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BETTER POLICIES FOR BETTER LIVES

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Foreword

This Survey is published under the responsibility of the Secretary-General of the OECD. The draft report was discussed at a meeting of the Economic and Development Review Committee on 24-25 June 2021, with participation of representatives of the Malaysian authorities. The 2021 OECD Economic Survey of Malaysia was prepared by Kosuke Suzuki, Zahid Ismail, Wan Fazlin Nadia Wan Osman, Sugumar Saminathan, Mohamad Norjayadi Tamam, Zafrulla Hussein, Suraiti Zainal Abidin, Halimahton Sa'diah Let, Mohamad Muzaffar Abdul Hamid, Nurrul Nur Aisyah Hamran, Suhaimi Hamad, Peter Gal, Francesco Losma, Laurence Todd and Eva Tène, under the supervision of Patrick Lenain. It benefitted from contributions at various stages by Alvaro Pereira, Isabell Koske, Cristiana Vitale, Ashikin binti Abdul Razak, Adlina Merican binti Zainuddin Merican, Tan Fung Ling, Zaharel Reeza Bin Ruslan and Mohd Aizuddin Noor Azman. Isabelle Luong provided statistical assistance and Stephanie Henry and Karimatou Diallo provided editorial support. Support from the World Bank and the governments of Malaysia and Japan is gratefully acknowledged. Information about the latest as well as previous Surveys and more information about how Surveys are prepared is available at http://www.oecd.org/eco/surveys.

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Basic statistics of Malaysia, 2019

Numbers in parentheses refer to the OECD average[1]

LAND, PEOPLE AND ELECTORAL CYCLE					
Population (million)	31.9		Population density per km² (2018)	96.0	(38.1)
Under 15 (%)	23.7	(17.9)	Life expectancy at birth (years)	76.2	(80.2)
Over 65 (%)	6.9	(17.1)	Men	74.2	(77.6)
International migrant stock (% of population)	10.7	(13.2)	Women	78.3	(82.9)
Latest 5-year average growth (%)	1.4	(0.6)	Latest general election		May-2018
ECONOMY					
Gross domestic product (GDP)			Value added shares (%)		
In current prices (billion USD)	365.3		Agriculture, forestry and fishing	7.3	(2.7)
In current prices (billion MYR)	1 513.2		Industry including construction	37.8	(26.6)
Latest 5-year average real growth (%)	4.9	(2.2)	Services	54.8	(70.8)
Per capita (000 USD PPP)	29.6	(47.6)			
GENERAL GOVERNMENT					
Per cent of GDP					
Expenditure	23.5	(40.6)	Gross financial debt (OECD: 2018)	57.2	(107.6)
Revenue	21.3	(37.5)			
EXTERNAL ACCOUNTS					
Exchange rate (MYR per USD)	4.14		Main exports (% of total merchandise exports)		
PPP exchange rate (USA = 1)	1.60		Machinery and transport equipment	45.2	
In per cent of GDP			Mineral fuels, lubricants and related materials	14.4	
Exports of goods and services	65.2	(53.6)	Miscellaneous manufactured articles	10.6	
Imports of goods and services	57.8	(50.0)	Main imports (% of total merchandise imports)		
Current account balance	3.5	(0.3)	Machinery and transport equipment	42.2	
Net international investment position (2016)	5.5		Mineral fuels, lubricants and related materials	14.4	
			Manufactured goods	11.6	
LABOUR MARKET, SKILLS AND INNOVATION					
Employment rate (aged 15 and over, %)	66.4	(57.5)	Unemployment rate, Labour Force Survey (aged 15 and over, %)	3.3	(5.4)
Men	78.3	(65.6)	Youth (aged 15-24, %)	10.5	(11.8)
Women	53.7	(49.9)	Long-term unemployed (1 year and over, %)	0.2	(1.4)
Participation rate (aged 15 and over, %)	68.7	(60.9)	Tertiary educational attainment (aged 25-64, %, 2016, OECD: 2019)[2]	18.8	(38.0)
Mean weekly hours worked	45.1	(37.5)	Gross domestic expenditure on R&D (% of GDP, 2016, OECD: 2018)	1.4	(2.6)
ENVIRONMENT					
Total primary energy supply per capita (toe, 2018, OECD: 2019)	3.0	(3.9)	CO2 emissions from fuel combustion per capita (tonnes, 2018, OECD: 2019)	7.2	(8.3)
Renewables (%, 2018, OECD: 2019)	3.4	(10.8)	Renewable internal freshwater resources per capita (1 000 m³, 2017)	18.6	
Exposure to air pollution (more than 10 μg/m³ of PM 2.5, % of population)	97.2	(61.7)			
SOCIETY					
Income inequality (Gini coefficient, 2016, OECD: latest available)	0.402	(0.318)	Education outcomes (PISA score, 2018)		
Poverty gap at $USD5.50 a day (2011 PPP, %, 2015)	0.6		Reading	415	(487)
Public and private spending (% of GDP)			Mathematics	440	(489)
Health care (2018)	3.8	(12.5)	Science	438	(489)
Education (% of GNI)	4.0	(4.4)	Share of women in parliament (%)	14.4	(30.7)

Note: The year is indicated in parenthesis if it deviates from the year in the main title of this table.

1. Where the OECD aggregate is not provided in the source database, a simple OECD average of latest available data is calculated where data exist for at least 80% of member countries.

2. For Malaysia, data refers to aged 25 and over.

Source: Calculations based on data extracted from databases of the following organisations: OECD, IEA, ILO, IMF, United Nations, World Bank.

Executive summary

COVID-19 suddenly disrupted Malaysia's ascending development

When the pandemic struck, Malaysia was relatively well prepared thanks to past efforts to build a robust policy framework. Over the past decades, Malaysia showed remarkable commitment to improve its economy and address its social challenges. This commitment remains intact as shown by the upcoming 12th Malaysia Plan 2021-2025, a stepped-up pivot on further reforms.

Nonetheless, the shock caused by the COVID-19 outbreak has been severe (Table 1). The government was quick to impose strict restrictions aimed at containing the first wave of infections in March 2020, but this resulted in one of the sharpest GDP contractions in the region. After managing the second wave, the third wave of infections in 2021 required renewed strict but targeted restrictions. To avoid large economic damages, sizable fiscal stimulus packages have been introduced and monetary policy has been eased.

The economy is projected to return to growth. Strong sales of electronics goods and health gears are boosting exports, and domestic demand benefits from government support. Nevertheless, risks are mostly tilted to the downside, calling for bold macroeconomic policy action in case of need.

Table 1. Growth is expected to rebound steadily

	2019	2020	2021	2022
Real GDP	4.4	-5.6	4.3	6.1
Private consumption	7.7	-4.3	3.3	7.5
Exports	-1.0	-8.9	10.4	3.5
Imports	-2.4	-8.4	10.3	3.3
Inflation (CPI)	0.7	-1.2	2.7	1.2
Federal government fiscal balance*	-3.4	-6.2	-6.4	-4.7
Federal government gross debt*	52.4	62.1	63.4	63.5
Current account balance*	3.5	4.2	3.8	4.0

Note: * denotes the series are expressed as a percentage of GDP.
Source: DOSM, MOF and OECD calculations.

Macroeconomic policy should remain supportive

Past prudence has allowed fiscal policy to react boldly. A series of relief packages amounting to more than 35% of GDP has rescued the most affected firms and workers, thus shoring up confidence. Financial support has been well targeted and its implementation has been swift thanks to an established distribution system. An emergency job-retention scheme has mitigated the rise of unemployment. A swift vaccination campaign should help avoid new waves of infections, but new outbreaks caused by virus mutations remain possible. Fiscal policy support should therefore not be withdrawn until the situation is fully under control and the recovery is well established, while public debt needs to be reduced under a medium-term fiscal consolidation strategy after the pandemic with further efforts to enhance revenue.

Monetary policy response was prompt and still has ample policy space. Headline inflation is rebounding after a large dive in 2020 caused by the decline in oil prices. Nevertheless, core inflation is forecast to be stable, and monetary policy should be very accommodative amid the prevailing downside risks.

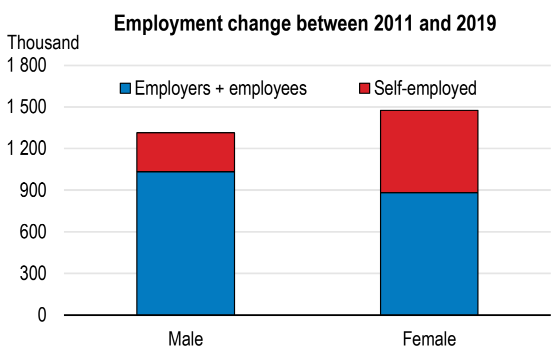
Massive moratorium programmes have alleviated financial distress of affected households and businesses. The policies have been effective, as micro-, small- and medium-sized enterprises account for a significant part of the economy. The rise of non-performing loans has been contained, and financial supervisors consider that capital buffers are sufficient. Nevertheless, the protracted pandemic will force more closures of businesses in severely affected sectors, such as tourism and retail.

The recovery needs to be more inclusive and greener

The pandemic has revealed the weakness of social protection in Malaysia. The crisis hit hard the most vulnerable in the labour market, notably women, young people, and lower-skilled workers. Women were particularly exposed because many of them are self-employed

(Figure 1), and operate in sectors that have not yet recovered, such as tourism and retail affected by tighter restrictions on business activity. The numerous self-employed workers are not well covered by social protection, despite recent government efforts to expand the coverage to them, which puts them at risk of poverty.

Figure 1. Female employment has increased fast, but jobs are precarious



Source: DOSM, Labour Force Surveys.

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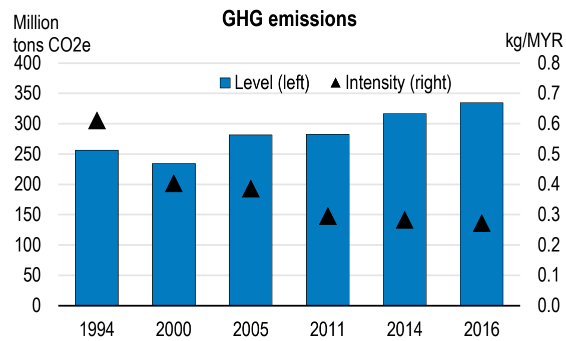
Due to the rapid rise of online services, the number of platform workers has increased sharply in Malaysia. Most platform workers, who are generally self-employed, are in a precarious position. The government has expanded the coverage of their social protection, but more could be done.

The economic recovery risks triggering a rebound of carbon emissions and other environmental damages. Since the adoption of the Paris Agreement, Malaysia has made steady progress in reducing its carbon emissions intensity, but its absolute volume has increased (Figure 2). Introducing a carbon tax could help transform the economy to a less carbon-dependent one. After increasing the use of coal, the government now intends to raise the share of electricity produced by renewables to 31% at the latest by 2025. Despite a small size in area, Malaysia is endowed with one of world's richest forest biodiversity. The government is stepping up its efforts to conserve Malaysia's invaluable forest, which needs to be implemented urgently.

Figure 2. Malaysia needs to become greener



Note: GHG emissions include emissions from land use, land use change and forestry, but exclude removals.
Source: Ministry of Environment and Water (2020), Malaysia - Third Biennial Update Report to the UNFCCC.

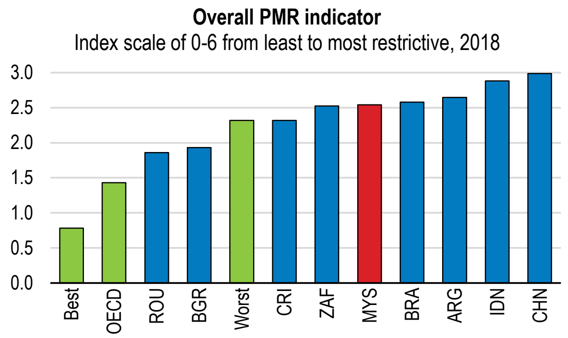
StatLink https://stat.link/orst5k

Stimulating business dynamism is necessary for a strong recovery

Steering a recovery to a sustained path needs invigorating business activity. Over the past years, reforms were progressively implemented to improve the business climate. The National Policy on Development and Implementation of Regulations has improved the regulatory frameworks, streamlining procedures for business activity. The establishment of competition authorities has levelled the playing field and secured competitive markets in a range of sectors, which should be further strengthened.

Nevertheless, regulations and procedures are still restrictive compared with OECD countries (Figure 3). The government can further reduce these restrictions in a range of sectors, such as retail trade. Private firms still face significant administrative burdens, especially new start-ups. Improving insolvency schemes further would also help restore business dynamism. The lack of collaboration between different government bodies is still impairing business dynamism, and regulatory processes could be more transparent. Malaysia has made notable progress in enhancing public integrity and the fight against corruption, including money laundering, and reform momentum should be kept up.

Figure 3. Barriers to competition are still high



Note: Best/worst represents the OECD best/worst performing country.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

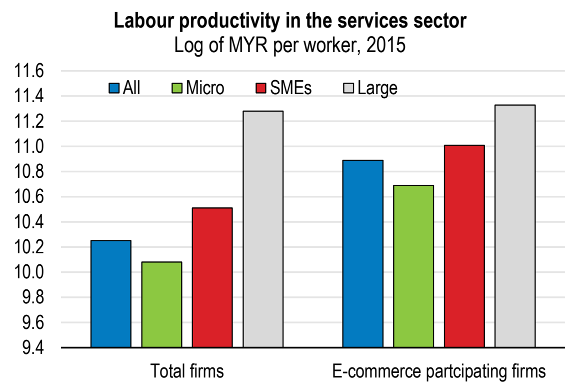
StatLink https://stat.link/lco1fp

A number of SMEs, especially micro-sized firms, do not use computers and the Internet. Most SMEs do not make their transactions through e-commerce, which has been a big hurdle during the periods of confinement. As a number of firms have just started to use digital tools, the adoption of an ambitious Malaysia Digital Economy Blueprint (Blueprint) in the middle of the pandemic was timely.

Digitalisation boosts business productivity, particularly in SMEs, even with small steps such as the use of personal computers (Figure 4). Along with the Blueprint, SMEs, particularly micro-sized firms are in need of further support to their digitalisation, and SME workers could benefit from opportunities to upgrade their digital skills. Further reforms in the fixed broadband market can help provide higher quality and more affordable services to both businesses and consumers. Together with further trade liberalisation, particularly in the services sector, these efforts will help SMEs expand their business across international borders.

The pandemic forced many workers in Malaysia to telework from home on a regular basis. The experience of teleworking did not bring about negative feelings among most workers according to a study conducted for this report. Nevertheless, not many firms anticipate regular teleworking after the pandemic compared with other countries, where most firms that experienced mandatory teleworking regulations now look forward to continuing regular teleworking practices. After the pandemic has subsided, some amount of teleworking will remain a new normal across the globe, as it has proved productive, if appropriately organised.

Figure 4. Digitalisation boosts productivity



Source: DOSM, Economic Census 2016 and OECD calculations.

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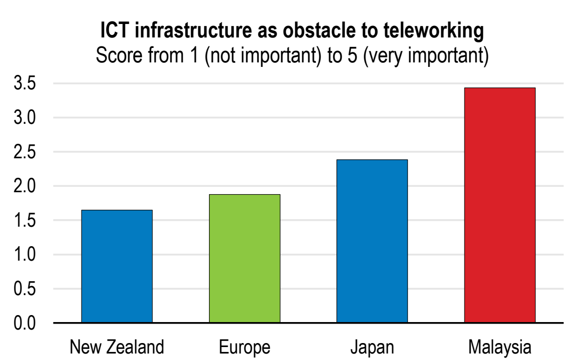
The government can help provide an enabling environment for businesses and workers to pursue teleworking. In Malaysia, the lack of ICT infrastructure is perceived as a major obstacle (Figure 5), hence digital investment could play an important role. Implementing the Blueprint as planned is crucial for infrastructure development.

Figure 5. Digital infrastructure needs to be enhanced



Source: OECD, Telework Survey, Global Forum on Productivity.

StatLink https://stat.link/zu7dyc

Main findings	Key recommendations
Macroeconomic policy and fiscal sustainability	
Despite the prospect of a steady economic recovery, the COVID-19 infections are still persistent and risks are mostly tilted to the downside.	Keep providing sufficient and targeted support to the affected households and sectors until the recovery is well established. Prepare a post-COVID19 integrated medium-term fiscal strategy to reduce public debt and contingent liabilities. Accelerate the vaccination programme by strengthening the partnership with the private sector.
While the rise of oil and commodity prices pushes up inflation, core inflation is stable and the recovery is not yet solid.	Maintain an accommodative monetary policy, until the recovery is well under way.
The government revenue ratio to GDP is low and has declined, while the increase of social spending is necessary to combat poverty.	Consider the re-introduction of the Goods and Services Tax as part of the medium-term fiscal strategy.
Ensuring a green and inclusive recovery	
Employment injury insurance has been expanded to the self-employed in some sectors, but not yet comprehensively.	Expand the coverage of employment injury insurance for the self-employed to more sectors.
The self-employed can voluntarily contribute to the pension scheme, the Employees Provident Fund, but the participation rate is low.	Include dependent self-employed workers, in particular platform workers, in the pension scheme under the Employees Provident Fund.
Almost no price signalling mechanism exists to reduce carbon emissions, except the Feed-in-Tariff for renewable power.	Introduce a carbon tax and gradually rising its rate over time, while mitigating its impacts on vulnerable households.
Creating a more dynamic business sector	
Despite several important reforms, registering a new business is still burdensome and fragmented.	Enhance the coordination among ministries and agencies by integrating and streamlining the business registration system.
The process for obtaining the necessary permits and authorisations for a new business is burdensome.	Improve the usability of the existing one-stop-shop mechanisms for business authorisations, by widening the number of participating agencies.
The insolvency regime may be acting as a disincentive for entrepreneurs.	Strengthen the insolvency scheme further, by improving debtors' access to credit and widening creditors' participation in the restructuring process.
The recently introduced measures to simplify the regulatory environment are not universally and systematically implemented across all ministries and agencies.	Ensure adequate and inclusive consultation which fully involves non-business stakeholders, with more systematic adoption of public consultation guidelines.
The appointment of Chief Commissioner of the Malaysian Anti-Corruption Commission is based on the Prime Minister's advice and the tenure is not pre-determined.	Establish an appointment procedure of Chief Commissioner of the Malaysian Anti-Corruption Commission that involves the Parliament.
Digital uptake is picking up, but remains low among SMEs, particularly e-commerce participation, while the productivity gap between firms that use digital tools and firms that do not use them is large.	Provide support programmes to promote the uptake of digital tools, including basic ones, such as computer and the Internet, particularly targeting older SMEs.
Skills development opportunities are scarce for SME workers.	Strengthen training programmes of basic digital skills for employers and employees of firms, in particular micro- and small-sized enterprises with less than ten workers.
Subscription of fixed broadband is increasing, but still relatively low.	Implement the Malaysia Digital Economy Blueprint as planned, by reviewing, improving and streamlining all relevant and state legislations and regulations related to digital infrastructure development.
Amid the flourishing business of online platforms, new policy challenges have been evolving, such as their abuse of dominant market power. Nevertheless, policy frameworks are underdeveloped.	Revise the Competition Act and the Competition Commission Act to provide the competition authorities with oversight of mergers and acquisitions.
Both employers and employees consider the lack of skills and equipment, including digital investment, as obstacles to teleworking, and firms in most sectors do not anticipate regular teleworking after the pandemic is over.	Enhance the financial support to firms and workers to help them acquire necessary equipment and investment in case they wish to telework but do not have adequate resources to conduct it. Provide more ICT training opportunities to workers to help them acquire necessary skills to practice teleworking.
The lack of adequate digital infrastructure is considered a major obstacle to teleworking in Malaysia.	Accelerate investment to upgrade digital infrastructure, such as in 5G and fixed broadband.

1 Key policy insights

The COVID-19 crisis has caused a deep economic contraction in Malaysia. A recovery is projected to unfold in the second half of 2021, thanks to government intervention to control the contagion, but mutations of the virus could jeopardise the return to growth. The pandemic has revealed acute policy issues that need to be addressed. Vulnerable groups were hit severely, despite social protection support from the government, and the SME sector has more suffered from the economic downturn than large firms. This chapter discusses the macroeconomic and social impacts of the pandemic and policy responses that will be required to achieve a sustainable and inclusive recovery and progress towards high-income status, including a strategy to decarbonise economic growth.

The post-pandemic recovery needs to be more inclusive and sustainable

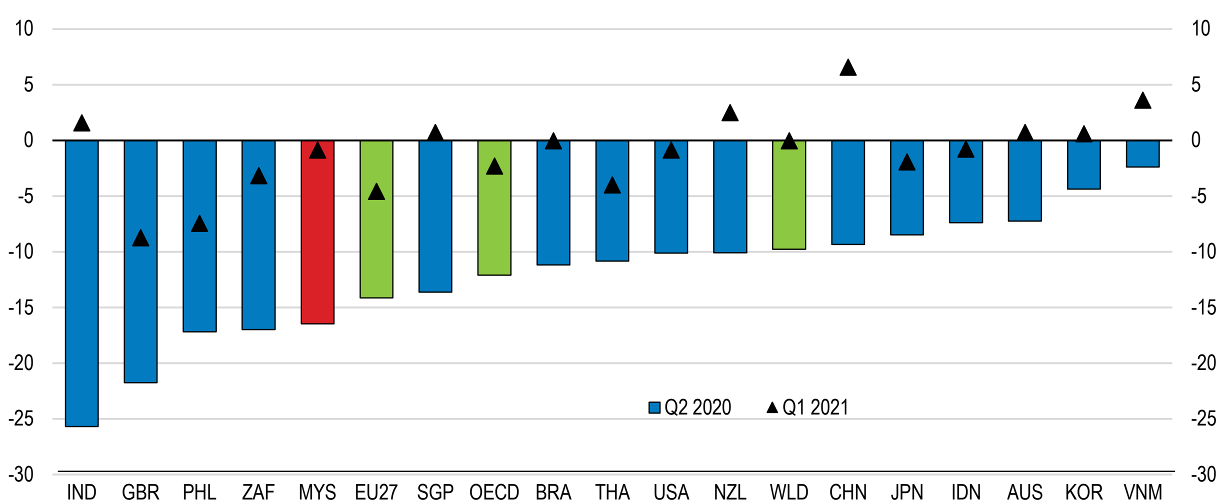
The COVID-19 pandemic severely hit the Malaysian economy. Like in many countries around the world, stringent restrictions on mobility and physical contact have constrained activity in sectors requiring in-person services, such as retail trade, food and beverage, and accommodation. Workers employed in these sectors, who are predominantly female, young and low skilled, have been disproportionately affected. Although government support targeting these people has helped mitigate the shock, those not covered by the social protection scheme, were exposed to job cutbacks and income losses. Because of these disruptions and lower external demand, GDP contracted sharply in 2020 (-5.6%), a large decline by international comparison (Figure 1.1).

Provided that the health crisis becomes under control, most sectors, including hospitality, will be able to restore their normal activities towards end-2021, when most restrictions on domestic travel are expected to be removed. Private consumption, buttressed by the continued government relief measures, is projected to restore its robustness gradually along with the recovery of broader economic activities. Assuming that the vaccination campaign advances as planned, the Malaysian economy is projected to recover steadily in 2021 (+4.3%), followed by the continued rebound in 2022 (+6.1%). On the external front, thanks to a faster-than-expected recovery of external demand, exports are expected to continue increasing throughout 2021 (Table 1.1). A rapid rebound of the Chinese economy and the recovery of the US economy have contributed to the uptick of merchandise exports from the Southeast Asian economies, including Malaysia.

As the infections subsides, the domestic economy is also projected to be on a steady recovery path, despite weak spots in the labour market. Private investment will gather momentum along with the rise of exports in manufacturing goods and relaxed movement controls. Expansionary fiscal policy will also support growth in 2021. Building up the public health capacity will help mitigate the social and economic impacts of the pandemic. Government measures to promote public and private investments in digital infrastructures will facilitate the digitalisation of businesses, which is expected to boost long-term productivity. The unemployment rate will return to its previous levels in 2022.

Figure 1.1. Malaysia was hard hit by the COVID-19 outbreak, but it has recovered relatively fast

Percentage change of real GDP relative to Q4 2019



Note: For China, data for 2020 Q2 refers to 2020 Q1, as this was the period of the first COVID-19 impact for this country.
Source: OECD, Economic Outlook database.

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Table 1.1. Macroeconomic indicators and projections

Percent changes from previous year unless specified

	2018	2019	2020	2021	2022
Output and demand					
Real GDP	4.8	4.4	-5.6	4.3	6.1
Consumption	7.1	6.6	-2.9	3.5	6.3
Private	8.0	7.7	-4.3	3.3	7.5
Public	3.4	1.8	3.9	4.5	0.8
Gross fixed investment	1.4	-2.1	-14.5	4.8	5.4
Private	4.3	1.6	-11.9	2.0	6.9
Public	-5.0	-10.7	-21.3	13.0	1.3
Net changes in inventory (contribution to GDP growth, % point)	-0.7	-0.4	0.7	-	-
Exports of goods and services	1.9	-1.0	-8.9	10.4	3.5
Imports of goods and services	1.5	-2.4	-8.4	10.3	3.3
Net exports (contribution to GDP growth, % point)	0.4	0.7	-0.9	0.7	0.4
Inflation and capacity utilisation					
Consumer price inflation	1.0	0.7	-1.2	2.7	1.2
Unemployment (% of labour force)	3.3	3.3	4.5	4.3	3.6
Output gap (% of potential GDP)	-0.2	-0.0	-7.6	-7.2	-5.3
Public finances (% of GDP)					
Federal government fiscal balance	-3.7	-3.4	-6.2	-6.4	-4.7
Expenditures	19.8	21.0	22.2	21.9	20.3
Revenues	16.1	17.5	15.9	15.4	15.6
Oil-related revenues	3.8	5.5	4.0	2.3	2.2
Federal government gross debt	51.2	52.4	62.1	63.4	63.5
External sector and memorandum items					
Oil price (spot market, Brent, USD per barrel)	71.0	64.2	41.6	64.0	65.0
World trade growth (volume)	4.1	1.3	-8.5	8.2	5.8
Trade balance (% of GDP)	7.9	8.2	9.8	9.1	8.0
Current account balance (% of GDP)	2.2	3.5	4.2	3.8	4.0
Gross official reserves (end-year, USD billion)	101.4	103.6	107.6	..	..
Total external debt (% of GDP)	63.8	62.6	67.6	..	..
Three-month money market rate, average, in %	3.7	3.5	2.5	..	..
Ten-year Malaysian government securities, average yield, in %	4.1	3.6	2.8	..	..
Household debt (% of GDP)	82.0	82.7	93.2	..	..
Nominal GDP (USD billion, at the market exchange rate)	359.0	365.3	337.2	377.8	406.6

Source: Department of Statistics Malaysia (DOSM), Ministry of Finance, Bank Negara Malaysia, OECD Economic Outlook 109 database and OECD calculations.

Policy measures, such as loan moratoria, have alleviated the hardship of businesses caused by the sanitary measures, weak demand and financial difficulties. Nevertheless, as the current crisis becomes protracted, many businesses will remain impaired and will face difficulties going forward. Over the past years, Malaysia advanced its regulatory reforms to streamline administrative burdens for businesses and simplify the procedure for start-ups. These reforms need to be accelerated further, and be extended to the liberalisation of individual services markets, such as the transport and retail sectors, some of which are still relatively restrictive compared with most OECD countries.

Digitalisation has accelerated over the course of the pandemic, and will continue to do so. While many Malaysians purchased goods and services online during the pandemic, business digitalisation was not pervasive before the pandemic. A number of SMEs do not use basic digital tools, such as computers and the Internet, and teleworking has been less prevalent than in other countries. This does not allow many firms and workers to make the best of digitalisation.

Aiming at achieving high-income status in the coming decade, the government is planning to present its 12th five-year plan. The announcement of the plan initially scheduled for 2020 has been postponed to take into account new emerging issues stemming from the pandemic. Taking into account the impact of the pandemic and drawing lessons for the future are necessary and will help restore confidence. In line with the upcoming 12th five-year plan, this *Economic Survey* discusses the following key challenges faced by Malaysia:

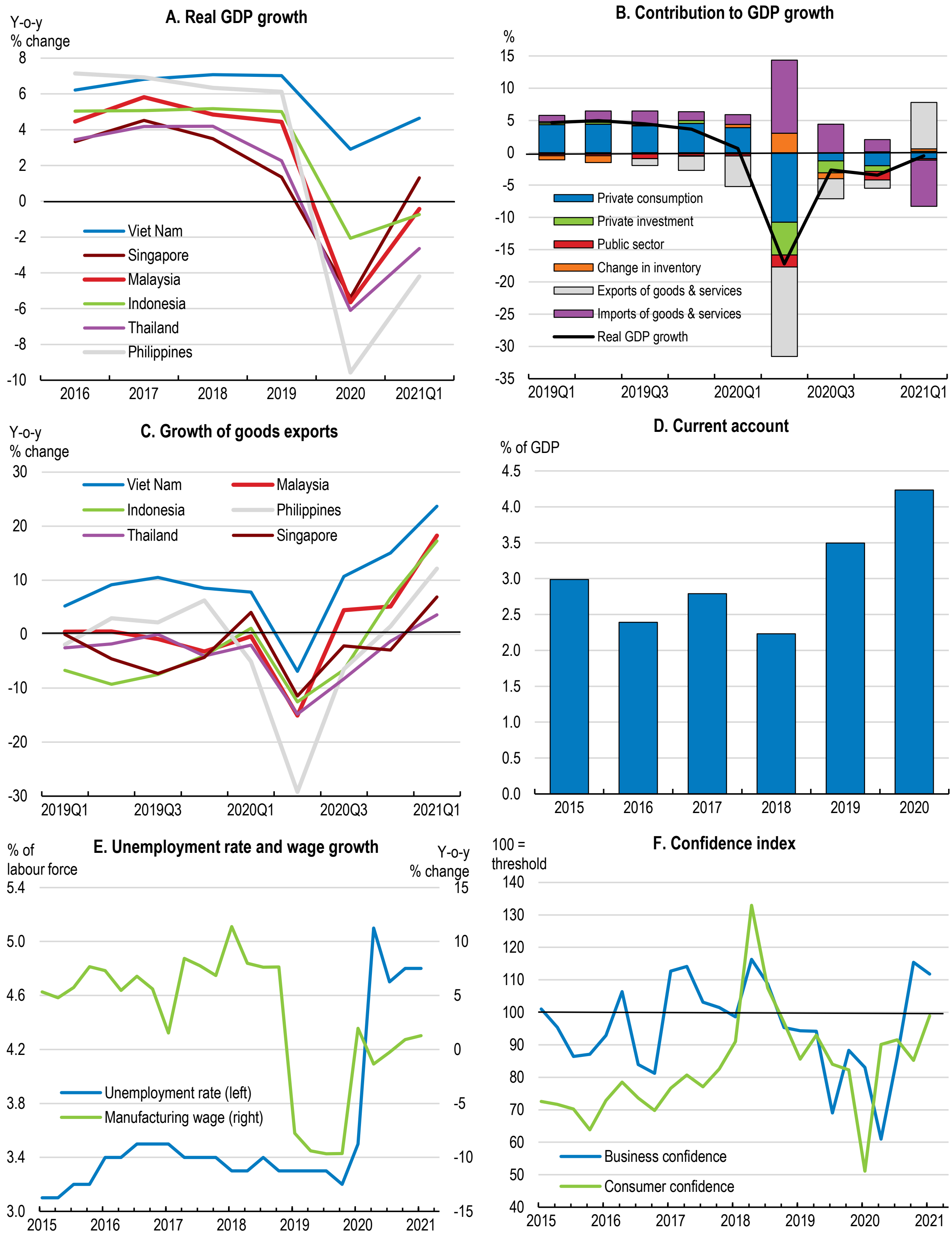
- Until the economic recovery is well under way, fiscal and monetary policies should remain supportive in particular to struggling citizens and businesses, while preparing a post-pandemic medium-term fiscal consolidation strategy to reduce public debt and contingent liabilities amid the looming ageing society.
- Re-invigorating business dynamism will be essential to achieve vigorous economic growth after the pandemic. This calls for further improving the business climate and lowering administrative burdens and regulatory obstacles. Easing regulation will facilitate the reallocation of resources, unleash untapped potentials, and stimulate innovation through the adoption of new technologies.
- To make the best of digitalisation, the uptake of digital tools needs to be further promoted together with the enhanced provision of training opportunities of workers, particularly those employed by SMEs. Securing more open and competitive markets will stimulate private investment needed to improve the quality of the broadband infrastructure, an essential element to accelerate business digitalisation and progress toward new working arrangements, including teleworking.

A strong economic recovery needs supportive macroeconomic policies

Strong and inclusive growth was suddenly interrupted

Malaysia’s growth was solid before the pandemic, unlike other Southeast Asian economies that suffered from international trade tensions and supply chain disruptions (Figure 1.2, Panel A). Thanks to various structural reforms, Malaysia has progressively shifted from a manufacturing to a service economy, and from a heavily trade-dependent to a more domestic-demand-driven economy (Figure 1.3). Moreover, the development of the labour market increasingly supported the robustness of private consumption, with lower-income households benefitting from fast income growth (Figure 1.4). The labour force participation of women increased dramatically over the past decade along with the increase in their education attainment. Although these developments plateaued somewhat in recent years, weakening inflation pushed up the purchasing power of consumers.

Figure 1.2. Recent macroeconomic developments



Note: In panel B, the public sector consists of government consumption and public investment.
Source: CEIC; DOSM; and Bank Negara Malaysia.

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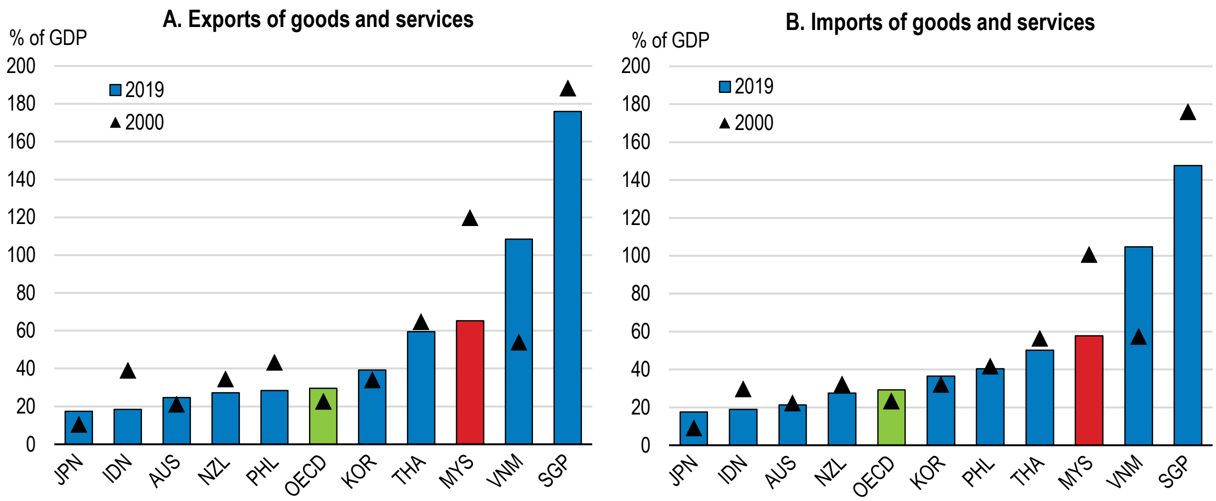
Figure 1.3. Malaysia has become a more domestic-demand-driven economy



Source: OECD, Economic Outlook database; World Bank, World Development Indicators database; CEIC; General Statistics Office of Viet Nam.

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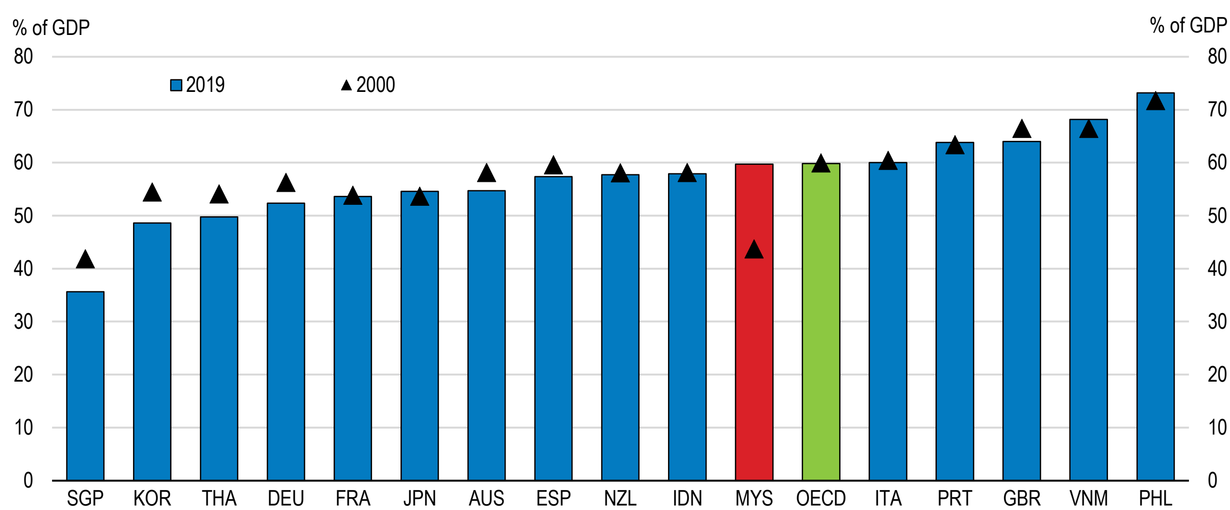
Figure 1.4. Private consumption has become a key component in the economy



Source: OECD, Economic Outlook database; World Bank, World Development Indicators database; CEIC.

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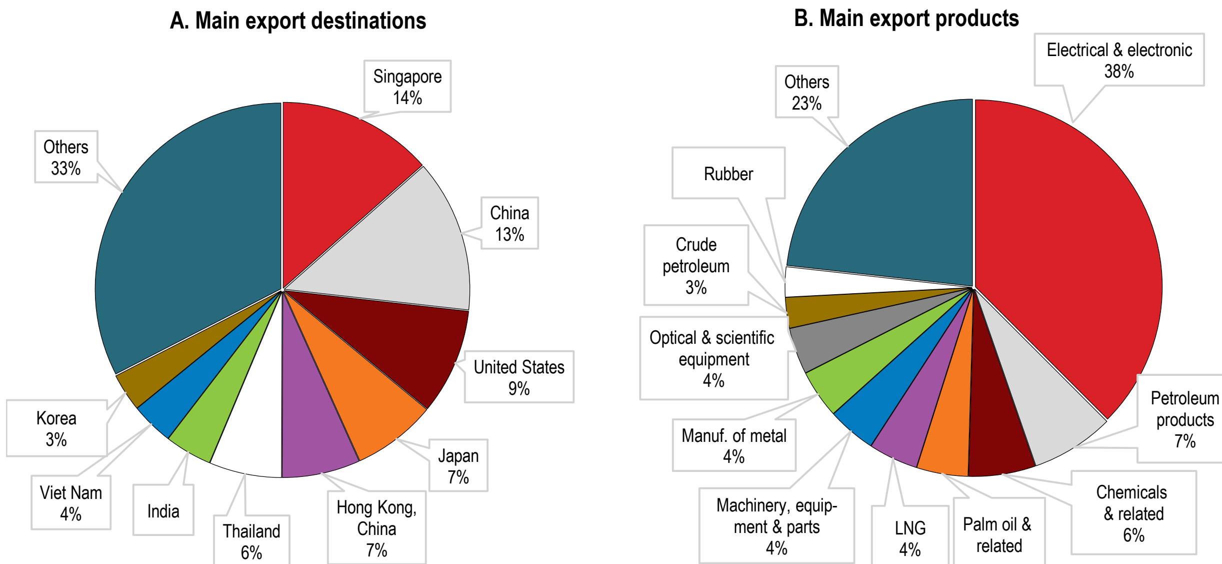
Despite having become a less trade-dependent economy, Malaysia was nonetheless sharply affected by the decline on international trade during the pandemic, as external demand was still an important source of growth (Figure 1.5). Exports to other ASEAN countries dropped sharply in Q2 2020 (-20% compared with the previous year). Although the share of tourism in exports, at 8% in 2019, was lower than in other countries, such as Thailand (20%), international tourism receipts have disappeared since early 2020. Since the middle of 2020, Malaysia's goods exports have swiftly recovered, faster than the exports of other ASEAN countries, thanks to its strong exports to China and the United States and the increasing global demand for electrical and electronics goods and personal protective equipment stimulated by the pandemic (Figure 1.2, Panel C). Exports to China already increased in Q2 2020, mitigating the contraction of global trade. Despite the low inflow of tourists, the current account surplus has increased further, reflecting weak imports stemming from subdued investment.

Figure 1.5. Exports by destination and products

Share of total exports, 2019



Source: Ministry of International Trade and Industry; Department of Statistics Malaysia.

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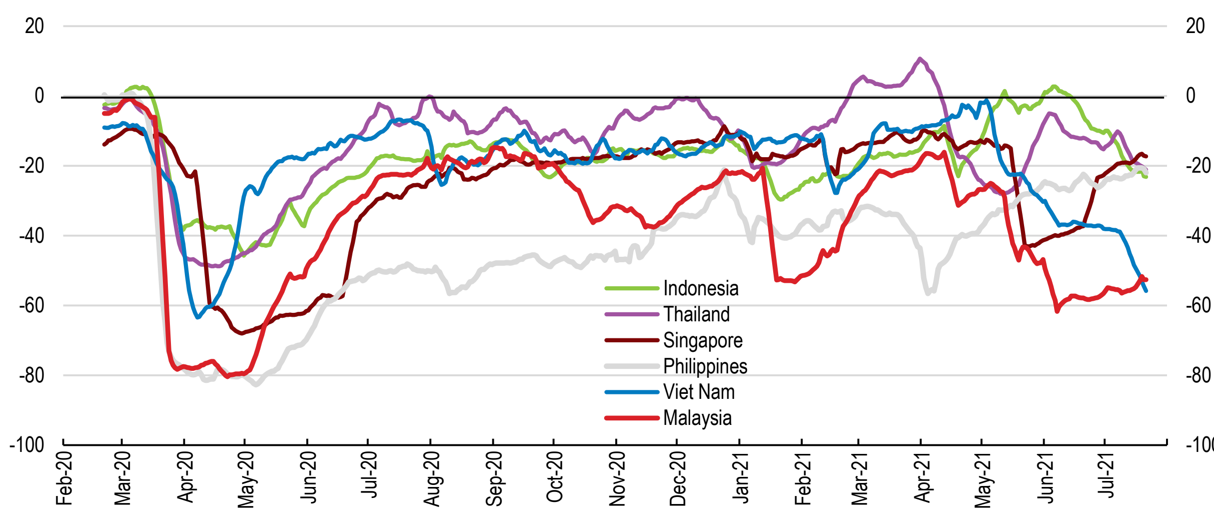
Figure 1.6. Mobility has been severely restricted

Percentage change of retail and recreation mobility from baseline, average of past 7 days



Note: The baseline is the median value, for the corresponding day of the week, during the five-week period January 3-February 6, 2020.
Source: Google LLC, "Google COVID-19 Community Mobility Reports", google.com/covid19/mobility.

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The domestic sector also contracted sharply in the first half of 2020. As soon as it detected a large-scale local outbreak in March 2020, Malaysia imposed strict restrictions on broader social and economic activities (Figure 1.6). Like some other Southeast Asian countries, Malaysia experienced several small outbreaks of zoonotic and infectious diseases in the past decades, such as severe acute respiratory syndrome (SARS) and Middle East respiratory syndrome (MERS), developing surveillance and emergency response systems. Although strict restrictions managed to weaken the first wave of infections swiftly towards mid-2020, economic costs were considerable (Box 1.1). In Q2 2020, Malaysia experienced one of the deepest contractions in the region and its recent history. GDP nosedived by 17.2% (year-on-year basis), and the unemployment rate increased to levels unseen since the economic crisis of the mid-1980s (Figure 1.2, Panel E).

Box 1.1. The targeted containment measures in Malaysia – a response to the COVID-19 pandemic

The first wave from March 2020 – a swift reaction to a large outbreak

From late January to early February in 2020, Malaysia swiftly imposed a border controls to China and Chinese travellers after it had found several cases related to Chinese tourists.

Towards mid-March 2020, new daily cases surged to three digits after an outbreak was detected nearby the capital (Figure 1.7). This prompted the government to impose broader restrictions on economic and social activities (the Movement Control Order (MCO)) from 18 March. The MCO included stay-at-home restrictions and domestic travel bans, the closure of borders, school closures, and the suspension of non-essential business activities, similar to the tight restrictions adopted in many other countries across the world (Figure 1.8). The detailed protocols, including sanitary codes for people and businesses, have been published as the Standard Operating Procedures (SOPs).

As new cases declined, the government gradually eased the restrictions from early May, starting from the Conditional Movement Control Order (CMCO), which allowed most businesses to operate subject to the adoption of sanitary measures. The government introduced the Recovery Movement Control Order in June 2020 with the further relaxation of the restrictions, such as the full capacity operation of public transport. Schools re-opened in phases from July 2020.

A protracted second wave from the second half of 2020

In September 2020, the resurgence of a local outbreak in the state of Sabah intensified. The government introduced targeted restrictions. Nevertheless, the resurgence gradually spread to other states, and from mid-October, the CMCO was re-imposed in the capital and the surrounding region. The tighter restrictions were then further extended to other states. Schools were closed nationwide from November 2020.

