

Structural Changes and the Prospect for FELDA

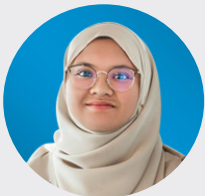
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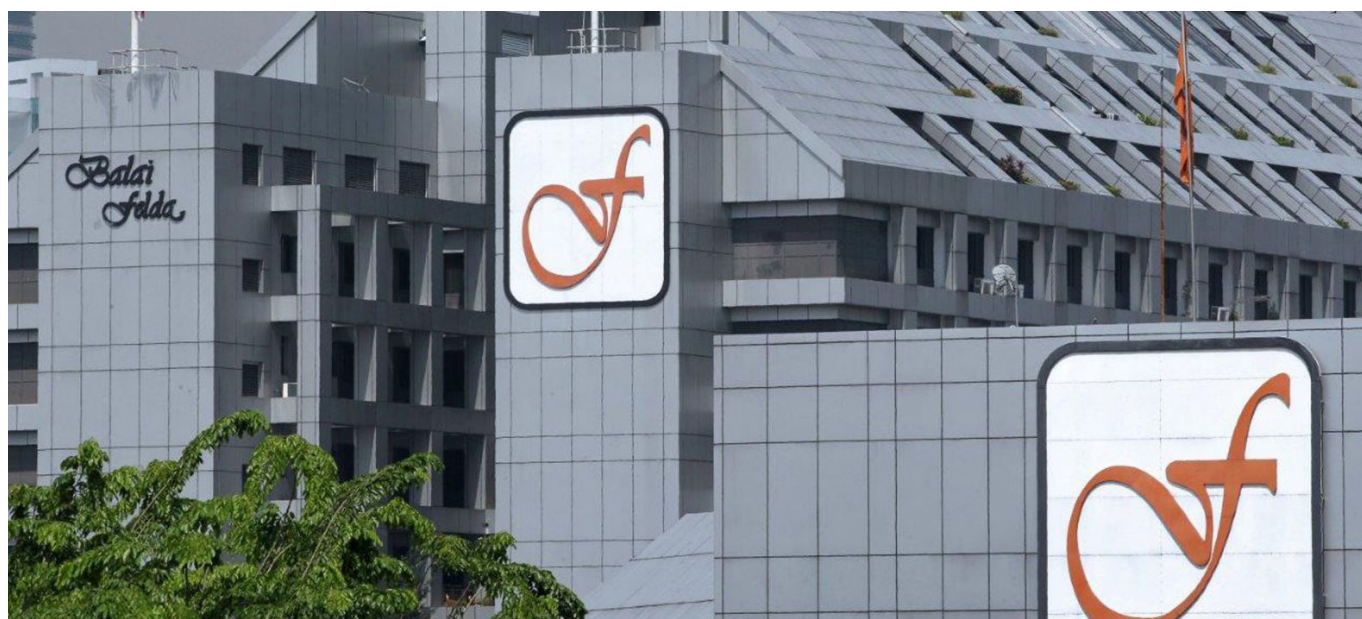
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* The authors would like to thank the following individuals for their feedback on this monitor: Tricia Yeoh, Laurence Todd, Lau Zheng Zhou, Sri Murniati and Wan Ya Shin. The authors would also like to thank Khor Yu Leng for her insights and Tay Yi Thong for her support with data collection.

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Introduction

The Federal Land Development Authority (FELDA) is a statutory body established according to the Land Incorporation Act 1956 to resettle poor Malay families who were previously in agriculture and help them to become modern smallholders, farming for export, initially focused on rubber but now primarily planted with oil palm. Over 98% of FELDA settlers are Malays and FELDA has been instrumental in driving inclusive national development. It was regarded by the World Bank as one of the most successful land development programmes in the world and had successfully quadrupled settlers' income between 1980 to 2016. FELDA has also lifted approximately 1 million people out of poverty.

However, during the Najib administration, shifts in policy to corporatize FELDA through the creation of subsidiary GLCs have resulted in huge losses, with the listing of FELDA Global Ventures (FGV) in 2012 being the catalyst for calls for reform in FELDA.

