-income groups, most of whom are employed in the services sectors and SMEs. Those with few or no assets or savings to fall back on; informal workers who are not adequately covered by social safety nets; and those who have lost their jobs, been placed on unpaid leave, or experienced pay cuts would remain vulnerable unless they are provided with adequate financial support.

Ongoing domestic political uncertainty could continue to affect investment sentiment and hinder the progress of the recovery. In January 2021, the government declared a state of emergency, scheduled to last until August 2021, with the objective of controlling and flattening the number of daily COVID-19 cases. Speculation regarding a possible extension to the state of emergency and the future of the current governing coalition have contributed to uncertainty surrounding Malaysia’s political stability and the overall direction of its economic policies. The suspension of parliamentary sessions has led to delays in the tabling of the 12th Malaysia Plan, possibly affecting the process for Budget 2022. The Conference of Rulers have stated that there is no need for the Emergency to be extended past its original end date of August 1 and parliament should convene as soon as possible. As domestic debt edges closer to the statutory limit, the suspension of parliamentary sessions is also constraining discussions related to revisions to the debt limit. If the government breaches the limit without a statutory basis, it would have negative consequences for the country’s fiscal and institutional standing.

**FIGURE 24**
Ineffective containment and a slow pace of vaccine rollout would be costly to the economy

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12 The Conference of Rulers is a council comprising the nine rulers of the Malay states, and the governors or Yang di-Pertua Negeri of the other four states.
In the near term, containing the current wave of the COVID-19 pandemic should remain the government’s topmost priority. Flattening the pandemic curve and thereby preventing further strains on the health system is vital to ensure a safe resumption of economic activities and to prevent a more protracted downturn.

A return to normalcy in economic activity will depend greatly on effectively containing the spread of COVID-19. The National Recovery Plan has outlined several milestones for the safe reopening of the economy which cover the number of new daily cases, ICUs capacity and vaccination rates. The Plan, however, did not present a testing target as well as other measures to contain the spread of the virus. Effective containment requires robust surveillance, active case detection, testing, contact tracing, and quarantine to reduce the effective reproduction rate of the virus. The evidence to date suggests that countries pursuing elimination of COVID-19 are performing better – in terms of outcomes for health, the economy, and civil liberties – than those trying to suppress the virus. The control measures for COVID-19 elimination are similar to those used for pandemic control, with the main difference in the intensity and timing of their application. This suggests that, minimally, a decisive and robust FTTIS strategy is what is needed to bring down case numbers and mortality in Malaysia today, and lead to a recovery of economic activity in the near future.

Malaysia’s capacity for smart containment should be strengthened prior to any relaxation of the movement control measures. A premature lifting of movement controls could lead to a resurgence of infections, with potentially far greater negative implications for the economy than those resulting from the lockdowns. An effective FTTIS strategy is essential to ensure a safe reopening of the economy and an easing of movement restrictions. Open and comprehensive testing policies are positively associated with both containment and growth outcomes. World Bank staff estimates suggest that on average, every 1,000 additional tests per positive case is associated with a one percentage point increase in output growth. Until a sizeable proportion of the population is vaccinated, large-scale, proactive testing and contact tracing and the effective adoption of non-pharmaceutical intervention (NPIs) is essential to limit the spread of the virus and instill greater confidence in people to engage in economic activity (see Box 2).

15 https://www.thelancet.com/journals/lancet/article/PIIS0140-6736(20)32007-9/fulltext
The Malaysian Health Sector’s Response to COVID-19

Malaysia’s pre-existing capabilities and its strong public sector health system enabled the government to implement a relatively robust response in the early stages of the COVID-19 pandemic. Malaysia has a strong health system that provides wide access and coverage for essential health services for its population. These foundations enabled the government to implement a swift response at the early stages of the pandemic. Key response measures included the use of primary health care facilities to screen suspected COVID-19 cases (including the establishment of separate care pathways for COVID-19 and non-COVID-19 cases); the optimization of hospital services by coordinating clinical responses through the Clinical Preparedness and Response Center; and the designation of hospitals for specific purposes (hospitals were designated as full, hybrid, or non-COVID-19 hospitals to maximize capacity for COVID-19 cases while enabling the continuity of other essential services).18

With the number of confirmed cases continuing to rise, Malaysia will need to intensify its efforts to implement effective public health interventions. Recent evidence suggests that the effective containment of COVID-19 depends on sustained non-pharmaceutical interventions (NPIs), complemented by the widespread implementation of vaccination programs. While vaccines have a strong potential to constrain the spread of the virus, this impact is unlikely to be felt until late in vaccine deployment. Production and distribution lags mean that many countries, including Malaysia, may not achieve herd immunity before the end of 2021. In the interim period, NPIs will be important to reduce case numbers and COVID-19 related deaths.19

Among NPIs, widespread testing, in particular, is critical to adequately monitor and control the spread of the virus.19 Epidemiological models suggest that the true number of infections far outnumber confirmed cases. Where the number of confirmed cases is high relative to the number of tests administered, it is likely that not enough tests are being conducted to properly monitor the outbreak.20 Thus, the positivity rate (the proportion of tests that are positive) can be viewed as a proxy for the adequacy of testing. The World Health Organization (WHO) suggests that a positivity rate lower than 10 percent, and ideally lower than 3 percent, can be regarded as a benchmark of adequate testing. There are significant variations in the positivity rate between countries, ranging from less than 1 percent in Australia and some European countries to more than 20 percent in countries with limited testing capacity.

Despite a significant increase in Malaysia’s COVID-19 testing capacity, the level of testing may still be insufficient. Testing capacity had increased from 1,000 tests per day in January 2020 to about 37,000 tests per day by June 2020.21 By January 2021, national testing capacity was estimated to stand at around 70,000 per day, with plans by the government to increase it to 200,000 per day in response to the ongoing increase in case numbers. Malaysia’s positivity rate in mid-May 2021 stood at 6.6 percent, with significant fluctuations over time (ranging from 0.1 to 16.3 percent in 2020), remaining above the 3 percent benchmark for most of Q4-2020 and Q1-2021. Compared to some comparator countries in the region, including Singapore, South Korea, Thailand, Malaysia’s positive rate is high (see Figure 25), with insufficient testing possibly partially explaining the recent surge in cases. Looking ahead, if case numbers continue to rise,

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Increased testing may need to be part of the suite of NPIs used to contain COVID-19.

**Achieving high coverage rates for Malaysia’s COVID-19 vaccination program will also be crucial.** Malaysia’s COVID-19 vaccination program has faced a number of implementation challenges, including procurement delays and low take-up from eligible populations. This has led to a slower-than-expected rollout. By the end of May 2021, an estimated 3 percent of the population had been fully vaccinated (with another 2.3 percent partially vaccinated), lower than in Singapore, South Korea, and Indonesia.

A strong COVID-19 vaccination campaign, with the swift rollout of vaccines and the widespread, sustained deployment of NPIs, will increase vaccine effectiveness. Vaccine effectiveness declines in the event of delays during deployment or if other control measures are unable to suppress the transmission of the virus. In Malaysia, there have been calls for the accelerated implementation of the vaccination program to meet the government’s coverage target; to reduce the number of infections and deaths; and to bring forward the possibly safe reopening of the country. However, this acceleration may be operationally costly and logistically challenging given worldwide production and procurement delays. More importantly, the impact of the vaccine in terms of containing the pandemic may be significantly reduced if its severity (measured in terms of the effective reproduction rate of the virus) increases, as is currently the case in Malaysia. Thus, an effective vaccination campaign may depend just as much on NPIs that have the potential to reduce the spread of COVID-19 while the implementation of the vaccination program is ongoing.

The COVID-19 pandemic has highlighted the importance of public health preparedness and, in the longer term, the need to continue investing in health services and systems. Malaysia’s robust health system and preparedness to handle health emergencies enabled it to manage COVID-19 relatively well in the early stages of the pandemic. As case numbers continue to climb, it will be important to sustain NPIs (testing, restrictions on movement, infection prevent and control measures etc.) while rolling out vaccines. In the long term, continued investments in the health system will be critical not just to improve health outcomes but also to facilitating a sustained return to normalcy and economic recovery.

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**FIGURE 25**
Malaysia’s testing level may still be insufficient

<table>
<thead>
<tr>
<th>Positivity Rate, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Malaysia</td>
</tr>
<tr>
<td>Positivity Rate, Percentage</td>
</tr>
<tr>
<td>Malaysia</td>
</tr>
</tbody>
</table>

Source: Oxford University’s Our World in Data
Note: As at 18 June 2021

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Given the current trajectory of the pandemic, the pace of the vaccine rollout plan needs to be accelerated to provide adequate protection to a larger proportion of the population. While the limited supply of vaccines has partially contributed to the slow rollout, the government has announced several steps, including the introduction of the use of the AstraZeneca vaccine in parallel with the national vaccination program and the deployment of private healthcare providers to implement the program. Nevertheless, the government could enact more proactive measures, including extending the opening hours of vaccination centers (including on weekends) and redeploying volunteers at these centers to reach remote areas where access may be more constrained. In addition, a sustained, effective public communication campaign should be implemented to address vaccine hesitancy amongst the public.

With movement restrictions expected to remain in force in the near term, additional targeted social spending is essential to protect vulnerable households and businesses. Since the pandemic began last year, fiscal policy has been providing support on three fronts – relief, recovery and growth. To date, the bulk of it has gone to relief-type stimulus spending that provides support to the labor market e.g. wage subsidy program. However, given the current situation in Malaysia, larger relief spending is necessary to help smooth household consumption and to avoid mass bankruptcies among firms. While a range of fiscal and financial support measures have been implemented through the various stimulus packages, these measures are mostly short-term, based on an assumption that the pandemic would be successfully contained within a short period of time. Confronted with the resurgence in infections, the provision of additional longer-term financial support for vulnerable groups, particularly those in the B40 and for SMEs, is still needed. This is vital to ensure that the welfare of these groups is protected while the pandemic continues.

