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KHAZANAH  
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# THE STATE OF HOUSEHOLDS



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## ABBREVIATIONS

ADBI	: Asian Development Bank Institute
APR	: Annual Percentage Rate
b	: billion
BNM	: Bank Negara Malaysia
BR1M	: Bantuan Rakyat 1Malaysia
CAGR	: Compound Annual Growth Rate
DoS	: Department of Statistics, Malaysia
EPF	: Employees Provident Fund, Malaysia
FAMA	: Federal Agriculture Marketing Authority, Malaysia
FAO	: Food and Agricultural Organisation of the United Nations
FDI	: Foreign Direct Investment
GDP	: Gross Domestic Product
GST	: Goods and Services Tax
ILO	: International Labour Organization
ITUC	: International Trade Union Confederation
LPG	: Liquefied Petroleum Gas
k	: thousand
km	: kilometres
m	: million
MGI	: McKinsey Global Institute
MIDA	: Malaysian Investment Development Authority
MOE	: Ministry of Education, Malaysia
MOF	: Ministry of Finance, Malaysia
MOHE	: Ministry of Higher Education, Malaysia
NAPIC	: National Property Information Centre
NEAC	: National Economic Advisory Council
OPEC	: Organisation of the Petroleum Exporting Countries
PMR	: Penilaian Menengah Rendah
RM	: Malaysian Ringgit
RCEP	: Regional Comprehensive Economic Partnership
SGD	: Singaporean Dollar
SMEs	: Small and Medium Enterprises
SPM	: Sijil Pelajaran Malaysia
STPM	: Sijil Tinggi Pelajaran Malaysia
TiVA	: Trade in Value-Added
TVET	: Technical and Vocational Education and Training
TPPA	: Trans-Pacific Partnership Agreement
USD	: US Dollar

This report was prepared by the Managing Director and the researchers of the Khazanah Research Institute, namely: Charon bin Mokhzani, Dr Muhammed Abdul Khalid, Dr Suraya Ismail, Wan Khatina Wan Mohd Nawawi, Intan Nadia Jalil, Junaidi Mansor, Adriana Nordin Manan, Aidonna Jan Ayub, Yap Gin Bee, Adibah Abdulhadi, Grace Chang, and Puteri Marjan Megat Muzafar.

We would also like to thank the Employees Provident Fund (EPF), who kindly shared with us their unpublished anonymized data on the incomes and savings of their members.

# SECTION

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# 01

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## INTRODUCTION

The state of households	01
The Malaysian workforce	01
Trade and investment policies	01



# INTRODUCTION

This report sets out some of the pressing issues of the nation that the Khazanah Research Institute is investigating and will provide policy recommendations on.

We examine:

## **The state of households**

An understanding of Malaysian households is key to understanding the issues that we face as a nation. This report looks at:

- the disparity and distribution of household incomes
- household expenditure and the impact of rising food prices
- housing affordability and household debt
- subsidy reform and the use of cash transfers.

## **The Malaysian workforce**

The income earners in most households are salaried workers and so this report sets out:

- the composition of our workforce and the wage structure
- the effect of migrant labour
- the education attainment and skills levels of our workforce.

## **Trade and investment policies**

Raising household incomes among other things requires the appropriate trade and investment policies. This report looks at:

- trade and investment policies that could lead to higher wages and household incomes, as well as less inequality
- advantages of the Regional Comprehensive Economic Partnership (RCEP).

These are by no means the only pressing issues of our nation. For example, creating high-income jobs will also need innovation and entrepreneurship, which we do not address directly here.

# SECTION

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## 02

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### THE STATE OF HOUSEHOLDS

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# THE STATE OF HOUSEHOLDS

## It's all about the households

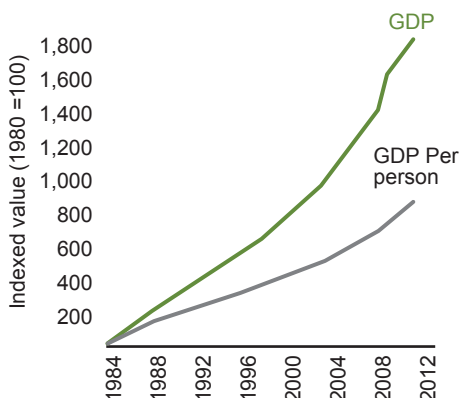
Malaysia can rightfully be proud of its economic transformation.

Our nominal GDP has grown 17.5x from RM53.3b in 1980 to RM984.5b in 2013, while nominal GDP per person grew 7.8 times from RM3,841 to RM32,984 during the same period.

**Table 1: Nominal GDP per person for Middle Income Countries in 2012<sup>1</sup>**

Country	USD
Argentina	11,573
Brazil	11,340
Turkey	10,666
Malaysia	10,432
World	10,318
Mexico	9,749
Costa Rica	9,386
East Asia & Pacific	9,040
Upper middle income	7,285

**Chart 1: Growth of Malaysian Nominal GDP and GDP per person 1980-2013<sup>2</sup>**



High GDP per person does not however always translate into high household incomes and high average income can be distorted by the incomes of the very well-off. The better measure is median household income, the half-way mark. Our median household income, like our GDP per person, is one of the highest in Asia after the developed nations (Japan, Singapore, South Korea and Taiwan).

<sup>1</sup> World Bank (2014)

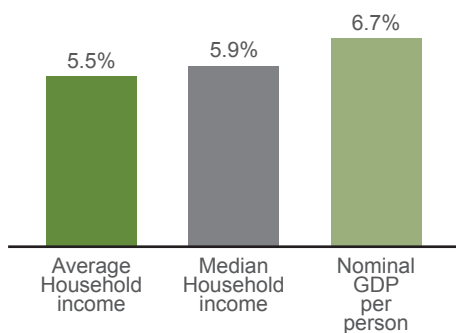
<sup>2</sup> DoS (2014a)

The data is clear that households have in fact benefited from our rising GDP. As Charts 2 and 3 show, the Compound Annual Growth Rate (CAGR) of median household income from 1995 to 2012 was 5.9%; it grew from RM1,377 to RM3,626, and has grown more than average household income. Incomes of the lower income households have grown the fastest – the average household income of those in the bottom 40% has grown the most, followed by the middle 40% and then the top 20% of households grouped by household income (Chart 4a).

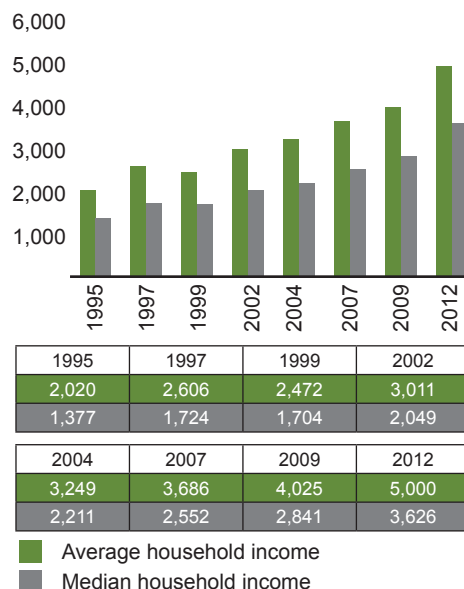
Between 2009 and 2012, Malaysia's real median household income grew by 19%; in contrast, in the US and the UK<sup>3</sup> real median household income dropped by 4%.<sup>4</sup>

The latest figures indicate that in real terms (ie after adjusting for inflation) median household income grew slightly faster than the growth of GDP per person (Chart 4b) although in the past, it was the latter that grew faster.

**Chart 2: Annualised Nominal Growth Rates 1995-2012 (percentage)<sup>5</sup>**



**Chart 3: Average and Median Monthly Household Income 1995-2012 (RM)<sup>6</sup>**

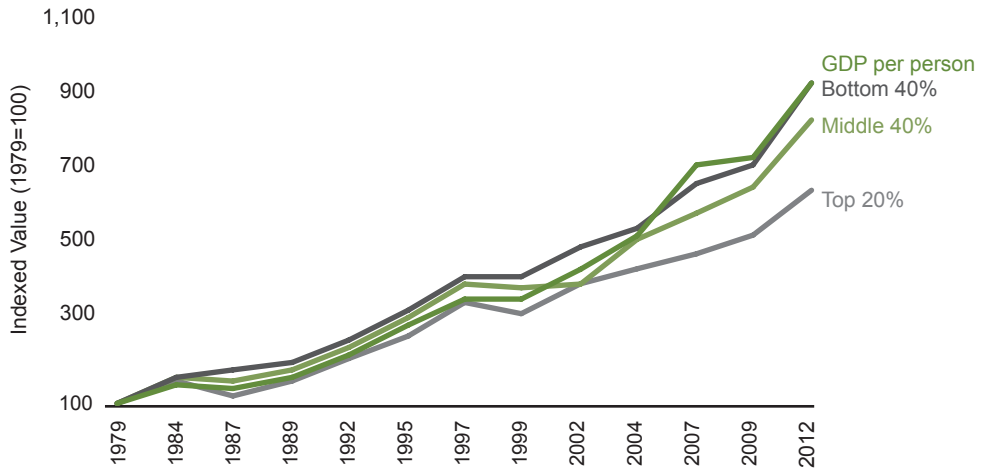


<sup>3</sup> This is in terms of median equivalised disposable household income

<sup>4</sup> The Economist (2014), office for National Statistics UK (2013)

<sup>5</sup> DoS (2013a), KRI calculations

<sup>6</sup> DoS (2013a); the Minister in the Prime Minister's Department had announced in September 2014 that the average and median household incomes for Malaysia in 2014 were RM5,900 and RM4,258, respectively. Pending publication of the Household Income Survey Report 2014 by DoS, our Report will use figures from the Household Income and Basic Amenities Survey Report 2012.

**Chart 4a: Growth of GDP per person and Nominal Average Household Income 1979-2012<sup>7</sup>****Chart 4b: Growth of Real Household Income and Real GDP per person 1995-2012<sup>8</sup>**<sup>7</sup> DoS (2013a), EPU (2013), KRI calculations<sup>8</sup> DoS (2013a), World Bank, KRI calculations

We have done well but we should, as always, strive for better. Our average monthly household income in 2012 was RM5,000. But our median household income was less, at RM3,626.

- 23% of households earned less than RM2,000 per month
- 55% less than RM4,000 per month
- 74% less than RM6,000 per month.

At the individual level, the latest data from DoS<sup>9</sup> shows that in 2013 the median monthly salaries and wages was RM1,700. This is consistent with the data from EPF that show that 62% of active EPF members earned less than RM2,000 per month and 96% earned less than RM6,000.

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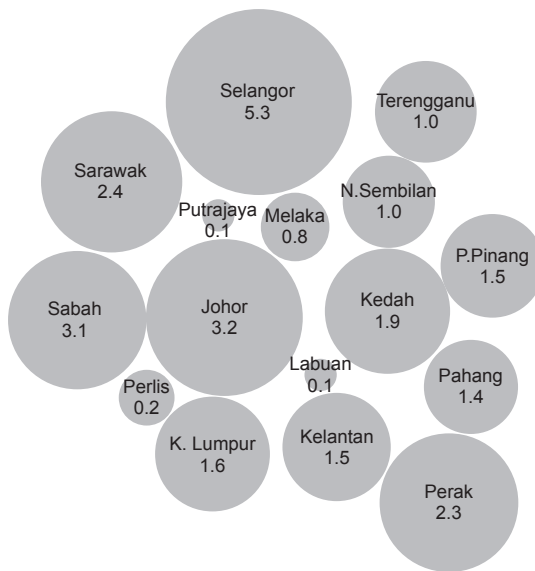
<sup>9</sup> DoS (2014b)



## About households

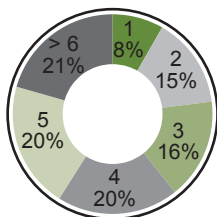
Based on the latest available data from DoS, the population of Malaysia in 2010 was 28.6 million. There were 6,341,273 households and an average of 4.3 people per household as of 2010.<sup>10</sup> The following charts tell us where our people live and the composition of their households.

**Chart 5: Population of Malaysia by State in 2010 (m)**

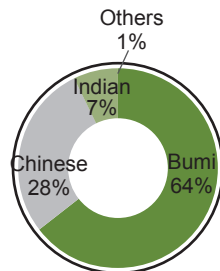


## What makes a household? Composition of households headed by a Malaysian by:

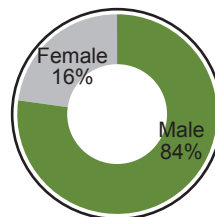
**Chart 5a:**  
Persons per Household



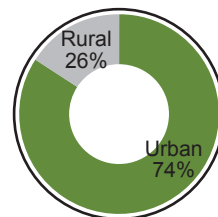
**Chart 5b:**  
Ethnicity of Household Head



**Chart 5c:**  
Gender of Household Head



**Chart 5d:**  
Location of Household

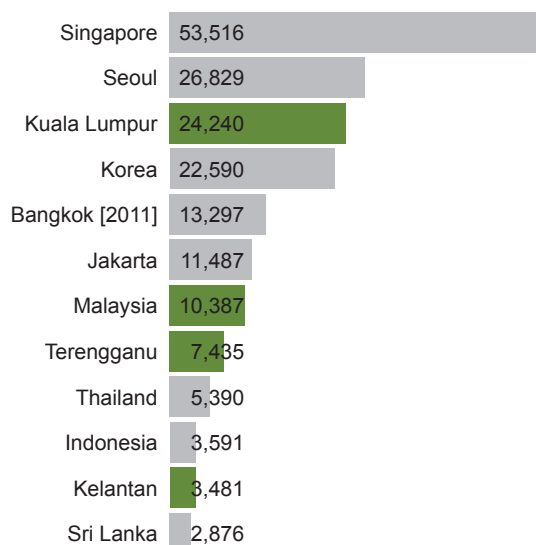


<sup>10</sup> DoS (2011b)

### Rich and poor states

There is a wide variation in nominal GDP between states. Kuala Lumpur, the second richest by nominal GDP but the first in GDP per person terms, has a higher nominal GDP per person than Korea. Kelantan, the poorest state by nominal GDP per person and second from the bottom in terms of nominal GDP, lies between richer Indonesia and poorer Sri Lanka in terms of GDP per person.

