INSTITUTE OF STRATEGIC ANALYSIS & POLICY RESEARCH

RECOMMENDED BUDGET INITIATIVES: THE LONG ROAD TO RECOVERY

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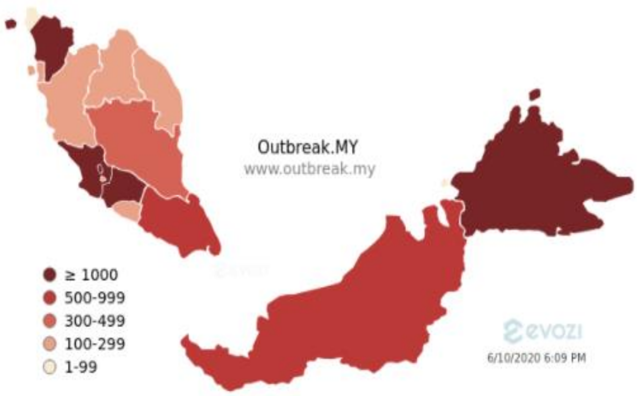
Summary

The COVID-19 pandemic has created radical uncertainty at all levels of government operations and policy. Policymakers are faced with difficult trade-offs between public health, economic and social interests and the challenges it raises. The regional and local impacts of COVID-19 are highly heterogenous, affecting states differently according to the local nuances of the individual states, creating a territorial dimension and significant implications for policy responses.

This report takes an in-depth look at the social, economic and fiscal impacts related to the COVID-19 crisis. The paper uses examples of good practice from both developed and developing economies to help mitigate the territorial effects of the crisis and offers several key takeaways on managing COVID-19's economic impact, its implications on the government, financial and public investment level, as well as points for policymakers to consider as they build economic and social resiliency across all regions. Lastly, the paper provides recommendations and key insight on the long-term initiatives needed to strengthen Malaysia's economic position in the wake of the COVID-19 crisis.

Introduction

In the first six months of 2020, COVID-19 has affected almost all countries in the world, affecting 36 million people worldwide. As of the time of writing, Malaysia had almost 14,000 confirmed cases since the start of the pandemic with 3,351 currently seeking treatment[1].



It is widely recognized that the pandemic had triggered the most serious and far reaching economic crisis in a century since the Global Financial Crisis (GFC) of 2008.

State, local and federal governments have a responsibility to work together in critical aspects of containment measures, healthcare, social services and economic management in the fallout of the pandemic.

As such mitigation responsibilities are shared amongst many levels of government, a coordinated and focused effort across various ministries, functions and state governments are critical to the success of the mitigation effort.

The hardest-hitting economic impact due to the fallout of the pandemic is correlated with local nuances of the state's exposure to globalization, connection with global value chains and specialization in specific sectors such as tourism and retail.

In addition, the fiscal impact of the pandemic has resulted in an increased committed expenditures bill in healthcare and containment measures while at the same time, revenues for both local and federal governments have reduced.

[1] https://www.outbreak.my/#states

It should be noted that while the impact on local government finances are not uniform across all states and local municipalities, it is expected to remain a long-lasting affair.

The paper provides some key takeaways as listed below on managing the impact of COVID-19, its implications for multi-level governance, local and national financing and public investment, as well as takeaways for policymakers to consider which will discussed in greater detail within the paper.

1. Introduce both permanent and temporary fiscal measures such as **tax arrangements and simplification**, **easier access to capital lending** as well as introducing more flexible and innovative financial management tools for more effective fiscal management. A particular focus should be made on strengthening Malaysia's revenue-side effectiveness as a means of restoring fiscal stability over the medium and long terms.

2. Strengthen the federal and state level **support for vulnerable groups** to limit further deterioration in their individual circumstances, ensuring that the most vulnerable groups receive the basic necessities of life during these troubled times. Effort should be made to strengthen social inclusiveness in the recovery phase, including **simplifying and facilitating access to government support programs**, ensuring that **services are well-targeted** and **providing liquidity to independent local charities** to capitalize on their local social infrastructure.

3. To ensure sustainable employment in the medium to long term, the **survival of local SME's** are of paramount importance. All levels of government should ensure that similar SME's are treated in the same way and have the same access to financing and public procurement contracts. Local government can act as brokers for local SMEs and the self-employed for government contracting and short-term financial support.

4. Attracting high quality foreign investment from a selected cluster of **high-value sectors** such as in Artificial Intelligence (AI), Robotics and High-end Manufacturing. In this regard, more consideration should be placed on **enhancing Malaysia's trade openness and the competitiveness of local SMEs**. Sectors that have a high potential for technology transference should be prioritized over more labour-intensive industries to develop long-term competitive advantages.

5. Reorienting national agricultural practices and policies to help **encourage private capital investment into food-based agricultural production** instead of the current focus on palm oil and commodity-based agricultural exports.

6. Malaysia needs to help **develop and foster a local supply chain ecosystem** with links to many foreign Multinational Companies to access the lucrative Global Value Chain to achieve better economies of scale, develop cost effectiveness and become more resistant to internal and external shocks in the long term.

7. Subsidization of national tertiary-based education programs through **technical and vocational training**, with a particular view toward new technologies to enable the Malaysian workforce to **build a pool of both high-tech and semi-skilled workers** targeted toward the rural and urban poor

8. Use of **public investment** across all levels of government to support COVID-19 recovery over time. The **National Fiberisation Policy** should be continued and enhanced to encourage the uptake of new technologies among all market players. In addition, public infrastructure projects that increase regional and national connectivity between cities should be encouraged to provide employment and stimulate domestic spending.

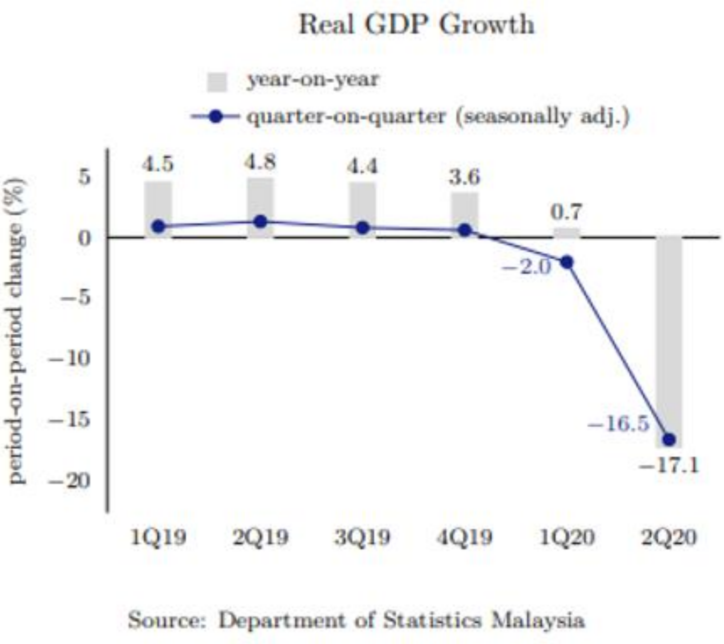
9. Malaysia's state and federal governments must introduce and encourage existing **multi-level coordination bodies** run by individuals independent of political affiliation that act to minimize the risk of a fragmented crisis response between federal and state bodies.
    a. The use of digital technologies should be used to include all municipalities and local government to help minimize disjointed policy responses and competition for resources among local and state governments during the economic recovery process.
    b. Consider adopting a **"place-based" recovery plan** which gives emphasis to a territorially-sensitive approach to the implementation of economic recovery policies. This provides a **distinction between urban and rural policy divergences** and local social nuances.

10. Effort should be made to **reduce the gap** between decreasing revenues and increased spending during the COVID-19 crisis to avoid underfunding policy mandates and incurring possible sharp cuts to important federal level spending. **Special grant schemes** by independent valuers would help greatly in closing these gaps, allowing for spending to take place for efficiency-verified programs performed at the best budgeted expenditure.

Impact of the COVID-19 Pandemic on Malaysia's Economy

Recently, Malaysia's central bank, Bank Negara Malaysia (BNM) had released the full 2nd Quarter data in late August 2020[2]. Data from the 2Q2020 is particularly useful in explaining the impact of the pandemic containment measures as most measures were implemented during that period. The scale of the economic and fiscal impact from measures to contain the coronavirus such as the Movement Control Order (MCO) had been severe. In addition, the collapse of external demand for Malaysian exports had pushed the Malaysian economy into a technical recession (two consecutive quarters of negative GDP growth).

Reported Year-on-Year (YoY) real GDP growth had fallen considerably, from 0.7% in 1Q2020 to -17.1% in 2Q2020. While Quarter on Quarter (QoQ) real GDP growth fell from -2% in 1Q2020 to -16.5% in 2Q2020 or a 14.5% drop during the period. These statistics represent the sharpest drop in real GDP QoQ growth figures since the Asian Financial Crisis of 1997.



The Malaysian economy was confronted by both a concurrent supply and demand shock arising from weak external demand and strict containment measures during the quarter.

On the supply side, this was reflected in negative growth rates across most economic sectors while on the consumption side, containment measures limited the ability of consumers to purchase goods and the resulting economic fallout had reduced the average income of households. Meanwhile, the export of goods and services registered a sharp contraction contributing to the decline in demand side factors.

[2] 2Q2020, BNM Quarterly Bulletin, August 2020

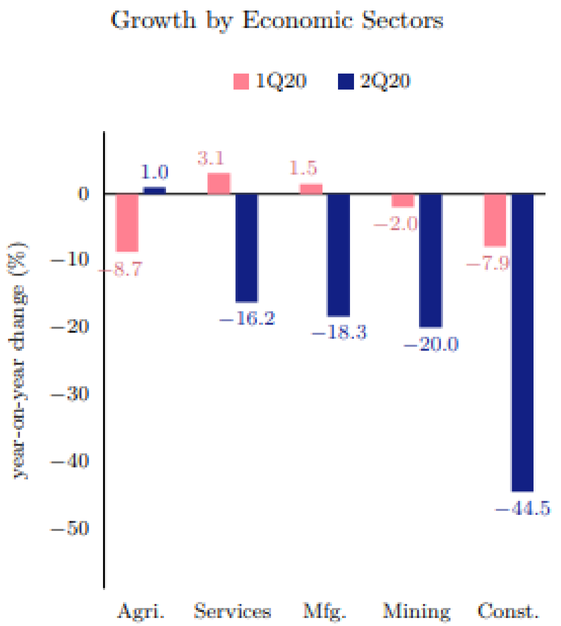
Impact on Economic Sectors

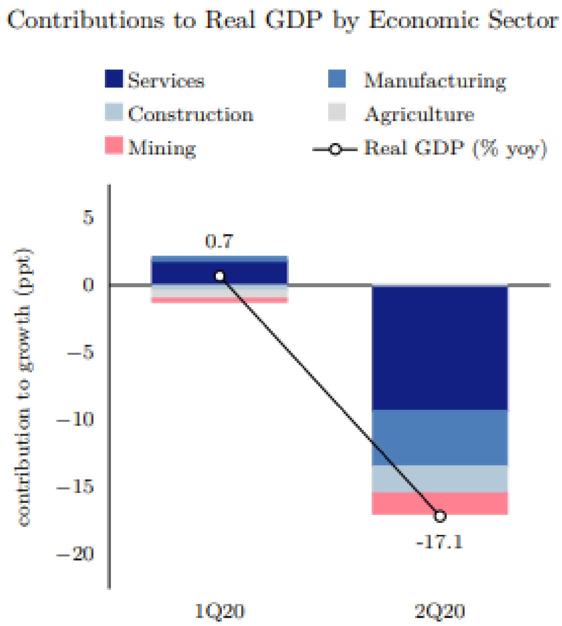
Nearly all economic sectors had suffered a sharp decline due to the MCO. The weakest YoY growth performance was shown in the Construction (-44.5%) sector, followed by Mining (-20.0%), Manufacturing (-18.3%) and Services (-16.2%) sectors. However, the most crucial of which, is the services sector, making up a nearly 58% share of the country's GDP in 2019. A contraction in this sector would result in a disproportionately larger share in the contraction of national GDP. Indeed, the Department of Statistics Malaysia (DOSM) showed that the contraction in the services sector this quarter was responsible for almost 60% of the total contraction in the -17.1% GDP growth profile seen in 2Q2020 (Illustrated below).

Services were particularly hit hard due to the nationwide MCO which only essential services were allowed to operate, such as food-related retail, utilities, banking, transportation as well as communication services were allowed to operate with limited capacity. The subsequent transition to the Recovery MCO (RMCO) provided some relief to businesses in the sector. The lockdown had substantially affected consumer spending and tourism activity as seen in the significant declines in retail and hotel accommodation sub-sectors. The sharp drop in tourist arrivals due to travel restrictions imposed on international tourist arrivals had resulted in a sudden stop in the transport and storage sub-sectors.

Meanwhile, the finance and insurance sub-sectors were weighed down by lower net interest income and lower fee-based income amid lower capital market activity. Despite this, there was a sustained high demand for data communication services especially during this period of remote working engagements.

The manufacturing sector was largely affected by both the MCO working restrictions, which forced many non-essential operations such as textiles and transport equipment to stop operations altogether and forcing many essential operations to function at lower than optimal capacity to ensure sufficient social distancing. Following the lifting of MCO restrictions in May, many firms restarted operations but did so while observing sector-specific health protocols amidst weakened market demand both domestically and externally. Nevertheless, the impact of weakened demand conditions was partially offset by a backlog of manufacturing orders which supported a faster production recovery, this was especially true in the electric and electronics (E&E) subsector.