In the current context, fiscal policy should prioritize the safeguarding of lives and livelihoods of the people over medium-term fiscal consolidation. Revisiting fiscal rules to create additional fiscal space may be necessary in order to provide continued support to the health system and to vulnerable groups. The Temporary Measures for Reducing the Impact of COVID-19 Act 2020, which included provisions to increase the government’s (domestic) debt limit from 55 percent of GDP to 60 percent and which was approved by parliament last year, was intended to provide the government with additional breathing space and to enable it to mitigate the impact of the pandemic, including through the acquisition of much-needed supplies of vaccines. With the debt level potentially nearing this debt limit, it may be necessary to revisit this limit to enable the government to access additional funds (see Figure 26).

FIGURE 26
Near-term measures should focus toward saving the lives and livelihoods of all Malaysians

Protecting the lives and livelihoods of all Malaysians

- Accelerating the pace of the vaccine rollout plan to provide adequate protection to the population
- Revisiting fiscal rules to create additional space for fiscal support
- Strengthening capacity for smart containment prior to any relaxation of the movement control measures
- Providing additional targeted assistance to vulnerable households and businesses

Source: World Bank staff elaboration

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25 On 28th May 2021, the government announced that it will no longer run the parallel AstraZeneca vaccination program. Instead it will be re-introduced in the main vaccination program.

The current pandemic underscores the importance of undertaking strong reforms

In the medium term, efforts to rebuild fiscal buffers through increased revenue collection and enhanced spending efficiency should remain a key policy priority. One of the most critical lessons learned from the current pandemic relates to the importance of having adequate fiscal space to mitigate shocks to the economy. Countries that entered the crisis with relatively strong fiscal positions were able to channel greater financial support over a longer period of time. These countries were also able to increase the capacity of their health systems, including through the implementation of effective containment measures. In these countries, these measures have played a vital role in mitigating the economic impact of the pandemic. Going forward, for Malaysia, efforts to increase revenue collection through a more progressive tax framework need to be accelerated, with a clear implementation timeline. These measures may include removing exemptions from consumption taxes on non-essential items; expanding capital gains taxes; and exploring other forms of progressive taxes, including wealth taxes (see Box 3). Together with these revenue-enhancing measures, measures to improve spending efficiency should also be introduced.

An effective social protection system can provide a guaranteed minimum standard of living for all and improve the resilience of the vulnerable against income shocks, including those resulting from events such as the COVID-19 pandemic.

Malaysia also needs to deepen its social protection system to provide at least the minimum level of protection appropriate to all those in need. The crisis has highlighted the importance of a strong social protection system. An effective social protection system can provide a guaranteed minimum standard of living for all and improve the resilience of the vulnerable against income shocks, including those resulting from events such as the COVID-19 pandemic. There is significant potential to deepen social assistance for the B40 and to achieve better outcomes by clarifying and harmonizing the objectives of the programs implemented by the Department of Social Welfare (Jabatan Kebajikan Masyarakat, JKM), and even more so of Bantuan Sara Hidup (BSH)/Bantuan Prihatin Rakyat (BPR).

In addition, there is potential to improve the delivery of social protection programs by better coordinating targeting approaches, information systems, and front-end service delivery. This may include moving toward a more standardized targeting system in terms of the unit of targeting, the eligibility thresholds for targeted programs, and the flexibility to handle programs targeting different segments of the population (see Box 4). In addition, information systems within and across social protection agencies could benefit from deeper integration or interoperability. Front-end service delivery in social protection programs could also be consolidated to improve efficiency, client orientation and institutional coordination.

Looking further ahead, structural reforms should be anchored on ensuring that Malaysia’s transition into a high-income country translates to an improvement in living standards for all Malaysians. Productivity growth and private-sector innovation will be the primary drivers of future growth. Deep structural reforms will be needed to remove distortions, encourage innovation, strengthen competition in markets, improve the investment climate, and facilitate deeper regional integration. These issues and policies are explored in greater detail in Part 2 of this edition of the MEM, titled Resilient Recovery for the Private Sector.
Exploring Capital Gains Tax and Wealth Tax

Countries around the world are currently facing the financial consequences of the COVID-19 crisis, and Malaysia is no exception. With public finances coming under severe pressure during the crisis, there will be an ongoing need to support economic recovery and meet spending commitments. It follows that taxation is going to play a large part in rebuilding public finances. This is not just a matter of setting appropriate tax rates and allowances, it is also important to get the right mix of taxes. Even before the crisis, policy makers in many countries were becoming increasingly concerned regarding growing wealth inequality. Now, they are increasingly focusing on ensuring that those most able to do so contribute appropriately to the reconstruction effort. For that reason, many countries are revisiting the manner in which they tax capital and wealth.

The taxation of capital income and wealth can both increase overall revenue and ensure that the burden of taxation is distributed fairly. For example, if a worker earns $20,000 and their neighbor sells an asset for a gain of $20,000, both individuals have the same income. It is not obvious why the worker should pay taxes on their income, but the investor should not. Wealthier individuals derive more of their income from capital gains and investments in any case. If the tax mix does not include taxes on capital and wealth, the tax burden will fall disproportionately on labor and the less well off.

For these reasons, taxes on capital and wealth are a feature of the tax systems in many countries. Taxes on capital gains are the most common, with over 100 countries around the world taxing individuals on capital gains to a greater or lesser extent. In addition to the direct revenue these taxes raise, they also protect income tax yield. When capital gains are not taxed, individuals have an incentive to choose investments that deliver a capital gain over those that provide income. Comprehensive capital gains taxes can make a significant contribution to revenue: in 2018-19, the UK collected £9.5 billion, which is around 5 percent of the income tax collected in that year.

Wealth taxes are less common and generally take two forms: recurrent taxes on the stock of wealth and taxes on wealth when it is passed on, by way of a gift or on death. Recurrent wealth taxes are relatively costly to administer, with the amount of revenue raised usually modest. As a result, such taxes have been in decline, with the number of OECD countries levying them declining from 12 in 1990 to three at present. On the other hand, inheritance taxes are still levied in 24 OECD countries, with a recent OECD report highlighting the role they can play in addressing wealth inequality and in raising revenue to help address the impact of COVID-19, amongst other purposes.

Comprehensive capital gains taxes can make a significant contribution to revenue

Currently, Malaysia raises only a small amount of revenue from capital taxes. There has been no tax on wealth transfers or inheritance in Malaysia since the abolition of estate duty in 1991. Neither are capital gains taxed, with the exception of disposals of real property and shares in real property companies, which are subject to the Real Property Gains Tax (RPGT). The tax applies to gains on the sale of private residences, which are often exempt from capital gains taxes in other countries. However, once a property has been owned for five years or more, the tax payable on the gain is low (5 percent). Overall, RPGT make a very small contribution to government revenue (0.6 percent). Malaysia has plenty of scope to broaden its tax base by adopting a more comprehensive CGT and/or a tax on wealth, probably in the form of a tax on gifts and inheritance.
Trends in Malaysian poverty dynamics: Do regional inequalities trump ethnic disparities?

Data from the nationally-representative Household Income and Expenditure Survey (HIES) confirm that Malaysia has achieved a remarkable degree of poverty reduction over recent decades. However, these surveys are not designed to provide information related to the dynamics of poverty. Are the poor in Malaysia mostly households that live in poverty over prolonged of time? Or is poverty more of a transitory phenomenon, with households moving into and out of poverty from one period to the next?

Data related to the dynamics of poverty are important to enable policymakers to design effective poverty-reduction policies. For example, if poverty is mostly chronic, policies to relieve constraints, such as investments in infrastructure or human capital, may be needed to overcome poverty. On the other hand, if there is much poverty mobility, social protection measures such as unemployment insurance or safety nets may be more appropriate. In addition, the effectiveness of policies and programs can vary between locations. Therefore, it is crucial to understand the trends in Malaysian poverty dynamics and to investigate the differences in the dynamics between population subgroups.

Like many other countries, Malaysia does not conduct panel surveys on income to follow the same households over several years, with such surveys necessary to measure poverty dynamics directly. In order to overcome this knowledge gap, Deaton (1985), Dang et al. (2014), and others have developed so-called pseudo- or synthetic panels, which attempt to provide information on these dynamics by exploiting specific information in consecutive cross-sectional surveys, such as time-invariant household characteristics. A new study by the World Bank/Rongen et al. (2021) uses these methods to estimate bounds for the relative shares of four poverty mobility transitions in Malaysia: (i) poor in both periods (chronic poverty); (ii) poor to non-poor; (iii) non-poor to poor; and (iv) non-poor in both periods.

The poverty dynamics study reveals three important patterns. First, chronic poverty has decreased significantly since 2004–2007 for all the main ethnic groups in Malaysia (Bumiputera, Chinese, and Indian). As shown in Figure 27, by the 2014-2016 period, bounds on chronic poverty had fallen to 3-13 percent for Bumiputera; 0-2 percent for Chinese; and 1-8 percent for Indian Malaysians.

Furthermore, the study shows that absolute differences in chronic poverty rates are greater along geographic dimensions than between ethnic groups. For example, in 2014-2016, an estimated 1-7 percent of those in urban areas experienced chronic poverty, while in rural areas the rate stood at 8-24 percent. In particular, this geographic difference is greatest when comparing households in urban areas...
of Peninsular Malaysia with households in rural East Malaysia (see Figure 28). It can be observed that in the former group, only 1-5 percent of the population lives in chronic poverty, while the figures for the latter group stand at 16-39 percent. It should be noted that the nature of poverty is also different across these areas. In East Malaysia, for example, it is not just that a larger proportion of the population lives in chronic poverty, but also that a larger proportion of all poor is chronically poor. Hence, the high level of chronic poverty is not just a function of the presence of more overall poverty, but also reflects that there are fewer opportunities to escape poverty.

There are also notable differences within the Bumiputera group across the country. A clear distinction can be observed between urban and rural Bumiputeras, and between Bumiputeras living in Peninsular Malaysia and those living in East Malaysia (see Figure 29). In 2014-2016, the proportion of Bumiputeras in Peninsular Malaysia who lived in chronic poverty stood at between 2-9 percent, while in East Malaysia, the figure stood at 11-29 percent. This difference is slightly less pronounced when comparing Bumiputeras in urban areas to those in rural ones.

The findings show that there is a need to shift to a new social contract, from ethnicity-based affirmative action policies to more inclusive policies. While chronic poverty has declined drastically in the period from 2004 to 2016, a shift in focus from ethnicity-based to region-based anti-poverty policies could be useful and timely. Given the striking differences in chronic poverty between urban Peninsular and rural East Malaysia and within the Bumiputera group itself, the findings show that the existing affirmative action policies may not be the best solution to reduce remaining chronic poverty among Bumiputeras either. The findings show that there is a need to shift to a new social contract, from ethnicity-based affirmative action policies to more inclusive policies.