**Chart 6: Nominal GDP per person in 2012 (USD)<sup>11</sup>**

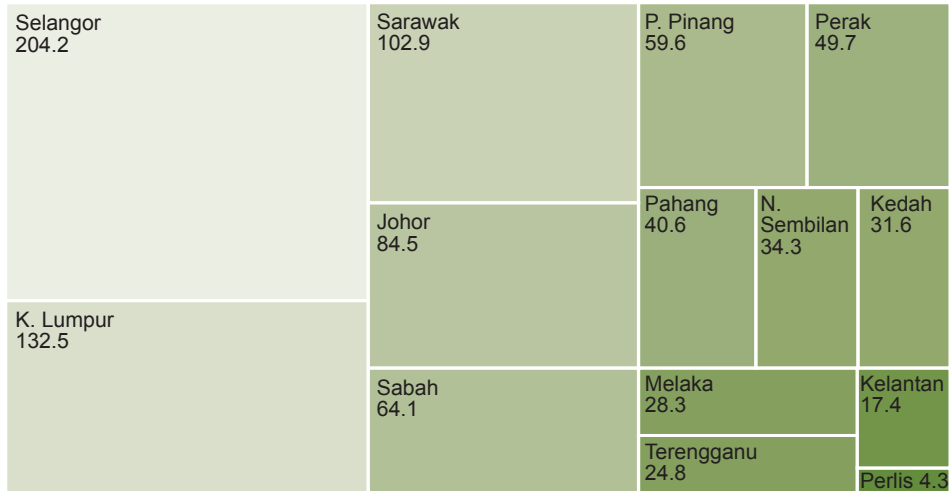


**Table 2: Nominal GDP per person by State in 2013 (RM)<sup>12</sup>**

Kuala Lumpur	79,752
Sarawak	41,115
P. Pinang	38,356
Selangor	37,851
Melaka	34,109
N. Sembilan	33,033
Pahang	26,759
Johor	25,302
Terengganu	23,285
Perak	21,150
Sabah	18,603
Perlis	18,519
Kedah	16,316
Kelantan	10,677
<b>Malaysia</b>	<b>32,984</b>

<sup>11</sup> GDP per person for all countries are obtained from the IMF except for Malaysia, which is sourced from DoS. Seoul, Bangkok and Jakarta data are sourced from the countries' respective national statistics departments. The exchange rates used are the spot exchange rates on 31/12/2012.

<sup>12</sup> DoS (2014a)

**Chart 7: Nominal GDP by Malaysian States in 2012 (RM b)<sup>13</sup>**

Nominal GDP in RM b

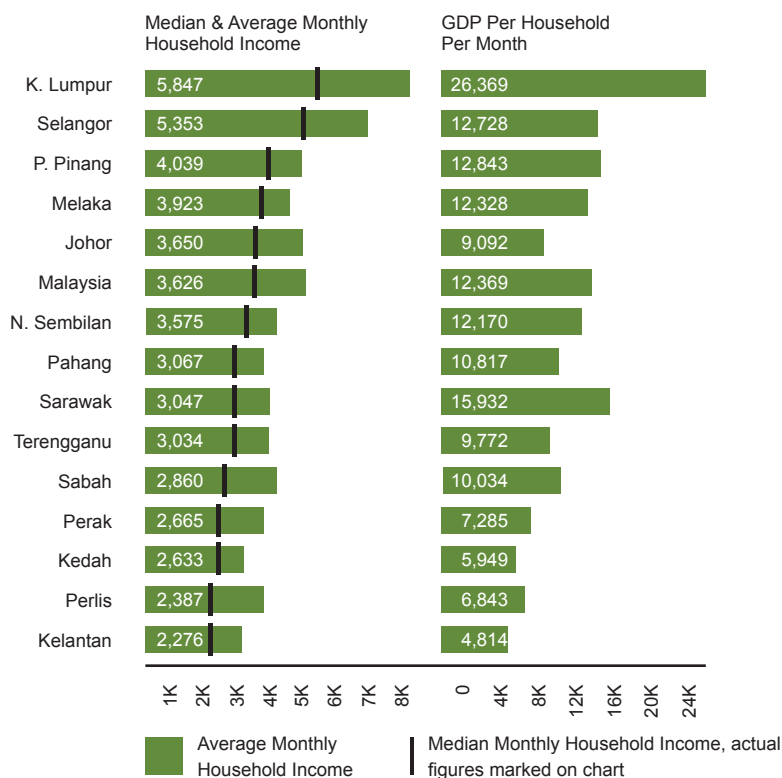
4.3 204.2

**GDP is not household income**

High GDP, GDP per person and GDP per household do not necessarily translate into high household incomes.

Average household income also often does not present a true picture of the income of most households as it can be distorted by the incomes of the very well-off. It disguises the fact that the median is actually much lower.

<sup>13</sup> DoS (2014a)

**Chart 8: Median and Average Monthly Household Income and GDP per Household per Month in 2012 (RM)<sup>14</sup>**

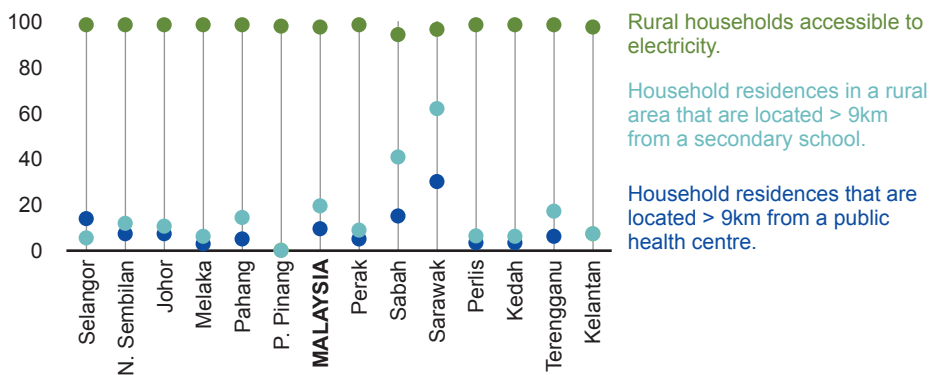
Sarawak for example has the second highest GDP per household but ranks eighth for average and seventh for median household income. Both Pahang's and Terengganu's average household incomes are lower than Sarawak's, but the median household incomes of all three states are almost the same. Amongst the bottom three states, Perlis has the highest GDP per household and average household income but still has a lower median household income than Kedah.

<sup>14</sup> DoS (2013a), KRI calculations. Sources of household income comprise employment (wages and emoluments), income from self-employment, property income (including royalties, rents, interests and dividends) and current transfers received (including remittances).

## Deprived households

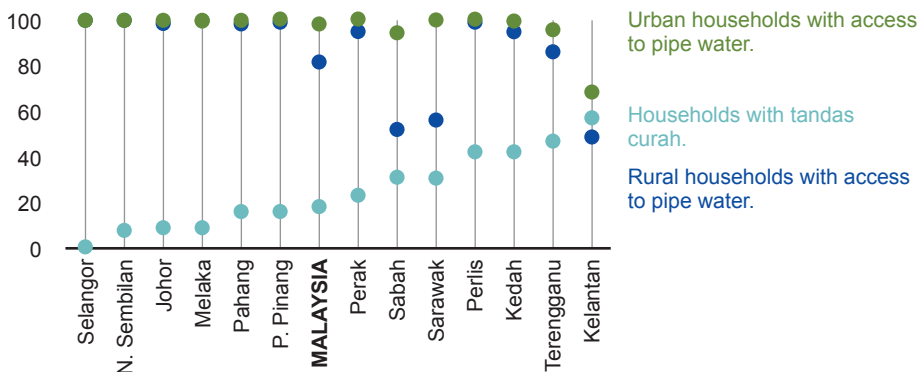
The federal government has done its part in providing schools, hospitals and electricity. Except in Sabah and Sarawak, which have remote interiors, most households have electricity and are less than 9km away from a secondary school or a health facility.

**Chart 9a: Percentage of Households that have Electricity, Schools and Public Health in 2012<sup>15</sup>**



Water and sanitation in some states on the other hand have not been as well provided, as the chart below shows. For example, in Kelantan, only 50% of its rural households and 68% of its urban households have pipe water. The majority (57%) of its households have no flush toilets but use ‘tandas curah’.

**Chart 9b: Percentage of Rural and Urban Households that have Pipe Water and Tandas Curah in 2012<sup>16</sup>**

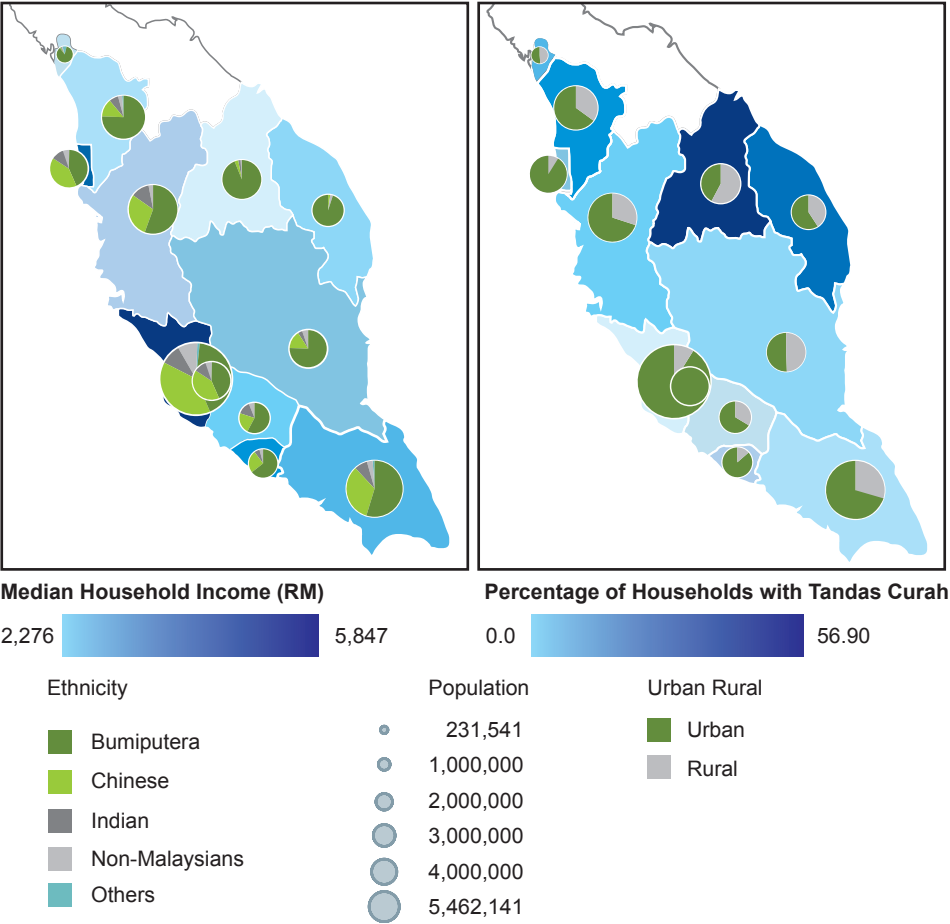


<sup>15</sup> DoS (2013a)

<sup>16</sup> DoS (2013a)

The states of the north: Perlis, Kedah, Kelantan and Terengganu

Chart 10: Characteristics of Households by Median Household Income, Ethnicity, Ownership of Tandas Curah and Strata in 2012<sup>17</sup>



Attention has rightly been focused on the development of our most southern Peninsular states, and Sabah and Sarawak, with their remote interiors. But we must also improve the state of households in the north. We must bring education and employment opportunities, and improve basic amenities like water and sanitation. The corridor initiatives and the double-tracking to Padang Besar will help, but we must do more.

<sup>17</sup> DoS (2013a)

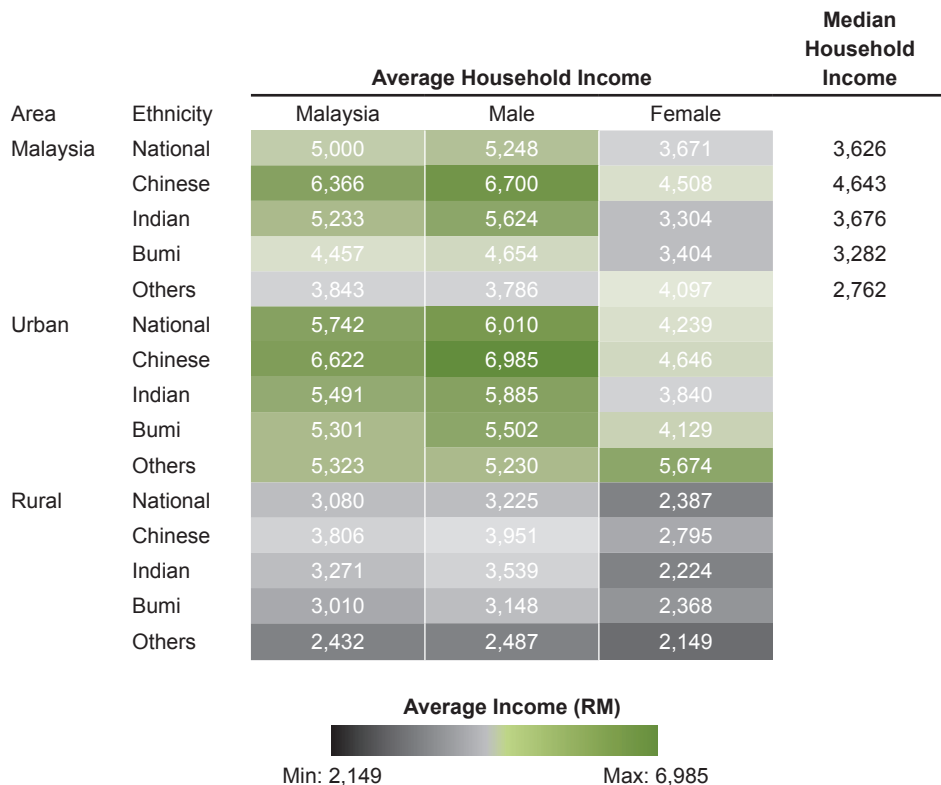


### There is an ethnic, urban-rural and gender divide

Of the three major ethnic groups, Chinese households are on average the richest and Bumiputera ones the least well-off. The average income of households headed by an urban male Chinese is the highest, while those headed by female Indians and Bumiputeras in the rural areas are the lowest.

The income gap between the ethnic groups is, however, less than the urban-rural income gap, which explains why young people move to towns from their kampung. For example, in the rural areas, the average Bumiputera household income is less than the average Chinese household income, whereas the average urban Bumiputera household income is much higher.