Source: Department of Statistics Malaysia

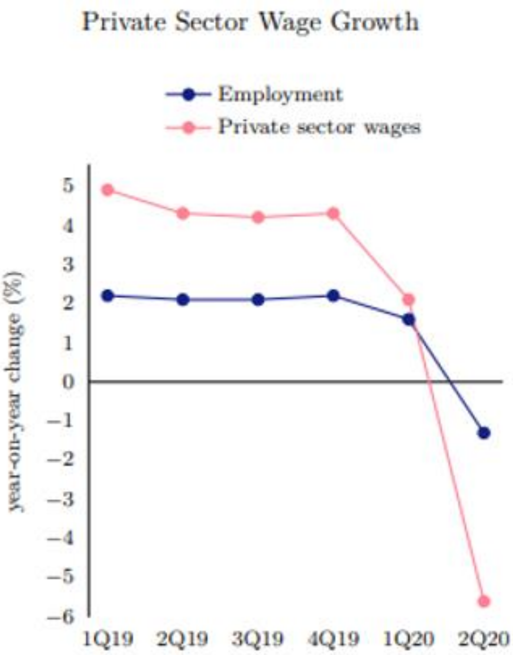
The mining sector recorded a sharp contraction in 2Q2020, mainly due to the collapse in both the global and domestic oil demand from the implementation of travel restrictions. In addition, maintenance works in East Malaysia had also contributed to a reduced oil and gas output.

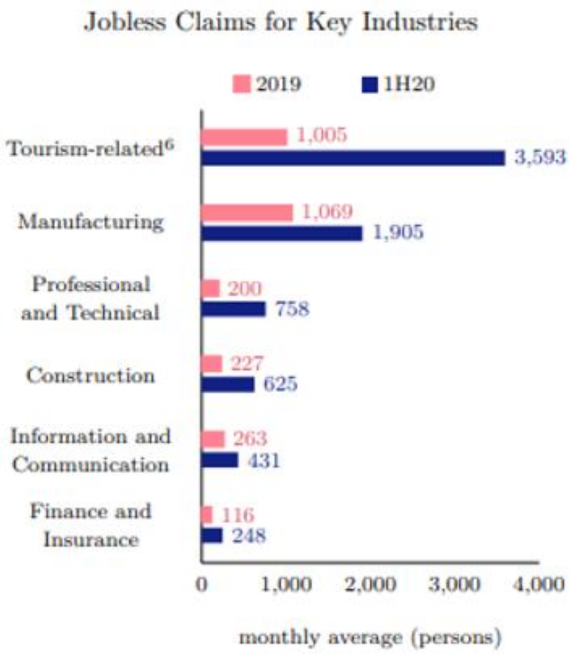
Economic activity in the construction sector effectively came to a grinding halt during the month of April. Despite the partial reopening of the economy in early May, most construction sites faced challenges in restarting operations due to the adjustments required to comply with the strict COVID-19 SOPs introduced. Most developers faced challenges to restart operations due to myriad factors, namely, 1) cashflow constraints, 2) the initial lack of clarity of SOP and COVID-19 testing, and 3) disruptions in the supply chain of construction material. Despite this, the situation has improved slightly as the government had since clarified SOPs and encouraged the usage of the MySejahtera app to trace construction workers.

The only non-negative growth sector was the agricultural sector, which rebounded during the quarter at 1.0% (1Q2020: -8.7%), mainly due to the recovery in oil palm production as fresh fruit bunch yields stabilized from the earlier impact of dry weather conditions. Malaysia's Oil palm recovery was supported during the period by higher harvesting activities due in large part to the greater presence of workers stuck within the estates during the MCO period. This increase in production more than offset weaker production and demand conditions in the fisheries and livestock subsectors.

Impact on Labour Market Conditions

The effects of the pandemic quickly spread uncertainty and severely weakened Malaysia's labour market performance. The measures implemented resulted in mass retrenchment, pay-cuts and unpaid leave which weighed heavily on employment and income conditions. QoQ employment declined by 1.3% (Q12020: +1.6%), which were concentrated in tourism-related industries as demand weakened considerably in those industries amid border closures. As a result, the overall impact caused unemployment to rise to 5.1% in 2Q2020[3] (1Q2020: 3.5%).





Source: Department of Statistics Malaysia and Employment Insurance System, Social Security Organisation

The decrease in average income was in large part due to fewer working hours demanded by the production-side economy and pay cuts among those who remained in employment. This resulted in a sharp decline in private sector wage growth in 2Q2020 to -5.6% (1Q2020: 2.1%).

3 https://www.theedgemarkets.com/article/malaysia-unemployment-rate-drops-sectors-reopen-during-rmco

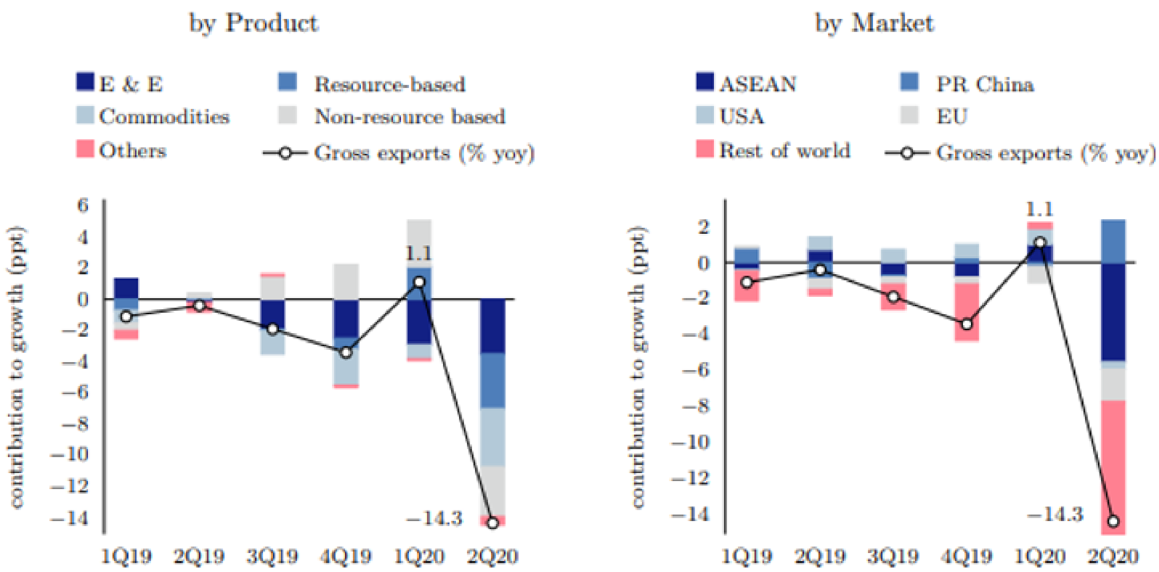
The main drivers of the negative private sector wage growth are as illustrated in the following table:

Private Sector Wage Growth - Employment Sector	2Q2020	1Q2020
Tourism-related Services -Wholesale and retail trade, food and beverage and hotel accommodation.	-3.5%	1.9%
Transportation and Storage Services	-29.7%	-3.5%
Manufacturing	-4.0%	3.4%
Transport Equipment and Other Manufactures	-13.3%	1.3%
Textiles and Apparel, Leather and Footwear	-15.3%	2.4%

Impact on Foreign Trade

In 2Q2020, YoY gross export growth declined to -14.3% (1Q2020: 1.1%), weighed down by weak growth in both manufactured and commodity exports. YoY Gross import growth similarly contracted to -15.1% growth (1Q2020: 1.3%), due mainly to lower intermediate and consumption good imports, due to disruption in the global supply chain. This resulted in a narrowed trade surplus of RM27.6Bil (1Q2020: RM37.0Bil).

Gross Exports by Product and Market



Source: Department of Statistics Malaysia

Malaysia's export performance in 2Q2020 was affected by COVID-19 lockdowns globally, resulting in disruptions in key supply chains, lower demand from key trade partners, particularly from ASEAN and the USA. Despite the turnaround in May and June for E&E exports, for the second quarter as a whole, manufactured exports contracted by 12.1% (1Q2020: 2.5%) due mainly to lower non-E&E exports, registering a QoQ decline of -14.1% (1Q2020: 11.2%). This was attributed to lower exports of petroleum, metal manufactures and chemical products. Commodities exports worsened to -24.7% (1Q2020: -5.6%) mainly in mineral exports following a contraction in global supply chain production of intermediate and finished goods.

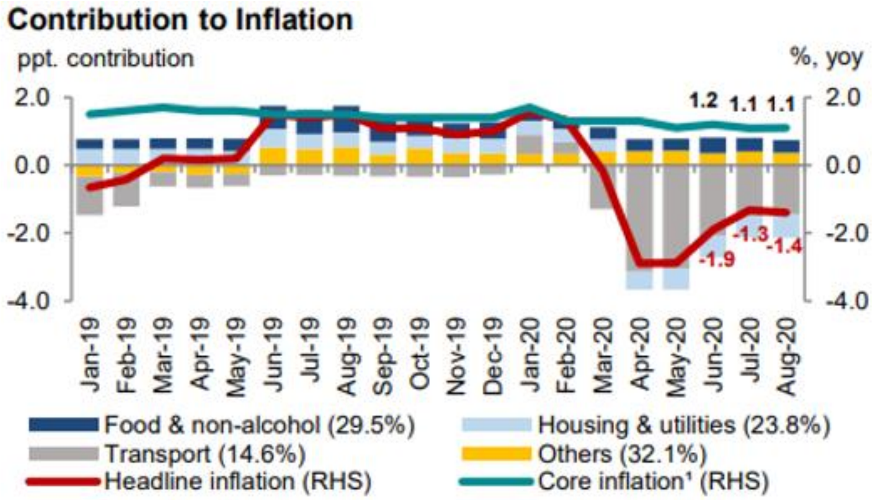
Intermediate goods imports contracted to -23.4% (1Q2020: 8.1%) during the second quarter due to lower imports of industrial supplies and fuel-lubricants amid weaker manufacturing activity. In line with this, consumption imports also declined -9.3% (1Q2020: 4.8%) driven primarily by a sharp contraction in durable consumer goods.

Impact on Inflation

During the secoind quarter, headline inflation had fallen sharply, from 0.9% in 1Q2020 to -2.6% in 2Q2020. This was mainly due to a sharp decline in transportation costs as the MCO caused a sharp short-term decline in the consumption of transportation services. Similarly, inflation was further weighed down from a sustained drop in housing and utility prices during the period due to lower rental yields across the board.

Despite the severe impact to headline inflation, core inflation remained relatively stable. The core measure fell from 1.3% in 1Q2020 to 1.2% in 2Q2020, representing only a marginal decrease in the consumption of necessity goods such as food and non-alcoholic beverages.

These results confirm our early opinions in prior economic releases that the COVID-19 crisis would ultimately impact the consumption patterns of consumers, whereby a demand substitution would take place, preferring inelastic goods of necessity such as food over the consumption of luxury items and real estate purchases.



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In August, headline inflation picked up marginally from 2Q2020, due mostly to the price of food away from home and jewellery, this was counterbalanced by the drop in the rental prices. It is important to note that the increase in jewellery prices may reflect demand for more inflation-resistant items such as precious metals, indicating that some expect that currency purchasing power might perform worse in the coming months.

In a key BNM report[4], several studies were done suggesting that the low core inflation and negative headline inflation rate in Malaysia may be in large part caused by important structural factors.

Key Takeaway 1: Firstly, it was noted that the consumption pattern of consumers changed after the implementation of the MCO. For instance, consumers are allocating more funds for necessities such as food and less for travelling, restaurants and tourism. As a result, the inflation rate computed from the current Consumer Price Index (CPI) might not truly reflect the real market situation in Malaysia. Had the CPI basket considered the shift in consumption patterns and allocated greater weight on necessities, the inflation rate would have been much higher. Hence, BNM suggested an adjustment to the CPI basket is necessary in the near term if the “new normal” permanently changes consumption patterns.

Key Takeaway 2: Secondly, the competitive dynamics of the market are also becoming more influenced by the pandemic. BNM found that many SMEs are being forced to leave the market as the effects of the pandemic continue. This is in accordance with the SME Association of Malaysia recent statement, that about 25% of SMEs may be forced to leave the market if there was a second wave of COVID-19 and another potential lockdown.

[4] COVID-19: Impact on Inflation, Peter Maojun and Nur Aimi Abdul Ghani,

If such SMEs collapse due the COVID-19 pandemic, most firms in the Malaysian market will tend either toward agglomeration or leave key markets open to big international corporations, reducing market competition. As a result, the price of goods produced in Malaysia may fluctuate in a very different way from what was previously considered normal.

When an oligopoly or only a handful of big international firms exist in the market, prices are more likely to be more responsive to international price movements and the price of their competitors. This can result in more volatile price movements in response to international market swings and the need to maintain key income margins of foreign companies. Therefore, it should be an absolute imperative to keep local SMEs operational and running in the near and longer term. There are several measures discussed below that focuses on government actions to assist local SMEs in developing a local sustainable ecosystem and enabling the adoption of the digital transformation essential to survive the economic fallout of the pandemic.

Key Takeaway 3: Thirdly, the COVID-19 pandemic will seriously threaten the labour market due to the devastating effects on the SME sector. SMEs account for 66%-70% of the total employed workforce in Malaysia. As more are anticipated to exit the market, this will undoubtedly result in higher short and medium-term unemployment especially in badly affected sectors such as in tourism and airlines.

