REFSA Policy Brief

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REFSA
Research For Social Advancement

Budget 2021:
Ushering in the New Economic Paradigm

REFSA Economics Team

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Executive Summary

The devastating economic effects of the Covid-19 pandemic were made painfully clear by Malaysia's Q2 GDP growth numbers, with a drop of 17.1%. Arguably, the drop would have been even larger were it not for the emergency support packages the government introduced in rapid succession in Q1 and Q2. Now with those short-term support packages about to expire, a heavy responsibility rests on the Budget 2021. It should aim to ensure the short-term revival of the economy, but also start the transformation to an economy that fixes the major flaws that were exposed by the pandemic.

Fortunately, there is a silver lining. Since the difficult economic conditions apply across the globe, any negative implications from budget deficits or higher public debt will not apply in this cycle. The government therefore has the fiscal space to support the economy in the short term, and to start implementing measures and programmes that will move the economy to a greener, more sustainable and more equitable future. In this, we see the government as a catalyst, using public investment in sectors critical to the future to precipitate private investment, and the resulting jobs and higher added value.

Each of the measures we propose is summarised in the table below, and explained in greater detail in the main paper.

Theme	Measures
Create Good Jobs	■ Expand public tertiary education, with learning incentives for all. ■ Expand the public health system to address ageing and develop the care economy. ■ Resume the Malaysia@Work scheme provisions for youth employment.
Invest in the Future	■ Develop renewable energy (esp. solar and biomass), increasing added value and creating good jobs in the process. ■ Incentivise local production of electric vehicles. ■ Develop the waste recycling sector, including waste-to-energy initiatives. ■ Address food security by providing incentives for urban farming. ■ Develop the local defence industry in alignment with the National Defence Investment Plan.
Strengthen the Social Safety Net	■ Increase BSH payouts to the minimum wage level (RM1,200 per month) ■ Expand EIS registration and coverage, by providing incentives to new subscribers.

Introduction

The preparations for the 2021 Budget take place against a drastically changed economic landscape compared to the beginning of this year. With the movement restrictions required by the Covid-19 pandemic and despite the record economic assistance packages, GDP growth saw a record drop of 17.1% year-on-year in the second quarter. This translates to a painful economic reality for Malaysians, in particular a drop in income that hypothecates spending and hence the chances for the economy to revive.

From this perspective, and considering that the short-term measures announced in the PRIHATIN package are due to expire soon, the upcoming budget will need to incorporate similar measures to ensure the survival of the economy in the short term, while balancing this with the creation of good jobs and a stronger social safety net, to lay the foundations for a dynamic economy in the future.

This paper outlines first of all our reasoning regarding the fiscal space available to the government, and then proposes focused measures designed to create good jobs, and at the same time orient the economy towards a higher added-value and greener future.

Spend the money: The government has the fiscal space

Budget 2021 provides the government with a rare opportunity to reset its fiscal priorities. It is a once-in-a-lifetime chance to commit to greater spending to address the long-term challenges Malaysia faces, while supporting a near-term economic growth trajectory, all without fearing too many market repercussions, in particular a sovereign credit rating downgrade.

This is all the more necessary in the face of the economic storm triggered by the Covid-19 pandemic. Although the government introduced a large support package for the economy in March, the true fiscal component of the package was smaller, compared to other countries. However, direct injections of public money in the economy yield the greatest "bang for the buck" in terms of overall impact on the economy, so with Budget 2021 the government should take the opportunity to significantly expand the amount of fiscal stimulus, compared to the earlier support packages.

There are at least two factors granting the government greater space to spend:

- All major countries are committing to significantly greater spending in this budget cycle
- Borrowing costs for the Malaysian government have become extremely cheap

For Budget 2021 as well over the medium term, we propose that economic growth should take precedence over fiscal consolidation. Even the IMF, normally a fiscally prudent organisation, calls for governments to step up public investment and to take advantage of low interest rates. In particular, they emphasise the large multiplier effect of well-judged public investment.

Indeed, even if the budget were to achieve a modest reduction in absolute deficit (the numerator), the deficit-to-GDP ratio could still deteriorate if the economy contracts overall (the denominator). Additionally, it is socially less disruptive to lower the ratio by expanding the economy, than by cutting the absolute deficit directly.