**Chart 11: Average Household Incomes by Ethnicity, Strata and Gender in 2012 (RM)<sup>18</sup>**



<sup>18</sup> DoS (2013a)

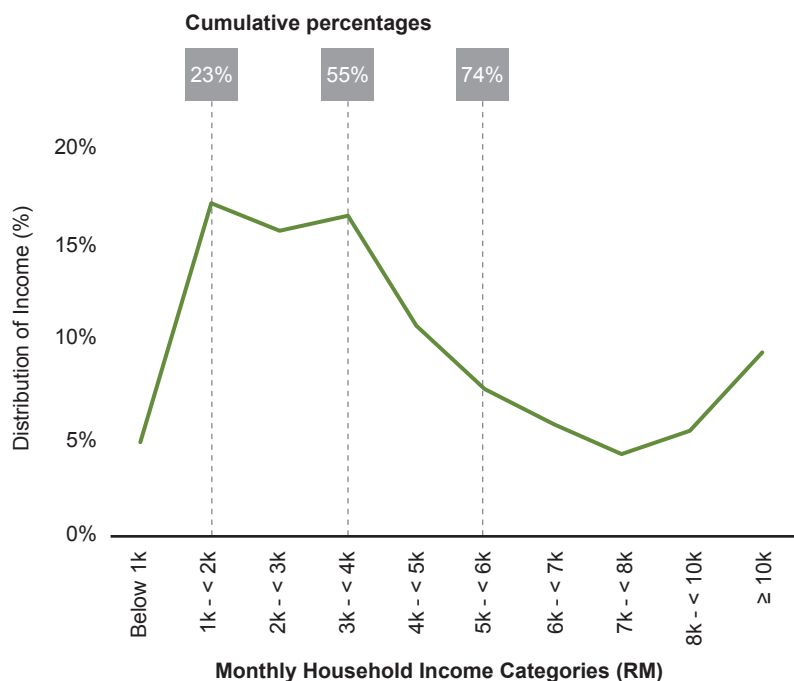
### Unequal household incomes

Income disparities vary by ethnic group and there is also an intra-ethnic inequality in income distribution.

The DoS Household Income Survey puts households in various monthly household income brackets. It starts with households that earn less than RM1,000 a month, then those that earn more than RM1,000 but less than RM2,000, all the way to those that earn RM10,000 a month or more.

‘Others’ and Bumiputeras tend to have higher proportions of households that earn less than RM2,000 a month, whereas the Chinese and Indians have higher proportions of households earning more than RM5,000 per month. The Chinese have proportionately the most households that earn RM10,000 or more per month.

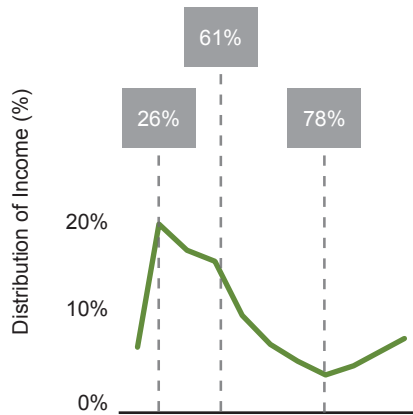
**Chart 12: Percentage Distribution of Households in Each Income Category in 2012: Malaysia and by ethnicity of the household head<sup>19</sup>**



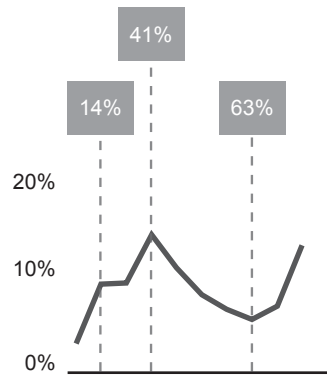
<sup>19</sup> DoS (2013a)

**Chart 12a:**  
**Bumiputera**

**Cumulative percentages**



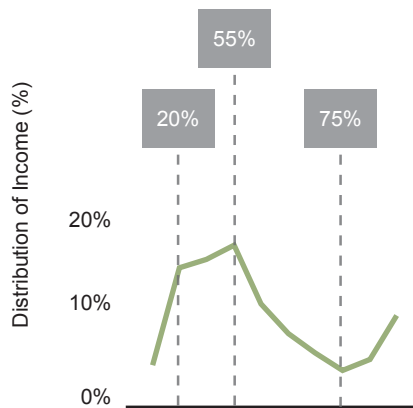
**Chart 12b:**  
**Chinese**



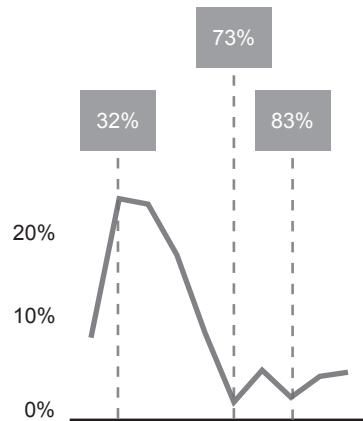
**Monthly Household Income Categories (RM)**

**Chart 12c:**  
**Indian**

**Cumulative percentages**



**Chart 12d:**  
**Others**



**Monthly Household Income Categories (RM)**

Notes: ■ Denotes cumulative percentages for  
(i) below RM2k; (ii) below RM4k; and (iii) below RM6k

The distribution of household incomes reflects individual income distribution. Employees Provident Fund (EPF) data on individual incomes, which includes salary or wages, overtime payments, and bonus shows that in 2013:

- 96% of active EPF members earn less than RM6,000 a month
- 85% less than RM4,000
- 62% less than RM2,000.

As mentioned earlier the median monthly salaries and wages per month for individuals is RM1,700. That means half of all workers get this much or less. The breakdown by ethnicity and strata is as Table 3 below.

**Table 3: Individual Wages by Ethnicity and Strata in 2013<sup>20</sup>**

<b>Ethnicity/Strata</b>	<b>Median monthly salaries and wages (RM)</b>
Malaysia (Total)	1,700
Bumiputera	1,600
Chinese	2,000
Indian	1,500
Others	900
Urban	1,680
Rural	1,040

<sup>20</sup> DoS (2014b)

# HOUSEHOLD EXPENDITURE

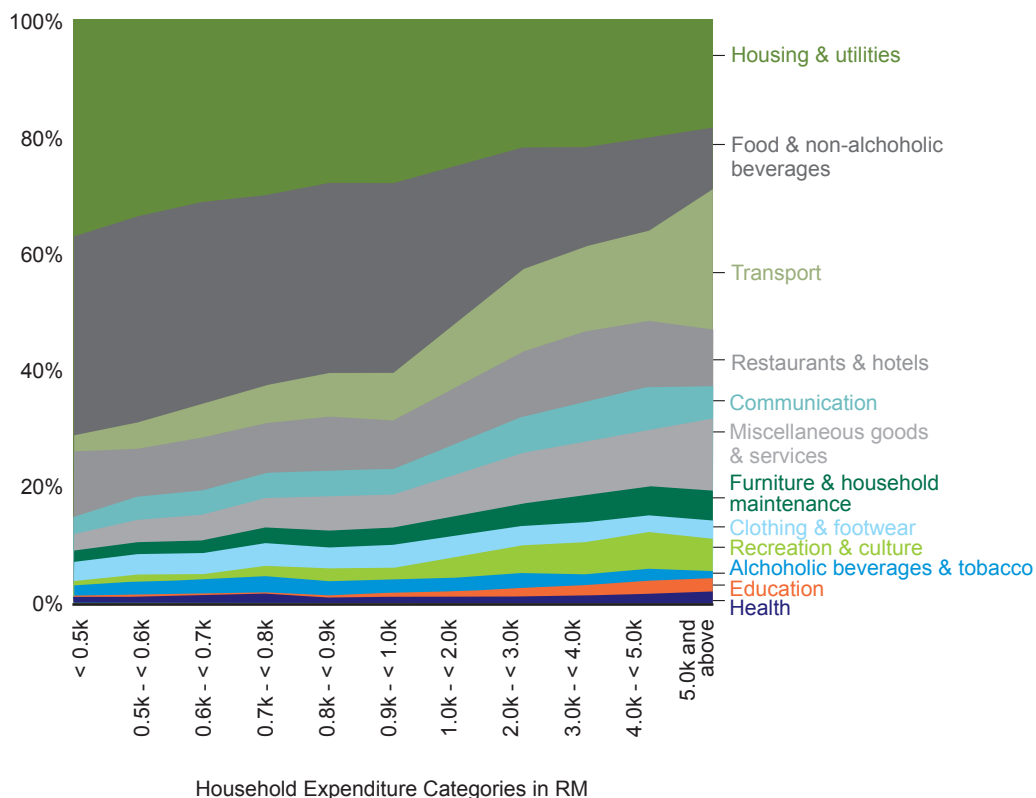
## Unequal spending

Like income, household spending is unequal.

The DoS Household Expenditure Survey puts households in different household expenditure categories, starting with households that spend less than RM500 per month, then those that spend RM500 or more but less than RM600, all the way to those that spend RM5,000 or more a month.

Chart 3 plots the components of household expenditure. It shows the percentage spent by households in each expenditure category on different types of goods and services. The lower the household income, the higher the proportion spent on food, housing and utilities as a percentage of total expenditure. Therefore, lower income households would be disproportionately affected by rising food and utilities prices.

**Chart 13: Percentage Monthly Spend on Goods & Services by Expenditure Category in 2010 (RM)<sup>21</sup>**



Average monthly household expenditure is RM2,190 and median household expenditure is RM1,793.<sup>22</sup> This means half of Malaysian households fall into the lower expenditure categories, from those that spend less than RM500 a month to those that spend RM1,000 to RM2,000 a month.

### Unequal food

Unequal spending translates to less food for the less well-off – less protein (meat, fish, eggs and milk) and less rice.

<sup>21</sup> DoS (2011a)

<sup>22</sup> DoS (2011a)



After fish, poorer households stock up on carbohydrates like rice and bread, and then only on vegetables and meat. Only when a household can afford to spend between RM1,000 and RM2,000 a month can it spend more on meat than on rice. And even then, it is only RM55 per month or RM1.83 per day on meat.

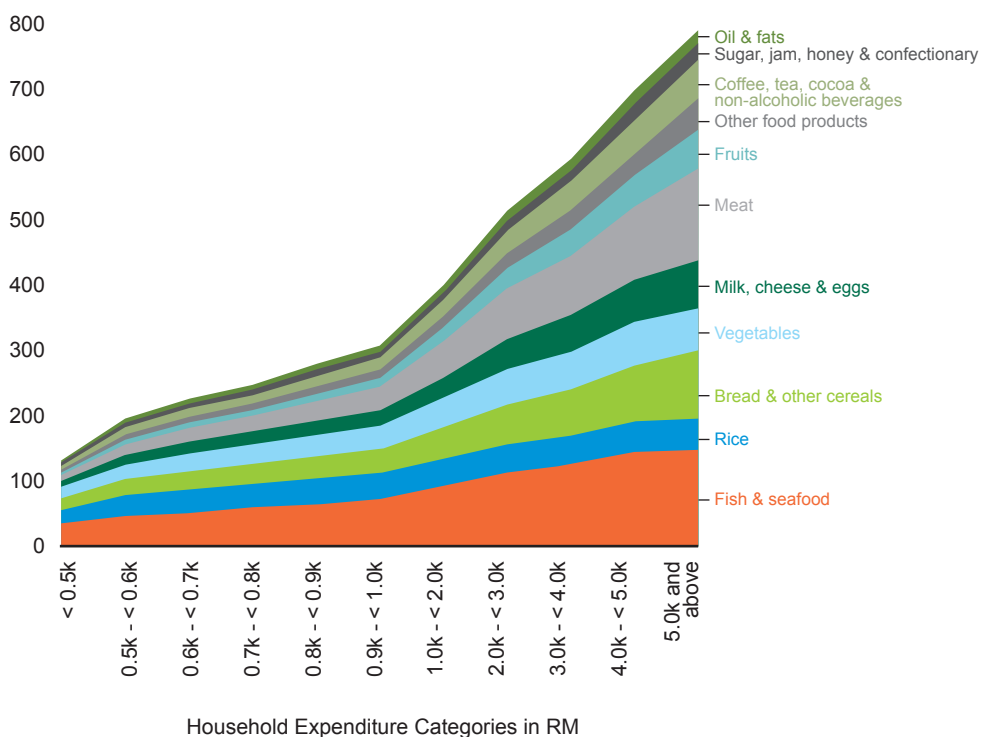
There is a limit to how much more affluent households can spend on rice or cooking oil compared to poorer ones, but when it comes to protein and other nutritious food, their high income means they eat much more.

**Table 4: Monthly Spend of Households on Rice, Meat and Fish & Seafood by Expenditure Category in 2010 (RM)<sup>23</sup>**

<b>Expenditure Category (RM)</b>	<b>Rice</b>	<b>Meat</b>	<b>Fish &amp; Seafood</b>
< 0.5k	22	8	34
0.5k - < 0.6k	32	15	46
0.6k - < 0.7k	35	21	51
0.7k - < 0.8k	35	24	60
0.8k - < 0.9k	39	29	64
0.9k - < 1.0k	39	35	72
1.0k - < 2.0k	41	55	92
2.0k - < 3.0k	43	76	112
3.0k - < 4.0k	45	89	124
4.0k - < 5.0k	47	110	142
> 5.0k	48	139	146

<sup>23</sup> DoS (2011a)

**Chart 14: Monthly Spend of Households on Different Food Groups (in Order of Amount Spent) by Expenditure Category in 2010 (RM)<sup>24</sup>**

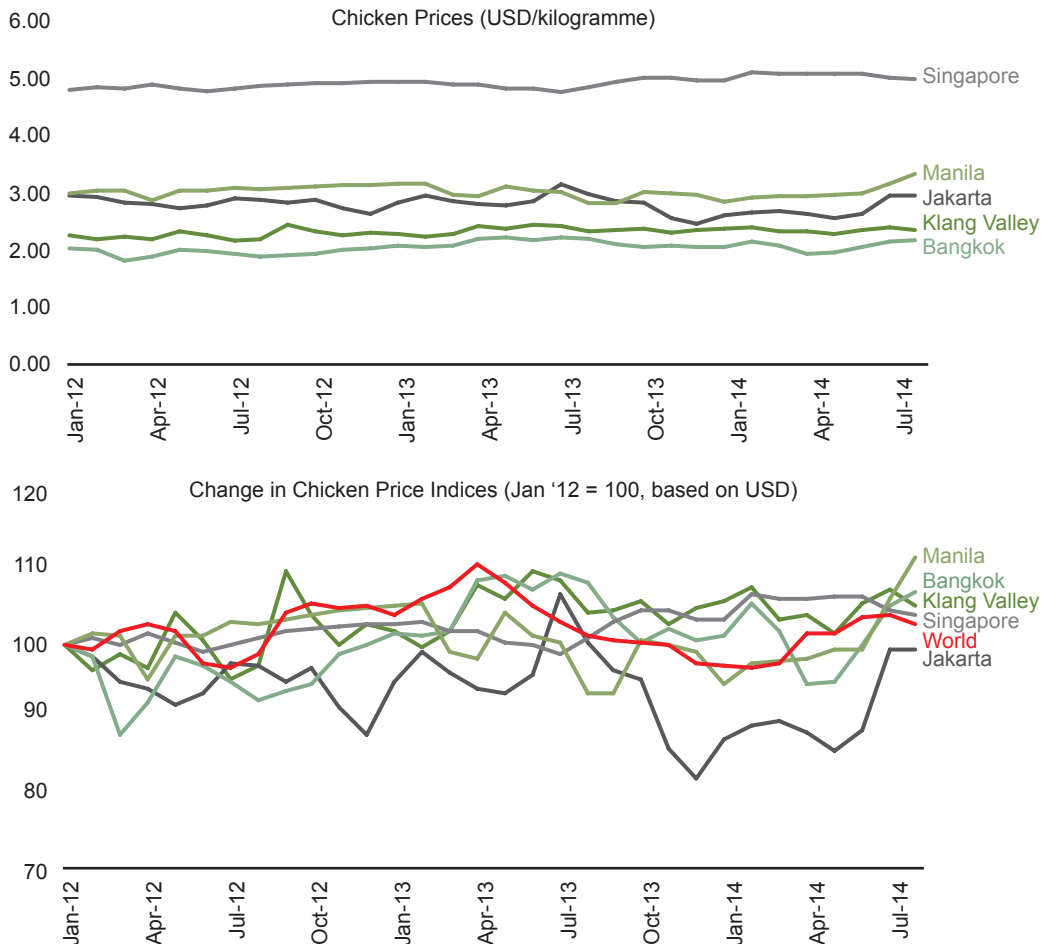


### The price of food

Our chicken prices are generally lower than in other ASEAN countries. But they are steadily increasing. We are also at the mercy of world food prices, which rose 5.15% in the first quarter of this year.