FIGURE 28
Differences in regional chronic poverty
Percentage of the Subgroup Population in Chronic Poverty

FIGURE 29
Regional differences in Bumiputera chronic poverty rates
Percentage of the Subgroup Population in Chronic Poverty

Source: World Bank staff’s calculations based on DOSM Household Income Survey data
PART TWO

Resilient recovery for the private sector
Resilient recovery for the private sector

The sharp increase in the number of COVID-19 cases and the subsequent re-imposition of the MCO increases the uncertainty around Malaysia’s economic recovery. While the effects of the negative spillovers from the pandemic were cushioned by less restrictive movement control measures and increases in manufacturing exports in Q1 2021, the level of activity in the Malaysian economy still remained below pre-pandemic levels. While the economy is expected to gradually recover over the coming years, the projected growth would not be sufficient to undo the pandemic-induced output losses until 2022, and output gaps are expected to remain negative for an extended period (exceed -3 percent in 2021). Mobility restrictions within countries and across borders result in higher transactions costs, exacerbating misallocation in the economy and lowering aggregate productivity growth. The pandemic is also likely to dampen Malaysia’s potential growth over the next decade through multiple channels, including through various adverse long-term effects on the private sector, especially if this damage also affects the more dynamic and productive firms.  

The fallout of the pandemic has also presented considerable fiscal challenges for Malaysia, implying that the post-pandemic recovery will be largely driven by the private sector. Prior to the crisis, the combined impact of a trend decline in revenue and increased committed expenditures as a share of GDP had already narrowed fiscal space. Increased public spending in response to the pandemic has exacerbated this. With the passing of the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020, the domestic debt level is expected to approach the revised statutory limit of 60 percent of GDP. At this level, the medium-term objective of fiscal policy will need to be on rebuilding fiscal buffers through fiscal consolidation. This limits the scope for medium-term growth impetus from fiscal policy and puts additional onus on the private sector to lead the growth process with the role of government policy shifting further towards facilitating private sector growth.

While the top policy priority will continue to be saving lives and livelihoods, it is essential for the government to focus on increasing the resilience of the private sector. In Malaysia, large-scale firm support measures such as wage subsidies, moratorium on loan repayments and temporary credit guarantees have been crucial in preserving jobs and limiting mass bankruptcies since the COVID-19 outbreak. With the pandemic entering its second year, continued firm support remains critical as pressure on firms’ balance sheets deepens. Given the large fiscal implications of these measures, analyzing the effectiveness of the various measures, as well as the regional and sectoral differences in the crisis’ transmission, could inform better implementation and effectiveness of these support measures.

In the medium to long term, the emphasis will need to be on facilitating the emergence of a more resilient private sector. In order to achieve this, it is important to understand the severity of the impact of the shock and its distribution and the adjustment mechanisms adopted by firms, and to design better policies that can help smooth the impact of the shock and support recovery in the medium to long term. In the context of the current uncertain global situation, it is particularly important for Malaysia to make the transition to a more innovation-based productivity led growth model.

The first section of the analysis will discuss the immediate effects of the pandemic on firms using the data from the COVID-19 Business Pulse Survey (BPS). It will be followed by a discussion of factors that will be important in facilitating a more resilient and sustainable private sector. The final section proposes policy interventions both in the near term to provide relief to the private sector, followed by short-term measures to recalibrate assistance programs, as well as medium- to long-term measures to build a resilient private sector.

27 World Bank (2021a)
The pandemic has impacted firms on both the production and demand sides

The COVID-19 pandemic has exposed the gaps and exacerbated the vulnerabilities in Malaysia’s private sector. This is especially the case for SMEs, which have been hard hit by both demand and supply shocks. Two rounds of the BPS were implemented in Malaysia to measure the various channels of impact of COVID-19 on firms, firm adjustment strategies, and public policy responses. The first round was implemented in early October 2020 and the second round was implemented in January to Mid-February 2021 when the country was under MCO 2.0. The analysis suggested that the recovery momentum that was evident from the first round of the BPS had been substantially weakened when the second round was implemented. Despite having a large share of firms operating in January to Mid-February 2021 period (see Figure 30), more firms shifted to operating only partially at 57 percent with only 27 percent operating fully. The situation in early October was the reverse, with 52 percent of firms fully operating and 38 percent of firms partially opened. More firms reported losses during the second CMCO (mid Oct-7 Dec), at 64 percent of firms compared to only 39 percent of firms in October 2020 prior to the re-imposition of CMCO (see Figure 31). In general, small firms continue to experience more severe revenue shocks than medium and large firms and the same goes for non-exporters compared to exporters.

**Affected by demand and supply shocks, firms are adjusting employment and are experiencing pressing liquidity constraints.** Firms are adjusting employment in response to the pandemic, by reducing working hours and lowering wages (see Figure 32). Malaysian firms are more vulnerable than their peers (Indonesia and Vietnam), with less cash in hand to withstand a crisis. Liquidity appears to be a pressing problem: a median Malaysian firm has only two months of cash flow available, while the average firm has 4.9 months cash flow available which is lower than its regional peer countries (see Figure 33). In addition, 60 percent of firms are either in arrears or at risk of falling into arrears within the next six months. Firms appear to be less willing to borrow due to fear of repayment risks, with sellers also appearing less willing to provide credit.

**FIGURE 30**
Firms were on the path to recovery at the end of the first MCO, but this trend has since reversed

**FIGURE 31**
More firms experienced a decline in sales once the lockdowns were reimposed in October 2020
Most firms responded to the pandemic with increased use of digital tools

The increased usage of digital platforms came up as the most popular strategy being implemented by firms in response to the COVID-19 shocks. In addition to making employment adjustments and performing supply chain adjustments, a majority of firms continue to respond to the challenges brought on by the pandemic through the increased use of digital tools. 58 percent of the firms surveyed increased the use of digital platforms in January-February 2021. The most common use of digital platforms continues to be for customer-facing functions such as marketing and sales functions (see Figure 34). Shopee and Facebook are the most popular sales and marketing digital platforms, while Maybank and Touch ‘n Go are the most popular e-wallet payment systems. There is also significant adoption for more complex functions such as production and supply chain management, which is more common among larger firms. Adoption of digital tools are not only beneficial for sales and marketing functions, as firms who adopted or increased use of digital platforms are also more likely to have remote work arrangements and introduce new products (see Figure 35).

Having described the vulnerability of the private sector in the short term, the following section will describe the conceptual framework for the discussion that will underpin the analysis and the recommendations for Malaysia.

Malaysia trailed peers both in terms of labor productivity and total factor productivity (TFP) even before the crisis, and the gaps are increasing. While Malaysia continues to experience positive labor productivity growth, its rate of growth remains below those of transitional and aspirational groups (see Figure 36). Malaysia also has lower TFP levels than these comparators, and the gaps are wider for small
and medium firms than larger firms, suggesting that Malaysia’s relatively low TFP levels are driven by the relatively poor performance of small and medium firms (see Figure 37). The TFP levels of large Malaysian firms are closer to the comparator groups, with TFP levels lower than those in the aspirational group, but higher than those in the transitional group.

**FIGURE 34**
Marketing and sales are the most increased business functions in digital adoption

<table>
<thead>
<tr>
<th>Business Function</th>
<th>Small</th>
<th>Medium</th>
<th>Large</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use of Digital Platforms</td>
<td>80</td>
<td>60</td>
<td>40</td>
</tr>
</tbody>
</table>

**FIGURE 35**
Adopters of digital solutions are also more likely to have remote work arrangements and offer new products

<table>
<thead>
<tr>
<th>Likelihood of Starting or Increasing Remote Work Arrangement Conditional on Region, Sector, Size Fixed Effects</th>
</tr>
</thead>
<tbody>
<tr>
<td>Oct 1-15 Jan 15-Feb 10</td>
</tr>
<tr>
<td>No increase/no use of digital platforms</td>
</tr>
<tr>
<td>Started using/increased use of digital platforms</td>
</tr>
<tr>
<td>Likelihood of Introducing Innovative New Products Conditional on Region, Sector, Size Fixed Effects</td>
</tr>
<tr>
<td>Oct 1-15 Jan 15-Feb 10</td>
</tr>
<tr>
<td>No increase/no use of digital platforms</td>
</tr>
<tr>
<td>Started using/increased use of digital platforms</td>
</tr>
</tbody>
</table>

Source: Kuriakose, Smita; Tran, Trang (2020)

**FIGURE 36**
Malaysia’s labor productivity has increased steadily over time but remains short of transitional and aspirational peers

GDP Per Employee, 2010 Constant Dollars

Source: World Bank (2020) ‘Malaysia – Productivity and Investment Climate Survey (PICS 3)’

**FIGURE 37**
Malaysia also has lower TFP levels than its peers, though relative TFP gaps decrease with firm size

Relative TFP of Comparator Groups to Malaysia, Percentage

Source: World Bank (2020) ‘Malaysia – Productivity and Investment Climate Survey (PICS 3)’
The crisis has exacerbated the productivity gap faced by firms, particularly SMEs

Malaysia’s SMEs have been underperforming those in peer countries, both in terms of output and productivity levels. In the manufacturing sector, although SMEs contribute to around half of all employment in the sector, they only account for 31 percent of output (see Figure 38). In the services sector, Malaysian firms’ labor productivity levels lag behind those of its aspirational and transitional comparators (see Figure 39). With the tourism and retail sectors having been particularly hard hit by the pandemic, these productivity gaps may have been further exacerbated. Analysis based on the BPS data shows that the pandemic has had an asymmetric impact on sectors and regions. In particular, the food & beverage sector experienced higher closure rates, particularly in the Northern states, where vendors largely rely on travelers from Kuala Lumpur and Selangor to patronize their food trails. By contrast, other manufacturing sectors have experienced particularly high closure rates in East Malaysia. These differences indicate the need for the customization of policies and programs, enabling the identification of sectors or regions where more support is needed.