Compounding this, the unemployed may lose the enthusiasm and incentives to actively look for work and opt out of the labour force. As many are expected to be remain unemployed for a protracted period, they may gradually lose their skills, leading to a long-term decrease in worker productivity and may cause the labour pool to have outdated expertise. The lower productivity among workers may add higher cost pressure in domestic production potentially causing cost-push inflation to a degree.

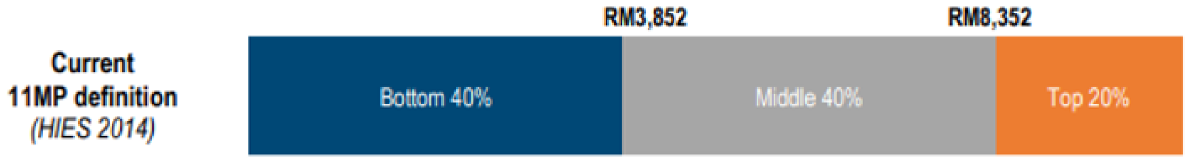
However, due to lower productivity, existing firms may opt for greater technological adoption over human workers, contributing to downward wage pressures as the marginal productivity per worker decreases over the long term. Moreover, downward wage pressure might also be caused by the increasing employment of the gig-economy worker due to COVID-19. Such workers gradually lose their bargaining power as more are hired.

Therefore, the inflationary pressure due to labour market conditions depends entirely on the degree of cost pressure relative to productive wages. Hence, it is important for policymakers to consistently check the shifts in the labour market in understanding the impact on inflation.

Understanding the Needs of the Urban Poor, Unemployment and the Underemployed

In 2019, the government of the day had revised its methodology in calculating the Poverty Line, while commendable, it had resulted in a two-fold increase in the average poverty line income (PLI) measure, increasing from RM980 per household per month to RM2,208. The absolute poverty rate shot upward dramatically from 0.2% to 5.6% using this new measure, reflecting the increased Malaysian living standards[5].

According to the 11th Malaysian Plan (11MP), the definitions of the Bottom 40%, Middle 40% and Top 20% (B40, M40 and T20 respectively) of income earners are laid out as illustrated below.



[5] Measuring Poverty: What About Eating Out?, Khazanah Research Institute, August 2020

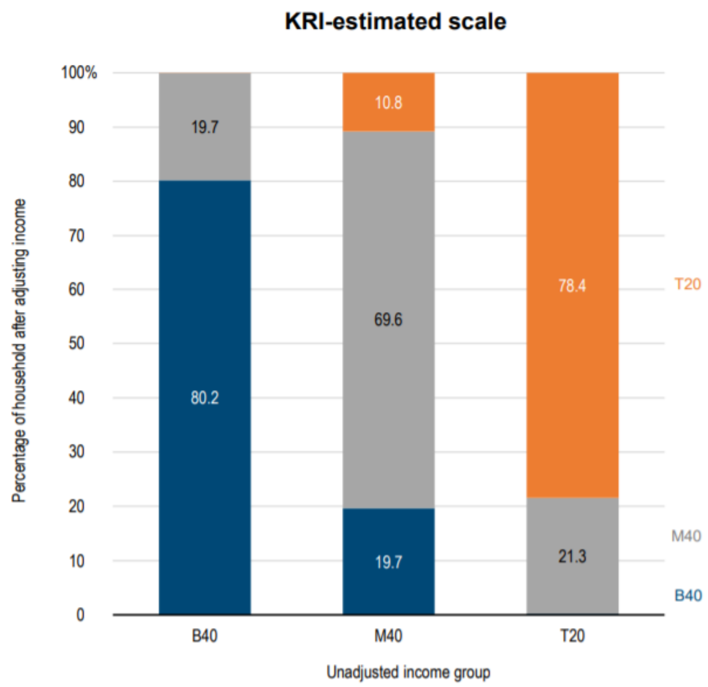
While instrumental for policy initiatives, the measure characterizes households based on total household income, without adjusting for household size and composition. This inadvertently biases policy initiatives towards smaller household sizes and disadvantages households with greater needs.

A study by Khazanah Research Institute (KRI)[6] on this issue suggested that the usage of B40 should be made redundant as a shorthand for the "poor". If the intended goal was to extend social assistance to households to survive only on basic needs, the B40 demarcation would benefit an additional 20% of households above the level of subsistence. If, however the intended goal was to bring households towards aspirational status, the B40 demarcation would exclude many households in the M40 who are still financially constrained. The study suggests that the use of B40 as an income category is too narrow a definition to initiate targeted policy initiatives.

However, the income category of B40 can still be used to identify the poor if an improved version of household income measurement that accounts for both household size and composition is developed. By adjusting for household size and composition, poverty reduction policy targeting can be rendered more effectively. This can be done by computing the income on a per capita basis, but this standard does not consider economies of scale when more people live together as economies of scale do happen when many people live together because when the household size increases by one member, it does not necessarily translate into a doubling of household spending.

When more people live together, they share the non-personalised goods. As the cost of non-personalised goods is divided among members, living costs per person reduces as household size increases. For example, the per person expenditure on clothing can be lower when it is shared amongst siblings.

Therefore, to consider household size, household composition and economies of scale, using equivalised income is an alternative to household income per capita. The equivalised income can thus be obtained by dividing the household income by an equivalence scale. The equivalence scale is a factor that standardizes the income of all households by adjusting the amount of household income according to the household size, household composition and economies of scale. The equivalised income enables the policymakers to classify the households into B40, M40 and T20 in an accurate manner as illustrated below.



[6] Are Both the B40 and M40 "Poor?": Evidence from an integrated income-expenditure analysis, February 2020

After adjusting the household income by the equivalence scale, 19.7% of B40 has become M40 while 19.7% of M40 becomes part of the T20. Therefore, this may indicate that 19.7% of households in M40, which really need the help and support from the government, do not receive the support such as targeted fuel subsidies due to the incorrect poverty standard used by the government. Therefore, it is important to use equivalence scales to adjust the household income especially during COVID-19 pandemic so that households which are in reality part of the B40 can receive necessary help.

To illustrate, 64.3% of B40 households are supported by only a single income earner. Secondly, 23% of households in the B40 are led by those aged above 60. Thirdly, only 9.2% of the leaders in B40 households have received post-secondary and tertiary education. This may be due to their lack of funds to further their study. Fourthly, most of the leaders in B40 households have either semi-skilled jobs (65.5%) or low-skilled jobs and not working (25.5%). These statistics show that more support should be given by the government to help more B40 households survive the COVID-19 pandemic.

Besides B40 households, it is also essential to support the unemployed. Due to the MCO, the fiscal sustainability of many companies become adversely affected leading to higher unemployment in the near-term. In August 2020, the official unemployment rate in Malaysia was 4.7%. Though month-on-month unemployment remained stagnant, the number of unemployed people had decreased by 3,500, from 745,100 in July 2020 to 741,600 in August 2020. The reduction in the number of unemployed people is caused by the increase in the employment in the services industries such as wholesale and retail sectors due to the gradual removal of movement restrictions.

The unemployment rate of 4.7% is however still higher compared to the pre-COVID-19 unemployment rate ranging from 3.2% to 3.3%. The main contributor to increasing unemployment is chiefly from the young demographic. In August 2020, the unemployment rate for the young people from 15 to 24 years old (13.7%) is much higher than the overall unemployment rate (4.7%) partly due to younger people having less experience and workplace skills. Therefore, policies should be designed to target the young, it should also be noted that many young workers in the private sectors face a higher risk of becoming unemployed when compared to workers in the public sector.

In 2017 alone, graduates facing underemployment amounts to 47% of total graduates. The COVID-19 pandemic had in fact intensified the mismatch between graduate supply and demand because most companies are due to implement labour reduction strategies due to near-term financial stress.

Therefore, it is equally as important to reduce the number of underemployed workers to better utilize our human capital and allocate human capital resources more effectively. This plays a significant role in improving the overall economy of Malaysia. According to the OECD, eliminating underemployment will improve GDP growth by up to 3%.

Therefore, policymakers must understand the needs of both the unemployed and underemployed to navigate through the COVID-19 pandemic. It should be noted that many do not have adequate access to healthcare services and online learning platforms. Besides this, they may also face food insecurity, contributing to malnutrition of the family's children.

Meanwhile, underemployed workers who are mostly skilled graduates face the problem of not having enough high-skilled jobs. Therefore, to increase the incentives of companies in offering high-skilled jobs, the government may consider tax incentives and private-public sector partnerships to increase the supply of high-skilled jobs.

In conclusion, the government can enhance the effectiveness of poverty reduction targeting through adjusting nominal household income to better define households into the B40, M40 and T20. Furthermore, the economic fallout of the pandemic has greatly intensified the problem of underemployment so it becomes necessary for the government to increase the supply of high-skilled jobs to better utilize Malaysia's human capital stock.

Proposed Short, Medium and Long-Term Responses and Initiatives to Ensure Sustainable Development

Due to the uncertain nature of the COVID-19 pandemic, there is a need to tackle the resulting economic fallout through multiple dimensions. Despite the recent PRIHATIN and PENJANA economic recovery plans and initiatives, which in total, has cost the nation roughly RM295Bil or 19.5% of GDP, Malaysia's economic growth performance has yet to show signs of improvement. However, much like treating COVID-19, the strongest dosage must be administered first, followed by medium and long-term treatment once conditions stabilize.

The total fiscal stimulus package for Malaysia is detailed below:

	Amount (MYR Bil)	% of GDP
Total Fiscal Stimulus	**~295.0**	**19.5%**
Direct budget stimulus (Cash handouts, tax waivers and etc.)	45.6	3.0%
- For Businesses	*30.1*	*2.0%*
- For Households	*15.4*	*1.0%*
Direct non-budget stimulus (EPF withdrawals and etc.)	160.9	10.6%
Government loan support	64.4	4.3%
Others	24.1	1.6%

Source: Various Government Ministries, Maybank Kim Eng

The above table demonstrates an estimated breakdown of the total government fiscal package rolled out in response to COVID-19. Though an estimated 19.5% of GDP had been earmarked for stimulus, if we exclude non-budget items from the stimulus packages, 8.9% of GDP had been used in total. The largest share of which was fiscal support in the form of government loans.

Direct government stimulus is estimated at 3% of GDP, two-thirds of which are directed towards business and one-third towards households. An example of the latter includes the PRIHATIN cash handout program based on a sliding scale of an individual's income.

In the wake of reduced purchasing power and income, it may be necessary to continue some form of individual cash handouts to households in the near future to ensure continued liquidity in the economic system. Increased liquidity is likely to create an economic multiplier effect that increases consumption in the calculation of GDP in the near term. A downside to increased liquidity however is that too much liquidity can generate inflationary pressure in the medium term, however with headline inflation on a downward slope (as seen above), inflationary pressure should not be an immediate concern as subdued demand in the near term has indeed dampened the more extreme effects of inflation.

To ensure a sustainable economic recovery path, continuation of the PRHATIN and PENJANA programs should be made on a cost/benefit approach, phasing out economically costly programs in favour of plans that have shown to be beneficial. For example, the cash handout scheme as mentioned above should be tapered down as private sector wage growth which contracted by 5.6% in 2Q2020 (seen above) returns to pre-pandemic normalcy.

Therefore, the following outlines measures to be undertaken in the short, medium and long term to stabilize Malaysia's economy and its return to normalcy.

West vs East Malaysia

An often-overlooked point of discussion is the territorial and sector specific implications on East vs West Malaysia and the divergence of economic development factors that affect either side of the country. Therefore, this paper will also consider the impact and a discussion of measures to develop both sides of the sea, however most initiatives for East Malaysia will be medium to long-term in nature as policymakers need to narrow the development gap between the two Malaysia's.

Short Term Measures

In the short term, the impact of COVID-19 is expected to be severe and long lasting, depending on the severity of the second and any subsequent infection waves in the country. It is neither prudent nor possible to keep the economy under a prolonged and constant state of lockdown. As the Prime Minister stated in an economic address in May, the country loses an estimated RM2.4Bil for each day that lockdown measures are in force[7], with total losses from the start of the MCO till May totalling RM63Bil. Indeed, plans to prolong the lockdown would spell disaster for the entire economy.

At the end of September however, as a result of state elections in Sabah, COVID-19 cases have spiked tremendously, reaching levels higher than the first wave of infections. In response, the government had imposed limited restrictions on targeted areas in early October, but stopped short of declaring a national lockdown.

Affected industries include the Tourism and Accommodation sectors, Fisheries, Land Transportation, Arts and Entertainment, Recreation and Wholesale and Retail sectors. As a result, Malaysia had registered 236,000 fewer jobs in the private sector during the second quarter of 2020 compared to the same period last year.[8] The Department of Statistics Malaysia (DOSM) had also stated that the PRIHATIN and PENJANA economic plans were able to offset the loss in employment and allowed most businesses to retain their employees.

Further, there was a notable shift towards digitization as projected previously in prior INSAP economic reports, registering a notable increase in employment within the e-commerce, delivery services and Information Technology (IT) related activities. As the effects of the pandemic are likely to be long-lasting, the worst groups affected will likely continue to be the youth and self-employed. Therefore, any short-term measures must consider those two groups as the main focus of their efforts.