Rising food prices affect lower income households the most. It is important to keep food prices down as this will boost their real income.

<sup>24</sup> DoS (2011a). The foods are in order of the amount spent by the lower expenditure group with the highest (fish & seafood) and the lowest (oils & fats).

**Chart 15: Chicken Prices 2012-2014 YTD<sup>25</sup>**

We are undertaking research on the food industry, looking at the supply chains of selected food items such as chicken and fish (fish is the largest item in the food expenditure basket), as well as on competition-related issues that could be the cause of rising food prices. As a start though, we must vigorously enforce our competition and consumer laws to keep prices as low as possible.

<sup>25</sup> CEIC, KRI calculations.

# HOUSING AND DEBT

## Affordable housing should cost 3x annual median income

**Table 5: Housing Prices as a Multiple of Annual Median Income<sup>26</sup>**

Country	Multiple
Malaysia	5.5x
Singapore	5.1x
US	3.5x
UK	4.7x
Ireland	2.8x
Hong Kong	14.9x

As Table 5 shows, our houses on average cost much more than 3x annual median income. In median income terms, our houses are more expensive than those in Ireland and even Singapore. At 21%, the profit margins of our property developers are high – almost 2x those of the US (12%), 1.2x those of the UK (17%) and higher than Thailand (14%), although Singapore has higher margins (25%).<sup>27</sup>

Table 6 shows the result of applying this widely accepted definition<sup>28</sup> of affordable housing to the median incomes of the middle and bottom 40% of Malaysian households.

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<sup>26</sup> Demographia (2013)

<sup>27</sup> KRI calculations and Bloomberg L.P. (2014, using end - 2014 figures)

<sup>28</sup> Demographia (2013)

**Table 6: Housing Affordability of Malaysians in 2012<sup>29</sup>**

	<b>Bottom 40%</b>	<b>Middle 40%</b>	<b>Malaysia median</b>
Average Income (RM)	1,847	4,573	-
Median Income (RM)	1,852	4,372	3,626
Affordable price @ 3x annual median income (RM)	70,000	160,000	130,000
No. of months to save a 10% deposit in EPF a/c 2	60	58	57
Monthly loan instalment (25 years @ 4.45% p.a.) (RM)	348	796	647
Instalment/median income	18.79%	18.21%	17.84%

Over and above their usual expenses (see Chart 13) households also have to make loan instalment payments, which are approximately 18% of their income at current interest rates. The recent hike in interest rates has increased the monthly loan instalment for households by 2% and they remain susceptible to further interest rate rises.

We are working on the appropriate policy response. The answers will lie in:

- reforms of the construction supply chain, land market price setting and land regulations
- innovation in building technology and finance
- the provision of affordable housing by the government and private sector.

<sup>29</sup> DoS (2013a), commercial bank websites, KRI calculations

### Low income households, high levels of consumerism

A very high proportion of households own cars (78%), motorcycles (66%), refrigerators (96%), and washing machines (91%). Almost every household owns a television (98%) and a mobile phone (95%). 57% subscribe for pay TV (Astro) but only 39% have an internet subscription.

Most cannot be buying all these with cash, since their incomes are low. They can only be doing so on credit.

Chart 16a: Ownership of Vehicles by Percentage of Households by State in 2012<sup>30</sup>

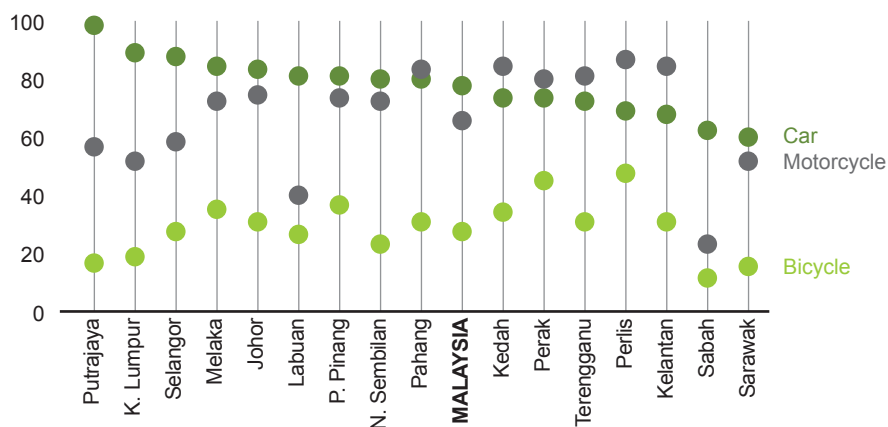
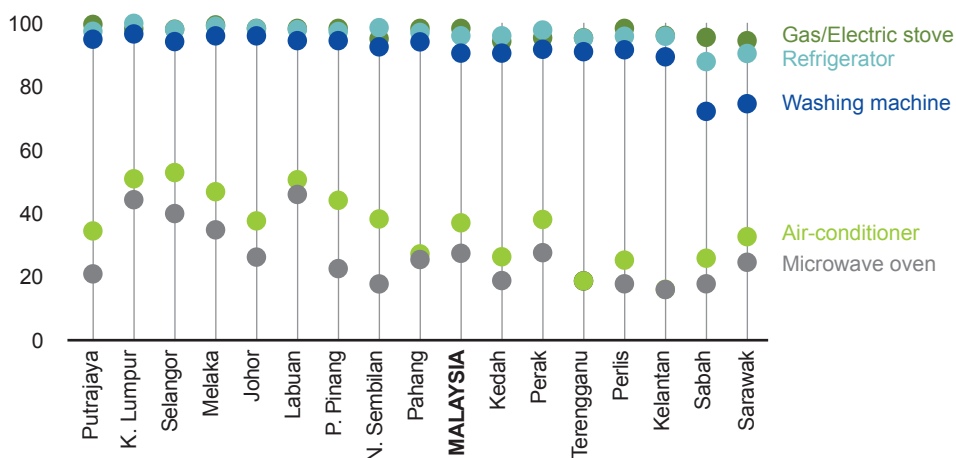


Chart 16b: Ownership of Electrical Appliances by Percentage of Households by State in 2012<sup>31</sup>

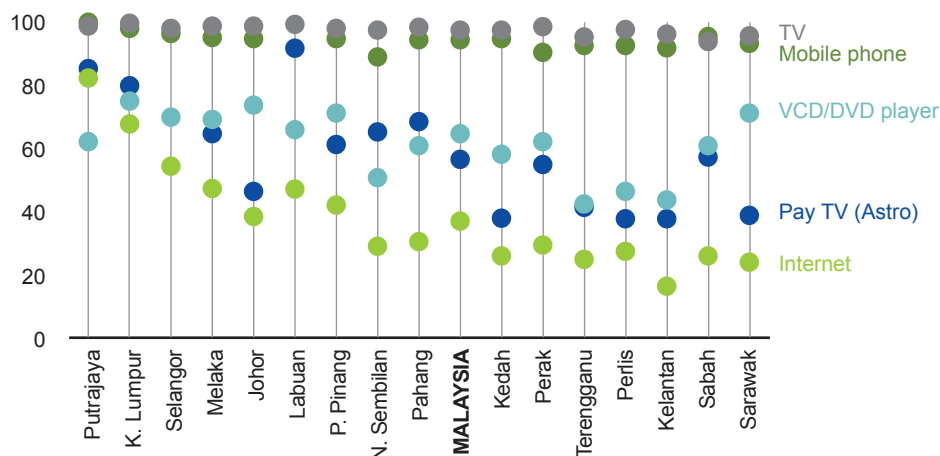


<sup>30</sup> DoS (2013a)

<sup>31</sup> DoS (2013a)



**Chart 16c: Ownership of TV, Astro, Mobile Phone, Internet and VCD/DVD by Percentage of Households by State in 2012<sup>32</sup>**



### The scourge of ‘ansuran mudah’

The wealthiest pay by cash; the better-off choose credit based on interest rates and the least well-off choose based on what is on offer and the instalment payments they can afford.

The Perodua Viva is Malaysia’s best-selling car<sup>33</sup>. With a nine-year loan, it seems affordable at RM271 per month. But the reality is that the buyer pays more than a quarter of the purchase price in interest payments. The problem is most acute with consumer durables. Rates are almost 50% per year!

<sup>32</sup> DoS (2013a)

<sup>33</sup> Frost & Sullivan (2014)

**Table 7a: True Annual Percentage Rate (APR) Calculations for Consumer Durables<sup>34</sup>**

	<b>Samsung TV</b>	<b>Toshiba Washer</b>	<b>Toshiba Fridge</b>
List price	RM1,549	RM1,024	RM1,049
Loan period	5 years	5 years	2 years
Instalment	RM15/week	RM10/week	RM16/week
Total interest paid	RM2,419	RM1,657	RM463
Total interest paid/price	156.14%	161.78%	44.14%
True APR	46.05%	47.41%	37.90%

**Table 7b: Published APR<sup>35</sup>**

<b>Platinum credit card APR</b>	<b>Private Banking overdraft APR</b>
15% - 18%	8.10%

**Table 7c: True APR Calculations for Cars<sup>36</sup>**

	<b>Perodua Viva</b>	<b>BMW316i</b>
List price	RM24,936	RM209,800
Advertised interest rate	3.38%	2.53%
Loan period	9 years	5 years
Instalment	RM271/month	RM3,545/month
Total interest paid	RM6,827	RM23,886
Total interest paid/price	27.38%	11.39%
True APR	6.14%	4.79%

<sup>34</sup> Catalogues and quoted rates from various retailers, Jun '14 and Apr '14. The published rates are based on various time intervals. The true Annual Percentage Rate (APR) annualises these rates so they are on a common basis, making it easier for comparison for the true cost of a loan.

<sup>35</sup> The Platinum Credit Card APR depends on the promptness of past payments and ranges from 15% to 18%. Private banking overdraft APR based on BLR (6.6%) + 1.5%: quoted rate from local bank, Jun '14 (the min. income eligibility for new credit card holders is RM24k per annum).

<sup>36</sup> Car HP interest rates: local bank, Jun '14 and based on 90% financing.

### Household debt reform

The DoS surveys currently do not measure the level of household debt, but the last BNM figures show that household debt to GDP exceeds 86.7%. Households earning less than RM3,000 have a relatively low share of total household debt but their borrowings are proportionately higher than the rest, at 7x annual income.<sup>37</sup>

Low-income households, who have low financial literacy and limited access to debt, appear to choose financing based on the 'affordability' of the monthly or weekly instalments rather than the true Annual Percentage Rate (APR).

The pressing concern then is how much debt low-income households have taken on relative to their ability to pay. They spend most of their income and have little savings, making them susceptible to financial stress should interest rates and inflation continue to rise.

The following reforms are proposed:

- Enacting a consumer credit law takes time, but in the interim we can protect consumers by requiring all providers of consumer credit to prominently advertise the true APR.
- Realignment of responsibility as currently the regulation of consumer credit is distributed between BNM, the Ministry of Domestic Trade, Co-operatives and Consumerism, and the Ministry of Urban Wellbeing, Housing and Local Government.
- Basic financial literacy must be taught in schools.

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<sup>37</sup> BNM (2014)

# INEQUALITY

## Wealth inequality

So far, we have been looking at income inequalities. But it is wealth inequalities that really count.

Findings from the latest UNDP Human Development Report for Malaysia suggest that many Malaysian households have limited savings. Their low levels of precautionary savings mean that most families would be in trouble in the event of a shock – such as a reduction in income, unemployment, or other emergencies. Higher income households meanwhile have a higher propensity to save, and given that their savings generate returns and increase their wealth, this widens the wealth gap even further.<sup>38</sup>

We have many wealthy people:

- Malaysians were the top foreign home buyers by transactions in Singapore in 2012.<sup>39</sup>
- Malaysians were the fourth largest buyers (4%) of newly-built London property in 2012.<sup>40</sup>
- Around 7,000 houses costing more than RM1m are sold in Malaysia each year.<sup>41</sup>
- Malaysians purchase many luxury cars.
- We have 38,000 USD millionaires in Malaysia or 0.1% of the population in 2012, according to Credit Suisse.<sup>42</sup>

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<sup>38</sup> UNDP (2014)

<sup>39</sup> Singapore Urban Development Authority

<sup>40</sup> Knight Frank UK (2013)

<sup>41</sup> NAPIC

<sup>42</sup> Credit Suisse (2014)

**Table 8: No. of Luxury Cars Sold in 2013 by Official Distributors<sup>43</sup>**

<b>Make</b>	<b>Quantity</b>
Volkswagen	9,538
BMW	7,057
Mercedes	5,550
Audi	3,102
Lexus	1,336
Land Rover	1,003
Mini Cooper	437
Porsche	275
<b>Total</b>	<b>28,298</b>

Publicly-available Amanah Saham Bumiputera (ASB) data<sup>44</sup> give an indication of the level of savings of most Bumiputeras. The bottom 71.4% of unit holders in 2013 have an average of RM554 in their accounts. The average for the top 0.2% is RM725,122. The disparity is even more marked when one realises that unit-holders can only invest a maximum of RM200,000 – the high account balances of the wealthy are from many years of dividends.