Box 1: Statutory Bodies in Malaysia

Historically, statutory bodies in Malaysia have been an important tool for the government to pursue socio economic policies. According to the Auditor General's report, there are 137 federal statutory bodies in Malaysia which own a total of 323 subsidiary and sub-subsidiary companies. Thus they have a significant footprint in the economy. A statutory body is a public authority or a government agency created through an Act of Parliament. Statutory bodies are established under their own respective legislation meanwhile government linked companies (GLC) are incorporated under the Companies Act 1965.

Multiple years of losses in FELDA led to the tabling of a White Paper by the Pakatan Harapan government in April 2019 in an attempt to revitalize the institution. The White Paper was set to reverse the trend of commercialisation by gradually disposing "non-core and non-strategic investments". The White Paper also explored measures to reduce reliance on palm oil and increase adoption of new technology.

However, this Monitor will argue that there are structural changes which will influence the sustainability of the current FELDA model in achieving its twin societal and economic objectives. These changes include global decline in palm oil prices due to the end of the commodity super cycle, shifts in global demand for palm oil and the changing demography of FELDA settlers.

The current model for FELDA thus may no longer be suited going forward and the government should perhaps readjust their strategy. The experience of the past seven years suggest that state intervention, especially the establishment of FGV, has led to massive losses and shifts in the demography of settlers further necessitates review of the functions of FELDA. One way forward is to implement fundamental reform to FELDA beyond recommendations of the White Paper. The government should focus on promoting the welfare of the settlers rather than preserving the institution, including incentives for upgrading and integrating young people. Initiatives for innovation and upgrading should also be a central part of the strategy moving forward.

I. The End of a Commodity Super-Cycle

Since its inception, the FELDA model is one that relies on the government for subsidy and intervention. Federal government incurs the cost of building FELDA housing, infrastructure and field preparation while crediting monthly subsistence allowances to the settlers. On top of that, the government heavily subsidises FELDA loans and writes off settler's bad debts. However, this model is not sustainable as there are changes in palm oil demand caused by external factors. This section will argue that FELDA continues to be highly exposed to palm oil prices, since prices will continue to decline and FELDA's efforts on commercialisation were not successful in reducing FELDA's reliance on palm oil sector and instead contributed to FELDA's financial problems.

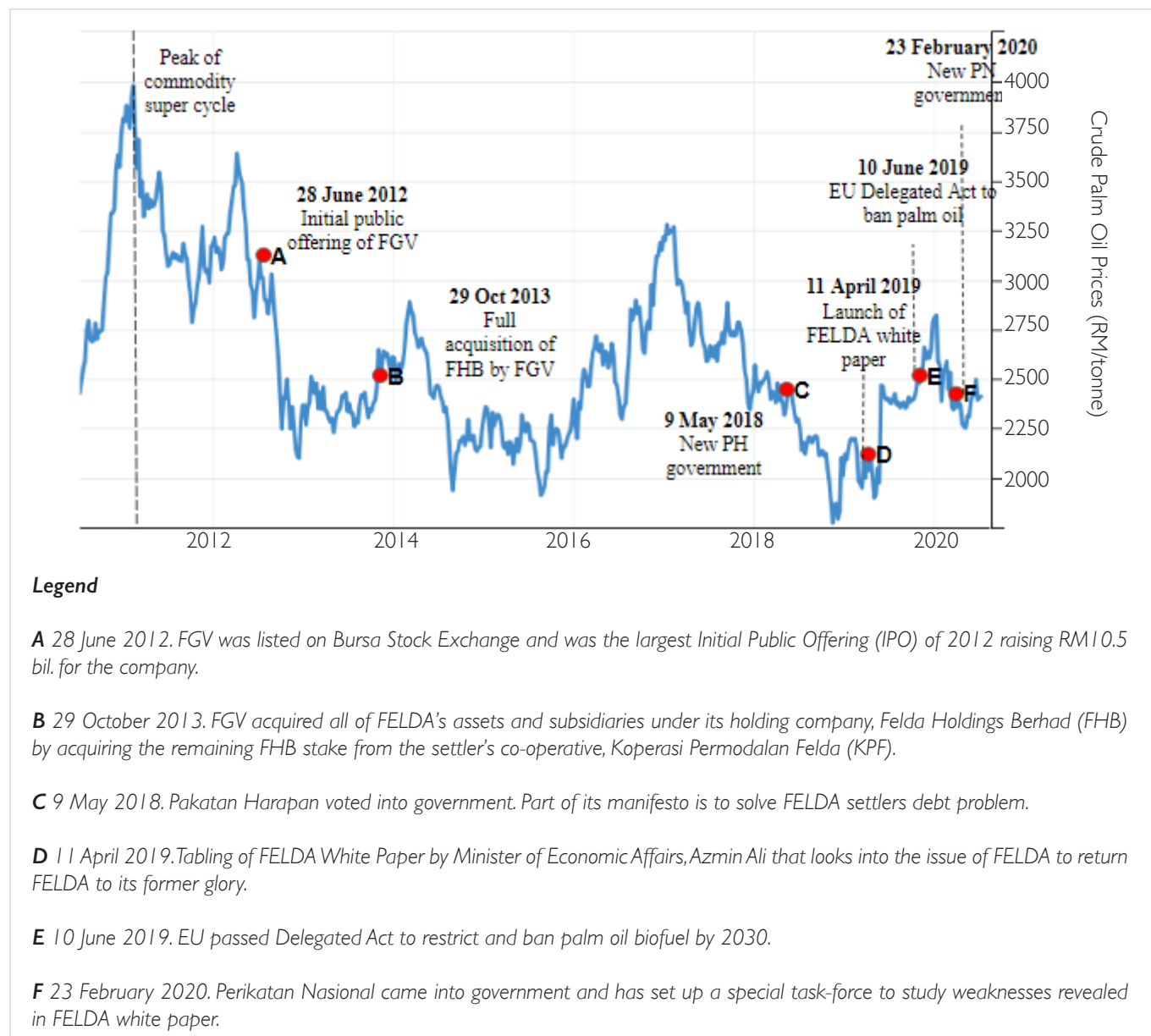
Box 2: What is the FELDA model*?

