REFSA BRIEF

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Rethinking Malaysia's Income Reclassification

Not B40, but B20

Darshan Joshi, *Lead Researcher* **darshan@refsa.org**

Executive Summary

- The idea that 40% of developing country populations live in poverty dates back to the 1970s.

- The classification of income groups in Malaysia into the B40/M40/T20 builds on this idea and was formally embraced in 2006.

- Following up on recent research conducted by Khazanah Research Institute, this paper presents further evidence of the existence of a B20 in Malaysia, rather than a B40, who are distinct to, and significantly lagging behind, their counterparts in the middle- and upper-classes.

- With this in mind, we propose that the Malaysian government **target and extend its welfare policies to the B20** specifically, and **focus on policies which can empower individuals and households in the middle-class** to boost their economic security.

- Some examples of such policies include the provision of affordable housing, healthcare, and transport, and measures which attract and create higher-skilled and better-paying jobs in(to) Malaysia.

Introduction

> *"Approximately 40% of their populations [...] are neither contributing significantly to economic growth nor sharing equitably in economic progress [...] this is absolute poverty [...] a condition of life so common as to be the lot of some 40% of the peoples of the developing countries."*
>
> – Robert McNamara, World Bank President, 1970

Malaysia in the 1970s was not exempt of the problem described by McNamara, with a reported poverty rate of over 50%. In recognition of the issue, Malaysia's New Economic Policy issued a variety of poverty eradication measures and had, by the early 2000s, contributed to a curtailment of the hardcore poverty rate to under 4%[1]. Yet, this emphasis on a left-behind 40% of the population never dissipated, and the Ninth Malaysia Plan of 2006 put into writing the classification of income in Malaysia into three distinct classes: the B40, M40, and T20.

This particular nomenclature has persisted until today, despite the decade-and-a-half of development that has since brought tremendous change to Malaysia's economy, its labour market, and aggregate national wealth. These classifications are important, too; they are used to determine the recipients of state welfare provisions, for instance through 'Bantuan Sara Hidup' (BSH) grants, which alone are budgeted to come at a cost of RM5bn to the government in 2020[2]. But is it effective and efficient to extend welfare to almost half of the population on the basis of income classifications developed at the start of the century, which were in turn inspired by comments 50 years ago? It is imperative that social welfare policies, such as the BSH, are fine-tuned to assist the neediest in Malaysian society[3].

The goal of this briefing is to determine **whether these three income subgroups still accurately reflect the state of income classes in Malaysia today – and if not, what the revamped arrangement should be**. In order to do this, we must analyse national income levels.

An Overview of Malaysia's Income Distribution

Figure 1 presents Malaysia's national income distribution, along with a broad view of the two key shifts policymakers should seek to engender over time. Several features of the distribution are worth discussing. First, consider that Khazanah Research Institute (2018) finds that households earning under RM2,000 spend virtually all their disposable income on basic consumption items. This leaves almost a tenth of Malaysian households without the ability to invest or save, which – in the absence of steady and significant wage growth – are crucial determinants of longer-run financial wellbeing and upward mobility. These households would benefit greatly from the provision of welfare, in both the short- and long-term.

Second, Bank Negara Malaysia (2018) and Employees' Provident Fund (2019) both estimate the living wage for a household of four living in the Klang Valley to be roughly RM6,500. Close to 60% of Malaysian households survive on less. While Figure 1 is a national-level depiction of Malaysia's income distribution and the cost of living does vary between rural and urban areas across the country, the fact that almost 80% of Malaysians live in cities and even assuming that all rural households fall under the sub-RM6,500 income bracket, **approximately two-fifths of Malaysian households subsist on incomes deemed insufficient to provide for**

a decent living. The worst-off 20% of Malaysians survive on less than half this figure, earning under RM3,000. Policymakers should strive to even out this distribution in two ways: first by **reducing the share of households which earn monthly incomes of under RM3,000**, and second by **ensuring that the income distribution peaks at incomes roughly on par with living wage estimates.**