Low savings are not however just a Bumiputera issue. The EPF data<sup>45</sup> show that savings are unequal regardless of ethnic group. The savings of the top 17,061 members are greater than the total savings of the entire bottom 44%, which comprises 2,854,419 members. For the top, this is a fraction of their total wealth, but for those at the bottom, it is close to their entire life savings.

Active EPF members in the 51-55 age group, who are on the brink of retirement and have careers' worth of savings, have on average RM147,057 each. The richest 5,446 members however have on average RM1.56m in savings. If these members are excluded, then the average savings for the remaining EPF members would be RM127,460. But the bottom 13.5% have average savings of only RM3,580, and the next 7% an average of RM14,848.

Low savings and low wealth are a result of low incomes. Low EPF savings of the bottom 20.5% and high wealth inequality are consequences of disparities in income.

<sup>43</sup> MAA. This does not include 'grey market' imports or second-hand sales.

<sup>44</sup> ASB (2012, 2013), KRI calculations

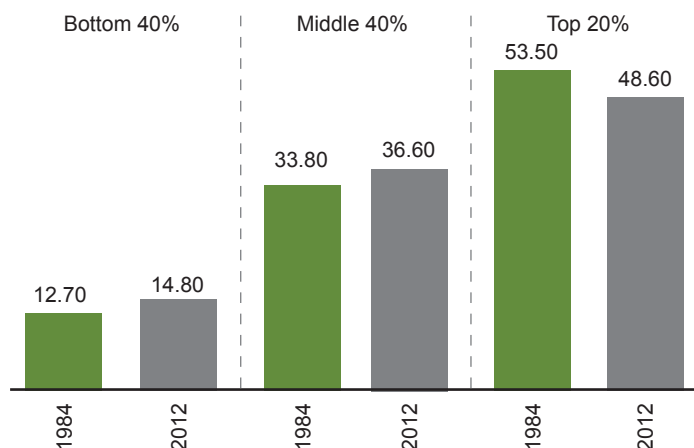
<sup>45</sup> EPF (2014), KRI calculations

### We have been improving income distribution

Household income inequality has been decreasing. One measure of this is the Gini coefficient – a Gini coefficient of one shows absolute inequality (one person has all the income) and a Gini coefficient of zero shows absolute equality (everyone has exactly the same income). There was a period, from 1970 to 1976, when our Gini coefficient worsened from 0.51 to 0.56. Since then it has been improving and was 0.42 in 2014. However, for the past two decades income inequality in Malaysia has remained relatively unchanged. By comparison, many Asian countries (eg China, Indonesia, Singapore, Japan and Korea) experienced increasing inequality.<sup>46</sup>

Another way of looking at inequality is the share of income. With GDP growing, all incomes have gone up, with the highest growth accrued to those in the lower income groups. Chart 17 below shows that from 1984 to 2012, the shares of total income of the bottom 40% and the middle 40% of households have increased, whereas that of the top 20% has decreased.

**Chart 17: Income Share by Income Group 1984 and 2012<sup>47</sup>**



### Perception and reality

The vast majority, the bottom 74% (4.36m) of households who earn less than RM6,000 a month live in a world where food prices really matter and savings are measured in the thousands of ringgit.

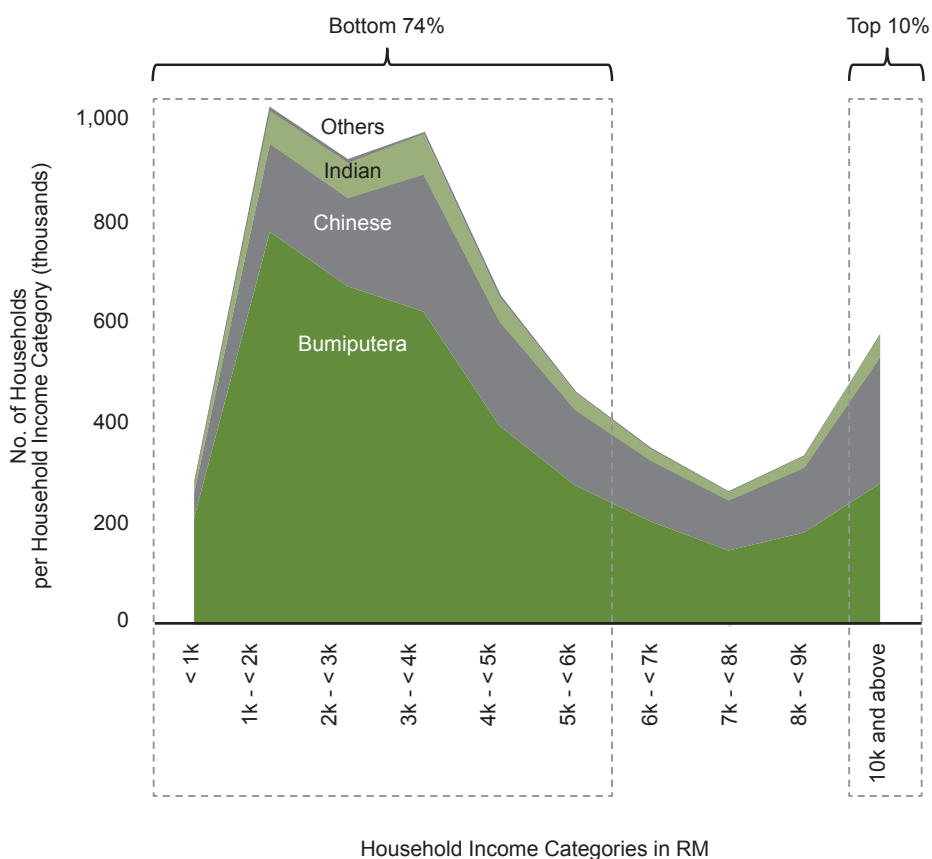
This compares to the top 9.7% of households who earn more than RM10,000 a month. They can afford to shop in high-end malls and go on foreign holidays.

<sup>46</sup> UNDP (2014)

<sup>47</sup> EPU (2013), KRI calculations

**Table 9: No. of Households per Household Income Category in 2012 (thousands)<sup>48</sup>**

	Bumiputera	Chinese	Indian	Other	Total
Top 10% (Households earning $\geq$ RM10k)	280	254	45	1	580
Bottom 74% (Households earning $<$ RM6k)	2,963	1,039	329	25	4,356

**Chart 18: No. of Households per Household Income Category in 2012 (thousands)<sup>49</sup>**<sup>48</sup> DoS (2011b) and (2013a), KRI calculations<sup>49</sup> DoS (2011b) and (2013a), KRI calculations

### Inequality matters

Income inequality reduces the pace and durability of economic growth. A recent IMF study<sup>50</sup> shows that it:

- undermines progress in health and education
- causes political and economic instability that reduces investment
- undercuts the social consensus needed to adjust to economic shocks.

A domestic demand-driven economy like ours needs households that have the disposable income to fuel consumption.

Lower income groups have a higher propensity to consume.<sup>51</sup> Increasing their incomes may lead to more consumption and higher growth. If their consumption falls because they can no longer service their debt due to rising costs (as happened in the US in their Great Recession), it can be very bad for the economy.<sup>52</sup>

To tackle inequality we have to address *market inequality and net inequality*.

*Market inequality* is inequality in wages, salaries and other income. Apart from minimum wage, which we have already implemented, what policies are needed for our citizens to be paid more?

Reducing *net inequality* is done through redistribution. This includes taxation, subsidies and targeted benefits. Should we not be giving help to those in need rather than welfare for corporates?

### Market and net inequality

Chart 19 shows the Gini coefficient for a country based on market income on the X-axis. The higher the number, the more unequal the society is based on market income. The Y-axis shows net inequality ie after redistribution. The lower the number, the more equal it is.

The farther a country is below the solid diagonal line, the more that country distributes income and reduces net inequality.

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<sup>50</sup> IMF (2014)

<sup>51</sup> BNM (2013)

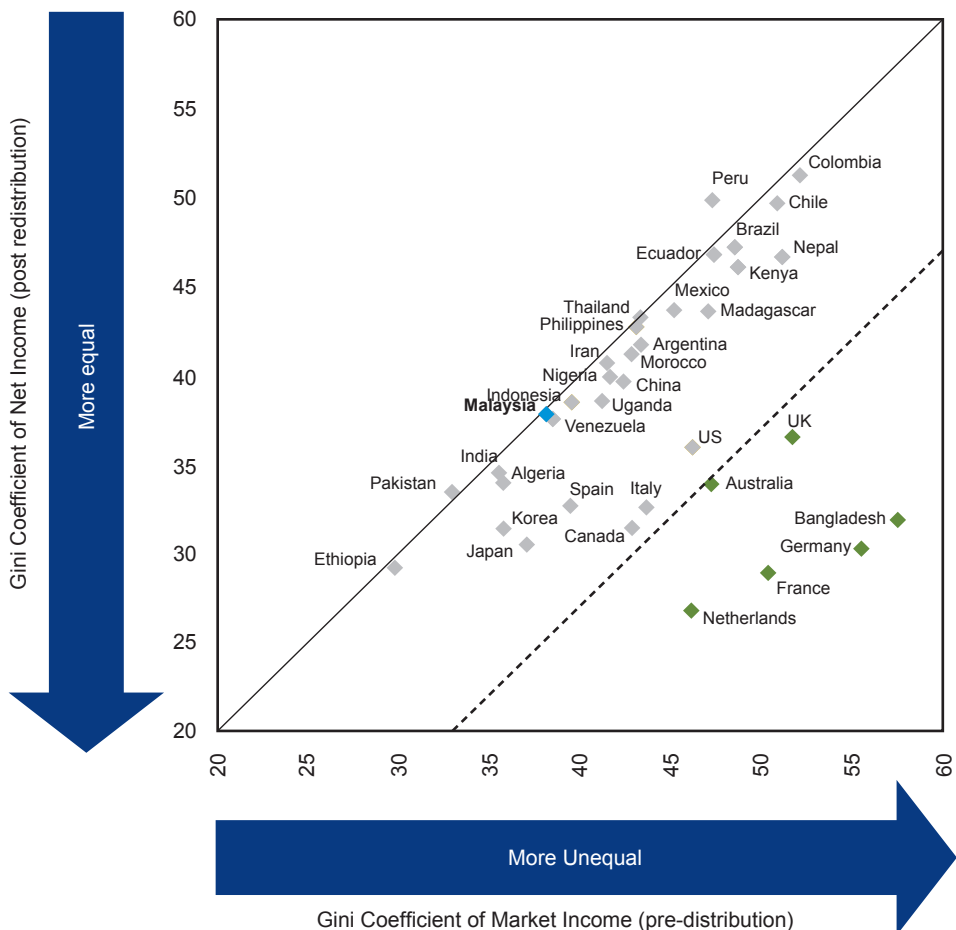
<sup>52</sup> Cynamon and Fazzari (2014) and Mian and Sufi (2014)



The chart contains only the top 20% of countries in the world by population. The countries represented by green diamonds lying below the dashed line are the top 25% in terms of redistribution out of the countries shown in the chart.

Malaysia is on the solid diagonal. Pre-BR1M, we did minimal redistribution.<sup>53</sup> Germany on the other hand, while very unequal in terms of market income, is a more equal society post-redistribution.

**Chart 19: Redistribution: The Top 25% and the Bottom 75%<sup>54</sup>**



<sup>53</sup> These calculations were made before the BR1M disbursements

<sup>54</sup> Ostry et. al. (2014)

# SUBSIDIES AND CASH TRANSFERS

## Tackling net inequality

Redistribution is emotive. To some, it sounds socialist and confiscatory. The well-off will especially say that it stifles growth and business and rewards the lazy and unproductive.

Yet dynamic developed economies like Korea and the US, and especially Germany, do redistribute – creating more equal societies. Singapore, through its Comcare, provides substantial cash transfers to low-income families.

We need to do more, but in a targeted progressive way. As we will see later, blanket subsidies are regressive. The rich enjoy more. We should replace these with cash transfers like BR1M.

The issue gets even more pressing as we introduce the Goods and Services Tax (GST). This, coupled with the potential removal of subsidies will disproportionately affect the lower income group.

The IMF<sup>55</sup> has given a list of measures that can be adopted to tackle net inequality (see Appendix). We will only deal with a few here but we are conducting research on all of them.

Set out below are examples of cash transfers from other countries:

### **Singapore<sup>56</sup>**

Comcare Transition Scheme: Monthly cash, educational, medical assistance and/or utility vouchers to households earning below SGD1,700. For households in the bottom 20%, the Singapore government tops up 90 cents for every SGD1 a household earns.

Workfare Income Supplement Scheme: Quarterly cash payment of up to SGD3,500 annually to supplement wages and retirement savings of older low-wage workers earning below SGD1,900.

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<sup>55</sup> IMF (2014)

<sup>56</sup> Ministry of Social and Family Development, Singapore

**Norway<sup>57</sup>**

Financial assistance: Applicable to those who show proof of their inability to support themselves.

Family-related benefits: Various target groups and rates; broken down to numerous categories ie pregnancy, birth and adoption, child benefits, single mother/father, and child support.

**The United States<sup>58</sup>**

Supplementary security income, earned income tax credit, and temporary assistance for needy families.

**The United Kingdom<sup>59</sup>**

Income support and working tax credit.

**Cash transfers are not new**

BR1M is the most familiar form of cash transfer, but it is not the first. We have a history of doing this, for example:

- Skim Bantuan Kebajikan under the Social Welfare Department (JKM) provides cash transfers to low-income families. The programme targets the elderly, single mothers, children and disaster victims. Payments range from RM150-RM500 per month.
- The Ministry of Education provides cash transfers for primary and secondary school students through its Kumpulan Wang Amanah Pelajar Miskin<sup>60</sup> (KWAPM). Payments range from RM200-RM900 per year.

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<sup>57</sup> Norwegian Labour and Welfare Administration, Norway

<sup>58</sup> The United States Social Security Administration

<sup>59</sup> The United Kingdom Government website

<sup>60</sup> MoE website

BR1M is far more ambitious and seeks to cover all households earning less than RM4,000 per month and singles over 21 who earn less than RM2,000 per month.