- Federal government allocates funds to cover the cost for infrastructure and special projects. Government further increased its allocation to FELDA in 2011 and 2016 through the 10th and 11th Malaysia Plan.
- FELDA is involved in managing settler's land and bears the cost of replantation, settlers subsistence loans and other socioeconomic assistance. These are initially financed through FELDA's internal funding but since 2009 FELDA had to take a loan to cover these commitments.
- FELDA settlers hold land titles under a loan payment scheme and granted land ownership rights once they settle repayment to FELDA.
- FGV manages all commercial activities and owns the palm oil processing mills. All of FELDA's assets and subsidiaries are parked under FGV.
- FGV has a 99-year land lease agreement with FELDA where FELDA leases out its land to FGV in return for fixed amount of fees each year and 15% share of profits.

*since 2012

Since 2011, commodity prices including palm oil have started to decline globally, sparking the notion of an end to a commodity super-cycle. Chart 1 shows a peak in the crude palm oil (CPO) prices in late-2011. This marked the end of a commodity super-cycle, an extended period of commodity prices being above their long-term trend, which started in the 1990s driven by great demand from emerging economies.

Figure 1. Crude palm oil prices and key events



Source: 10-year palm oil prices, Trading Economics

The government did not succeed in utilising the profit during the high prices period to nurture higher value-added economic activities to diversify against future price fluctuations. Instead it saw the opportunity to list FGV on the stock exchange. As Chart 1 shows, the listing of FGV in 2012 took place after the peak years and was followed by downward pressure on CPO prices, at least until 2016.

Despite being the second-largest producer of palm oil behind Indonesia, the export industry of palm oil faces an uncertain future. Between 2007 and 2017, FELDA's profitability dropped by 590% and started to record losses after the listing of FGV in 2012 as shown in Table 1. This suggests that the model has so far failed to reduce reliance on palm oil exports.

The downsizing phase of previous commodity super cycles has lasted between 14 to 28 years. Given the softening global demand and rising interest in sustainability issues, the decline in palm oil prices could continue further. As the income of FELDA smallholders is heavily dependent on palm oil cultivation and selling activities, and FGV performance remains more vulnerable to palm oil price swings than its peers, the continuous low palm oil prices will have a significant impact on the sustainability of FELDA.

Table 1: Net profit/(loss) of FELDA Group, 2007-2017

RM billion	Profit/(loss) after tax
2007	1.0
2008	1.1
2009	0.2
2010	1.1
2011	0.2
2012	5.8
FGV was listed (June 2012)	
2013	(2.0)
2014	(1.0)
2015	(1.1)
2016	(0.7)
2017	(4.9)

Source: Felda White paper, 2019

Note: Latest figure not available as FELDA 2018 and 2019 annual report are not available

In 2017, average CPO price was low at RM 2,790 per tonne whereas in 2008 when average CPO prices were almost the same at RM 2,850 per tonne, FELDA still generated profits. FELDA's earnings were affected by commercial actions and particularly in 2017 by FELDA impairments from the scandalous investments in PT Eagle High Plantations.