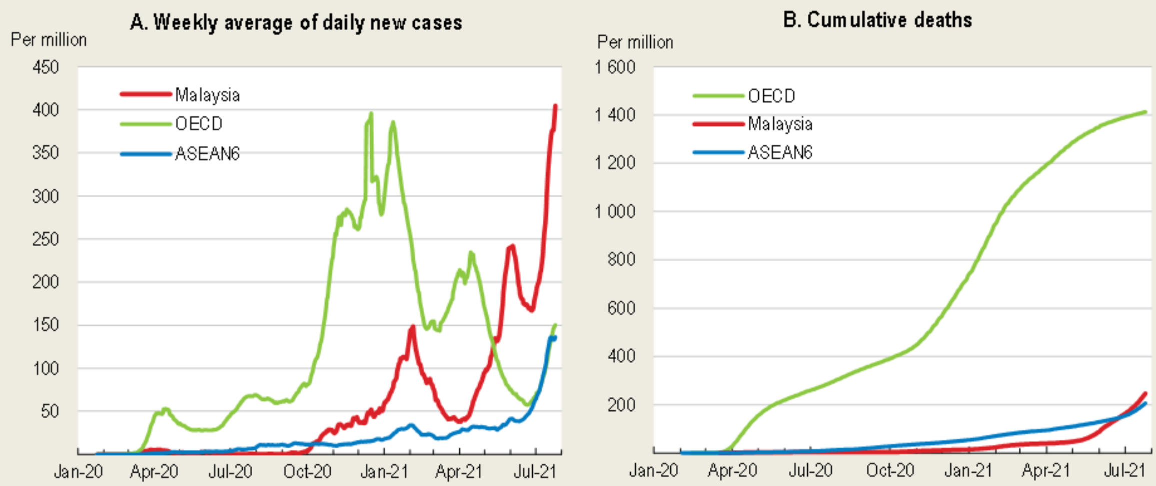
As the infection further intensified, the government resumed the MCO in mid-January 2021 for five states and the federal districts, but less stringent than the first imposed in March 2020. At the same time, considering the worsening situation, Malaysia proclaimed a state of emergency effective from 12 January to 1 August 2021, under which the Parliament and all elections were suspended.

Along with the decline in new daily cases, the restrictions were relaxed again in phases. From early March 2021, several states and districts, including the capital and its outskirts, reverted to the CMCO, and the restriction of business operations in areas under the CMCO was removed from April. Schools also resumed from April (albeit closed again from late May), but the inter-state travel bans have not yet been removed.

The third wave – strict restrictions reintroduced amid intensified infections

New daily cases were contained to around 1 000 towards mid-April 2021, but since then the number surged rapidly to over 9 000 in late May. More contagious variants of Delta (B.1.617.2,) and Alpha (B.1.1.7) have been detected. The government has once again tightened the restrictions progressively, imposing a nation-wide strict MCO from mid-May 2021. These lockdown measures have been stepped up further, including a stay-at-home restriction, since the beginning of June, to be continued until public health conditions (the number of daily cases, hospital capacity and the vaccination rate) improve.

Figure 1.7. Malaysia seeks to control the COVID-19 outbreak



Note: ASEAN6 is the population-weighted average of Indonesia, Malaysia, the Philippines, Singapore, Thailand and Viet Nam. OECD is also population-weighted.
Source: https://ourworldindata.org/coronavirus.

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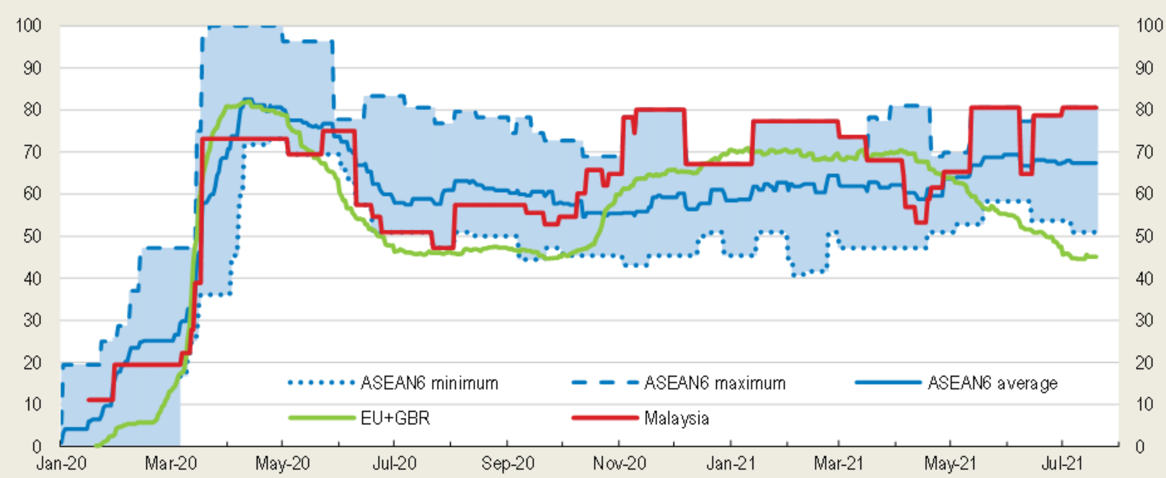
Figure 1.8. Malaysia has imposed severe restrictions on economic activities

Oxford government stringency index



Note: The stringency index is a composite indicator based on nine sub-indicators including school closures, workplace closures, and travel bans. Aggregate series are simple averages.
Source: Oxford COVID-19 Government Response Tracker.

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As the number of cases declined in mid-2020, the government lifted the severe restrictions gradually, allowing the economy to regain its pace. The rebound was quick, including exports. Detailed but clear guidelines (Standard Operating Procedures (SOPs)) also helped households and businesses to manage and operate economic activities. However, as stricter restrictions were re-imposed on wider areas of the country, growth dipped again in Q4 2020 (-3.4% on a year-on-year basis, while Q3 was -2.7%), and the unemployment rate, once declining, edged up again, which has posed a concern for the sustainability of private consumption. A more targeted approach was used during this second wave together with a series of stimulus packages, which helped revive confidence (Figure 1.2, Panel F). As the rate of infections was subdued towards April 2021, growth also picked up rapidly (-0.5% in Q1 2021 on a year-on-year basis). Nevertheless, infections once again intensified from May 2021 amid the emergence of more contagious variants, which required the government to re-impose nation-wide strict restrictions on people's mobility. While this is expected to drag down economic activity significantly, the government announced in June 2021 the National Recovery Plan, a four-phased exit strategy to resume normal economic and social activities towards the end of 2021.

Policy reactions were prompt when the pandemic struck

Before the pandemic, Malaysia retained a solid macroeconomic position. The robust economic position and the sound policy framework allowed Malaysia to react to the pandemic-induced recession swiftly and boldly. In 2020, the government rolled-out five stimulus packages (the second includes the first one) amounting to 21.5% of GDP, including non-fiscal measures (Table 1.2). The 2021 Budget strengthened the containment and support measures, increasing federal government expenditure by 2.7% from 2020. The government adopted four additional stimulus packages in 2021 equivalent to 15.9% of GDP to tackle the persistently high rate of infections, some of which are front-loaded expenditures from the 2021 Budget. The largest components are financial mitigation measures, including a six-month loan moratorium on all bank loans except for credit card loans (MYR 100 billion (Malaysian ringgit) in the PRIHATIN package), government loan guarantees (MYR 50 billion in the PRIHATIN package) and liquidity provision by the central bank through the reduction of the statutory reserve requirement (MYR 30 billion in the PRIHATIN package). Malaysia also adopted a job-retention measure, which has been extended several times. These measures have supported affected sectors, particularly SMEs and households.

Table 1.2. Stimulus packages have been large

Package name	Announced date	Total		of which fiscal measures	
		Amount (MYR billion)	% of 2020 GDP	Amount (MYR billion)	% of 2020 GDP
Pre PRIHATIN	February 2020	20	1.4	3.2	0.2
PRIHATIN	March 2020	230	16.3	21.8	1.5
PRIHATIN SME+	April 2020	10	0.7	10	0.7
PENJANA	June 2020	35	2.5	10	0.7
KITA PRIHATIN	September 2020	10	0.7	10	0.7
PERMAI	January 2021	15	1.1	0	0.0
PEMERKASA	March 2021	20	1.4	10	0.7
PEMERKASA+	May 2021	40	2.8	5	0.4
PEMULIH	June 2021	150	10.6	10	0.7
Sub total	2020	305	21.5	55	3.9
Sub total	2021	225	15.9	25	1.8

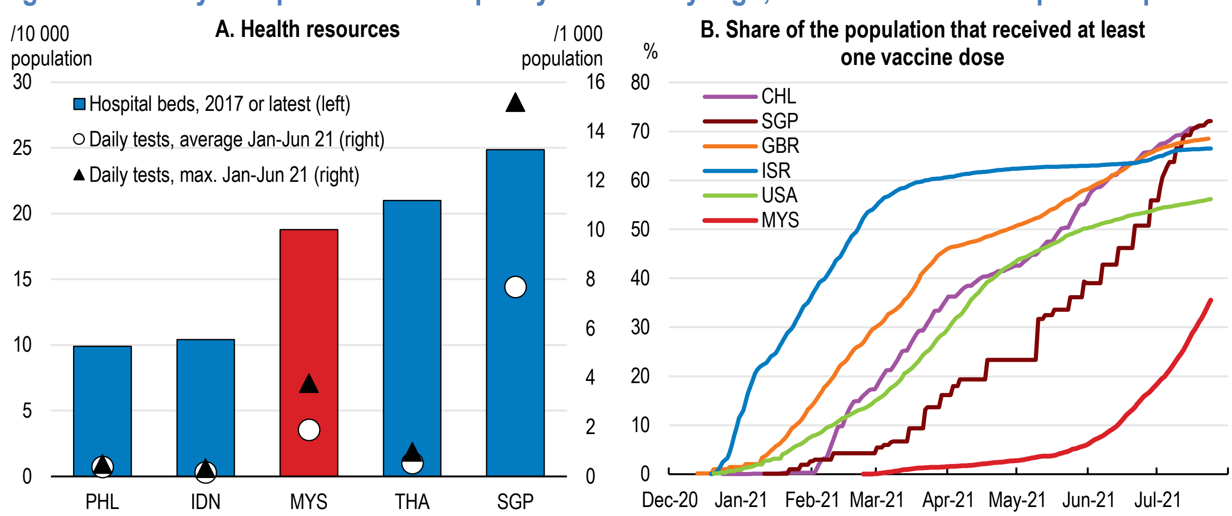
Note: The denominator is 2020 GDP, MYR 1 416.6 billion.
Source: Prime Minister's Office, Ministry of Finance, and DOSM.

In implementing effectively a large stimulus package announced in March 2020, the government set up the Economic Stimulus Implementation and Coordination Unit (LAKSANA) at the same time of the package adoption. In addition to monitoring the roll out of the stimulus packages, this unit adds transparency in the policy implementation. Progress reports have been published every week since April 2020 to disseminate the latest situation to the public.

In addition to economic relief, the government has also strengthened its public health capacity to tackle the crisis. The shortages of testing supplies and personal protective equipment have been eased. The testing capacity increased from less than 0.01 per thousand population in early 2020 to above 2 in May 2021 (Our World in Data) (Figure 1.9, Panel A). Malaysia has a universal healthcare system, under which health services are provided by government-funded public hospitals with minimal out-of-pocket payments from patients. The public hospitals, including university and military hospitals, have been fully deployed. In addition, private sector resources have been mobilised to expand hospital capacity for COVID-19 patient treatment since January 2021 amid the rapidly increasing new cases. Under Malaysia's dual healthcare system, privately run hospitals also provide health services through private health insurance and out-of-pocket payments from patients, or employer funding. The services quality of private hospitals are high, as Malaysia is one of the most popular destinations of medical tourism in the region, although the latter has stagnated due to the border closures. Under the state of emergency, the government adopted an Emergency Ordinance to request private hospitals to accept COVID-19 patients and non COVID-19 patients, the latter of which is to expand the public hospital capacity. Accordingly, the number of intensive care unit (ICU) beds for COVID-19 patients increased significantly from 442 in August 2020 to 1 767 in June 2021 (as of 13 June, WHO COVID-19 Situation Report). Nevertheless, the occupancy rate of ICU beds once reached at its full capacity in mid-2021, before easing off.

In February 2021, the government announced a national vaccination programme, a National COVID-19 Immunisation Programme, which now aims for at least an 80% inoculation by the end of 2021. Vaccination is provided free of charge to both citizens and non-citizens living in Malaysia aged 18 years and above. The first batch of vaccination started soon after the adoption of the programme (Figure 1.9, Panel B). The programme is on a voluntary basis, and to facilitate the participation, a mobile app is used. Previous study suggests that anti-vaccination sentiment is not too strong in Malaysia compared with other countries and is likely to have improved recently to some extent (de Figueiredo et al., 2020[1]). Nevertheless, the slower speed of inoculation, particularly at the initial stage, implies that there may be a certain degree of people's hesitancy, and the implementation needs to be accelerated further by appealing to people's awareness to achieve the government target.

Figure 1.9. Malaysia's public health capacity is relatively high, and vaccination has picked up



Source: WHO; https://ourworldindata.org/covid-vaccinations.

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Despite the improved sanitary situation and prospects of a steady recovery, risks are mostly tilted to the downside. In addition to the delay in the vaccination programme, the propagation of new and more contagious or vaccine-resistant variants of the virus could overwhelm the existing public heath capacity, and undermine the recovery, adding fatigue sentiment. The external environment poses downside risks, although there are some upsides. A weaker-than-expected recovery of the Asian economies, some of which are grappling with the protracted or re-intensified pandemic, would pull down external demand through the dampened value chains. On the one hand, the yield upsurge of the US sovereign bonds would trigger the turnaround of financial flows, putting strong upward pressure on interest rates that would weigh on growth prospects. On the other hand, a steady but strong growth of its main export counterparts, particularly the US and Chinese economies, could sustain a high level of external demand.

On lower-probability vulnerabilities, the escalation of trade tensions between major trade partners and geopolitical strain in the region also constitute downside risks and add uncertainties. Political instability could not only thwart the restored confidence but also delay necessary policy reforms. Some uncertainties difficult to evaluate their risks are presented as extreme events (Table 1.3). The pandemic shows that building up robustness against extreme risks, such as enhancing fiscal risk assessment, is important (see below).

Table 1.3. The pandemic is the present danger, but other lower-probability vulnerabilities exist

Extreme shocks	Potential impacts
Political instability	Political instability could not only deteriorate the sentiment of foreign investors, but also undermine both private consumption and investment, stalling reform momentum.
Geopolitical tensions	The escalation of conflicts in the South China Sea or other serious social destabilisations would harm broader economic activities in Southeast Asia, which are highly interconnected with each other, degrading its economic prospects.
Another pandemic	The emergence of deadly virus mutations or new contagious diseases would disrupt overall economic activities and cause huge social distress.
Natural disasters	A strong earthquake and large-scale tsunamis would severely affect the economy.

Against this background, in the short run, policy should continue to be supportive until the recovery is well established. Particularly, as the economic shock is prolonged, the most vulnerable need to receive continuous support. In this regard, cash transfer and job-retention programmes are included in the 2021 Budget. In case of a further downturn, spending authorised in the budget could be further frontloaded, and the government could consider lifting the debt ceiling temporarily. The priority should be given to vaccination, which needs to be accelerated under an enhanced partnership with the private health sector even after the end of the emergency decree. Moreover, the weakening of private investment needs to be reversed through re-invigorating foreign direct investment (see Chapter 2).

The priority should also be put on reducing income inequality. While Malaysia's social protection is rather weak, the level of the household savings rate is low (1.4% in gross terms in 2015, Distribution & Use of Income Accounts and Capital Account, Department of Statistics Malaysia (DOSM)). This implies that the consumption of lower-income households is more susceptible to an economic slowdown. Previous study suggests that individuals with monthly earrings less than MYR 3 000 possess smaller liquid financial assets than debt (Siti, Lim and Muhammad, 2018[2]). In addition to the cash handout to the most vulnerable, social protection, particularly employment insurance nets, needs to expand its coverage (see below). The enhanced social protection system would improve income prospects of households, and thus the sustainability of private consumption.

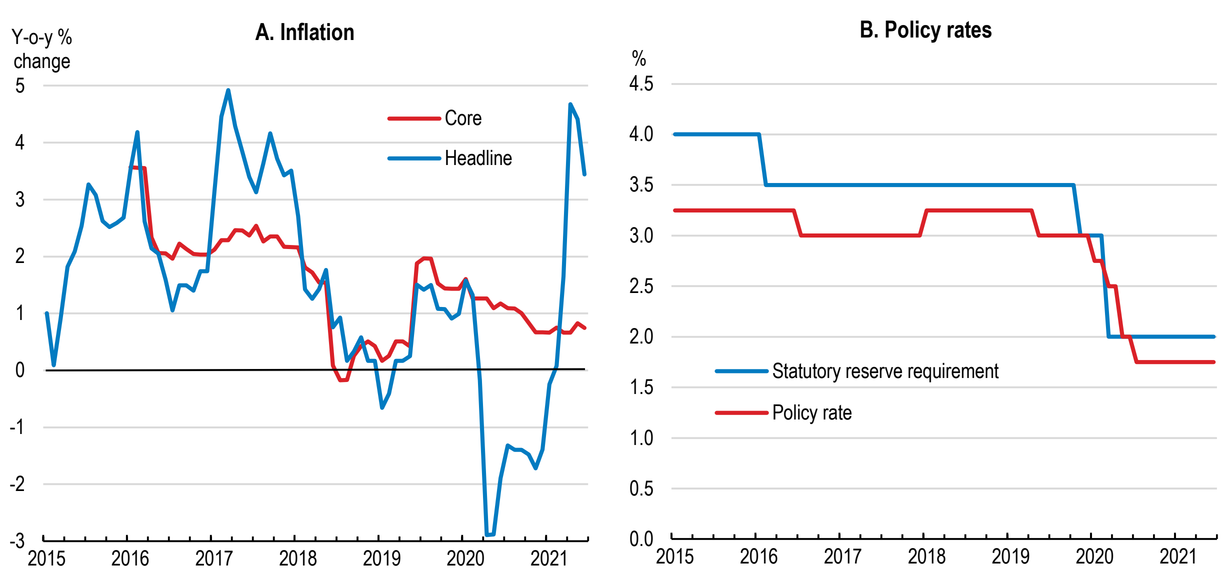
In addition, youth unemployment rates were persistently higher even before the pandemic, and the weaker labour market prospect stemming from the pandemic is weighing on younger generations, such as new graduates. Therefore, it is crucial to prevent scarring effects on the youth caused by long-term unemployment or out-of-the-labour-force status (see below). Restoring the ascending labour participation rates, particularly for women (male 81.1% in Q4 2019 and 80.9% in Q1 2021; female, 56.1% and 55.4%), which have been pushed down by the pandemic, is also important to sustain the growth potential of the economy for the medium term.

Monetary policy should remain accommodative

Similar to those of many other central banks, the monetary policy objective of the central bank of Malaysia, Bank Negara Malaysia (BNM), is to maintain price stability while remaining supportive of economic growth. It does not set, however, a specific inflation target. The central bank has the *de jure* independence of its operation and uses an overnight interest rate as its policy rate. This policy framework aims to ensure a high degree of flexibility on monetary policy actions, while taking into account other important risks, such as asset price bubbles and the destabilising unwinding of these assets (Bank Negara Malaysia, 2018[3]). The framework also allows the central bank to be more supportive of the economy in its achieving higher levels of potential output and growth. Previous study suggests that while explicit inflation targeting has contributed low inflation and price stability in some Asian countries, such as Indonesia, the Philippines and Thailand, a more discretional framework adopted in other countries, including Malaysia and Singapore, has also attained a similar inflation performance (Filardo and Genberg, 2010[4]).

While the pandemic started affecting the Malaysian economy from February 2020, inflation abruptly turned negative in March due to the declining oil prices, although core inflation was rather stable. Monetary policy reacted swiftly against the downturn. From March to July 2020, the central bank cut its policy rate by 100bps to 1.75%, a historic low level. The BNM also reduced in March 2020 its statutory reserve requirement (SRR) to banks from 3.00% to 2.00% with an additional ease in its conditions (the holdings of Malaysian Government Securities and Malaysian Government Investment Issues can be considered as part of the SRR compliance, first for Principle Dealers and then expanded to all banking institutions in May 2020, which will be effective until the end of 2022) in order to provide sufficient liquidity to the financial markets (Figure 1.10). From the second half of 2020, while external demand rebounded faster than expected and re-opening of the domestic economy expanded, the central bank maintained its policy rate. Headline inflation was considerably negative over the course of 2020, but core inflation was stable at around 1%, which legitimised this policy stance.

Figure 1.10. Monetary policy has reacted promptly to the economic disruption



Source: CEIC.

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Looking ahead, as headline inflation has already reversed its course from early 2021 responding to the rise of oil and other commodity prices, inflation is projected to be above 2% in 2021. Core inflation is expected to be stable between 0.5-1.5% throughout the projection period, as significant slack will remain until the economy grows at full throttle, in addition to the effect of fixed price ceilings on staples and fuels. Since Malaysia is a commodity exporting country, an increase in oil and commodity prices may lead to the appreciation of the local currency, which implies that the inflation pressure stemming from the price rise of commodities would be mitigated to some extent. Economic activity is expected to regain its normality towards end-2021 along with the advancement of vaccination and business reopening. Against this background, until the recovery becomes solid, monetary policy should maintain its accommodative stance. If considerable downside risks materialise, the central bank needs to use its ample policy space swiftly to support the economy.

Financial stability has prevailed, but risks remain

Financial institutions entered into the economic crisis with sufficient buffers, which were accumulated over the years. Soon after the onset of the pandemic, the government introduced a range of measures to alleviate financial distress of households and businesses. This included a massive loan moratorium programme (7.1% of GDP) for six months starting from April 2020, a government loan-guarantee scheme and special lending facilities for SMEs. These programmes have supported affected sectors very effectively in the emergency phase, particularly SMEs, and helped mitigate short-term liquidity constraints. Accordingly, the ratio of non-performing loans has been stable, while some other countries in the region have seen a rise, in some cases, to a considerable level (Figure 1.11, Panel A). The liquidity coverage ratio has been stable within the range of 140-153% since the beginning of 2020, and the total capital ratio stood at 18.1% in March 2021. Since the second half of 2020, in accordance to the removal of the restrictions on business activities, the financial support measures have become more targeted.

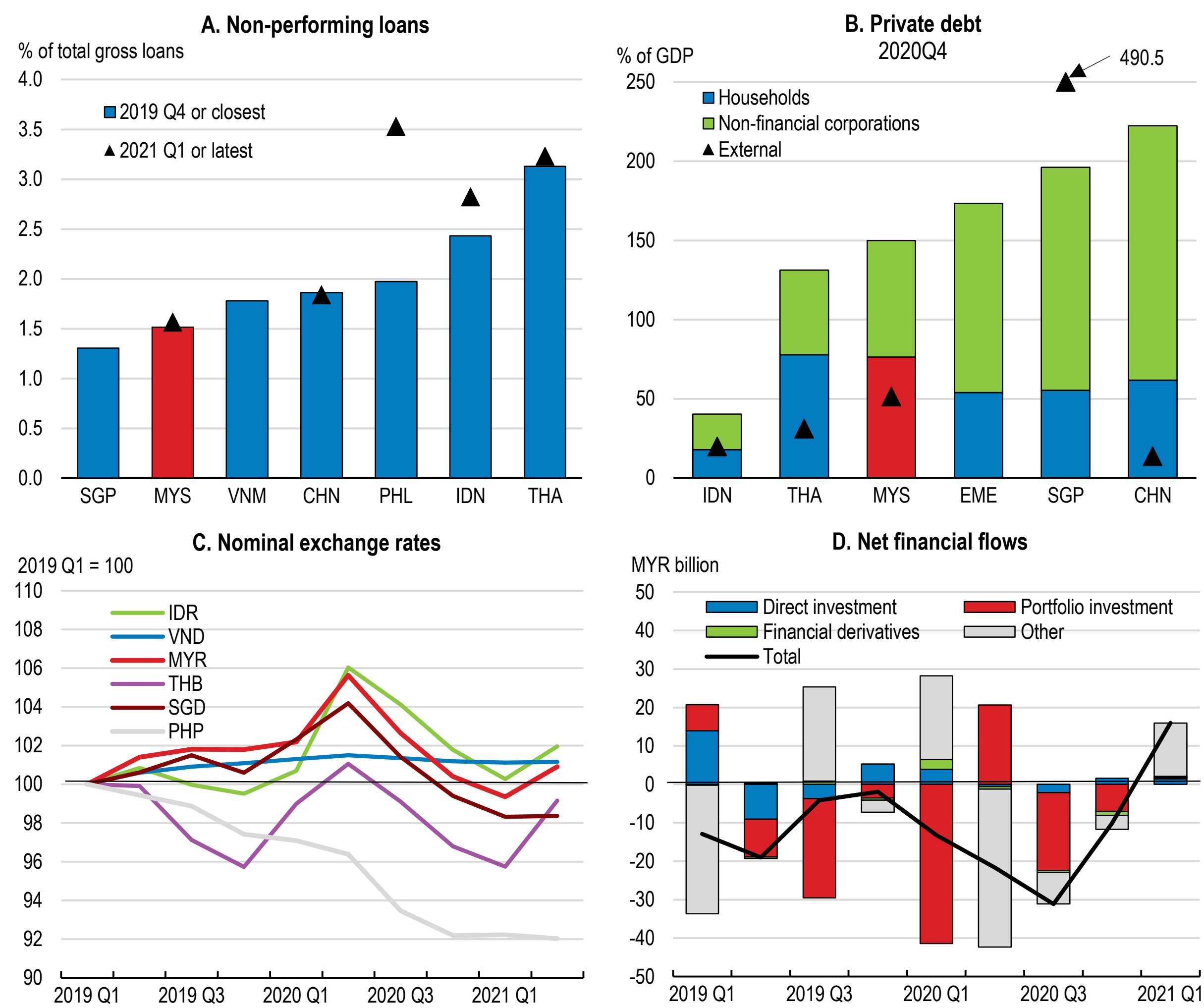
Nevertheless, along with the protracted crisis, policy focus has moved from liquidity constraints to insolvency concerns. Therefore, corporate restructuring and debt restructuring of the private sector (including households for the latter) will become more urgent after policy support is removed. Swift processing of insolvencies would facilitate resource reallocation to more viable businesses, an important element of a strong recovery (see Chapter 2).

Malaysia developed out-of-court insolvency schemes after the Asian Financial Crisis, and the Companies Act 2016 has expanded the flexibility of court-sanctioned processes by introducing a voluntary scheme. Building on these past reforms, the government has introduced more flexibility in these insolvency schemes (Bank Negara Malaysia, 2021[5]). In September 2020, an out-of-court platform for SMEs, the Small Debt Resolution Scheme (SDRS), established in 2003, was absorbed into an out-of-court scheme for individuals, the Credit Counselling and Debt Management Agency (Agensi Kaunseling dan Pengurusan Kredit (AKPK)). As micro-sized firms owned by individual entrepreneurs, which are predominant in Malaysia, are more susceptible to adverse economic shocks, this integration will generate greater synergy. Moreover, the government is also considering the amendment of the Companies Act 2016 to widen the coverage of eligible firms and to enhance its safeguard mechanism against potential abuse.

High levels of household debt could become a concern (Figure 1.11, Panel B). Although part of gross debt reflects a high housing ownership rate in Malaysia (77% in 2019, DOSM), which is more applicable to higher-income households, given the wider income gap, more vulnerable lower-income households need further support, particularly if the recovery in the labour market is delayed.

On the external front, some emerging market economies, including Malaysia, experienced large capital outflows and sharp downward pressure on their currencies (Figure 1.11, Panel C and D). The Malaysian ringgit, which had been stable for years, declined by 6% against US dollar between January and April 2020, before rebounding to the previous levels in the second half of 2020. Like some other emerging market economies, Malaysia's central bank carried out in April 2020 direct purchase of government bonds amounting to 0.5% of GDP to tame capital outflows (0.7% in total from March to December 2020). In addition, since then, the central bank has introduced a series of measures to improve the functioning of the foreign exchange market. Resident exporters were exempted from the requirement to convert export proceeds into local currency below MYR 200 000 per transaction, among other measures. The conversion requirement was then removed in April 2021, liberalising the foreign exchange market further. As the flexibility of exchange rates can serve as a buffer to adverse external shocks, gradual but further liberalisation of the market is encouraged. The external debt ratio to GDP slightly increased to 68% at the end of 2020 (from 63% of 2019) due to the smaller GDP value, but private debt stood at 51%, of which the non-financial sector was low at 27% (Figure 1.11, Panel B).

Figure 1.11. Recent developments in financial markets



Note: In panel B, EME is comprised of Argentina, Brazil, Chile, China, Colombia, the Czech Republic, Hong Kong SAR, Hungary, India, Indonesia, Israel, Korea, Malaysia, Mexico, Poland, Russia, Saudi Arabia, Singapore, South Africa, Thailand and Turkey. Household debt and non-financial corporation debt are those from banking institutions.
Source: BIS; IMF; CEIC; Bank Negara Malaysia.

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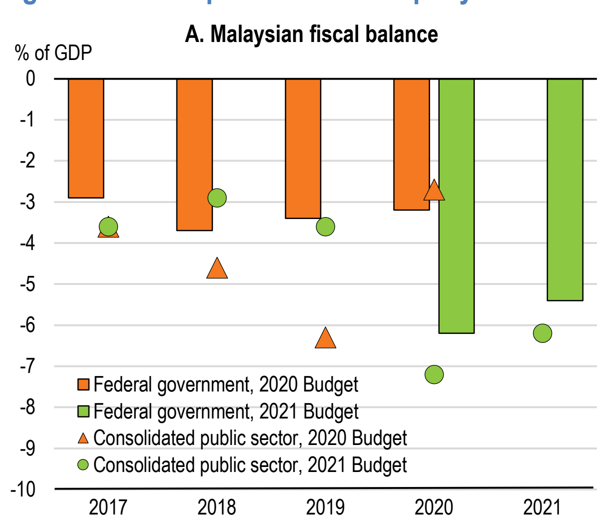
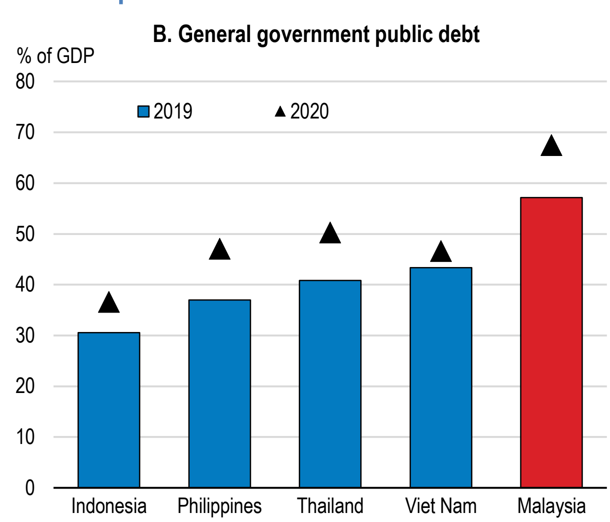
Fiscal policy should remain supportive

Malaysia's fiscal prudence is underpinned by several legislative schemes. Borrowing is confined to investment expenditure, and ceilings are imposed separately on federal government domestic debt (55% of GDP) and its external debt (MYR 35 billion). However, the fiscal response to the pandemic called for more fiscal space: the domestic debt ceiling of the federal government was raised to 60% of GDP until end-2022, and additional borrowing was allowed for a COVID-19 fund, which was created to secure the transparency on pandemic related spending.

Similar to many countries, the impact of the pandemic was large enough to widen the fiscal deficit to 6.2% of GDP in 2020, despite government efforts to reallocate spending within the budget (Figure 1.12). Accordingly, Malaysia's relatively high level of government debt has been further pushed up. The government has been cautious about the deterioration of its fiscal position, and plans to pursue fiscal consolidation once the recovery is well established. Particularly, it is crucial to reduce public debt and the contingent liabilities of the government more effectively in the medium term. Considering the low level of tax revenue, this would require a comprehensive fiscal consolidation planning that strongly underpins revenue enhancing measures, in addition to spending reprioritisation and sustainable debt management. In the meantime, because significant downside risks remain, targeted policy support remains essential. Moreover, if the economic situation worsens, the government should be ready to expand its fiscal space, temporarily adjusting the debt ceiling during the pandemic. In this regard, an integrated fiscal framework with medium-term targets would give the government more flexibility and discipline, and provide more confidence to markets. The government has already announced in 2018 the introduction of a Fiscal Responsibility Act towards 2021. Like some other countries, such as Ireland, New Zealand and Thailand, where a similar fiscal responsibility legislation was adopted, under the planned Fiscal Responsibility Act, government revenue, expenditure, budget balance and debt will be managed consistently with one another through pre-determined rules and reporting in order to enhance its transparency and accountability. The current Medium-Term Fiscal Framework (MTFF) that provides macroeconomic and fiscal projections for the next three years in the annual budget process could also be integrated to the new framework with a longer projection period, which could improve overall consistency among various government policies. Moreover, some countries, such New Zealand, include fiscal risk assessment in their framework (see below). The preparation of the legislation should thus be accelerated.

Figure 1.12. The pandemic has rapidly worsened the fiscal position





Note: Consolidated public sector consists of general government and non-financial public corporations.
Source: Ministry of Finance, Fiscal Outlook and Federal Government Revenue Estimates, Fiscal Updates 2020; Bank Negara Malaysia, National Summary Data Page for Malaysia; IMF, World Economic Outlook database.

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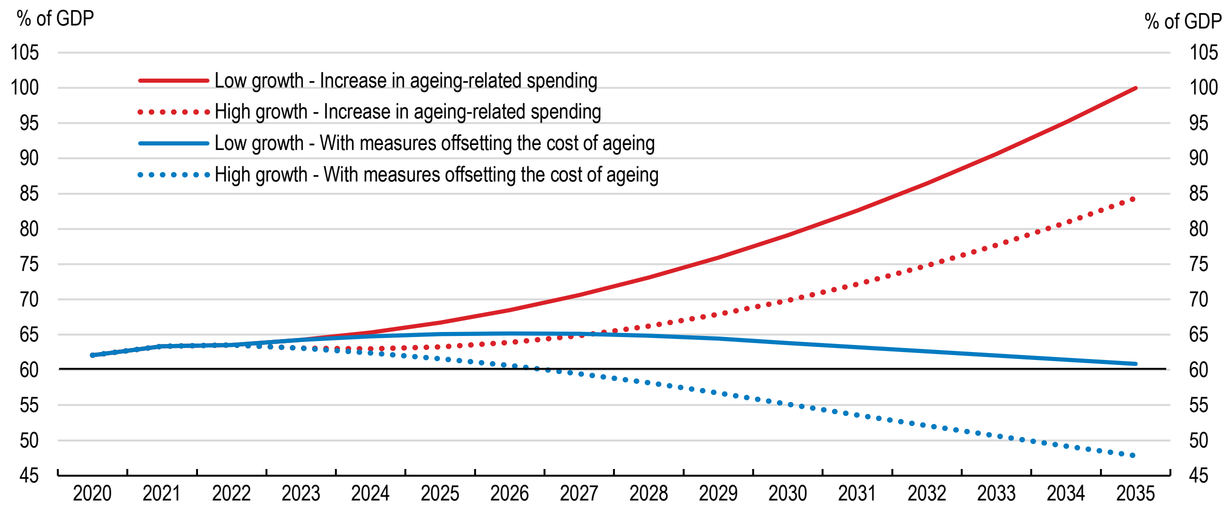
The fiscal positions of entities outside the scope of the federal government need to be monitored closely: extra-budgetary entities and state-owned entities have been mobilised to provide various support measures in the stimulus packages. The deficit of the consolidated public sector that includes all government bodies and non-financial public corporations is expected to have widened in 2020, before slightly narrowing in 2021 (Figure 1.12, Panel A). Nevertheless, the consolidated public sector does not cover public financial corporations, through which the government has given guarantees to businesses during the pandemic. In this regard, the government reported that the estimated federal government loan guarantee ratio to GDP increased to 20.8% in 2020 from 18.2% in 2019. Adopting an integrated fiscal framework covering the whole public sector, including contingent liabilities, would strengthen fiscal monitoring. For example, Australia and New Zealand developed a more general framework of fiscal risk assessment embedded in budget process (OECD, 2020[6]). Similar frameworks have been adopted by a number of OECD countries to improve the transparency and the accountability of fiscal policy. These frameworks analyse and present a range of risks, both quantifiable (e.g. alternative economic scenarios) and non-quantifiable (e.g. natural disasters), that could cause deviations from fiscal forecasts. The reporting of contingent liabilities in Australia and New Zealand is comprehensive, covering uncalled capital, guarantees, indemnities and liabilities stemming from legal disputes, including those non-quantifiable (Department of Finance, 2020[7]) (The Treasury, 2021[8]). Australia reports contingent liabilities of both federal and general governments.

In the medium term, in addition to improving spending efficiency, strengthening the revenue base will be essential (Figure 1.13). Malaysia's social protection system mostly relies on the government, including for universal health insurance (Figure 1.14), not social security schemes. Social spending is funded mostly by the tax revenue of the federal government. In this regard, some countries not adopting broader social security schemes, such as Australia and New Zealand, have a stronger tax base to fund social spending, which is a contrast to Malaysia. Currently, the share of social spending is at around 3% of GDP, which is much lower than the OECD average of 15%, while the dependency rate (ratio of population aged 0-14 and over 65 to aged 15-64) is projected to increase from 44.2% in 2020 to 47% in 2045 (UN Population Prospects 2019). The population ageing would not only increase social protection expenditure, but also reduce tax revenues, as less people will be active in the labour market. This also implies that it would be more costly to delay the choice of social protection system (a system relying on tax revenues, social security contributions or a combination of both) to a later period when the population will become older. The pandemic has also revealed the need to strengthen social protection. Although income inequality has declined, redistribution is rather weak (Figure 1.15). Since social spending is expected to increase rapidly, the revenue base needs to be expanded.

Figure 1.13. Ageing-related spending will call for offsetting fiscal measures

Federal government debt scenarios



Note: The ageing-related spending scenario assumes that social assistance spending will increase by 10% of GDP by 2050 to reach levels currently observed in Australia and New Zealand, two countries without broader social security systems. The old-age dependency rate (+65/15-64) of Malaysia is assumed to reach 25% by 2050 (UN World Population Prospects 2019), which is similar to the current levels of Australia and New Zealand. The scenario "with offsetting measures" assumes that measures to offset the cost of ageing, including revenue raising measures, are sufficient to reduce the primary deficit to zero by 2030 and it remains stable thereafter. Nominal GDP growth rates are assumed to be 7% from 2023 onwards for the high-growth case (respectively 5% for the low-growth case). Interest rates are set to be at its historical average of 4%.
Source: OECD calculations.

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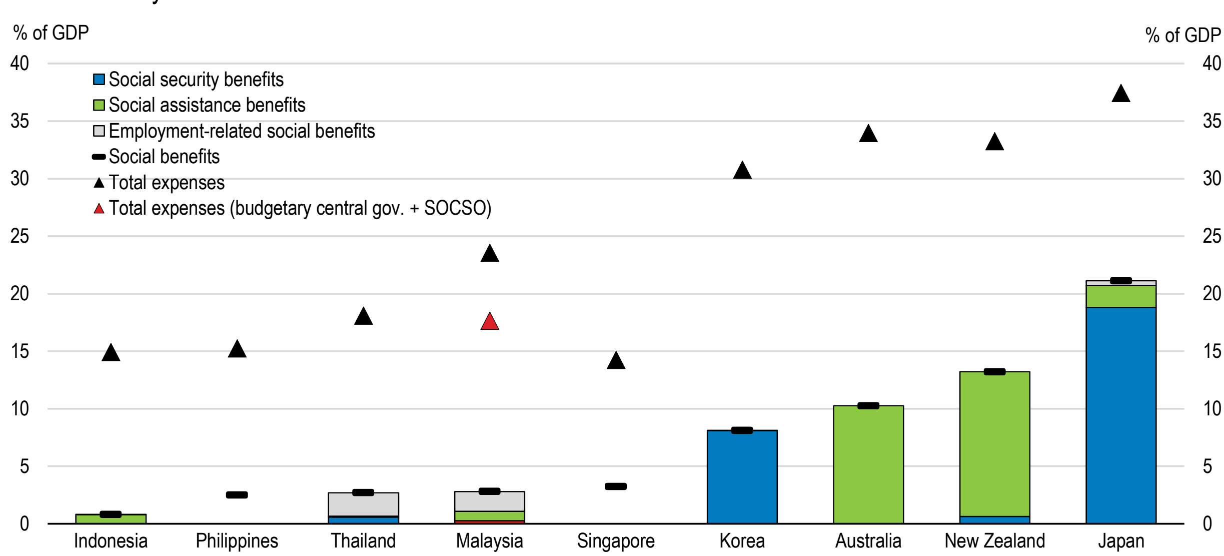
Figure 1.14. Malaysia's social spending is low relative to total expenditure

2019 or latest year available



Note: Expenses are recorded on a general government basis, unless otherwise indicated. For Malaysia, except for the "total expenses", expenses cover budgetary central government (central government excluding statutory bodies) and SOCSO. SOCSO is considered as social security fund. Social benefits consist of spending by social security system (social security benefits), other spending (social assistance benefits) and benefits to government officials (employment-related social benefits). Singapore and the Philippines do not have the breakdown.
Source: IMF, Government Financial Statistics and World Economic Outlook databases; Malaysia's Social Security Organisation (SOCSO), Annual Report; and OECD calculations.

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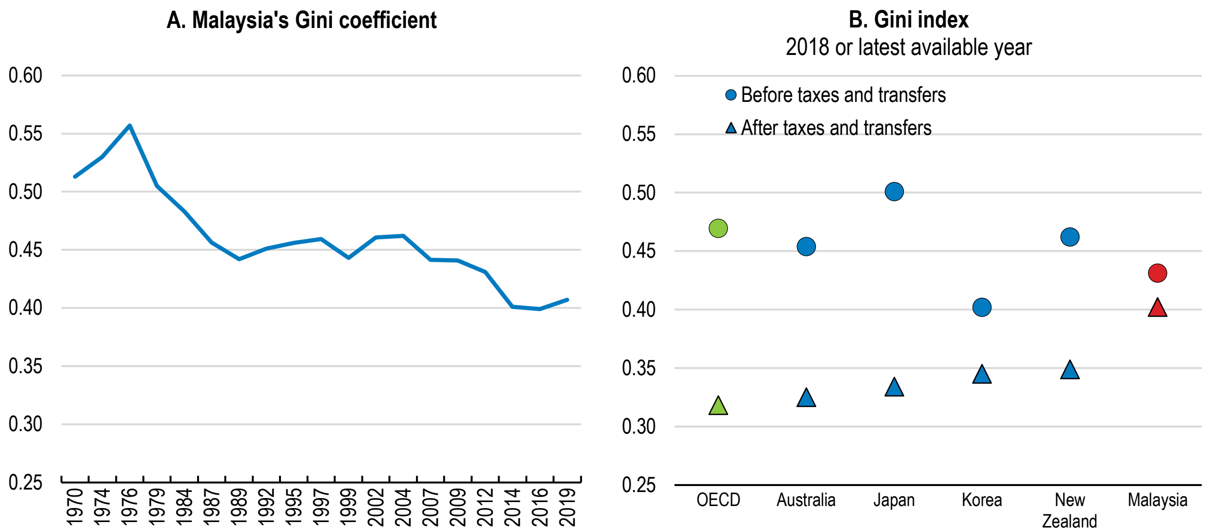
Figure 1.15. Inequality has declined, but the tax and transfer system needs to be more efficient



Note: In panel A, the Gini coefficient is based on gross income, which includes taxes and transfers receivable but excludes those payable. Before 1979, it refers to Peninsular Malaysia only. Since 1989, data is based on Malaysian citizens.
Source: DOSM, Household Income and Basic Amenities Survey, Table 10.6; OECD (2021), Income Distribution Database; F. Solt (2019), "The Standardized World Income Inequality Database, Versions 8-9", Harvard Dataverse, V5, https://doi.org/10.7910/DVN/LM4OWF.

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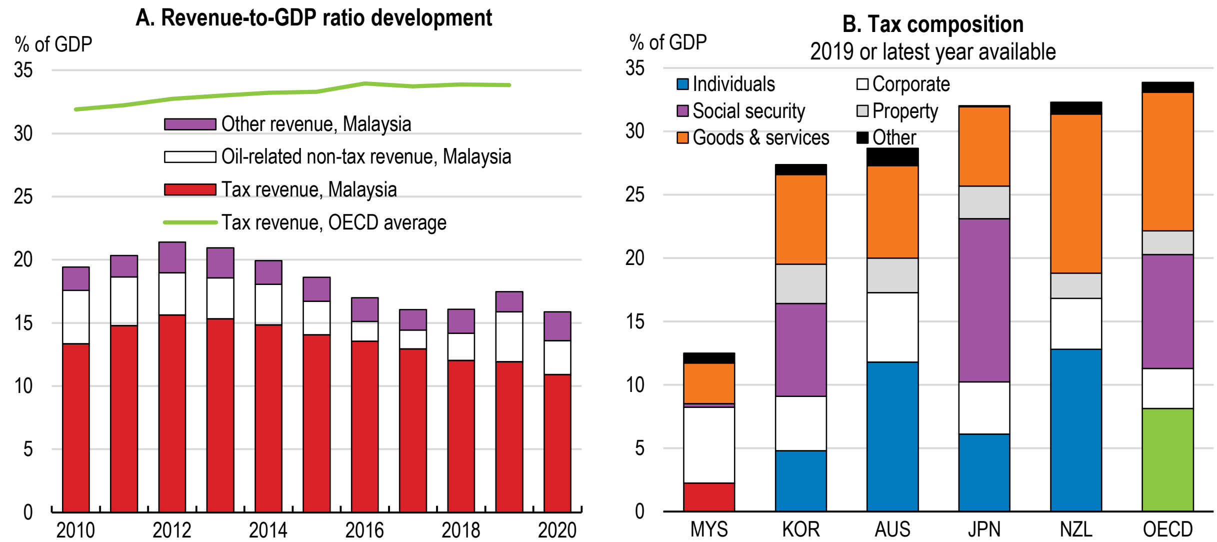
The ratio of federal government revenue to GDP has declined for years (Figure 1.16). The government first needs to strengthen tax compliance and efficiency of tax collection, while securing the transparency of its enforcement. The government has made considerable efforts to expand its tax base by introducing new taxes (Table 1.4), but overall tax base could also be broadened through reviewing tax relief and exemptions. The introduction of the Goods and Services Tax (GST of 6%) in 2015 helped shore up the federal government revenue considerably. Nevertheless, the GST was repealed in 2018 amid the concern about its regressivity affecting the purchasing power of low-income households, and the former Sales tax and Service tax were reintroduced (also 6% for the Service tax but on a narrow list of products). Considering the efficiency of tax collection and the needs to raise revenue, the government could consider reintroducing the GST in the medium term, while enhancing overall social protection, including through social transfers targeted at low-income and vulnerable households (Table 1.5). In terms of the personal income tax, the progressivity was enhanced in 2020, introducing a new bracket of above MYR 2 million per annum subject to a 30% tax rate (before 28%). The progressivity needs to be enhanced further in the medium term, while strengthening the efficiency of tax collection (Box 1.2). The overall design of the personal income tax could also be strengthened through reviewing its tax base, which has been narrowed by various tax relief and exemptions. Some of these tax relief and exemptions would be less targeted and regressive, adding administrative costs.