**Table 10: BR1M Payments and Total Costs<sup>61</sup>**

	2012	2013	2014
Payment to households earning < 3k per month	RM500	RM500	RM650
Payment to households earning 3k - < 4k per month	-	-	RM450
Payment to 21 year old singles earning < 2k per month	-	RM250	RM300
Total no. recipients (households and singles)	3.4m	7.0m	6.9m
Total govt expenditure	RM1.8b	RM3.0b	RM4.6b

In 2014, 4.6 million households and 2.3 million single individuals received BR1M payments. As of 2012 however, only 4.2 million households had an income of less than RM4,000 per month. It would appear that improvements can be made in targeting the delivery of this assistance.

<sup>61</sup> MoF (2014)

## Corporate welfare

Chart 20: Government Subsidy Expenditure for LPG, Diesel and Petrol 2000-2013 (RM b)<sup>62</sup>

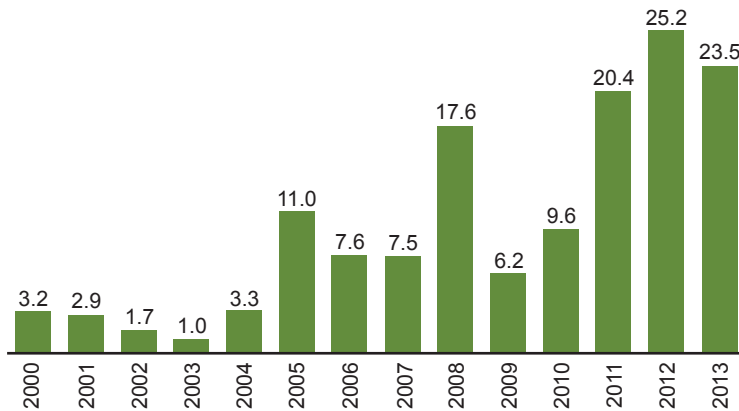
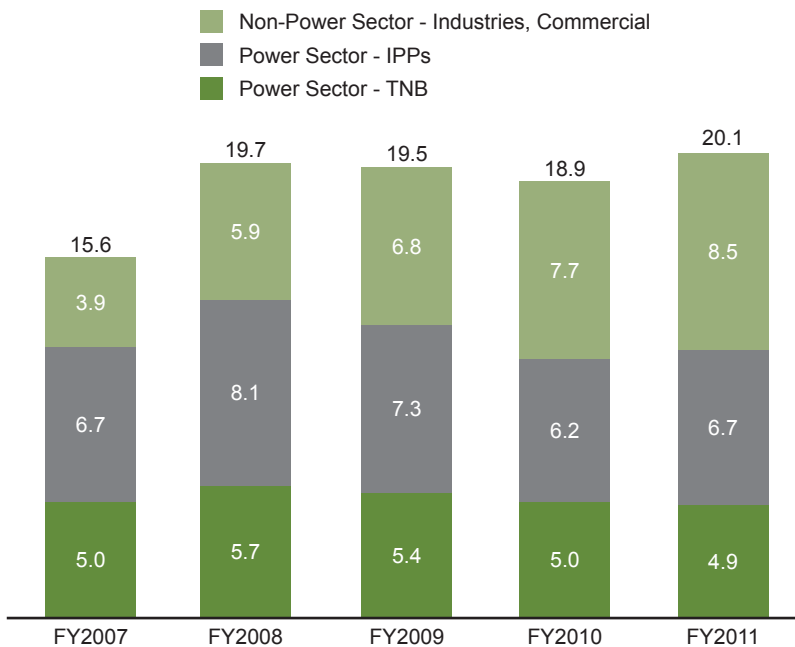


Chart 21: Gas Price Subsidies in Malaysia by PETRONAS (RM b)<sup>63</sup>



<sup>62</sup> Ilias, Lankanathan and Poh (2012), Budget 2015

<sup>63</sup> World Bank (2013b)

We spend a huge amount on petroleum and other subsidies.

We estimate that in 2013<sup>64</sup>:

- less than 23.8% (RM5.6b) of the entire fuel subsidy went to households and the remaining RM17.9b or more went to businesses, corporations and elsewhere.<sup>65</sup>
- less than 20% (RM4b) of the gas subsidy (through PETRONAS) went to households and the remaining RM16b or more went to businesses, corporations and elsewhere.<sup>66</sup>
- only 22% of the entire energy subsidy went to households.

On average each household receives an annual subsidy of RM625 per year for electricity and RM885 per year for fuel. But, most of this is enjoyed by the high-income households, who get about 80% of the subsidies<sup>67</sup>.

Subsidies are regressive. Most subsidies go to businesses rather than households. Of what goes to households, the high-income group benefits the most – a household that only has a motorcycle and ceiling fans enjoys far less subsidy than a multiple-car and air-conditioned household in Damansara Heights.

Table 11 demonstrates how petrol subsidies favour the better-off. As motor-vehicles get more expensive, from a motorcycle to a German saloon, the subsidy the owner gets per 1,000 kilometres increases dramatically.

<sup>64</sup> These calculations were made prior to the petrol price increase of 20sen on October 2 2014 and based on the total fuel subsidy expenditure in 2013, as described in the Economic Report 2014/15. This is due to the unavailability of data on the total fuel subsidy expenditure in 2014.

<sup>65</sup> DoS (2011b), KRI calculations

<sup>66</sup> TNB (2012), KRI calculations

<sup>67</sup> NEAC (2010)

**Table 11: Vehicles by Specifications and Total Fuel Subsidy<sup>68</sup>**

Vehicles under 2 litres	Fuel tank (litre)	Fuel consumption (km/litre)	Fuel consumed for 1,000km (litre)	Cost of RON95 for 4 full tanks/ month (RM) prior to petrol price increase <sup>69</sup>	Subsidy value for 1,000km (RM) prior to petrol price increase <sup>70</sup>	Subsidy value for 1,000km (RM) post-increase <sup>71</sup>
Honda EX5	3.7	53.6	18.7	38.0	8.8	5.0
Viva 660	36.0	22.0	45.5	370.1	21.4	12.3
Viva 1.0	36.0	18.7	53.5	370.1	25.1	14.4
Saga SV	40.0	16.0	62.5	411.2	29.4	16.9
Myvi 1.3	40.0	16.3	61.3	411.2	28.8	16.6
Vios 1.5	42.0	15.0	66.7	431.8	31.3	18.0
BMW 318	63.0	12.0	83.3	647.6	39.2	22.5

## Reforming the fuel subsidy system

Reform is required. In addition to being regressive, the current system:

- *creates distortions in the economy*: Subsidised prices do not reflect the actual cost, and create a deadweight loss in the economy, ie wastages that cannot be reclaimed. The money spent for subsidies could have been better allocated in more productive sectors that improve economic growth or development projects that are better-targeted at helping vulnerable groups.

<sup>68</sup> Official websites of the distributors: Boon Siew Honda, Perodua, Toyota, BMW, assisted with data from the Automobile catalogue and the Autoworld Forum.

<sup>69</sup> The calculation is based on the actual price of RON95 at RM2.57/litre, as published in petrol stations on September 30 2014.

<sup>70</sup> Calculations made prior to the petrol subsidy reduction of 20sen on October 2 2014. Subsidy rate was 47sen/litre for rate RON95.

<sup>71</sup> Calculations made after the petrol subsidy reductions of 20sen on October 2 2014. Subsidy rate is 27sen/litre for RON95, assuming no change in the actual price ("harga sebenar") of RON95 as it was yet to be announced at time of writing.

- *encourages wastage*: We have one of the highest fossil fuel (oil, gas, coal) consumption subsidies per person in Southeast Asia. Among non-OPEC members, Malaysia is ranked fourth in fuel subsidies per person. The under-priced fuel distorts resource allocation by encouraging excessive energy consumption. Malaysia's ranking in share of energy usage in the transport sector is already excessive – we are only second to China. Further, our per person carbon dioxide emission was 114% higher than the average for countries in East Asia and Pacific and 88% higher than the global average for middle-income countries.<sup>72</sup>
- *is costly*: Fuel subsidies can come at a high price, both in the actual expenditure and its economic cost. The cost of subsidising fuel will continue to be a burden, especially if energy prices keep on increasing. Without a reform in subsidies, our fiscal cost will continue to rise. This would mean less allocation to other important areas of government spending.
- *promotes criminal behaviour*: It has been reported that 10% of fuel is smuggled out of the country, equivalent to an outflow of RM660m, and about 230 petrol stations are suspected to be involved. Between 2007 and April 2014, the government recorded around 3,500 cases of diesel smuggling.<sup>73</sup> Smuggling and associated criminal acts require the government to spend more on law enforcement.<sup>74</sup> Worst of all, criminal activity on this scale corrupts all who come in contact with it.
- *encourages 'fuel tourism'*: Drivers in Singapore and Thailand cross the border to refuel, exploiting the petrol price differences.

Reform must be done gradually, and it should be simple, progressive, discourage leakages and excess consumption, and maximise savings to the government.

In our subsequent reports we will investigate the gradual replacement of fuel subsidies with targeted cash transfers. Compared to all other means of subsidy reform, they are the most optimal.<sup>75</sup>

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<sup>72</sup> World Bank (2013b)

<sup>73</sup> The Star (May 2014)

<sup>74</sup> EPU (2005)

<sup>75</sup> Clements et. al. (2010), IMF Energy (2013), IMF (2011)



# SECTION

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# 03

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## THE MALAYSIAN WORKFORCE

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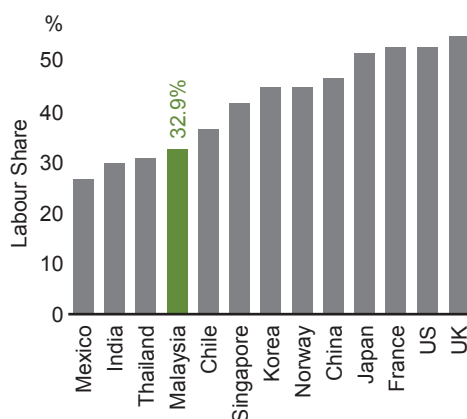
# THE MALAYSIAN WORKFORCE

## Low pay, high profits

**Table 12: Salaries and Benefits, % of EBITDA across Countries<sup>76</sup>**

Country	Index	Salaries and benefits, % EBITDA
Malaysia	FBMKLCI	37.7%
Indonesia	Jakarta Composite Index (JCI)	38.9%
Thailand	SET Index	44.8%
Singapore	Straits Times Index (STI)	63.3%
UK	IPSA Index	65.3%
Chile	FTSE 100 Index	68.9%

**Chart 22: Share of Salaries and Wages, % GDP in 2011<sup>77</sup>**

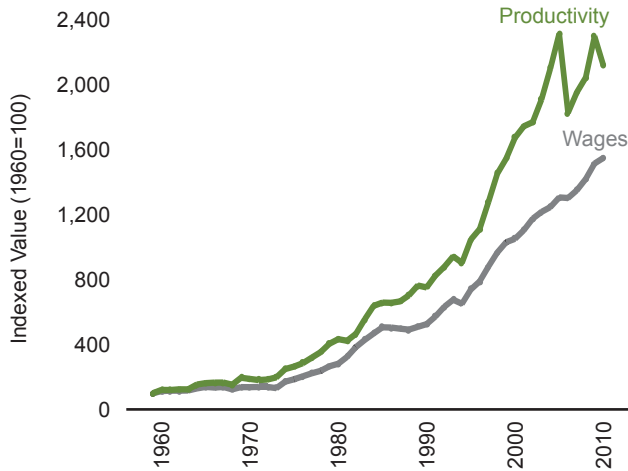


As an economy, we reward shareholders better than workers – and that is after including CEO salaries as workers’ salaries.

There is no iron-clad rule on what the right share is between labour and capital. What is clear, however, is that our businessmen are better than others in getting a bigger share.

<sup>76</sup> Bloomberg, KRI calculations

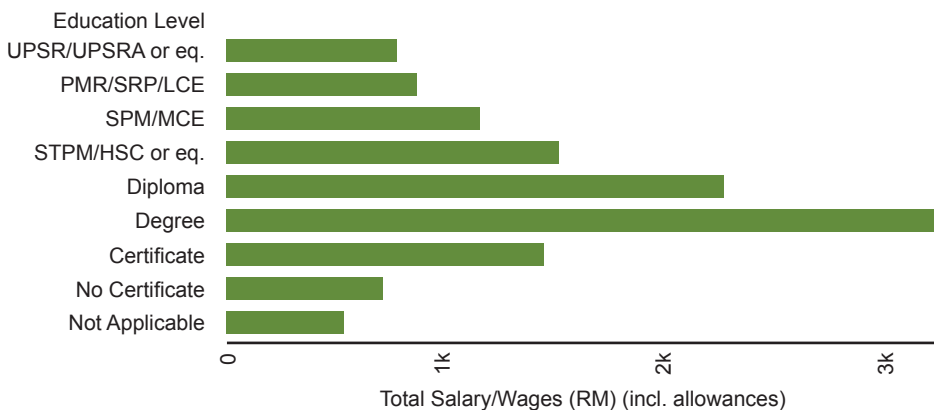
<sup>77</sup> ILO Global Wage Database (2011) except Malaysia (DoS) & Singapore (DoS)

**Chart 23: Growth of Wages and Productivity<sup>78</sup>**

Even when our productivity increases, wages do not increase in tandem. It is symptomatic of the lack of bargaining power of low-skilled labour and our over-reliance on low cost as a competitive advantage.

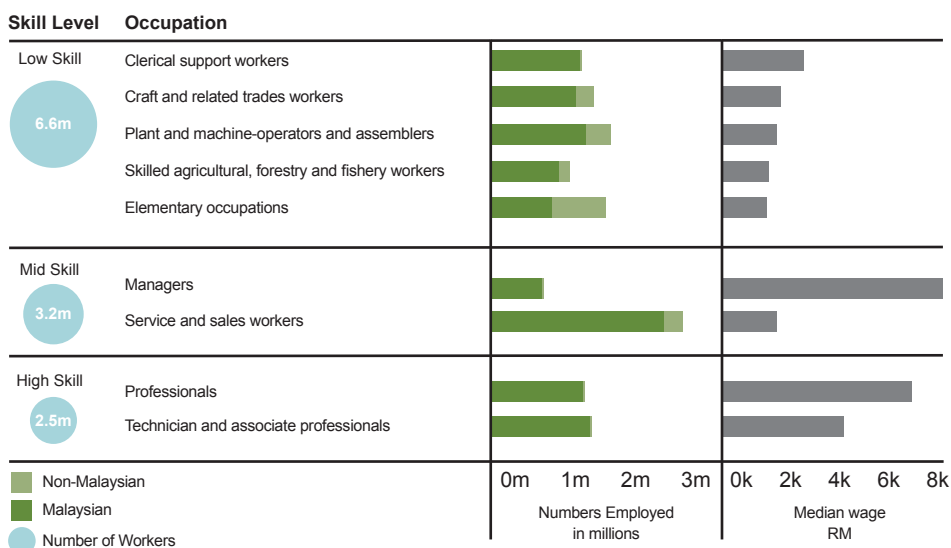
### Our workforce

We had a workforce of 12.3 million employed persons in 2011, of which 1.7 million (13.8%) were migrant workers. By 2013, this had grown to 13.2 million, with 1.76 million (13.4%) legal migrant workers.