FIGURE 38
Malaysia has a high number of SMEs, but they account for a low share of the activity

FIGURE 39
Malaysia’s labor productivity gap in Services Sector compared to peers

Source: World Bank (2020) ‘Malaysia – Productivity and Investment Climate Survey (PICS 3)’

To achieve higher rates of more inclusive and sustainable productivity growth, Malaysia will need to implement deep structural reforms. To reduce poverty and ensure shared prosperity, growth that creates a greater number of more productive jobs is needed. Economic transformation through deeper structural changes and market integration that catalyze business opportunities are needed to create an environment in which workers are able to shift into higher productivity activities, resulting in higher incomes as they generate greater returns on their labor and other assets (see Figure 40). Without accelerated economic transformation, the potential to create more and better jobs is limited (World Bank, 2019). The Jobs and Economic Transformation framework provides a lens to discuss improving aggregate productivity through economic transformation in a manner that results in a sustainable increase in the number of productive jobs for a greater number of people.

Firm level productivity growth can be broken down into three components. First, productivity improvements can occur when firms upgrade their

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29 In this analysis we define SMEs as a firm with less than 100 employees.
30 Other Manufacturing in the BPS is broadly categorized as manufacturing sector excluding Automotive and Electronics sub-sectors.
Connectivity and integration are key for market development

Effective trade, competition reform in the services sector and investment policy reforms boost growth and productivity. Openness to trade and investments is vital for the achievement of economic transformation, with export-led strategies providing access to larger markets that enable economies of scale, increase technology transfer, and leverage competition to raise productivity. FDI plays a crucial role in facilitating internal capabilities through innovation or the adoption of new technologies or better management techniques (within-firm component). Second, improvements can occur when resources are reallocated from low-productivity firms to high-productivity firms within or across sectors and industries (between-firm component). In this case, incumbent firms that are more productive can gain market share at the expense of less productive incumbent firms. And third, improvements in aggregate productivity can occur when less productive existing firms exit the market or industry and new firms that are more productive enter the market (entry-and-exit or selection component). Each of these three components has a potential impact on aggregate productivity growth and economic transformation. Thus, the government’s initiatives to enhance productivity should address all three of these components (see Figure 40).

The next section will assess Malaysia’s performance against some of the salient elements of the Jobs and Economic Transformation framework shown in Figure 40. These include (i) connectivity and integration that will include a discussion on competition in the services sector; (ii) skills, technology and innovation and (iii) enabling foundations to expand private investments where the discussion will focus on two factors namely (a) the access to finance and (b) the sustainability framework.
technology spillovers. Increased FDI flows, especially those involving participation in producer-driven supply chains, increase the adoption of technology.

**Uncertain trade and investment prospects have given Malaysia a renewed sense of urgency to strengthen its competitiveness.** Malaysia faces not only a pandemic but also a considerably less benign global environment amid heightened policy uncertainty, shifting patterns of international production and trade and an acceleration of disruptive technologies that will alter the nature of comparative advantage. Persistent uncertainty about the post-pandemic landscape has weighed heavily on business confidence and contributed to a sharp decline in investment globally and domestically. In Malaysia, private investments fell by 11.9 percent last year, with FDI contracting by 55 percent, a greater decline than in many other regional economies given its openness to international trade and deep integration within global value chains. Even before the current crisis, Malaysia had experienced a decade-long decline in private investment growth. There had been concerns that Malaysia’s private investment has been moderating and underperforming relative to its regional comparators (see Figure 41 and Figure 42), and that this underperformance may constrain its ability to achieve its longer-term development aspirations. Productivity driven growth will rely on reversing this secular decline in private investments that are an important source of new technology and firm-level process innovations and improvements in management practices.

**A comprehensive review of Malaysia’s investment framework is needed to strengthen the overall effectiveness of investment targeting.** In particular, there is considerable scope to enhance investment promotion by addressing the overlapping mandates among the 32 investment promotion agencies (IPAs) in Malaysia. This overlap has led to undue competition amongst IPAs and confusion among investors and, consequently, the dilution of promotion efforts and investor services. There is also a need to enhance Malaysia’s tax incentive policies and administration system by strengthening investment targeting and addressing the issues relating to the complexity of administrative procedures, the quality and accessibility of laws and regulations, and bureaucratic discretion which appear to be among the major obstacles for investors in Malaysia (see Box 5).

**FIGURE 41**
Malaysia has been experiencing a decade-long decline in private investment growth...

**FIGURE 42**
...and its FDI has been underperforming relative to some regional comparators

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**Reasons for investing in Malaysia and the effects of COVID-19 on MNCs in East Asia: Evidence from Investor Surveys**

This box summarizes findings from the 2019 Global Investment Competitiveness (GIC) survey and the February 2021 Multinational Corporations (MNC) Pulse Survey, which together provide critical insights into the actions, motivations, and strategies of MNCs. The GIC survey covers a large sample of MNCs operating in Malaysia, and offers insights into pre-COVID-19 investment plans, major reasons for investing in Malaysia, and remaining obstacles. The MNC Pulse Survey, while being more limited in size, is more recent and thus helps to provide a better understanding of the impact of COVID-19 on MNCs in East Asia.

**FIGURE 43**

Major determinants for investing in Malaysia

How important were the following factors in your parent company’s decision to invest in the country?

<table>
<thead>
<tr>
<th>Factor</th>
<th>Important</th>
<th>Critically Important</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macroeconomic stability and exchange rate</td>
<td>46</td>
<td>43</td>
</tr>
<tr>
<td>Business-friendly legal and regulatory environment</td>
<td>51</td>
<td>52</td>
</tr>
<tr>
<td>Availability of talented and skilled labor force</td>
<td>46</td>
<td>47</td>
</tr>
<tr>
<td>Good physical infrastructure</td>
<td>32</td>
<td>46</td>
</tr>
<tr>
<td>Low tax rates</td>
<td>48</td>
<td>35</td>
</tr>
<tr>
<td>Size and purchasing power of the new market</td>
<td>47</td>
<td>32</td>
</tr>
<tr>
<td>Low cost of labor and other production inputs</td>
<td>47</td>
<td>32</td>
</tr>
<tr>
<td>Availability to source locally</td>
<td>51</td>
<td>29</td>
</tr>
<tr>
<td>Coordination of your company’s supply chain</td>
<td>42</td>
<td>25</td>
</tr>
<tr>
<td>Investment protection guarantees</td>
<td>37</td>
<td>29</td>
</tr>
<tr>
<td>Ability to export and compete in international markets</td>
<td>36</td>
<td>39</td>
</tr>
<tr>
<td>Protection of intellectual property</td>
<td>51</td>
<td>30</td>
</tr>
<tr>
<td>Access to endowments (e.g. land, raw materials)</td>
<td>46</td>
<td>19</td>
</tr>
<tr>
<td>Availability of local companies and their technology</td>
<td>44</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations using WBG 2019 GIC Survey. Note: restricted to firms in Malaysia only.

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The 2019 GIC Survey suggests that the most important reasons why MNCs invest in Malaysia are related to its perceived macroeconomic and political stability, business-friendly legal environment, and skilled labor force (see Figure 43). Over 85 percent of respondents mark these as ‘important’ or ‘critically important’ factors for their decision to invest in Malaysia. It also scores relatively highly in terms of several other factors, including good...
physical infrastructure, low tax rates, the size of local market and the cost of labor. It is noteworthy that tax incentives do not feature as a prominent reason.

However, Malaysia scores relatively low in terms of the share of MNCs that plan to expand investment in the next three years. Only 40 percent of foreign affiliates in Malaysia planned to expand their investment over the next three years, which is the third-lowest share in the survey, ahead of China (17 percent) and Turkey (35 percent), but way behind Nigeria (about 80 percent) and India (66 percent).

While its investments laws and policies are perceived as a relatively insignificant constraint, the overall complexity and quality of Malaysia’s legal and regulatory system appears to weigh on its investor performance (see Figure 44). While Malaysia performs well in most areas of its investment laws and policies, a major exception is the cumbersome approval system, with 56 percent of respondents stating that this is either a moderate or major obstacle.

**FIGURE 44**
Remaining obstacles for investors in Malaysia

To what degree are the following factors an obstacle for your company to operate in the country?

Source: Authors’ calculations using WBG 2019 GIC Survey. Note: restricted to firms in Malaysia only.
2. The February 2021 Multinational Corporations Pulse Survey

The latest MNC Pulse Survey, administered in February 2021, suggests that while the pandemic has adversely impacted a wide range of productive inputs for MNCs globally, respondents appear highly positive regarding their recent performance in Q1 2021. A majority of the respondents reported that the impact of the pandemic had adversely affected the reliability of their supply chains in the period from October to December 2020. However, MNCs appear to be highly optimistic regarding their recent production performance, providing hope for a relatively rapid recovery period ahead. This in part reflects the large stimulus packages directed towards such firms and MNCs’ shifting strategies to adjust and recover from the initial supply chain disruptions related to the pandemic.

The expected rapid recovery from the impact of the pandemic also means that few companies are planning to radically shift their investment or sourcing strategy. The supply chain vulnerabilities exposed by COVID-19 have also rekindled the debate on reshoring, nearshoring, and GVC regionalization. Some expect that MNCs will reshape their GVC strategies, with an emphasis on holding higher levels of inventory, diversifying suppliers, and shortening supply chains (Javorcik 2020; World Economic Forum). However, other experts suggest that such prescriptions oversimplify the problem. The Pulse Survey provides supporting evidence in favor of the latter camp. When it asked what the company’s foreign parent plans to do in the host country in the next one to three years, it finds that MNCs operating in the EAP region are largely keeping their investment and sourcing strategies on the same course, with 96 percent of respondents noting no change in their investment plans and 100 percent noting no change to their input suppliers.

The pandemic has resulted in a much greater focus on the use of new technologies by MNCs and a push towards greening supply chains (see Figure 45). The survey data shows that 94 percent of respondents have increased their use of digital tools to manage their supply chains and to conduct work remotely. In addition, 90 percent of respondents have scaled up their deployment of e-commerce solutions. The increased use of automation and robotics is a third critical technological trend that has emerged or been intensified by the pandemic, with around 77 percent of respondents stating that they had increased their use of such tools. Another pre-existing trend, related to the improved sustainability of production, has also been intensified, with 75 percent of respondents acknowledging a push towards greening their supply chains.