Proposed Short-term Measures

Financial Assistance to Businesses

To encourage stability in overall employment, the government must ensure that businesses, particularly small to medium enterprises (SMEs) have ample liquidity to remain operational. During this pandemic, many firms are experiencing a massive shortfall in cashflow due to both subdued external and domestic demand factors as well as measures to restrict movement and consequently, hampering economic activity.

Recommendation 1: Provision of Supplementary, Sustained and Short-term Fiscal Stimulus

The provision of supplementary, sustained and extended government funded stimulus/ recovery packages for SMEs will help to minimize their operational cash flow losses and allow short-term fiscal sustainability. These measures should also aim to assist the worst-affected sectors, particularly in the low and semi-skilled services sectors to ensure that they remain both viable and operational at least in the short-term.

Such a stimulus package however must not create an over-reliance on cash grants by the government, potentially creating a "hand-out economy" which is neither desirable nor sustainable in the long-run. Therefore, it is suggested that cash grants to SMEs be specifically targeted toward SMEs who can demonstrate severe cash flow shortages and threats to its going concern. Priority should be given to the retail and hospitality sector SMEs, as these sectors contribute significantly to the employment of youth in the country.

[7] https://www.nst.com.my/news/nation/2020/05/588982/pm-malaysia-has-suffered-rm63-billion-losses-due-mco
[8] Principal Statistics of the Labour Force Malaysia 2Q2020, Department of Statistics Malaysia

Recommendation 2: Support Interest-free or Subsidized Soft Banking Loans to Affected SMEs

Supporting interest-free/ subsidized soft loans to SMEs where the government will collaborate with financial institutions to provide a cheap source of emergency funding and in which the government will absorb a variable/ sliding percentage of interest payments for a period of up to two years.

This program is similar to the Sarawak government's initiative under the Bantuan Sarawaku Sayang (BKSS) wherein the state government participated with seven local banks to provide a RM1Bil relief package for local SME's. Under this scheme, the state government pledged to absorb all interest payable for a period of three and a half years without requiring any initial collateral from the applicants. Though commendable, such initiatives can weigh heavily on national finances if rolled out on a blanket scheme.

Therefore, to roll out such a scheme nationally, the program requires targeted reductions in its scope and applicability to lighten the heavy cost burden on national finances. It is suggested that the applicability criteria should be scaled back to favour both Micro-enterprises and SME businesses after providing evidence of an immediate threat to their going concern.

In addition, SMEs within affected sectors such as the retail and hospitality industries should be given greater priority. Such businesses should be eligible for a higher interest payment subsidy than SMEs facing a lower threat to their fiscal sustainability, such as in IT-related services and e-commerce which should be given a lower rate of interest payment subsidy by the government.

Recommendation 3: Empower Locals in Providing Cash Grants to Effective SME Investments

Following from Recommendation 1, the Federal Government should provide funding and empower local governments to provide cash grants to effective investments at the local level in providing cash support subsidies on rental, deferment of capital investment repayment for the operational and maintenance costs for SMEs.

In accordance with the aim of empowering local governments, cash subsidies for SMEs should be made on the basis of promoting effective locality-based investments, which have the potential to both boost its own local competitive advantage and on the basis of long-term profitability. Investment preference should be given on the basis of local supply and demand of services, such as in areas where local IT or delivery services are lacking.

This will help introduce severely needed services in areas where the bulk of the private market has yet to reach, such as in the rural countryside and hard-to-reach areas.

Recommendation 4: Extension of the Banking Loan Moratorium on a Case-by-case Basis

The government should consider an extension of the Bank Negara Loan Moratorium on a case by case basis, however special attention should be given to SMEs and affected industries so that they are able to sustain operations and keep their employees on the payroll at least until the end of the year 2020.

This will contribute to efforts in keeping loans outstanding as a lower cost burden and be sustainable for SMEs to ensure they will not be made shut down due to cash flow shortages in the short-term. This measure also allows for the deferment of loans to be repaid at a time when it is more convenient for SMEs to do so. Such a measure however should be made on a case-by-case and voluntary basis based on the industry sector, with BNM acting as a backstop for the nation's financial stability.

If this measure was instead blanketly forced onto the banking industry, it would create many adverse ripple effects in an industry that provides high-skilled and high-income employment to nearly 165,000 people throughout the country. A moratorium on loan repayment could jeopardise the banking sector's liquidity position, reducing its ability in providing fresh loans and puts the bank in a more financially strained position as loan repayments are a chief source of income for every bank, further eroding the sector's capital adequacy, an important metric for a developing nation such as Malaysia.

Recommendation 5: Special Recovery Discount on Electricity/ Internet Bills for Affected SMEs

Consider a government-sponsored subsidy/ discount for electricity and internet bills up to a fixed amount for businesses until the year's end to reduce operational costs to the SME firm. During the SARS outbreak, a helpful fixture in helping SMEs navigate their immediate cashflow crisis was the BN government's provision of discounts for electricity and utility bills for affected sectors such as the tourism and food and beverage SMEs. At the lowest and most immediate level, it helps allow SMEs to stay afloat amid uncertain cash flows and risks to its short-term profitability.

Recommendation 6: Bolstering Micro-credit as a Sustainable Growth Catalyst for Rural SMEs

For large sections of the rural community, micro-credit schemes have been a continuing source of support for many families throughout the past several years. The most famous micro-credit institution in Malaysia is undoubtably Amanah Ikhtiar Malaysia or AIM. The microfinance institution has an immense reach of over 379,000 people throughout the country.

According to a 2011 research paper on AIM published in the International Journal of Business and Society[9], the regression analysis found that the financial performance of AIM participants significantly improved for individuals who were financially literate and were able to guarantee a higher micro-loan amount from the institution. This gives us several policy implications for micro-financing to be a viable model for catalysing income growth for rural communities.

Analysis shows that micro-credit schemes should be equipped with adequate financial literacy programs and should be financially expanded to achieve the fiscal space to lend at greater levels. However, despite the success of its participants in the study, the impact of the COVID-19 pandemic will affect such rural communities the hardest, as many are based on hands-on cottage industry manufacturing and low-cost sundry shop retail, making flexible work from home policies impossible, thereby making it harder for rural communities to recover as long as containment measures are in place.

However, it should be noted that AIM has a chiefly rural Muslim-Malay demographic which is an inherent weakness in bringing SME development to impoverished minority communities. For illustration, in 2011,[10] Chinese and Indian participants make up less than 1% of the total participant base.

Therefore, despite AIM having the potential to reach many impoverished rural communities, for microfinance to pave the way and act as a catalyst for overall higher-value SME development nationally, such programs must be more geographically and demographically inclusive and begin operating in more semi-urbanized technologically-enabled environments to access more developed local markets absent in the rural countryside.

Financial Support for Vulnerable Groups and Sectors

Since the outbreak of the pandemic, national restrictions on movement have caused domestic demand to fall in the near-term. Consequently, many businesses, particularly those in the tourism and retail sectors have been heavily impacted. As businesses in these sectors face a major revenue shortfall, many workers have faced the

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[9] An Economic Impact Assessment of Microcredit in Malaysia: The Case of Amanah Ikhtiar Malaysia (AIM), Norma Md Saad, International Journal of Business and Society, 2011

[10] The Role of Microfinance in Poverty Alleviation: AIM's Experience, AIM, 2011

higher possibility of being laid off or placed on unpaid leave. As a result, an increasing number of people have become more vulnerable. Therefore, the government must take action to protect the welfare of such vulnerable groups to restore long-term economic growth.

Recommendation 1: Increase the efficiency of stimulus packages (PRIHATIN and PENJANA)

Though the PRIHATIN and PENJANA plans were effective in supporting vulnerable groups and businesses, many aspects in their efficiency can be improved.

The PRIHATIN package displays a lack of efficiency for several reasons. Firstly, several vulnerable groups had been excluded from registering for the PRIHATIN package. According to the World Bank's Malaysia Economic Monitor, the applications of several vulnerable groups for the cash aid had been declined due to various reasons, most notably, losing employment near the closing date of application[11]. Rejected individuals had to make an appeal for reconsideration, resulting in a time period with no cash inflow. Such teething problems have thus reduced the overall efficiency of the package. However, through the use of digital technologies and real time tracking, the government can indeed fix these issues in subsequent stimulus packages to ensure better inclusion of vulnerable groups.

Secondly, under the wage subsidy program, it was shown to have been unsuccessful due to the fact that many SMEs fail to agree to keep their employees in the company for a minimum of six months. In addition, this clause also prevents them from forcing unpaid leave and requiring the company to continue regular salary payments over the next six-months. Therefore, many SMEs may value the cost of retaining the employee higher than the benefits of receiving a wage subsidy. Therefore, the government may consider increasing the amount of subsidy available to every SME to encourage the uptake of the program, reducing unemployment.

PENJANA was also criticized as several measures proved to be more beneficial to high-income households over the poor. These measures include relief on stamp duties, real property gains taxes and vehicle sales taxes. Since low-income households typically focus their expenditures on everyday consumer items, such tax relief will not benefit those in the low-income category.

Recommendation 2: Increase the amount of financial assistance in the stimulus package

The policymakers behind the PRIHATIN and PENJANA plans which provided financial assistance to the vulnerable presumed that the economic crisis will end at the end of the year. However, in actuality, at least 2 years are needed for the job economy to recover to pre-COVID-19 levels. Therefore, more liberal financial assistance needs to be meted out during this trying period so that vulnerable groups can be shielded from the worst effects.

Greater financial assistance measures are needed for many vulnerable groups because working adults whose income is lower than RM4,000 have a lower financial ability to support their daily expenditures during the pandemic. In a recent survey by DOSM[12], it was found that the PRIHATIN package was effective in helping the vulnerable to get through the first round of MCO, but 82% of them suggested that they needed additional financial assistance if the MCO is implemented again. In short, the vast majority of recipients reported that additional financial assistance is needed to help vulnerable groups in getting through the worst hardship caused by this potentially long-lasting pandemic.

[11] Surviving the Storm, World Bank Group
[12] Report of Special Survey on Effects of Covid-19 on Economy And Individual (Round 2), Department of Statistics Malaysia, July 2020

Recommendation 3: Provide skill building initiatives

As a result of the pandemic and the subsequent MCO, many companies have been forced to accelerate their rate of digitalization and technological adoption. While a welcomed change, this also means that many skills learned before the pandemic might be rendered obsolete in addition to the automation of many company functions. Therefore, it is important for the government to provide skill-building initiatives so as to ensure that the most vulnerable and newly unemployed are able to develop the theoretical skills that are needed by a post-pandemic business environment, upgrading their social mobility in the long-run.

Hence, it is recommended that not only more educational programmes are developed but Active Labour Market Programs (ALMPs), such as those implemented in the United States and the UK that focus on helping the unemployed and fresh graduates in the labour market to both acquire skills through dedicated training programs and assistance with interview skills and resume writing.[13].

Programs such as the Malaysians@Work or MalaysiaKerja initiatives announced during the PH administration are noteworthy programs which support the employment of youths and women by providing a wage subsidy of RM500 per month to the employee and RM300 monthly to the company for each new hire. Such a program has the potential to increase the job security of workers through cash incentives and employment subsidies.

The government should likewise consider working closely with larger MNC corporations in the technology and IT sectors to develop classes on software and programming to train and upskill fresh graduates as well as the B40. For example, the government of Bangladesh had teamed up with Microsoft to roll out a training program to educate thousands of women on hardware repair and software usage[14]. Such programs that target women among the B40 are more likely to help improve social mobility, developing critical skills that increase household income.

In short, due to the rapid pace of digitalization in Malaysia, skill building initiatives should be implemented in both the short and long-term to both help increase the pool of skilled workers required by a post-pandemic economy.

Recommendation 4: Design Sector Specific Measures

As a result of the pandemic, sectors such as the tourism and retail were more heavily affected when compared to other sub-sectors as they carry out non-essential economic activities that involve physical interaction.

The tourism industry in Malaysia is extremely important for the country because it had collectively contributed 15.9% of GDP in 2019[15]. In addition, the tourism industry also supports 23.6% of the total employed workforce in Malaysia. Since the start of the pandemic however, it had suffered a loss of RM45Bil in the first half of 2020.

Therefore, it is important to design a stimulus package that is specially tailored to the tourism industry to inject fiscal liquidity into the sector. For example, the government can increase the amount of wage subsidies for the local tourism industry. In addition, the government can extend the loan moratorium for businesses and employees in the tourism industry for a more extended period than other industries in line with the Prime Minister announcement that the industry requires at least another 4 years to recover to pre-crisis levels[16].

Hence, the government should consider providing higher wage subsidies and extending loan moratoriums to operators in the tourism industry so that employment in this industry can be regulated and kept operational in the near and long-term.

[13] Surviving the Storm, World Bank Group
[14] https://news.microsoft.com/en-my/2018/01/12/upskilling-digital-transformation-economic-transformation/
[15] Tourism Satellite Account 2019, Department of Statistics Malaysia
[16] https://www.ttgasia.com/2020/07/13/matta-calls-for-extension-of-loan-moratorium/

Medium to Long Term Measures

In the medium to long term, the economic outlook is expected to improve. Projections by several high-profile institutions have provided key insight into Malaysia's market performance in the subsequent year.

The Asian Development Bank (ADB) has maintained its GDP forecast for 2021 at 6.5%[17], spearheaded by the manufacturing of medical and pharmaceutical goods which have increased by 22.2% in the 1H2020 due to strong global demand, much of which is expected to continue into the near future. However, they caution that their projected outlook is highly vulnerable to external risks and volatility in the international financial market.