Figure 1.16. Malaysia's tax revenue is low and has declined



Source: Ministry of Finance; DOSM; OECD, Tax Revenue Statistics database.

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Table 1.4. Past recommendations on macroeconomic policies

Recommendations	Action taken since July 2019
Prepare for unexpected shocks by building fiscal space. The fiscal medium-term trajectory should aim at cutting the budget deficit further than the target of 2% of GDP to create a buffer in case of unexpected shocks.	• The Parliament Special Select Committee on Budget was established in 2019 to scrutinise and oversee the federal budget matters. In July 2019, the committee issued eight recommendations to improve debt and liabilities management, including regular reporting of government debt and liability positions to the Parliament. In August 2019, the mid-year review of the 2019 Budget was tabled to the committee to enhance fiscal transparency. • The *Fiscal Outlook and Federal Government Revenue Estimates 2020* showed for the first time a debt sustainability analysis to strengthen the monitoring of fiscal consolidation efforts.
Monetary policy should remain vigilant to downside risks.	• In January 2020, Bank Negara Malaysia reduced its policy rate by 25bps to 2.75% as a pre-emptive measure. From March to July 2020, the central bank further cut the policy rate to 1.75% to tackle the economic downturn caused by the pandemic.
Raise tax revenue ratio to GDP by further improving efficiency of tax administration, broadening tax bases, and increasing indirect tax revenue, in particular consumption-related taxes to reduce reliance on oil-related revenues.	• Tax base has been continuously broadened. New taxes were introduced concerning imported taxable services (2019) and digital services purchased through foreign service providers (2020). In 2021, the tourism tax was extended to accommodation services booked through online platforms and an excise duty on electronic cigarettes was introduced.
Strengthen targeted cash transfers to low-income people and access to public services.	• In 2021, Bantuan Sara Hidup (BSH), a social assistant programme to the bottom 40% income group was revamped as the Bantuan Prihatin Rakyat (BPR) programme, which offers a higher amount of cash aid and becomes more targeted. In addition, during the pandemic, a one-off cash transfer programme for low-income people, Bantuan Prihatin Nasional (BPN), was introduced.
Ensure full compliance with the proposed Government Procurement Act.	• Instead of having the proposed Act, the enhancement of the government procurement rules and regulations has been considered. • The existing rules and regulations under the Treasury Circulars have been reviewed to strengthen compliance and governance, but no legislative reform has been implemented.
Accelerate the enactment of a Fiscal Responsibility Act.	• A Steering Committee, consisting of related ministries and the central bank, was established in 2019 to prepare a legislation draft of the Act. • Technical assistance has been provided by the IMF to formulate the draft legislation. A workshop was held in 2020.

Table 1.5. The fiscal cost of reforms is modest

Additional annual costs, % of GDP

Reforms	Details	Fiscal costs
Matching grants for platform workers' contribution to employment injury insurance	Based on government contribution provided to platform workers during the pandemic (MYR 163 for 7 months, 70% of the total contribution) and the estimation on the number of platform workers (gig workers) by the Department of Statistics Malaysia (DOSM), 0.6 million in 2018.	0.01
Matching grants for platform workers' pension contribution	Based on the current scheme (i-Saraan: annual government contribution up to MYR 250) and the estimation on the number of platform workers (gig workers) by the Department of Statistics Malaysia (DOSM), 0.6 million in 2018, while assuming that 0.1 million of them already contribute to the scheme.	0.01
Matching grants for self-employed workers' pension contribution	Based on the assumption that a similar scheme to i-Saraan (annual government contribution up to MYR 250) is applied to all self-employed workers (3.3 million in 2019). Those who have already contributed to the EPF voluntarily and the additional fiscal cost for platform workers calculated above are excluded.	0.04

Source: OECD calculations.

Box 1.2. Malaysia's main taxes

Among Malaysia's federal taxes, the corporate income tax, the personal income tax, and the Sales Tax and Service Tax (SST) (Figure 1.16, Panel B) constitute the major revenue sources.

Corporate income tax

Companies with paid-up capital of not more than MYR 2.5 million are subject to a 17% tax rate up to the chargeable income of MYR 600 000 and 24% on the incomes exceeding that amount. The tax rate for companies with paid-up capital of more than MYR 2.5 million is 24%.

Personal income tax

Individuals are required to pay tax on all kinds of earnings, including interest and dividends. Tax rates progressively increase according to the increase in chargeable incomes (taxable income minus tax deductions and tax relief). The lowest rate is zero (chargeable income MYR 0-5 000), and the highest is 30% (chargeable income above MYR 2 million).

Sales Tax and Service Tax (SST)

The SST consists of two different taxes, namely, the Sales tax and the Service tax. The Sales tax is a single stage tax levied on imported and locally manufactured goods, when these goods are imported or sold by manufacturers. The Sales tax rates varies depending on goods (5%, 10%, a specific rate or exempted). The Service tax is a tax charged and levied on taxable services provided by any taxable person in Malaysia in the course of its business. The tax is due and payable when the taxable person sells taxable services to customers. The Services tax rate is 6%. Firms exceeding a certain income threshold need to pay the SST.

Source: Royal Malaysia Custom Department, Inland Revenue Board of Malaysia.

Nevertheless, the increasing cost of ageing could not be addressed only by the strengthening of tax revenue, adding more difficulties to fiscal consolidation. A more comprehensive macroeconomic approach beyond fiscal policy would also be helpful. For example, a number of countries have raised a pensionable age to mitigate the fiscal cost of pension payment. As Malaysia adopts a collective defined contribution scheme for private sector employees (see below), raising the eligible minimum age of withdrawal does not have direct fiscal impacts. Nevertheless, encouraging more elderly people to stay longer in the labour force would bring about multiple economic benefits. Increasing labour input would push up economic growth. It would also help reduce old-age income poverty and thus government social spending, and raise government revenue. While the statutory retirement age of public sector workers has risen to 60, the pensionable age of private sector employees is still 55, which is much lower than most OECD countries (assuming a full career from age 22, the average age across the OECD countries, at which individuals are eligible for retirement benefits, was 64.2 in 2018 (OECD, 2019[9])).

Anti-corruption remains a priority

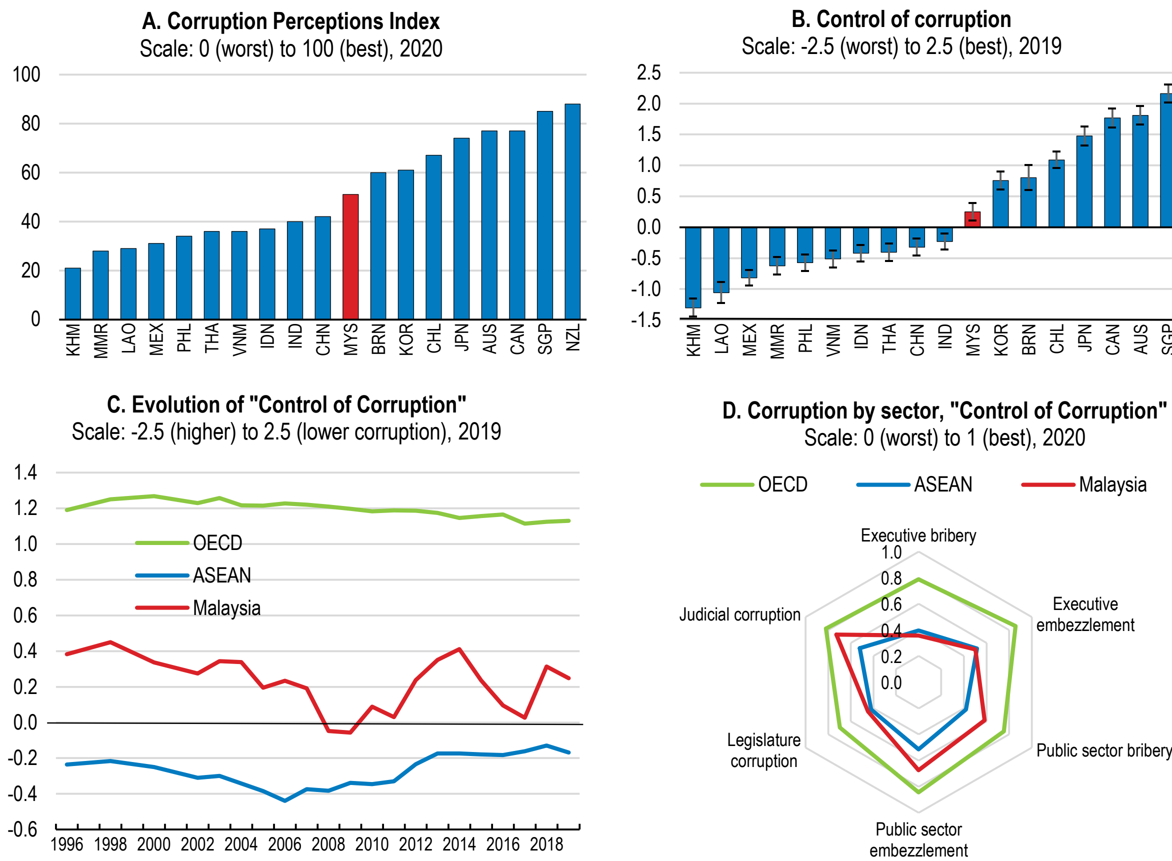
Public sector integrity is essential to establish trust in governments, which in turn helps promote higher compliance of citizens with laws, including the payment of taxes. Malaysia has progressively strengthened its public sector integrity for years. In 2009, the Anti-Corruption Agency (ACA) established in 1967 was converted to the Malaysian Anti-Corruption Commission (MACC). The Whistleblower Protection Act was introduced in 2010, much earlier than in many other countries. In addition, a major reform started after the general election in 2018, upon a still-disputed large-scale embezzlement case related to a state-owned fund, 1Malaysia Development Berhad (1MDB) (OECD, 2019[10]). The Special Cabinet Committee on Anti-Corruption (JKKMAR) led by the Prime Minister and its secretariat, the National Centre for Governance, Integrity and Anti-Corruption (GIACC), were set up to monitor anti-corruption measures enshrined in the National Anti-Corruption Plan (NACP) 2019-2023 (Table 1.6).

The new government formed in March 2020 inherited the reform programmes that had started in 2018. Together with the Malaysian Anti-Corruption Commission (MACC), the Special Cabinet Committee on Anti-Corruption (JKKMAR) and the National Centre for Governance, Integrity and Anti-Corruption (GIACC) continue to be the core of the government's anti-corruption undertakings. The 115 initiatives in the NACP have been steadily implemented. For example, in 2019, the Parliament passed a bill to establish the National Anti-Financial Crime Centre (NFCC), which would strengthen the coordination of government bodies in combating financial crimes and integrating enforcement. The amendment of the Malaysian Anti-Corruption Commission (MACC) Act 2009 (Section 17A) passed in 2018 by the Parliament was enforced in 2020. Under the revised Act, all commercial organisations or associated persons can be found guilty by the courts if these persons are charged for committing corruption offences for the benefit of their organisations. Further reforms are under way, such as the improvement of the public procurement rules and regulations, among others. Accordingly, overall Malaysia has improved its evaluations in a range of international assessments for the past years (Figure 1.17) (Figure 1.18).

Table 1.6. Past recommendations on public sector integrity

Recommendations	Action taken since July 2019
Monitor and evaluate rigorously the implementation of the National Anti-Corruption Plan (2019-2023)	• The National Centre for Governance, Integrity and Anti-Corruption (GIACC) published in 2020 a progress report of the National Anti-Corruption Plan (2019-2023). The plan includes 115 initiatives, of which 30 were to be implemented in 2019. As of December 2019, 29 initiatives were completed, while the rest of 86 initiatives were still in progress.

Figure 1.17. Malaysia has stepped up its anti-corruption efforts



Note: Panel B shows the point estimate and the margin of error. Panel D shows sector-based subcomponents of the "Control of Corruption" indicator by the Varieties of Democracy Project.
Source: Panel A: Transparency International; Panels B & C: World Bank, Worldwide Governance Indicators; Panel D: Varieties of Democracy Project, V-Dem Dataset v11.

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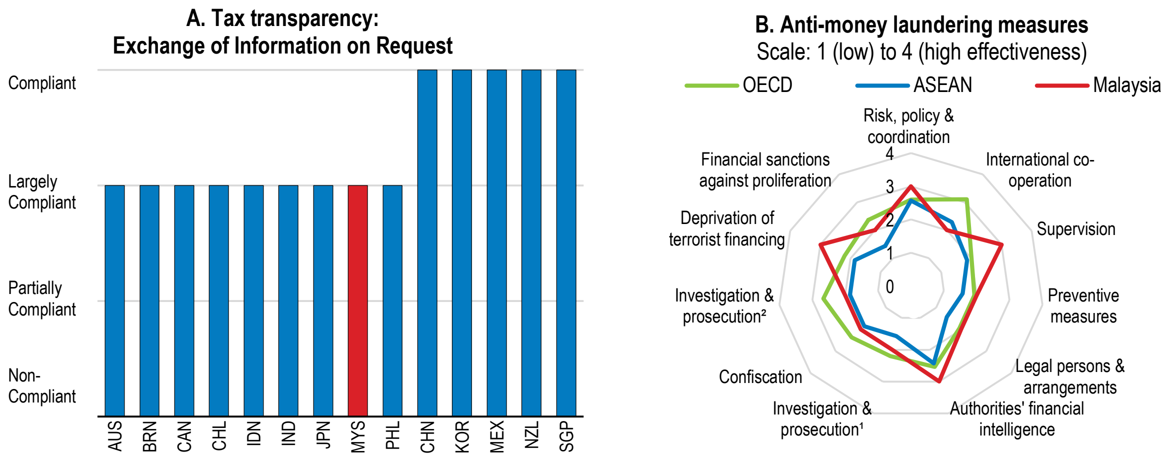
The strong anti-corruption momentum should be maintained, and needs to evolve towards a more robust framework. Particularly, recent cases highlighted the close and opaque relationship between public and private sectors, resulting in heightened risks of undue influence, nepotism, and regulatory and policy capture (Dettman and Gomez, 2020[11]). This calls for policy reforms in the area of political party financing, as unlimited anonymous party donations are still allowed and political parties can own businesses. The Public Service Act needs to be introduced to ensure an apolitical public service with greater clarity and accountability, and lobbying needs to be regulated as well as pre- and post-public employment. Moreover, the independence and enforcement power of the Malaysian Anti-Corruption Commission (MACC) could be further enhanced. Currently, the MACC is given mandate of investigation as MACC officers can arrest a suspect without warrant. Nevertheless, prosecutorial discretion remains with the Attorney General's Chambers. Moreover, a Chief Commissioner is appointed by the King on the advice of the Prime Minister for the period specified at the appointment. The appointment of the Chief Commissioner would be more transparent if a Parliamentary committee could recommend the nomination, and the tenure would be secured by law. In addition, there may be room for improvement in the Whistleblower Protection Act, as the Legal Affairs Division of the Prime Minister's Department (BHEUU) has been working on this issue. The enforcement of the Act is under the purview of each government agency. This would discourage potential whistleblowers in fear of weak protection (Bajpai and Myers, 2020[12]), and the Act does not provide protection for those who disclose allegations to the media.

Figure 1.18. Malaysia's anti-money laundering has progressed



Note: Panel A summarises the overall assessment on the exchange of information in practice from peer reviews by the Global Forum on Transparency and Exchange of Information for Tax Purposes. Peer reviews assess member jurisdictions' ability to ensure the transparency of their legal entities and arrangements and to co-operate with other tax administrations in accordance with the internationally agreed standard. The figure shows first round results; a second round is ongoing. Panel B shows ratings from the FATF peer reviews of each member to assess levels of implementation of the FATF Recommendations. The ratings reflect the extent to which a country's measures are effective against 11 immediate outcomes. "Investigation and prosecution¹" refers to money laundering. "Investigation and prosecution²" refers to terrorist financing.
Source: OECD Secretariat's own calculation based on the materials from the Global Forum on Transparency and Exchange of Information for Tax Purposes; and OECD, Financial Action Task Force (FATF).

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The governance of state-owned enterprises has also been strengthened. In 2018, the government issued a directive to require all state-owned enterprises (SOEs) to establish an Integrity and Governance Unit (IGU) in order to strengthen internal controls and prevent the risk of corruption and abuse of power. The Malaysian Anti-Corruption Commission (MACC) is mandated to monitor the implementation of this directive. From 2019, preparing an Organisational Anti-Corruption Plan (OACP) has become mandatory for all government agencies, including SOEs, to assess corruption risks in their administrative or business operations. Nevertheless, despite efforts to limit the role of politicians in statutory bodies and SOEs, political appointments continue to be made for board and chairman positions and threaten the autonomy of SOE decision-making bodies. In this regard, Malaysia could benefit from adopting the recommendations of the OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises (OECD, 2019[13]) (OECD, 2020[14]).

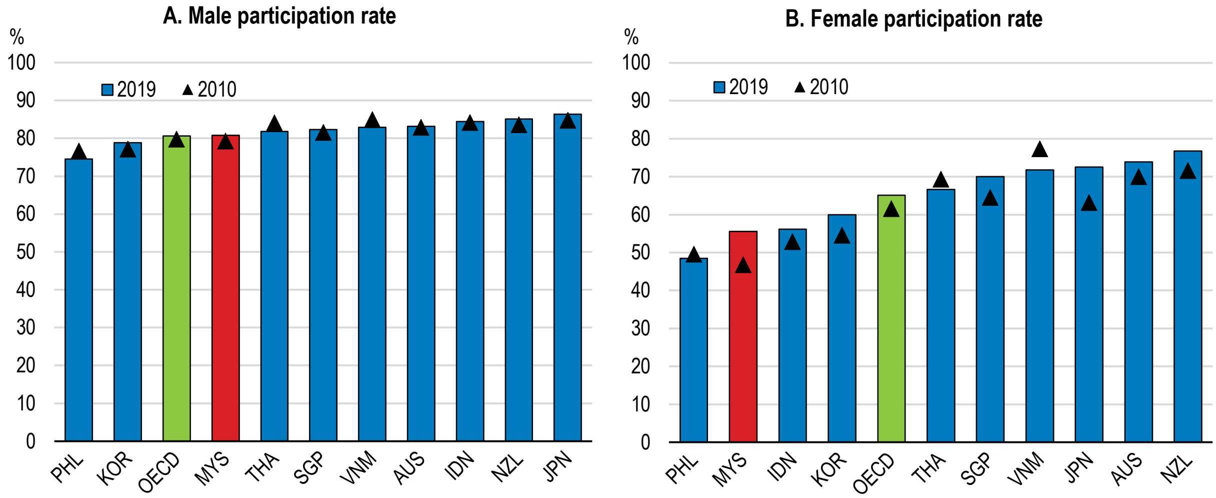
The pandemic-hit labour market calls for more social protection

A decade-long inclusive progress before the pandemic is being challenged

Before the pandemic, Malaysia's labour market saw a distinctive advancement in its inclusiveness. Female labour force participation increased dramatically in the last decade (Figure 1.19). Although it was short of a 59% target set in Malaysia's 11th five-year Plan for 2020 and still low compared with some other countries, the participation of women aged 15-64 rose to 56% in 2019 from 47% in 2010. As a result, the increase in the number of employed females was larger than that of males. While the rise of education attainment played a significant role, participation of female workers increased in all age categories. The entry of more women in the labour force pushed up the total labour force participation rate (aged 15-64) from 64% in 2010 to 69% in 2019, helping the economy achieve high growth.

Figure 1.19. Malaysia's female labour participation rate has increased rapidly

As a percentage of the population of the same gender aged 15-64



Note: For Singapore, data in 2010 refer to 2012.
Source: OECD, Labour Force Statistics database; ILO; CEIC.

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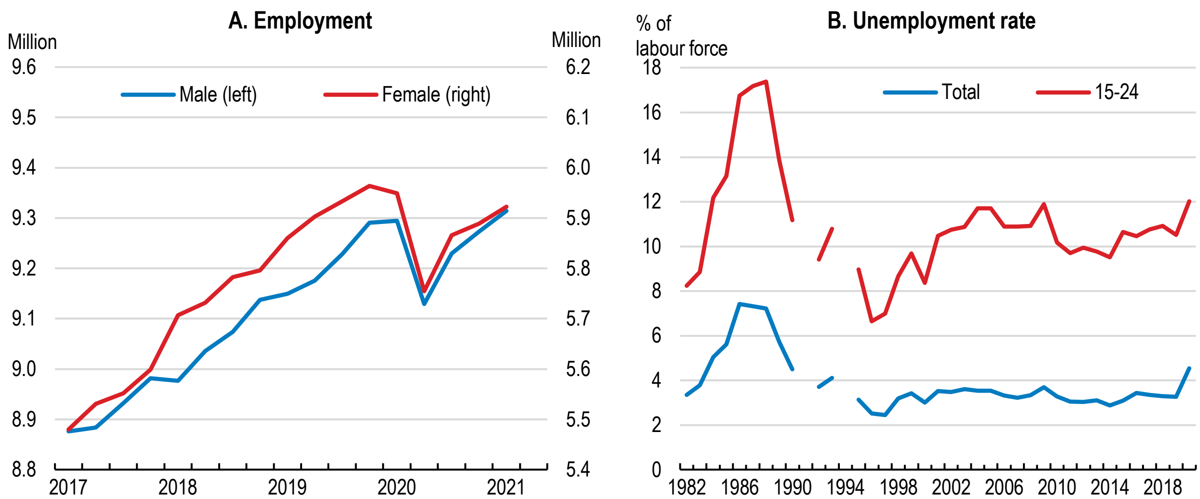
Another welcome development was that low-income households gained additional purchasing power in the late 2010s. Between 1999 and 2019, gross income (market income + social transfer received) grew at annual 8% for the bottom 40% households, while growth for the top 20% was 6%. Policy efforts to ameliorate employment conditions have also supported this development. In 2013, Malaysia introduced a minimum wage, and it has been raised progressively. The minimum wage was standardised in 2018 across the country to MYR 1 100 per month (USD 273), a rise from MYR 1 000 (USD 241) in Peninsular Malaysia and MYR 920 (USD 222) in East Malaysia in 2016, followed by another increase to MYR 1 200 (USD 286) in 56 city and municipal council areas in 2020.

Nevertheless, the pandemic has posed a significant challenge. Although being in the course of a gradual recovery, the labour force participation rate has dropped both for male and for female, particularly sharply in Q2 2020. The number of the employed has not yet recovered (Figure 1.20, Panel A), and the unemployment rate reached a historically high level of 5.3% in May 2020, although it has levelled off since then (Figure 1.20, Panel B). The current crisis has therefore revealed weaknesses in social and labour market policies in Malaysia, in particular the lack of sufficient social protection of the most vulnerable people – women, youth, the self-employed, less-educated, and migrant workers, including those in the informal sector (Cheng, 2020[15]). The impact on these people, which is likely to persist, calls for a revision of labour and social policies.

Figure 1.20. The pandemic has affected females and young workers disproportionately



Source: DOSM, Labour Force Surveys.

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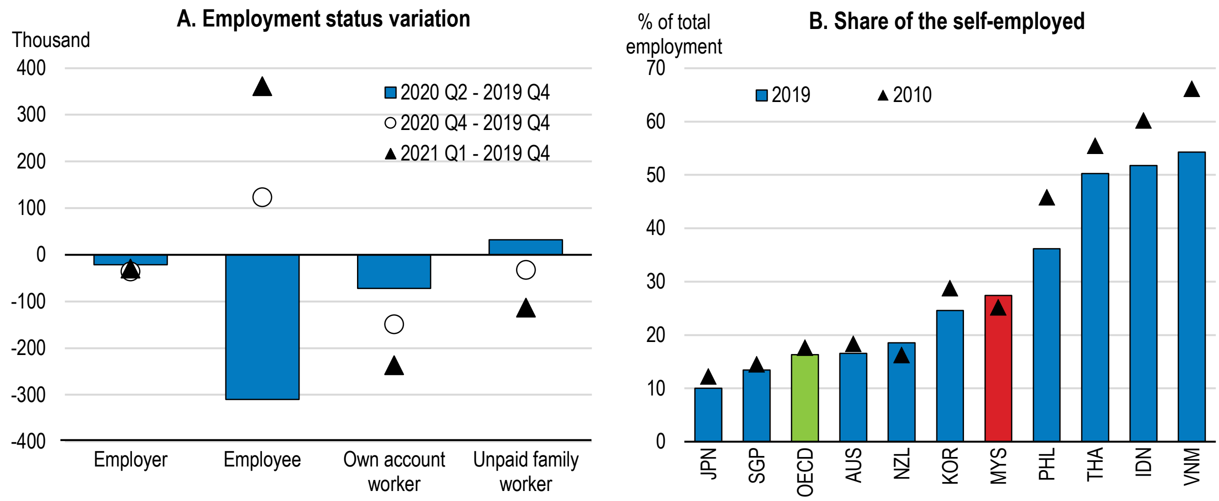
Encompassing the self-employed would make social protection more inclusive of women

In many countries, due to tighter restrictions on physical contact and border controls, the pandemic hit certain sectors and occupations more than others, calling for targeted policy actions by governments. In Malaysia, the self-employed have been hit hardest. While the number of employees have already returned to the pre-crisis level, partly thanks to the government's job-retention scheme, the situation has not improved for the self-employed (Figure 1.21, Panel A).

This also means that the pandemic has challenged Malaysia's decade-long improvement in the labour market. Between 2010 and 2019, the self-employed accounted for one third of the increase in female employment (0.6 million out of 1.7 million), a level larger than that of male (0.2 million out of 1.5 million). This pushed up the female share in all self-employed to 38% from 25%, while raising the share of the self-employed in total employment for Malaysia (Figure 1.21, Panel B). These self-employed are concentrated in the wholesale and retail trade sector, and the accommodation and food services, which have been directly hit by the health crisis. Even after the pandemic is over, some of these lost jobs may not return for a long time. Hence, the enhancement of social protection for the self-employed is crucial to avoid losing gains from the past progress made in integrating women in the economy.

Apart from its universal healthcare services, Malaysia has a three-tier social protection system. The first tier is an income support scheme directed towards the most vulnerable households. The second is employment insurance, which comprises an insurance scheme for job-related injuries provided by the Social Security Organisation (SOCSO) and unemployment benefits for employees (the Employment Insurance System, EIS), the latter of which was set up in 2018. The third tier is a well-established pension system mostly for employees. While entrepreneurship has been encouraged in Malaysia, the self-employed are less covered by social protection, particularly with second and third tiers of the social protection system. In addition, the minimum wage cannot be applied to the self-employed.

Figure 1.21. The job recovery of the self-employed has been weaker than for regular employees



Source: DOSM, Labour Force Surveys; World Bank, World Development Indicators database.

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In many countries, employers pay social security contributions for employees, but the self-employed do not (OECD, 2018[16]). If the difference is large, this creates skewed incentives for both employers and the self-employed, leading to an inefficiently high level of self-employment. In particular, firms tend to hire workers as self-employed contract workers, not as employees, to save costs. Some countries have reviewed their unbalanced taxes and social contributions between employees and the self-employed. For example, in Austria, employers need to pay the same social security contributions for contract workers as standard employees.

Against this background, the government has decided to enhance the social protection of the self-employed. The Social Security Organisation (SOCSO) introduced in 2017 a mandatory employment insurance (mostly for injuries) for taxi, e-hailing and bus drivers. In January 2020, the government extended the coverage of the scheme to 19 other sectors, including hawkers. In addition, during the pandemic, as a temporary measure, the government introduced an additional scheme for platform workers, in which the government subsidies 70% of SOCSO contributions for platform workers.

Nevertheless, there is some room for improvement. In many countries, a large part of employees are covered by the social protection system, while the self-employed pay fewer taxes and social security contributions than employees as they receive less social protection. Moreover, potential moral hazard problems exist in providing social protection to the self-employed. For example, it is difficult to distinguish whether or not they are unemployed. Nevertheless, amid the rise of dependent self-employed workers, which include platform workers, some countries have extended the statutory coverage of employment insurance. For example, Portugal introduced in 2012 unemployment insurance for contract workers who rely mostly on single employers. In addition to extending the statutory coverage of job-related injury insurance to the self-employed in more sectors, including platform workers, Malaysia could consider an unemployment benefit scheme for the dependent self-employed.

Moreover, access to training opportunities should be equally provided for both employees and the self-employed. In Malaysia, firms with more than ten employees need to pay levies to the Human Resource Development Corporation (HRD Corp), which provides training programmes for employees. Therefore, the training schemes prepared by the government focus more on entrepreneurs and contract workers, including freelancers for digital services, which is appropriate. The government sponsored schemes include eUsahawan, a technical and vocational education and training (TVET) for entrepreneurs, and eRezeki and the Global Online Workforce (GLOW) programme for digital freelancers (see below).

To further enhance training opportunities for the self-employed, personal training accounts attached to lifelong training mechanisms would be useful to provide portable training rights for the self-employed (OECD, 2019[17]). For example, in France, individual training accounts (Compte Personnel de Formation (CPF)) cover all adults, including the self-employed and job seekers, to which employers are main contributors (the self-employed persons pay a flat-rate contribution) (Perez and Vourc'h, 2020[18]). Individuals can accumulate training credits on their individual accounts based on the time spent in employment and working time during the year, which can only be used by the individual. The Netherlands is planning to introduce from 2022 a personal learning subsidy scheme, the Simulans Arbeidsmarktpositie (STAP) budget ((Permanent Representation of the Netherlands to the European Union, 2020[19]). Every person over 18 and below pension age can apply for a government subsidy for lifelong learning, which is expected to complement the development of private-sector's individual learning accounts.

The pandemic also revealed the long-term vulnerability of the self-employed during economic shocks, which makes it difficult to prepare for retirement, as pension systems may have biases against them. A number of countries have different pension systems for employees and the self-employed. In Malaysia, all private-sector employees are obliged to participate in a government-run pension fund, the Employees Provident Fund (EPF), which is a defined contribution scheme. Both employers and employees must contribute. Government officials, including army officials, are members of independent pension schemes, which are funded by government revenue. Public sector workers not included in the government schemes must contribute to the EPF with the federal and state governments contributing for the employer shares. Sole proprietors, the self-employed and workers in the informal sector can contribute to the EPF voluntarily, but their participation rate is lower.

Moreover, the number of female self-employed workers has increased more rapidly over the past decade than that of males. Most of them are not covered by pension (Figure 1.22). In addition, this increase has been concentrated on younger generations, suggesting that some of them could not prepare sufficiently for their retirement. Between 2011 and 2019, female self-employed workers below 40 years of age increased by 0.4 million, while the total increase in the number of female self-employed workers below the age of 64 was 0.6 million. This is consistent with the fact that, compared with the increase in the total number of female employed workers below the age of 40, the increase in female contributors to the Employees Provident Fund was smaller for the same age group during the same period. As the pandemic shows, the self-employed are more prone to be affected by economic downturns. It is therefore crucial to help them prepare for their future retirement, as the relative poverty rates among the elderly are higher than the youth and working generations.

Some countries have expanded the pension coverage of the self-employed. For example, in Austria, some categories of contract workers, such as lecturers, artists, scientists, journalists, writers, among others, have been covered by social protection (health, pensions and accidents), including pensions, since the 1990s. Other countries have special schemes for the self-employed. For example, the German artists' insurance is a mandatory scheme for artists and writers that provides health, pensions and long-term care insurance. A public subsidy covers 20% of contributions and 30% by services users, such as publishers.

Figure 1.22. Female self-employed workers increased, but social protection is weak

Change during 2011-2019

Note: The age band for Employees Provident Fund (EPF) members is 16-65 while it's 15-64 for employment. The number of government officials is assumed to be equal between 2011 and 2019. Kumpulan Wang Persaraan (KWAP) contributing members, which consist of the employees of statutory bodies, local governments and agencies, are evenly distributed between male and female.
Source: KWAP and EPF, Annual Report, 2011 and 2019; DOSM, Labour Force Surveys.

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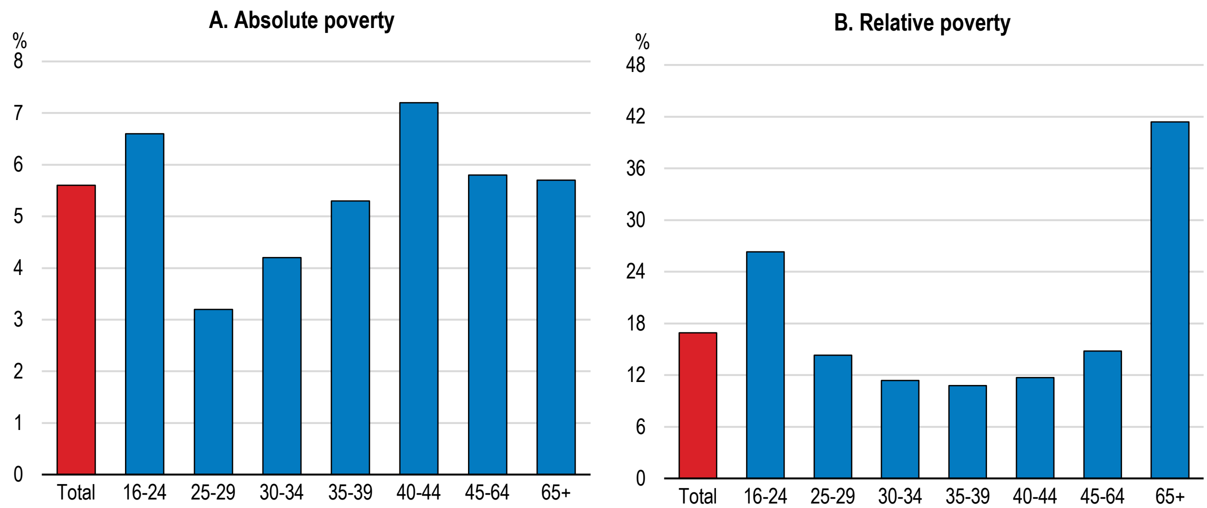
In Malaysia, the government has encouraged voluntary contribution to the Employees Provident Fund (EPF). The EPF set up in 2018 the i-Saraan programme, to which the self-employed below the age of 55 who do not earn regular income can make voluntary contributions for their retirement savings up to a maximum of MYR 60 000 per year. In this programme, the government provides a matching contribution amounting to 15% of the total contribution or maximum MYR 250 per year until 2022. Although the up-take increased from 98 874 in 2018 to 120 738 in 2019 (Annual Report, EPF), it is still small (4% of the total self-employed). To enhance the social protection of the self-employed, in the medium term, the government could consider making the contribution by employers compulsory for dependent self-employed workers (contract workers), while maintaining the matching contribution scheme for other self-employed workers.

As not all elderly people are covered by the pension schemes, currently, the first-tier income supports provide a basic backstop for elderly people with lower or no income. Nevertheless, old-age poverty continues to prevail (Figure 1.23). Lower income households are mostly among the elderly, which suggests that the income support is not sufficient to alleviate old-age poverty. The problem of old-age poverty is likely to worsen with the upcoming ageing of the population. This calls for expanding the pension scheme coverage beyond workers. In this regard, the i-Suri programme launched in 2018 provides an incentive for women registered under the e-Kasih Database (a national poverty database), mostly housewives, to contribute to the EPF. The government offers a matching contribution of up to MYR 480 per year upon a minimum contribution of MYR 5 per month made by the members. In 2019, 81 511 individuals contributed through the scheme, up from 63 297 in 2018 (Annual Report, EPF). The government could further utilise matching schemes to expand the pension coverage to other groups, including those out of labour force.

Figure 1.23. Poverty rates are high among elderly people

2019 data



Note: According to the Malaysian 2019 definition, absolute poverty is characterised by a monthly income less than MYR 2 208 for a household with an average size of 3.9 persons. Relative poverty is defined as a household earning less than half the median monthly income of MYR 5 873.
Source: DOSM (2020), Household Income and Basic Amenities Survey Report 2019, Tables 6.2 and 7.2.

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Box 1.3. An overview of Malaysia's pension system

Malaysia has pension schemes that covers mostly employees, but available for the self-employed and non-workers.

Employees Provident Fund (EPF)

The EPF is a publicly run defined contribution scheme. Employers and employees of the private sector are required to contribute to the scheme. The minimum contribution rates of employers and employees are 12% and 11% respectively for employees earning more than MYR 5 000, and 13% and 11% for those who earn below MYR 5 000. Due to the pandemic, the employee contribution rate has been temporarily reduced to 7% from April 2020 to December 2020 and 9% from January 2021 to December 2021. Withdrawal is available from the age of 55, while contribution is accepted up until the age of 75. The self-employed can voluntarily contribute to the EPF up to MYR 60 000 per year.

Public sector pension

The public sector pension is a defined benefit scheme funded by government general revenue. Government officials are covered by this scheme, and a lump sum gratuity and monthly allowance (maximum 30 years) are provided. The mandatory retirement age has been raised gradually from the original 55 in 1951 to 60 in 2012. A trust fund was established in 1991 to manage the finance of the pension scheme, which in 2007 became the Retirement Fund (Kumpulan Wang Persaraan, KWAP).

Armed Force Retirement Fund (LTAT)

This is a defined contribution pension scheme for the armed force personnel, funded by both employers (the government) and employees. The mandatory age is 55, but as the enlistment period is shorter (12 to 21 years) than that of government officials, the pension would not provide full retirement finance to retirees.

Private Retirement Scheme (PRS)

This is a voluntary scheme starting from 2012, in which private fund managers offer pension saving products. Tax relief is provided to contributors.

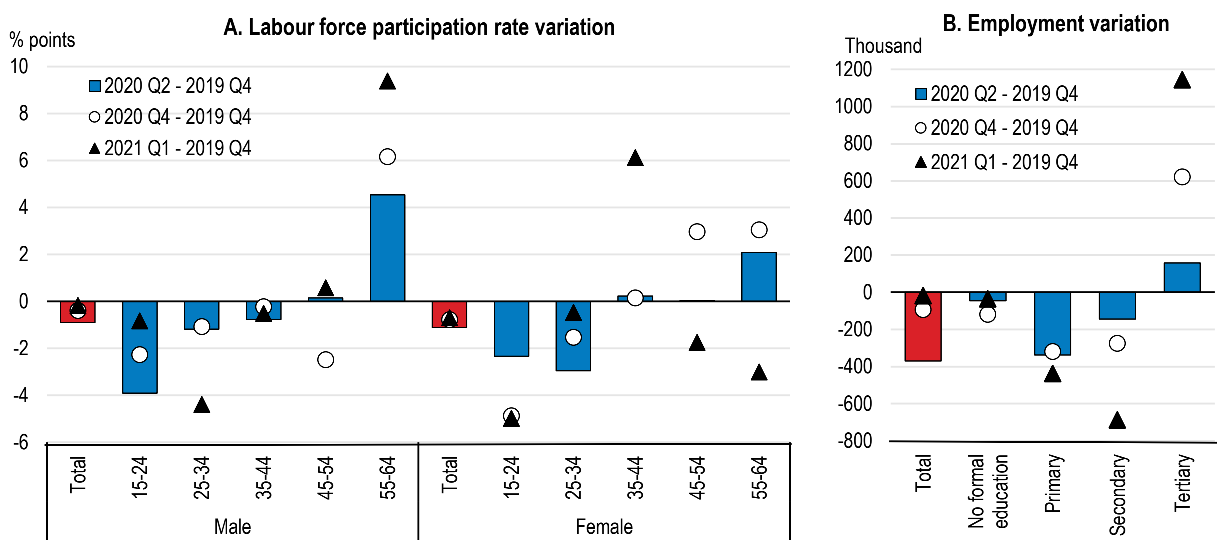
Source: (Nurhisham Hussein, 2019[20]).

Youth and less-educated people have been more affected by the pandemic

The pandemic hit young people more severely in many countries, including Malaysia. Even before the pandemic Malaysia had experienced high youth unemployment, similar to most other Southeast Asian countries. During the pandemic, young people were hit by unemployment, and the situation has not returned to pre-crisis levels (Figure 1.24, Panel A), with the risk of undermining their future employability. A protracted high unemployment of the youth risks causing long-term scarring effects. It is therefore crucial to provide them with job opportunities (Box 1.4).

Persons with tertiary education did not suffer from job losses during the pandemic. In contrast, those with only primary and secondary education saw a severe decline in employment opportunities (Figure 1.24, Panel B). The difference between the two groups has persisted and expanded since mid-2020, suggesting a divergence in the trends of sectors employing high-skilled and low-skilled workers. As the pandemic gets protracted, the job recovery in sectors employing low-skilled people, mostly in-person services, is likely to be very slow, and this calls for policy interventions to facilitate human resource reallocation among sectors.

Figure 1.24. Many young workers have not yet come back to the labour market



Source: DOSM, Labour Force Surveys.

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Providing skills training opportunities, particularly for the youth, should be made a priority. The government launched in October 2020 the Penjana KPT-CAP programme, which consists of three different sub-programmes to new graduates in 2020 and those could not find jobs in 2019. The matching and placement programme aims to provide training in the partnership with the private business sector. The second entrepreneurship programme offers knowledge and know-how to start a business, and the gig economy programme trains graduates to get a freelancer job. Under the matching and placement programme, the participating companies are expected to offer a job to graduates after they are certificated with a six-week training course. This programme should be continued until employment prospect improves for the youth, and programme could be enhanced further to improve job matching between the youth and SMEs. For SMEs, an economic hardship could also be considered as an opportunity to hire skilled workers, including new graduates, as SMEs cannot offer competitive wages when labour demand is strong.

In addition, while effective employment protection improves overall welfare of employees, the high cost of terminating jobs could make firms reluctant to hire new employees unintentionally. This would particularly affect the employment of young people who enter the labour market lately, as workers with longer tenure could remain on their jobs longer irrespective of their performances. Even in cases of wrongdoing, severance costs are relatively high, which is a source of complaint by domestic and foreign employers. According to the Global Competitive Index (Global Competitiveness Report, World Economic Forum), Malaysia's labour market is not overly rigid. It ranked 16th out of 141 economies for the labour market flexibility index in 2019. The score of the sub-index for hiring and firing practices was 5.0 (The best is 7.0), ranking 10th. Nevertheless, its redundancy costs were much higher than other countries (23.9 weeks of salary), with the rank of 109th, which implies that there is still some room for improvement, as a few crucial factors could act as a hindrance to overall labour market flexibility. After the Global Financial Crisis, a number of EU countries eased the strict dismissal regulations of regular workers to reduce dualism in the labour market (OECD, 2020[21]). For example, Italy introduce in 2015 the Jobs Act to eliminate the possibility of reinstatement and replace *ex ante* reconciliation procedures with *ex post* ones together with the abolishment of a special allowance for collective dismissals. Portugal adopted in 2013 laws to lower severance pay.

Easing employment protection must go hand in hand with greater support to the unemployed. While a range of social protection programmes are provided by various ministries and agencies, which could be more consolidated, the effectiveness of these programmes could be improved by adopting graduation mechanisms for recipients of the programmes linked with active labour market policies (ALMPs). This will require imposing some conditionality, such as compulsory enrolment in skills training programmes, on the eligibilities for these benefits.

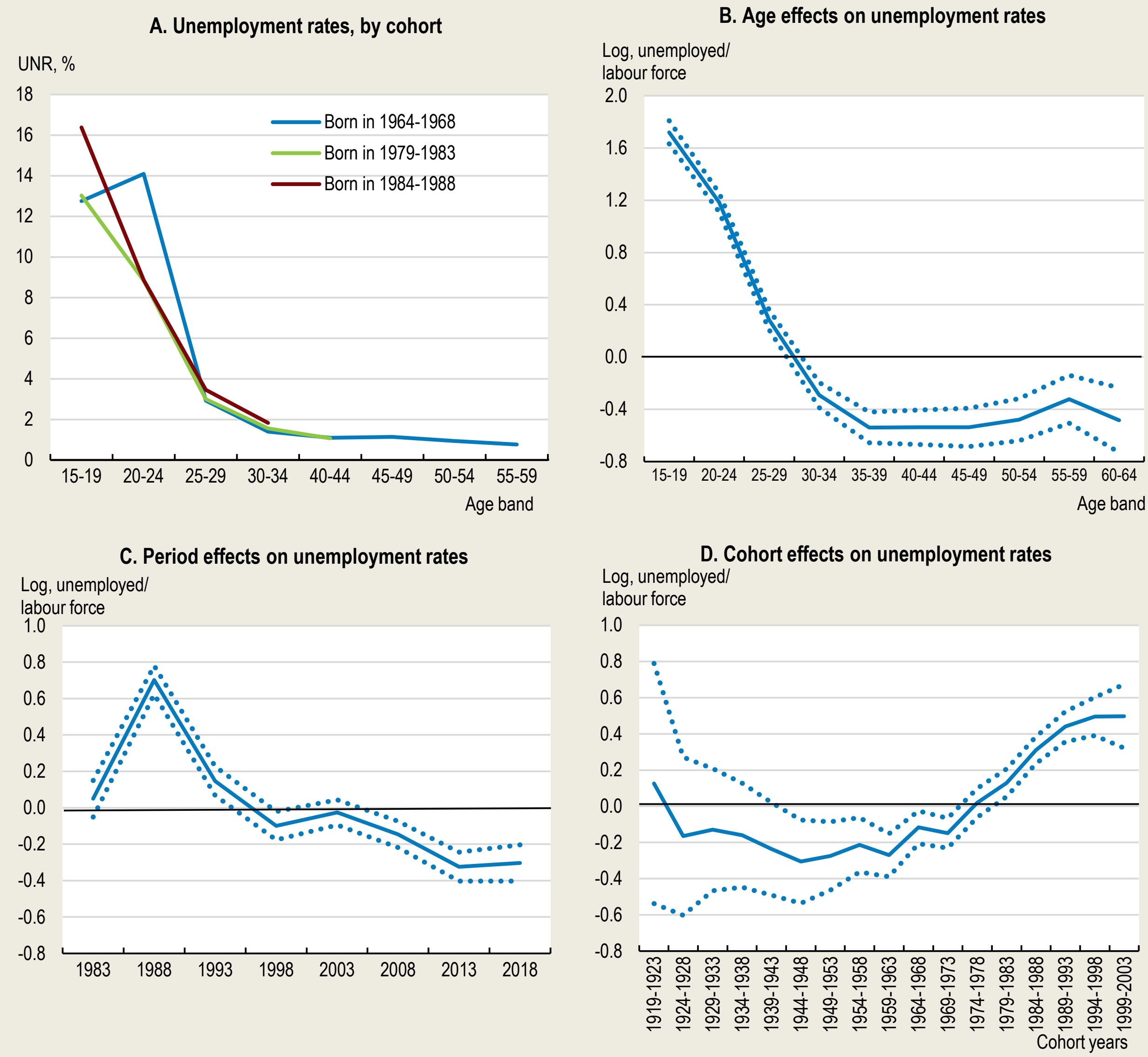
Box 1.4. High unemployment of young people risks affecting their employability

In many countries, including Malaysia, unemployment rates are higher for younger persons, and lower for older persons. This relationship generally holds for the unemployment profile of each generation, which suggests that the probability of being unemployed declines when a person becomes older. Nevertheless, unemployment profiles vary among different generations, because of different economic conditions that each generation experiences (Figure 1.25, Panel A). The groups of young people who face a severe economic shock typically suffer higher unemployment over the course of their life, because of the deterioration their employability stemming from scarce job experience.