**Chart 24a: Median Salary/Wages by Education<sup>79</sup>**

<sup>78</sup> DoS (2013b, 2013c), KRI calculations

<sup>79</sup> DoS (2013b, 2013c)

**Chart 24b: Median Wages and Employment by Occupation<sup>80</sup>**

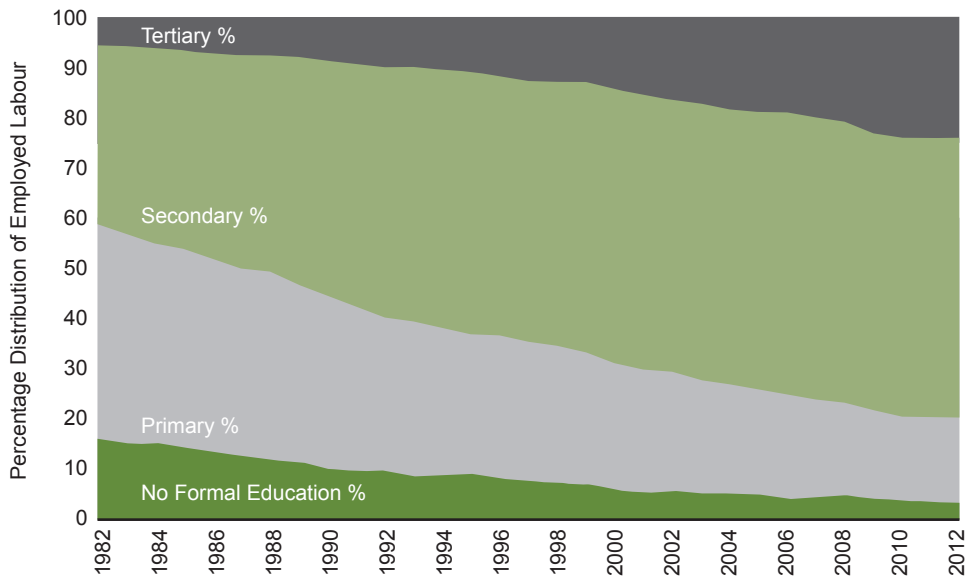
Our workforce is relatively low-educated – jobs with the highest pay (managers and professionals) absorb the least number of workers compared to low-paying jobs such as service and sales.

<sup>80</sup> DoS (2013b, 2013c). Skill levels as defined in World Bank (2012)

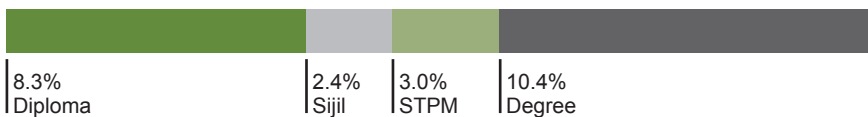
## How educated are our workers?

The proportion of tertiary educated workers has increased.

**Chart 25: Educational Attainment in the Workforce 1982-2012<sup>81</sup>**



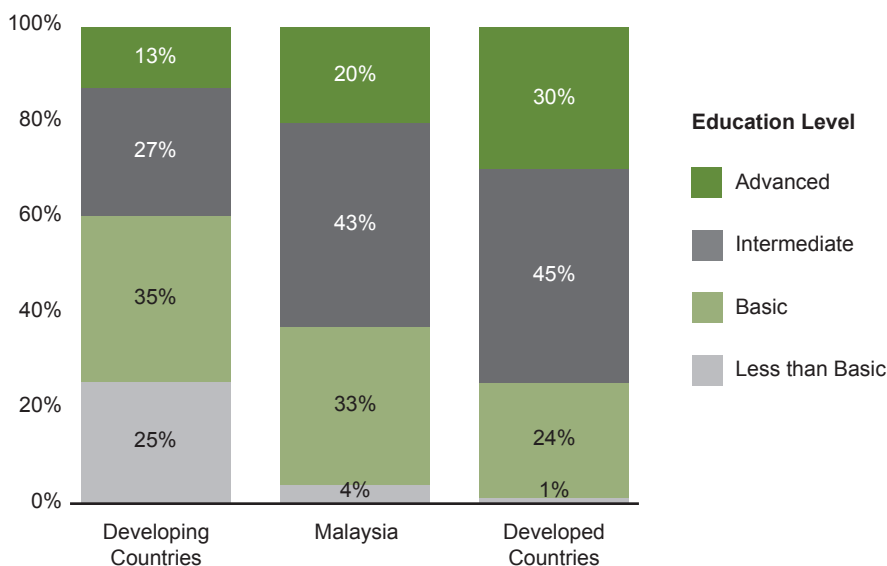
However in 2012, out of the 24% of the workforce with tertiary education, only 10.4% were degree-holders.



As we will see, this lack of education of the overwhelming majority of our workforce is one of the most important causes of our low wages and low household incomes. While, for statistical purposes, we count anyone who has passed STPM and has a certificate (no matter what the course or how short it is) as having a tertiary education, he or she is not the same as a graduate.

<sup>81</sup> DoS (2013b, 2013c)

**Chart 26: Highest Level of Education Attained in the Workforce: Grouped country comparison in 2012<sup>82</sup>**



### Unemployed graduates

Despite the high demand for graduates (as demonstrated by the higher salaries they get), a substantial proportion of graduates are unemployed. It would seem that there is a discrepancy between the skills they have and the skills employers desire.

<sup>82</sup> ILO (2012) LABORSTA database

a) Developed countries are classified according to the definition of “Advanced Economies” by the IMF. Developing countries include all countries that are not part of Advanced Economies. Data for Japan’s educational workforce above basic level is not available. Data for the US and South Korea are not available.

b) Level of education refers to the highest level completed, classified according to the International Standard Classification of Education (ISCED). Education levels have been normalised across countries. Less than Basic indicates no formal education, Basic: primary level education; Intermediate: secondary level; and Advanced: post-secondary.

**Table 13: Employment Status of 2012 Graduates<sup>83</sup>**

Employment Status	Institut Pengajian Tinggi Awam	Institut Pengajian Tinggi Swasta	Polytechnic	Community College	Technical and Vocational Training Institution
Employed	47.4%	56.7%	51.9%	60.3%	48.7%
Pursuing further study	20.8%	8.7%	21.1%	20.2%	21.7%
Upgrading skills	1.6%	1.2%	1.7%	0.9%	0.9%
Waiting for work placement	5.5%	4.6%	1.4%	1.0%	2.0%
Unemployed	24.7%	28.8%	23.9%	17.6%	26.7%

### Our economy needs migrant workers

*“... many sectors of the Malaysian economy are based on foreign workers supervised by secondary-school educated Malaysian workers.”<sup>84</sup>*

From 1990 to 2011, migrant labour as a proportion of total employed persons grew from about 240,000 to 1.7 million workers. Almost all of them (95%) are unskilled<sup>85</sup>. According to a news report<sup>86</sup> there is an equal number of undocumented or illegal migrant workers.

We should not however be xenophobic.

Theory predicts that migrant labour has a substitution effect (it displaces native workers) and a scale effect (with more migrant workers output expands, thus creating jobs for natives).

As Table 14 shows, the scale effect has overwhelmed the substitution effect. Overall migrant workers have been good for creating jobs for native workers. The exception to this however are native workers who only have primary education or lower, who are then displaced by unskilled migrant workers.

<sup>83</sup> MOHE (2013)

<sup>84</sup> Ozden and Wagner (2014)

<sup>85</sup> ILMIA and World Bank (2013)

<sup>86</sup> Bernama (2014)

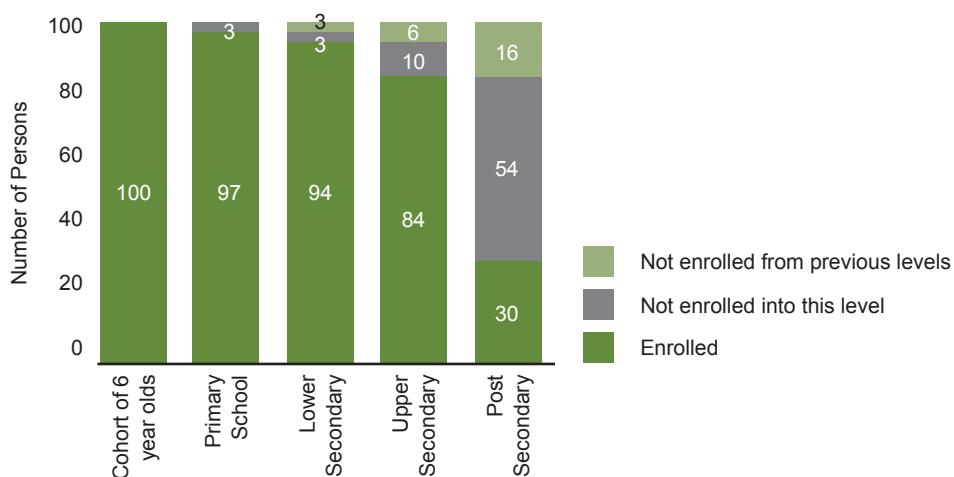
**Table 14: Effect of Migrant Workers Hired on Native Jobs and Wages<sup>87</sup>**

Education Level	Native jobs created/lost for every 10 new migrant workers hired	For every 10% increase in the number of all migrant workers, native wages increase <sup>a</sup>
Native workers with primary education or less	-3.0	-0.71%
With lower secondary (PMR)	1.6	0.38%
With upper secondary (SPM)	3.1	0.26%
With a Certificate/Diploma	0.5	0.00%
With a Degree or above	0.0	0.00%
<b>Net effect</b>	<b>2.2</b>	<b>-0.07%</b>

<sup>a</sup> As at 2010, this would mean an increase of 130,000 migrant workers.

## 1 in 6 children do not get to Form 4 ...

... and out of those who do, the large majority do not continue to post-secondary education.

**Chart 27: Out of Every 100 Children in a Cohort of 6 Year Olds ...<sup>88</sup>**

<sup>87</sup> Ozden and Wagner (2014)

<sup>88</sup> MoE (2013)



We have to keep our children in school. Programmes like the Yayasan AMIR trust schools show that if schools are given administrative autonomy, they can keep children motivated and in school (and give remedial classes if needed).

**Table 15: Secondary Schools and TVET Numbers and Enrolment<sup>89</sup>**

Type of school	No. of schools	Students enrolled
Secondary schools	2,340	2,296,189
TVET	88	40,917

Out of the government school students who enrolled in SPM, 91% passed their SPM examinations<sup>90</sup>, but only about 36% (30 out of every 84 students) of those who start Form 4 go on to post-secondary education.

Our education system has to provide alternatives for those who do not want to go on to university. We need to expand our TVET (Technical and Vocational Education and Training) and give our children a chance to learn a trade or skill starting from Form 4. At the public secondary school level, we have more children in government-aided religious schools (61,818) under the MoE than we have in technical and vocational schools (40,917)<sup>91</sup>.

The Education Blueprint contains these recommendations and more. We must implement it faster and not wait 12 years.

<sup>89</sup> MoE (2013)

<sup>90</sup> World Bank (2013a)

<sup>91</sup> MoE (2013)

## Youth and Serious Crimes in Malaysia

### Profile of a youth criminal<sup>92</sup>:

**Age: 21-30 | Gender: Largely male | Ethnicity: 63% Malay, 26% Indian, 6% Chinese, 5% Others | Type of crime: Robbery, snatch theft, rape | Education level: Approximately 80% have at least some form of secondary education (not necessarily up to Form Five or with a SPM certificate), while 10% have at most a UPSR certificate | Parents: Low income, majority both working | Residence: Low cost housing**

*The following is the profile of a young male from the Klang Valley who is involved in serious crimes:<sup>93</sup>*

He would be one of a few siblings in a family that lives in a working-class neighbourhood, especially low-cost, high-rise public housing projects. Both his parents would be working, clocking in long hours. In primary school he would be an average student, but he would stay in school and even be involved in extracurricular activities.

In secondary school however, he would find that studies are difficult to cope with, or simply uninteresting. Committing truancy would be easy, as fake medical certificates are easily obtained and the school does not call his parents to report his constant absenteeism.

His parents would advise him repeatedly to stay in school and study hard, but there would be other things on his mind: joining friends to play video games or picking up smoking and gambling. Eventually, drugs would enter the picture, at first recreationally and then, to give him the ability to numb the fear of committing armed robbery. His friends would demonstrate to him how it is done and snatch a handbag or necklace from someone on the street. Then, he will be asked to join in on a trial “mission.”

If he gets a job, he will find the pay is too low to accord him the lifestyle he wants. So, armed robbery and theft would become his source of income. His parents would advise him to stop or in some cases, even tolerate his behaviour as long as it means he does not run away from home.

The day comes that he is caught and sentenced to prison. When asked why he did not stay in school, he would say “tak minat”, “suka main dekat luar” or simply, “apa yang diajar memang tak boleh masuk.”

<sup>92</sup> Prisons Dept. (March 2014), which states the breakdown of male inmates at Kajang Prison (21-30 years old) sentenced for involvement in serious crime.

<sup>93</sup> Preliminary analysis of a study on ‘Action Research on Serious Crimes and Youths in Malaysia’, UKM-KITA, 2014.

### Low wage equilibrium

Malaysian employers generally hire low- to semi-skilled workers ie those who have at most a secondary school education. Our workforce matches this – the vast majority is not educated beyond Form 5.

Until we change this model, the wealth and income inequality that we find in our country will persist. The majority will have low-paying to semi-skilled jobs and low household incomes. A minority, those who are better-educated, have better skills, or have accumulated capital, will continue to prosper.

We risk being overtaken by less developed countries, like Vietnam and Indonesia, who will be even lower-cost than us, offering lower wages and the same level of skill.

We cannot keep to this model much longer. To break out of this we need to address both the supply of skilled labour and the demand.