Meanwhile, RHB Investment Bank had upgraded its 2021 real YoY GDP growth projection to 7%, based on the assumption of a mass COVID-19 vaccine deployment in the second half of 2021[18]. The deployment of the vaccine itself is said to cause gradual economic improvements as the deployment will spur an increase in public health spending. Besides this, continued government support for local industries will aid domestic economic growth. Not to mention that the low-interest rate environment is expected to persist into the coming year.

While the World Bank projects Malaysia's GDP growth to resume growth normality in 2021 at 6.9% as the outbreak eases due to the country's diversified economy and exports and strong economic fundamentals[19]. Finally, BNM had opined that Malaysia's economy is expected to recover gradually in 2H2020 as the economy progressively reopens and external demand improves from the initial COVID-19 outbreak. They forecasted a GDP growth of between 5.5% and 8% in 2021[20], well within the expectations of market experts.

Despite the positive GDP growth projections described above, proactive steps by the government need to be undertaken to ensure that Malaysia achieves its desired rate of economic growth. The following are several recommendations to ensure a stable growth path for Malaysia

Recommendation 1: Ensuring the Economy be Switched on and Functional

Ensuring that the Nation's economy continues to be largely switched on and operational. Oversight and monitoring on the pace and degree of job and business losses especially in the SME category should be continually made on a bi-monthly basis to ensure that proper aid be given to the right industries. Higher priority should be given to higher valued SMEs and those that hire a significant number of people, in the context of an SME (>40 employed persons).

Recommendation 2: Ensuring Sufficient Liquidity for Consumers

Ensuring that people have sufficient liquidity to continue consuming even if they are not employed. As consumption in the economy is expected to be dampened in the near-term and moderately sluggish in the medium-term as people gradually rebuild their lost income in the following recovery, a counter-cyclical boost should be implemented to ensure that while incomes are dampened, domestic consumption can be maintained at a more desirable level. Increasing disposable income in the near and medium term is key to maintaining a long-term rate of consumption stability.

Increasing disposable income in the present can be performed either in the form of a cash handout or a universal tax credit. However, between the two methods, the former is most likely to be successful, this is because many workers in Malaysia do not qualify for taxable income and many may not understand the process of claiming special tax credits to begin with, needing more effort by the government in education.

[17] ADB maintains Malaysia's 2021 growth outlook at 6.5%, Bernama, September 2020
[18] Investment bank upgrades Malaysia's 2021 GDP forecast to 7%, The Star, October 2020
[19] World Bank, IMF project larger Malaysia GDP contraction in 2020, The Edge Markets, June 2020
[20] BNM: GDP expected to improve to between 5.5% and 8% in 2021, The Edge Markets, August 2020

Therefore, to fix the problem of low liquidity in the short and medium-term, it is more prudent to simply provide a cash handout on a sliding scale, similar to the cash handouts given similar to the RM7Bil allocation under the PRIHATIN Cash Aid program. However, instead of having a single pay-out between long stretches of time in between, it is far more prudent to segregate such aid on a monthly basis without increasing the total nominal amount. This will allow consumers to have a more flexibility in planning monthly expenses, resulting in a more efficient income smoothing process for recipients.

Recommendation 3: Public Investment in Local SMEs

Increasing public investment in local SMEs with an eye towards long term growth in high value production and which can boost the long-term competitive advantage of a locality. Effort should be made to look at both rural and urban initiatives separately and avoiding public investment using the same paint brush standard. Focusing on rural and urban initiatives separately is key in building local economies of scale and increasing local productive capability.

In practice, this could be done in several ways, firstly, as banks are becoming more cautious in private lending practices, the local government could help to step in and act as a broker for shortlisted applications based on future profitability and ability to provide a local comparative advantage. The local government could provide a letter of government guarantee on 5%-20% on the initial investment capital needed depending on the scale of the investment, which would allow the banks much needed risk-adjusted flexibility in the provision of such loan agreements.

Secondly, the local government could simply provide a grant scheme on smaller yet effective investments of up to RM5-RM20K for the initial investment. Such an investment however would likely be more costly than the former suggestion and could result in a lower number of recipients in total. Therefore, additional safeguards need to be put in place such as a more stringent commercial viability vetting process and a localized monitoring of commercial performance is needed ex post to ensure that the cash grant is put to effective usage.

Recommendation 4: Reopening the Economy by Sector and Stages

The government should develop a strategy of reopening the economy by district and in phases. In this regard, a joint government-private sector committee is needed at the earliest stage possible to strategize a comprehensive reopening of sector-specific private sector and SME companies.

Due to the current partial containment measures and threats of subsequent infection waves however, this feat may be harder than it seems. This is due to the fact that for this exercise to be effective, the government, public health officials and both SME and private sector groups need to be in universal agreement of containment measures, in worst- and best-case scenarios, including implementing a detailed, sufficiently thought-out strategy when an outbreak wave occurs.

In addition, a risk/reward analysis must be undertaken to arrive at optimal decisions for more essential sectors and businesses that have a higher investment risk than others but contribute significantly to employment and GDP leading to trade-offs between different subsectors in the private market.

Recommendation 5: Fostering Local SME Supply Chains

Foster local SME supply chains by reorienting government initiatives toward the encouragement of domestic enterprise in intermediate good production with an eye toward foreign markets. Local SMEs should be encouraged to export and compete internationally, with our foreign trade partners whom we have Free Trade Agreements

(FTAs) with while focusing most notably on the ASEAN region as long-standing trade partners with a future aptitude towards both global and regional supply chain manufacturing.

Indeed, in a research piece conducted by CIMB ASEAN Research Institute (CARI)[21], they argue that the path forward for countries in a post-pandemic ASEAN is to foster greater intra-ASEAN trade and investment initiatives, as a greater regional bloc can help strengthen its markets in an increasingly uncertain trading environment and decouple the region from external market volatility and shocks in addition to the added advantages in creating a single regional market.

Regional trade agreements such as the Regional Comprehensive Economic Partnership (RCEP) can serve as multilateral mechanisms to push back against protectionist sentiments and bolster ASEAN centrality, giving the region a louder voice in managing great power relations in the region.

Recommendation 6: Implementing an Enterprise Investment Scheme

Implement an Enterprise Investment Scheme (EIS) similar to what is in place in the United Kingdom (UK) that makes it easier for SMEs to raise capital. The EIS in the UK provides a 30% federal tax relief to the investor's individual income tax owed for the year, this scheme acts as an incentive to investors to make purchases of SME equity shares. The maximum amount of claimable tax relief is capped in the UK at £300,000 for equity shares purchased from qualifying companies directly or through an EIS fund. Similarly, in the Malaysian context, the maximum tax relief should ideally be capped at a lower monetary amount (eg. RM100,000) to account for the loss in taxation in public tax revenue collection.

Malaysia should consider setting up a qualification agency under the government that follows specified regulations, which prevents companies and investors from abusing the law and subverting its goal of encouraging investment into SMEs. For example, several regulatory measures are to require investors pay for the shares at the time of receiving them, shares issued without payment or under a delayed payment structure are not eligible for tax relief. In addition, the investor must hold onto the shares for at least 3 years and shares purchased must be ordinary shares that do not give preference the investor in the face of SME risks.

Finally, the EIS does not allow any arrangement to be made solely to provide tax relief, such as when two investors agree to invest on the condition that both invest in each other's companies in return. Such arrangements if found out, qualify as immediate disqualification and a penalty is applied.

Implementing such a scheme in Malaysia will greatly benefit SME sector groups in raising private market capital. In addition, foreign investors who wish to invest in a local company should also fall under the scheme to encourage individual foreign investors to provide the initial seed capital needed for Malaysian enterprises.

Recommendation 7: Diversifying the Economy Towards New Growth Sectors

Diversifying the Malaysian economy to favour new growth sectors that can be more resilient towards similar crises in the future. In observing market trends, future global projections by the World Economic Forum[22] point toward a more technologically-enabled, innovation and knowledge-based economy. Industries that allow for workplace flexibility that can accommodate working from home policies will be best poised to capitalize on the new post-pandemic normal.

In this regard, there needs to be a long-term and sustained effort to keep people employed and educated in relevant sectors and industries. In this regard, it is necessary to build on the recommendations provided in the earlier

[21] How COVID-19 will transform global supply chains and how ASEAN must respond, CARI, April 2020
[22] New tech infrastructure will help economies recover after COVID-19, World Economic Forum, May 2020

segment in providing education to vulnerable groups. It is necessary for the government to implement educational policies that favour the innovation economy, professions that require technological know-how such as in the STEM fields, computer programming and artificial intelligence (AI) development in order to create the large pool of high skilled workers of future industries.

Recommendation 8: Reorienting Malaysia's Agricultural Policy from Commodities to Food Production

Refocusing on a food-based agricultural policy, instead of the current commodity-based one. There is a need to reorient our priorities in agriculture, as the pandemic has shown, Malaysia as a whole and in several states such as in Sabah, where food imports make up almost 75% of total food consumption, food security continues to be a major issue.

Malaysia, as a nation blessed with large arable tracts of land has to refocus its efforts on becoming food independent however this should not come at the expense of inflicting additional tariffs or restrictions on food imports, which would only negatively exacerbate food availability in many parts of the country, particularly in East Malaysia.

A suggestion would be to provide state-backed subsidies to rural farmers to upgrade their farming methods and measures to increase the per worker productivity of farmers with the same amount of land used. The government can consider reorienting the goals of FELDA and FELCRA to diversify their total production toward a 10- 15% crop portfolio in high yielding fruits and vegetables, the sale of which will be partly supported by profits from regular palm oil operations, increasing the overall supply and a more diverse range of foodstuff.

In addition, effort should be made to re-examine the rice monopoly held by Bernas. In a report by the Institute for Democracy and Economic Affairs (IDEAS)[23], they found that though the Bernas rice monopoly in Malaysia had stabilized food prices, this had come at the cost of resource efficiency, equity, growth and sustainability in the long-run. The state-backed monopoly measures have crowded out competition, limited the incentives for productive innovation, created an uneven playing field and severely hampered both upstream and downstream SMEs in the entire industry. The authors of the report conclude that a thorough re-examining of the state-backed monopoly position must be reviewed otherwise little to no innovation can occur in the rice production sector.

They suggest that instead of maintaining the government-sanctioned monopoly, a national rice value chain board should be set up to undertake a long-term structural transformation of the rice industry, while reviving the framework for new cooperatives and SMEs while encouraging the adoption of new technologies in rice paddy farming.

Developing the East Malaysian Economy

The economy of West and East Malaysia has often been recognized as running at two different speeds. While West Malaysia is home to much of the nation's infrastructural development and economic growth, East Malaysia has been neglected compared to the former. Basic infrastructure such as banking and healthcare facilities, electricity and water supply as well as access to internet and telephone usage are critically lacking in rural areas. Despite the two states being rich in hydrocarbons, where Malaysia extracts most of its oil and natural gas for export, the lack of basic amenities have adversely impacted the state's efforts to attract investment and by extension, economic growth.

According to a GPS statesman, Anyi Ngau, East Malaysia needed more allocation on development to help achieve the target of becoming a developed state by 2030. According to the Sarawak Planning Unit, Sarawak needs at

[23] Effectiveness of State Trading Enterprises in Achieving Food Security: Case Studies from Bernas in Malaysia and Bulog in Indonesia, IDEAS, November 2019

least 8% in GDP growth every year in order to achieve developed status by that time[24]. The following recommendations detail suggested measures needed to develop East Malaysia.

Recommendation 1: A Government Guarantee on the Pan-Borneo Highway

The Pan-Borneo highway which links Sabah and Sarawak should be a top priority in the development of both eastern states. Since both states are relatively isolated from each other, building a highway along the 706-km corridor is of paramount importance to allow for development along the highway, incentivizing economic development along the project's route.

The Ministry of Works had announced that the Pan Borneo Highways in Sabah and Sarawak have each recorded 32% and 52% progress respectively in June 2020. While commendable, the government should ensure a guarantee that the highway be given priority in their development expenditure. In February 2020, the then-Works Minister, Batu Bian had insisted the completion date to be June 2022, however since the shift in government, the new completion date was instead revised to 2023 for Sabah and 2022 for Sarawak, as the latter government had terminated the project delivery partner model used by the previous administration.

The extension in the completion date is likely to cause a degree of uncertainty and investor anxiety as such a move would adversely impact the investor's initial investment projections. Therefore, the government needs to show a greater level of commitment and concern to the completion of the highway by announcing a public guarantee and timeline on the project, allaying the fears of investors.

Recommendation 2: Government Investment in Basic Infrastructure and Internet Connectivity

It is unfortunate that despite its vast hydrocarbon reserves and energy refining facilities, East Malaysia lacks basic infrastructure and lags behind in connectivity. Due to this, a principal problem arises from the above recommendation of enhancing digital technologies. The development and rolling out of new technologies are highly dependent on first having a reliable internet infrastructure and stable internet connectivity.

Therefore, there is a need to bridge the development gap between East and West Malaysia to share and roll out new technologies in the two states. This is especially important in the rural areas in East Malaysia. From a survey conducted by Jali, an assistant professor in communication studies, it was found that 67.1% of people from Sabah and Sarawak felt dissatisfied with their Internet connection.[25] Further, it was found that stable internet connection was unavailable in the homes of 14.6% of respondents. When respondents are asked whether they had communicated such connectivity problems to their service providers and authorities, 50.3% expressed that they have complained to the authorities before but their problems were still not effectively solved.