To estimate the individual effects of, age, period and generation (cohort), a simple calculation was conducted by using an estimation method used in public heath analyses, such as incidence rates of a disease in population (Yang, Fu and Land, 2004[22]).

Estimation results suggest that the recent generations (born after 1980) who experienced high unemployment since the early 2000s when they first entered into the labour market are likely to face a higher probability of unemployment over the course of their work life (Figure 1.25, Panel D), although in general they are more likely to be employed as they get older (Figure 1.25, Panel B). In the meantime, the impact of the recession in the mid-1980s, a temporary economic shock, was likely to affect all generations significantly who were in the labour market at that time (Figure 1.25, Panel C).

Figure 1.25. Unemployment rates vary between different generations



Note: The dotted lines represent the 95% confidence intervals.
Source: DOSM, Labour Force Surveys and OECD calculations.

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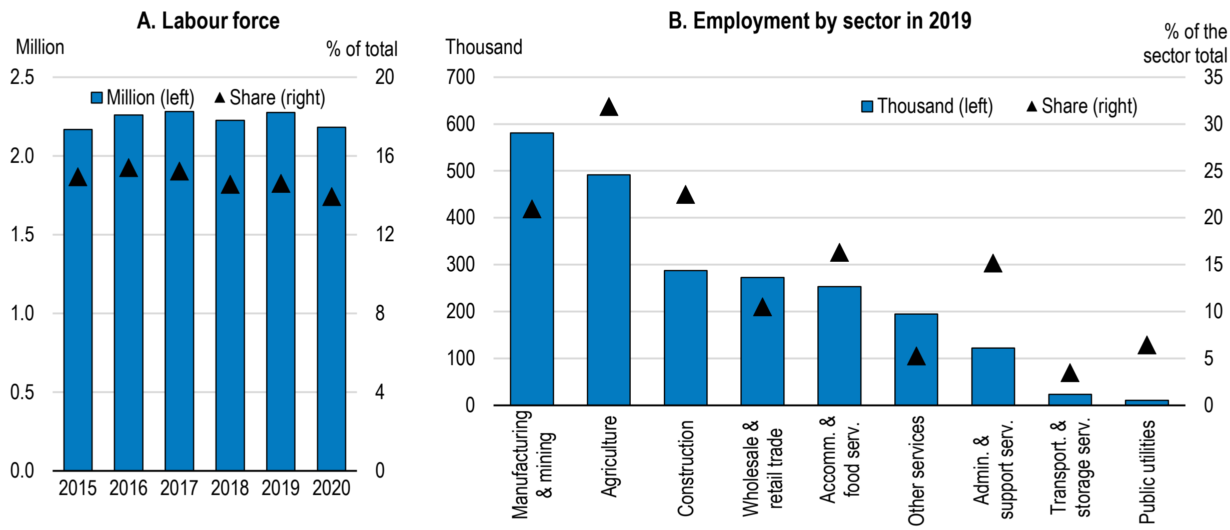
Foreign workers account for a significant share in Malaysia's labour market

Thanks to its high economic growth, Malaysia has long been attractive to foreign workers. According to the Labour Force Survey, as of 2019, 2.3 million non-Malaysian citizens were in the labour force, 15% of the total (Figure 1.26). Although it declined slightly in 2020 due to the restrictions on economic activities and border closures, the share of the non-Malaysian citizens still stood at 14% of the total labour force. Foreign workers are concentrated in specific sectors, notably manufacturing, agriculture and construction, and most of them are lower-skilled workers.

Malaysia adopts a two-track system to manage the entry of foreign workers, based on the skills levels of workers determined by monthly wages. Workers with wages above MYR 3 000 are categorised as skilled expatriates, whereas those with less than MYR 3 000 are classified as low-skilled foreign workers. Permitted skilled expatriates will be given an Employment Pass, which allows them to take a job contract up to five years. They could also become permanent residents. The inflow of low-skilled foreign workers is more rigorously controlled through a quota system, a Visit Pass, under which a number of additional conditions are imposed, such as the age of applying workers (18-45) and the maximum length of stay (ten years). Moreover, the Visit Pass system only applies to those who come from a list of 15 countries, and bilateral agreements restrict sectors that workers can apply to. For example, workers from Bangladesh can only apply to the plantation sector.

Figure 1.26. Malaysia provides a significant number of jobs for non-Malaysian citizens

Persons aged 15-64



Source: DOSM, Labour Force Surveys.

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In many countries, including Malaysia, low-skilled foreign workers (foreign workers) are more likely to be affected by economic shocks, and the sectors, which these workers work for, such as construction, have been severely damaged by the pandemic. During the pandemic, the government adopted some measures to address work conditions of migrant workers. Although an adverse incentive has been given to employers to replace foreign workers with local workers in sectors relying on foreign labour force, such as plantation and construction, foreign workers will be treated under the universal healthcare system for COVID-19 infection. A levy on employers who hire foreign workers has been reduced. The restrictions preventing foreign workers from changing jobs between sectors have been temporally lifted to reduce supply constraints of labour.

In this regard, the inclusiveness of the labour market could be improved. While imposing the tight control to the migrant flow, the government has been extending the coverage of social protection to low-skilled foreign workers for years. Foreign employees can opt to contribute to the Employees Provident Fund. From 2019, except for domestic helpers, all foreign workers migrated from the previous Foreign Workers Compensation Scheme, which had provided limited benefits, became eligible to employment injury insurance provided by the Social Security Organisation (SOCSO). Moreover, in 2021, the employment injury insurance extended its coverage to domestic helpers with the status of Malaysian citizens, permanent residents and foreign workers. The government could consider including foreign workers into the unemployment benefit system.

In addition, although Malaysia manages the flow of low-skilled workers, previous study suggests that there are a significant number of undocumented (irregular) foreign workers. According to the World Bank, the total number of foreign workers, when irregular foreign workers are also included, would be likely to be in the range of 3 million to 3.3 million in 2017 (Yi et al., 2020[23]). The lower band is slightly higher than the number from the Labour Force Survey, and more than 40% of them are deemed irregular. Therefore, although there is no one-size-fits-all solution, promoting formalisation is important. Together with effective enforcement, the extending coverage of social protection would be conducive to the formalisation.

Malaysia needs to lower carbon emissions

A more ambitious target is pertinent and achievable

Malaysia's greenhouse gas (GHG) emissions have increased, but its share in the global emissions is small (0.6% excluding net emissions from land use in 2016 and 0.3% including net emissions from land use, Our World in Data). In 2015, following its adoption of the Paris Agreement, Malaysia set a goal to reduce its GHG emissions intensity in terms of CO2 equivalent per GDP: namely a 35% reduction by 2030 or 45% conditional on receipt of international support (compared to the 2005 level), like other countries in the region (Table 1.7). Progress has been made since then (Figure 1.27, Panel A) (Table 1.8).

Table 1.7. Southeast Asian countries have pledged to reduce GHG emissions

Country	Nationally Determined Contribution under the Paris Agreement
Indonesia	An unconditional 29% reduction of GHG emissions by 2030 and a conditional 41% reduction from the business-as-usual (BAU) level.
Malaysia	A 35% reduction of GHG emissions intensity in terms of CO2 equivalent per GDP by 2030 or a 45% reduction conditional on receipt of international support (compared to the 2005 level).
Philippines	GHG emissions reduction and avoidance of 75%, of which 2.71% is unconditional and 72.29% is conditional, for the period between 2020 and 2030.
Singapore	Peak emissions at 65 metric tons of carbon dioxide equivalent (MtCO2eq) around 2030 (a 36% reduction in its emissions intensity from 2005 levels by 2030).
Thailand	A 20% reduction of GHG emissions by 2020 from the business-as-usual level or a 25% reduction conditional on adequate and enhanced access to technology development and transfer, financial resources and capacity building support.
Viet Nam	An 8% reduction of GHG emissions compared to the business-as-usual scenario with the 2010 base year, which can be increased by up to 25% with international support through bilateral and multilateral cooperation and the implementation of new mechanisms.

Source: UNFCCC, Interim NDC Registry.

Table 1.8. Past recommendations on green growth

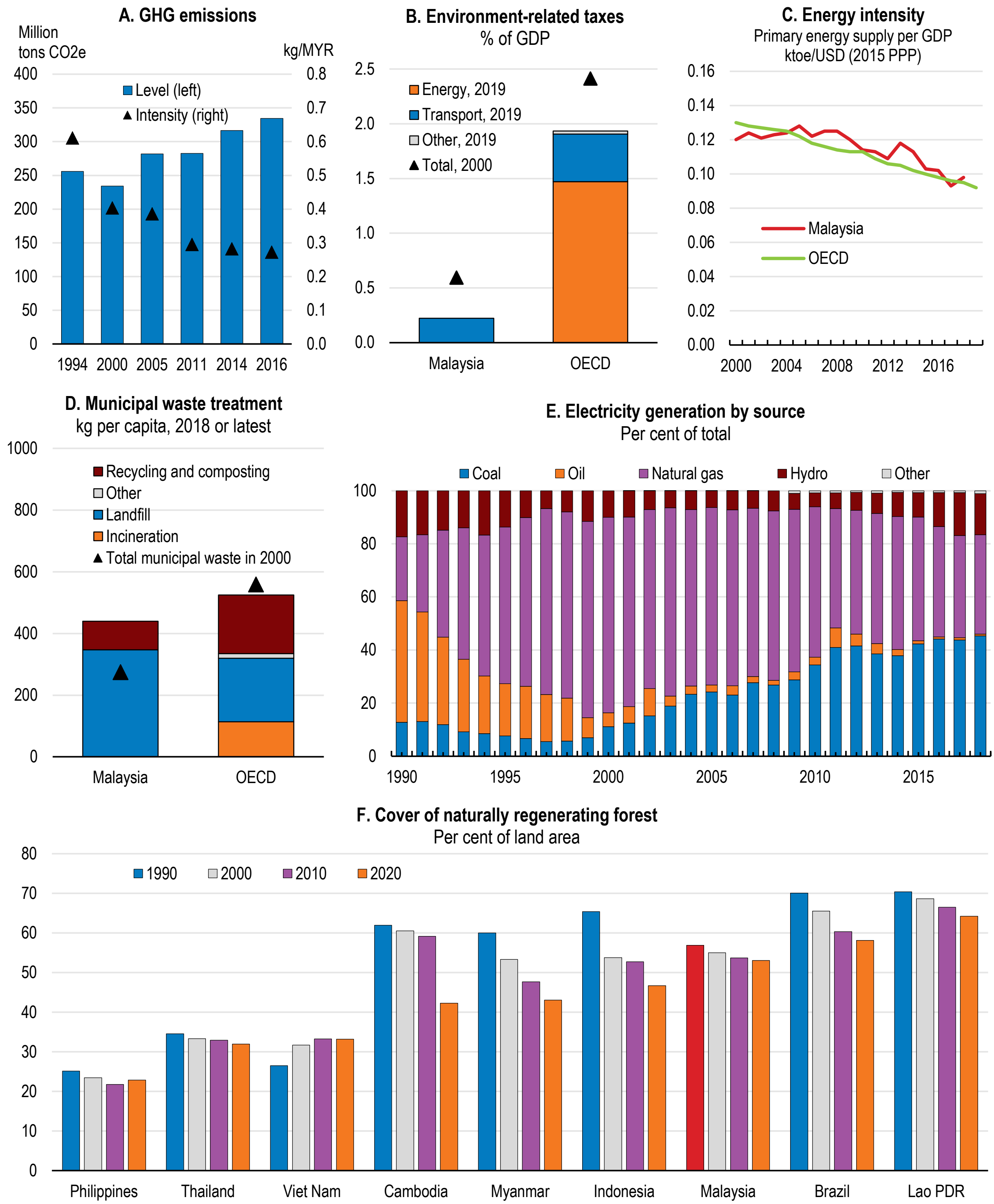
Recommendations	Actions taken since July 2019
Eliminate energy subsidies and, instead, provide targeted cash transfer.	• Since 2019, the electricity bill subsidy scheme has been more targeted to lower-income groups by using the e-Kasih Database (a national poverty database).
Promote vertical and across-municipality co-ordination on green growth.	• The number of local authorities that have adopted the Low Carbon City Framework, which aims to set up and implement coherent strategies to reduce carbon emissions at the local level, increased to 52 in 2019 from 25 in 2017. • The Low Carbon City Catalyst Grant was launched in 2021 to support policy implementation of the local authorities.
Consider to implement a carbon tax.	• No action has been taken.

Nevertheless, it is urgently needed that Malaysia further strengthens its policy efforts, as its absolute volume of GHG emissions has grown and will do so in accordance with its high economic growth. Recently, a number of countries announced the goal of achieving carbon neutrality by the middle of this century, although it is a difficult challenge for any country. Particularly, a complete transformation in the production and the use of energy will be required to achieve global net zero emissions by 2050 (IEA, 2021[24]). As investors and consumers have become more concerned about climate change, the private sector is now moving faster than the public sector, setting its own ambitious targets. In Malaysia, Petronas, a state-owned oil company, pledged in 2020 to realise net zero emissions by 2050. The government is also stepping up its efforts, considering the enhancement of its policy framework through the amendment of the Environmental Quality Act 1974. Taking into account its achievement of reducing its GHG emissions intensity thus far, Malaysia could pursue more ambitious national targets and, for this purpose, consider the introduction of a carbon tax, as currently almost no price signalling mechanism exists to reduce carbon consumption (Figure 1.27, Panel B). Nevertheless, the introduction of carbon taxes needs to be associated with proper compensation policy to negatively affected people by the carbon taxes.

The financial markets can also play an essential role in transforming the economy. Recently, a number of countries have developed a classification system (i.e. taxonomy) of sustainable economic activities and financial products to provide a coherent and transparent framework for the markets. In Malaysia, the central bank, Bank Negara Malaysia, issued in 2021 the Climate Change and Principle-based Taxonomy as a guidance for financial institutions to evaluate and screen their economic activities according to sustainability criteria (Bank Negara Malaysia, 2021[25]). Looking ahead, the central bank is considering developing complementary guidelines for financial institutions about climate-related risk management and scenario analysis. These efforts could be further stepped up. For example, in the European Union, the regulations related to the EU Taxonomy have been enforced (European Commission, 2021[26]). From 2022, large financial and non-financial companies, and financial market participants will be required to disclose their activities following the EU Taxonomy. Moreover, the European Central Bank is planning to carry out climate stress-test of individual banks in 2022.

In addition, given that state-owned enterprises (SOEs) constitute an important part of the economy, the government could also consider incorporating climate goals into its state ownership policy to allow for public disclosure of expectations for sustainability, and establishing mechanisms for their implementation. In this regard, ensuring coordination between general climate policy and SOE-specific objectives and creating a level playing field among private players are crucial to ensure competitive neutrality (OECD, 2020[27]).

Figure 1.27. Malaysia's environment performance has improved, but more could be done



Note: GHG emissions include emissions from land use, land use change and forestry, but exclude removals.
Source: OECD (2021), OECD Environment Statistics database; OECD National Accounts database; IEA (2021), IEA Energy Prices and Taxes database and World Energy Balances database; UNSD Waste Statistics; FAO, Global Forest Resources Assessment 2020; Ministry of Environment and Water (2020), Malaysia - Third Biennial Update Report to the UNFCCC.

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Renewable energy can be further promoted in tandem with market liberalisation

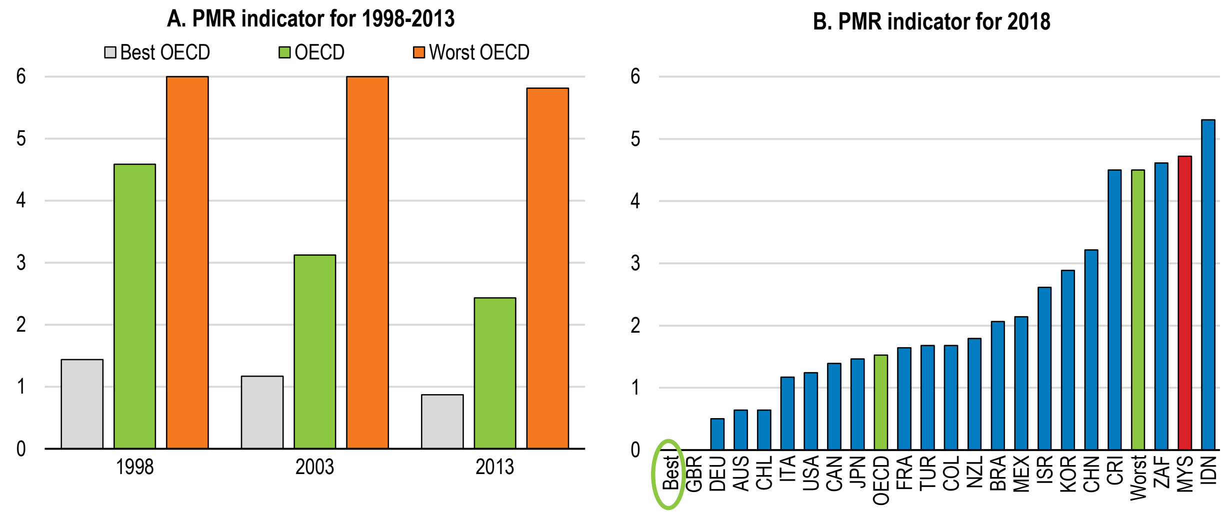
Despite its improving energy efficiency (Figure 1.27, Panel C), Malaysia's energy consumption has increased rapidly along with fast economic growth. Therefore, in addition to the continued pursuit of energy efficiency, transforming the energy sector into a lower emission sector is crucial. Electricity generation is one of the major sources of carbon emissions (electricity and heat production accounted for 39% of CO2 emissions in 2016, Third Biennial Update Report to the UNFCCC, Ministry of Environment and Water). The installation of large coal power plants in the past two decades has pushed up coal to the predominant position in electricity generation (Figure 1.27, Panel E), surpassing natural gas. The decision to enhance coal share of power generation was driven by the dual objective of affordability and energy security of supply. In 2010, a fire incident on the Bekok C offshore gas platform created tightness in domestic natural gas supply as a fuel-to-power generation resulted in gas supply curtailment. This drove the decision to increase coal share in the power generation mix to safeguard security of supply and energy security. In addition, affordability benefits to be passed down to consumers have also be considered, given a lower cost of power generation from coal than that of natural gas. Nevertheless, currently no further installation of coal power plant is planned, and in order to rebalance its energy mix, the government aims at increasing the share of renewables to an ambitious 31% by 2025 and 40% in 2035 (Energy Commission, 2020[28]). This requires expanding the capacity of renewables from the current 7 995 MW in 2020 to 13 000 MW in 2025.

In promoting renewables, the structure of a country's electricity market needs to be taken into account. In Malaysia, the electricity market in Malaysia has been gradually liberalised since the early 1990s (Kumar, Poudineh and Shamsuddin, 2021[29]). For Peninsular Malaysia, the public electricity utility became a listed company in 1990, Tenaga Nasional Berhad (TNB), followed by the introduction of independent power producers (IPPs) to the market in 1993. Next was the creation of an independent regulator, the Energy Commission in 2001 (Sarawak's market is regulated by the state government). Following a first initiative of market reform, the Malaysia Electricity Supply Industry (MESI) 1.0, in 2014, two ring-fenced divisions were established in TNB (the Single Buyer and Grid System Operator) to secure transparent and fair electricity procurement from generators as well as management and control of network and generation dispatch. Nevertheless, TNB still maintains a sole responsibility in the transmission, distribution and retail of electricity in Peninsular Malaysia, and a wholesale market does not yet exist.

Looking ahead, to maximise the benefit of private sector dynamism in expanding renewables, the liberalisation of the electricity market needs to be further pursued. In the past decade, particularly from the late 1990s to the early 2000s, a number of OECD countries carried out electricity market reforms, keeping the momentum even afterwards (Figure 1.28, Panel A). For example, although the scale is not comparable because of its market integration, EU countries have implemented the electricity market liberalisation in tandem with the promotion of renewables. Portugal initiated its market reforms in the mid-1990s, and it now has one of the most liberalised markets. Transmission, distribution, generation, and end user supply have been unbundled, while succeeding in promoting renewables, which account for more than 50% of electricity generation (in 2019, OECD Green Growth Indicators) (OECD, 2012[30]) (OECD, 2019[31]). A newly calculated OECD Product Market Regulation indicator shows that Malaysia's electricity market still presents considerable regulatory barriers to competition compared with OECD countries (Figure 1.28, Panel B). The government is planning to move ahead in this direction. In 2019, a more ambitious MESI 2.0, was approved to push ahead with market liberalisation, including the creation of a wholesale market and the introduction of alternative retailors, but in 2021, the government decided to review it once again to incorporate the latest economic and social development stemming from the pandemic. It is crucial to keep the reform momentum.

Figure 1.28. More liberalisation in the electricity market can be conducive to green growth

Indicator of regulations in the electricity sector, index scale of 0-6 from least to most restrictive



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). The 2018 PMR indicators are not strictly comparable to the previous ones. Best/worst represents the OECD best/worst performing country.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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Solar power is increasing, even though it remains small, but it has a huge potential in Malaysia due to its proximity to the equator. Like other countries, Malaysia has progressively developed a framework to increase electricity generation by renewables, capitalising on the emerging ability of the private sector. A feed-in-tariff (FiT) scheme started in 2011 except for the state of Sarawak. Consumers using more than 300 kWh of electricity per month pay an additional 1.6% to their electricity bills to fund the implementation of the FiT scheme that aims to develop renewable projects capped at a maximum capacity of 30 MW. Under the FiT scheme, utility companies are obliged to purchase renewable electricity generated at a given premium price. The uptake of the FiT scheme has increased dramatically (annual 38% between 2012 and 2018), particularly for solar, which accounted for 64% of the capacity in 2018 (Annual Report 2018, SEDA). With solar renewables gaining tractions among electricity consumers in Malaysia, the provision of premium buy-back tariff under the FiT scheme was discontinued. Accordingly, a new scheme, the Net Energy Metering (NEM), started in 2016 as a new solar opt-in programme, which enables all electricity consumers to produce solar electricity for their own use and to offset excess electricity for a period of 24 months. All 500 MW quota allocated under the first phase was taken up by the end of 2020, and an additional 500 MW quota has been allocated for the second phase (2021-2023) with an improved peer to peer energy offsetting system, which allows prosumers (consumers who simultaneously generate power to sell) to virtually offset excess electricity with a maximum of three other grid connected consumers. In addition, a competitive bidding process has started since 2016 for large-scale solar projects with the above 30 MW capacity (Large Scale Solar).

While solar power has shown a leapfrog progress, other sources of renewables could be further promoted to diversify generation sources in view of ensuring more security and reliability of electricity supply. In addition to bioenergy sourced from oil palms, Malaysia is also pursuing further development of renewables, such as waste to energy from municipal solid waste and small hydro (up to 30 MW in size). In order to facilitate green investment, including electricity generation from diverse renewables, a soft loan provision, the Green Technology Financing Scheme (GTFS), was introduced in 2010, and its second allocation ended in 2020 (the third phase will be announced soon). All types of renewable generation projects can apply for the GTFS. Moreover, the GTFS and the other schemes for renewables complement each other. Renewable power generators under the FiT, the NEM or the Large Scale Solar schemes are eligible to apply to the GTFS.

Conserving forests pays off

Malaysia is endowed with rich rainforests. Although its land covered by forests is less than 4% of Brazil's (as of 2020, World Forest Resources Assessment 2020, FAO), it embraces one of world's most abundant tree biodiversity, most of which are endemic to Malaysia (Beech et al., 2017[32]). The benefit of forests is not limited to its economic values. Forests bring about multi-facet benefits, such as social, cultural and environmental welfare, but could also be a source of innovation, such as new pharmaceuticals, all of which will constitute the well-being of future generations. In the case of Malaysia, as its pristine nature has become a powerful global tourist attraction, the government's priority now gears to promoting green tourism (Ministry of Tourism, Arts and Culture, Malaysia, n.d.[33]). Moreover, until the mid-2000s, it was not a net carbon emitter thanks to the carbon sink of its vast forests (Ministry of Environment and Water, 2020[34]). Therefore, although it would entail a certain amount of present costs, conserving forests should be essential part of its green growth strategy. In this regard, Malaysia firmly upholds its pledge to maintain its forest and tree cover at least 50% of its land area, while other countries in the region have lost its forests rapidly amid their economic expansions (Figure 1.27, Panel F). Nevertheless, Malaysia's forestry policy could be strengthened further in order to conserve its rich forests for its future generations, preventing long-standing problems of deforestation and degradation.

Under the Constitution, forest administration is under the remit of the state governments, and the role of the federal government is mostly confined to policy advice, technical assistance, and research and development. The sole authority over the extraction of forest products (i.e. timbers and non-timber forest products) and discretion of punishment under the laws and regulations is under the jurisdiction of the state governments. The royalties and fees on timber harvesting are an important source of their revenue. As a result, the quality of forest management varies considerably from state to state, including enforcement and corruption control, although for Peninsular Malaysia, the Forestry Department of Peninsular Malaysia is responsible for the formulation of forestry policies and provides technical advice and assistance to the State Forestry Departments in Peninsular Malaysia (Regional forest distribution in the national total forest cover: Peninsular Malaysia 32%, Sabah 26%, Sarawak 42%, in 2018, Compendium of Environment Statistics, DOSM). It is still important to take into account notable regional differences, such as the involvement of different stakeholders, including indigenous people. Nevertheless, different from the period of the early stage of economic development, when economic and social benefits of forests, such as those from wood production, were mostly tied to related small local communities, the extensive welfare of forests spreading beyond a locally limited area has now been widely recognised. A definitive policy orientation at the national level that can generate stronger policy coherence between states has been long overdue (Hammond, 1997[35]).

Moreover, while the sustainable footing of Malaysia's forestry policy dates back to the early 20th century when its forests were eroded by the rapid expansion of rubber plantation and tin mining (Hammond, 1997[35]), its policy emphasis has focused more on the productive values of forests for years. In the past decades, like in many other countries during the process of economic development, Malaysia's sustainable forestry policy has gradually evolved. For example, a Sustainable Forest Management practice has been introduced since the early 1970s as a new form of forest management encompassing a vast array of utilities that would bring social and economic benefits and protect the environment for future generations. A forest management certification started in the early 1990s in Peninsular Malaysia to maintain the forest resources, particularly permanent reserved forests (PRF), under the Sustainable Forest Management practice. A further initiative began in 1994 in Peninsular Malaysia under the criteria and indicators for the Sustainable Forest Management of the International Timber Trade Organization. The government has also promoted an international mechanism to reduce emissions from deforestation and forest degradation (REDD+) led by the United Nations Framework Convention on Climate Change (UNFCCC), under which developing countries are offered financial incentives to reduce emissions from forests and invest more for sustainable development. The government adopted a national strategy for REDD+ in 2016 (Ministry of natural Resources and Environment, 2016[36]). Nevertheless, further strengthening of these developments has been strongly called for in recent years.

Against this background, the government has been further stepping up its efforts. In March 2021, the government adopted for the first time an overarching policy framework, the Malaysia Policy on Forestry 2020, encompassing the revised forestry policies at the regional level (the Forestry Policy of Peninsular Malaysia 2020, the Sabah Forest Policy 2018 and the Sarawak Forest Policy 2019). The Policy focuses on maintaining adequate forest areas for local ecosystem, conserving biodiversity, protecting the environment and promoting sustainable use of resources for the country's socio-economic development and the well-being of present and future generations. Moreover, the government is proposing the amendment of the National Forestry Act, last revised in 1993 (see below). This aims at tightening the land use change of forest area including that from permanent reserved forests, strengthening enforcement, increasing penalties and giving greater clarity to the law provisions to facilitate effective policy implementation by state governments. All revisions would be useful if they are effectively implemented. The government should accelerate the amendment of the Act and move on to its swift implementation. The state governments also need to take actions to review their state forestry Enactment/Ordinance and related laws.

The coordination and monitoring functions of the federal government could be enhanced further. Malaysia has the National Land Council, a Constitutional body for nation-wide land use control, consisting of both the federal government and all state governments. The Council's portfolio has expanded to include forestry matters since 2010, and now acts as a focal point of coordination and common approaches in forestry policies. In 2019, the Council agreed on tightening the conditions on palm oil plantation to prohibit its expansion into forest areas. The area for palm oil plantation is capped to 6.5 million hectares. While this also calls for a rigorous implementation at the state level (for example, Sabah has already set up an initiative to ensure that the palm oil sector contributes to forest conservation and sustainability with globally recognised certification systems), the role of the National Land Council could be further strengthened, particularly in the monitoring of overall policy implementation at the national level. Unlike past leadership by a federal minister or a Deputy Prime Minster, now the Prime Minster presides over the Council, which could provide strong impetus to enhance its role.

A number of countries have been combatting illegal activities causing deforestation, such as illegal logging. In Malaysia, the National Forestry Act, applicable to Peninsular Malaysia, was amended in 1993 to impose heavier penalties on offences, amid serious illegal logging prevalent in the late 1980s and early 1990s. Sabah and Sarawak have a similar framework, known as the Sabah Forest Enactment 1968 and the Sarawak Forest Ordinance 2015. Moreover, the collaboration of the whole government institutions, including army, has been strengthened, and more sophisticated technologies, such as drones, satellite observations and remote sensing, are now deployed. Accordingly, in the case of Sabah, the number of annual reported cases has been on the downward trend from 252 cases in the 2000s to 164 cases in the 2010s (Annual Report, Sabah Forestry Department). Moreover, the expected amendment of the Act will enhance overall policy levers. Nevertheless, some lessons in other countries, where illegal forest activities have been a serious problem, could be useful to brush up its policy tools. Particularly, resources should be sufficiently dedicated to law enforcement. Brazil, which had developed a solid forest protection framework, has seen the resurgence of deforestation due to the decline of enforcement resources (OECD, 2020[37]). Moreover, together with stringent measures, financial incentives could also be utilised. In Brazil, subsidised credit contingent on the compliance with environmental restrictions has been effective to reduce illegal cattle farming that faces financial constraints (Assunção et al., 2020[38]). Malaysia could consider the applicability of financial tools tied with severe restrictions.

Better solid waste management is utmost urgent

Along with its economic development, waste generation is increasing and diversifying in Malaysia, and thus appropriate management of solid waste is urgent to realise a greener economy. In this regard, Malaysia is on the way of catching up with its own rapid economic expansion, giving more consideration on the venous side of its economy. A case in point is its recycling rate. It has been increasing rapidly from a mere 10.5% in 2012 to 30.7% in 2020 (Department of National Solid Waste Management; Environment Statistics, UNSD), surpassing a national target for 2020 (30%) set in the Mid-term Review of the 11th Malaysia Plan (2016-2020), thanks to new regulations (see below) and a large public campaign. Nevertheless, the recycling rate is still much lower than in OECD countries (Figure 1.27, Panel D). Moreover, most solid waste goes to non-sanitary landfills, which are scattered and located at unsuitable places, causing a range of environmental and health concerns. As of May 2021, only 21 are sanitary landfills out of 137 landfills in operation (Ministry of Housing and Local Government). In addition, the GHG emissions stemming from solid waste sites have been steadily increasing at annual 4.6%, although the amount is still small (20% of the total methane emissions in 2016) (Ministry of Environment and Water, 2020[34]).

In Malaysia, solid waste management had long been under the sole responsibility of local governments. Nevertheless, the lack of funds led to poor management. To improve and standardise the service quality regardless of the income level of local governments, the Solid Waste and Public Cleansing Management Act 2007 (Act 672) was introduced for Peninsular Malaysia and the federal territories of Putrajaya and Labuan (Bin Yahaya and Larsen, 2008[39]). Based on the Act, the National Solid Waste Management Department (NSWMD) and the Solid Waste and Public Cleansing Management Corporation (SWCorp) were established to strengthen the responsibility of the federal government. Although the implementation of the Act has been gradual (it was first enforced in 2011), waste separation became mandatory from September 2015. Under the Act, individuals failing to separate their waste will be fined. Moreover, an additional regulation of separation at source for industrial and commercial wastes was enforced in 2020. Nevertheless, the six states and the two federal territories that accept the Act 672 account for only 36% of the national population (Current Population Estimates 2020, DOSM), while the other states that do not accept the Act include Selangor, which embraces 20% of the national population. In non-Act states, solid waste management is still under the purview of local governments, which have their own restrictions. While environmental harm caused by solid waste, such as water pollution, can easily affect wider areas than municipal districts, benefits of better environment can also be shared with people beyond the municipal boundaries. A standardised framework at the national level would be more effective and provide scale merit. It is thus crucial that the remaining states are strongly encouraged to participate in the national scheme.

The availability of new landfill sites has declined, amid the stricter regulations, the rising trend of waste generation and the increasing public environment concerns, which calls for more diversion from landfill. From the view point of life-cycle management of materials, as most of solid waste is organic (45% was food waste in 2012, Survey on Solid Waste Composition, Characteristics & Existing Practice of Solid Waste Recycling in Malaysia, NSWMD), this could be considered as an additional source of energy, such as biogas (Abdullah et al., 2019[40]). In OECD countries, the recovery rate of solid waste was 55% in 2015, of which recycling and composting accounted for 35% and incineration with energy generation was 20% (OECD, 2019[41]). Although waste to energy (WtE) technologies have gained more attention in Malaysia, the existing four incinerators are all without energy recovery. The government has thus shifted its policy focus, considering the installation of six new energy recovery plants by 2025. In this regard, biogas, highly efficient incineration and landfill gas collection with energy recovery could be promoted more.

Moreover, the introduction of an extended producer responsibility (EPR) scheme would also be a useful policy tool to reduce the overall amount of solid waste, through recycling of reusable materials (OECD, 2016[42]). A number of OECD countries introduced the EPR scheme in the past decades, although categories of waste covered by these schemes differ between countries (OECD, 2019[41]). Malaysia has been exploring the possibility of using an EPR scheme (Ministry of Housing and Local Government, 2019[43]). Although producer responsibility would ideally be implemented at the level of individual producers, most existing EPR schemes adopt a collective producer responsibility framework because of its scale and scope merits. In this regard, a nation-wide application of the Solid Waste and Public Cleansing Management Act 2007 (Act 672) would provide a strong foundation to introduce effective EPR in Malaysia. In order to make EPR schemes supportive of reducing solid waste, EPR schemes could also be integrated into policy targets of recycling.

Table 1.9. Table of Recommendations

MAIN FINDINGS	RECOMMENDATIONS (Key in bold)
Macroeconomic policy and fiscal sustainability	
Despite the prospect of a steady economic recovery, the COVID-19 infections are still persistent and risks are mostly tilted to the downside.	**Keep providing sufficient and targeted support to the affected households and sectors until the recovery is well established.** **Prepare a post-COVID19 integrated medium-term fiscal strategy to reduce public debt and contingent liabilities.** **Accelerate the vaccination programme by strengthening the partnership with the private sector.**
While the rise of oil and commodity prices pushes up inflation, core inflation is stable and the recovery is not yet solid.	**Maintain an accommodative monetary policy, until the recovery is well under way.**
Malaysia's fiscal framework is underpinned by several legislative schemes.	Accelerate the introduction of a Fiscal Responsibility Act.
The government revenue ratio to GDP is low and has declined, while the increase of social spending is necessary to combat poverty.	**Consider the re-introduction of the Goods and Services Tax as part of the medium-term fiscal strategy.** Strengthen tax compliance, enhance the progressivity of the personal income tax and broaden its tax base.
Strengthening public sector integrity	
The appointment of Chief Commissioner of the Malaysian Anti-Corruption Commission is based on the Prime Minister's advice and the tenure is not pre-determined.	**Establish an appointment procedure of Chief Commissioner of the Malaysian Anti-Corruption Commission that involves the Parliament.** Stipulate the tenure of the Chief Commissioner in the Malaysian Anti-Corruption Commission Act.
The enforcement of the Whistleblower Protection Act is under the purview of each government agency and no protection is provided for those who disclose allegations to the media.	Revise the Whistleblower Protection Act to consolidate the enforcement power into the Malaysian Anti-Corruption Commission.
Despite efforts to limit the role of politicians in state-owned enterprises (SOEs), political appointments continue to be made for board and chairman positions of SOEs.	Adopt the recommendations of the OECD Guidelines on Anti-Corruption and Integrity in State-Owned Enterprises.
Enhancing social protection to achieve an inclusive labour market	
Employment injury insurance has been expanded to the self-employed in some sectors, but not yet comprehensively.	**Expand the coverage of employment injury insurance for the self-employed to more sectors.** Expand the coverage of unemployment benefits to dependent self-employed workers, in particular platform workers
The self-employed can voluntarily contribute to the pension scheme, the Employees Provident Fund, but the participation rate is low.	**Include dependent self-employed workers into the pension scheme under the Employees Provident Fund.**
The current pension schemes do not cover all private sector workers as well as non-workers (people who are out of the labour force or unemployed).	Expand the use of a matching scheme to encourage voluntary contribution of those who are not employees to the Employees Provident Fund.
Young people have been hard hit by the labour market contraction and youth unemployment, which was high before the pandemic, has risen further.	Continue and expand the active labour market policy measures for the youth in order to prevent long-term scarring effects on their employability.
The Malaysian economy relies on foreign workers, but their social protection is still underdeveloped.	Expand the coverage of the unemployment benefit scheme to foreign workers.

MAIN FINDINGS	RECOMMENDATIONS (Key in bold)
Pursuing greener growth	
Almost no price signalling mechanism exists to reduce carbon emissions, except the Feed-in-Tariff for renewable power.	**Introduce a carbon tax and gradually rising its rate over time, while mitigating its impacts on vulnerable households.**
The electricity market has been liberalised, but still lack competitive pressure, and no wholesale market exists yet.	Accelerate the liberalisation of the electricity market, in particular the Malaysia Electricity Supply Industry (MESI) 2.0.
The capacity of solar power has increased since the introduction of the Feed-in-Tariff scheme, but some other sources of renewables are still untapped.	Promote further use of renewables other than solar, particularly small hydro and energy recovery from solid waste.
While state-level forest management can well take into account the regional difference among states, policy coherence at the national level becomes more important than before.	Strengthen the monitoring role of the National Land Council concerning forest management.
Policy measures to combat illegal logging have been enhanced by the 1993 amendment of the National Forestry Act, including forestry laws and regulations at the state level, but more strengthening is necessary.	In addition to the strengthening of forest laws, enforcement and governance, consider financial incentive as a tool to prevent illegal deforestation activities in view of enhancing forest conservation and rehabilitation.
Based on the Solid Waste and Public Cleansing Management Act 2007 (Act 672), separation became compulsory from 2015, but the Act is not adopted by all states.	Encourage further the remaining states to accept the Solid Waste and Public Cleansing Management Act 2007 (Act 672).
Most solid waste is transferred to landfill sites and incinerators are less utilised.	Increase the installation of biogas, highly efficient incineration and landfill gas collection with energy recovery.
Solid waste has been steadily increasing.	Accelerate the introduction of an extended producer responsibility scheme.

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Annex 1.A. Follow-up to past recommendations

Annex Table 1.A.1. Past recommendations on the other issues

Recommendations	Action taken since July 2019
Structural reforms	
Align the framework of state-owned enterprise governance with the OECD guidelines.	• Preparing an Organisational Anti-Corruption Plan (OACP) has become mandatory for all government agencies, including state-owned enterprises since 2019.
The regulatory framework (of public-private partnerships) needs to be aligned with international best practices throughout the project cycle.	• Study has been conducted to review and improve the Privatization Masterplan for public-private partnerships adopted in 1991, among others, but no further action has been taken.
Improve the policy framework of facilitating female labour participation such as maternity leave, childcare and flexible working practices.	• From 2019, TalentCorp started reaching out to SMEs to increase their awareness about flexible work arrangements.
Education system	
Lower the school starting age to at least 5 and make secondary schooling compulsory.	• Policy review has been conducted, but no action has been taken yet.
Provide incentives and implement rotation schemes to attract more qualified and experienced teachers to disadvantaged schools.	• No action has been taken.
Continue efforts to reduce teacher administrative workload so that teachers can spend more time preparing lessons or participating in mentoring or professional development activities.	• From 2019, several initiatives were introduced to reduce administrative burdens of teachers. These initiatives include the abolishment of the terminal examinations for Primary Grades 1-3, the streamlining of filing and documentation tasks, and the standardisation of pupil monitoring processes.
Adopt a more student-centred teaching approach and put more emphasis on developing communicational skills.	• No action has been taken.
Promote involvement of employers in the design and review of curricula to ensure they meet the labour market needs and embed work-based learning modules intro the curricula.	• The Code of Practice for TVET Programme Accreditation (COPTPA) was introduced in 2019 as the main reference for TVET programme accreditation, and updated in 2020. • In 2020, the Program Quality Evaluation Committee (JKPKP) for TVET was established under the Ministry of Education to ensure the quality of TVET programmes.
Adult Learning	
Add additional questions to existing household and/or employer surveys or building new surveys focussing on the topic of adult learning.	• No action has been taken.
Develop an easy-to-use online database that provides information on all available training opportunities and providers, together with an indication of their quality.	• In 2020, MYFutureJobs (https://www.myfuturejobs.gov.my/private-employment-portal/) was launched as an online one-stop portal to provide information on training opportunities and that of providers.
- Develop specific programmes and provide incentives to facilitate access to training for these groups of adults (older adults, workers in micro-enterprises workers in the informal sector and women). - Reinforce the Employment Insurance System to become a key player in the adult learning system that provides guidance and support to underrepresented groups.	• As part of the PENJANA stimulus package, the Hiring Incentives and Training Programmes were launched in 2020. Employers hiring unemployed workers, school leavers and graduates can receive financial support from the Social Security Organisation up to six months.
Tie guidance services closely to labour market information, and make training incentives more generous for programmes that develop in-demand skills.	• The MYFutureJobs portal launched in 2020 enables employment services officers to provide guidance that is more suitable to individuals based on their competencies and skills when selecting training programmes.
Female labour market participation	
Increase the minimum maternity leave entitlement to at least 14 weeks, in line with international standards.	• The amendment of the Employment Act 1955 is in progress, which will include the increase of statutory maternity leave from 60 to 90 days.
Develop a co-financing arrangement for maternity leave, with the majority of the cost carried by the government.	• No action has been taken.

Recommendations	Action taken since July 2019
Invest in public childcare facilities and provide subsidies to private and workplace facilities.	• The 2021 Budget includes a matching grant of MYR 20 million to encourage companies to set up childcare centres at their premises.
Implement a stronger enforcement of minimum training requirements in childcare centres and pre-schools and gradually increase these training requirements.	• In 2021, the Program Diploma Perguruan Malaysia (PDPM) started in order to ensure that teachers in public and private childcares and pre-schools can obtain at least a diploma in early childhood education.
Attract more workers to the childcare profession by making working conditions more attractive.	• In 2021, the coverage of social security protection (under the Employees' Social Security Act and the Employment Insurance System Act) was extended to childcare workers working at private households, who are classified as domestic helper.
Actively promote the benefits of flexible working practices among employers and develop tools to share information on how to implement these practices.	• TalentCorp has been advocating flexible work arrangements through various channels, such as knowledge sharing and free advisory to companies. For example, it published in 2020 *My Work, My Future: Embracing the Winning Formula for Flexible Work Arrangements* to disseminate best practices.
High-skill demand	
Establish a one-stop information centre acting as a repository of all available programmes and assistance related to the promotion of entrepreneurial skills.	• In 2020, the MyAssist MSME portal (https://myassist-msme.fiscald.com/elementor-2126/) was launched as an online one-stop portal to provide information on a list of government programmes for SMEs and entrepreneurs.
Consider adopting a more selective approach to the inflow of low-skilled foreign workers, while maintaining open policy for high-skilled foreign workers.	• No action has been taken.
Governance	
Develop a national skills strategy based on whole-of-government collaboration and stakeholder engagement.	• In 2020, the Human Resource Development Corporation was mandated to coordinate and monitor up- and re-skilling programmes provided by various ministries and agencies. As part of its implementation, the UpskillMalaysia portal was set up as a one-stop information centre (https://upskillmalaysia.gov.my/). • As of July 2021, the government is in the process of establishing a National Skills Registry (NSR) as a central platform that will provide standardised information on occupations and skills to enhance policy planning and coordination of government agencies and strengthen the engagement with private sector stakeholders. TalentCorp is refining the draft framework of the NSR.