Figure 1[4] **Malaysia's National Income Distribution**

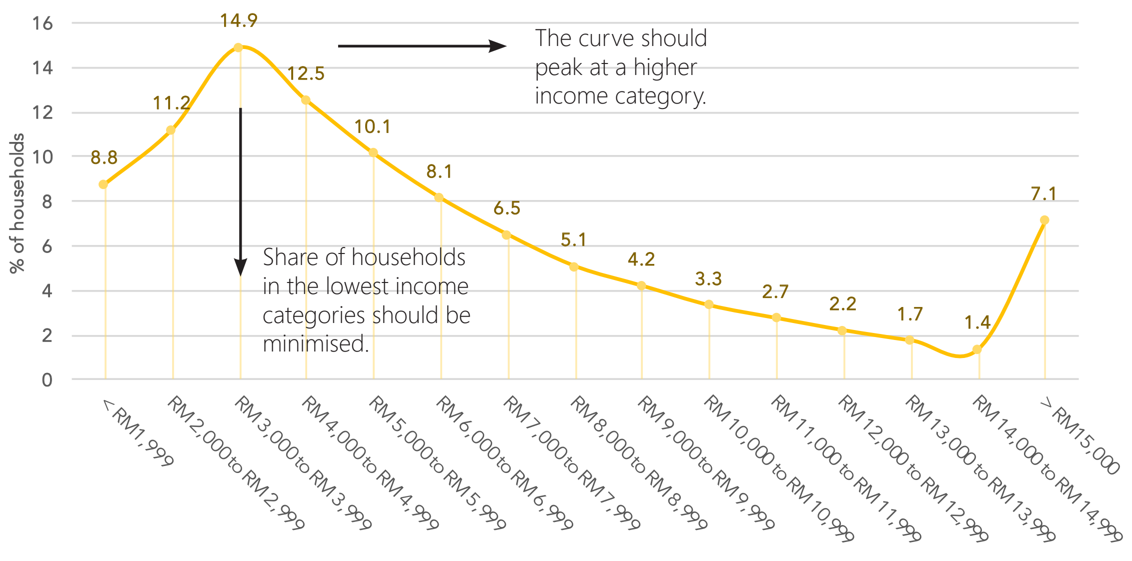


Figure 2 **Total Income Share per Income Bracket**

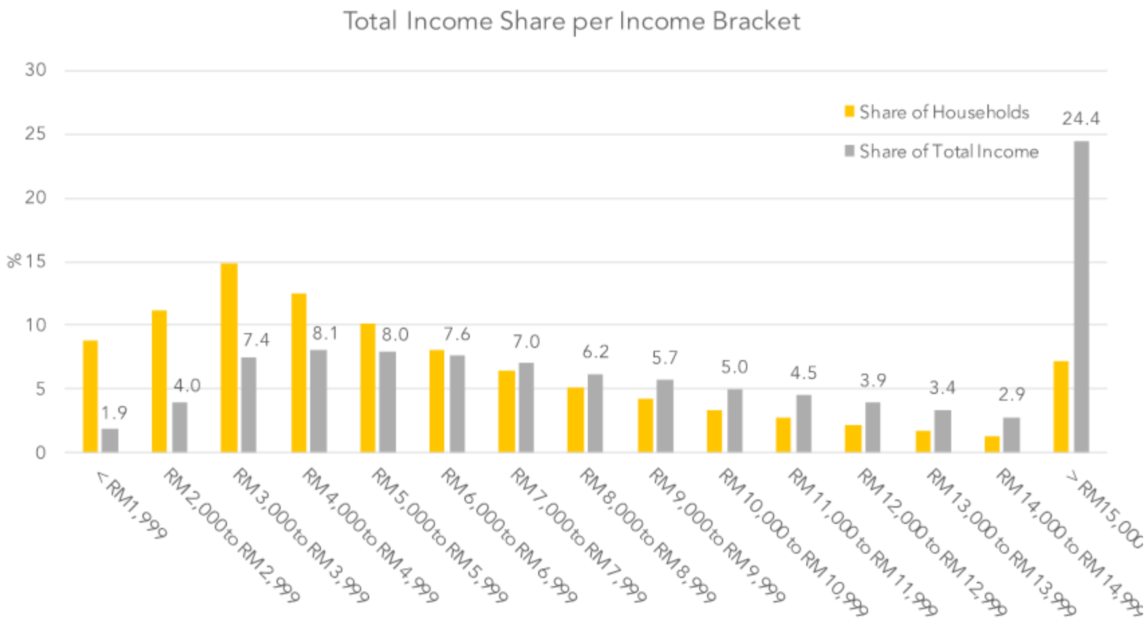


Figure 2 brings shares of national income into the equation, with household shares conforming to those in the income distribution presented in Figure 1. At lower levels of income, households hold significantly less than a one-for-one share of total income. For instance, the worst-off 8.8% of households have a total income share of just 1.9%; it is only at the RM6,000 to RM6,999 income range that this disparity is largely eliminated. Another striking feature is the fact that the top 7% of Malaysian households, defined as those earning over RM15,000 per month, hold roughly 24.4% of total income – an introductory signal of the extent of income inequality in Malaysia, particularly between the very richest and the rest.