The main problem in internet connection may be in part caused by the monopoly of Telekom Malaysia in providing Internet service. Approximately 90% of the fixed broadband services are provided by the company in Malaysia.[26] Since there is a lack of fixed broadband service providers in East Malaysia, the people in Sabah and Sarawak are limited in their selection and are forced to engage with Telekom Malaysia as their uncontested service provider. Therefore, many do not opt for mobile broadband because of the low speed and reliability. Telekom Malaysia may be abusing their natural advantage in the market even though the services provided are largely inefficient.

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[24] MPs highlight development gap between east and west, Bernama, July 2020
[25] https://medium.com/@nuurrianti.jalli/in-east-malaysia-internet-connection-is-still-a-privilege-1b0d73d96671
[26] https://www.malaysiainternet.my/2019/12/telekom-malaysia-never-5g-infrastructure/#:~:text=Telekom%20Malaysia%20(TM)%2C%20the,(NTIP)%20in%20the%20country.

Recommendation 3: Opening Up Telecommunication and Internet Connectivity to International Market Competition

One option is for the government to design open market policies that encourage greater international competition in the East Malaysian telecommuting and internet market[27], though this would come at the expense of breaking up the monopoly position of Telekom Malaysia. This measure can provide greater alternatives to consumers and lower the average price for internet services.

Besides this, greater market competition could also increase the efficiency of firms as failure to innovate will cause many to lose their market share and lower profit margins. However, despite the projected benefits, many powerful interest groups would be strictly against such a proposal. Though simply the threat of opening the market to competition may potentially force Telekom Malaysia to improve their services.

Recommendation 4: Allocation of Funding Towards Wireless Connectivity

Another reason that might cause internet connection problems may be the slow development of telecommunication infrastructure despite the government setting up a sizable number of plans to address the digital divide that runs deeply in their society. In the survey written by Jali, it was found that most people in East Malaysia believe that government plans for reducing the digital divide are empty promises that will never be carried out.

Jali cites the “1Malaysia Wireless Village” initiative, which was intended to enable people living in rural and semi-rural villages to enjoy stable internet connection did not achieve its aim.[28] This was in large part due to the limited coverage of the WiFi transmission-equipment in villages that disable people living far away from such hotspots from enjoying reasonable Internet services.

Specifically, only houses built inside a 250m radius from the hotspot generated by the WiFi transmission-equipment have access to the internet. Therefore, the government can allocate additional funding to upgrade the WiFi transmission range and equipment in remote villages to enable locals to enjoy more reliable Internet connection.

Aside from upgrading the WiFi transmission-equipment in the “1Malaysia Wireless Village” campaign, the government can also speed up the National Fiberisation and Connectivity Plan (NFCP) which aims to provide internet connection to people in rural and urban area equal access to faster and cheaper Internet connection across the whole of Malaysia. This plan is discussed in greater detail in a later section (please refer to page 28) as it also plays as an important role in educational reform even after the aftermath of the pandemic subsides.

Solving the internet connectivity problem especially in rural areas in East Malaysia requires a deep commitment from the government to ensure that investment in fixed broadband services be increased to provide more efficient connectivity services to consumers. In addition, basic telecommunication infrastructure required for decent internet connection can be enhanced by upgrading investments into the “1Malaysia Wireless Village” while expediting the NFCP.

Initiatives to Boost Domestic and Foreign Direct Investment

During the GFC eleven years ago, Malaysia’s approved private investment nearly halved while net Foreign Direct Investment (FDI) plunged 78.6% during the period[29]. A similar situation could likely repeat itself this year on the back of both COVID-19 and the oil price rout. The unprecedented economic turmoil has shaken both domestic and

[27] https://www.theedgemarkets.com/article/time-allow-more-competition-bring-prices-down-economists-urge
[28] https://www.thestar.com.my/news/community/2014/11/17/limited-access-to-wifi-govts-initiative-not-achieving-objective-to-provide-wireless-facilities-in-ru
[29] https://tradingeconomics.com/malaysia/foreign-direct-investment

foreign companies alike and will be taking a step back with their pockets sewn tighter as many investors hold off their investment decisions.

In 2019, Malaysia recorded RM208Bil in approved investments, comprised of RM126Bil in Domestic Direct Investment (DDI) and RM82Bil in FDI, which was a meagre 1.72% improvement from 2018. Given the unprecedented events in 2020, to even maintain such a level would be an almost Herculean effort as economists project the decline in total approved investments could contract as much as 50% this year[30].

The United Nations Conference on Trade and Development (UNCTAD) in its latest Trends Monitor Report expects the downturn on global FDI flows to contract by between 30% to 40% in 2020-2021 due to the global disruption caused by the pandemic[31], this was revised downward from an earlier estimate of 15%-20% contraction in FDI flows.

SERC executive director, Lee Heng Guie stated that behavioral changes in household and business spending in the new normal post-COVID could mean a reorientation of global supply chains and supply networks as investors adjust their approach to domestic and foreign investments. He expects a sharp 42.8% decline in FDI to an estimated total of RM128Bil in 2020, due to a highly cautious investor sentiment and significantly undermined cashflow estimates for the year. Of the 42.8% decline, it would be led by a contraction in FDI of 46.6% and DDI of 40.2%.

On the domestic front, Malaysian investors are expected to rebuild their impaired balance sheets and stabilize their losses before committing to any further investment in the near-term. Lee expects that the bulk of the investor risk-appetite will stem from the E&E, chemical and pharmaceutical-based sectors, as well as in digital networking and new technologies such as nanotechnology and 5G development.

Projections from other economists are not much brighter. UOB senior economist, Julia Goh, expects a drop in total approved investments to RM100Bil for the year 2020. A slower pace of project development due to imposed lockdown measures will see tepid real private sector investment growth for the year, forecasting a 12% decline in private sector investment growth.

Anthony Dass, AmBank Group Chief Economist also opined that the combination of global supply disruptions amid weakened demand factors will impact consumer and business confidence, while weak FDI flows and cautious DDI investment will weigh heavily on the Malaysian economy. Anthony opined that lower investment growth this year will weigh heavily on Malaysia's growth profile through lower service sector growth, low job and SME growth and most notably, a reduced current account on our balance of payments.

Therefore, since the near-term outlook is set to be bleak by all estimates and projections, Malaysia should instead focus on its medium to long term investor attractiveness as its most immediate concern. The below initiatives detail several proposed measures in attracting long-term foreign investment.

Recommendation 1: Capitalize on the Exodus of FDI from China Due to the US-China Trade War

The US-China trade war is showing no sign of slowing down. The Economist expects to see worsening attitudes in non-tariff areas namely in technology, finance, investment and security[32]. The group expects that a gradual corporate exodus is likely, diversifying their operations into other parts of Asia to mitigate the impact of the dispute. Plans by US firms to shift their processes to Taiwan is met with only moderate success due to the latter's high labour and land costs, as well as stiff competition from China's industrial clusters. A similar situation exists in Singapore, Japan and South Korea, whose economies struggle with comparatively high labour, land and utility costs.

[30] https://www.thestar.com.my/business/business-news/2020/05/04/need-to-boost-fdi
[31] 'Rapid deterioration' in global investment flows as Coronavirus spreads: UN trade body, UNCTAD, March 2020
[32] Up for grabs: Asia's trade war investment plans, The Economist, October 2019

In response, Indonesia, Thailand and India have been quick to seize the opportunity, Indonesia began offering a super-deduction tax break for qualified activities in Research and Development (R&D) as well as establishing training centres and expanding new investments in labour-intensive industries. In addition, Thailand had unveiled a relocation package for foreign companies affected by the trade war. The measure includes a 50% corporate tax cut for 5 years, contingent on recipient firms investing at least Bt1Bil (RM133Mil) into the country by 2021. Similarly, they have also offered generous tax cuts for training programs on emphasized skills. Not to be outdone, India had cut its corporate tax rate from 30% to 22% while reducing the tax rate for new manufacturing companies in the E&E, automotive and textile sectors to 15% from 25% previously.

Malaysia on the other hand, had not done enough compared to our regional competitors in bringing in foreign investments from the US-China trade war. Therefore, Malaysia should begin offering similar tax incentives targeted at high-valued investments from US and European firms that have previously had operations in China. Malaysia should specifically target high-value investments that encourage technology transference from technologically advanced firms.

A list of initiatives by regional competitors that Malaysia could design its policy is provided below:

Thailand	Indonesia	India
50% corporate tax reduction for five years, although applicants must apply by 2020	300% tax reduction for domestic taxpayers that conduct qualified R&D activities; needs to be aimed at invention, innovation, technology development or technology transfers	Corporate income tax cut from 30% to 22%
Tax deductions on investment in automation, but also training for advanced technology and skills development	200% tax reduction for skill training activities, including internship programmes and other human resources development	For new manufacturing companies (starting operations after October 1st 2019, but before March 31st 2023), new rate has been reduced to 15%, from 25% previously
Requires an investment of at least Bt1Bil (RM133Mil) by 2021, but no geographic restriction	60% tax deduction based on total costs incurred by new or expanded investments in labour-intensive industries	Large focus on automotive, electronics and textiles; future additional support plans are being drafted

Source: The Economist Intelligence Unit, Baker Mckenzie

In this regard, Malaysia should focus on offering more flexible tax-free statuses to foreign companies with good potential for high quality and high value technology transference. These tax initiatives should be targeted at firms with a focus on new technologies such as AI, 5G and Robotics. This will allow Malaysia to leverage on its relatively lower semi and high-skilled labour costs and offer attractive packages and cheap 99-year term leases on large tracts of undeveloped land in industrial zones throughout the country.

In addition, infrastructure in promoted industrial zones should be well developed, complete with road and train lines that make the transportation of goods easier to execute, special attention should be given to developments along the East Coast Rail Link (ECRL) and High-Speed Rail (HSR) Link between Kuala Lumpur and Singapore.

In addition, improving current policies on the liberalization of investment-linked policies such as enabling wholly owned foreign entities to venture in Malaysia's high-tech manufacturing and selected high-value service sectors complete with the freedom to repatriate capital, interest, dividends and profits abroad. This freedom of course should not be applied across the board to all firms, a suggested alternative would be to provide these freedoms for a select number of high-value and high-tech firms that meet stringent qualifications to prevent lower valued, labour-intensive companies that does not provide sufficient long-term benefits in line with Malaysia's growth objective.

Among non-tax initiatives, the government should ensure that FDIs into Malaysia have relevance in the current global business environment. The Promotion of Investments Act 1986 should be revised to leverage on the SME ecosystem approach and accelerate the shift towards high-value added, knowledge and innovation-based industries in selected services and manufacturing sectors.

Recommendation 2: Develop an SME Ecosystem that can Supply Inputs Cheaply to Foreign Investments.

Malaysia should adopt the long-term strategy instead of relying on short-term rewards. Malaysia's goal in the long-term should focus on developing both the local manufacturing and high value-added services sector. From the technology transference between local companies and foreign investors, local Malaysian SMEs should be encouraged to base equivalent and improved designs from their western counterparts, be able to produce them locally and in the long-term, be able to export finished goods throughout our regional trade partners.

Such an ecosystem requires an integrated and holistic approach to promote local production across the value chain. In addition, Malaysian industrial policy should encourage the formation of many similar-industry geographic clusters to promote the entire production value chain.

In this regard, identified clusters should be enabled by good infrastructure and supported by relevant industries to act as a natural pull for investors. In this regard, to develop a robust localized supply chain for important foreign investors and Multinational Corporations (MNCs), participation from a network of local upstream and midstream partners can help SMEs meet the challenges where the flow of information is transparent along the value chain and long-term business contracts are respected and where local SMEs can integrate their production alongside the MNCs, giving many access to the global value chain.

The government should prioritize the usage of local intermediate and inputs for foreign manufacturers, this is to ensure that they are able to realize higher yields with the lower cost of production in ringgit. Similarly, once local economies of scale are achieved by local SMEs and the foreign manufacturer, the export of said inputs should be promoted internationally as international prices become more globally competitive globally as domestic output from SMEs increase.

Recommendation 3: Provide Support to Local SMEs to be Part of the Lucrative Global Value Chain

A strategy by the Ministry of International Trade and Industry (MITI) is to support and provide initiatives for a localized SME value chain, which can then feed into large MNCs and foreign investors in both manufacturing and high-end services domestically. Such a strategy would provide a win-win scenario for both the MNC and the local SME value chain. As the MNC has access to cheaper and more efficient production of intermediate goods and local SMEs have long-term access to the global value chain and increased stability in process orders.

A report by the OECD[33] found that in a study across 20 nations, the participation in global value chains enhance SME internationalisation and growth. It was found that participation provides SME suppliers access to global markets at significantly lower costs than those faced by individual small-scale producers, due mainly to the long-term intermediation contracts assured by the contractor. It found that firms that have successfully integrated into one or more value chains have been able to expand their businesses quicker and more easily, in addition to maintaining revenue stability.

In addition, small firms that focus on multipurpose technologies have secured their position in the market by becoming specialized suppliers in serving different global value chains. This is especially true in the mid-stream automotive, scientific and precision instruments. Specialization causes more niche competitive advantages than

[33] Enhancing the role of SMEs in Global Value Chains, OECD

their similar-industry counterparts and reach economies of scale at a quicker pace. Many firms have also succeeded in leveraging key intangible assets namely in their reputation in precision and cost effectiveness.