FIGURE 45
Change in the use of technologies due to COVID-19

To what extent have you changed deployment of the following strategies in your host country as a result of the pandemic?

<table>
<thead>
<tr>
<th>Strategy</th>
<th>Decreased</th>
<th>No change</th>
<th>Increased</th>
</tr>
</thead>
<tbody>
<tr>
<td>Digital tools to manage supply chain and remote work</td>
<td>2</td>
<td>4</td>
<td>94</td>
</tr>
<tr>
<td>E-commerce and customer engagement solutions</td>
<td>10</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>Automation and robotics</td>
<td>4</td>
<td>19</td>
<td>77</td>
</tr>
<tr>
<td>Increased supply chain sustainability &amp; decarbonization</td>
<td>25</td>
<td></td>
<td>75</td>
</tr>
</tbody>
</table>

Source: Authors’ calculations using WBG Pulse Survey 4 (Q1 2021). Note: restricted to EAP firms only.
Services sector competition has been hampered by exclusions for foreign investors

For Malaysian markets to operate more efficiently, it is necessary to address regulations and practices that restrict business entry and market competition. Market competition is an important determinant of productivity-led growth. Firms facing vigorous competition have strong incentives to reduce their costs, to innovate, and to become more efficient and productive than their rivals. According to indicators related to product market regulations (PMR), Malaysian markets are characterized by higher levels of restrictiveness than those in comparator countries, with the role of the state being a major factor in determining PMR scores.

While being generally open to trade and investment, Malaysia has retained a number of exclusions on foreign suppliers in certain key sectors. Malaysia is relatively more open to FDI than most of its less developed regional peers, but still behind High Income Countries (HICs) and Upper Middle-Income Country (UMIC) peers (see Figure 46). Investments in Malaysia’s manufacturing sector are highly liberalized. Foreign investors can hold 100 per cent of the equity in all investments in new manufacturing projects, as well as in investments to expand and diversify existing projects. Since 2009, in order to attract higher levels of investment, the government has also liberalized foreign participation in the services sector. However, there are continued restrictions in certain specified sectors, including transport services, finance and professional services. Beyond explicit equity restrictions, foreign suppliers are also subject to different operational restrictions, such as prescribed opening hours for foreign retailers. These in turn, can affect the competitiveness of the users of these inputs (downstream sectors).

FIGURE 46
Malaysia is relatively more open to FDI than less developed regional peers, but still behind the HIC and UMIC averages

FDI Restrictiveness Index for Malaysia and Selected Asian Countries, 2019

Source: OECD FDI Restrictiveness Index, 2019

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35 Specifically, 27 service sub-sectors were liberalized on 22 April 2009, with all equity conditions removed. The government then further liberalized an additional 18 service sub-sectors in 2012, allowing for up to 100 per cent foreign equity participation.

36 High income countries include Australia, Austria, Belgium, Canada, Croatia, Cyprus, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Latvia, Lithuania, Luxembourg, Malta, Netherland, New Zealand, Norway, Poland, Portugal, Romania, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, and United Kingdom. Upper middle-income countries include Albania, Argentina, Brazil, Bulgaria, Chile, Colombia, Costa Rica, Indonesia, Kazakhstan, Mexico, Peru, Russia, Serbia, South Africa, and Turkey.
Skills, technology and innovation are essential for productivity led growth

Investments in technology, R&D and skills will be critical to enhance productivity. On the upside, the pandemic has accelerated the level of digitization among firms in Malaysia, creating an opportunity for Malaysian SMEs to bridge the digital divide. As we saw in the first section, there has been an increased use of digital solutions by firms as a response to the pandemic in Malaysia (see Figure 47). However, small and medium-sized firms’ rate of digital adoption continues to lag behind those of large firms (see Figure 48). At the aggregate level, most of the digital adoption is related to sales and marketing functions, with a smaller portion of firms using digital solutions for more complex business and production functions (see Figure 47). This creates an opportunity to expedite the digitization process amongst SMEs by recalibrating policies to encourage SMEs to engage in the use of digital tools to facilitate more complex business and production functions. However, a lack of adequate access to finance to invest in digital platforms and solutions may act as an obstacle to increased uptake and usage, especially in the case of SMEs.

While great emphasis has been placed on the enhancement of the quantity of R&D and innovation in Malaysia, less emphasis has been placed on its quality and its links with industry. Despite Malaysian businesses spending a relatively high amount on R&D as a percentage of GDP (see Figure 49), compared to comparators in the transitional group, Malaysia’s performance in the area of patenting is lower than that of countries in both the aspirational and transitional groups (see Figure 50). Malaysia has had less firms investing in R&D, providing training, and introducing new products in the last three years compared to its global peers (see Figure 51). While Malaysia has implemented a number of policies and initiatives to foster R&D and commercialization efforts, a number of challenges and obstacles continue to constrain technology transfer and commercialization (see Box 6). Public research institutes and institutes of higher educations’ research funding is skewed towards basic research rather than applied research (see Figure 52). This lack of adequate attention to the quality of R&D and its links with industry implies lost opportunities to make a greater positive impact on economic diversification, industrial development, and growth (see Box 6).
PART TWO - Resilient recovery for the private sector

FIGURE 49
Firms in Malaysia are investing more in R&D compared to the transitional group...

Business Expenditure on R&D as a Percentage of GDP

![Graph showing Business Expenditure on R&D as a Percentage of GDP for Malaysia, Transitional, and Aspirational groups from 2000 to 2016.]

Source: World Bank Enterprise Surveys

FIGURE 50
...but patent applications lags behind transitional group

Patent Application, Per Billion PPP$ GDP

![Graph showing Patent Application per Billion PPP$ GDP for Malaysia, Transitional, and Aspirational groups from 2000 to 2018.]

Source: National Survey of Research and Development (R&D) in Malaysia 2020

FIGURE 51
Malaysian firms are less likely to invest in upskilling and innovation

Share of Firms Investing in Training and R&D, Percentage, 2019

![Graph showing Share of Firms Investing in Training and R&D, Percentage, 2019 for Malaysia, Regional, Transitional, and Aspirational groups.]

Source: World Bank Enterprise Surveys

FIGURE 52
Malaysia’s public research organizations have been investing more in basic and experimental research

Research Orientation by Sector, RM Million

![Graph showing Research Orientation by Sector, RM Million for Business Enterprises, Government Research Institutes, and Higher Education Institutes.]

Source: National Survey of Research and Development (R&D) in Malaysia 2020
With the trend toward increased digitization and automation in the current context, the availability of an adequately skilled workforce has become even more critical. Analyses across the three Productivity and Investment Climate Surveys (PICS), PICS-1 (2002-03), PICS-2 (2007) and PICS-3 (2019-20) have shown that skills shortages are a major constraint for firms operating in Malaysia (World Bank, 2020b). Investments in the development of human capital through the provision of training and increased access to new and improved skills are an important step toward achieving higher levels of productivity at the firm level over the long term. Jobs are becoming less manual and more analytically and socially demanding. With this increased demand for digital skills, critical skills shortages persist in the Malaysian economy. Paradoxically, the proportion of high-skilled workers in priority sectors set forth in the Malaysian government’s Industry4WD strategy has decreased in the period from 2009 to 2015, with a high percentage of workers remaining in the semi-skilled category. The skills needs associated with the emergence of the Industry 4.0 paradigm have been further compounded by the increase in the levels of digitization and automation triggered by the pandemic.

There is strong evidence to show that firms’ management practices significantly impact their productivity and performance. Differences in management practices have been identified as one of the main causes of variations in levels of productivity across firms and countries (see Box 7). Studies show that higher levels of productivity are associated with firms using modern or innovative management practices, rather than traditional practices (Ichniowski et al. 1997). In addition, it has been found that the manner in which a management practice is implemented is more important for productivity than whether the practice is implemented or not (Black and Lynch 2001). It has also been found that higher-performing managers are consistently more likely to be deployed by better managed firms (Bertrand and Schoar 2003). Recent analysis conducted for Malaysia confirms that firms in subsectors with workers with a higher educational profile of workers and those with sophisticated organizational management systems tend to have higher levels of productivity.

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57 Five priority sectors in Industry4WD Strategy document are E&E, Machinery and Equipment, Chemicals, Aerospace and Medical Devices.
A range of actors play pivotal roles in the innovation ecosystem, including firms, public research organizations and universities, with each playing a different role in the creation and diffusion of new knowledge. To facilitate diffusion, the ecosystem and institutional context should encourage knowledge to move between innovation actors, particularly between knowledge creators and users (firms and societies). In this regard, the government can play an important role by designing and implementing policies to facilitate this knowledge transfer. This relationship between academia, government and industry is often referred to as the triple helix. As innovation as a means to achieve higher levels of national competitiveness gains prominence, countries are allocating substantial national budgets to finance research activities, including public research sector. Further, governments worldwide are urged to track and evaluate the impact and results of public funding of research, science, and technology (Zuniga, 2020). This has led to the focus on technology and commercialization of intellectual property as measures of technology transfer.

Increased support for Malaysia’s public research organizations (PROs) and universities is crucial to revive innovation-driven growth and thereby to weather the current global crisis and to facilitate the achievement of Malaysia’s aspirations of becoming a high-income nation. The channels through which technology transfer is facilitated depend on a number of factors, including: (i) research capabilities and relevance (orientation); (ii) the institutional setting of research institutions (structure and governance); (iii) the legal and regulatory framework governing public research institutions and universities (e.g., employment laws); (iv) supportive intermediary structures and finance availability; and v) firms’ absorptive capacity. With the aim of analyzing the levels of knowledge and technology transfer in Malaysia, a recent World Bank study, Assessing the Effectiveness of Public Research Institutions: Fostering Knowledge Linkages and Transferring Technology in Malaysia, utilized the recent survey on public research institutions, encompassing a multitude of aspects pertaining to knowledge and technology transfers in Malaysia.

The findings of the study are consistent with a number of persistent key issues affecting Malaysia’s innovation ecosystem. While the quality of recent institutional-level statistics related to public.
research organizations and university research centers has improved over the past few years, the dynamics of knowledge transfer and commercialization of research outputs are different. For instance, the propensity to engage in technology transfer activities are markedly lower than the propensity to engage in knowledge transfer activities. Only a small number of surveyed institutions have sustained frequent success in technology transfer and commercialization. With multiple actors, including ministries, agencies and research organizations, and the varying nature of research, the context in which research institutions operate is highly complex. This situation has led to a lack of coordination to facilitate and encourage research commercialization and the transfer of new knowledge and technology.