In the current environment, Malaysia would not be at a comparative disadvantage

First, almost all countries are focusing on growth over fiscal consolidation in 2020 and are likely to continue to do so in the near future. The global recession caused by the Covid-19 pandemic has forced governments all around the world to commit to large additional expenditure to preserve societal welfare, which has been badly affected by movement restrictions and resulting job destruction. This means Malaysia will not be alone in experiencing deteriorating fiscal metrics like deficit/GDP ratios, as shown in Figure 1.

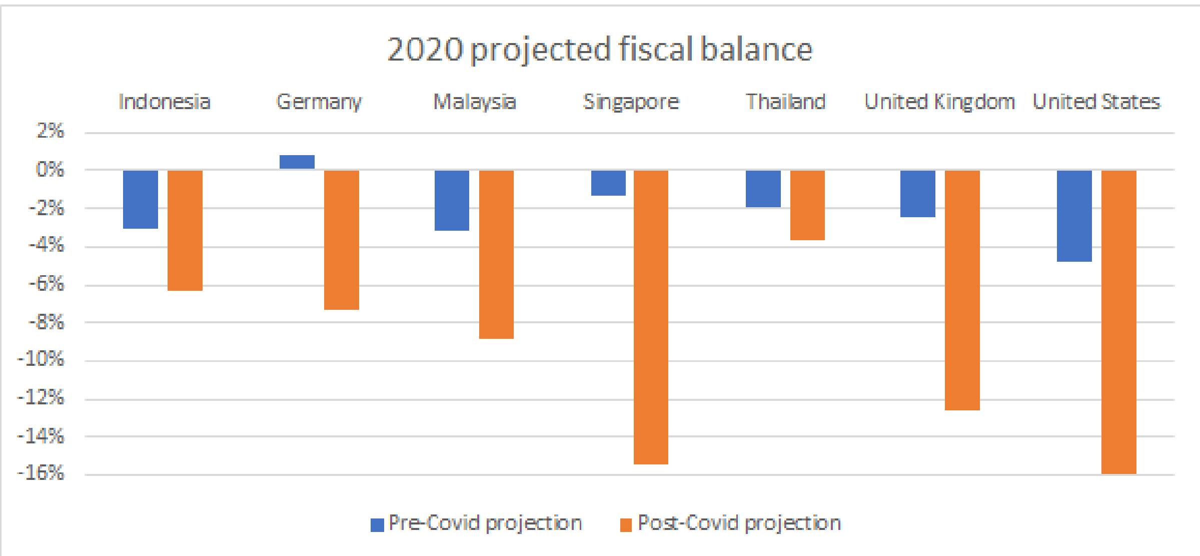
Given the general global trend and with everybody at risk of a credit rating downgrade, Malaysia is unlikely to be singled out by fixed income investors. This also justifies large additional spending.

Borrowing costs are at historic lows

Second, yields on government bonds in Malaysia have been falling since early 2019. The following chart shows the trend for 10-year MGS, with the latest monthly average being 2.55%, the lowest in history (Figure 2).

With yields at record lows, we propose for the government to borrow its way out of the crisis, with the caveat that money be used wisely and without the typical development expenditure restriction imposed on borrowing. Moreover, it is a chance to refinance pre-existing bonds, and help cut down on debt servicing costs.

Figure 1: Comparing pre-Covid and post-Covid fiscal balance projections.
Source: REFSA calculations