Another key advantage to developing a local SME ecosystem lies in successful SMEs having the opportunity to outsource non-core activities, allowing them to gain competitiveness and optimization in resource allocation. In addition, due to the constantly evolving nature of regional SME competition, SMEs require innovation and keeping up with new technologies to consistently upgrade their cost effectiveness compared to other regional economies. Therefore, the government should consider establishing a fund for SMEs registered within the domestic value chain of the MNC to apply for funding to continually upgrade their manufacturing process to ensure long-term cost effectiveness.

In developing a stronger industrial supply chain between new and existing upstream and downstream industries, it is also necessary to build industry connections by organizing supplier's conferences, vendor development programs and business matching events. The government should organize engagements on a regular basis between MITI and the industry chambers of commerce, captains of industry and foreign business chambers, embassies and foreign high commissions to develop solutions to challenges faced by foreign investors in implementing investment projects. The government should take an active role in mitigating such problems and developing sound practical solutions to the problems of investors

Recommendation 4: Pursue Free Trade by Considering the Ratification of the CPTPP

There are several international agreements that foster international trade and partnership between nations, examples of these include Free Trade Agreements (FTAs), International Investment Agreements (IIA) and Double Taxation Agreements (DTAs). Malaysia has a strong commitment to free international trade policy, being a signatory to many international trading pacts, most notably with ASEAN.

However, with the impact of COVID-19 on the economy, it is now more urgent for Malaysia to accelerate its commitment to fair international trade by joining the Comprehensive and Progressive Agreement for Trans-pacific Partnership (CPTPP). In the current market outlook, trade and investment appear greatly suppressed internationally. In such an environment, the CPTPP presents an opportunity for Malaysia to become more internationally competitive, which is even more important in a culture of suppressed market demand.

According to Laurence Todd of IDEAS, there is an urgent need to re-stimulate the economy and that can come from a liberalized trade environment that the CPTPP can provide[34]. Despite this call, many local unions oppose the CPTPP over the seeming lack of protection for local worker's rights at a time when jobs are becoming scarcer.

However, despite the concerns, it is projected that ratifying the CPTPP will improve Malaysia's appeal as a manufacturing hub for the region and could serve as a base for many MNCs looking to restructure their supply chains in response to the pandemic. The agreement is potentially important for ASEAN as it provides a platform for integration that greatly facilitates regional and global value chains. Thus, the many initiatives discussed above in developing and bringing local SMEs access into the lucrative global value chain rely on Malaysia's participation in the CPTPP in the medium to long term.

Early projections by Laurence indicate that pegging the CPTPP agreement will improve Malaysia's long-term GDP growth by a full percentage point, noting that there are relatively few low-cost actions the government can take to increase GDP by such a drastic amount, but the CPTPP ratification is potentially one of the rare few. In addition, though the Malaysian government had indeed signed the agreement, it had yet to ratify it in parliament.

However, there are concerns from the Malaysian Trade Unions Congress (MTUC). Firstly, the CPTPP poses a significant threat to many workers and puts a large number of jobs at risk. Secondly, the Investor-State Dispute

[34] CPTPP: The Case for Ratification, Lawrence Todd, IDEAS

Settlement clause allows foreign companies to sue CPTPP governments for a loss of profits due to policies that go against the central tenants of the agreement.

In particular, there are severe measures to increase transparency and anti-corruption measures, as well as improved governance of GLCs that are forced to follow non-discriminatory treatment, full transparency in an open and competitive tender process when procuring goods and services. This will have wide and far-reaching impacts on Malaysia's GLC sector where many will be obligated to follow non-discrimination policies and practices.

Therefore, policymakers need to weigh and consider the inherent trade-offs in ratifying such a policy, due to the obvious far-reaching effects of many interest groups. However, with the economic fallout of the pandemic, it may signal that this may be the right time to push forward with a greater eye toward internationalism.

Recommendation 5: Developing a Special Channel for High-Value Foreign Investors

Building on the prior government's Shared Prosperity Vision 2030, Chinese investors were allowed a "Special Channel" through InvestKL that featured a one-stop channel that brought aspiring Chinese investors to seek assistance and information without engaging with different government agencies to get their investments approved. This is a useful and commendable initiative, reducing red tape and having to be bogged down by multiple government agencies before getting investments approved, enabling FDIs to get approvals quickly and hassle-free.

In this regard, the focus on hassle-free applications and approval processes should be expanded to firms that meet a set of criteria in line with bringing in high-value technological expertise from the United States and the European Union. Further, building on the National Committee on Investment I (NCII) which has the authority to approve investment initiatives to foreign investors immediately, the NCII should be refocused to expedite high quality investments with incentives given within a short period of time.

The NCII approval of incentives however require proof of investment over the period of 5 years, provided that such investments provided at least RM5Bil into the Malaysian economy and proving that they are able to expand their businesses and exports globally. Such investment proof takes into account high quality job generation, supporting SMEs and consolidating local manufacturing and service ecosystems over the 5-year period[35].

Unfortunately, these investment proofs constitute a high barrier to access such incentives. It would be more prudent to reduce these high cost barriers, especially for the need to invest at least RM5Bil over a five-year period, for selected high-value industries that have the potential for high-value technology transference.

Worker Protection from the Economic Fallout

Despite the need to bring in foreign investment, it should also be made abundantly clear that foreign investment should not come at the expense of rolling back worker protections. Despite the near-term agenda of stimulating economic activity, there is also a need to strengthen the protection of businesses and households to ensure that they have sufficient resources to absorb the unprecedented economic shocks over the next few months and can restart production as soon as the crisis is over.

Several measures in the first-round economic stimulus (PRIHATIN) had emphasized the need for employee retention, which the government had introduced the retention strategy called the Employment Retention Program (ERP). The program offered a sliding-scale cash pay-out to employees who were forced to take unpaid leave as an extension of the Employment Insurance Scheme (EIS), it should be noted that typically the EIS is strictly meant for retrenched employees and not for workers suffering from other forms of labour reduction measures. Therefore,

[35] Key Budget 2020 takeaways for foreign investors, The Malaysian Insight, 2019

the continuation of the ERP is a good initiative given the likelihood for firms to adopt indirect forms of labour reduction measures in mitigating COVID-19.

Recommendation 1: Expansion of the ERP

Firstly, despite the good intentions of the ERP, there are other forms of labour reduction measures firms are likely to undertake, such as a reduction in wages or hours that would not amount to retrenchment or unpaid leave and would likely not fall under the purview of either the ERP or EIS. Evidence of wage reduction is also shown by the 5.6% contraction in private sector wage growth for 2Q2020 as illustrated above.

Therefore, the ERP should be expanded to consider the reduction in wages as a potential preference by firms, especially in the context of SMEs who are likely to have stronger employer-employee relations than larger firms. In addition, the expansion of the ERP should incentivize joint-responsibility between the public and private sectors in supporting employees.

One method would be to expand the ERP to include measures to partially and temporarily subsidize the wages of employees of SMEs whose monthly average wage contracts by over 25% at a limit based on the average Malaysian wage of RM3,224 in 2019. In addition, SME sector-specific groups should remain in contact with and report to the relevant EIS authority of any drastic cuts in employee wages over the near-term course of the ERP expansion.

Recommendation 2: Inclusion of the Self-Employed and Informal Sector

Secondly, the ERP does not include the bulk of the self-employed and non-formal workers who do not contribute to the EIS. This can potentially exclude a large part of the Malaysian workforce. According to an estimate by the International Labour Organization (ILO), an estimated 25.2% of Malaysia's total employed workforce in 2020 is self-employed[36].

In addition, according to the DOSM, the informal sector in Malaysia represents 17.4% of the total workforce or 2.66 million people according to the Informal Sector Workforce Survey conducted during 1Q2020[37]. The same report also estimated that 70% of informal employment comprised of the self-employed. It should be noted here that informal sector workers are much greater disadvantaged than formal workers as the former group are largely unlicensed and are neither registered nor covered by any social protection such as EPF, SOSCO and etc.

Therefore, the informal sector gives rise to two key problems, firstly the government is unable to track and monitor the economic survivability of such individuals and secondly, the government is unable to determine the level of cash aid an individual is eligible for as many do not provide accurate or verifiable information on their day to day sales. Moreover, the moral hazard risk of forging or providing lower-than-accurate guestimates are higher than formal sector workers if they are aware of a potentially higher pay-out based on lower sales numbers, largely in response to the existing asymmetric information.

Despite this, an immediate measure that the government can perform is to first of all, extend the ERP coverage to the self-employed and self-employed micro-SMEs, similar to how it has extended benefits to formal employees on forced unpaid leave. However, given the fact that many self-employed individuals are in the unlicensed informal sector, the pay-out should be capped at a lower rate (eg. RM500-800 per month) than formal sector workers to mitigate the effects of the aforementioned moral hazard.

However, enhancing employee protection on this scale would undoubtedly require greater fiscal injection from the Federal Government into the EIS. The first-round stimulus package to help employees on unpaid leave was

[36] https://tradingeconomics.com/malaysia/self-employed-total-percent-of-total-employed-wb-data.html
[37] Informal Sector In Malaysia, Salimah Ponggot, DOSM

estimated at RM120Mil, however with the proposed expansion, funding for the package needs to increase dramatically. This conclusion invariably leads to a later topic for discussion on the space for fiscal expansion.

Education Reform in a Post-COVID-19 World

Due to the pandemic, there has been a major change in the way classes are traditionally conducted. The provision of education transitioned from physical classes to being conducted online. However, the transition from physical to online classes had greater revealed the serious digital divide in Malaysia. More specifically, the technological shift showed that not all students have equal access to online education in Malaysia.

The most immediate challenge revealed that many students lack appropriate devices to support an e-learning platform. In a survey carried out by the Ministry of Education involving 900,000 students, 37% of surveyed students did not possess any device to access the e-learning platform.[38] The purchase of an appropriate device is easy for wealthier families, while many poor families struggle with the problem of not having enough money to invest in the same equipment. As the above discussion KRI paper showed, poorer families tend to spend most of their income on necessities like food and shelter.

Recommendation 1: Encourage Affordable Educational Devices

In order to increase the possession of devices among the students, the government should design a subsidy policy that makes such devices more affordable for the B40. There are several ways to do this, the government can provide special interest-free loans for the students to buy a device under an educational device loan scheme, modelled on the textbook loan scheme.

Aside from this, the government can alternatively provide such devices for free to students from B40 families. The government has shown in the past that this measure can be rolled out, as 1Malaysia Netbook Project in 2010 is one such example. In addition, it is also important for the government to encourage both education-based NGOs and private companies to seek donations for second-hand laptop for students from disadvantaged backgrounds.

Recommendation 2: Improving Internet Connection in Economically Disadvantaged and Rural Settings

Many students from B40 backgrounds unfortunately do not have adequate access to a good Internet connection due to a lack in internet infrastructure. According to a report by the KRI[39], it was found that the mobile broadband penetration rate per 100 people was estimated at 120% in 1Q2019. However, the fixed broadband penetration rate per 100 people accounts for only 8%. As Fixed broadband networking is relatively faster and more reliable than mobile broadband, it is an imperative that the uptake needs to be upgraded to ensure a smooth e-learning experience for students. Aside from this, the relative insufficiency of a reliable fibre optic network infrastructure is one of the key barriers that hinders students from accessing a proper and reliable internet connection.

To improve overall Internet connection, the government should provide incentives for households, especially ones in rural areas to adopt a fixed broadband connection by providing government-sponsored discounts for internet access. Encouraging the use of fixed broadband infrastructure not only ensures good internet connection, but also has a positive effect on GDP growth. According to the World Bank, an increase of 10% in the fixed broadband penetration rate is expected to increase GDP growth in developing countries by 1.38%, this translates to an estimated RM20Bil in increased GDP for Malaysia[40].

[38] Covid-19 and Unequal Learning, Hawati Abdul Hamid and Jarud Romadan Khalidi, April 2020.

[39] 1Q2019 Communications and Multimedia: Facts and Figures, MCMC, 2019

[40] Jendela's aspirations, The Star, September 2020

Despite mobile broadband being slower and less reliable than a fixed broadband connection, 5G technology can enhance the speed and reliability of mobile broadband. The Malaysian government had earlier planned to introduce 5G technology in September 2020. However, this was subsequently cancelled and delayed to 2021 amid concerns that the spectrum allocation to Altel Communications did not go through an open and transparent public tender process.[41] Despite this, when 5G is introduced within the next year, the government should ensure that sufficient 5G coverage be provided to both urban and rural areas to ensure that students from all income categories enjoy the benefits of new technology.

To improve the coverage of fibre optic networks, the National Fiberisation and Connectivity Plan (NFCP)[42], with a stipulated time frame of 5 years from 2019 to 2023, plays an important role. The objective of this plan is to provide all people in Malaysia, both in urban and rural settings, equal access to Internet services that are faster and more affordable.[43]

There are several challenges in this endeavour however, from a purely technological point of view, the range of radio frequencies for high data rate implementations of 5G do not travel over long distance, nor do they bend corners or penetrate through obstacles. These inherently limit the overall rollout of 5G as it requires 5G networks to be placed much closer together compared to 4G systems. A typical range of a 5G cell has a range of 500 feet, in contrast to a range of 1200 feet for 4G. Therefore, it makes more economical sense to roll out 5G in more urban, densely populated areas and makes rural deployment much more economically costly to sustain.

a) One feasible approach to close the internet gap between urban and rural would be to use the 5G wireless network for the “last mile” then link these 5G pockets to more cost-effective landline long haul networks. This hybrid development will eliminate the exorbitant cost of providing 5G cells to every remote area, instead, the end user will have wireless internet access while those along the landline will only be able to access the internet through the long-haul landline infrastructure network.

b) Another approach would be to use lower radio frequencies, similar to 4G speeds in 5G cell towers in rural areas. This however means that the high data rates advertised for 5G will not be achievable in rural areas using this deployment approach. This is still with the understanding that even today, large pockets of rural Malaysia do not even have reliable 4G access.