Some of the key challenges that fundamentally affect innovators’ ability to successfully transfer and commercialize technology include inconsistent funding, ineffective implementation of incentives, and cultural gaps between industry and research, all of which affect both research and knowledge and technology transfer. The complex funding mechanisms, combined with budgetary pressures, contribute to inconsistency in the flow of funding for public research institutions, limiting their ability to conduct certain research activities and to transfer knowledge and technology. Additionally, incentives to encourage technology transfer and commercialization are ineffectively implemented, with career progressions still being largely driven by scientific publications. Cultural gaps between research institutions and industry arise due to the differences in expectations between parties resulting in a perceived lack of demand from industry. Combined with communication obstacles that constrain collaboration and the alignment of interests, frictions between the two inhibit effective collaborative networks and industry-focused research outputs and innovations.

FIGURE 53
Gross domestic expenditure on R&D declined precipitously in 2018

![Chart showing R&D Expenditure by Sector and GERD](source)

Source: National Survey of Research and Development (R&D) in Malaysia 2019

FIGURE 54
The number of active research personnel has also declined across all functions in recent years

![Chart showing R&D Staff by Functions](source)

Source: National Survey of Research and Development (R&D) in Malaysia 2019

Management Practices in Malaysia

The management practices of firms have been found to have a significant impact on their productivity and performance. Research based on data from the World Management Survey (WMS) confirms the positive relationship between management practices and firm productivity and performance. For example, Bloom et al. (2012) find that a one-point increase in a firm’s management score according to the WMS is associated with an increase of 26 percent in labor productivity; a 2 percent increase in profitability; a 7 percent increase in FIGURE 55

If management practices in Malaysia were to catch up with the US, labor productivity could increase by 13 percent

Source: World Bank staff calculations based on World Management Survey
in sales; and a 1 percent reduction in bankruptcy or liquidation (a substantial impact given that the average bankruptcy rate in the relevant sample is 2.4 percent).

While the quality of management practices in Malaysia’s manufacturing sector is roughly equal to that of other countries at a similar level of development, it lags behind those of advanced countries such as the United States, Japan, and Germany. Data from the WMS, which reflects four dimensions of management practices (operations management, performance monitoring, target setting, and talent management) show that while Malaysia’s overall management score is in line with the country’s level of development and close to the median across countries, there is significant room for further improvements (see Figure 55).

While Malaysia performs relatively well in terms of performance monitoring, it performs particularly poorly in terms of operations management. More specifically, Malaysia’s performance in terms of the four dimensions of management practices, measured on a scale of 1 (practically no structured management practices implemented) to 5 (best practice in industry), can be described as follows:

- **Operations management**: Malaysia’s score of 2.68 implies that some modern processes have been implemented in the average manufacturing firm in Malaysia. However, they have not yet been fully formalized and are sometimes implemented only to catch up with competitors. In comparison, the average manufacturing firm in countries with scores above 3.00 implement modern practices to reach forward-looking business objectives or stay ahead of the curve.

- **Performance monitoring**: The score of 3.01 suggests that the average Malaysian firm has a formal performance monitoring process in place, with a good set of indicators. However, these indicators may not be measured as often as they could be, resulting in possible inefficiencies.

- **Target setting**: The score of 2.63 implies that while an average manufacturing firm in Malaysia has a formal set of targets, these usually define broad objectives rather than measurable actions with clear time frames. Further, there is no strong link between targets and individual employees’ day-to-day responsibilities. To achieve a score above a 3.00, firms would also need to have a good rationale for benchmarking their targets to ensure that these targets are challenging yet achievable.

- **Talent management**: Malaysia’s score of 2.92 suggests that the average firm in the country has somewhat formal systems of appraisal and employee accountability, though these systems may not always be rigorously followed. For a score of 3.00 or above, there would need to be more transparent and accountable ways of evaluating employees, including through a wide array of performance metrics. In addition, all promotions would need to be based on merit rather than tenure.

Overall management scores vary substantially between firms with different characteristics. Scores are generally higher for larger firms with more than 200 workers. The more technology-intensive subsectors, such as the chemical and pharmaceutical and computer and electrical subsectors, have relatively higher management scores than do the relatively low-technology intensive clothing and apparel subsector. Management scores are also generally higher for older firms and for firms located in the most central and developed parts of Malaysia.

Increasing Malaysia’s productivity growth through better management practices will require a systematic, comprehensive policy approach that fosters the different drivers of management practices in a systematic and mutually reinforcing way. Realizing productivity gains through improved management practices will necessitate increases in the intensity of competition, reforms to the ownership structure of firms, and investments to enable access to talent through higher quality education and training.

Note: The World Management Survey is an internally standardized quantitative instrument to measure the quality of firms’ management practices across countries and industries. The findings from this survey for Malaysia are internationally comparable and representative for all manufacturing firms in the country with more than 50 employees.

Enabling foundations to expand private investments

The pandemic has exacerbated issues related to access to finance, which could constrain private sector recovery and future growth. According to a survey conducted by BNM in 2018, SMEs rely heavily on informal sources of funding such as self-financing (51 percent) and funding from family and friends (17 percent). However, to the extent that SMEs rely on formal sources of finance, most of them borrow from banks. As stated earlier, the BPS survey shows that Malaysian firms remain relatively vulnerable compared to their counterparts elsewhere in the region in terms of available cash flow, with repayment risk being the main barrier to accessing finance. An examination of the level of non-performing loans (NPLs) for SMEs in banks' portfolios may provide insights into the extent of this vulnerability.

The impact of the pandemic in terms of the level of non-performing loans NPLs is becoming increasingly apparent, with this level expected to increase as the pandemic-related government borrower relief programs come to an end. The six-month blanket loan repayment moratorium in place through September 2020 and the subsequent targeted repayment assistance initiatives for MSMEs have largely obscured the impacts of the pandemic on repayments. MSME NPL ratio rose by 0.2 percentage points to 3.2 percent in December 2020 after the end of the blanket moratorium (see Figure 56). The increase was most notable in three sectors, namely, finance, insurance, real estate (FIRE); wholesale and retail trade and construction (see Figure 57). While there are signs of economic recovery, many MSME loans have been restructured and the full impact on the quality of the loan portfolio may not be seen until later in 2021. Banks have continued to set aside additional provisions as a precaution against future credit losses.

Supported by government measures, the overall lending to MSMEs increased in the past year. The MSME portfolio expanded by 9.6 percent in 2020 compared to the previous year, with the government and BNM increasing the value of special funds and implementing guarantee schemes and other policy measures to encourage lending. Funds to a value of RM10 billion allocated to the BNM’s SME Special Relief Facility, which was established with the specific purpose of assisting SMEs to address cashflow constraints, were fully utilized, with the beneficiary SMEs primarily coming from three sectors: wholesale and retail trade (47.2 percent of total); manufacturing (15.2 percent); and construction (9.0 percent).

FIGURE 56
MSME NPLs have been slowly rising across enterprise sizes

FIGURE 57
MSME NPLs by sector

38 BNM’s Second Half Financial Stability Review noted that MSMEs accounted for 90 percent of total loans approved for rescheduling and restructuring.
39 BNM Annual Report 2020
Mainstreaming sustainability in economic policy is pivotal to increase firm resilience

It is necessary to increase resilience in order to enhance the competitiveness of Malaysia’s industries. Mainstreaming an economic growth strategy that incorporates green and environmental sustainability may play a positive role in improving competitiveness. This would require well-functioning economic and market structures that enable innovation and healthy competition between firms. The potential benefits to be derived through the promotion of sustainable industry processes include improved water and energy efficiencies and increased operational cost savings, higher industry asset values, reputational advantages, and greater investments from risk-informed global companies looking for sustainable investment opportunities. These investments in improved resilience would also support higher levels of connectivity with global value chains that increasingly require all participants in the chain to engage in green and sustainable production processes, and other synergies between social, environmental, reputational, and economic benefits.

The next section elaborates the policy recommendations to foster a resilient recovery for the private sector. These recommendations are organized in terms of what the Government of Malaysia could implement in the near term to weather the surge followed by short-term, medium-term and long-term policy measures that would help Malaysia get back on track on a productivity led innovation growth model as it aspires towards attaining high income nation status.

Clear and accessible support measures required to provide private sector relief

Clear and accessible support programs that enable firms to reduce expenses in the near term will be key to support relief measures. A vast majority of firms were able to access government support programs that were introduced in the PRIHATIN and PENJANA plans. In fact, access to government support in Malaysia is the highest in the region (see Figure 58). However, access by small firms (80 percent) still lag that of large (94 percent) and medium firms (93 percent). Measures that had high take up soon after the first MCO included loan deferrals, rent reductions and deferrals, electricity discounts and deferrals. Access remained high with slight increases among new measures or measures that have been extended or accelerated under PERMAI and PEMERKASA packages. These included the EPF program, tax relief, wage subsidies, hiring incentives as shown in Figure 59. It will be critical to ensure that SMEs are able to access the new support measures during the current lockdown in June 2021.

Conditional wage subsidies have been effective in limiting layoffs in Malaysia and should be considered an important measure to provide relief to firms. Analyzing the data from the BPS surveys, wage subsidy appears to be effective in limiting layoffs. Conditional on firm characteristics, including sales growth and liquidity, having access to wage subsidies significantly reduces the likelihood that firms lay off workers (by ~8 percent). Conversely, firms’ liquidity (cash flow availability) is significantly correlated with probability of firing workers with businesses that expected cash flow shortages being ~9 percent more likely to fire workers relative to those who did not. At the sectoral level, most sectors indicated that payment deferral and wage subsidies were the most important type of support. The only exception was the agriculture and mining sector that rated support to adopt health protocol and buy local products campaign as the most needed support after payment deferrals. These insights can also lend to support programs that are targeted to sectoral needs.