As we have seen, on the supply side we must take measures to:

- *keep children in school.* Those who drop-out end up with the worst paying jobs, competing with unskilled migrant workers. They are likely to feel the most disenfranchised and disconnected from society.
- *improve and extend TVET to cover all those who do not go to university.* Germany for example has a much admired apprenticeship system where students as young as 16 can learn a trade or skill and then move on to full time employment as a skilled and well-paid worker. We may not be able to adopt this in its entirety, but we have to develop a Malaysian version of it.
- *make our graduates more employable.*

On the demand side, we have to promote industries that create high-paying jobs. We have to stop promoting industries that only create low-paying ones, particularly those industries that are reliant on migrant unskilled labour – even if they appear to add exports or GDP.

# SECTION

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# 04

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## TRADE AND INVESTMENT POLICIES

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# TRADE AND INVESTMENT POLICIES

## Promoting the right investments

Despite stiff competition from rivals China and Vietnam, Malaysia set a new record of RM216.5b worth of approved direct investments in 2013.<sup>94</sup>

We promote investments, particularly Foreign Direct Investment (FDI), by providing among others :

- tax incentives
- grants
- subsidised power and fuel
- cheap water
- access to unskilled foreign workers.

We have to be discerning in what investments we promote. Our policies should only promote industries that, amongst others:

- are value added
- employ skilled high-paid domestic labour
- have deep linkages to the rest of the economy and create high value jobs in the rest of the economy
- provide technology transfer and skills training
- do not degrade the environment
- make the best use of our scarce natural resources.

Our investment approval process should have rigorous and detailed checklists to ensure this. We must also follow up and ensure that the investors keep to the pre-approved commitments.

We are developing these checklists as part of our continuing research into this area.

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<sup>94</sup> MIDA (2014)

### **It's the value-added**

The value of iPhones exported from China to the US are counted as Chinese exports. In fact the components of an iPhone come from nine companies located in China, Korea, Japan, Germany, and the US.<sup>95</sup> It is misleading to count its value as the total value of Chinese exports to the US.

The Trade in Value-Added (TiVA) analysis is a new methodology to calculate and analyse the value-added of trade activities in a country. Using the TiVA analysis, it is estimated that the assembly activities in China only contribute to 3.6% of the total cost of iPhones exported from China to the US.

The new methodology is granular. It provides a more accurate understanding of bilateral trade imbalances, the employment content of trade, and a country's true competitiveness position, among others.

Our trade policy must be based on TiVA; not on increasing the headline trade numbers. We are conducting research on this now. We have to only promote trade that is in the right part, ie the high-value part of the value chain. High value-added products require skilled and high-paid labour.

### **The losers from free trade**

There are winners and losers in any country (including Malaysia) as a result of a Free Trade Agreement (FTA).

For instance, exporters are commonly the beneficiaries as post-FTA they enjoy greater market access in the other FTA partners' markets.

It is the import-competing market players – especially the SMEs that tend to lose out. Of greater concern are the workers in these companies who may be forced out of their jobs and are unlikely to find similar jobs locally.

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<sup>95</sup> Xing and Detert (2010)

The US, the EU, Korea and others have recognised the need for a trade adjustment assistance programme to assist such trade-dislocated workers. In the case of the US, their FTAs are typically ratified by the Congress together with separate Trade Adjustment Assistance Acts as different FTAs may affect workers in different industries or sectors.

Trade adjustment assistance programmes come with a cost. The US Department of Labor distributed a total of USD756m for the programme in 2013 while the EU provided a maximum annual budget of EUR150m for the period 2014 to 2020.<sup>96</sup>

Our research is looking at:

- how to quantify the effect on an FTA on the ‘losers’
- the type of trade assistance programme we need; bearing in mind the dangers of it being turned into yet another subsidy.

## RCEP

Malaysia is currently participating in two ‘mega’ FTAs negotiations: the Trans-Pacific Partnership Agreement (TPPA)<sup>97</sup> and the RCEP<sup>98</sup> (also known as ASEAN+6). Malaysia should focus on the RCEP as it benefits Malaysia more.

The major reason for becoming a Party to an FTA is to gain as much market access as possible in the other Parties for trade in goods and services as well as investment.

<sup>96</sup> Arirang News (2014), US Department of Labour (2014) and European Commission (2014)

<sup>97</sup> The current TPPA countries are Australia, Brunei Darussalam, Chile, Japan, Malaysia, Peru, Singapore, the US, Vietnam, Mexico, Canada and New Zealand.

<sup>98</sup> The RCEP countries are the ten ASEAN Member States (Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand and Vietnam) and six other countries with existing FTAs with ASEAN - Australia, China, India, Japan, Korea and New Zealand.

Malaysia stands to gain more from its RCEP partners than its TPPA partners:

- The RCEP market is geographically more relevant for Malaysia – important in terms of managing the transaction costs for businesses and investors.
- China and Korea will have to commit to greater tariff liberalisation for goods in the RCEP, thus providing greater market access for Malaysian products.
- The RCEP will encourage more FDI for Malaysia from China and Japan thus reversing the shrinking trend in the FDI stock from these countries.
- The RCEP is expected to complement ASEAN's efforts in becoming a single production base, thus ensuring that Malaysia is in the investment radar of investors.

### Does the government know best? Does business?

*"In a society that respects business success; political leaders will inevitably and rightly seek the advice of business leaders on many issues, particularly those that involve money. All we can ask is that both the advisers and the advisees have a proper sense of what business success does and does not teach about economic policy ...*

*... A successful business leader is no more likely to be an expert on economics than on military strategy."*<sup>99</sup>

The Anglo-American view is that government has no business in business. Government should only be concerned with "peace, easy taxes and a tolerable administration of justice" and let free markets do the work. The last thing a government should do is pick winners.

Fortunately, that consensus no longer seems to hold.<sup>100</sup>

<sup>99</sup> Krugman (1996)

<sup>100</sup> The main text of this section, including quotations, summarise Wade (2010). The quotations are from that work. Stiglitz and Greenwald (2014) is a recent example of this. This work also talks of the importance of developing a learning society, which leads to innovation and increased productivity. These are subjects that we are conducting more research on.



The reality is that the world is not open. Few countries move up but many, especially those in the middle income category, move down.

Countries like Malaysia can get caught in a ‘middle technology trap’: “their firms stuck in the relatively low value-added segments of global production chains, unable to break into innovation-intensive activities or into the market for branded products, where the high profits are to be made.” So, our export value-added has stagnated; FDI factories have few domestic linkages; and domestic innovation has increased little despite higher R&D spending. Liberalisation does not necessarily lead to accelerating growth.

Nor does ‘investor-friendly’ regulation. Foreign businessmen “may judge any state regulation of their activities to be ‘growth inhibiting’”. As Korea demonstrates, ‘red-tape’ can be deliberate – it can be used to slow down an FDI-business if the state feels that it will help locals to catch up.

The growing view is that industrial policy can be successful and desirable. It can be ‘leadership’ as when Korea created POSCO, now a leading steel company. Or it can be ‘followership’ – ‘nudging’ private companies to extend their capabilities and FDIs to use domestic suppliers.

Our research will look at what our industrial policy should be and how it should be monitored – learning the lessons of our past and bearing in mind the risks of policy being captured by special interest groups.

# SECTION

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# 05

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## CONCLUSIONS AND PRELIMINARY POLICY RECOMMENDATIONS

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# CONCLUSIONS AND PRELIMINARY POLICY RECOMMENDATIONS

## Conclusions

1. Inequality of income, wealth and access to physical infrastructure is a matter of concern. There is inequality across the population (by ethnicity and gender) and by geography (state, urban vs rural).
2. The northern states of Peninsular Malaysia are underdeveloped economically and in terms of basic infrastructure, especially water and sanitation.
3. Food prices are rising and we should find out the causes and how to address them. There is an urgent need to relook at the incentives, licenses and permits for food products.
4. By international standards our housing is not affordable. Resolving this is complex and needs further research. Current interventions are insufficient to allow average Malaysians to purchase a home.
5. The cost of consumer debt is unjustifiably high and reform is needed. Low-income households pay much higher interest than others.
6. There is scope for subsidy reform as currently the main beneficiaries of subsidies are businesses rather than households. Of that which goes to households, high-income households benefit the most.
7. Generally, our workforce is not well-educated and our companies rely on cheap labour, which places us in a low-wage equilibrium.
8. Most of our workers are low- or medium-skilled. Their salaries and wages reflect this and hence their low household incomes.
9. Migrant workers are a symptom of our underlying employment structure, rather than a cause of low wages.

10. Education reform, as set out in the Education Blueprint, has to be implemented as a matter of urgency. In particular, we have to keep children in school and expand and improve TVET. Those who drop out end up with the worst paying jobs, competing with unskilled migrant workers. They are likely to feel the most disenfranchised and disconnected from society.
11. Our trade and investment policy should be coordinated and aimed at promoting value-added, high-income job creating industries.

### **Preliminary policy recommendations**

1. We must put households at the centre of our economic policy. Driving economic growth is important. But so is ensuring the growth in the income of the majority of households – the bottom 74%; and not just growth in corporate profits and the incomes of the wealthy. We are heartened that the Prime Minister in his 2015 Federal Budget speech said that the “people economy” is the “bedrock in prioritising the interests of the rakyat” (“paksi dan pegangan dalam mendahulukan kepentingan rakyat”). Our policy recommendations complement this.
2. Fuel subsidies should gradually be replaced with targeted cash transfers. The Khazanah Research Institute will be publishing a more detailed policy recommendation on this.
3. We need to provide truly affordable housing. The Khazanah Research Institute will be publishing a series of reports and policy recommendations on how to achieve this.
4. We need to prioritise the development of the northern states. Water and sanitation must be improved. The corridor initiatives must look at raising household incomes.

5. We must immediately make it compulsory to prominently advertise the true APR and teach basic financial literacy in schools. The various agencies and ministries responsible for consumer finance must act in a coordinated way to protect the interests of consumers.
6. We must vigilantly enforce competition law. We cannot afford monopolists (middlemen or permit holders) in the food supply chain. The Khazanah Research Institute will be publishing research and policy recommendations on this and on food security.
7. We must accelerate the implementation of the Education Blueprint, ensure that children stay in school, and expand and improve TVET.
8. We should concentrate on RCEP, the FTA which is the most beneficial.
9. Our trade and investment policy must be geared to promoting industries that are high value-add and create high-paying jobs, not just headline export and investment numbers. The Khazanah Research Institute will be publishing research and policy recommendations on trade and investment policy.

## IMF REDISTRIBUTION POLICY OPTIONS

### Social spending

- Improve fiscal sustainability of existing pension systems through increasing statutory retirement ages.
- Tighten link between contributions and benefits.
- Expand non-contributory means-tested social pensions.
- Expand means-testing of family benefits with stronger link to work.
- Intensify use of Active Labour Market Programs (ALMPs) and in-work benefits for social benefit recipients.
- Develop unemployment savings accounts.
- Consolidate social assistance programmes and improve targeting.
- Replace general price subsidies with targeted transfers.
- Expand conditional cash transfer programmes as administrative capacity improves.
- Improve design of public works programmes as a safety net instrument.
- Improve access to education of low-income families.
- Increase private financing of tertiary education.

- Maintain access of low-income groups to essential health services.
- Expand coverage of publicly financed basic health package.

### Taxation

- Implement progressive Personal Income Tax (PIT) rate structures.
- Relieve low-wage earners from tax or social contributions.
- Expand coverage of the PIT.
- Reconsider income tax exemptions, based on a critical tax-expenditure review.
- Impose a reasonable PIT exemption threshold.
- Tax different types of capital income in a neutral manner.
- Develop more effective taxation of multinationals.
- Automatically exchange information internationally.
- Utilize better the opportunities for recurrent property taxes.
- Examine scope for more effective taxes on inheritances and gifts.
- Minimize VAT exemptions and special VAT rates.
- Set a sufficiently high VAT registration threshold.
- Use specific excises mainly for purposes other than redistribution.

- *Denotes policies applicable for developing countries*

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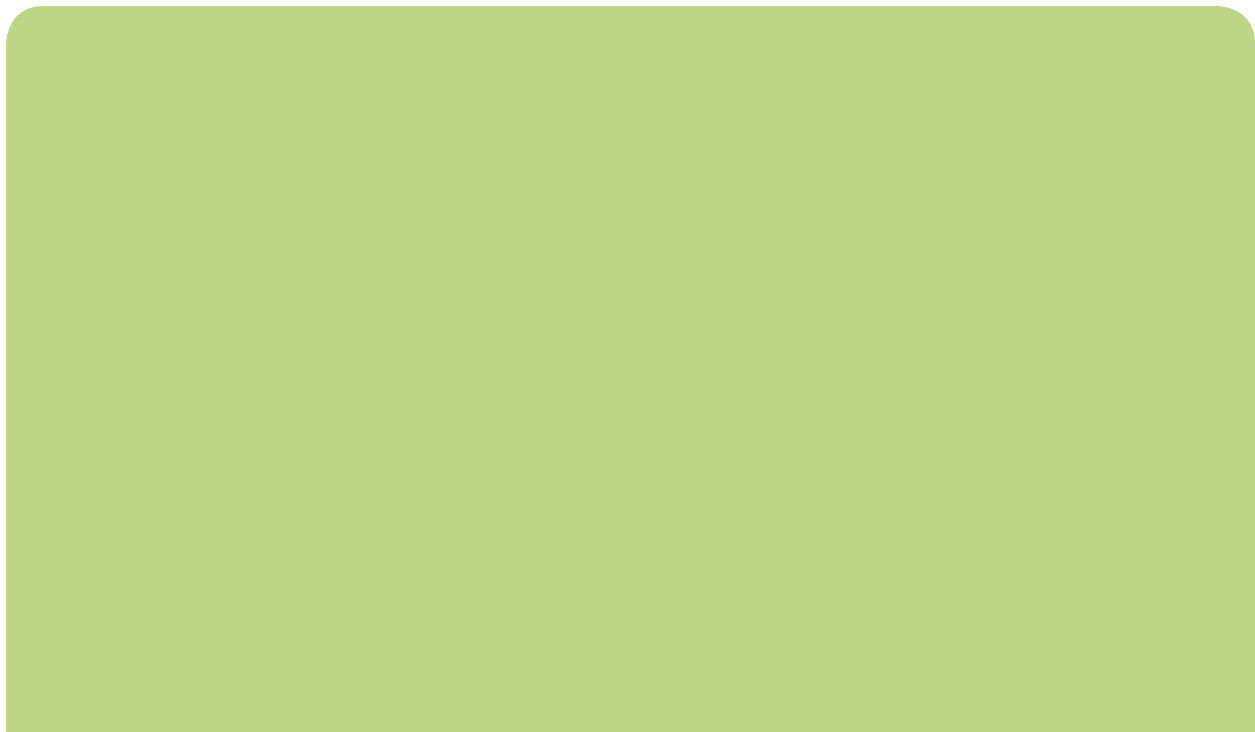
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