This presents itself as a difficult balancing act between providing high data rates to sparsely populated rural areas and keeping the infrastructure and maintenance costs for 5G low. It is likely that due to the cost constraints, 4G networks will carry the bulk of internet traffic in rural areas, while hybrid networks slowly come to the fore.

Despite the initial budget allocation of RM21.6Bil for the NFCP, due to the delays presented and difficulties in rolling out to rural zones, it is likely that the initial investment may not be sufficient enough to roll out 5G throughout the country. Therefore, the government should consider allocating greater resources to speed up the network deployment nationwide.

Recommendation 3: Improving the National Technical and Vocational Education Training Program and Providing Assistance to the Disadvantaged

Educational reform should also consider increased investment in Technical and Vocational Education Training (TVET) programmes in Malaysia. Due to the higher rate of digitalization and automation as an aftermath of the

[41] https://asia.nikkei.com/Business/Telecommunication/Malaysia-delays-5G-by-12-months-as-spectrum-allocations-nullified
[42] The National Fiberisation and Connectivity Plan (NFCP) 2019-2023, The Government of Malaysia.
[43] https://www.nst.com.my/news/government-public-policy/2019/08/516769/govt-approves-rm216-billion-plan-gives-urban-rural-folk

pandemic, TVET programmes in Malaysia have to prepare the students for the changes in demand in the labour market.

Despite the TVET program offering courses that prepare students for the Fourth Industrial Revolution (IR4.0), such as in cloud computing and programming, the quality of our local TVET programs has room for improvement.[44] According to Junita Mohamad, Institute of Strategic and International Studies (ISIS) fellow in economics, trade and regional integration, the quality of TVET for youths are lacking, requiring rigorous oversight and initiatives to streamline quality training programs.

She opined that to date, there are numerous TVET programs concurrently provided by seven different ministries at certificate, diploma and degree levels, which creates an overlap and redundancy of training courses. She suggests to consolidate these programs into fewer flagship programs along with measurable monitoring and evaluation mechanisms can help to weed out low-performing programs and improve administration capacity.

The government should consider these concerns and action should be taken to ensure the quality of the TVET programmes, through a method of stricter qualification evaluation, phasing out non-performing individuals. In addition, to allow more students from the B40, the government should encourage them to enrol in TVET by subsidizing their transportation costs and providing a small meal allowance to ensure that they do not stop midway as alleged by a letter to The Star.[45]

Finding Fiscal Space and Flexibility

Due to the series of expenditures to be incurred, the question of revenue arises. Currently, Malaysia's budget deficit is expected to climb to 6%-6.5% of GDP this year, according to Malaysian Rating Corp Bhd (MARC)[46]. This is due to an expected sharp decline in revenue collection as well as rising expenditures to finance various stimulus packages introduced to support the economy in the PENJANA and PRIHATIN schemes. Due to the dire fiscal situation affecting the nation's economy, fiscal space is indeed limited.

As a result, the parliament had in August, lifted the statutory national debt ceiling to 60% of GDP as part of a temporary measure to mitigate the effects of the pandemic on public services and local businesses. The PENJANA and PRIHATIN schemes have altogether cost the government an estimated RM46Bil in direct fiscal injections, which raises Malaysia's debt ceiling to an estimated 56% of GDP[47], which is set to expire at the end of 2022.

Another restriction on the government's ability to finance additional fiscal measures includes the requirement for the country's operating expenditure to be financed by revenue and not through borrowings[48] through the Loan (Local) Act 1959. Currently, our fiscal space is limited by a budget balance rule – the "Golden Rule" which in short, means that the government can only borrow for development or capital spending and fiscal balance cannot be in the negative.

The following details key takeaways in which the government can finance the additional measures in the face of an anticipated budget shortfall.

Reintroduction of the Goods and Service Tax (GST)

Raising public revenues through a consumption tax during an economic crisis can be highly detrimental to the recovery of the consumption economy. While it is possible to reintroduce the GST at a lower rate of 3-4% as opposed to the previous rate of 6%, an immediate problem arises wherein the consumption function in the

[44] https://www.theedgemarkets.com/article/state-nation-opportune-time-reinvent-malaysias-labour-market
[45] https://www.thestar.com.my/opinion/letters/2019/02/11/make-tvet-accessible-to-the-economically-disadvantaged
[46] https://www.nst.com.my/business/2020/07/607460/malaysias-deficit-rise-65pct-marc
[47] https://www.theedgemarkets.com/article/parliament-approves-raising-govt-debt-ceiling-60
[48] https://www.unescap.org/sites/default/files/04_%5BAb%20Wahab%5D%20Malaysia%20ADBI.pdf

calculation of GDP will be sharply and immediately impacted as retailers and businesses adjust the increase to their cost of sales.

Alliance Bank Chief Economist, Manokaran Mottain stated in March 2020 that bringing back the GST at 4% is projected to generate RM32Bil compared to RM27.5Bil under the current Sales and Services Tax (SST) Regime. While such a scenario is possible, there are several adverse factors to consider in the short-term when advocating for the reintroduction of the GST.

This adjustment toward the reintroduced tax can potentially lead to initial teething problems in its implementation amidst a global pandemic. Many local businesses and SMEs in particular will have to fully readjust their operations and income projections from two unanticipated events, this could lead many to exit the market if these new measures are implemented. In addition, the lack of effective consumption and the collapse of tourism and foreign investment in the near term will make it harder for many enterprises to invest in new software and manpower to comply with the reintroduced GST standards.

Despite this, the executive director of the Socio-Economic Research Centre (SERC), Lee Heng Guie had rationalized that the reintroduction of the GST should be done to widen the government's revenue base, given a slump in oil prices and the need for the government to maintain a reasonable fiscal deficit[49]. However, Lee had opined that the special exemption threshold should be raised higher for SMEs so that they will not be as heavily impacted due to the increase in the cost of doing business and additional costs for compliance.

According to Lee, the impact on inflation should not be a major worry as headline inflation is on a downward trend (deflation), therefore, according to him, it's a good time for the government to revisit the GST. However, Lee's comments belie the fact that Malaysia's deflationary pressure is in large part caused by a short-term collapse in demand-side factors. If the GST is compounded into both the costs of production and the final retail price, it is likely to dampen consumer spending even further, leading to further adverse changes in consumer behaviour patterns in the short and medium-term. To address inflation in the short and medium term, policymakers should strive to stimulate both aggregate demand-side activity and supply-side growth concurrently.

Despite this, Lee had made several noteworthy comments on the reintroduction of the GST, such as the raising of the fiscal exemption threshold for SMEs and widening the government's revenue base. His suggestions should therefore not be completely ruled out. Indeed, while the reintroduction of an SME-adjusted GST should be considered, it should be performed at a more opportune time as businesses recover from the effects of the COVID-19 pandemic. It should be stressed that current business conditions are not conducive for such an unanticipated fiscal move in the near-term and can potentially be both damaging to national consumption statistics and politically disastrous for any group who proposes such a move during a national economic crisis.

Recalibration of Public Expenditure

Since increasing public revenue through taxation is not a realistic avenue in the short-term and the drastic collapse in the international price of crude oil has slashed oil revenue collection, not to mention the collapse in economic activity will reduce revenue collection under the current tax regime. An option that can be considered would be the recalibration of the budget towards greater development or capital spending, as such public expenditures permit borrowings under the aforementioned "Golden Rule".

This recalibration does come at a cost however, as state subsidies for fuel and social assistance which have the potential to reach firms and households more immediately cannot be substantially increased in the near-term. Therefore, in the short-term, this is not a preferrable option to address more immediate shocks.

[49] SERC: Reintroduction of GST can enhance government's revenue, Ee Ann Nee, July 2020

There is another option of reallocating resources within the budget, reallocating resources from the non-essentials to the essentials, specifically this means putting off more development expenditures to a later date and prioritizing development expenditures with the highest long-term payoff. In addition, there has been recent arguments made about defunding non-critical government ministries and reallocating such funds toward the public healthcare system and worker protection agencies[50].

It is more important than ever to reallocate resources towards public healthcare as the pandemic forces upward pressure on healthcare expenditure dramatically. Indeed, there had been an increase in spending related to buying healthcare equipment, personal protective equipment, medical staff salaries, medical transportation cost and etc. In addition, it is important for worker protection agencies to source additional funds as workers, especially in the SME sector become more vulnerable in the short and medium term to worker exploitation as their employers become affected by the pandemic, reducing their collective bargaining power.

More Prudent Fiscal Monitoring by Integrating Federal, State and Local Agencies

To effectively reallocate funding for public health and worker protection, the government should consider differences in impact from the pandemic on expenditure and revenue among different levels of government, namely the federal, state, and local governments. This depends mainly on their how governments source their revenue and on what activities they are responsible for spending.

Aside from reorganizing the different levels of government, the heterogenous nature of the impact from the pandemic on governments should also be considered. For example, the pandemic has a significantly different impact when compared between Selangor and Kelantan. As Selangor had registered a greater number of cases than Kelantan, it is obvious that Selangor requires a greater level of funding to deal with COVID-19 pandemic.[51]

Though an extreme example, it illustrates the vast differences in how differently the pandemic has impacted different states and localities. Therefore, in order to monitor and reduce expenditures where required, the vertical coordination between federal, state, and local governments is of utmost importance in dealing with the socio-economic problems and recovery of local economic activities.

Without proper vertical coordination, different levels of government may develop different policy responses to the COVID-19 pandemic. For instance, Penang had rolled out its own tracing application called PGCare but the state had to discontinue its use due to the federal announcement that the use of MySejahtera App would become nationally compulsory[52]. If there were closer non-partisan vertical coordination between the federal and state agencies, such events would have been prevented.

Hence, a non-partisan committee that involves different levels of government should be created. For example, in Australia, the government formed a National Cabinet which was joined by the Prime Minister and the First Ministers of every state in the country to deal with health and economic issues[53]. The National Cabinet is assisted by the Australian Health Protection Principal Committee who provide professional national healthcare advice. In Malaysia, although the government had formed an Economic Action Council, it fails to bring together the ministers and interest groups across all the states and continue to be plagued by political partisanship[54].

Therefore, the government should consider creating a non-partisan crisis management committee formed by interest groups from all states to ease the process of vertical coordination. The committee should jointly hold discussions on a weekly basis to ensure coordination with plans to combat the pandemic can be knowingly and

[50] Defund non-critical ministries to fund the Ministry of Health more, Hafiz Noor Shams, March 2020
[51] http://wrlr.blogspot.com/2020/10/covid-19-malaysia-15-october-2020.html
[52] https://www.malaymail.com/news/malaysia/2020/08/05/penang-phases-out-pgcare-app-in-favour-of-mysejahtera/1891211
[53] The territorial impact of COVID-19: Managing the crisis across levels of government, OECD, June 2020.
[54] Sekretariat Majlis Tindakan Ekonomi, Unit Perancang Ekonomi, October 2020.

wilfully adjusted based on the constantly changing situation in each state. The adjustment may be made based on changes in geographical locations, socio-demographic factors, and local economic initiatives that influence the ability of each state to deal with the pandemic.

From such vertical integration, each level of government knows exactly what their roles are to avoid overlapping responsibilities at different levels of government. As a result, local policy responses will be more consistent across the rural and urban divide and different states, minimizing the risk of public confusion. In addition, there should be in each state, a committee that coordinates the relationship between state and local governments. The shared synergies among local and state governments may expedite the recovery from the pandemic. By increased cooperation among different levels of government, the usage of state funds can be more efficiently utilized.

In short, the non-partisan vertical coordination among the federal, state and local governments in Malaysia is an important mechanism for the effective and efficient allocation of funds for public health and desired economic initiatives. Through the formation of a well-organized and non-partisan committee that allows for equal representation and frequent interaction between different levels of government, improving the consistency and effectiveness of government responses.

Concluding Remarks

In conclusion, Malaysia has great potential to weather through the pandemic-infused economic storm. In INSAP's opinion, Malaysia should revise its focus from the short-term effects of the pandemic towards a long-term and holistically developed objective of creating high-valued and highly demanded industries of the future. Encouraging professions of the future that allow for minimal contact between individuals and flexible working arrangements such as professions that can be performed from home.

Malaysia should adopt a greater focus on SME development, encouraging SMEs to access the global value chain and developing long-term relationships with international MNCs, developing our local and natural competitive advantages and achieving economies of scale and cost effectiveness in the medium to long-term. In this regard, Malaysia should strengthen its commitment towards greater integration with the world economy, enhancing internationalism and the pursuit of free trade around the globe, enabling Malaysia to become a key international player in the high-tech manufacturing sector.

However, despite the above recommendations and push for global and regional economic integration, Malaysia must develop short and long-term policies that enhance the welfare of its citizens, especially those from the ranks of the B40 who have limited opportunities for social mobility.

In essence, the above is a Keynesian economic vision of a Malaysia with the benefits of both international and domestic free trade, a countercyclical boost to market capitalism, SME and targeted development initiatives and most importantly, the development of a social safety net that enhances social welfare among the poorest and least advantaged in our society.