Reclassifying Malaysia's Income Groups

Given this basic overview of the income distribution in Malaysia, attention now turns toward reclassifying national income groups first into five distinct categories, and later, three distinct – if slightly simplified – categories which more accurately reflect Malaysian society in 2020. Figure 3 presents these initial five categories – stylistically referred to as the Bottom 20%; the Lower Middle 40%; the Upper Middle 20%, the Lower Top 10%, and the Upper Top 10%. The B20 is composed of households earning no more than RM2,999 per month, which as a single entity hold under 6% of national income. Figure 4, which displays the share of households required within each income subgroup to earn a single percentage of total income, reveals that it takes 3.4% of households to earn 1% of total income within the B20 – contrasted with 1.6% of households within the LM40 and just 0.29% of households within the topmost 10%.

Figure 3 **Income Classifications and Total Income Share**

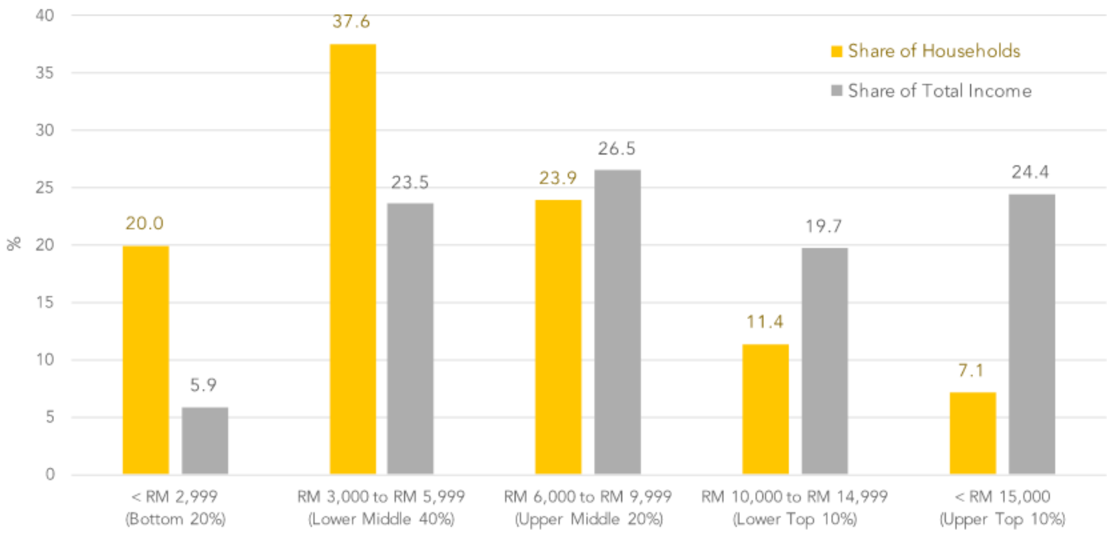
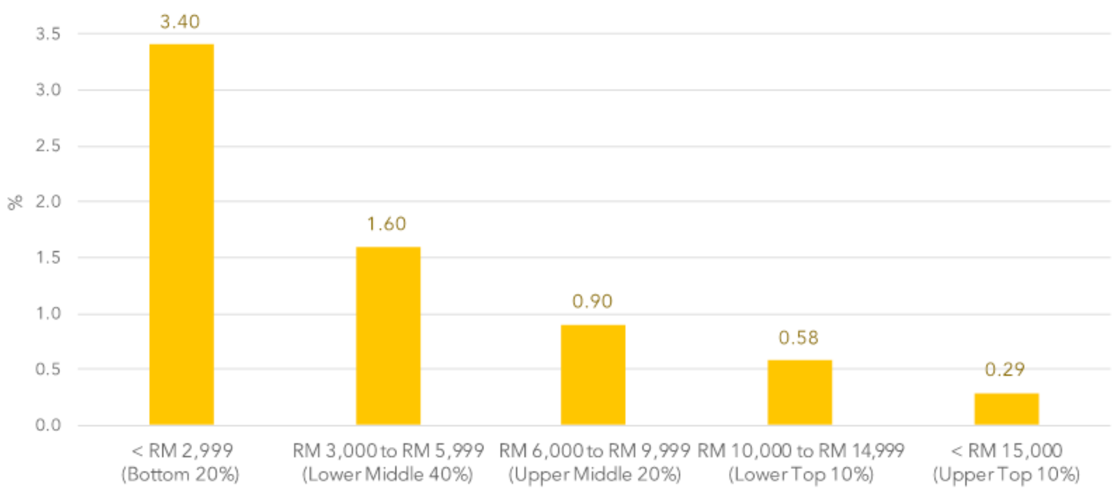