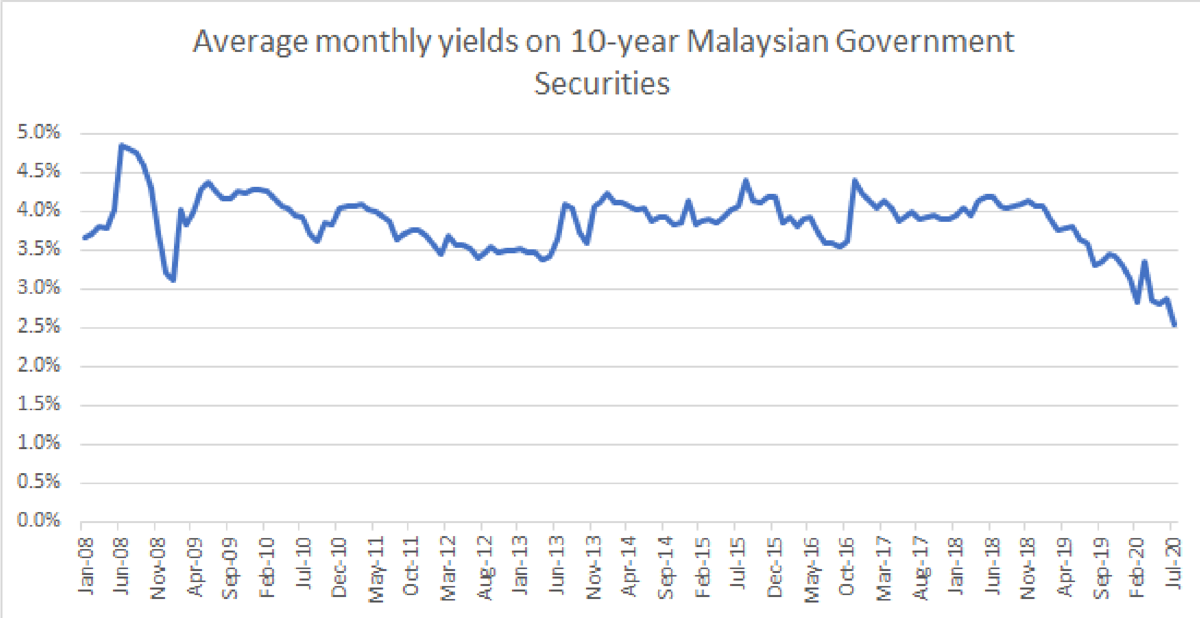


Figure 2: Average monthly yields on 10-year MGS.
Source: Bank Negara Malaysia

The Malaysian capital market is large enough to absorb any significant increase in government demand for debt. Based on reports from the Securities Commission, in 2019, the size of the Malaysian capital market is estimated to be RM3.2 trillion. Out of this, RM1.5 trillion was debt. And out of the RM1.5 trillion bond market, approximately 60% were government bonds.

Furthermore, large domestic funds continue to grow and have the capacity as well as the appetite to hold more Malaysian government bonds. For instance, the Employees Provident Fund alone has assets under management worth RM925 billion as of December 2019, with nearly RM250 billion in the form of government bonds.

Judging from these numbers and given the low yields on MGS and other related government securities, it is easy to conclude that there will be more demand for government bonds. Financing greater government spending will not be a large problem.

Initiatives

As to what to do with the additional financing, we believe it should be utilized in service of two main goals: create good jobs for Malaysians, and strengthen Malaysia's social safety net.

Create good jobs

Creating good jobs is fundamental to the future prosperity of Malaysia in normal times, and becomes all the more so in these crisis times. By good jobs, we mean jobs that are meaningful to those who do them, fulfil a societal need, are "future-proof," and pay a living wage. We propose four separate initiatives that will promote such job creation in four strategic areas:

- Expansion of the public tertiary education and the public health system
- Resumption of the Malaysia@Work scheme
- Investment in the green economy
- Investment in the defence sector

Selected expansion of the public sector

The government has the ability to jumpstart the job market directly by investing in the public sector. Here, we propose for the government to expand:

- the public tertiary education system
- the public healthcare system

The selected expansion of the public sector would create jobs and raise income at a time when the private sector's demand for labour is weak. More importantly, the expansion of these sectors would also assist Malaysia in meeting two long-term challenges: technological and demographic changes.

Expanding the public tertiary system

The supply shock caused by the Covid-19 recession has disrupted the labour market severely. This coincides with advances in automation across our society that threaten hitherto safe professions. While the adoption of automation has been relatively slow thus far in Malaysia, the supply-shock caused by the pandemic is pushing firms to hasten their automation process, and reduce their reliance on labour.

While automation could create more higher-skilled jobs, in the short term it would likely lead to a persistent increase in unemployment, while workers switch from one field to another. They require reskilling and that requires time.