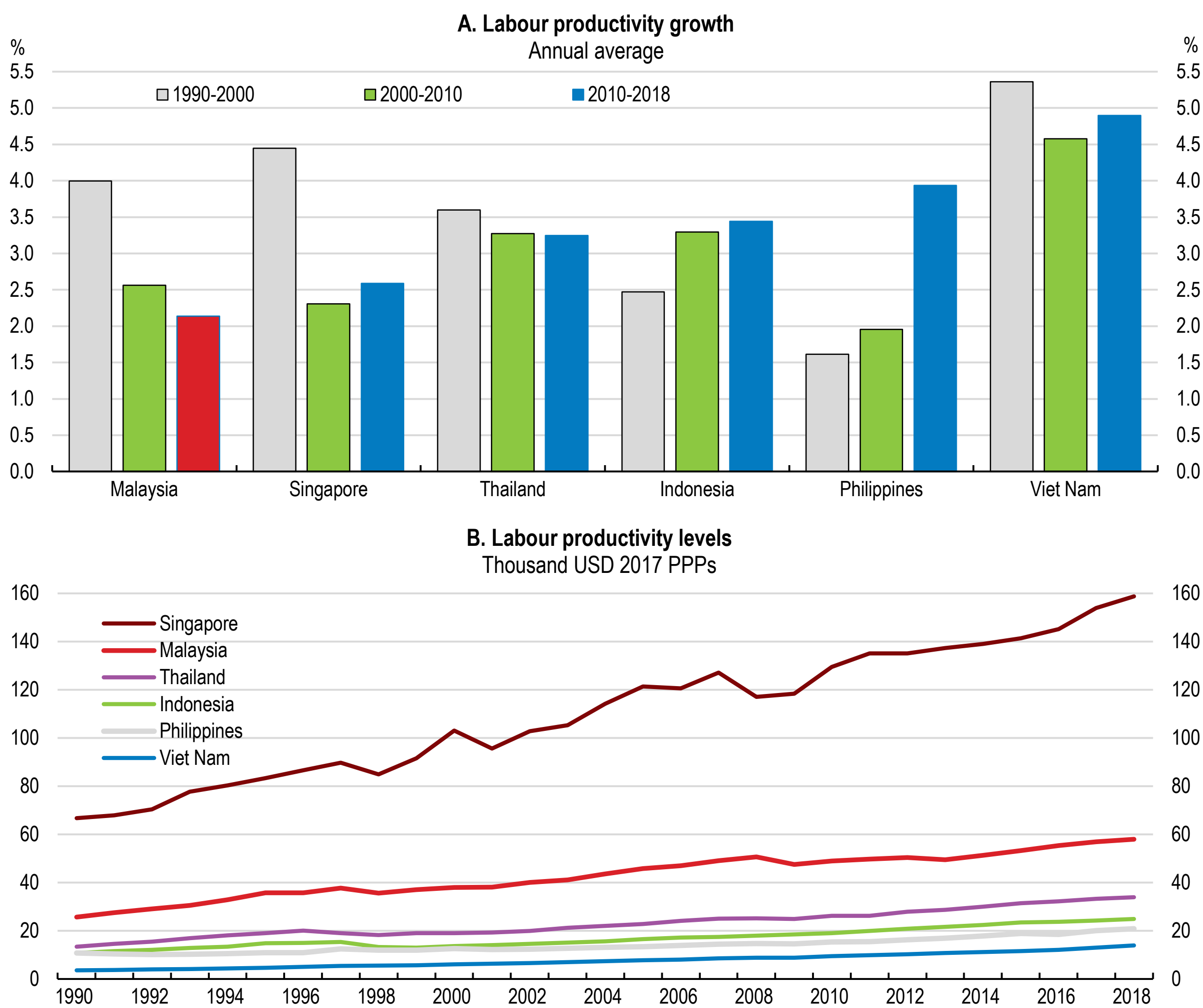
2 Unleashing business dynamism for the post-COVID19 recovery

Before the COVID-19 pandemic, Malaysia undertook a series of vigorous reforms, ranging from the improvement of regulatory framework to the digitalisation of the economy, with the aim of boosting productivity. While the protracted pandemic has inevitably stalled reform efforts in many countries, including Malaysia, strengthening the business climate has become all the more important. This will be essential to achieve a robust recovery, accelerate digitalisation, and adopt a new working environment combining productivity and sanitary precautions. This chapter discusses: 1) how Malaysia can reinvigorate business dynamism with new regulatory reforms; 2) how it can boost the uptake by businesses of digital solutions; and 3) based on the recent experience of teleworking, how it can prepare an enabling working environment for the digital age.

Malaysia needs to re-boost its productivity growth once again

While maintaining robust economic growth before the pandemic, Malaysia's labour productivity growth had declined over the past decades, in contrast with other Southeast Asian countries (Figure 2.1). The decline of labour productivity growth is not entirely surprising as Malaysia has succeeded in converging to a higher level of labour productivity frontiers. Nevertheless, to restore strong economic growth after the pandemic, it is key for Malaysia to uplift its labour productivity growth. Over the past decades, Malaysia has carried out a range of structural reforms, but the productivity challenge calls for renewed efforts to put forward bold policy reforms back on the agenda. Against this background, the first section of this chapter discusses Malaysia's business climate and regulatory reforms necessary to re-invigorate business dynamism. The second section discusses digitalisation that could make Malaysia's business sector, particularly SMEs, more productive and competitive. The final section then discusses the future of work, which is one aspect of the digitalisation of the economy, deriving lessons from the teleworking during the pandemic.

Figure 2.1. Malaysia needs to boost its labour productivity growth



Note: Labour productivity is defined as GDP per worker.
Source: Asian Productivity Organisation, APO Productivity database 2020.

StatLink https://stat.link/uacygt

Improving the business climate is crucial for the post-pandemic recovery

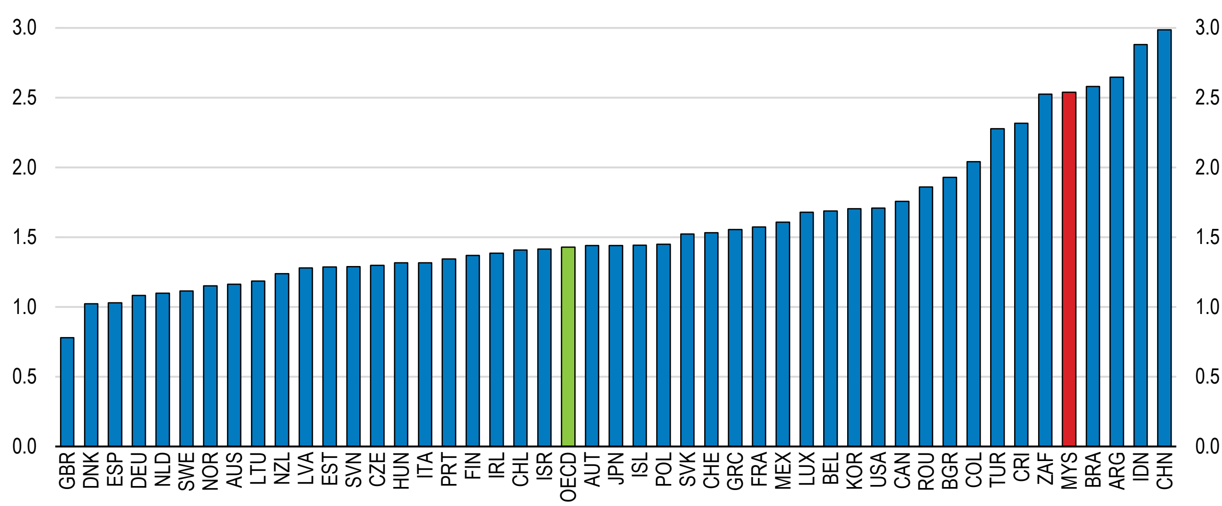
Malaysia has strived to improve its business climate for years

A regulatory environment that fosters competition and encourages business dynamism is an important component of a successful strategy to deliver long-term, sustainable economic growth. Malaysia has made a series of reforms to improve the competitiveness and dynamism of the business environment in recent years, and has a strong track record of adopting good regulatory practice (GRP) tools. Overall regulatory frameworks have been revamped under the National Policy on Development and Implementation of Regulations (NPDIR), which streamlined various procedures related to business activity, and is implemented across government, with the support of the Malaysia Productivity Corporation (MPC). As a result of these and other reforms, Malaysia shows a remarkable performance in a number of international benchmarks of competitiveness ranking, for instance, 12th in the World Bank's Doing Business Index in 2020. The government has also increased its focus on improving competition, with adoption of the Competition Act 2010, and a number of sectoral initiatives to increase competition, notably in telecommunications and energy. As Malaysia transitions to high-income status, the future sources of growth will increasingly need to shift to innovation and productivity gains, which calls for further improvements in business dynamism. In this section, the recently compiled OECD Product Market Regulation (PMR) indicators for Malaysia are used to assess Malaysia's business environment and identify possible reforms, building on previous OECD assessments.

OECD PMR indicators assess the extent to which regulations support or restrict competition in key sectors of the economy, including the extent to which firms can enter the market and compete with incumbents. Vibrant competition is an essential component of business dynamism, as it fosters cost reductions, innovation and promotes productivity growth. Therefore, ensuring that the regulatory environment encourages effective competition is essential to Malaysia's long-term growth. According to the PMR indicators, Malaysia's regulatory policies impose significant restrictions on product market competition compared to OECD countries (Figure 2.2). However, the indicators also suggest that Malaysia's regulation is less restrictive than in large non-OECD countries covered by the indicators, including its important regional peers, Indonesia and China.

Figure 2.2. Barriers to competition are high in Malaysia

Overall Product Market Regulation indicator, index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia).
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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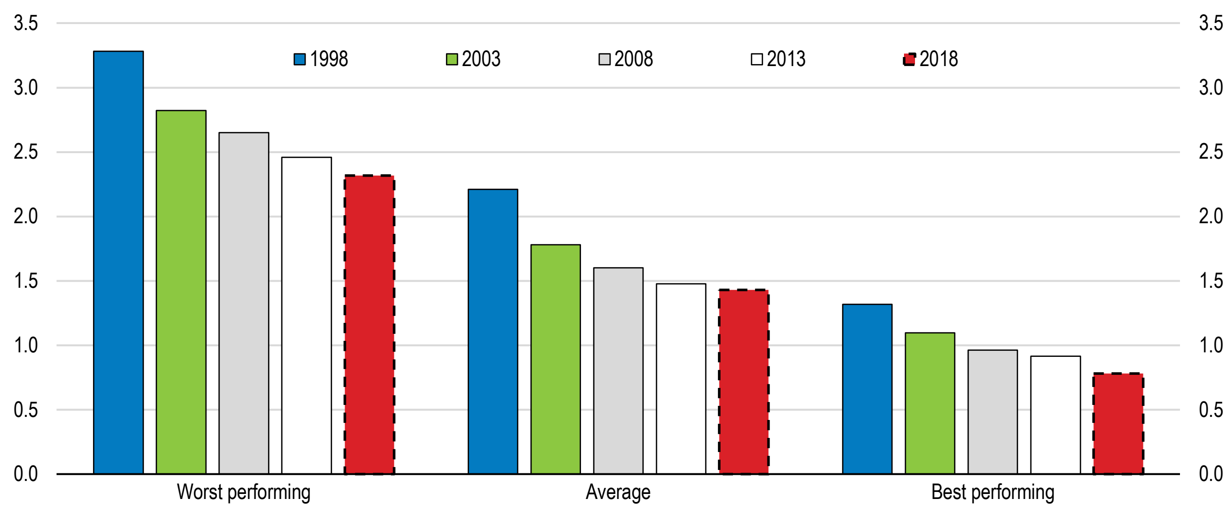
The PMR indicators were originally designed to support the pursuit of market liberalisation in OECD countries. The indicators have proved useful in policy making and a number of developing countries have started using them to implement similar major reforms along with their economic development. For any country, structural reforms are a difficult and often daunting task. Policy makers need to consult with or convince a range of stakeholders to design a reform plan. It also takes time to implement these policy measures, and OECD countries have pursued structural reforms for decades. For instance, many OECD countries liberalised their major markets, such as telecommunications, between the late 1990s and the early 2000s, as did Malaysia with the implementation of the Communications and Multimedia Act 1998. However, the speed of reforms varies across countries, as these reforms require considerable policy efforts. More importantly, even the least restrictive countries have continued their reform efforts. Malaysia's relatively more restrictive PMR score can be understood in this context, and the PMR indicators could provide a useful benchmark to Malaysia's ongoing regulatory reforms, which are expected to bear fruit in the coming years (Figure 2.3).

Figure 2.3. Structural reforms are an ongoing process

Overall PMR in OECD countries, index scale of 0-6 from least to most restrictive



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). The 2018 PMR indicators are not strictly comparable to the previous ones. Worst performing refers to the OECD country with most restrictive PMR overall score and best performing refers to the OECD country with the least restrictive score.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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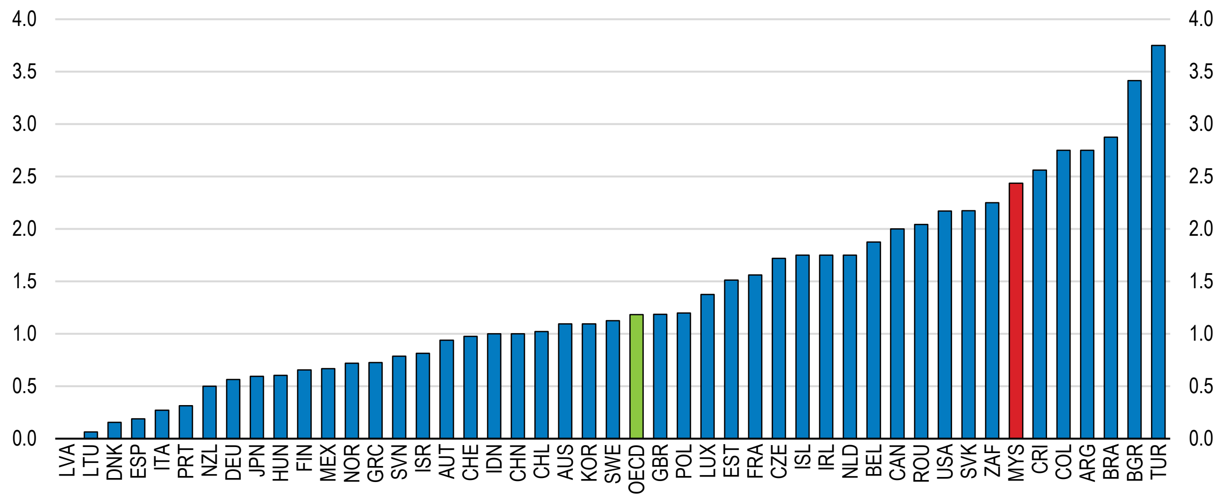
The ease of starting a new business has improved, but is still burdensome

A key determinant of business dynamism is how easy it is for new firms to enter the market, or entrepreneurs to start up new businesses. This is particularly important in the wake of the pandemic, which has resulted in multiple business failures. Around 30 000 businesses shut down between March and November 2020 (the Companies Commission of Malaysia). Malaysia has made significant improvements to the process for starting a business, led by the Technical Working Group of the Special Task Force to Facilitate Business (PEMUDAH), and as a result, its score in the Doing Business Index (83.3 for starting a business in 2020) is not far from the global frontier. However, in relative terms, starting a business remains an area where Malaysia underperforms. Although Malaysia ranked 12th overall in the World Bank's Doing Business Index in 2020, it ranked 126th for its sub-indicator of starting a business, suggesting that the burden on new start-ups could be further reduced. These conclusions are supported by the findings of the PMR indicators, which highlight that Malaysia could further improve in the category of administrative burdens on start-ups, to close the gap with OECD countries (Figure 2.4).

Figure 2.4. Administrative burdens on start-ups are relatively high in Malaysia

Indicator of administrative burdens on start-ups, index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia).
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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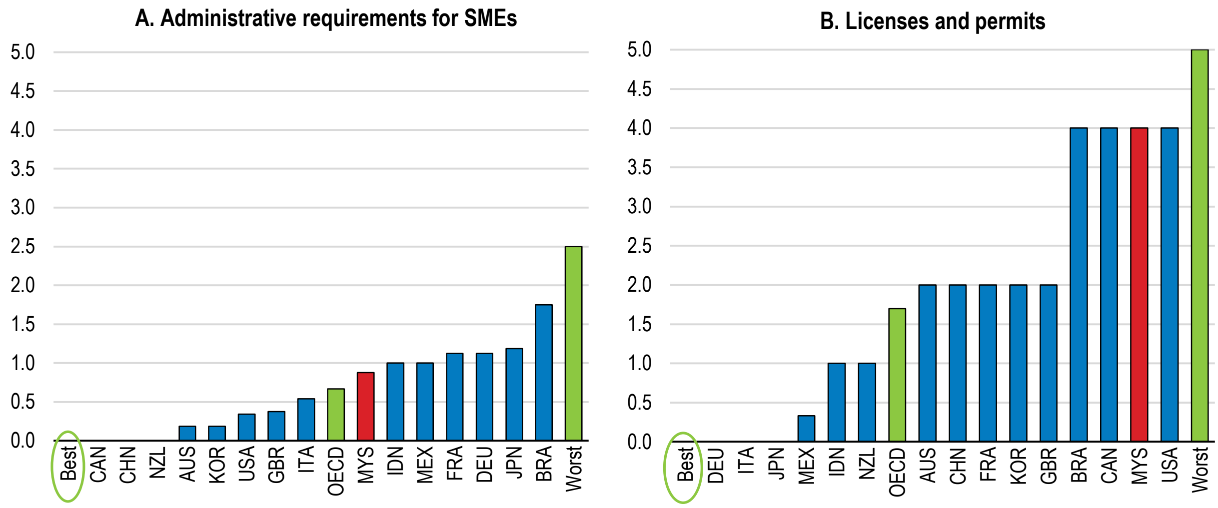
The PMR indicator is comprised of two sub-indicators: the administrative requirements for new start-ups, which relates solely to the core process of registering a new company or business with the authorities, and licenses and permits, which relates to various permissions and authorisations that may be required depending on the nature of the business. According to the PMR indicators, the process for registering a new business or company is relatively fast and inexpensive, but gaining the necessary licenses and permits is more burdensome (Figure 2.5).

Figure 2.5. Licences and permits to start a business are still burdensome in Malaysia

Index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). Best/worst represents the OECD best/worst performing country. In panel A, SMEs refer to limited liability companies and personally-owned enterprises.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

StatLink https://stat.link/763yox

Further streamlining registration procedures can enhance Malaysia's strong performance

Malaysia has succeeded in keeping the cost of registering a new business low, with limited fees and minimal capital requirements. The process has also been simplified as a result of the revamped Companies Act 2016, for example, by reducing the number of shareholders and directors required to incorporate a private company. However, streamlining the registration process could further strengthen Malaysia's performance in this area. Establishing a new business requires registration with five or more different entities, including tax authorities and social security institutions. Each registration must be undertaken separately, and can significantly add to the time taken to establish a new business. Previous attempts to streamline the registration process faced challenges. The different public bodies are incorporated as distinct statutory bodies, which becomes an obstacle in integrating registration processes because they cannot share financial resources and business registration data due to legislative and data protection constraints.

Some other countries have streamlined the requirement to register with multiple authorities. For example, Canada has managed to reduce the number of entities that must be interacted with to just one: once a corporation is created via the Electronic Filing Centre, the corporation's information is automatically transmitted to the Canada Revenue Agency, which then transmits back the Business Number with the corporate income tax account number. This number can be accessed within a day from the online database of federal corporations on Industry Canada's website. Introducing a similar system for registering new businesses in Malaysia would significantly reduce the burden on start-ups. The recently launched MalaysiaBiz portal provides a one-stop-shop for various business registration and licensing processes. Integrating all mandatory registrations, including for tax and social security, under this new portal would further streamline the process of starting a business.

There is also scope for additional streamlining for the requirements in the Companies Act. For example, the amended Act states appointing a company secretary is optional during registration. However, companies still have to appoint a secretary within 30 days after the incorporation of the company. This requirement is applied to all companies regardless of size. The requirement to appoint a company secretary could be amended so that it does not necessarily apply to all companies. For example, the United Kingdome has waived the requirement to appoint a company secretary for private limited companies.

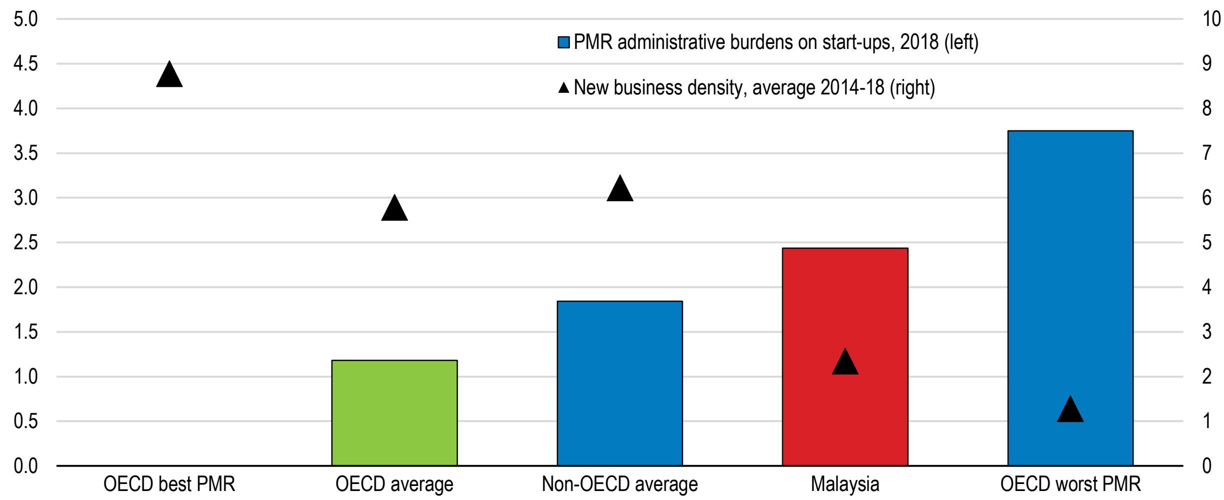
Simplifying licenses and permits could significantly reduce the burden on new start ups

In comparison to business registration, the process for obtaining all the necessary licenses and permits to operate in Malaysia is significantly more burdensome. According to the Global Business Complexity Index (GBCI) 2020 report (TMF Group), Malaysia is the ninth most complex country in the world to do business in and the third most complex in Asia. For example, the Malaysia Productivity Corporation (MPC) reports that a small retail store can require as many as ten different licenses, permits and approvals to operate (Malaysia Productivity Corporation, 2017[1]). This is reflected in the PMR indicators, which find that licenses and permits in Malaysia represent a significantly higher burden to new start-ups than in OECD countries (Figure 2.5).

In December 2020, the government launched the MalaysiaBiz portal as a one-stop centre to manage business registration and licensing in Malaysia. This Portal is now managed by the Ministry of Entrepreneur Development and Cooperatives (MEDAC). MalaysiaBiz has integrated 17 agencies that conduct business registration and issue licences. MalaysiaBiz is also integrated with several local authorities (PBT) that use their own systems (eLesen), such as Kuantan Municipal Council (MPK), Penang Island City Council (MBPP), Kuala Lumpur City Hall (DBKL), Subang Jaya City Council (MBSJ), Kajang Municipal Council (MPKj) and Petaling Jaya City Council (MBPJ). The portal is integrated with the Business License Electronic Support System (BLESS) that facilitates company representatives to select relevant licences, fill up the online application forms, submit online and track the progress of the application throughout the process until notification of approval or otherwise. However, the number and type of licenses integrated with MalaysiaBiz are limited, subject to the readiness and consent of each licensing authority. As a continuous improvement measure, MEDAC is working with agencies to encourage more business licenses to be integrated with the MalaysiaBiz portal. Further expanding the scope of licenses available through the portal will significantly streamline the process for establishing a new business. Previous OECD assessments of one-stop shops have demonstrated the importance of ensuring that improving user experience should be the central objective, not simply automating existing processes. Therefore, the development of MalaysiaBiz should also align with and support programmes for the simplification of registration and licensing processes for end users (OECD, 2020[2]). The absence of key simplifying tools in the system of licenses and permits contributes to the restrictiveness and complexity of regulatory procedures. For instance, the “silence is consent” rule, can accelerate approvals, but is not widely applied in Malaysia. The utility of this tool has been demonstrated recently in Malaysia on a pilot basis: as part of efforts to reduce administrative backlogs during the pandemic, the “silence is consent” rule was successfully applied to several thousand Certificates of Completion and Compliance (Malaysia Productivity Corporation, 2020[3]). Building on this pilot and extending the application of the silence is consent rule to other areas where it can be applied, without compromising health or other essential safety standards, would improve the flexibility of Malaysia’s regulatory framework.

Reforms that address these issues may help stimulate firm creation. Although there is no straightforward relationship between regulation and business start-up rates, the latter of which are determined by many factors, including both regulatory and economic factors, it is notable that Malaysia has a higher burden for new start-ups and lower rate of new business creation than the average of both OECD and non-OECD countries (Figure 2.6).

Figure 2.6. Lowering administrative burdens would stimulate new business creation



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). The OECD PMR indicator ranges from 0 (the least restrictive) to 6 (the most restrictive). New business density is defined by World Bank as new registrations per 1 000 people aged 15-64.
Source: OECD, Product Market Regulation database; OECD-WBG, Product Market Regulation database; and World Bank, World Development Indicators database.

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Improving the insolvency framework can also help improve business dynamism

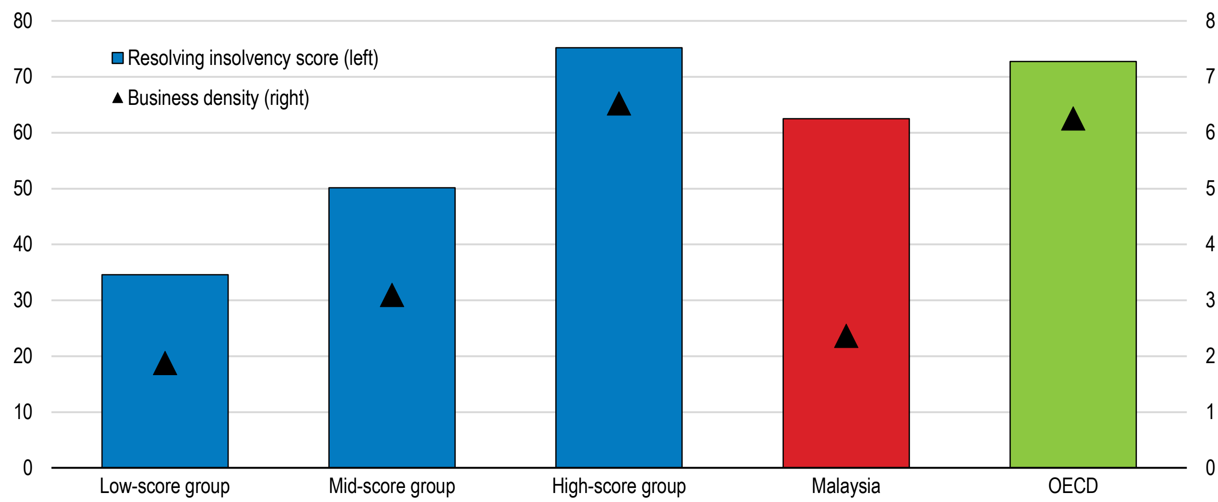
Ensuring businesses can be closed down quickly is an important component of ensuring business dynamism. Effective insolvency regimes encourage new firms to experiment with new business models and facilitates the reallocation of resources towards the most productive firms. Within the same country, industry and period, inefficient insolvency regimes have a much larger impact on the growth dynamics of entrants than of incumbents (Calvino, Criscuolo and Menon, 2016[4]). An effective insolvency regime should allow for efficient and swift exits of non-viable companies, but also successful restructurings of viable companies. Indeed, debt restructuring provides a less expensive alternative to bankruptcy when a debtor is in financial turmoil, and can work to the benefit of both debtor and creditor. Moreover, poorly performing insolvency regimes can be associated with labour productivity weakness through the survival of so-called “zombie” firms, capital misallocation and stalling technological diffusion (OECD, 2018[5]). Therefore, insolvency reform can be an important component of strengthening the business environment.

Malaysia has undertaken a series of reforms of its insolvency and bankruptcy regimes. Amendments to the Companies Act in 2016 introduced two new corporate rescue mechanisms alongside additional controls on court-sanctioned schemes of arrangement to make the process more effective as a means of effecting a corporate debt restructuring. These reforms facilitate more efficient corporate restructuring together with additional undertakings since the onset of the pandemic, which would help support the vigorous economic recovery from the pandemic (see Chapter 1).

Building on this progress, additional reforms could further encourage the establishment of new firms. According to the 2019 GEM survey (Global Entrepreneurship Research Association), nearly 45% of adults who identify good business opportunities would not start a business for fear of failure. There are many factors that influence entrepreneurial rates, but an insolvency regime which imposes a disproportionately large burden on failed entrepreneurs, can be a disincentive. Insolvency regimes that do not excessively penalise failure – as measured by a lower cost to close a business – can promote the flow of capital to more innovative firms, by reducing the expectation of entrepreneurs that they will be heavily penalised in case of failure (Andrews, Criscuolo and Menon, 2014[6]). Comparing business density and the ease of resolving insolvencies, as measured by the World Bank's Doing Business Index, suggests a positive relationship between more efficient insolvency regimes and new business creation (Figure 2.7).

Figure 2.7. Improving insolvency regimes further could help stimulate business dynamism

2018 or latest year available, average of each group



Note: The score for resolving insolvency is the simple average of the scores for each of the component indicators: the recovery rate of insolvency proceedings involving domestic entities, as well as the strength of the legal framework applicable to judicial liquidation and reorganisation proceedings. Business density is defined as new registrations per 1 000 people aged 15-64. 124 countries, where data is available, are grouped by the score of resolving insolvency (41 countries for the low-score group, 42 for the middle, and 41 for the high). Malaysia belongs to the high-score group.
Source: World Bank, World Development Indicators database and Doing Business 2020 database.

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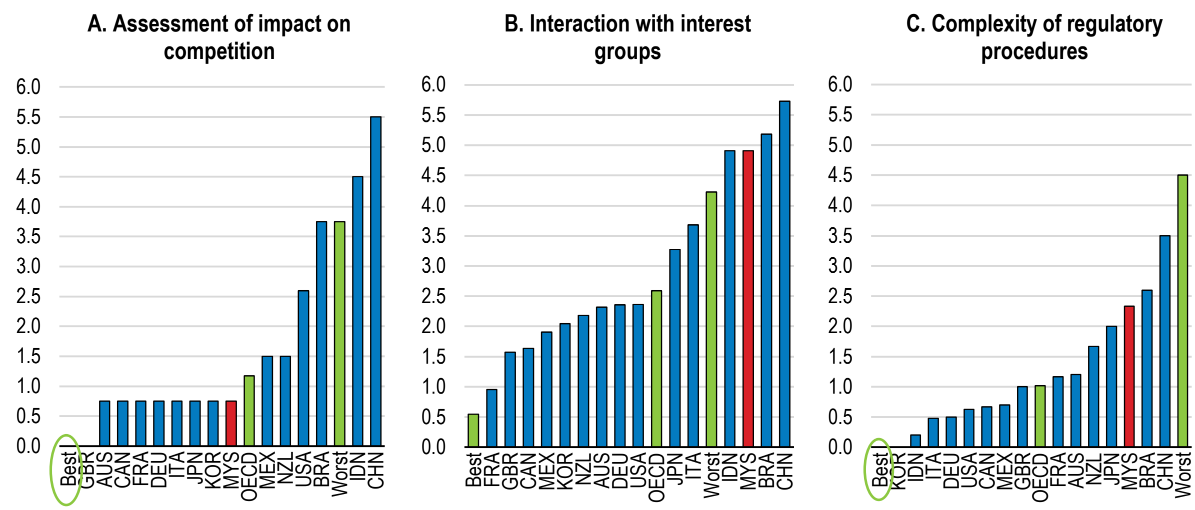
The Malaysian government should therefore consider how to continue with the direction of reform in the Companies Act 2016 to increase the incentives for prospective entrepreneurs. For example, unlike the insolvency regime in other common law jurisdictions, such as the United Kingdom, Malaysia's insolvency framework does not distinguish between blameless and blameworthy bankruptcies. Malaysia's regime could also support debtors back into business through broadening asset exemptions and providing for access to credit after the commencement of insolvency proceedings. According to the Doing Business Assessment by the World Bank, the time to resolve insolvencies in Malaysia (estimated at 1 year on average) is lower than the OECD average (estimated at 1.7 years) and the recovery rate for secured creditors is higher (an OECD average of 70.2 against 81 for Malaysia). Nonetheless, there may be other areas where the insolvency regime could be strengthened, including improving creditor participation. For example, the current system does not require approval by the creditors for sale of substantial assets of the debtor and does not provide a creditor the right to request information from the insolvency representative. The total cost of insolvency in Malaysia (estimated at 10% of the estate) is also relatively high compared to Japan (4.2%) and Korea (3.5%), suggesting that there is scope for further streamlining of the process.

Reducing regulatory complexity can support competition and boost business dynamism

Beyond the process of starting and closing down businesses, the nature of regulations that regulate the conduct of business are also a crucial feature of the overall business environment. As such, the PMR indicators also include an assessment of the process of introducing new regulations and simplifying existing regulations, to capture how existing businesses interact with the regulatory framework. The PMR indicators aim at capturing three dimensions of this regulatory process, namely; assessment of new regulations impact on competition; interaction with interest groups throughout the regulatory process; and the complexity of the regulatory procedure. Some sub-indicators suggest that there is further room for improvement in how Malaysia manages the regulatory process (Figure 2.8).

Figure 2.8. Malaysia performs well in regulatory assessment

Indicators of the simplification and evaluation of regulations, index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). Best/worst represents the OECD best/worst performing country.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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Regulatory management reforms have been well advanced for the past decade

Malaysia has been implementing a series of regulatory management reforms for over 15 years, and the OECD has been working with Malaysia on reviewing these reforms and providing recommendations. Regulatory reforms began in earnest in 2007 under the Modernising Business Regulation programme, aimed at reducing regulatory burdens and facilitating business processes. This also saw the establishment of PEMUDAH (OECD, 2018[7]). In 2013, the government established the National Policy on the Development and Implementation of Regulations (NPDIR) in line with good regulatory practice (GRP) principles. The NPDIR was followed in 2014 with the Guide to Reducing Unnecessary Regulatory Burdens (RURB): Core Concepts and the Guideline on Public Consultation Procedures. These policies establish important principles, including public consultation and Regulatory Impact Analysis (RIA) that include an assessment of the potential impact on competition (OECD, 2015[8]). Such requirements help ensure that new regulations in Malaysia do not inhibit the business climate, and as a result, Malaysia performs well in this sub-indicator of the PMR (Figure 2.8).

Having laid strong foundations for a system of regulatory reform since the implementation of the National Policy on the Development and Implementation of Regulations (NPDIR), the primary focus of Malaysia's regulatory reform journey between 2018 and 2020 has been to strengthen the implementation of regulatory reform through the introduction of new regulatory tools and mechanisms. Between 2018 and 2020, Malaysia has continued to fortify its evidence-based rule-making methodology in line with the good regulatory practice (GRP) principles through various initiatives, such as Modernising Business Licensing (MBL), Reducing Unnecessary Regulatory Burden (RURB), and Cutting Red-tape (MyCURE), among others. The GRP outreach has also been expanded to states and local authorities. For example, the state government of Sarawak had passed its own Circular on Sarawak Good Regulatory Practice in 2019.

Ensuring public consultation on new regulations can promote better regulatory outcomes

Transparency during the development of new regulations and consultation with all relevant stakeholders throughout the process is essential for ensuring that new regulations address the legitimate concerns of stakeholders. Malaysia has sought to improve the process for public consultation (OECD, 2018[7]). The National Policy on the Development and Implementation of Regulations (NPDIR), which aligns reforms to good regulatory practices in accordance with OECD recommendations, mandates consultation across all government agencies. The recently introduced Unified Public Consultation portal (UPC) provides a single platform for different regulating agencies to engage with and receive feedback from stakeholders. These policies establish many good practices for public consultation, but could benefit from more systematic adoption across government agencies, as identified by a recent peer review of public consultation within APEC. While several agencies have embraced the NPDIR principles, there is room for improvement across many agencies in the scope and quality of public consultation (APEC Economic Committee, 2019[9]). The Guideline on Public Consultation Procedure issued by the Chief Secretary to the government in 2014 to support the implementation of the NPDIR mandates online consultation of 12 weeks. However, the APEC peer review suggests that this requirement is not systematically followed (APEC Economic Committee, 2019[9]). As a result, there is a risk that business stakeholders are only involved relatively late in the regulatory process and with limited time to contribute. It is also important to ensure that consultation reaches beyond the business community to include other stakeholders and issues groups, including consumer interests, public health and the environment. According to APEC, while many ministries regularly consult with businesses, the other groups are generally not consulted.

There are also more procedural gaps in transparency identified by the PMR indicators, which could be addressed, including maintaining a complete online and free access to database of all regulations in force and providing a six-month forward look of legislation and regulation likely to be introduced or amended, such that stakeholders can plan their contributions. One potential barrier to improving transparency appears to be the overuse of the Official Secrets Act 1972, which states that any document that has been declared as an official secret by any government official may not be released to the public (APEC Economic Committee, 2019[9]).

Although the regulatory process should include interaction with legitimate interest groups. However, without effective regulation, interest groups can acquire undue influence over the regulatory process resulting in less pro-competition regulation, or regulation which protects incumbents or firms with stronger lobbying capacities. Therefore, the PMR indicators also assess whether countries have in place regulations for lobbying activities. Malaysia currently has no regulation in place to govern lobbying which creates the risk of undue influence over the regulation process. This issue has been highlighted as part of Malaysia's anti-corruption efforts, and measures to address it are included in Malaysia's National Anti-Corruption Plan (NACP). Timely implementation of the NACP can thus also contribute to promoting a more transparent and dynamic business environment.

Measures to reduce the burden of new and existing regulations could be strengthened

The National Policy on the Development and Implementation of Regulations (NPDIR) mandates Regulatory Impact Analysis (RIA) to mitigate the potential negative impact of new regulations. The framework is aligned with OECD guidance and recommendations, but there is scope for improvement in how it is implemented. A recent study by the World Bank identified a non-compliance rate of 40% in the period from January 2016 to May 2018 in RIA applications attributed to a general lack of awareness and capacity to undertake RIA (World Bank Group, 2019[10]). The Malaysia Productivity Corporation (MPC) has played an important role in advocating RIA and significant efforts have been made to embed RIA in regulators' rule-making processes. As a result, since 2019, there has been an increased take-up rate of RIA as compared to 2018. To further increase compliance with the RIA framework, the government can consider how to strengthen the oversight framework. In some countries, bodies for quality control may exercise a sanctioning or gatekeeping function, i.e. have the power to stop a regulation or evaluation from proceeding to the next stage if the tool's quality (in this case, RIA) is considered inadequate (OECD, 2018[7]). Malaysia should review their system of oversight vis-à-vis emerging practices across OECD countries and develop the necessary institutional reforms to strengthen oversight.

Improving the capacity to undertake high quality regulatory assessments is a persistent challenge. Building on the OECD's previous recommendation to strengthen the use of Regulatory Impact Analysis by exploring other approaches to further improve the analysis of regulations (OECD, 2018[7]), the government can draw from the experience in OECD countries of integrating new technologies to improve regulatory functions. Across different countries and sectors, economic regulators have developed tools to adopt data-driven technologies to improve regulatory assessment and other areas of the regulatory landscape, including enforcement (Box 2.1).

Box 2.1. The role of technology in empowering economic regulators

New technologies offer opportunities to resource-constrained regulators to improve their regulatory and capacity. Technology can be used to dramatically increase the role of data in informing the development of new regulations and undertaking supervisory functions. An OECD study published in 2020 considered several case studies to identify emerging uses of technology among regulators, in order to support the dissemination of best practices. Across the case studies the report identified several new data driven processes being adopted by economic regulators, including:

- Use of "data-driven" regulation to enable **data-collection**, which in turn provides a more **comprehensive picture of the regulated environment** to inform regulatory decisions. For example, the French Transport Regulator (ART) is running regular data collection campaigns to monitor the quality of regulated services and undertaking benchmarking exercises in the transport sector to inform the development of regulation.
- Adoption of digital tools underpinning data-driven regulation can significantly improve **enforcement activities**, including supervision and inspections. For example, the National Land Transportation Regulatory Agency has implemented an intelligent national network for the monitoring and mapping of transport flows in logistics corridors called the "Green Channel Brazil" (Canal Verde Brasil). As a result of this initiative the number of freight transportation inspections went from 905 213 vehicles inspected between 2010 and 2016, to 116 million vehicles inspected between 2016 and January 2020.
- Use of information technology to **increase transparency** and to allow stakeholders (consumers, businesses, policy makers and local authorities) to make more informed choices. For example the French telecom regulator (ARCEP) has developed a reporting platform ("J'alerte l'Arcep") to allow any stakeholder (individual, businesses or local authorities) to report a malfunction which they experienced with a service provider – either telephone operator (fixed or mobile), internet service or postal operator.

The case studies examined in the report highlight the priority issues which economic regulators need to address in order to best capitalise on emerging technologies, including (but not limited to):

- **Generation and analysis of data**: i) adaptation of regulatory frameworks in order to make sure that market players produce the relevant data in an appropriate fashion; ii) development of new analytical skills within the regulator, alongside the necessary digital infrastructure to support data generation, collection, storage, management, sharing and dissemination.
- **Inclusion of stakeholders**: encouraging challenge to traditional models can be facilitated by including stakeholders – such as end-users – to participate in the regulatory process and end-users in the regulation equation and ensure that technology adoption becomes a collaborative process.
- **Co-operation between regulators**: establishing platforms for regulators to share expertise, building capacity and identifying good practices are key requirements for adopting new technology-drive approaches.

Source: (OECD, 2020[11])

The government has also initiated programmes to improve *ex post* evaluation of regulations to reduce the number and complexity of existing regulations. Starting with the Modernising Business Licensing (MBL) programme carried out between 2011 and 2014, under which 767 business licences were re-engineered, 454 converted into composite licences and 29 were abolished (Malaysia Productivity Corporation, 2016[12]). This was followed by the Reducing Unnecessary Regulatory Burdens (RURB) programme, which seeks to identify licenses, permits and other regulatory processes that can be removed or simplified focussing on particular priority sectors, such as construction, healthcare and logistics. These efforts have recently been redoubled in response to the pandemic, with the government establishing the #MyMudah programme to reduce regulatory burdens and stimulate the economic recovery (Malaysia Productivity Corporation, 2020[3]).

The Reducing Unnecessary Regulatory Burdens (RURB) programme, and its successor #MyMudah, provide important tools to reduce the burden of existing regulations, but could be strengthened. According to the OECD's assessment of different national practices, a "portfolio" of approaches to *ex post* review of regulation will generally be needed. In broad terms, such approaches range from programmed reviews to reviews initiated on an *ad hoc* basis or as part of ongoing "management" processes (OECD, 2020[13]). Both RURB and #MyMudah represent *ad hoc* review mechanisms. The RURB programme has focussed on priority sectors at the federal level, and #MyMudah is open to proposals from stakeholders of where the regulatory burden can be reduced. As of June 2021, 300 issues have already been submitted. These *ad hoc* reviews could be supported by enforcement of provisions to automatically review existing legislation on a programmed basis. The NPDIR mandates review of regulation after five years but this is not widely implemented across agencies (APEC Economic Committee, 2019[9]). The use of post-implementation reviews should therefore be strengthened. To encourage this, sunset clauses could be more widely implemented to act as a "trigger" for review. Finally, the government could also adopt stock-flow linkage rules whereby government departments and agencies are required to ensure that new regulations do not impose a net additional cost for business by finding a commensurate reduction in regulatory burdens elsewhere (OECD, 2020[13]) (Trnka and Thuerer, 2019[14]).

Foreign investment needs to be stimulated further to boost post-pandemic recovery

Reversing the weakening of private investment is key to sustaining the strong recovery and foreign investment needs to be re-boosted to this end. Although Malaysia is still an attractive destination of foreign direct investment (FDI), the share of FDI stock in ASEAN has become smaller in recent decades. Malaysia has thus progressively removed various restrictions on FDI over past years (OECD, 2019[15]). In March

2021, the government eased the regulations on foreign currency transactions of exporting companies, including the removal of the surrender requirement of export earnings to local currency (see below). This is expected to reduce the costs of foreign businesses, and attract more FDI to Malaysia. In addition, the Malaysian Investment Development Authority (MIDA) has implemented a series of initiatives to simplify the process for licensing and other applications for both domestic and foreign investors (Box 2.2).

Box 2.2. Initiatives to facilitate both domestic and foreign investments in Malaysia

The Malaysian Investment Development Authority (MIDA) is the government's principal investment promotion and development agency under the Ministry of International Trade and Industry (MITI) to oversee and drive investments into the manufacturing and services sectors in Malaysia. The wide range of services provided by MIDA includes providing information on the opportunities for investments, as well as facilitating companies which are looking for joint venture partners. Within MIDA, there is the Advisory Services Centre (ASC) which comprises representatives from across various agencies and departments to provide advisory services to investors. MIDA has also recently established the Project Acceleration and Coordination Unit (PACU) that provides end-to-end facilitation to all projects approved by the National Committee on Investment (NCI).