2. FELDA's Commercialisation

FELDA shifted its focus to commercialisation since the 1980s and 1990s as less rural households were interested in resettlement. The focus on commercialisation has some merit in terms of trying to diversify income sources.

However, the benefit from creation of new subsidiary companies throughout the years did not make FELDA resilient to palm oil price fluctuations. The various businesses owned by FELDA were meant to enable FELDA to generate profit and complete the value chain of its core activities. Though it is questionable the extent that FELDA companies benefited FELDA and its main stakeholders, which are the settlers. FELDA's presence in sectors such as property and tourism might also crowd out private companies.

Table 2: Number of new FELDA subsidiary companies incorporated (1951-2020)

1951-1960	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010	2011-2020
2	0	13	9	26	20	26

Source: FGV Annual report 2018, full list of subsidiary companies in the Appendix.

Furthermore, the listing of FGV is a clear indication of a poor track record in commercialisation. FGV was listed under a new FELDA business model introduced in 2010 during Najib's era. Under the model, all of FELDA's assets and subsidiaries under its holding company, Felda Holdings Berhad (FHB) and the settler's co-operative Koperasi Permodalan Felda (KPF) were transferred to FGV as part of its listing to raise funds for the company. Prior to the listing, 51% of FELDA shares were held by FELDA settlers through KPF, but these shares were acquired by FGV, making settlers lose their shares in FELDA. FELDA also submitted its commercial land management activity via a 99-year land lease agreement (LLA) to FGV in return for fixed amount of payment for lease and a share of FGV profits which was below expectation since FGV did not do well.

Table 3: Key entities in FELDA

Entity	Incorporation Year	Function	Initial Capital (RM mil.)
Koperasi Permodalan FELDA (KPF)	1980	Co-operative for savings and investment of FELDA settlers	340
Felda Holdings Berhad (FHB)	1995	Holding company for FELDA's assets	220
Felda Global Ventures Berhad (FGV) (33% owned by FELDA)	2007	For overseas investment in plantation-related matters	1800
Felda Investment Corporation (FIC) (100% owned by FELDA)	2013	Main investment wing for non-plantation related matters	150

Source: C4, The Felda Crisis and FELDA White Paper

FELDA's commercialisation activities, particularly the listing of FGV not only failed to promote diversification, instead it contributed to serious financial problems. FGV was the biggest IPO in Malaysia in 2012. However, FGV's stock price fell 72% from its IPO price trading at RM4.55 apiece in 2012 to RM1.29 as at July 2020 (see Chart 2). FELDA spent RM6 bil. from the RM10.5 bil. raised in FGV's initial public offering (IPO) on loss-making and unproductive ventures. This includes the acquisition of Grand Plaza Kensington Hotel, London and the Merdeka Palace, Kuching both at an inflated price under Felda Investment Corporation (FIC). There are allegations of political interference in FGV, including the contentious acquisition of Asian Plantation which resulted in FELDA former directors facing court trial.

Figure 2: FGV Holdings Berhad Share Price Since Listing



Source: KLSE Investor

3. Global Demand for Palm Oil

This section will show that on top of declining prices, increasing demand for sustainable palm oil will impact the future of Malaysian palm oil. Global trends towards environmental awareness and the demand for sustainable palm oil has affected Malaysia's appeal as an exporter. Global consumption of palm oil is predicted to fall further as the corona-virus led recession reduces demand for edible oils and fat. The effect of the pandemic was felt by FGV as it was forced to temporarily close five mills in Sabah. The company also posted a net loss of RM142.35 mil. in the first quarter of 2020, after recording its first quarterly profit in the preceding quarter following six successive quarterly losses.

The outlook of palm oil is complicated by the European Union's (EU) policy to restrict and ban palm oil biofuel by 2030. In June 2019, the European Commission (EC) adopted a Delegated Act of the Renewable Energy Directive (RED II) which renders biofuel produced using palm oil less competitive in the EU market compared to other products.