The government can hasten the searching and reskilling/upskilling process by creating more space for Malaysians to acquire diploma, bachelor's and master's degrees at public tertiary education institutions, including for vocational training. This means greater funding for those institutions is required. A greater intake of students will require more hiring in the form of lecturers, lab technicians, and other specialists, as well as administrative staff.

Additionally, the government can also encourage more Malaysians to reskill themselves by granting full or partial public sponsorship in the programmes at public tertiary education institutions, in particular for mid-career job seekers. If such a route is taken, then the government could tie them to serve in projects the government deem necessary, including other initiatives such as the green economy investments proposed further below.

If the expansion of the public higher education sector is to last for four years, our preliminary estimates suggest the government would need to increase its allocation by 0.1%-0.2% of GDP yearly above the business-as-usual scenario over the duration. This should increase the number of post-secondary graduates by 50,000 persons per year, and bring Malaysia's graduates-to-population ratio closer to the upper-middle income country average level of 23%, up from approximately 21% now.

Expanding the Public Healthcare system

By 2035, 15% of Malaysia's population is expected to be 60 years and older. As society ages and enters the 'ageing' category, demand for affordable healthcare will rise. For the public healthcare system to address the issue, the government will need to invest in it early. Furthermore, it has been proven that in case of health emergencies like the Covid-19 pandemic, the public healthcare system is critical to address the situation.

Expanding and strengthening the public healthcare system now will prepare the country for an ageing society.

By investing in this sector, more jobs would be created for healthcare professionals as well as administrative staff. Moreover, these jobs are largely professional service-based jobs, which are less susceptible to become obsolete due to automation.

To achieve this objective, we estimate the government would ultimately have to raise its allocation to healthcare by 2% of GDP. This would bring Malaysia's health expenditure-to-GDP ratio up to the average for upper-middle income countries of 6%, versus our current level of 4%.

Resumption of the Malaysia@Work scheme for youth

Secondly, we propose for the government to proceed with the portion of the Malaysia@Work programme designed for youth and fresh graduates. The programme works by encouraging private firms to create new jobs for fresh graduates by cheapening hiring costs, and raising wages for fresh graduates toward living wages.

Employers participating in the scheme would be provided by the government with RM200 per month per new hire of fresh graduates for a period of two years in the form of tax rebate. Simultaneously, the government would top-up the salary of the qualifying hired employee with RM400 per month over the same duration. The government would be able to specify the sector which it would like to focus on to ensure the programme supports the creation of good jobs, such as in high value-added manufacturing or services.

It is proposed that a person with at least a diploma with less than two years working experience would be eligible for the programme.

The programme should run for five years, targeting to create 132,000 new jobs for graduates. Given the estimated number of jobs, the programme would likely cost the government approximately RM1.5 billion over five years, or RM304 million yearly on average, without accounting for administrative costs.

The Employees Provident Fund (EPF) had been preparing to launch the programme in the first half of 2020, therefore, it should be able to get it off the ground relatively quickly.

Beyond these direct interventions in the economy, amply justified by the current situation, we are strong proponents of the "mission-oriented" policy framework advocated by Prof. Mariana Mazzucato, for supporting and stimulating the rise of new sectors in the economy. In this framework, public investment by the state serves as a catalyst for the development of private markets and firms, in areas that are desirable from a societal perspective. With the additional fiscal space available, now is the time to kickstart two critical missions, the first one to build a greener economy, the second one to strengthen our social safety net.

Investment in the Green Economy

The aim of investment in the green economy is twofold: to address Malaysia's contributions to climate change by achieving reductions in emissions as well as adapting to a changing climate, and to create sustainable, long-term jobs in a strategic, future-proof sector.

Renewable Energy: Solar and Biofuels

Emphasis is required on investment in Renewable Energy (RE), in order for Malaysia to meet its target of 20% of the electricity generation capacity by 2025, as well as its international commitments for climate change mitigation. The 20% target requires a total RE capacity of roughly 3,800MW by 2025, and this figure is likely to continue rising beyond that. This creates scope for investments which can promote the local production and deployment of RE technologies, preferably by local industry 'champions'. Efforts should be focused towards solar and biofuels due to their domestic abundance.