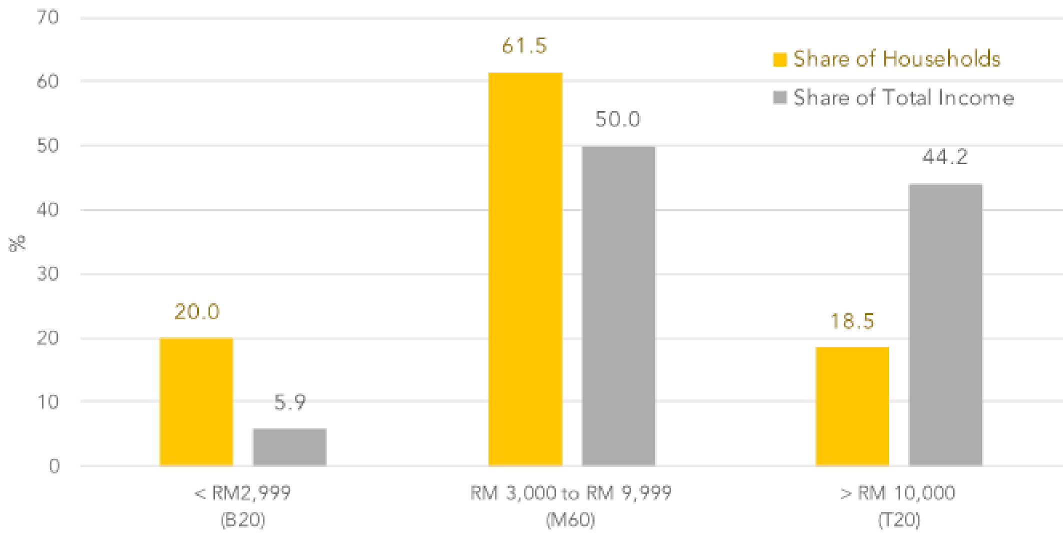
Figure 4 **Shares of Households Required per Pecentage of Total Income Group, by Income Group**



The data presented in figures 3 and 4 make clear the **magnitude of the gap between the B20 and the middle-classes**; the difference in the share of households required per percentage of total income is greatest between the B20 and the LM40 at roughly 1.8%, in contrast with the 0.7% difference between the LM40 and UM20, or the 0.32% difference between UM20 and LT10. This metric adds significant weight to the idea that Malaysia is composed of a B20, rather than a B40, of households who are falling significantly behind the middle and upper classes of society. This idea is corroborated by the findings of Khazanah Research Institute (2019).

Figure 5 closes this section off by introducing income classifications in Malaysia that are more indicative of reality as we move into the 2020s, rather than the outdated B40-M40-T20 arrangement introduced in the mid-2000s. **Malaysia is composed of a B20 of households earning under RM3,000 per month; an M60 of households earning between RM3,000 and RM9,999; and a T20 earning in excess of RM10,000 per household**. With this revamped arrangement in mind, attention turns toward the policy options that would serve to enhance the economic security of households in, particularly, the B20 and M60 income groups over the course of the next decade.

Figure 5 Broad Income Classifications and Total Income Share



Policy Recommendations

The evidence presented in the previous sections suggests the existence of a B20 that has largely been left behind relative to the middle and upper classes, and who as a group hold just 6% of total national income. Efforts should be made to provide this income subgroup with a catalogue of social welfare schemes, employment opportunities, access to free public healthcare and transport, and low-cost housing. Together, these provisions can play a role boosting their share of aggregate national income as well as supporting improvements to their individual and household wellbeing by pushing the B20 out of, in some instances, poverty[5,6]. The government, meanwhile, would be in a position to **streamline its welfare expenditures without compromising the wellbeing of the worst-off in Malaysian society, simply by more specifically targeting these policies**.