Improving predictability of SOP regulations and expediting approvals and disbursements for existing loans would be key to successfully implementing the economic recovery plan. Overall, the assessment of firms on the government policy and programs has been fairly positive. A majority of

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40 World Bank. 2020c.
41 World Bank. 2020c.
firms surveyed in January 2021, expressed confidence in the way the government is handling the pandemic with 57 percent of businesses expressing “very high” or “quite high” confidence in the government’s overall handling of the pandemic. Businesses were also asked to state the improvements in government policy implementation that would benefit their businesses the MOST in the next six months. The top ranked implementation reform priorities for firms continue to be improving predictability of the SOP regulations (see Figure 60) and expediting the approvals and disbursements for existing loans and grants under PRIHATIN and PENJANA (see Figure 60 and Figure 61). These would be useful to keep in mind to successfully implement the economic recovery plan to ensure that firms are able to access the support they need to tide over this crisis.

**FIGURE 58**
Access to government support programs in Malaysia is the highest in the region

<table>
<thead>
<tr>
<th>Share of Firms Receiving Government Support, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>100</td>
</tr>
<tr>
<td>80</td>
</tr>
<tr>
<td>60</td>
</tr>
<tr>
<td>40</td>
</tr>
<tr>
<td>20</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>

Cambodia Jan/Feb | Vietnam Sep/Oct | Indonesia Oct | Malaysia Jan/Feb

Source: Kuriakose et al. (2021)

**FIGURE 59**
Access to support measures and their rate of uptake in Malaysia

<table>
<thead>
<tr>
<th>Share of Firms with Access to Support Policies, Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>EPF support</td>
</tr>
<tr>
<td>Electricity deferral or discount</td>
</tr>
<tr>
<td>Tax relief for Covid expenses</td>
</tr>
<tr>
<td>Wage subsidies</td>
</tr>
<tr>
<td>Loan payment deferral</td>
</tr>
<tr>
<td>e-CAP</td>
</tr>
<tr>
<td>Tax deferrals/rebates/exemptions</td>
</tr>
<tr>
<td>Rent deferral or reduction</td>
</tr>
<tr>
<td>Hiring Incentives</td>
</tr>
<tr>
<td>FA to implement social dist.</td>
</tr>
<tr>
<td>Subsidized loans</td>
</tr>
<tr>
<td>Digitalization grants</td>
</tr>
<tr>
<td>Access to new credit</td>
</tr>
<tr>
<td>ICT acc. capital allowance</td>
</tr>
<tr>
<td>HRDF levy exemption</td>
</tr>
<tr>
<td>Acc. payment terms from GLCs</td>
</tr>
<tr>
<td>E-commerce training</td>
</tr>
<tr>
<td>Penjana Tourism Financing</td>
</tr>
</tbody>
</table>

Source: Kuriakose et al. (2021)

**FIGURE 60**
The topmost priorities for firms continue to be improving predictability of SOPs

<table>
<thead>
<tr>
<th>Most Beneficial Government Policy Improvements, Percentage of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Clarity &amp; predictability of SOP</td>
</tr>
<tr>
<td>Expedite PRIHATIN/PENJANA</td>
</tr>
<tr>
<td>Simplify wage subsidy scheme</td>
</tr>
<tr>
<td>Increase use of e-Government</td>
</tr>
<tr>
<td>Expedite immigration approvals</td>
</tr>
<tr>
<td>Clarity on foreign labor policy</td>
</tr>
<tr>
<td>Others</td>
</tr>
</tbody>
</table>

Source: Kuriakose et al. (2021)

**FIGURE 61**
The disbursement of PRIHATIN/PENJANA loans has generally improved over time

<table>
<thead>
<tr>
<th>Disbursement of PENJANA/PRIHATIN Loans Comparing Mid-Mar to Mid-Oct Versus Mid-Oct to Mid-Dec, Percentage of Firms</th>
</tr>
</thead>
<tbody>
<tr>
<td>Improved</td>
</tr>
<tr>
<td>Same as before</td>
</tr>
<tr>
<td>Worse than before</td>
</tr>
<tr>
<td>Not sure/Not applicable</td>
</tr>
</tbody>
</table>

Source: Kuriakose et al. (2021)
In the short term, programs need to be recalibrated towards increasing firm efficiency

Risks related to the long-term uncertainty could reduce the capabilities of these firms to invest in technologies that improve productivity. Based on the findings of the BPS survey in February 2021, limited access to finance remains the most significant constraint for firms’ investing in digital solutions (see Figure 62), followed by a lack of information and lack of certainty regarding the benefits to be derived. In fact, despite the already high proportion of firms adopting digital technology, the vast majority of firms (90 percent or more of firms surveyed) are interested in government assistance for the adoption of digital solutions to deal with COVID-19 crisis (see Figure 63). On the regulatory front, firms indicated that digital privacy, consumer protection and cybersecurity are the top three barriers for firms to use the internet, social media and digital platforms.

The crisis creates an opportunity for the government to recalibrate its programs to promote private sector growth on the basis of the identified needs of firms (see Figure 64). Over the years, the Malaysian government has introduced, implemented, and reformed numerous instruments and programs to support a wide variety of SME activities. A forthcoming program efficiency review covering all SME programs in Malaysia shows that increased efficiency gains could be achieved by decreasing redundancies that exist due to overlapping mandates between agencies and programs. With new programs being designed to expedite the recovery of the private sector, there is an opportunity to recalibrate program support towards

The vast majority of firms (90 percent or more of firms surveyed) are interested in government assistance for the adoption of digital solutions to deal with COVID-19 crisis

Malaysian government has introduced, implemented, and reformed numerous instruments and programs to support a wide variety of SME activities. A forthcoming program efficiency review covering all SME programs in Malaysia shows that increased efficiency gains could be achieved by decreasing redundancies that exist due to overlapping mandates between agencies and programs. With new programs being designed to expedite the recovery of the private sector, there is an opportunity to recalibrate program support towards

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**FIGURE 62**
Finance remains the biggest constraint for not investing in digital solutions among firms

**FIGURE 63**
The vast majority of firms are interested in government’s assistance for the adoption of digital solutions

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**FIGURE 62**
Finance remains the biggest constraint for not investing in digital solutions among firms

**FIGURE 63**
The vast majority of firms are interested in government’s assistance for the adoption of digital solutions

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priority areas, such as through initiatives to build the digital capabilities of SMEs to increase private sector growth and resilience. In these initiatives, the government can play a pivotal role through the establishment of close dialogue and partnerships with the private sector to facilitate feedback mechanisms that inform policy design and implementation (see Box 8).

There is a need to develop an enabling framework that provides more efficient and inclusive financial services, particularly for SMEs. Innovations in the area of digital technology create an unprecedented opportunity to mitigate the impact of the COVID-19 crisis on SME financing. Simplified loan application processes and the use of alternative data for credit decisioning could be leveraged by banks to reduce the turn-around times for processing SME loans. The introduction of digital financial services could stimulate competition between financial service providers to offer lower cost products to the SMEs. The creation of a centralized notice-based collateral registry could enable unincorporated MSMEs to pledge movable assets as collateral, effectively widening the provision of services to previously underserved communities. In addition, an expansion to the scope of credit reporting data to include alternative data sources could help to lower the cost of financing and enable the provision of better terms for borrowers with scarce credit information.

FIGURE 64
Summary of immediate measures to provide relief and short-term measures to increase firm efficiency

Source: World Bank staff elaboration
Public-Private Dialogues – Recent Development and Best Practices

Private and public sector collaborations can generate numerous benefits. These benefits pertain not only to private firms and the government but can span towards the whole economy. While it is difficult to isolate the impact of public-private dialogues, the existing literature suggests that they promote cross-sectoral reforms that translate directly into macro-economic benefits. The main benefits include:

1. Facilitating the effective implementation of regulatory reforms and improvements to investment climate conditions.

2. Increasing the levels of competitiveness by establishing a favorable environment for business growth, job creation and domestic and international competition.

3. Fostering good governance and transparency in the policy-making process.

4. Serving as a catalyst for innovation and spurring innovative activities.

To reap these and other benefits, policymakers should strive to understand and manage the challenges associated with public-private dialogues and partnerships. Overall, this process entails significant transaction costs and is marred by asymmetries of information which, if administered poorly, can limit its benefits to a select few entities and waste valuable resources. This may result from monopolization and capture, which could result in rent extraction, undermining potential reforms and reinforcing the power of vested interest groups and...
existing elites (Pinaud, 2007). Likewise, poor organization and governance of private-public dialogues can result in ineffective, fragmented and costly operations process, with relevant associations not being represented due to uncoordinated efforts that dilute the potentially positive impacts of the initiative.

The success of public-private collaborations depends crucially on a few key factors. These factors are: 1) the ability to effectively coordinate the government’s position through one agency with sufficient power to implement its mandate; 2) the importance of a consultative process embedded in public agencies through formal and informal linkages; and 3) the credibility of the organizations enabling the private sector to speak with one voice (Ansu, Booth, Kelsall and Te Velde, 2016).

In Malaysia, an example of an effective public-private dialogue and collaboration can be seen in the case of PEMUDAH. Pasukan Petugas Khas Perniagaan (PEMUDAH), the Special Task Force to Facilitate Business, was established to facilitate closer collaboration between the public and private sector and thereby to enhance public service delivery and to improve the Malaysian business environment. PEMUDAH identifies and addresses regulatory business or policy issues and formulates solutions that enhance business activities in line with the national agenda and good regulatory practices. The work is carried out by its members, who are heads of federal government ministries and departments, accomplished leaders of trade and industry, and members co-opted from key public sector agencies, working in cooperation with a wide range of stakeholders, with the Malaysian Productivity Council serving as its Secretariat. Its governance framework and organizational structure effectively cuts across silos, smoothens process implementation and encourages teamwork and information sharing.

PEMUDAH-led initiatives have made Malaysia an easier place to do business by creating a more investment-friendly business climate. Malaysia has experienced steady improvements in its business climate for domestic small and medium-sized enterprises over the years. A total of 24 reforms have been implemented since the Doing Business 2010 study, highlighting the country’s ongoing efforts to reduce the gap between its performance and international good practices. Additionally, the establishment and implementation of good regulatory practices have made Malaysia’s regulatory policy one of the best in the world. Apart from the general statistics and rankings, PEMUDAH’s efforts to facilitate business operations can be seen through numerous initiatives and reforms in a range of different sectors, from construction to healthcare.