In terms of labour market impacts, evidence indicates than on average roughly 6.5 direct, indirect, or induced jobs are created per annual GWh of electricity generated from solar PV sources, with a further 21.6 'short-term' jobs created per MWp of installed capacity during the construction phases of solar PV projects. Should financing be provided so that Malaysia is able to reach its RE target using solely solar, then, a total of between 108,000 and 122,000 new jobs will be created, of which roughly 80,000 would be short-term jobs that occur during construction phases.

For biomass, job creation lags behind that of solar, with 6.4 short-term construction jobs created per MWp and between 0.5 to 1.1 jobs created per annual GWh generated. If Malaysia were to meet a quarter of its RE target using biomass (i.e. a total of 950MW), a total of between 10,250 and 15,250 jobs would be created, with roughly 6,000 of these being short-term construction jobs.

In totality, investment in solar and biomass plant construction, operation, and maintenance that aims to help Malaysia reach its RE targets would create between 118,000 and 137,000 jobs, excluding jobs created during the processes involved in the manufacturing of solar panels.

Transportation sector

Three strategies are proposed which can culminate in both positive environmental impacts and the creation of jobs within the transport sector. The first of these pertain to the local production of fuel-efficient cars and electric vehicles, the second improvements to Malaysia's public transportation networks, and finally, improvements to pedestrian and cycling infrastructure in urban areas.

Estimating the number of jobs created through these initiatives is a complex endeavour. It is straightforward, however, to envision how policies such as fuel economy standards for internal combustion engine vehicles and incentives for local automakers to produce and assemble components for electric vehicles can create specialised, high-skilled jobs within the automotive industry. Investment in improvements to Malaysia's public transport infrastructure will also boost the domestic construction industry and, provided jobs are reserved for locals, can provide labour market boosts as well. The construction industry would also stand to benefit from investment earmarked for improving the condition of Malaysian roads, particularly in cities, including retrofitting certain areas with dedicated bicycle and bus lanes, as well as steps to improve pedestrian infrastructure.

Waste Management Sector

A policy emphasis should be placed on increasing recycling rates for commercial, industrial, and residential sectors. While conventional waste collection and landfill disposal creates one job per 1,000 tonnes of waste material managed, recycling – depending on material – creates anywhere from 6 to 13 per 1,000 tonnes. Particular focus should be placed on improving rates of recycling for metals and electronics. Labour market benefits can be realised should the government provide access to cheap financing for companies to build new or expand existing sorting and recycling facilities for such waste, a process that will create specialised long-term jobs, especially as waste generation is expected to increase further as Malaysia continues to develop.

Jobs, as well as positive environmental impacts, can also be created through the promotion of waste-to-energy initiatives such as the commissioning of gasification plants and anaerobic digesters, in addition to the focus on the use of biofuels as a form of RE. This particular focus has the potential to create higher-skilled jobs, both in the construction and operation of such plants, and combined with action to promote recycling rates can contribute to enhancing 'circularity'.

Agricultural Sector

Climate change and its consequences are expected to play a role hampering agricultural yields and contributing to crop failure over the coming decades. If steps are not taken to hedge against and limit these risks, Malaysia's long-term food security and agricultural self-sufficiency will come under further question. For this reason, it is proposed that Malaysia takes steps to advance its nascent urban vertical farming industry.

Financing should be provided for farmers, entrepreneurs, communities, and/or non-profits seeking to start up urban farms. Streamlining the bureaucratic processes involved in acquiring the necessary land or buildings, along with permits to grow and sell food would make it easier to boost the number of urban farming sites across the country, as well as improve the financial viability of entrance into such a nascent industry. The government should also play a role assisting in the procurement of the necessary feedstocks for such farming systems and provide, through industry groups and universities, subsidised training programs for prospective urban farmers. Finally, tax exemptions should be provided to such enterprises within their first years of operation, conditional on the meeting of specified production targets for products where Malaysia's current self-sufficiency ratios are low.

Defence Sector

Investment in the defence sector should be focused on developing niche areas in our defence industry that best supports the Malaysian Armed Forces' transformation along interest-based requirements under the Defence White Paper, while also creating new high-paying jobs. A principle of limited self-reliance should be employed, where focus needs to be given on some basic defence needs as well as more high-value added niche sectors, such as shipbuilding and cyber capabilities.