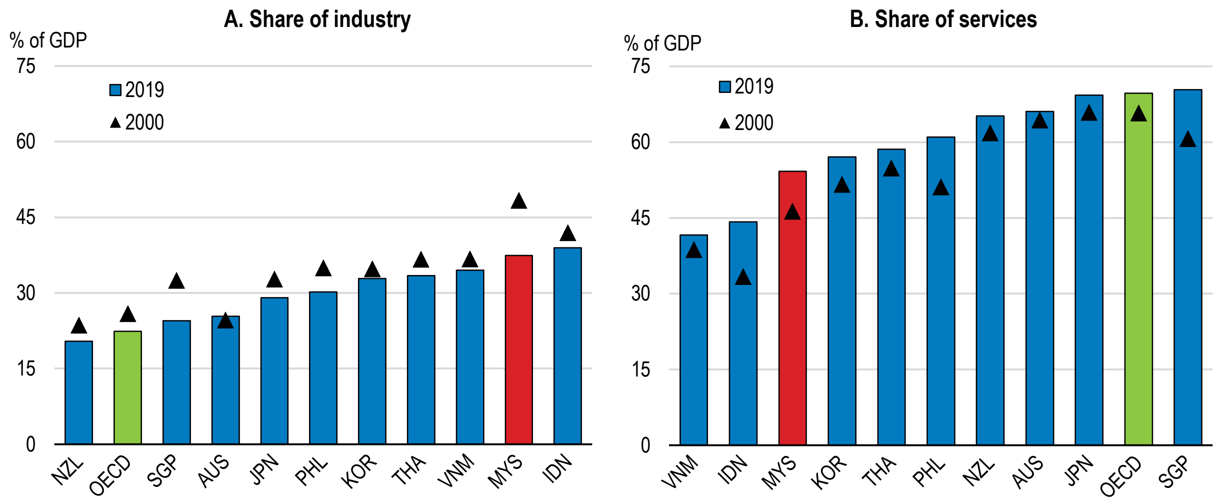
To ease the process of doing business, MIDA has sought to streamline a number of business processes, including through the following initiatives:

- The e-Manufacturing Licence 2.0 (e-ML 2.0), a new digital platform which enables companies to submit and obtain approvals for the application within two business days for non-sensitive industries.
- Tax incentives (e-Incentive 2.0 module) and import duty and sales tax exemption on raw materials or components as well as machinery or equipment (JPC Online Application Module) have been introduced as online applications.
- Further to the above initiatives, in March 2021, MIDA launched the InvestMalaysia portal, an online application submission module serves as a single-entry point of submission for various applications, including e-ML2.0.
- In April 2021, the government has announced certain relaxation of incentive conditions for manufacturing and services projects that have been approved with incentives under the purview of MIDA.

Source: Malaysian Investment Development Authority (MIDA).

Although Malaysia has rapidly transitioned to a service economy over the past two decades, the share of services in total value added is still smaller than in some other countries (Figure 2.9). The importance of the services sector will further increase in Malaysia, as services have become a centrepiece in global and regional value chains. Other sectors, such as manufacturing, now rely more on services inputs, such as digital services (OECD, 2020[16]). In this regard, Malaysia could further reduce the FDI restrictions on services (see below), as it undertook in 2009 and 2012. Moreover, other countries in the region have also introduced or are planning to implement further reforms. For instance, Indonesia adopted an ambitious set of reforms (the so-called Omnibus Law) to streamline business procedures, boost job creation and attract more investment. The Philippines has also pledged to amend its FDI-related laws, in addition to the reduction of the corporate tax rate from 30% to 20% and the expansion of tax incentives. Malaysia needs to continue implementing additional reforms to improve its overall business climate, which could stimulate both domestic business investment and FDI. The protracted pandemic means that some jobs and businesses will not return after the pandemic, and these policy efforts would help accelerate the reallocation of capital and labour resources to other sectors.

Figure 2.9. The share of services has increased rapidly



Source: World Bank, World Development Indicators database.

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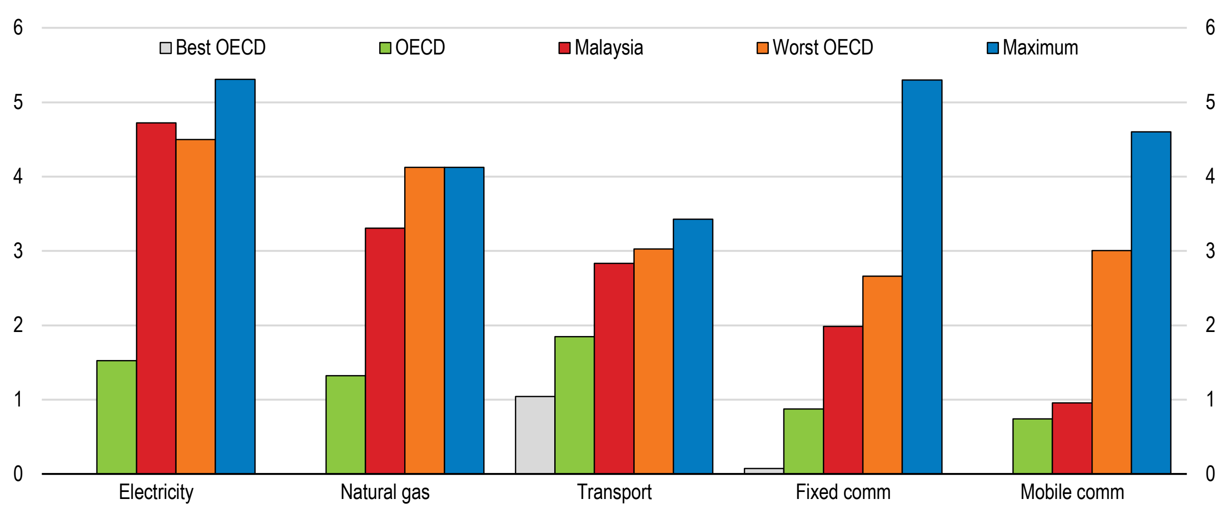
Regulatory barriers inhibit competition in some key sectors

In addition to cross cutting restrictions, the PMR indicators can also help to benchmark sectoral regulations and economic conditions. The PMR indicators focus on the telecoms, energy and transport sectors, professional services and retail. Generally, Malaysia's regulations are assessed as being more restrictive than the OECD average (Figure 2.10).

Figure 2.10. Several network sectors are strictly regulated in Malaysia

Index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). Best OECD/worst OECD represents the OECD best/worst performing country, while maximum corresponds to the most restrictive country among those in the PMR database. For electricity, natural gas and mobile communications, the OECD best scores are zero.

Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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Malaysia has embarked on successive privatisation efforts of key state-owned utilities and infrastructure providers. However, state-owned enterprises retain a significant market share across most network and infrastructure sectors. Fostering greater competition and ensuring neutrality between state- and privately owned firms would stimulate private sector development and support a more dynamic business environment. Malaysia's mobile telecoms market stands out as a significant achievement. The regulatory framework is considered on a par with OECD countries, and has helped nurture a contested market of multiple providers offering high speeds and low prices to consumers. Further entrenching competition in the provision of fixed-line telecommunications – where the state-owned Telekom Malaysia retains the majority market share – will encourage broadband adoption and support digitalisation among SMEs (Record et al., 2018[17]). The Malaysia Communications and Multimedia Commission (MCMC) has taken significant steps to achieve this, which have already delivered benefits (see below).

Although Malaysia's energy markets are significantly more restricted than the OECD average, they are undergoing substantial reform. Third Party Access for the transmission and distribution networks for natural gas has recently been introduced that will enable new providers of retail and wholesale gas to enter the market. In the electricity market, generation is already liberalised, and access to the distribution and retail supply markets is expected to be liberalised under the proposed Malaysia Electricity Supply initiative (MESI) 2.0, although MESI 2.0 is currently under review. These reforms will enable a more dynamic energy market that creates opportunities for new private players, and can also be aligned with efforts to reduce reliance on fossil fuels.

Reforming Malaysia's transport sectors may help improve logistics

Efficient transport services are an important component of a dynamic economy and can play an important role in Malaysia's ambition to integrate into global value chains (World Bank, 2021[18]). Reducing logistics costs is also essential for stimulating domestic supply chains, where transport costs continue to be a significant factor (Box 2.3). For example, the Market Review of Retail Services undertaken by the Malaysia Competition Commission (MyCC) identified that retail firms in Sabah, Sarawak and rural areas across Malaysia face prevalent high logistics cost to transport their products as the retailers are forced to increase their selling price and charge different pricing to these locations to make up for the high logistics cost.

Box 2.3. OECD Competition Assessment and Competitive Neutrality Assessment of the logistics sector in Malaysia

Logistics is a crucial sector for the development of Malaysia. Malaysia's infrastructure, international shipments, port sector and liner-shipping connections with other countries have significantly improved in the last decades. In 2019, the transport and storage sector accounted for 3.8% of the country's GDP.

Similar to other countries in the region, Malaysia is suffering from the socio-economic impact of the COVID-19 outbreak. The pandemic has resulted in the disruption of supply chains, and the logistics sector has been affected by operational constraints and lower demand in other industries. Ensuring competition as well as a level playing field between public and private market participants is important to resume sustainable growth and job creation, by enhancing competitiveness, encouraging investment and stimulating productivity in the logistics sector, with knock-on economy-wide effects and benefits for its consumers.

In January 2020, the OECD completed two studies on Malaysia – one on the assessment of rules and regulations in the logistics sector and another of the analysis of the role and impact of state-owned enterprises on competition in small-package delivery services, which remain crucial to support e-commerce growth.

Working in close co-operation with the Malaysia Competition Commission (MyCC) and other public and private stakeholders in Malaysia, the OECD scrutinised more than 50 pieces of legislation and made more than 70 recommendations that aim at ensuring competition in the logistics sector and a level playing field in small-package delivery services. Key recommendations included:

- Remove the authorities' power to set freight rates, in line with current practice where rates are determined by the market, to ensure price competition.
- Remove unnecessary criteria considered by the authorities in renewing a commercial vehicle operation licence, such as business viability, to avoid discrimination.
- Introduce clear requirements for applicants requesting a licence for maritime transport to reduce costs and facilitate market entry.
- Remove the licence freeze for customs brokers to allow new entrants.
- Require revenue and costs related to the universal service obligations to be clearly separated in the state-owned enterprise's accounts. Accounting separation is required to ensure that compensation is adequate irrespective of the mechanism adopted.
- Refrain from providing state guarantees to state-owned enterprises' loans to prevent state-owned enterprise from accessing preferential interest rates.

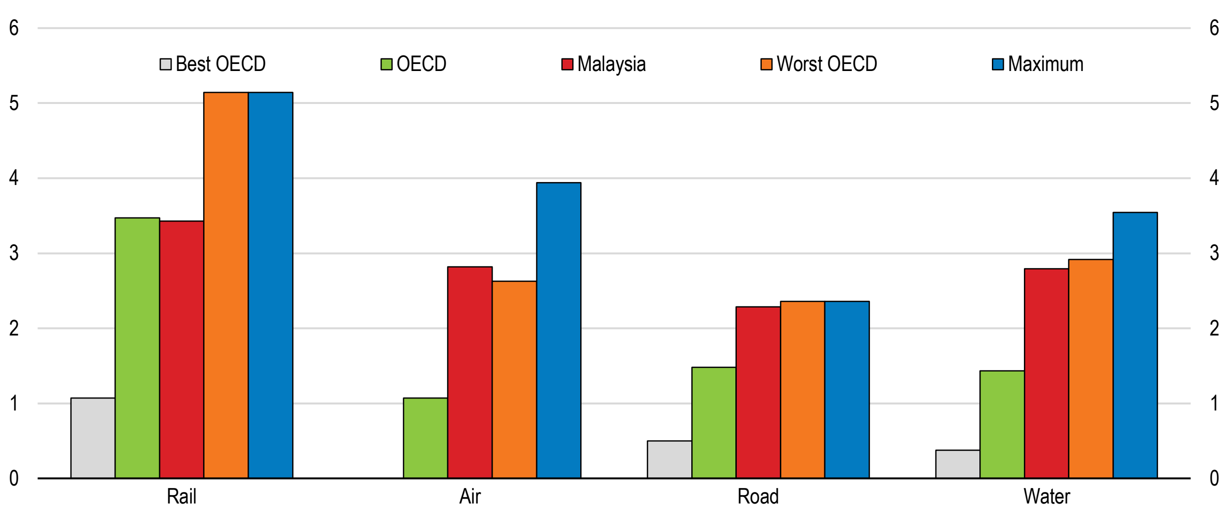
If fully implemented, the OECD recommendations can be expected to generate significant benefits to the Malaysian economy. The full implementation of the recommendations is expected to deliver positive long-term effects on employment, productivity, growth and the ability of businesses to compete.

Note: This work is still ongoing and will be published once completed.
Source: (OECD, 2021[19]), (OECD, 2021[20]) (both forthcoming).

According to the PMR indicators, regulation of transport in Malaysia is more restrictive than the OECD average, with the exception of rail (Figure 2.11). Transport services in Malaysia are generally open to market competition, although the government retains a significant presence that limits the scope for dynamic private competition. The government controls at least one firm in every transport sector assessed, including where private sector operators are present.

Figure 2.11. Malaysia's transport markets are more restrictive than those of OECD countries

Index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). Best OECD/worst OECD represents the OECD best/worst performing country, while maximum corresponds to the most restrictive country among those in the PMR database. For air transport, the OECD best score is zero.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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In a number of OECD countries, rail is often characterised by more restrictive market conditions compared with other transport services, as the costs of infrastructure provision are high and the existence of bottlenecks (e.g. peak times) makes it more complex to create a competitive market. In Malaysia, the legislation allows new rail operators to be licensed but use of the publicly owned rail infrastructure is exclusive to the state-owned enterprise, Keretapi Tanah Melayu Berhad (KTMB) and competitors do not have access to it. The government has proposed progressive liberalisation to create a multi-operator environment in the provision of rail services in the National Transport Policy 2019-30 as part of efforts to stimulate the development of the rail network, which is relatively under-used and under-developed as compared to the road network (Ministry of Transport, 2019[21]). As the government takes forward reforms to introduce new operators, it will need to ensure a transparent system is in place to govern universal service obligations and any associated subsidies.

Foreign transport services providers are restricted by cabotage policies across different transport sectors. In road freight services, foreign firms can only transport for their own account. In maritime transport, cabotage policy remains in place, although some block exemptions have been agreed, including between Peninsular Malaysia and the states of Sabah and Sarawak. Otherwise, foreign vessels may only serve domestic routes by obtaining a temporary license through the Domestic Shipping License Board. Further liberalisation could stimulate shipping activity and facilitate Malaysia's position as a logistics hub.

In air transport, Malaysia has been a leading advocate within ASEAN for deepening integration of the ASEAN Single Aviation Market. However, there are relatively few agreements with other partners, and the agreements in place are relatively narrow in scope. This compares unfavourably to OECD countries, which are also EU Member States and are therefore part of a fully liberalised internal market for aviation services. The National Transport Policy 2019-30 calls for the implementation of all ASEAN and Dialogue Partner air transport agreements. If Malaysia can continue to champion this agenda within ASEAN and on a bilateral basis, it can help increase the competitiveness of the air transport market in terms of price and consumer choice.

Other regulatory restrictions can undermine effective competition and inhibit business dynamism, including time limited licenses and restrictive approvals. For example, road freight licenses are time limited and all air transport routes are also subject to approval by the Malaysian Aviation Commission (MAVCOM). Liberalisation of these requirements could enable firms to respond more quickly to changing demands and foster a more dynamic business environment.

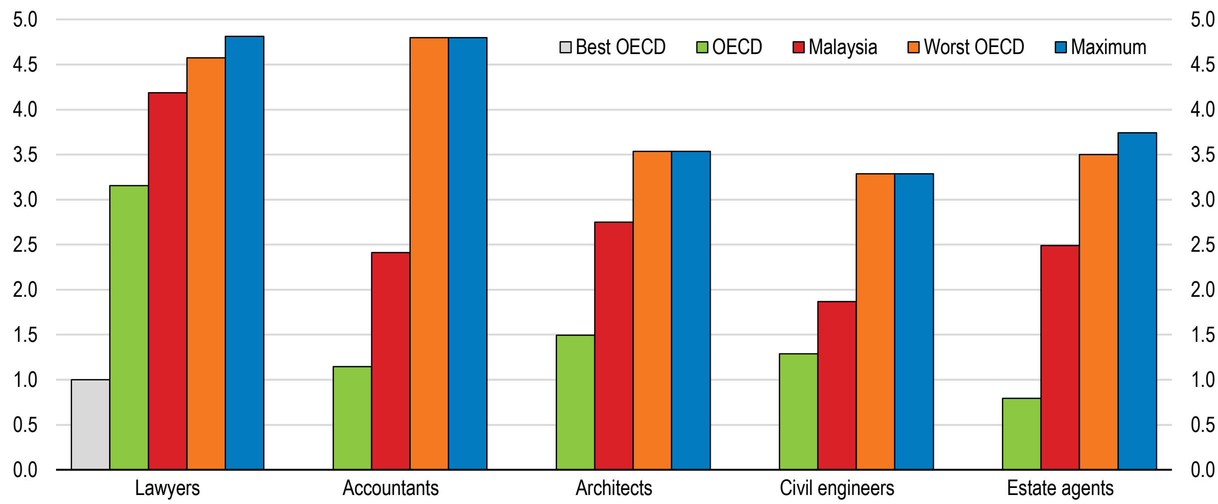
Lowering restrictions in professional services is crucial to transition to services-driven growth

As Malaysia transitions to high-income status, value-added services will become an increasingly important component of the economy. Business services, in particular professional services, have been shown to be effective in improving overall productivity and economic growth across economies (Gajic and Kordic, 2015[22]).

According to the PMR indicators, regulation of professional services is more restrictive than in OECD countries (Figure 2.12). This observation aligns with analysis by the World Bank and the Economist Intelligence Unit, which shows that, on average, the regulations governing professional services in Malaysia are more restrictive than in regional peers, such as Singapore and the Philippines and in countries of similar levels of economic development as Malaysia (World Bank, 2021[18]).

Figure 2.12. Less restriction in professional services would foster productivity

Index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). Best OECD/worst OECD represents the OECD best/worst performing country, while maximum corresponds to the most restrictive country among those in the PMR database. Except for lawyers, the OECD best scores are zero. Notaries are not included as it is not recognised as a separate profession in Malaysia.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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The PMR indicators distinguish between entry regulations – which restrict which qualifications and other prerequisites are required to enter a given profession – and conduct regulations, which restrict how professionals conduct their business, including regulated minimum fees and requirements on the legal form of firms. Entry regulations for professionals in Malaysia are broadly on a par with OECD countries. Indeed, entry regulations for lawyers, accountants and civil engineers are considered less restrictive than the OECD average, but the entry regulations for architects and estate agents are slightly more restrictive. For example, there is only one pathway to becoming an architect since all Registered Architects must first be registered Graduate Architects. However, Malaysia is assessed to be more restrictive with respect to how the conduct of professional services is regulated.

All professional services assessed under the PMR indicators are subject to significant restrictions on the legal form of business. Lawyers are subject to the most restrictive regulations as the Legal Profession Act 1976 restricts a lawyer to only practice through a sole proprietor or a partnership or to be employed by a sole proprietor or a partnership. The Limited Liability Partnership Act 2008 provides an alternative option, but amendments to the Legal Professions Act 1976 are required before lawyers can take advantage of this option. The other professional services are subject to a range of different restrictions. Civil engineers, architects and estate agents are allowed to incorporate but with restrictions on equity structure and voting rights. These regulations may limit the capacity for professional services firms to identify additional sources of finance and reduce opportunities to develop management skills. Inter-professional collaboration is also restricted. Lawyers and accountants are prohibited from entering into collaborations with other professions, and civil engineers and architects are restricted to tightly defined "multi-disciplinary" practices with prescribed equity and voting structures. These restrictions may limit the ability of firms to exploit efficiencies and offer new and potentially valuable combinations of services to their clients.

The government is currently considering an amendment to the Registration of Engineers Act 1967 on shareholding by non-professionals. The Act includes provisions for the Minister of Works to proscribe limits on shareholding in engineering firms. It is currently limited to 30% shareholding by non-engineers, with a proposal to amend this to 100%. As such, the restriction on the ownership of engineering firms of 70% for professional engineers with a practicing certificate (PEPC) shall be removed, in line with the practice in other countries, such as Singapore and Australia. The proposed amendment is intended to make Malaysia engineering firms more competitive and increase their capital base.

The fees for professional services in Malaysia are also regulated, which can undermine competition. Fees for certain services provided by lawyers, accountants, civil engineers, architects and estate agents are prescribed by their respective governing bodies (Malaysia Competition Commission, 2013[23]). The rational for such regulations is usually due to the fact that professional services are “experience goods” (i.e. a product or a service whose quality, and hence price, is difficult to evaluate in advance), and in some cases even credence goods (difficult to assess quality even after the service has been purchased). Therefore, consumers of these types of goods need to be protected from the risk of encountering low quality providers through price regulation. However, the fact that there are countries where such price regulation has been removed without damaging consumers suggests that this argument may not be valid and there is scope for removing such regulatory constraints to competition. Hence, the extent to which there is a requirement for professional services fees to be regulated in Malaysia should be subject to review, as part of efforts to stimulate competition and dynamism across the sector.

Reform of professional services has delivered economic benefits in several European countries. For example, Greece undertook significant reform in 2011 to reduce restrictions on entry and conduct for professional services, including the removal of defined mandatory fixed and percentage prices or fees for certain service providers, such as lawyers and auditors. As part of these reforms, geographical restrictions and economic needs tests for law firms were abolished. The entry requirements for accountants were also relaxed from licensing to simply announcing the commencement of activities. Research has found that these reforms resulted in lower prices for consumers, and the number of start-ups for several professional services more than doubled in 2014 compared with the yearly average before the liberalisation (Athanassiou et al., 2015[24]).

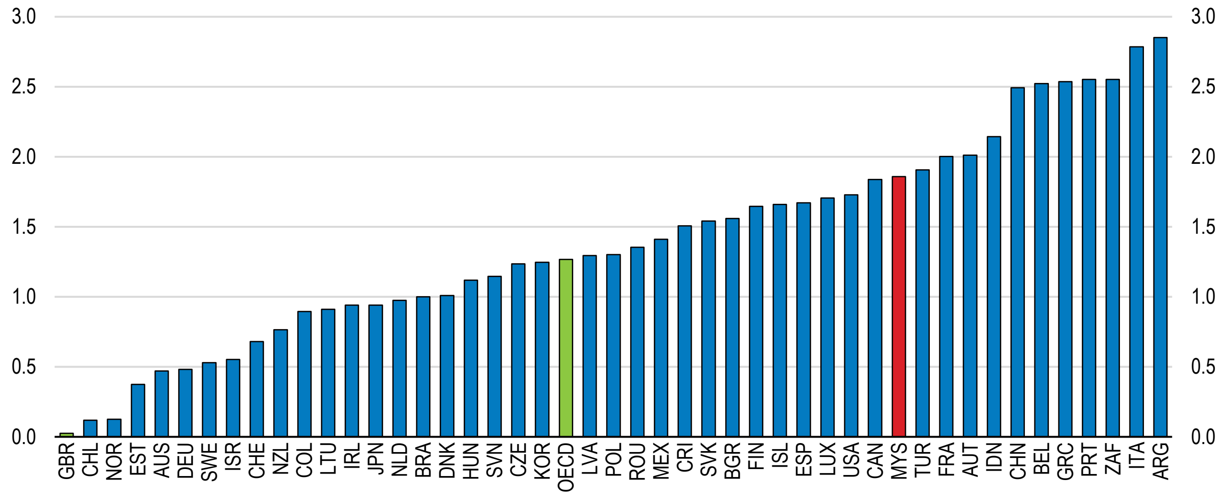
Reducing restrictions in the retail can support the growth of Malaysia’s SMEs

The retail sector is an important driver of the SME economy in Malaysia: with 89% of SMEs in the services sector, of which 51% are in retail (Economic Census 2016, DOSM). As an industry, retail has been one of the hardest hit by the pandemic, with reports that more than 51 000 retail stores (about 15% of the total industry supply, Retail Group Malaysia) in the country are expected to close down. Developing a more competitive and dynamic business environment within the retail sector can therefore be an important part of Malaysia’s pandemic recovery.

According to the PMR indicators, Malaysia’s retail sector is more restrictive than in many OECD countries, suggesting that there is potential to enhance the business climate (Figure 2.13). One issue highlighted by the PMR indicators is the ongoing use of price controls. The Price Control and Anti-Profiteering Act 2011 enables the government to specify prices on any products it deems necessary to regulate, and the government is currently regulating the maximum price of a number of goods, including sugar, petrol and diesel. The government also routinely sets the maximum price of a range of goods on a temporary basis during festive seasons, including chicken, pork and certain vegetables. These measures were implemented to prevent profiteering and to reflect the fact that several of the products subject to controls are subsidised by the government.

Figure 2.13. Malaysia's retail services market is more restrictive than OECD countries

Index scale of 0-6 from least to most restrictive, 2018



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia).
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

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In addition to price controls on specific products, the government has also implemented a broad anti-profiteering framework. Based on a defined formula the government determines "reasonable" profits and can take action against retailers making profits beyond this level. The anti-profiteering regulation may limit business strategies and therefore inhibit business dynamism. For example, according to a Market Review of selected Retail and Wholesale Products undertaken by the Malaysia Competition Commission (MyCC), firms have reported deliberately avoiding lowering prices to avoid being accused of profiteering in subsequent years. This reduces the capacity for retailers – and consumers – to respond to changes in underlying market conditions. In addition, the Review highlights that reporting requirements under the Act also create an administrative burden for firms, which may disproportionately affect SMEs (Malaysia Competition Commission, 2020[25]).

In other countries, anti-profiteering regulations have been introduced on a time-limited basis to manage the introduction of new taxes on consumption. In Malaysia, the anti-profiteering regulations were originally intended to protect consumers from excessive price rises following introduction of the Goods and Services Tax (GST) in 2015. However, despite the subsequent abolishment of the GST in 2018, the regulations have not been phased out. Moving forward, the government could consider regular reviews to assess the impact and necessity of the anti-profiteering regulations.

The Market Review undertaken by MyCC also highlights a number of competition issues within the retail sector that could particularly affect SMEs. Distributors have reported that large retailers can impose anti-competitive conditions on their suppliers, including "back-margins" (such as listing fees for selling certain products) the cost of which can range from 5% to 30% of product value in some circumstances (Malaysia Competition Commission, 2020[25]). Stronger enforcement and increased awareness of the Competition Act 2010 could help reduce the proliferation of such unfair trade practices.

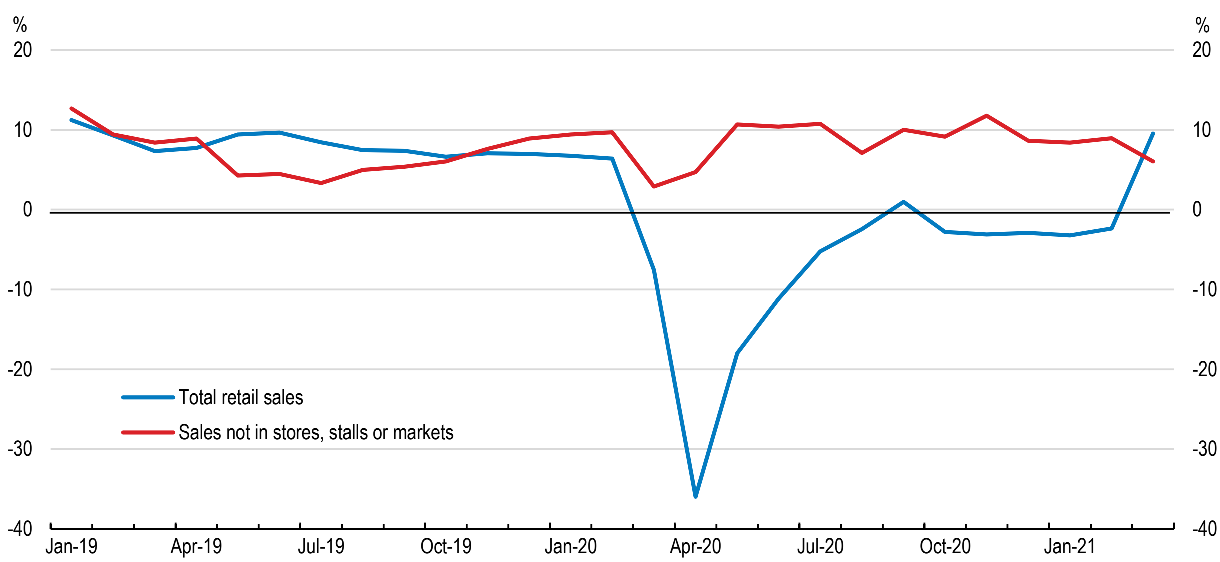
In Malaysia, foreign-owned retailers are subject to a separate regulatory regime through the Guidelines on Foreign Participation in Distributive Trade Services in Malaysia, which imposes restrictions on floor size and opening hours, which do not apply to domestically owned firms. Foreign-owned firms are also subject to separate reporting requirements, which impose an additional bureaucratic burden. This is reflected in Malaysia's relatively high score in the OECD Services Trade Restrictiveness Index (STRI) for the distribution services, which was at 0.342 in 2020 notably higher than the OECD average of 0.178. In 2020, the government relaxed certain restrictions, including abolishing the requirements for a local partner for superstores and a local population of at least 200 000. Foreign hypermarkets can now also open stores measuring as small as 1 000 m^2 in urban areas. However, several other restrictions remain, including size limits for rural and suburban areas. These reforms should help modernise the retail sector and encourage foreign investment.

The pandemic calls for accelerating digitalisation

The pandemic has increased the importance of digitalisation for business activities across the globe. Like in many other countries, in Malaysia, retail online sales have continued growing during the crisis, although their share is still small (Figure 2.14). Malaysia has a traditional strong focus on digitalisation. A case in point is the establishment in 1996 of a special economic zone to nurture ICT and ICT-related industries through attracting foreign and domestic investment, also known as the Multimedia Super Corridor. Thanks to its wide range of incentives and privileges, the Multimedia Super Corridor has generated approximately an MYR 470 billion (Malaysian ringgit) of turnover and 180 000 jobs until the end of 2018, with almost 3 000 participating companies. After the pandemic, digitalisation will become an even more essential determinant of business competitiveness and the government has therefore decided to provide an enabling environment. In particular, the government adopted in February 2021 a comprehensive national strategy for digital economy, the Malaysia Digital Economy Blueprint (Box 2.4).

Figure 2.14. Online sales keep expanding during the pandemic

Year-on-year growth rate of the volume index of retail trade



Note: The sub-category of "not in stores, stalls or markets" includes sales of any kind of product over the Internet.
Source: DOSM (2021), Performance of Wholesale and Retail Trade, March, Table 7.

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Box 2.4. Malaysia Digital Economy Blueprint – a national strategy for digitalisation

In February 2021, in the middle of the pandemic, the government announced MyDIGITAL, an initiative to drive the digitalisation of the economy with an ambitious goal of implementing a range of whole-of-nation programmes by 2030 through the Malaysia Digital Economy Blueprint (Blueprint). The adoption was deemed timely as the pandemic had made many people aware of the importance of digitalisation. The Blueprint consists of six pillars:

- Driving digital transformation in the public sector;
- Boosting economic competitiveness through digitalisation;
- Building enabling digital infrastructure;
- Building agile and competent digital talent;
- Creating an inclusive digital society;
- Building trusted, secure and ethical digital environment.

These pillars broadly cover most acute policy issues, ranging from skills development to the renewal of policy frameworks for data protection and intellectual property rights. The Blueprint also sets out concrete objectives and timelines for each pillar, with a particular focus on inclusiveness and SMEs. It aims at ensuring by 2025 Internet access for all households and for 875 000 micro-, small- and medium-sized enterprises (MSMEs) participating e-commerce transactions. The Blueprint also highlights the importance of both foreign and domestic investments, including those in infrastructure.

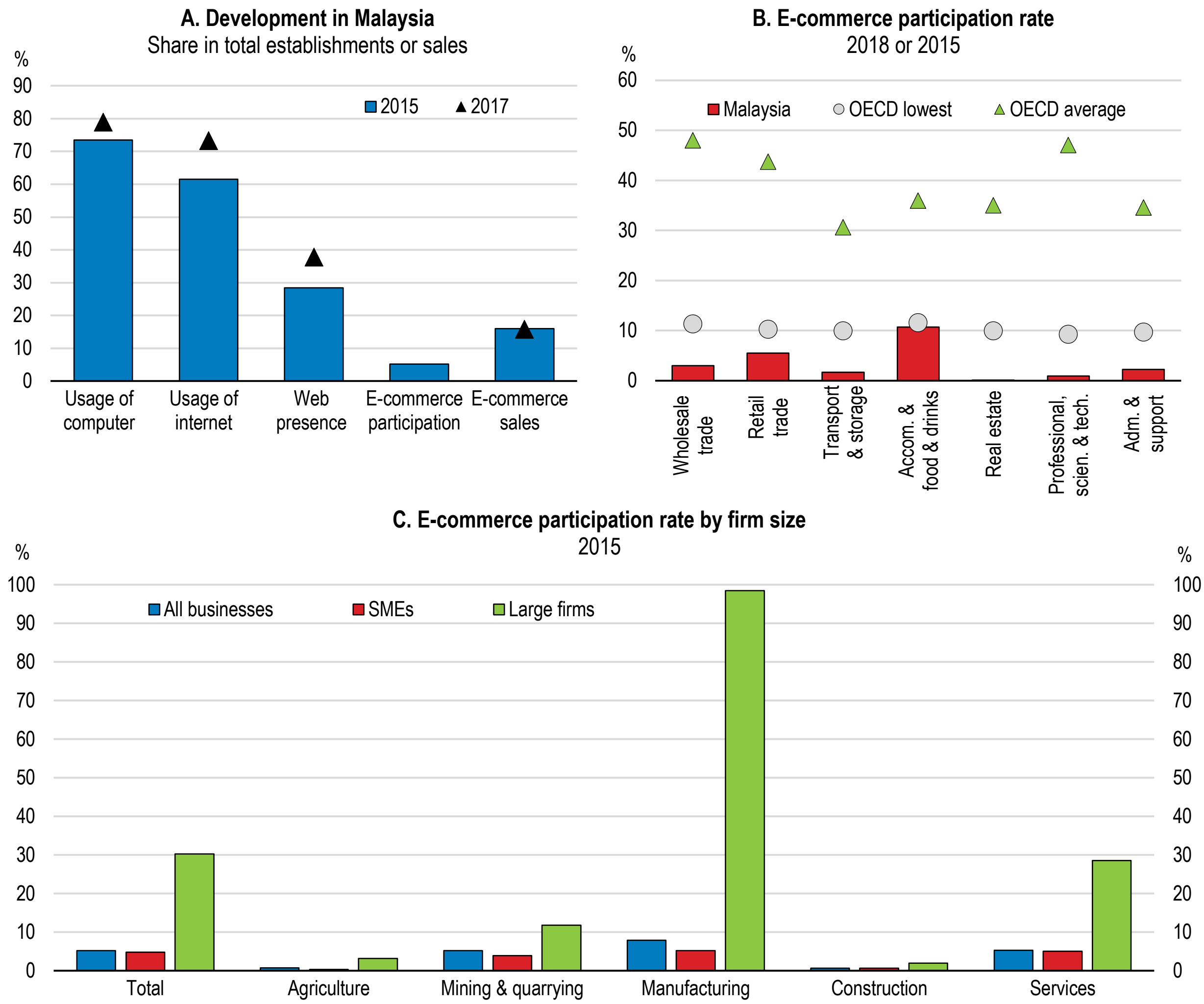
As an outcome, the government expects that the digital economy will contribute to 22.6% of GDP and create 500 000 jobs by 2025, also uplifting the level of productivity in all sectors by 30% towards 2030.

Source: (Economic Planning Unit, Prime Minister's Department, 2021[26]).

Few SMEs are digitalised, but they are more productive

The digital uptake of businesses in Malaysia was growing before the pandemic, but use of the technology remained limited (Figure 2.15). While the share of e-commerce income in total business sale of 16% was comparable to that of OECD countries in 2015, the participation in e-commerce was much lower than in some OECD countries (Figure 2.15). Moreover, large differences in digital uptake prevailed among the large number of SMEs. Based on the national definition, SMEs represented 99% of all establishments in 2015, of which 86% were with less than ten workers and 64% were with less than five workers (Economic Census 2016, DOSM). In most countries, the digital uptake of SMEs is much lower than that of large firms (OECD, 2021[27]). The same situation of low SME digital uptake prevails in Malaysia (Figure 2.15). Although digital uptake has accelerated during the pandemic among Malaysia's SMEs (SME Association of Malaysia, 2020[28]), it is crucial to achieve higher levels of digitalisation in the next few years.

Figure 2.15. Digital uptake in Malaysia's businesses was evolving before the pandemic



Note: E-commerce participation is either receiving orders or making purchases over computer networks.
Panel A: share of total sales for the indicator e-commerce sales, and share of total establishments for the others.
Panel B: data refer to businesses with more than 10 workers; 2018 data for wholesale and retail trade excluding motor vehicles and motorcycles; 2015 data for all other sectors.
Panel C: data refer to all-sized business establishments, including those with less than 10 workers. SME classification is based on the national definition: for the manufacturing sector, SMEs are firms with sales turnover below MYR 50 million or whose full-time employees are below 200; for the services sector, SMEs are those firms with sales turnover below MYR 20 million or with less than 75 full-time employees.
Source: DOSM, Economic Census 2016, Annual Economic Statistics 2018, Usage of ICT and E-commerce by Establishment 2018, Wholesale and Retail Trade Census 2019; and OECD, Information and Communication Technology - ICT Access and Usage by Businesses database and OECD calculations.

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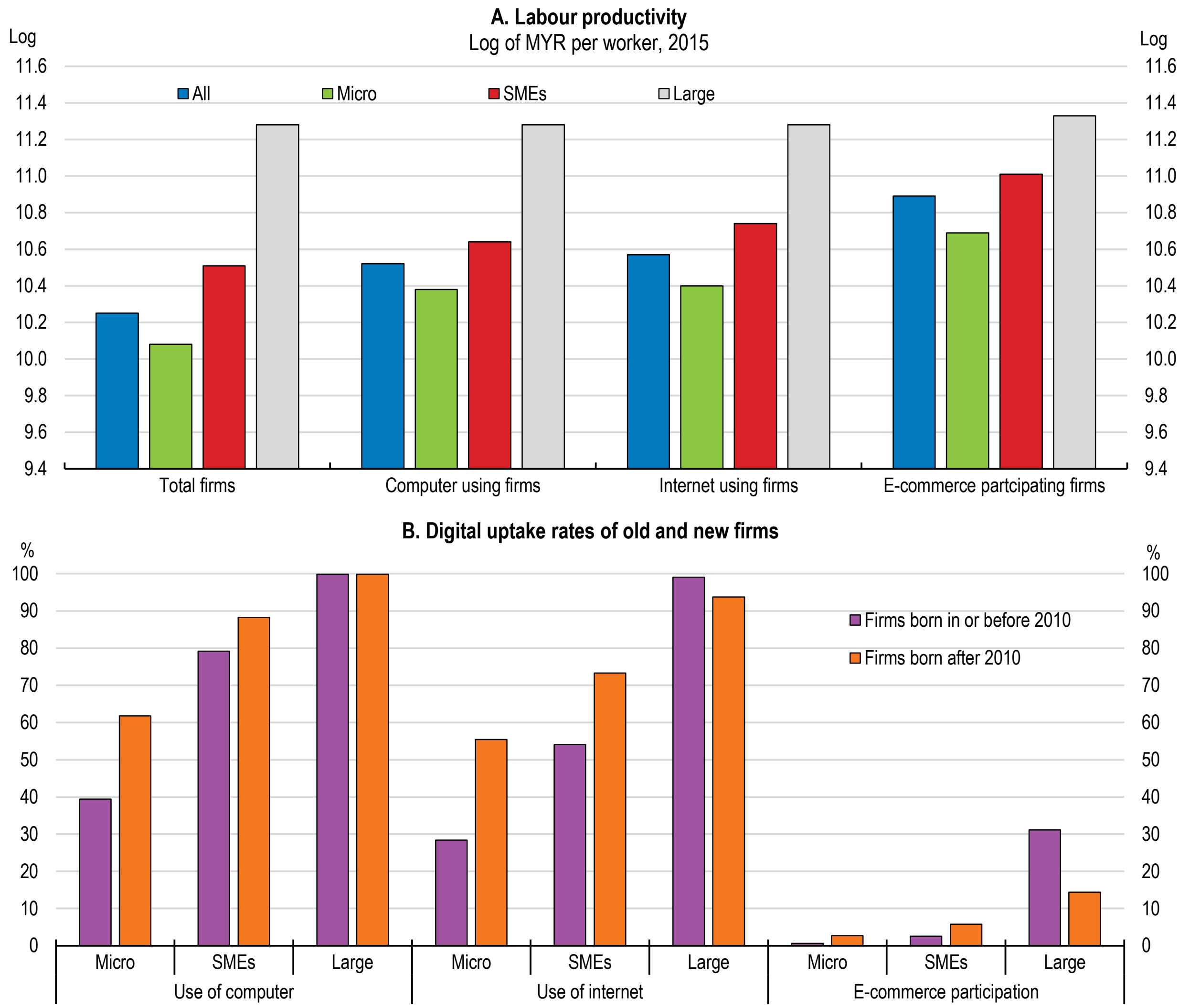
Although Malaysia's business sector is still at an early stage of digitalisation, new analysis performed for this report, using Malaysia's firm-level data, suggests that the uptake of digital technologies, particularly e-commerce participation, is associated with higher growth and levels of productivity of firms in the services sector (Box 2.5). Because of the different nature of activity, the need for digital technologies is not the same among sectors. Nevertheless, overall, in the services sectors, the gap in the level of productivity between firms using digital tools and firms not using these tools is more pronounced among smaller firms than large firms (Figure 2.16). This implies that digital tools, including e-commerce, would help overcome resource constraints, in particular the shortage of labour, contribute to the expansion of their customer base, and push up the profits of participating smaller firms. Moreover, newly created firms are more likely to use digital tools, being more agile in adopting new technologies, so they would benefits more from these technologies than old firms (Figure 2.16).

Figure 2.16. In the services sector, SMEs adopting digital tools show higher labour productivity



Note: Micro firms are defined as having less than 5 workers, SMEs as having between 5 and 75 workers. The reference years for the wholesale and retail trade sectors are 2013 and 2018, and 2010 and 2015 for all other services sectors. E-commerce participation is either purchase or sell online. Three groups of digital uptake are not mutually exclusive. For example, computer using firms could include Internet using firms or e-commerce participating firms.
Source: DOSM, Economic Census 2011 and 2016; and OECD calculations.

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Box 2.5. Digital uptake and productivity – firm-level evidence in Malaysia

In the quinquennial survey for business establishments conducted in 2016 (Economic Census 2016), the Department of Statistics Malaysia (DOSM) introduced a standardised questionnaire on digital uptake proposed by the OECD. By using the firm-level data for services sectors of the Census, the relationship between digital uptake and productivity has been analysed for this report. Regression results suggest that, similar to previous study in other countries, digital uptake, namely the use of computers, the use of the Internet and the participation in e-commerce are likely to correlate with growth and the level of productivity at the firm level in Malaysia (Table 2.1).

Table 2.1. Digital uptake boosts firm-level productivity of services sectors

Regression of growth or log level of productivity on digital uptake (computer, Internet and e-commerce)

	Dependent variable is Productivity growth between 2010 and 2015	Dependent variable is log productivity level in 2015
	(1)	(2)
Initial productivity gap with top 5% firms	0.658	x
	(0.002)	x
Assets per workers	0.018	0.078
	(0.001)	(0.0004)
Firm size (with 5-75 employees)	0.035	0.206
	(0.004)	(0.002)
Firm size (with above 75 employees)	0.230	0.524
	(0.020)	(0.012)
Use of computers	0.172	0.260
	(0.005)	(0.004)
Use of the Internet	0.132	0.090
	(0.006)	(0.004)
Participation in e-commerce	0.236	0.091
	(0.019)	(0.008)
Sub-sector dummy	Yes	Yes
Observations	114 531	472 815
Adjusted R^2	0.426	0.276

Note: The variable for assets per workers is growth for growth regression and a log value for level regression. Digital uptake variables are all binary. Initial gap in productivity level is calculated at the sub-sector level. Firms with top 5% in productivity level are excluded from the regressions. ( ) represents p-value.
Source: DOSM, Economic Census 2011 and 2016, and OECD calculations.

Because of the pandemic, many SMEs have become aware on the importance of digital adoption. Nevertheless, a number of SMEs are less digital-savvy, so that it is crucial to ensure that the digital divide among firms does not increase further. Moreover, the e-commerce participation rates of smaller firms were lower than of large firms, and the current situation is likely to remain the same despite the pandemic. Although overall profit margins would diminish because more e-commerce enhances competition between firms, it is still important to help the adoption of digital tools by SMEs. In this regard, many countries provide policy support to help SMEs accelerate their technology extension through financial or non-financial measures. For example, Colombia, where SMEs, including family-owned micro businesses, account for large part of employment, has developed digital strategies targeting SMEs, providing training and technical assistance and conducting information campaigns. The MiPyme Vive Digital plan succeeded in connecting 75% of SMEs to the Internet by 2018, achieving its target of 70% (OECD, 2019[29]).

Developing the digital skills of workers is particularly crucial. The government has provided for years a range of training and up-skilling programmes for basic digital skills, with strong emphasis on entrepreneurs (Record et al., 2018[17]). In 2015, a major programme, eUsahawan was launched together with eRezeki, to provide people in the bottom 40% income group with opportunities to develop basic digital skills for jobs, such as programming and translation. The eUsahawan programme is a training programme for entrepreneurs provided by public education institutions, targeting micro-entrepreneurs who lack digital knowledge. The number of trained people has steadily increased: in 2020, 73 017 people were trained, up from 3 108 in 2015. In addition, in 2020, the government launched the #MyDigitalWorkForce Movement that provides a training and hiring incentive to businesses in order to enhance digital skills of workers and the unemployed. Rapidly changing business digital technologies, even for basic ones, makes it difficult for individuals to learn by themselves. Therefore, these programmes are useful to shore up overall levels of digital knowledge among smaller firms, especially micro-sized firms.