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The case of PEMUDAH provides important lessons for public-private dialogue and collaborations elsewhere. PEMUDAH is an institutional innovation of an effective PPD. Part of its success lies in its structure and its ability to influence favorable business reforms. It has sufficient power to fulfil its mandate and can effectively coordinate the government’s position. Through PEMUDAH, representatives from both the public and private sectors work together and share experiences and expertise to champion transformational reform bearing significant outcomes and pursue closer collaboration between relevant stakeholders through various technical working groups. Critically important, the private sector enriches PEMUDAH’s resources through its industrial expertise and experience.

The key characteristics of PEMUDAH provide a framework for public private collaborative efforts to steer and regulate transformation initiatives globally. The case of PEMUDAH is an inspiration for other PPDs that endeavor to foster a healthy relationship between the public and the private sector in the pursuit of an improved investment climate. Its innovative, flexible, adaptive, and multi-stakeholder approach serves as an example for other institutions to strengthen the delivery of regulatory reform to enhance private sector competitiveness and productivity.

Source: Adapted from Kuriakose, Smita; Eknath, Varun. 2020.

The case of PEMUDAH is an inspiration for other PPDs that endeavor to foster a healthy relationship between the public and the private sector in the pursuit of an improved investment climate. Its innovative, flexible, adaptive, and multi-stakeholder approach serves as an example for other institutions to strengthen the delivery of regulatory reform to enhance private sector competitiveness and productivity.
In the medium to long term, there is a need to undertake deep structural reforms

Following the substantial liberalization of Malaysia’s manufacturing sector, the focus should be on further liberalizing the services sector. In recent years, Malaysia has entered into a number of major regional trade agreements, such as the Comprehensive and Progressive Agreement of Trans-Pacific Partnership (CPTPP) and the Regional Comprehensive Economic Partnership (RCEP). These come with deep commitments, including in areas such as competition policy, government procurement, investment policies and investors’ protection, intellectual property rights, and Government-Linked Companies (GLCs). An early ratification of the CPTPP and the swift entry into force of the RCEP should be prioritized (see Figure 65 for summary of medium to long-term measures). A clear timeline and work plan must be established with regards to the next steps vis-a-vis these agreements. The commitments implied by these agreements could have a significant positive impact in terms of attracting investment, including investment that spurs innovation and technological upgrading. Given the restrictions identified through the analysis of the PMR, the government should prioritize measures to build strong domestic services sectors and to enhance access to foreign services. These measures will play a key role in improving the competitiveness of Malaysia’s manufacturing sector into the future.

There is also a need to modernize Malaysia’s investment ecosystem to attract more quality investments to support private sector recovery and long-term growth. The recently announced National Investment Aspirations (NIA) serve as a crucial starting point towards reinvigorating private investment in Malaysia. These well-defined investment policy goals can then be translated into a list of clear and objective eligibility criteria to guide the identification of priority investments and track progress towards the achievement of Malaysia’s longer-term development objectives. The tax incentive policy framework could also be enhanced to ensure the better targeting of investments, guided by the principles of predictability, transparency, accountability and proportionality. Lastly, Malaysia’s investment promotion framework could be

FIGURE 65
In the medium to long term, focus should be on undertaking deep structural reforms

1. Trade Agreements
   - Prioritize the early ratification of the CPTPP and the swift entry into force of the RCEP
   - Further liberalize the services sector

2. Investment Ecosystem
   - Translate NIA into clear and objective eligibility criteria
   - Enhance the investment monitoring and evaluation framework
   - Reform the tax incentive policy and administration system
   - Build a more coherent IPA framework

3. Industry-Research Collaboration
   - More coordinated approach towards public R&D and innovative activities
   - Implement consistent monitoring and evaluation framework
   - Enhance the incentives system to facilitate greater technology transfer

4. Skills and Technology Readiness
   - Incentivize firms to invest in basic managerial and organizational practices
   - Increase the development of applied tech skills and structured partnerships for internship and capstone projects

5. Sustainability
   - Deepen collaboration between stakeholders to develop Eco-Industrial Parks
   - Provide support to firms especially SMEs to mainstream Environmental, Sustainable, and Governance (ESG) standards
   - Leverage sustainable finance instruments

Source: World Bank staff elaboration
made more effective by building a more coherent IPA framework and strengthening the capacities of the agencies involved.

There is a need to encourage deeper linkages between public research institutions and industry to increase commercialization of research. While the recently launched 10-10 Malaysian Science, Technology, Innovation and Economy (MySTIE) Framework aims to realign research with industry needs, its appropriate implementation will be crucial to its success. Policy makers will need to ensure appropriate resource allocations, with the right institutions established to support the drive towards the effective implementation of policies to encourage innovation, technology adoption and productivity growth. Measures to improve these processes could include: (i) the better implementation of incentives systems to facilitate technology transfer and commercialization of research; (ii) streamlined management processes to facilitate commercialization activities within public research institutions; and (iii) strengthening Technology Transfer Offices (TTOs) to enable them to support enhanced linkages with industries and to facilitate demand-driven research and technology transfer capabilities.

Measures to strengthen firms’ technological readiness are critically important to ensuring that Malaysia’s firms are globally competitive. The programs to support firms’ increased capacity to adopt technology need to be combined with measures to increase workers’ technological readiness. In addition, there is a need to improve Malaysian firms’ basic managerial and organizational capabilities and practices, particularly in the case of SMEs. Realizing productivity gains through improved management practices will necessitate increases in the intensity of competition, reforms to the ownership structure of firms, and investments to enable access to talent through higher quality education and training. Policymakers should emphasize the development of applied tech skills and structured partnerships with industries for internship and capstone projects.

In line with having a more resilient private sector, environment sustainability should be mainstreamed into economic policy making. The Malaysian government has introduced the concept of Eco-Industrial Parks in its Mid-Term Review of the 11th Malaysian Plan (2016-2020), with the establishment of these parks intended ‘to significantly reduce industrial waste and promote optimization of resources while maximizing economic returns’ (EPU, 2018). The design and consequent adoption of the Eco-Industrial Park framework would be an important first step towards developing a framework to foster green industrial growth. Through the deployment of specific policy tools, the pivot towards environmental sustainability will require collaboration between national and local governments, public infrastructure operators, manufacturing firms along multiple supply chains, industry associations, industrial park operators, and financial institutions. Consequently, SMEs will need to be provided with support to mainstream environmental, sustainable, and governance (ESG) standards into their production processes to leverage new growth opportunities through increased participation in GVCs in which there is a growing demand for cleaner and greener products.

Sustainable finance is a key new development that could be leveraged to maximize financial benefits for a more resilient private sector. Capital market instruments such as green sukuk and sustainability sukuk, and their banking sector equivalents such as green loans and sustainability-linked loans, are potentially useful tools that could be used to reach a wider and more diverse source of potential investors and lenders. Incorporating sustainable financial practices into corporate strategy both improves internal governance as well as positions firms to be more attractive to increasingly climate-conscious investors and clientele.

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43 World Bank. 2020a
44 World Bank. 2020c
# TABLE 4
Summary of policy recommendations for creating better jobs and economic transformation

<table>
<thead>
<tr>
<th>Immediate and short-term policies to counter the surge and facilitate a recovery</th>
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<tbody>
<tr>
<td><strong>Immediate relief measures to counter the surge</strong></td>
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<tr>
<td>Implement clear and accessible support programs in the near term</td>
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<tr>
<td>• These include having very clear eligibility criteria for firms with expedient turn around on applications made.</td>
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<tr>
<td>Extend conditional wage subsidies that have been effective in limiting layoffs in Malaysia</td>
</tr>
<tr>
<td>Improve the predictability of SOP regulations and expedite approvals and disbursements for existing loans</td>
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<th><strong>Short-term policies</strong> to facilitate private sector recovery</th>
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<tbody>
<tr>
<td>Recalibrate programs towards firms support informed by the demands of the firms</td>
</tr>
<tr>
<td>• Use the crisis as an opportunity to recalibrate programs to meet the needs of firms for increased digital capability and greening, especially in the case of SMEs.</td>
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<tr>
<th><strong>Medium- to long-term policies to increase private sector resilience</strong></th>
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<tbody>
<tr>
<td><strong>(i) Connectivity and Integration</strong></td>
</tr>
<tr>
<td>Prioritize the early ratification of the CPTPP and the swift entry into force of the RCEP</td>
</tr>
<tr>
<td>• Further liberalize the services sector and prioritize measures to build strong domestic services sectors and enhance access to foreign services.</td>
</tr>
<tr>
<td>Modernize Malaysia’s investment ecosystem to attract more quality investments</td>
</tr>
<tr>
<td>• Translate NIAs into clear and objective eligibility criteria to guide the identification of priority investment activities and for granting incentives.</td>
</tr>
<tr>
<td>• Enhance the investment monitoring and evaluation framework to track progress toward the achievement of objectives defined by the NIAs and to detect inefficient expenditures.</td>
</tr>
<tr>
<td>• Reform the tax incentive policy and administration system, on the basis of the principles of predictability, transparency, accountability and proportionality.</td>
</tr>
<tr>
<td>• Build a more coherent IPA framework and strengthen the strategic and operational capacities of the agencies involved.</td>
</tr>
</tbody>
</table>

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45 Short-term – Up to 1 year.
| (ii) Skills, technology and Innovation | Encourage deeper linkages between public research institutions and industry to increase commercialization of research  
  - Adopt a more coordinated approach towards public R&D and innovative activities.  
  - Implement consistent monitoring and evaluation frameworks across public research institutions to inform policy making.  
  - Enhance the incentives system to facilitate greater technology transfer and commercialization of research.  

**Strengthening firms’ technological and skills readiness**  
  - Incentivize firms to invest in basic managerial and organizational practices.  
  - Increase the development of applied tech skills and structured partnerships with industries for internship and capstone projects. |

| (iii) Enabling foundations to expand private investments | Mainstream green and environment sustainability into economic policy making  
  - Deepen collaboration between national and local governments, public infrastructure operators, manufacturing firms, industry associations, industrial park operators, and financial institutions to develop Eco-Industrial Parks.  
  - Provide support to firms especially SMEs to mainstream Environmental, Sustainable, and Governance (ESG) standards into their production processes.  
  - Leverage sustainable finance instruments to maximize financial benefits for a more sustainable and resilient private sector. |
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