For the middle class, more emphasis must be placed on improved job opportunities and wage growth, as well as access to affordable healthcare and (higher) education. The former two, which would have a direct impact alleviating economic insecurity and leading to improvements in the standard of living of the middle class, are reliant on both the creation and import of higher-skilled, better-paid jobs into Malaysia. Along with putting effort into improving the quality of education systems within the country, which in turn positively influences the quality of graduates, the role of the government in this regard is to create a holistic ecosystem in which local and international companies, particularly within STEM industries, are attracted to, and can thrive within, Malaysia – as has been done with Malaysia's financial sector over the past three decades. Should these goals be achieved, there will be opportunities **for middle-class households to minimise the disparities between themselves and the upper class of Malaysian society through jobs and wage growth rather than direct financial support** – adding a sense of independence and self-empowerment to these households.

Finally, another issue this analysis has highlighted is the significant proportion of wealth which accrues to the T20 – or perhaps more pressingly, the T10 – and which must, to a reasonable degree, be addressed. This takes us right into the heart of the debate over income taxes, and whether Malaysia's current income tax structure is designed appropriately enough to tackle the **growing issue of income inequality**, and whether steps can be taken to render it more redistributive. While a discussion on income taxes in Malaysia is beyond the immediate scope of this paper, lowering rates faced by the bottom- and middle-classes, while raising taxes on the richest, would ensure significant increases in the disposable incomes of the former – and ensure no significant reductions in revenues collected by the public sector – and in doing so have a positive impact on their sense of economic security. A future REFSA briefing will cover a proposal for income tax reform in Malaysia with these exact goals in mind.

A Summary of Policy Recommendations to Enhance the Economic Security of the B20 and M60		
Income Classification	Monthly Household Income	Policies to Enhance Economic Security
B20	< RM 2,999	○ Targeted welfare through BSH, mySalam, i-SURI, Bantuan Awal Persekolahan, Skim Peduli Kesihatan, electricity rebates, fuel subsidies, etc. ○ Job opportunities; ○ Access to low-cost housing ownership or rental schemes; ○ Access to free public healthcare; ○ Access to free public transport.
M60	RM 3,000 to RM 9,999	○ Improved job opportunities, through importing of higher-skilled jobs into Malaysia; ○ Wage growth; ○ Affordable housing; ○ Access to affordable public healthcare; ○ Access to affordable public transport through the My50 and My100 transport passes.

Concluding Comments

Income classifications play a critical role determining the recipients of welfare provisions in Malaysia. At present, most forms of social welfare are disbursed to households in the B40, but as this analysis has shown, there is evidence of the existence of a B20 in the country, of households who survive on under RM3,000 a month, and a M60 earning between RM3,000 and RM10,000. In an attempt to more finely **target its welfare policies**, the government should direct its aid programs solely to the B20 in an attempt to enhance their economic security, while also ensuring them access to low-cost housing, and free public healthcare and transport.

Evidence also points towards the existence of a significant middle-class in Malaysia, for whom improved job opportunities and sustained wage growth would assist in the achieving of their aspirations of **upward economic mobility** in a more dignified manner than the outright provision of welfare. For this group, self-empowerment might be better-placed to assist in enhancing economic security, and this is most effectively done through employment. As well as helping through playing a role creating and attracting (higher-skilled) jobs into the country, the government should also make efforts to improve the wellbeing of these households by providing them with access to affordable public housing, healthcare, and transport, all of which would serve to augment their disposable incomes.

Footnotes

1. It should be noted that numerous concerns over the indices used over the years by the Malaysian government to measure poverty have been voiced by domestic and international institutions. As a result, it is recommended that readers focus less on the numbers and more on the message that hardcore poverty is less pervasive than it was in Malaysia in the 1970s.

2. In addition to the BSH, B40 households qualify for a range of other welfare schemes. An extensive list of these is provided in Table 1.

3. Limiting the range of households which qualify for welfare limits the extent to which households are reliant on handouts.

4. All data presented in this analysis has been derived from Department of Statistics (2017).

5. Other relevant policies for lower-income (i.e. B20) households, suggested in World Bank (2019), include i) aligning price controls with lower-income consumption patterns; ii) extending and enhancing childcare services to these households to enable greater labour force participation by parents; and iii) improving financial literacy amongst this group, including the provision of financial planning tools and raising awareness of responsibilities in household financial management.

6. UN (2019) calculates Malaysia’s poverty rate to be between 15 and 20%.

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