Several major plans will be crucial for scrutiny and discourse as these developments unfold. The timeline for defence spending under the current White Paper is 10 years, that is from 2021 to 2030, which covers two Malaysia Plans. The National Defence Investment Plan and a revised joint capability plan will both be crucial in determining the necessary capabilities required, the timetable of acquisitions, and the total amount of investment required to see through those acquisitions. The Defence Industry blueprint will guide government interaction with industry players, and commit the government to developing key defence-economic capabilities domestically.

Currently, the average annual development expenditure for the Ministry of Defence is about RM3 billion a year, which is approximately only 20% of a RM15 billion budget. Once key capabilities have been identified and prioritized for acquisition, the government must be prepared to increase the value of the development budget commensurate to the capability requirements thus defined. Furthermore, life cycle costs need to be factored in as well, as the time horizon for such equipment tends to transcend the five-year plan period.

Equally important will be the means to ensure transparency and accountability from that spending. Bipartisan legislative committees will be crucial to ensure that any spending that is announced is not only relevant but also put to good effect. Furthermore, given the life cycle horizons of military assets that often stretch for 10 to 20 years, timely delivery of assets is an absolute must. Mechanisms must be put into place to ensure that assets are delivered outside of a reasonable expectation of tardiness, as was unfortunately the case for the Littoral Combat Ship programme and the AV8 Infantry Fighting Vehicle programme.

The measures listed above are included because they offer a good balance between short-term creation of jobs and stimulating the growth of sectors critical to the future of the economy. There are more sectors to be developed to transform our economy into a high value-added, sustainable and prosperous economy for all, which we see as the main objective of the 12th Malaysia Plan, and for which we will also publish proposals in due course.

Overall, our aim is to fully employ the capabilities of the government as a provider of finance to risky endeavours that promise to deliver significant future growth to the economy, while also ensuring that the majority of jobs will be good jobs.

However, employment is not the only pillar we can rely on for a prosperous society for all, this also requires strengthening the social safety net, as described in the next section.

Strengthen the Social Safety Net

Malaysia's social protection programmes have long been identified as being in need of reform. They are highly fragmented across more than 110 programmes, organized by more than 20 ministries and agencies. As a result, operating and delivering social protection in Malaysia is costly, overlapping and redundant. As part of the efforts to reform the social protection programme, we welcome the revival of the Social Protection Council (MySPC) by the Minister at the Prime Minister's Department in charge of the Economic Planning Unit (EPU).

To date, the only permanent component to the programme is the cash transfers to low-income households, nicknamed the B40, using the Bantuan Sara Hidup (BSH) mechanism. Additionally, in light of the COVID-19 pandemic, the Bantuan PRIHATIN Rakyat was further implemented to expand the programme specifically for the Covid-19 crisis. Other programmes such as Bantuan Orang Tua (BOT), Program Susu, Program Makanan Tambahan and Elaun OKU for example are cyclically dependent on the annual budget. There is a need for a structured programme that streamlines cash transfers and/or in-kind transfers consistently across a person's lifecycle where they fall into vulnerability.

Therefore, in the middle to long term, we recommend that the social protection ecosystem in Malaysia be seriously reorganized across the lifecycle in Figure 3.

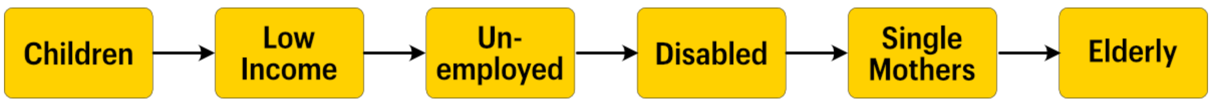


Figure 3: Proposed lifecyle for social protection system.

In the short term however, in light of the COVID-19 pandemic and the obvious exacerbation of the need for social protection, we recommend that the upcoming budget expediently consider the following social protection programmes to support Malaysians' livelihoods as we navigate the pandemic in Malaysia. We recommend using the opportunity to turn this into a test case for a larger more streamlined social protection ecosystem for Malaysia in the future.