Nevertheless, the government could further enhance the provision of digital skills training programmes for SME workers in addition to entrepreneurs, as SMEs often do not have sufficient resources to this end. Although the Human Resource Development Corporation (HRD Corp) provides programmes to train workers (see below), SMEs with less than ten workers are exempted from the HRD Corp levy, so that they are not eligible for these programmes unless they voluntarily contribute to the HRD Corp. Moreover, SMEs with less than five employees are not covered by the HRD Corp. Equipping SME employers more with digital skills could also facilitate the digitisation of SMEs and their workers. In this regard, the government has promoted awareness among SMEs to facilitate their digital adoption. For example, the Digital Productivity Nexus (DPN) was established in 2017 under the Malaysia Productivity Blueprint (MPB) to coordinate various programmes, including training, provided for SMEs in a range of sectors. Under the initiative, the Industry4WRD Readiness Assessment and the Productivity 1010 have been carried out, which provide consulting services for SMEs in the manufacturing and services sectors to improve their digital readiness. In addition, older firms are less inclined to invest in digital technologies, resulting in lower productivity and its growth. More analysis is needed, but this would be related to the age of employers who are less willing to catch up with new digital tools, although some new applications are easier to handle. Therefore, it would also be useful that some programmes could target older SMEs. In addition to basic digital skills, acquiring soft skills, such as communication skills, would become more important for workers to conduct businesses using digital tools (see below).

The participation of SMEs in e-commerce transactions should be promoted further in Malaysia. In many countries, business to consumer (B2C) sales have been increasing rapidly. In Malaysia, although the share of B2C sales in total e-commerce income has remained low, at 18% in 2017 for all firms, B2C sales have expanded faster (9% per year) than that of total e-commerce sales (6% per year) between 2015 and 2017 (Use of ICT and E-commerce by Establishment 2018, DOSM). Although not directly comparable, web-based B2C sales in EU countries account for 41% of total web sales in 2020, a large increase from 30% in 2015. B2C activities have thus a lot of room to expand further in Malaysia. Compared with other countries, Malaysia shows a significant gap between the shares of firms using computers or the Internet and the share of firms participating in e-commerce (Figure 2.16, Panel A). The participation of SMEs in e-commerce transaction could therefore expand rapidly with the right framework conditions.

The government has emphasised the participation of businesses in e-commerce. Under the National eCommerce Strategic Roadmap (NeSR) announced in 2016, capacity and capability development programmes have been provided with the collaboration of private e-commerce platforms to help SMEs participate in e-commerce businesses. Moreover, during the pandemic, SMEs have been encouraged to use e-commerce to sell their products online. The cumulative number of SMEs adopting e-commerce through this initiative has exceeded 490 000 (Malaysia Digital Economy Corporation), which is significant. Nevertheless, there would be still a large number of SMEs not adopting e-commerce, considering the recent increase of firms (from 648 000 in 2010 to 920 000 in 2015, Economic Census, DOSM). In addition, since 2020, the National Entrepreneurial Institute (INSKEN) has provided the Online Onboarding Coaching (e-Board), a training programme for SMEs to help them use online platforms for marketing and other business activities. Together with the digitalisation of public services, encouraging e-commerce participation of SMEs would also be useful to facilitate the formalisation of these firms.

In addition, as businesses have accelerated their digital uptake, other necessary conditions to e-commerce would become more important, such as provision of high quality logistics services (see above), consumers' digital adaptation and SMEs' digital security profile. Particularly, the digital uptake of consumers and enabling financial infrastructure could play an important role. As few people are inclined to pay online, the government has stepped in (Record et al., 2018[17]). Before the pandemic, the government collaborated with private e-commerce companies to facilitate the use of e-payment among lower-income households (e-Tunai Rakyat initiative). Moreover, the government launched in August 2020, the Shop Malaysia Online initiative, which featured discount vouchers co-funded by both the government and e-commerce platforms for online purchases. About 8.2 million of consumers, 210 000 local suppliers and 22 e-commerce platforms participated in the programme, resulting in sales amounting to MYR 2 billion. Accordingly, the use of internet banking increased (62% of households in 2020 compared with 51% in 2019, ICT Use and Access by Individuals and households Survey Report 2020, DOSM), and online purchases of goods and services surged (54% in 2020 compared to 23% in 2019). While the number of people holding credit cards is still low (about 35% of population aged over 15 in 2020), almost similar to the level in 2016, users of network-based payment grew at annual 67% between 2016 and 2020 (Payment Statistics, Bank Negara Malaysia).

Due to rapid technological progress, use of digital technologies in businesses is expanding from basic communication tools, such as email and online transactions, to more advanced business tools, such as administration (e.g. enterprise resource planning (EPR)) and marketing (e.g. big data analyses) with also greater adoption of cloud computing services (see Annex 2.A.). SMEs tend to be slow in adopting these new digital tools in Malaysia, like in many OECD countries (OECD, 2021[27]). Although not all SMEs need highly advanced digital technologies and there is a large difference between sectors, it is crucial for growing SMEs to absorb and adopt the latest technologies according to their readiness and business strategy so as to remain competitive. In Malaysia, the government has prepared matching grant schemes to provide incentive and financial support to SMEs and start-ups, which cover some advanced digital tools, such as EPR and digital marketing. During the pandemic, the government launched an additional outcome-based grant scheme for SME's digitalisation, #SMART Automation Grant (SAG). In addition, the i4.0 Accelerator Programme (ACE) and the Adoption of Digital Solutions (ADS) Programme offer customised digital solutions, training and handholding for SMEs and micro-enterprises respectively to help them adopt advanced digital technologies, such as automation. In this regard, a number of countries have similar schemes. For example, Germany's Go-Digital is a co-funding programme, through which SMEs can receive expert advice on IT security, online marketing and digital business processes (Federal Ministry for Economic Affairs and Energy, 2021[30]). Government funding covers 50% of consulting fees or a maximum EUR 1 100 per day up to 30 days in total.

Looking ahead, Malaysia's SME digitalisation policy needs to broaden its scope. A number of countries have expanded their support to SME digitalisation and now include important aspects, such as the protection of digital data and of intellectual property rights where SMEs often lack the necessary capabilities, in addition to the traditional schemes of financial and knowledge supports (OECD, 2021[27]). For example, in Spain, as part of a broader intellectual property strategy, the Spanish Patent and Trademark Office has carried out for years numerous initiatives of intellectual property promotion targeting SMEs and entrepreneurs, through organising seminars, workshops and courses (Spanish Patent and Trademark Office, 2020[31]). In this regard, the Malaysia Digital Economy Blueprint includes an awareness programme on intellectual property rights to facilitate businesses intellectual property registration. Enhancing data protection regulations would safeguard SMEs from abusive power of large online platforms (see below), but could also put disproportional burdens to SMEs as they have less internal capacity. This would call for support measures to strengthen SME capacity of data handling.

Greater openness of digital trade would benefit SMEs

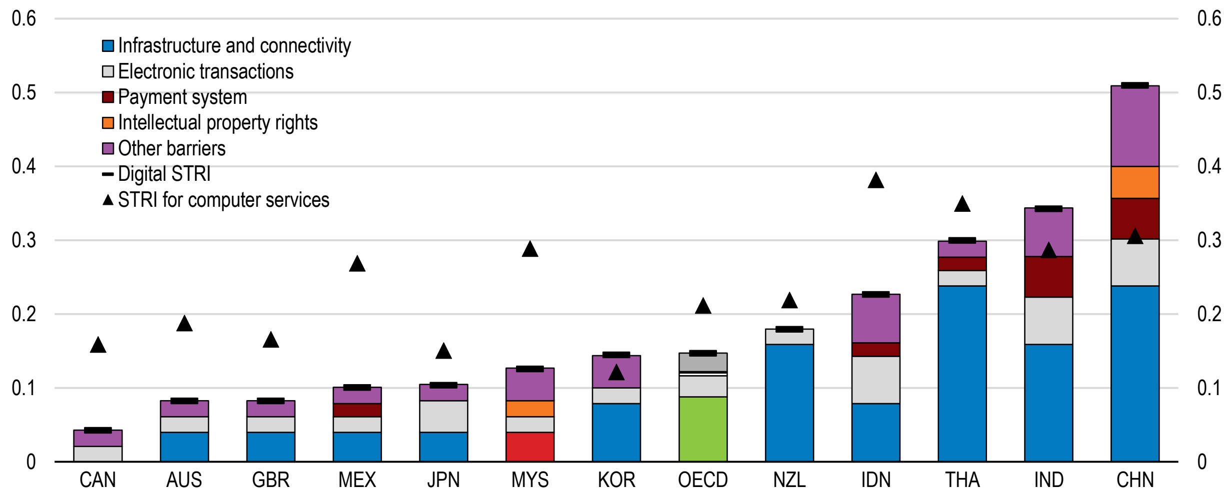
Digital technologies could allow SMEs easily to expand their business opportunities beyond national borders. Smaller firms in ASEAN countries, including those in Malaysia, are likely to engage in export businesses if they have web presence (López González, 2019[32]). Nevertheless, like in other countries, Malaysia's SMEs lag behind in exploring overseas markets through digital means. Although it grew in some sectors, such as agriculture, only 11 % of e-commerce income was from international transactions in 2017 slightly up from 10 % n 2015 (Economic Census 2016, Use of ICT and E-commerce by Establishment 2018, DOSM), and its share was smaller for SMEs (6% in 2015). In this regard, the government has supported SMEs aiming to go global. The National eCommerce Strategic Roadmap provides training programmes of cross-border e-commerce participation for SMEs.

In the digital era, trade involves complex regulatory frameworks related to electronic transactions (e.g. e-signature), secured payment systems, intellectual property rights and cross-border digital services (e.g. video streaming). The OECD Digital Services Trade Restrictiveness Index, which aims at capturing the soundness of these regulatory environments (Ferencz, 2019[33]), suggests that Malaysia has a more enabling environment than many other countries in the region for digital trade (Figure 2.17). Nevertheless, Malaysia could further improve its regulatory environment, in particular regulations affecting infrastructure and connectivity, data flows and electronic transactions. Domestic reforms and ambitious commitments in trade agreements to lower barriers and open markets could improve these regulatory frameworks further. Malaysia has been very active in contributing to regional and international regulatory harmonisation, such as APEC and ASEAN. It is essential to keep improving these regulatory environments, including for digital trade. Trade costs resulting from high trade barriers fall disproportionately on SMEs as complying with regulatory hurdles and diverging regulations across countries are more costly for smaller firms with limited resources. Indeed, on average, services trade barriers may represent as high as 14% additional tariff equivalent on small firms' cross-border exports compared to large firms (OECD, 2017[34]). Thus as barriers to services trade are eased, SMEs are first to gain.

Despite recent improvements, trade restrictions imposed on computer services essential to digital economy are still relatively high in Malaysia (Figure 2.17). Foreign firms are required to incorporate or register a branch in Malaysia to provide services, including computer and other digitally enabled services. The labour market test for the temporary entry of foreign intra-corporate transferees and the relatively short permitted period of stay for foreign specialists (12 months) constitute restrictive conditions to the movement of skilled labour. As the lack of skilled workers is one of the obstacles faced by Malaysian SMEs, reducing these barriers would foster their digitalisation. Malaysia introduced a law to protect personal data in 2010 (Personal Data Protection Act 2010). Nevertheless, data users cannot transfer personal data abroad except for specified jurisdictions, although there are some exemptions, such as the existence of users' consent. While no whitelist has yet been issued, the government has started the review of the Act, including the removal of this condition in view of facilitating e-commerce trade (Department of Personal Data Protection, 2020[35]). If implemented, the revision would help facilitate cross-border data flows, an essential element of the digital economy.

Figure 2.17. Malaysia is open to digital trade, but could be more open to computer services

Services Trade Restrictiveness Index ranging from 0 (open) to 1 (closed), 2020



Source: OECD, Services Trade Restrictiveness Index database.

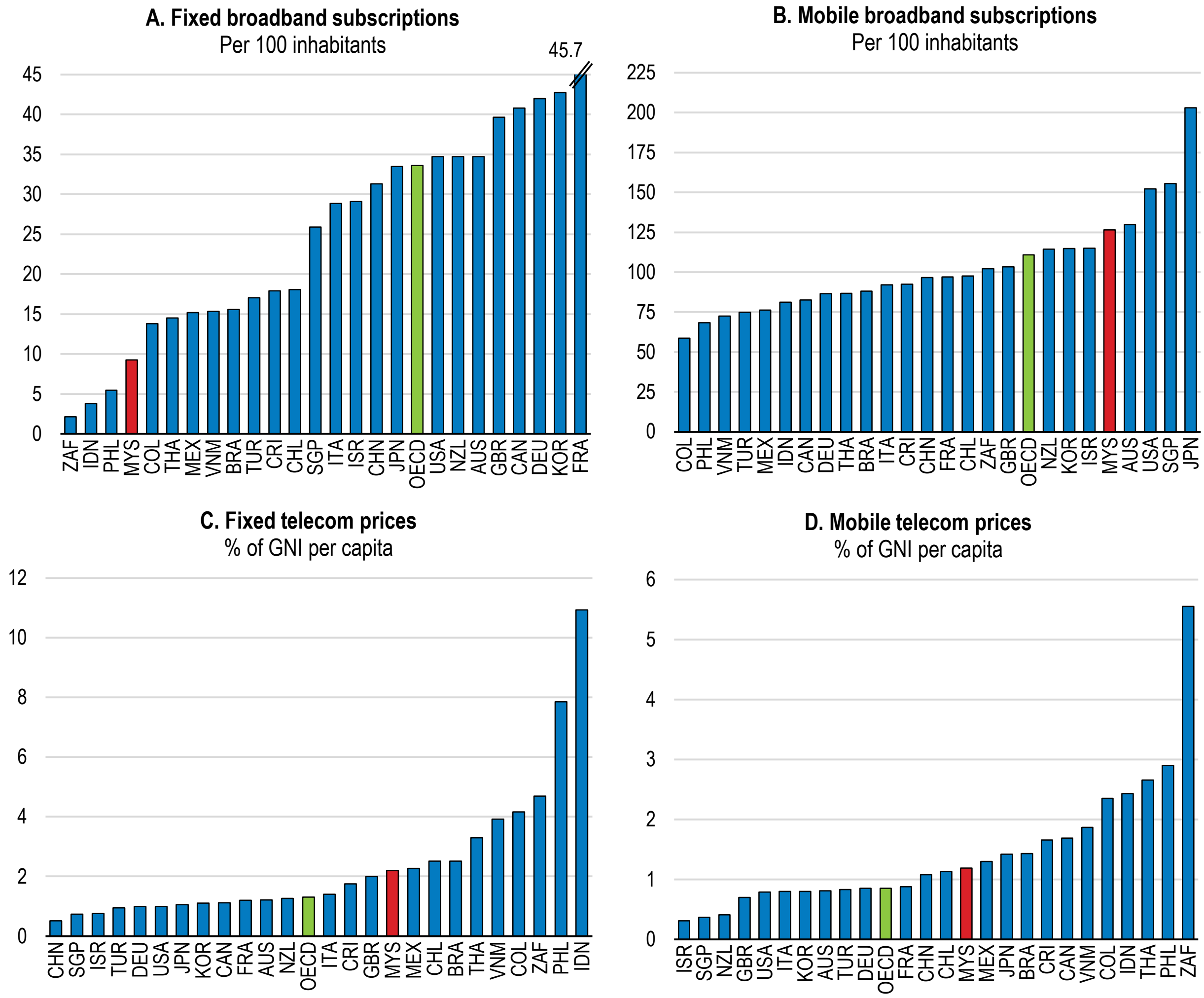
StatLink https://stat.link/08x7p5

Stimulating private sector dynamism is crucial for better network services

Provision of high quality and affordable digital communication services, such as broadband, supported by better infrastructure is a prerequisite to business digitalisation, including teleworking. Malaysia made considerable progress in providing digital communication services. For example, to boost investment in broadband networks necessary to provide these services, a public-private partnership initiative with a state-owned enterprise, Telekom Malaysia, was set up in 2008. Nevertheless, while Malaysia is well advanced in the penetration of mobile broadband services and the prices of digital communication services have declined recently, it somewhat lags behind in fixed broadband (Figure 2.18). In this regard, amid the COVID-19 pandemic, the government has stepped up its efforts to enhance the infrastructure of digital networks. In August 2020, the government announced the Pelan Jalinan Digital Negara (JENDELA), aiming at an 83% coverage of fixed broadband with gigabit speed by 2022.

Figure 2.18. Malaysia is advanced in mobile broadband subscriptions, but less in fixed broadband

2020 or latest year available



Note: The fixed telecom price refers to a fixed-BB basket with 5 GB and the mobile telecom price refers to a high usage voice and data allowing up to 140 minutes of phone calls, 70 SMS and 1.5 GB data. 2019 data for the fixed and mobile broadband subscriptions and 2020 data for both fixed and mobile telecom prices.
Source: International Telecommunication Union.

StatLink https://stat.link/m1k72p

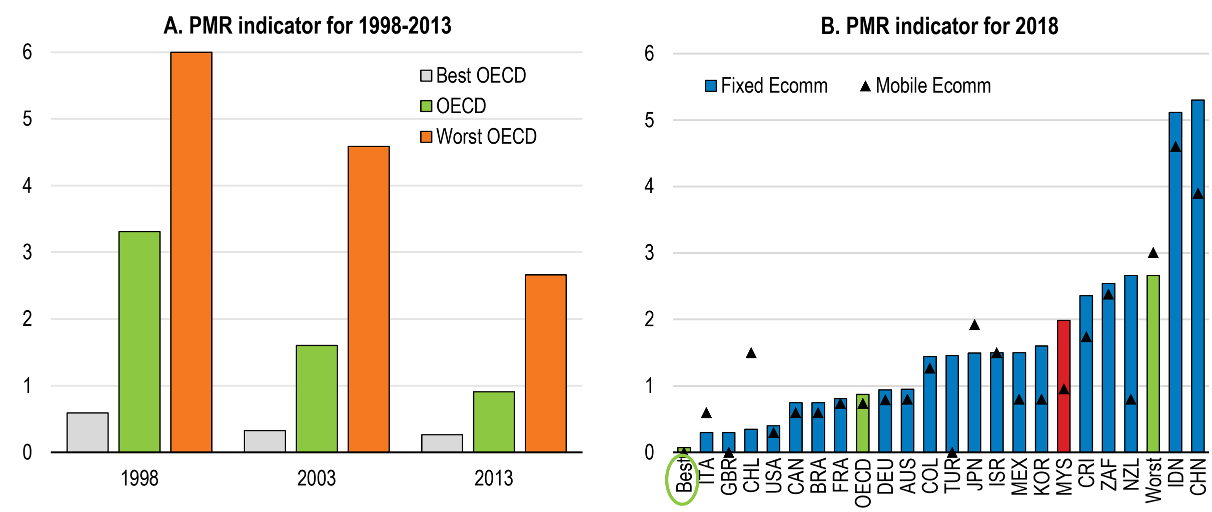
The rapid changes caused by emerging digital communication technologies have allowed competition to develop in telecommunication services markets (ITU, 2013[36]). In this light, for the past decades, although approaches differ, many countries have liberalised these markets (Figure 2.19). Competition has stimulated investment in new or upgraded infrastructure, resulting in the provision of quality services with lower prices (Record et al., 2018[17]). In Malaysia, a regulatory authority, the Malaysian Communications and Multimedia Commission (MCMC) was established in 1998 to regulate the communications and multimedia sectors and encourage competition. While reform of the mobile network market has brought substantial benefits (see above), the liberalisation of the fixed telecommunications market has relatively lagged behind, like in some other emerging market economies (Figure 2.19).

Nevertheless, reform has been implemented in phases. Although Telekom Malaysia is still vertically integrated, the Communication and Multimedia Act 1998 ensures that the provision of wholesale services is regulated to ensure access at non-discriminatory conditions to all competing operators (the retail market has been liberalised). Vertically integrated operators, including Telekom Malaysia, have been required to maintain accounting separation between their wholesale and retail activities to ensure that no cross-subsidies are possible, as the latter could distort competition and favour the incumbent. The list of services and the terms and conditions, including prices, at which these services have to be offered, have been periodically reviewed by the MCMC.

In 2018, the government included for the first time regulated wholesale prices of high-speed fixed broadband services in the list of services to which maximum price caps apply (Mandatory Standard of Access Pricing: MSAP) for the period between 2018 and 2020. *Ex ante* price regulation is applicable to the wholesale services when the market is not sufficiently competitive (ITU, 2012[37]). In Malaysia, as the market for the provision of these services was dominated by Telekom Malaysia (around 90% in 2017, (World Bank, 2019[38])), this policy change had a significant impact. The share of Telekom Malaysia in the retail market declined due to the increased competition from other operators, such as Maxis, TIME and Celcom, and the entry of Digi into the market. The average retail price of high-speed plans (above 1Gbps) fell by more than 40% in 2018, and the average speed increased threefold by early 2019 (World Bank, 2019[39]). Moreover, new wholesale service providers participated in the market. Accordingly, the market share of Telekom Malaysia appears to be declining further, although precise information is not available.

Figure 2.19. Malaysia's telecom market liberalisation has been progressing

Indicator of regulations in the telecommunications sector, index scale of 0-6 from least to most restrictive



Note: Information used to calculate the 2018 PMR indicators is based on laws and regulation in place on 1 January 2018 or a later year (1 January 2020 for Malaysia). The 2018 PMR indicators are not strictly comparable to the previous ones. Best/worst represents the OECD best/worst performing country.
Source: OECD, Product Market Regulation database and OECD-WBG, Product Market Regulation database.

StatLink https://stat.link/9mrfk3

As the timely adoption of the Malaysia Digital Economy Blueprint is expected to have a strong effect on private investment, it is crucial for Malaysia to keep expanding its digital infrastructure. Looking forward, reliance on more competition would be more conducive to stimulating investment in Malaysia (OECD, 2008[40]) (ITU, 2012[37]). As the case of the price cap measure shows, there could be further room for improvement. In the European Union, regularly reviewing wholesale markets to determine if competition is effective and ensuring that access to wholesale services is provided on a non-discriminatory basis at prices that reflect the cost of an efficient operator when competition is not yet so, are the focal points of its policy approach to ensure the development of competitive markets for telecommunication services (European Union, 2002[41]) (European Union, 2002[42]). In the United States, amid the emergence of potentially competitive similar services, such as cable TV networks, the abolition of the obligatory access to wholesale fibre networks (unbundling regulations) in the early 2000s boosted investment both by the incumbents and by new entrants (OECD, 2011[43]). In this regard, the Malaysia Digital Economy Blueprint states that the government aims to review, improve and streamline all relevant and state legislations and regulations related to digital infrastructure development (Economic Planning Unit, Prime Minister's Department, 2021[26]), which should be pursued as intended.

Online platforms continue to be an important avenue to SMEs' digitalisation

Online platforms are becoming important incentives of business digitalisation, and are growing exponentially. For example, the online retail marketplace transaction (gross merchandise value: GMV) of Sea, the largest e-commerce and digital payment platform in the region, grew at annual 87% between 2018 and 2020 from USD 3.4 to 11.9 billion (Annual Report, Sea Limited). The GMV for the delivery services of Grab, a ride-hailing and delivery services platform initially founded in Malaysia, surged by 203% annually from USD 0.6 to 5.5 billion during the same period (Investor Presentation 2021, Grab). Particularly, compared with other forms, such as firms' own websites or email, online platforms provide a powerful tool for SMEs, which have fewer resources compared with larger firms, allowing them to connect with a large customer base at low cost. SMEs selling online tend to rely on online platforms more than large firms (OECD, 2019[44]). Moreover, the importance of some online platforms, such as platforms for deliveries, has increased further during the pandemic due to the physical restrictions.

While online platforms benefit the economy, they also pose some new challenges to the current policy frameworks, particularly concerning competition policy (Box 2.6), and a number of countries are considering the revamping of their competition policy. These challenges are even more complicated in emerging market economies, including Malaysia. The abusive behaviour of online platforms could harm not only consumers but also SMEs and self-employed workers, who have fewer choices to access final consumers and less control over the collection and use of their sensitive data. This concern would be exacerbated in a country where SMEs, particularly micro-sized firms, and self-employed are prevalent, like in Malaysia. SMEs using a dominant online platform would be faced with high costs when switching between online platforms, or even could not have alternative options. This also means that they would also find it difficult to use multiple online platforms at the same time (multi-homing) due to lock-ins. Moreover, in addition to the lack of digital skills and adaptability to new business models, SMEs would have difficulties in dealing with the fee structure of online platforms and in sharing of sensitive business data. Other underdeveloped regulations, such as data and consumer protection, would add more challenges.

The online platform business is still nascent in Southeast Asia, despite its rapid expansion. For example, Amazon's market share in the US online retail market is deemed to be over 50% (Subcommittee on Antitrust, Commercial and Administrative Law of the Committee on the Judiciary, 2020[45]). Alibaba Group, a Chinese e-commerce giant, had 726 million retail customers in China for 2020, 52% of its population (Annual Report, Alibaba Group Holding Limited). On the other hand, in the case of Lazada, an e-commerce platform popular in Malaysia and an international online marketplace run by Alibaba Group, the number of retail customers was over 80 million in 2020 (2020 Investor Day, Lazada Group), 14% of the population for the ASEAN6 countries. Therefore, it is crucial to strike the right balance between nurturing the online platform business and helping consumers and businesses, notably SMEs. Giving SMEs and consumers freedom to choose or to switch between different services is crucial, which calls for securing competitive markets for online platform businesses. Moreover, since Malaysia's digital policy aims at promoting more e-commerce participation of SMEs, securing competitive online platform markets would benefit both online platform business and SMEs.

Box 2.6. New policy challenges posed by online platforms

Digital technologies bring about a number of emerging issues for competition policy, such as collusive behaviour by artificial intelligence. *Inter alia*, some major issues are pertaining to online platforms.

An online platform can be defined as a digital service that facilitates interactions between two or more different sets of users (firms or individuals) via the Internet. Online platforms cover a range of services from an online marketplace to an open innovation lab, and are becoming a linchpin of the digital economy. Online platforms provide multiple benefits through economies of scale and scope, notably a large customer base and synergy effects connecting different markets, the latter of which would call for cross-cutting liberalisation or deregulation in broader sectors to stimulate innovation, such as Fintech.

Nevertheless, online platforms pose some new challenges for competition policy. Some recently highlighted issues are:

- **Criteria for defining relevant markets and assessing market power**: As online platforms have multi-sided markets, i.e. sell-side and buy-side markets, some traditional gauges for competition, such as consumer surplus and market shares, could not be applicable straightforwardly. In order to expand its customer base in one market, a platform could maximise the user benefits of one market (e.g. providing consumers with free delivery services) to the detriment of the users in another market (e.g. firms participating in the online marketplace).
- **Competition for online platform markets**: Because of the winner-take-all or -almost nature of the online platform business, costs to switch to other online platforms become higher and a few online platforms would be likely to become dominant in the markets. Moreover, a dominant online platform may carry out acquisition of growing start-ups (not necessarily in the same market), which it considers potential threats. This would enhance the dominant position of the online platform.
- **Competition on online platforms**: On a marketplace provided by an online platform, the online platform could act both as player and as rule maker. This would give the online platform a position of great bargaining power towards its business users, which the online platform could easily abuse.
- **Access to personal data**: The larger the amount of personal data are, the more useful the data become. While collecting a large set of data is difficult for new entrants, this would give the incumbent great advantage, enhancing its dominant position further. Moreover, the superior position of the online platforms would allow them to collect the personal data of their users (consumers or firms) more easily, or in an exploitive manner in some cases, further enhancing their data power.

While competition policy would play an important role and need to be enhanced, other regulatory schemes, such as the measures to promote the transparency of dominant online platforms' business practices and the regulations on data protection and consumer protection, could also need to complement competition policy. Competition policy is more case-specific and focuses on *ex post* intervention. On the other hand, the other regulatory schemes are designed to pre-determine the behaviour of market participants.

Source: (OECD, 2019[46]), (Crémer, De Montjoye and Schweitzer, 2018[47]), (Krämer and Schnurr, 2018[48]).

In Malaysia, despite its recent establishment in 2011, the Malaysia Competition Commission (MyCC) has actively overseen online platforms. MyCC has taken several provisional or final actions against large online platforms, such as Grab in 2019 (an online ride-hailing platform) for the alleged abuse of its dominant position and Dagang Net (a monopolistic firm for online trade facilitation services), the latter of which was considered to have abused its dominant positions in the relevant markets. Nevertheless, Malaysia's competition policy framework needs to be further enhanced. The Competition Act 2010 prohibits abuse of dominance and cartels, and MyCC covers all sector except the aviation, telecommunications and energy sectors under the jurisdiction of specific laws. Nevertheless, the Competition Act has no provision on the *ex ante* scrutiny of mergers and acquisitions. Providing the competition authorities with the power to assess the impact on competition of mergers above some minimum thresholds before these mergers are authorised would ensure that Malaysia benefits from a policy tool essential to ensure that markets remain contestable and competitive. This is particularly crucial in the current economic environment, where a few online platforms have shown exponential growth across numerous markets and economic sectors.

In addition, it is also essential to strengthen other regulations complementary to each other with competition policy framework. Particularly, measures to ensure the transparency of the business practices of powerful online platforms could also be introduced. The European Union (in 2020) and Japan (in 2021) introduced regulations that require large online platforms to disclose terms and conditions of the services they offer to users and to provide prior notice of amendments to these terms and conditions. These online platforms must also provide transparency on the scope, nature and conditions of their access and use of data, including the data generated by business users through their use of the platform services, and disclose information on how they determine rankings (where relevant). In terms of data protection, in Malaysia, the government has started reviewing the Personal Data Protection Act 2010 concerning data portability and users' consent, which the European Union's General Data Protection Regulation has addressed (Department of Personal Data Protection, 2020[35]). Strengthening consumer protection related to digital transactions would benefit not only individuals but also SMEs, including self-employed workers. In Malaysia, the Consumer Protection Act 1999 was amended in 2007 to include e-commerce transactions, followed by the enforcement of the Consumer Protection Regulations for Electronic Trade Transactions in 2012. These two regulations aim to prevent deceptive and misleading or fraudulent commercial practices, while also covering online disclosures (i.e. online information provision to consumers), data protection and dispute resolution. Nevertheless, there is still room for improvement. For example, currently no scheme exists for creditors' liability claims for breaches by sellers, which is essential for e-commerce transactions. In this regard, OECD recommendations on consumer protection in e-commerce can provide useful guidance to improve overall policy frameworks (OECD, 2016[49]).

Moreover, as some large online platforms have expand their business in other Southeast Asian countries, international, particularly regional, policy cooperation and coordination, not only on competition enforcement, but also in other related policy areas, is going to become more important. Coherent frameworks at the regional level could also facilitate regional trade and help ensure larger markets for local companies, including SMEs. Some development has been seen. For example, recently, ASEAN issued policy guidelines for consumer protection in online businesses (ASEAN, 2020[50]), which is a policy area that is rather underdeveloped in ASEAN countries. Nevertheless, regional arrangements could be further enhanced, as policy ambiguity and incoherence among countries would also be an obstacle to the further evolution of online platform businesses in the region. In the case of Grab's acquisition of the Southeast Asia operations of Uber (a ride-hailing online platform) in 2018, the reactions of the competition authorities varied from country to country, resulting in the imposition of interim measures or remedies in some countries (not in Malaysia) (UNCTAD, 2019[51]). In this regard, in addition to policy dialogues, participating in trade agreements that pursue regulatory harmonisation would also be useful.

Preventing the widening gaps is utmost important

Emerging new technologies further change the form of labour. Because of new technologies, while flexible work arrangement becomes possible for those who can telework (see below), precarious jobs – the so-called platform workers or gig workers – have also increased, which calls for policy interventions to prevent the widening economic gaps. Platform workers have received increasing policy attention in many countries. Platform workers can be classified as self-employed, but have limited control over their work, like employees (Lane, 2020[52]). Although the share is still relatively small, the number of these workers was on a rising trajectory even before the pandemic (OECD, 2018[53]), and has continued increasing during the pandemic. Malaysia is not an exception. Previous survey by the Department of Statistics Malaysia suggests that, in 2018, 0.6 million (3.8% of the total employed, of which 54% are male) could be considered platform workers ("gig workers") (Nurfarahin, Noraliza and Nur Layali, 2020[54]). Although a direct comparison is difficult due to the lack of a standardised definition, the share of platform workers is likely to be higher in Malaysia than a 0.5-3.0% share of similar types of workers in some OECD countries (OECD, 2018[53]).

Some aspects of these new jobs are attractive. For example, flexible work arrangement could encourage more people to find jobs, who would otherwise stay away from the labour market. In Southeast Asian countries, online platforms have catalysed the transferring of a considerable number of drivers to deliverers during the pandemic, alleviating a job losing risk of these workers (Grab Taxi Holdings Pte. Ltd, 2020[55]). Nevertheless, platform workers are usually paid less, and are often out of formal social protection system. There is also a power imbalance between online platforms and platform workers. Digitalisation would further increase these types of workers, which could widen gaps in income and wealth among people, affecting their well-being. Therefore, strengthening policy supports, including social protection, is utmost important.

Although approaches vary between countries due to the difference in existing policies for the self-employed, some policy orientation has been evolving (Lane, 2020[52]). One way is to improve working conditions of platform workers. This includes establishing a new category of employment status for dependent self-employed workers, including platform workers, or providing platform workers with an employment status similar to that of employees. Normally, collective bargaining rights are not granted to the self-employed, as in the case of Malaysia. Nevertheless, in some European countries, independent unions already act as a *de facto* body for collective bargaining, and case-by-case considerations have been given. New York City has applied a minimum wage to platform workers. In the case of the United Kingdom, the Supreme Court gave a ruling in 2021, under which drivers working for Uber qualify for workers' rights, including the national minimum wage and paid annual leave, which are more relevant to employees (The Supreme Court, 2021[56]). As platform workers are typically considered as self-employed, enhancing policies to improve the social protection of the self-employed would be useful, and some of these measures could target platform workers. Strengthening the enforcement of existing regulations (tax payment, social security contribution and labour regulations) is also be crucial.

In Malaysia, the social security protection of the self-employed has evolved in past years (see Chapter 1). Since its introduction in 2017, the Self-Employment Social Security Scheme (SPS-SOCSO) has been compulsory for the self-employed in the passenger transportation sector, which covers e-hailing drivers, in addition to taxi and bus drivers. The occupational coverage has been expanded progressively. Another scheme (i-Saraan) was also introduced in 2018 to encourage self-employed workers to participate in the pension fund, the Employees Provident Fund. On top of this, during the pandemic, the government has reacted fast, focusing on platform workers (gig workers). Amid the increasing accident risk of deliverers, in the Short-Term Economic Recovery Plan (PENJANA) announced in June 2020, the government prepared matching grants to encourage these platform workers to participate in the SPS-SOCSO (Penjana Gig). In this scheme, the government subsidised 70% of contribution, while platform workers or online platforms contributed the rest 30%. In the 2021 Budget, the Penjana Gig programme has been replaced with a new programme, an SPS Lindung targeting delivery riders, in which the government contributes 100% (until December 2021). Nevertheless, these measures introduced during the pandemic are temporary.

Looking ahead, while these efforts have been useful, a more comprehensive approach would be needed in Malaysia, as is stated in the Malaysia Digital Economy Blueprint. For Southeast Asian countries, at online platform businesses are still developing and will help their economic advancement, pursuing better collaboration with online platforms would also be important. In this regard, the first priority for Malaysia would be to strengthen the social protection schemes, including pension, to expand its coverage of the self-employed (see Chapter 1). Encouraging the registration of more self-employed workers into social protection system with the help of online platforms could also help reduce economic informality. In Estonia, the tax authorities pre-fill tax forms of drivers by obtaining financial transaction information from passenger transport platforms, which also reduces the administrative burden for drivers.

As platform workers are more likely to be out of the labour force easily or become informal sector workers, in addition to providing training opportunities, introducing universal social protection covering non-workers could be considered in the medium term. For up- and re-skilling programmes, the Global Online Workforce (GLOW), was introduced in 2018 to train people, particularly the unemployed and graduates who cannot find their jobs, for digital skills necessary to become skilled freelancers. Nearly 55 000 people have been trained. In addition, a range of digital skills programmes, which also cover or target unemployed people or job seekers, have been provided through the MyFutureJob portal launched in 2020, such as Digital Skills for Tomorrow Jobs and MySTEP Program 2021. Nevertheless, while Malaysia has a universal healthcare system, currently the pension schemes do not cover all private sector workers as well as non-workers. A voluntary defined contribution scheme, the Private Retirement Schemes, was launched in 2012 with tax relief to contributors, but despite the recent rapid increase, the number of contributor was 416 913, 4% of working-age population in 2018 (301 279 in 2017) (Press release, Private Pension Administrator Malaysia, 15 January 2019). In this regard, it would be useful to consider a matching grant scheme, adopted in some other emerging market economies, to expand the coverage of pension.

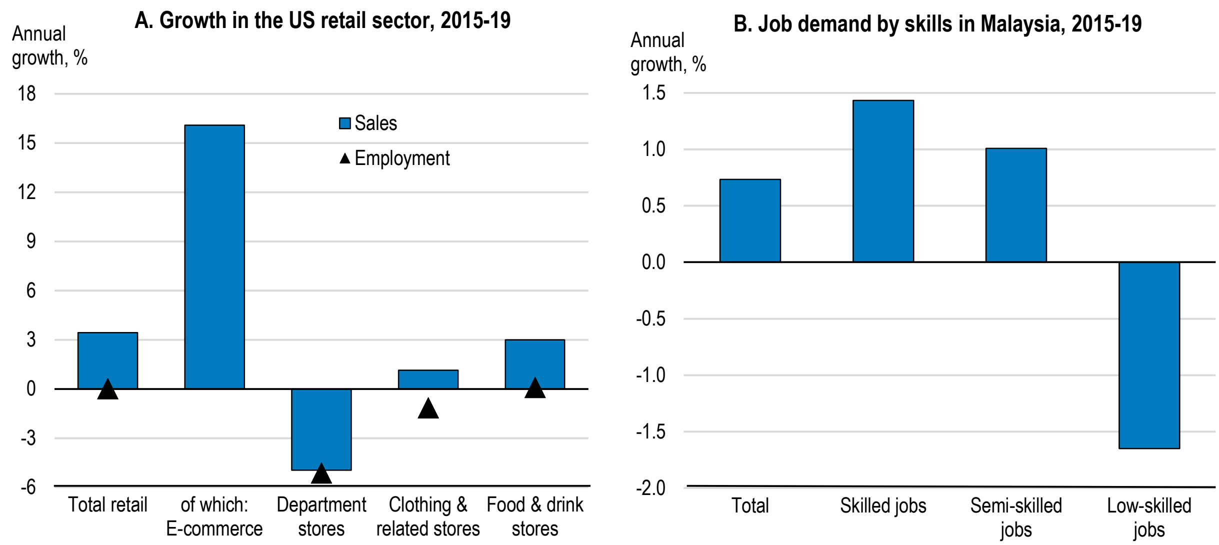
The pandemic has accelerated the transition to new forms of working

The COVID-19 crisis is accelerating the transition to new working arrangements in Malaysia and other countries. Despite the stagnant labour market, demand for skills specialised in new technologies is buoyant. The crisis has also brought about a huge disruption in the way of working – teleworking has been prevalent at unprecedented levels during the lockdown periods, as Malaysia has imposed severe stay-at-home restrictions. Once the pandemic is contained, the use of teleworking will decline, but more businesses and workers are getting used to it. Therefore, it is essential for Malaysia to harness the potential of teleworking in order to improve the well-being of workers and unleash their innovative capacity.

Demand for higher skills will further intensify after the pandemic

Emerging new technologies already changed working arrangements before the pandemic. In the US retail sector, the shift from bricks-and-mortar to online sale has reduced labour demand in some sub-sectors mostly relying on physical facilities (Figure 2.20), but it increased demand for skills, such as data analysts or supporting services jobs for e-commerce. Automation also reduces the demand for low-skill workers. In emerging market economies in Asia, including Malaysia, together with rising costs of labour, the availability of new technologies has reduced the demand for routine manual jobs among factory workers, while creating new demand for highly skilled jobs in the same manufacturing sector (Asian Development Bank, 2018[57]). Amid these new emerging technologies, Malaysia has undergone the transformation of its industrial structure from manufacturing to services. Accordingly, demand for skilled workers grew faster than for semi- or low-skilled workers in the past years (Figure 2.20), although faster growth in the supply of tertiary graduates than demand has caused some mismatch in the labour market.

Figure 2.20. Technology advance has changed the landscape of jobs



Note: DOSM classifies jobs offered according to their occupational categories. Skilled jobs are composed of managers, professionals, and technicians and associate professionals. Semi-skilled jobs cover clerical support workers, service and sales workers, skilled agricultural, forestry, livestock and fishery workers, craft and related trades workers, and plant and machine operators and assemblers. Low-skilled jobs correspond to elementary occupations.
Source: US Census Bureau, Annual Retail Trade Survey; US Bureau of Labour Statistics, Current Employment Statistics; DOSM, Quarterly Employment Statistics.

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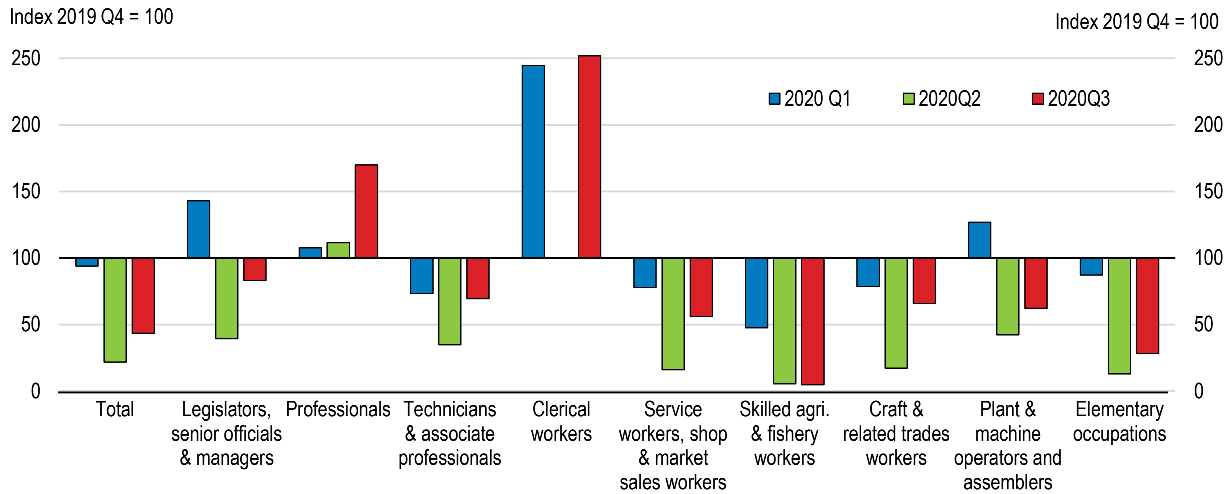
Strong demand for skilled jobs has not receded during the pandemic, and it is likely to increase further once the sanitary situation normalises. In Malaysia, even in Q2 and Q3 2020, when the COVID-19 pandemic was most severe, the demand for skilled workers was less affected than for other occupations, except for clerical workers, who are semi-skilled and saw strongest demand partly due to temporary reasons related to the pandemic, such as demand for the medical and logistics services (Figure 2.21). Looking ahead, some employers in Southeast Asian countries foresee a more drastic shift in job demand (Figure 2.22). While some jobs requiring more advanced knowledge and skills in information technologies, such as data analysts, are expected to increase in the coming years, factory engineers and logistics specialists would see less demand.

Figure 2.21. Demand for skilled jobs was robust during the pandemic

Job vacancies by occupations



Source: Bank Negara Malaysia, Monthly Highlights and Statistics in January 2021, Table 3.5.12.

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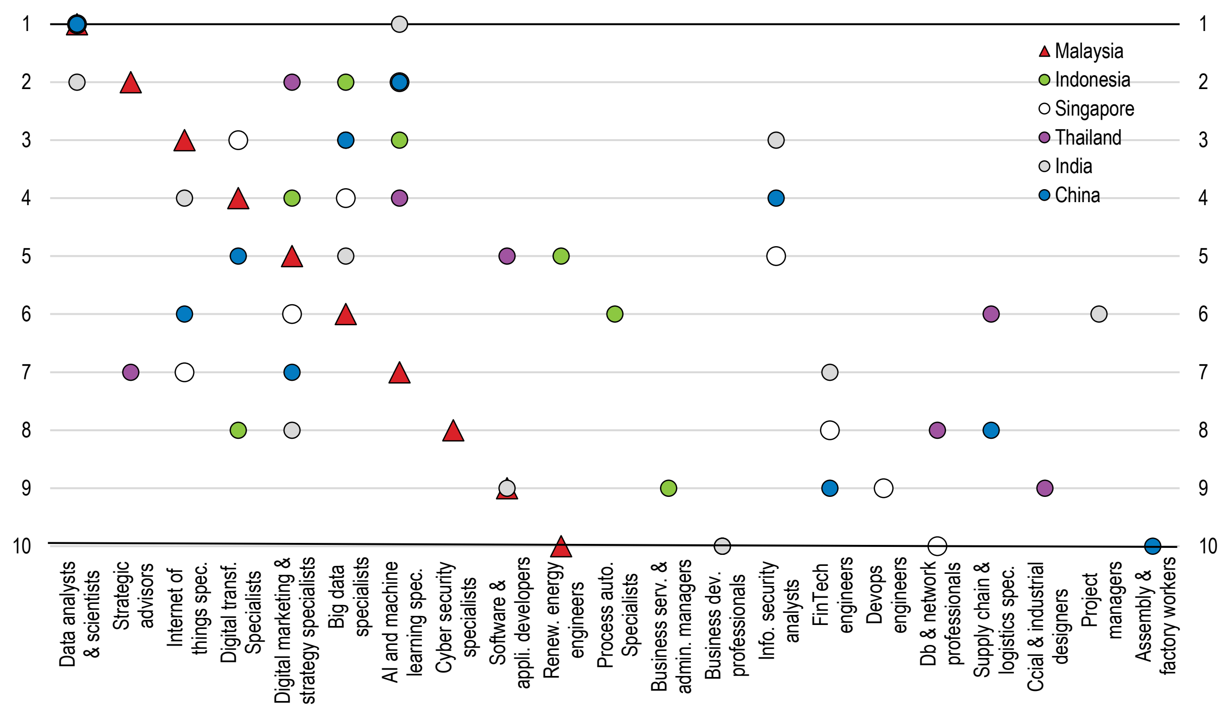
Figure 2.22. Demand for high digital skills would continue to increase

Jobs expected to be in increasing demand by 2025, score by decreasing order of importance



Note: Survey respondents are senior executives in charge of human resources, strategy and innovation departments of large companies with more than 100 employees.
Source: World Economic Forum (2020), The Future of Jobs Report 2020, October, http://www3.weforum.org/docs/WEF_Future_of_Jobs_2020.pdf.