BSH 2.0 or PRIHATIN 2.0

Given the current pandemic, we advocate for a substantial allocation in the upcoming budget to provide cash support to the group of BSH recipients, targeting to reach at least the monthly minimum wage level (RM1,200) for each person of working age in the recipient household. In effect, this is committing to roll-over and even increase the additional support provided in the PRIHATIN package.

We believe this is a key measure to keep the economy afloat in the near term, because empirical data shows that cash transfers to lower-income groups ensure that most of the transfer gets consumed, hence providing more economic activity and a positive multiplier effect.

In the medium term, structuring a programme such as this will provide useful information and experience that can undergird the transition to a truly comprehensive social safety net, that ensures a minimum wage to all.

Expand EIS registration and coverage

In Budget 2014, the government introduced a "PRS Youth Incentive Scheme" to encourage the opening of Private Retirement Scheme (PRS) accounts, to supplement retirement savings from EPF. Under the scheme, individuals below 30 years old who opened a PRS account with a minimum investment of RM1,000 by the year 2018 would receive a RM500 incentive paid for by the government. By Budget 2017, this incentive was increased to a matching amount of RM1,000 for the first RM1,000 deposited into PRS accounts. The incentive contributed significantly to the 38% growth in the number of PRS subscribers between 2017 and 2018, bringing the percentage of PRS subscribers below 30 years old to almost 40%.

We recommend that the Government adopt a similar incentive programme to increase subscriptions to the Employment Insurance Scheme (EIS), both by employees and employers. As of April 2020, there are only 7.5 million active contributors to SOCSO's EIS, even though the EIS was made compulsory and enrolment automatic from January 2018 onwards. Excluding the 1.6 million-odd civil service employees who are not eligible for EIS, close to 6.0 million of the 15.1 million workforce in Malaysia are without EIS insurance, when in fact this group includes some of the most vulnerable workers, such as domestic workers, self-employed workers and foreign labourers.

Whilst many workers have already lost their jobs due to the crisis, this proposed incentive could still encourage enrolment in the system and at least qualify new subscribers for the SIP Plus 60 scheme. Promoting enrolment in an insurance scheme at a time when the risks of the insured event are clearly rising undoubtedly presents a problem of adverse selection, however we believe this is a worthwhile trade-off for the following reasons:

- Greater coverage of EIS will provide a more robust channel for the government's cash assistance, instead of being faced with leakage or underprovisioning when targeting low-income households, such as in schemes like BSH or PRIHATIN
- Expanding the coverage of EIS will lay one of the foundations for the more comprehensive and integrated social security framework mentioned earlier, and provide greater coverage when the economy stabilises.
- Expanding enrolment now will limit the loss of income for any new subscribers who do happen to lose their job, thanks to the coverage provided by other members in the system, rather than having to rely on direct support from the government. In this way, expanding the coverage of the system reduces the government expenditure that would otherwise be required to achieve the same economic effect.

Conclusion

Rarely will a budget prove so consequential to the future of the economy as Budget 2021, even in a calendar year that effectively already saw three budget cycles. Although the economic conditions are dire, they also afford a unique opportunity, in the form of additional fiscal space, to support jobs and income in the short term, and to kickstart the transition to a greener, more sustainable and more equitable economy in the longer term. The proposals outlined above are calibrated to take advantage of this opportunity, and their implementation will yield benefits for years to come.

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About REFSA

Research for Social Advancement (REFSA) is a progressive, non-profit think tank that promotes social advancement in Malaysia. Since its inception, REFSA has been at the forefront of policy discussions and debates in the important political and socio-economic issues of the nation. Today, our aspiration hasn't changed – we want to power the movement for a just, inclusive and multi- ethnic society.

About REFSA Brief

REFSA Brief is a series of briefs and opinion pieces that aim to analyse pertinent socio-economic issues and encourage discussions in policy issues across the public, private and the third sector.

REFSA
Research For Social Advancement

REFSA
Level 5, Block A
Wenworth Building
Jalan Yew, Off Jalan Pudu
55100 Kuala Lumpur

T (03) **9285 5808**
W www.**refsa**.org