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The faster shift in job demand calls for policy intervention to equip workers with digital skills. In Malaysia, the government introduced a range of policy measures to upgrade workers' skills even before the pandemic. Its notable scheme, the Human Resource Development Corporation (HRD Corp), to which employers contribute, provides training opportunities for their workers through private contractors, including those to improve digital skills. A grant is provided for employers to organise in-house or external training courses (Skim Bantuan Latihan (SBL)). Employers undertaking digital transformation can apply for the Purchase of Training Equipment and Setting up of Training Room scheme (ALAT), which subsidises them for training facilities and equipment. In addition to the HRD Corp programmes, eRezeki provides people from the bottom 40% income group with opportunities to develop basic digital skills, and eUsahawan provides training courses for entrepreneurs through community centres, public education institutions and an online learning platform (Go-eCommerce) (see above). In June 2020, the government adopted the National Economic Recovery Plan (PENJANA) to revitalise economic growth. Under PENJANA, a number of up- and re-skilling programmes have been introduced by the HRD Corp. Among them, the Industrial Revolution 4.0 (IReV 4.0) specifically aims to support employers in training their workers for digital skills, although the uptake is still relatively small (3 259 as of March 2021).

In addition to acquiring or updating digital knowledge, improving cognitive and non-cognitive skills would become more important in the age of the rapidly changing digital technologies. These skills include a range of soft skills, from critical thinking to social and emotional skills (OECD, 2019[58]). In Malaysia, a significant share of employers expressed the difficulties in finding skilled workers amid the emerging importance of these cognitive skills, such as problem-solving, analytical and critical thinking skills and creativity (OECD, 2019[59]). While soft skills can be enhanced through curricular and extra-curricular activities in the education system, these skills can also be developed further during working life. Therefore, lifelong learning policies need to include the development programmes for these skills, such as oral communication, leadership and mentoring programmes for young workers. In Malaysia, the HRD Corp has also developed the assessment of necessary skills and competencies for detailed occupation categories, the Industrial Skills Framework (IndSF), with the aim of helping employers, employee and training providers understand the latest development in skills in need. The skill sets described in the IndSF cover a range of soft skills, such as "social intelligence and ethics" and "learning to learn", expected to become important for each occupation. This provides good guidance to all stakeholders, including training providers, and could be updated regularly.

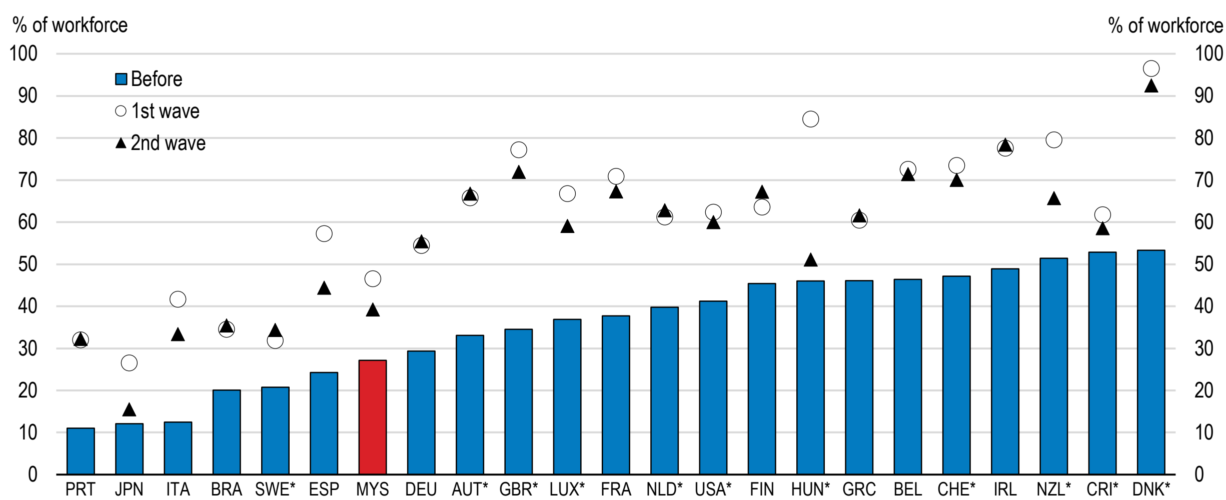
Preparing a better working environment is crucial – lessons from forced teleworking

Teleworking can be defined as working remotely by using ICT tools, but not in office premises, irrespective of its regularity. Teleworking is one form of technology influence on job, i.e. the future of work. Although the exact benefits of teleworking during and post pandemic have not been qualified yet, previous work showed that productivity can increase under certain conditions and for certain activities (Bloom et al., 2015[60]). In the United Kingdom, workers found that their productivity improved with teleworking during the pandemic (Taneja, Mizen and Bloom, 2021[61]), while in Japan employers reported the decline of productivity (Morikawa, 2021[62]). Such differences across countries suggest the importance of conditional factors to maximise the benefits from teleworking, such as ICT infrastructure, managerial styles and working culture. Indeed, teleworking could boost and worker welfare if well organised (OECD, 2020[63]). On one hand, teleworking could improve worker satisfaction and efficiency, raising firm performance. Teleworking can also contribute to overall cost reductions. On the other hand, teleworking could decrease worker efficiency through reduced opportunities of knowledge exchange and experience sharing at in-person meetings, which are more effective than remote or online communication. Teleworking could also reduce the efficacy of managerial oversight. The pandemic was an exceptional occasion on which regular teleworking was adopted across the economy – a kind of large-scale social experiment. The experience of teleworking during the pandemic, although one-off, shows some weaknesses in the current working and digital environments in Malaysia, but also reveals high potential of its technology adaptability. Therefore, it would be useful to derive policy lessons from the experience during the pandemic.

Similar to some other countries, before the pandemic, teleworking was less prevalent in Malaysia. According to a Telework Survey (the Survey) conducted for this report, in cooperation with the OECD Global Forum on Productivity and the Malaysia Productivity Corporation, around 30% of workers teleworked regularly before the pandemic among surveyed firms (Box 2.7) (Figure 2.23). Responding to the first large outbreak of COVID-19, the government imposed in March 2020 the Movement Control Order (MCO), which restricted overall mobility of people with a strict stay-at-home restriction. Nearly additional 20% of workers in Malaysia were forced to work from home during the initial wave of the pandemic, according to firms that responded to the Survey (Figure 2.23), which is similar to European countries, where larger sample surveys also shows the increased in the share of teleworking workers by 10% to 30% during the pandemic (OECD, 2021[64]). After flattening the first wave of infections, the restrictions were relaxed in mid-2020. Since late 2020, because of the resurgence of the outbreak, the restrictions have been gradually tightened in a wider area of the country, although more targeted in areas and in sectors than in early 2020. Accordingly, a still large but less significant share of workers (additional 10% of workforce compared with the pre-pandemic level) were forced to work from home once again in early 2021. The similar trend was observed from other data sources (Figure 2.24).

Figure 2.23. The pandemic has forced many workers to telework

Share of regular teleworkers



Note: Data show the percentage of respondents answering that they regularly telework (at least once a week). * denotes countries with less than 50 respondents. The results for other countries than Malaysia are preliminary.
Source: OECD (2021), Telework Survey, Global Forum on Productivity (forthcoming).

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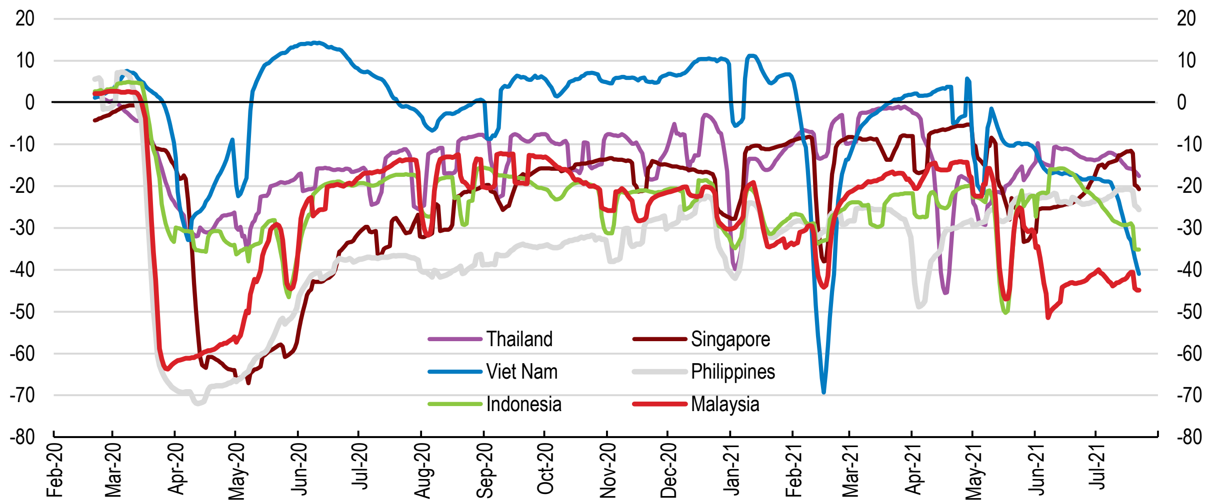
Figure 2.24. Southeast Asian countries have experienced work from home during the pandemic

Percentage change of movements to workplaces from baseline, average of past 7 days



Note: The baseline is the median value, for the corresponding day of the week, during the five-week period January 3-February 6, 2020.
Source: Google LLC, "Google COVID-19 Community Mobility Reports", google.com/covid19/mobility.

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Taking into account the strict restrictions adopted in Malaysia (see Chapter 1), the share of teleworking workers appears relatively small. Even during the first wave in early 2020, some essential businesses, such as financial institutions were allowed to open. The gap between the stringency of the restrictions and the prevalence of teleworking also suggests that some workers could not work from home because of constraints, such as the lack of necessary digital facilities, skills of either employers or employees, or any other conditions, such as the lack of space and being merely less prepared for teleworking. Moreover, given the small representation of SMEs in the Survey respondents, the actual share of teleworkers would be smaller than these numbers. Nevertheless, the protracted public health crisis would change people's behaviour and preference more rapidly than anticipated from the past trends or shown by the Survey results. From mid-May 2021, because of the intensified infections, the government re-imposed stricter restrictions on the mobility of people (the Movement Control Order 3.0), under which 40% of private sector employees and 80% of government employees must work from home (the Survey does not cover this period). In addition, the stay-at-home measure resumed from the beginning of June 2021. While restrictions for compulsory teleworking would inevitably facilitate the adjustment and adaptation in the business sector, the findings from the Survey would provide useful information for policy making.

Box 2.7. Telework Survey of the OECD Global Forum on Productivity for Malaysia

The OECD Global Forum on Productivity carried out a teleworking survey in Malaysia from March to May 2021, with the help of the Malaysia Productivity Corporation, a statutory body under the Ministry of International Trade and Industry. As the same surveys were conducted in other countries, thanks to the support of the Business and Industry Advisory Committee (BIAC) and the Trade Union Advisory Committee (TUAC) to the OECD, OECD networks of employer and employee associations, its result provides useful information for cross-country comparison. The Survey asked the use of regular teleworking before, during and after the pandemic, its perception, and obstacles to teleworking. Self-employed workers are not included.

The survey questionnaire was sent out to managers and workers of firms through business associations and labour unions in Malaysia, and received high participation rates (128 respondents for employers and 151 for employees) (Table 2.2). Although detailed profiles of most firms that respondents belong to are not obtained, the share of SMEs, which account for a large part of businesses in Malaysia, would be relatively small in the Survey.

The Survey was carried out to collect illustrative evidence and was not meant to cover a large representative sample of the whole population of firms. Its primary usefulness lies in uncovering patterns related to the opinions and experiences of telework during the pandemic and the expectations for the future and how these vary for different groups involved (managers and workers).

Table 2.2. Composition of respondents

	Manager survey	Worker survey
Total respondents	128	151
Firm size (employees), share		
- 75	27%	12%
76 – 200	10%	3%
201 -	13%	35%
Unknown	51%	50%

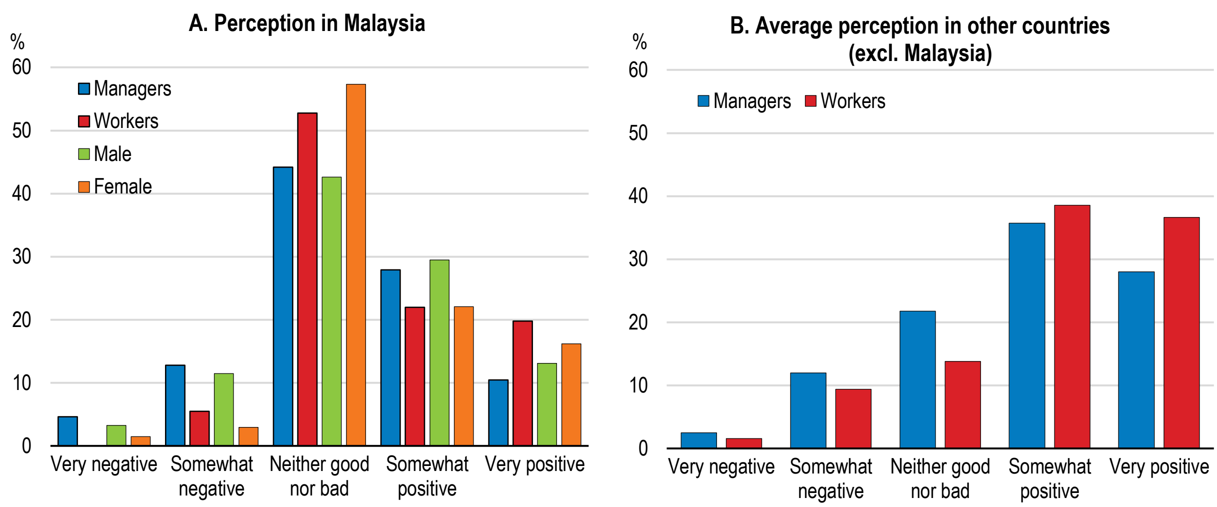
Source: OECD, Telework Survey, presentation at the 2021 Annual Conference of the Global Forum on Productivity, https://www.oecd.org/global-forum-productivity/researchandimpact/human-side-of-productivity/.

Preparing enabling conditions for teleworking is important after the pandemic

According to the Survey, while around 20% of employees have a very positive view on teleworking, higher than that of employers, a large share of the Malaysian employees and employers consider the teleworking experience during the pandemic as neither positive nor negative (Figure 2.25). This contrasts with the perception in other countries, where on average 60-75% of employers and employees conceive teleworking somewhat or very positive. While it is difficult to detect the cause of this difference, as teleworking was less prevalent in Malaysia before the pandemic, to some extent, people were likely to be less used to teleworking than in other countries. In addition, some other conditions specific to the pandemic but not related to teleworking itself, such as, the severe restrictions on daily living (e.g. people were not allowed to go out freely to purchase staples), would affect people's general perception. Nevertheless, only a small share of employers deem teleworking negative or very negative, and that of employees is much smaller, which implies that there are some trade-offs and un-met conditions for teleworking. This suggests that if these obstacles to teleworking were removed, people's perception could improve.

While a certain share of male employers and employees found that teleworking was a negative experience, more females considered it neutral, and less female employers and employees found it negative or very negative (Figure 2.25). Nevertheless, the perception difference is rather small between males and females. This implies that there would be more universal reasons behind these perceptions, such as the lack of digital skills and broader work conditions, including labour regulations, working culture or housing environments (e.g. less working space at home). In European countries, these conditions would have some influence on the difference in the prevalence of teleworking even before the pandemic (Milasi, González-Vázquez and Fernández-Macías, 2021[65]).

Figure 2.25. A number of managers and workers have positive views on teleworking



Note: Percentage of respondents replying to a question on telework experience during the pandemic from the perspective of "overall performance of the company" for managers and "work-life balance and wellbeing" for workers.
Source: OECD, Telework Survey, presentation at the 2021 Annual Conference of the Global Forum on Productivity, https://www.oecd.org/global-forum-productivity/researchandimpact/human-side-of-productivity/.

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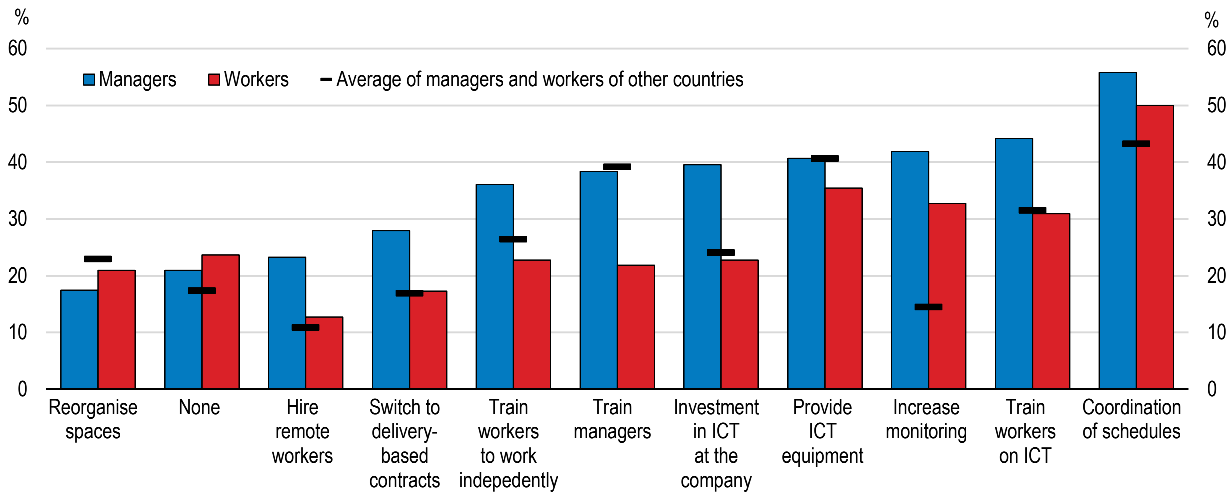
As a number of employers considered teleworking during the pandemic as a negative experience for their businesses, it would be useful to look into more details. The Survey respondents expressed that, like other countries, in Malaysia, schedule coordination is considered as one of the major difficulties in organising teleworking, followed by the lack of digital equipment and skills among employees (Figure 2.26). Particularly, although the shares of employees encountered these difficulties are broadly smaller than those of employers, the gap is smaller for the provision of digital equipment, which implies that this could be one of the most important bottlenecks for teleworking in Malaysia. Moreover, compared with other countries and also employees in Malaysia, a larger share of employers think it important to improve employees' digital skills, managerial oversight (to reduce the increasing monitoring costs) and digital investment at their companies. The lack of these conditions could also explain the lower prevalence of pre-pandemic teleworking compared with other countries. SMEs account for a large share in employment (65% in 2015, Economic Census 2016, DOSM) in Malaysia, and both employers and employees of SMEs are likely to have less resources to adopt the sudden forced teleworking. For SMEs, allocating resources to manage their employees working remotely would entail significant costs, especially if employers also need to work remotely. Therefore, these results imply that the actual situation would be more cumbersome for most of businesses.

Figure 2.26. Managers find many obstacles to teleworking

Necessary organisational changes for teleworking, % of respondents



Note: Percentage of respondents replying to the question "what types of organisational changes and HR management practices would you find useful to introduce to better accommodate teleworking?" (Multiple options possible).
Source: OECD, Telework Survey, presentation at the 2021 Annual Conference of the Global Forum on Productivity, https://www.oecd.org/global-forum-productivity/researchandimpact/human-side-of-productivity/.

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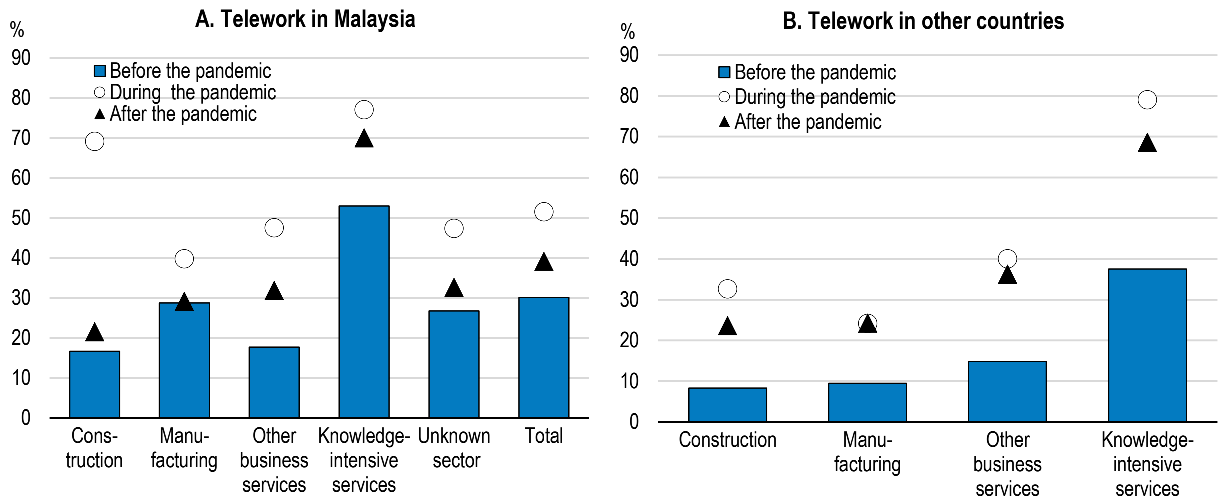
Looking ahead, promoting teleworking itself is not a priority, but it is essential that teleworking remains an available option to both employers and employees in Malaysia. In this regard, during the pandemic, while some sectors found a certain degree of difficulties in practicing their management and jobs remotely in an efficient way, others did well. According to the Survey, in Malaysia, for the knowledge intensive services sector, a higher share of responding firms practiced teleworking regularly (at least once a week) during the pandemic, and they look for continued teleworking after the pandemic, which shows a similar tendency to other countries (Figure 2.27). The respondents from the other business services sector expect a slight decrease in the use of teleworking compared with the during-pandemic level, and employers from manufacturing are likely to be reluctant to continue regular teleworking. While these gaps are to some extent caused by inherent difference of business operations in each sector, the weak expectation for teleworking among these sectors compared with the actual adoption during the pandemic shows a stark contrast with the prospect in other countries, where many surveyed firms expect the continuation of teleworking almost at the same as the during-pandemic levels. This implies that the conditions preventing the practice of teleworking before the pandemic would persist after the pandemic. This is also consistent with the positive perception revealed by both employers and employees about the forced teleworking during the pandemic in other countries. In addition, there may be other obstacles to teleworking for less digitally equipped sectors, such as the accommodation and food services, which would be exacerbated by the prevalence of SME in these sectors.

Figure 2.27. Pandemic-induced teleworking will not continue in Malaysia while other countries will

Share of workforce teleworking



Note: The number of observations for Malaysia's construction sector is less than 10. Knowledge-intensive services include IT, finance and professional services. Other business services include wholesale and retail trade, hotels, restaurants, transport and other services.
Source: OECD, Telework Survey, presentation at the 2021 Annual Conference of the Global Forum on Productivity, https://www.oecd.org/global-forum-productivity/researchandimpact/human-side-of-productivity/.

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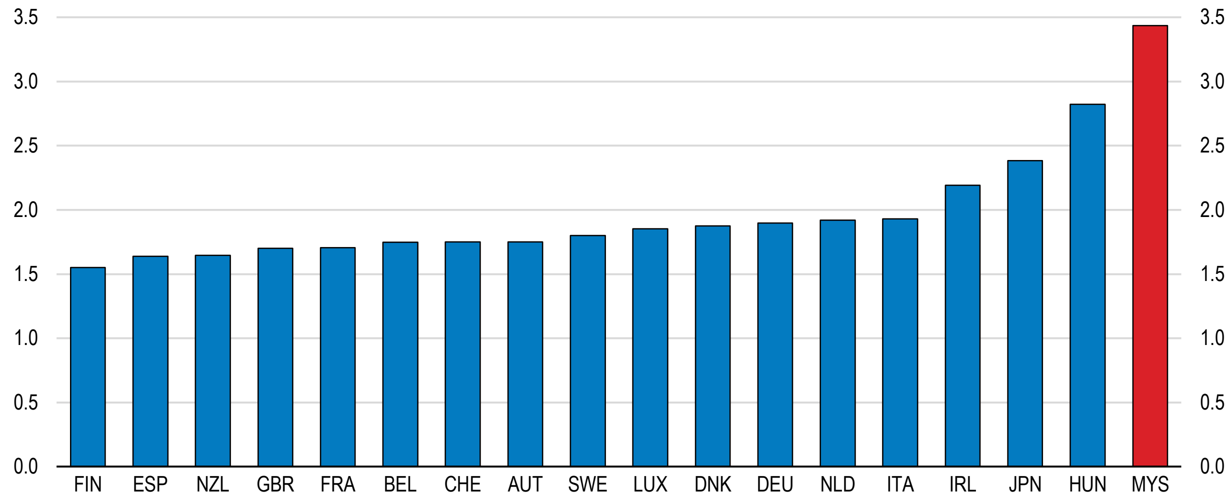
The existing gap between those who can make the most of teleworking and those who cannot would persist or even widen if no policy intervention were undertaken. Therefore, for Malaysia, it would be crucial to remove hindrances to teleworking so that the negative perception during the pandemic does not prevent further adoption of remote work practices. In this regard, in a relief package announced in June 2020 (Short-Term Economic Recovery Plan (PENJANA)), the government included measures to support the adoption of teleworking, such as tax incentives, for both employers and employees, to help the purchase of digital equipment. In addition, the Social Security Organisation (SOCSO) has expanded the social security coverage to teleworking (injuries occurred during teleworking will be covered). These measures are appropriate and timely. Nevertheless, these measures could be enhanced and more targeted toward SMEs and the self-employed in less adopting sectors. Moreover, improving infrastructure is more acute for Malaysia, as a significant share of respondent employers consider it not sufficient (Figure 2.28). The government needs to facilitate investment in digital infrastructure according to the Malaysia Digital Economy Blueprint, with the view of stimulating private investment (see above).

Some countries aim at using teleworking as a tool to facilitate reforms. For example, Ireland adopted in March 2021 an “Our Rural Future” blueprint to promote rural development after the pandemic, so that more people could relocate to rural areas and work remotely (Department of Rural and Community Development, 2021[66]). The government plans to establish a network of more than 400 remote working hubs, provide tax incentives for remote working both of individuals and of businesses, and roll out high-speed broadband. Other countries, such as Italy, have adopted specific laws for teleworking to secure similar work conditions for teleworkers to office premises, which cover flexible work arrangement and employers’ responsibility of providing necessary ICT tools (ILO, 2020[67]). In the case of Malaysia, teleworking could be useful to improve work conditions, particularly for female workers, which would increase their labour force participation (see below). Teleworking would also be conducive to facilitating the transformation of the Malaysian economy to a service-oriented one, as knowledge intensive services are more adaptable to the new form of work practice.

Figure 2.28. Digital infrastructure is a major obstacle to teleworking in Malaysia

ICT infrastructure as preventing factor, score from 1 to 5



Note: Average score of respondents replying to the question on whether or not "no access to appropriate ICT infrastructure" will prevent wider use of telework after the crisis at respondents' company. Respondents choose the appropriate number from 1 (not important at all) to 5 (very important).
Source: OECD, Telework Survey, presentation at the 2021 Annual Conference of the Global Forum on Productivity, https://www.oecd.org/global-forum-productivity/researchandimpact/human-side-of-productivity/.

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Female workers could benefit more from teleworking

Teleworking would also be supportive of female workers to improve their work-life-balance. The Survey shows that fewer female employers and employees found teleworking negative than male did, although slightly (Figure 2.25, Panel A). Moreover, similar to some other Asian countries, in Malaysia, a family member, often woman, tends to look after regularly a child or a sick, elderly or disabled person, which is one of the obstacles to continued job careers for females. In this regard, teleworking would allow women to stay in the labour force, improving their economic and social opportunities, as teleworking could provide more flexible work conditions, in addition to its direct impact of reducing commuting time. According to a UNDP survey on teleworking in Malaysia (the survey cover the self-employed), during the first wave of infections in early 2020, working parents with childcare responsibilities found their quality of life better off while teleworking, although less so for female parents (61% improved and 27% worsened for male; 54% and 33% for female,) (UNDP, 2020[68]). Moreover, more female workers felt that domestic duties became easier (50%) than more difficult (34%) due to teleworking, although less salient for aged 35-44 (45% and 40%).

Teleworking could expand the possibility of flexible work arrangements, which could improve the work conditions for females. For example, remote work could make it easier to organise staggering working time. In Malaysia, the government has long promoted flexible work arrangements. Accordingly, a number of firms (48% of the responding firms in a TalentCorp survey) already offered their workers flexible working time arrangements to improve their work-life-balance, particularly for female workers, but only 22% adopted the staggering time regime (TalentCorp, 2018[69]). Moreover, broader flexible work arrangements have not yet been prevalent, such as compress or reduced work period arrangements. Continued adoption of regular teleworking after the pandemic could help a more use of flexible work arrangements. In this regard, during the pandemic, the government further encouraged businesses to utilise the pandemic as an opportunity to facilitate the changes in their work arrangements (TalentCorp, 2020[70]).

In addition to these encouragements, the government could strengthen the measures targeting workers. Nevertheless, these policy measures should not fixate the domestic role (or burden) of female workers (Ng and Jin, 2000[71]). Skills training on broader digital skills, including those for teleworking, would be more preferable than tax incentives to teleworking targeting female workers. More provision of childcare facilities and services is also crucial (see below). Since the establishment of the Ministry of Entrepreneur and Cooperative Development (MECD) in 1995 and the Ministry of Women, Family and Community Development (MWFCD) in 2001, Malaysia has promoted female entrepreneurship, providing a range of financial support and training schemes, such as MySMELady (financing), TemanNita (financing) and the Successful Women Entrepreneurship Engagement Talent (SWEET) programme (training, financing and business matching). The measures to support the teleworking of female workers, such as skills training and childcare facilities, would also be conducive to stimulating female entrepreneurship.

Particularly, the availability of childcare services is still limited in Malaysia. Between 2014 and 2019, the number of childcare centres increased from 3 760 to 4 933, but only 1% of children aged 0-4 were registered at these facilities in 2019 (Children Statistics 2020, DOSM). As the government considers that high costs and scarcity of childcare services are important obstacles to a further increase of female labour force participation irrespective of the adoption of teleworking (Economic Planning Unit, 2018[72]), it has stepped up the policy efforts. The government has offered financial incentives to encourage both public and private employers to provide on-site childcare facilities for children of their employees. For example, the 2021 Budget includes a matching grant of MYR 20 million for private companies. The subsidy and incentive schemes could be further enhanced to help more employers set up childcare facilities.

Moreover, in Malaysia, teleworking is often considered as a synonym of work from home. Nevertheless, in some other countries, amid the COVID-19 pandemic, more attention has been given to different types of remote work. For example, satellite offices (teleworking from an office nearby home) could help mitigate some constraints, such as limited working space at home, in Malaysia.

While teleworking could raise worker satisfaction, work efficiency would also decrease because of less frequent in-person interactions, which weaken knowledge exchange. Worker satisfaction would also decrease due to solitude and hidden overtime. While teleworking in early 2020, an almost equal share of female non-childcare givers felt that their productivity increased or decreased (36% and 34%), although more felt decreased for childcare givers (35% and 41%) (UNDP, 2020[68]). If teleworking becomes regular practice, particularly for female workers who would be likely to prefer it, it would help develop digital skills necessary for teleworking. Nevertheless, teleworking could hamper the development of their soft skills, which can be trained through daily in-person interactions. As developing soft skills takes time, female workers, who stay in the labour force by practicing telework to reconcile their dual or triple duties, should be given more opportunities to train these skills (see above).

Table 2.3. Table of Recommendations

MAIN FINDINGS	RECOMMENDATIONS (Key in bold)
Fostering a better business environment	
Despite several important reforms, registering a new business is still burdensome and fragmented.	**Enhance the coordination among ministries and agencies by integrating and streamlining the business registration system.** Further streamline registration requirements, including removing the mandatory requirement to appoint a Companies Secretary.
The process for obtaining the necessary permits and authorisations for a new business is burdensome.	**Improve the usability of the existing one-stop-shop mechanisms for business authorisations, by widening the number of participating agencies.** Consider introducing a "silence is consent" rule to foster administrative efficiency.
The insolvency regime may be acting as a disincentive for entrepreneurs.	**Strengthen the insolvency scheme further, by improving debtors' access to credit and widening creditors' participation in the restructuring process.**
The recently introduced measures to simplify the regulatory environment are not universally and systematically implemented across all ministries and agencies.	**Ensure adequate and inclusive consultation which fully involves non-business stakeholders, with more systematic adoption of public consultation guidelines.** Review oversight arrangements to promote more systematic adoption of regulatory management policies. Ensure easier access to online legislation and regulations, including at the state and local levels. Strengthen *ex post* review of legislation in line with OECD best practice, including the use of sunset clauses and the introduction of a one-in-one-out rule to drive efforts to reduce the volume of regulations.
Private investment was weak even before the pandemic.	Reduce unilaterally restrictions on FDI, particularly in the services sectors.
Several restrictions persist in Malaysia's transport services, which may inhibit competition and the development of new firms.	Develop a clear timeline for implementation of the reforms identified in the National Transport Master Plan.
Professional services are subject to relatively strict restrictions on their conduct, including regulated fees and limited options for legal form.	Consider measures to provide additional operational freedom to professional services firms, including more flexibility in legal form and inter-professional collaborations. Review the use of regulated fees across professional services.
The retail sector is subject to a number of burdensome regulations, including broad ranging anti-profiteering regulation and differential treatment of foreign suppliers.	Review the impact of the Price Control and Anti-Profiteering Act. Promote wider awareness and stricter enforcement of the Competition Act to limit anti-competitive practices in the retail sector. Level the playing field between domestic and foreign retailers by amending the Guidelines on Foreign Participation in Distributive Trade Services.
Accelerating business digitalisation	
Digital uptake is picking up, but remains low among SMEs, particularly e-commerce participation, while the productivity gap between firms that use digital tools and firms that do not use them is large.	**Provide support programmes to promote the uptake of digital tools, including basic ones, such as computer and the Internet, particularly targeting older SMEs.** Promote further SMEs' participation in all ranges of e-commerce (B2B, B2C and B2G).
Skills development opportunities are scarce for SME workers.	**Strengthen training programmes of basic digital skills for employers and employees of firms, in particular micro- and small-sized enterprises with less than ten workers.**
Despite the long-standing progress in trade liberalisation, some services sectors, such as computer services, are still relatively restricted.	Pursue further opening up of services markets, through participating in ambitious trade agreements or unilaterally, with more emphases on the mobility of skilled foreign workers and digital data.
Subscription of fixed broadband is increasing, but still relatively low.	**Implement the Malaysia Digital Economy Blueprint as planned, by reviewing, improving and streamlining all relevant and state legislations and regulations related to digital infrastructure development.**
Amid the flourishing business of online platforms, new policy challenges have been evolving, such as their abuse of dominant market power. Nevertheless, policy frameworks are underdeveloped.	**Revise the Competition Act and the Competition Commission Act to provide the competition authorities with oversight of mergers and acquisitions.**

MAIN FINDINGS	RECOMMENDATIONS (Key in bold)
There are more platform workers, but most of them are not covered by the current social protection scheme.	Expand the coverage of Malaysia's employment safety net provided by the Social Security Organisation (SOCSO) to more self-employed workers. Enhance training programmes for the unemployed. Consider establishing a universal pension scheme in the medium term.
Preparing for the coming future of work	
Digitalisation has accelerated the change in demand for jobs from routine to non-routine jobs, which requires more soft skills, rather than mere knowledge.	Enhance the provision of up-skilling programmes of soft skills to adults.
Both employers and employees consider the lack of skills and equipment, including digital investment, as obstacles to teleworking, and firms in most sectors do not anticipate regular teleworking after the pandemic is over.	**Enhance the financial support to firms and workers to help them acquire necessary equipment and investment in case they wish to telework but do not have adequate resources to conduct it.** **Provide more ICT training opportunities to workers to help them acquire necessary skills to practice teleworking.**
Female workers feel better off by practicing teleworking.	Promote further the flexible work arrangement, which will be conducive to regular teleworking and *vice versa*. Enhance training programmes of ICT skills necessary for teleworking, targeting female workers.
The lack of adequate digital infrastructure is considered a major obstacle to teleworking in Malaysia.	**Accelerate investment to upgrade digital infrastructure, such as in 5G and fixed broadband.**
High costs and the limited availability of childcare services are important obstacles to a further increase of female labour force participation.	Enhance the subsidy and incentive schemes to encourage more employers to provide childcare facilities.

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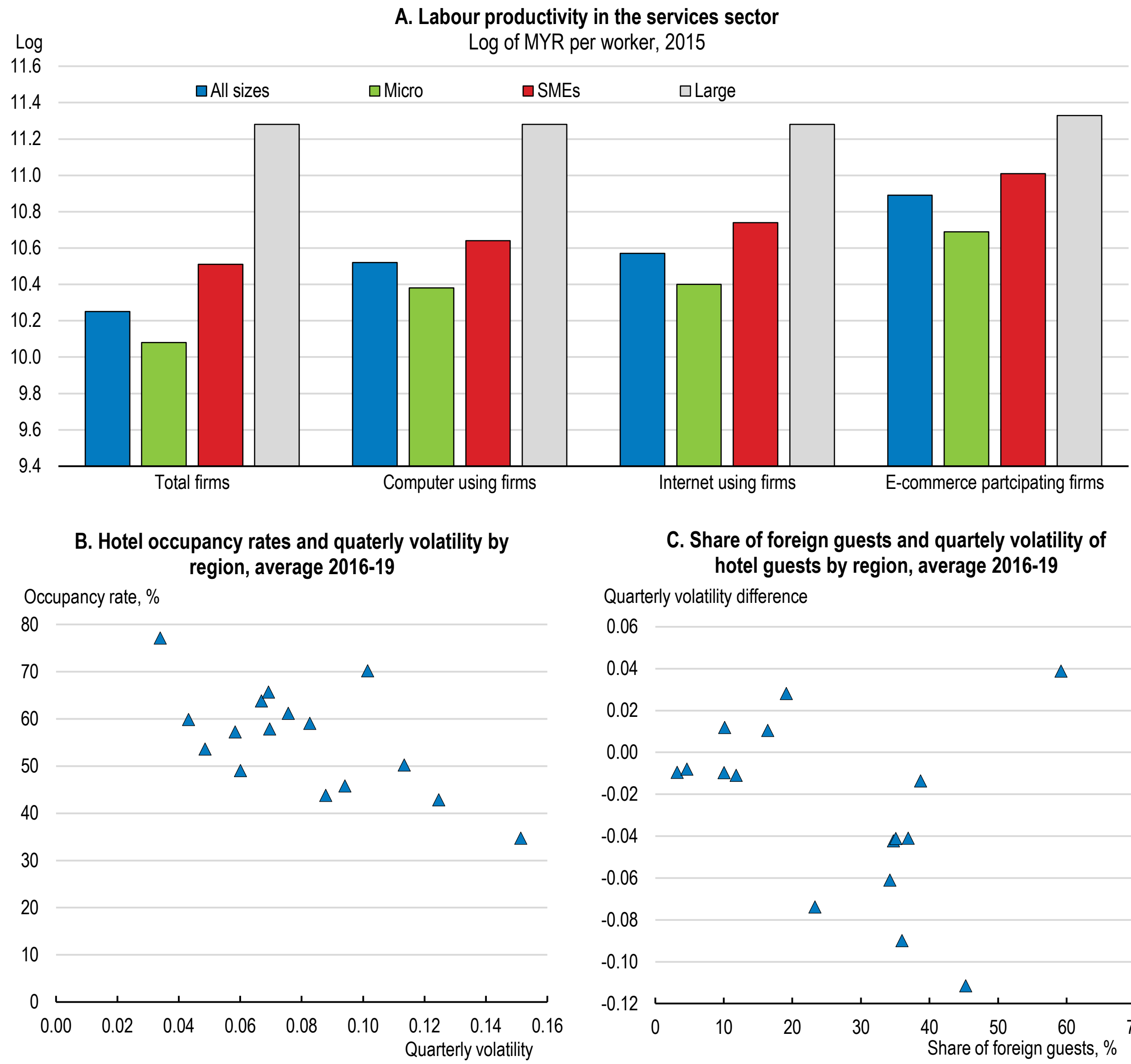
Annex 2.A. Demand fluctuation and productivity

Demand fluctuation is often discussed in the context of business cycle with the frequency of years. Nevertheless, some previous study suggests that more high-frequent volatility in demand has some impacts on business productivity (Morikawa, 2012[73]) (Butters, 2020[74]). This is particularly relevant for the services sector, as most services cannot adjust their production through the changes in inventory. High short-term volatility in demand would reduce overall operating rates, which could result in lower profits and investment. A case in point is the accommodation services. In this regards, digital technologies would help manage demand fluctuation through matchmaking wider potential consumer base or dynamic pricing, among others. In Malaysia, the level of productivity of e-commerce participating SMEs (below 75 employees) in the accommodation sector is higher than the level of productivity of SMEs not participating in e-commerce (Annex Figure 2.A.1), which is also comparable to the level of productivity of overall large firms (Economic Census 2016, DOSM). Nevertheless, the share of firms participating in e-commerce accounts for 8% for SMEs and just 1% for firms with less than 5 employees, while 67% for large firms.

To estimate how short-term demand fluctuation affects operating rates of the accommodation services in Malaysia, a simple calculation was conducted concerning hotel occupancy rates. By using data of the Hotel Survey (Tourism Malaysia), in which quarterly data of 13 states and 3 federal districts are available, OLS regression was estimated. Quarterly volatility of hotel occupancy rates are correlated with the annual level of occupancy rates (Annex Figure 2.A.1). However, this may be caused by the seasonality of tourism activity in each region. If a region's tourism activity is limited to a very short period of each year due to its weather condition, the quarterly volatility becomes higher and the occupancy rates are lower. To remove this effect, fixed effect model is used. At the firm level, when demand is weak, a firm could adjust its services supply to reduce the short-term fluctuation of operation, so that endogeneity needs to be taken into account. As the regional level of occupancy rates would not be likely to affect that of quarterly volatility at the regional level, endogeneity is not considered in this estimation. Although a careful consideration is needed due to the small sample size, similar to previous study, the coefficient of quarterly volatility is statistically meaningful (Annex Figure 2.A.1).

Recent study in other countries suggests that the different seasonality of inbound tourists would reduce the overall seasonal volatility of hotel occupancy rates, thus raising productivity (Morikawa, 2016[75]) (Morikawa, 2017[76]). In Malaysia, the share of foreign hotel guests significantly varies between regions, and has strong correlation with the annual average of hotel occupancy rates. Nevertheless, the share of foreign hotel guests does not have influence on the quarterly volatility of hotel occupancy rates. This is because while foreign hotel guests offset the seasonality of domestic hotel guests in some regions, they rather amplify the seasonality in other regions (Annex Figure 2.A.1). Taking into account the share of foreign hotel guests, the coefficient of quarterly volatility of hotel occupancy rates is still statistically meaningful.

Annex Figure 2.A.1. Productivity of the accommodation sector could be further improved



Note: Panel A: Micro firms are defined as having less than 5 workers, and SMEs as having between 5 and 75 workers. E-commerce participation is either purchase or sell online.
Panels B and C: All data shown are averages of 2016-19. The quarterly volatility for each year is calculated as the coefficient of variance (C.V.) of quarterly occupancy rates (respectively of quarterly hotel guests) of that year. The quarterly volatility difference of each year is calculated as the difference between the quarterly volatility of total hotel guests and the quarterly volatility of domestic hotel guests of that year. A negative number means that foreign hotel guests reduce the volatility of total hotel guests.
Source: DOSM, Economic Census 2016; Tourism Malaysia, Hotel Surveys; and OECD calculations.

StatLink https://stat.link/uo0nk7

Annex Table 2.A.1. Demand fluctuation affects the level of hotel occupancy rates

Regression of annual hotel occupancy rate on its quarterly volatility

	Dependent variable is annual hotel occupancy rates		Dependent variable is log quarterly volatility of total hotel guests
	(1)	(2)	(3)
Constant	50.81656	33.61466	-1.645089
	(23.89411)	(5.200741)	(-14.80693)
Log quarterly volatility	-1.835520	-2.085500	x
	(-2.362131)	(-2.850519)	x
Foreign guest share	x	0.631493	-0.001674
	x	(2.796916)	(-0.459954)
Fixed effects	Yes	Yes	No
Observation	64	64	64
Adjusted R^2	0.931976	0.940599	0.003401

Note: The quarterly volatility of for each year is calculated as the coefficient of variance (C.V.) of quarterly variables. The estimation period is for 2016-2019. ( ) represents t-value.
Source: Tourism Malaysia, Hotel Surveys and OECD calculations.

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MALAYSIA

Like many other countries, Malaysia was hit hard by the COVID-19 pandemic starting in early 2020. Its past policy prudence has allowed Malaysia to react swiftly and boldly to the public health and economic crisis. Nevertheless, the crisis revealed the necessity of further reforms that Malaysia needs to pursue in order to achieve more inclusive and high growth after the pandemic. Vulnerable workers have been more affected during the pandemic and many firms have been urged to use digital tools, such as e-commerce and teleworking, for the first time. Going forward, strengthening social protection is of utmost important to improve the well-being of the Malaysian people, including self-employed workers, and prepare for the ageing society. Easing government regulations further is crucial to stimulate business dynamism and restore vigorous growth. Accelerating digitalisation will be key for Malaysian firms to become more productive in the post-pandemic era. Along with its further economic development, Malaysia needs to transform itself into a greener economy.

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