The implication of EU's policy is significant as it is the second largest buyer of Malaysia's palm oil exports and more countries are expected to follow in the EU's footsteps. As the EU is imposing its standards on the developing world, some countries like Vietnam, who have signed trade agreements with the EU, are also being pushed to raise the issue of sustainability. There will be long-term impacts of the different trading standards to Malaysia's trade arrangements. Compounding EU's policy is the widespread public sentiment and associated consumer movements in Europe to demonize palm oil and there is also talk that the EU will extend trade restrictions to food products using palm oil.



This has likely played a role in the volatility of the palm oil market from 2018 to present and will continue to have a significant impact on Malaysian palm oil exports.

For decades, Malaysia has been facing an uphill task to convince palm oil critics of the sustainability and trustworthiness of its palm oil. Malaysia introduced the Malaysian Sustainable Palm Oil (MSPO) certification scheme and has made it obligatory to all local producers. At the end of 2019, 63.2% of Malaysian palm oil plantations have become MSPO-certified and the aim is to certify 100% of palm oil by the end of 2020. To date, all 68 of FGV's mills are MSPO-certified. However, while the MSPO is more affordable and more accessible to smallholder farmers and meets certain environmental and labour rights requirements, it is less strict compared to the Roundtable for Sustainable Palm Oil (RSPO) which is the international standard for palm oil sustainability. The MSPO regulations are also less stringent compared to that of Indonesia. Thus, although the national certification is recognised by countries such as Japan, China and India, it remains to be seen whether the EU and other developed countries will recognise it.

The recent diplomatic spat between Malaysia and India has caused the export of palm oil to India to cease virtually overnight in 2019. India is the largest importer of Malaysia's palm oil accounting for 15% of total exports. These sorts of boycotts cannot be predicted but it is likely to occur again in the future given the state of the international arena in the coming decade as India and China, both major buyers of Malaysia's palm oil, flex their power.

4. Socio-Economic Role of FELDA

This section will bring up changes in FELDA demographic profile which affects the socioeconomic role it plays. Since the 1990s, a high proportion of second-generation settlers has become middle-class professionals and have migrated to the cities. Currently, 69% of settlers are between 61 to 79 years old and there is high dependence on foreign labourers to work on the farms. According to a recent survey, close to 96% of youths whose parents work in agriculture are not interested in following in their footsteps and this can be explained by the findings that agriculture sector as a whole has an average salary of RM1,865, which is much lower than the national average salary of RM3,087.

According to a FELDA document published in 2018, a total of 112,635 settler families were settled in FELDA schemes between 1958 and 1990. Recent FELDA annual reports still report the same number as the total of FELDA settlers nationwide, not reflecting the changes caused by outmigration of second-generation settlers. FELDA employs about 35,000 foreign workers in 2017 and a report in 2015 quoted that nearly 85% of FELDA plantation workers are foreign workers.

As a result, the ongoing use of foreign workers as a short-term labour solution continues to put FELDA in a cost-competitive model. This model does not create the right incentives to pursue research and development (R&D), investment in latest technology and other productivity-enhancing initiatives. There is a clear need for a strong policy shift to attract young people back into the sector to contribute to the modernisation effort, but FELDA's commercialisation activities have not succeeded in providing enough incentives to promote modernisation partly a result of continued use of subsidy payment to support settlers.

The use of foreign labour also undercuts the original aim of FELDA, i.e., giving Malay families a working income. With the second and third generation of FELDA settlers preferring to move to urban areas and non-agricultural employment, the reality is that FELDA is now, more or less, similar to other private sector oil palm plantations. Thus, the socio-economic contribution by FELDA to the advancement of the rural Bumiputera community will be further undermined in the coming years.

While plantations remain in common ownership by the original settler households and their descendants, the annual dividends received is insufficient to sustain their livelihoods. Most settlers remain in primary production and are not as involved in the processing sector which is a higher value-add activity.

This raises the question whether or not FELDA has been effective in improving the socioeconomic outcome of the Bumiputera. Given all the different macro trends, FELDA's role needs redefining. Instead of subsidising livelihood which includes cash assistance, housing and education, FELDA should consider integrating young people and making modernisation its core mission.

The FELDA White Paper is a good step in the right direction as it recognises the importance of reducing FELDA's reliance on palm oil and the importance of promoting the use of mechanization and automation technology to improve productivity and reduce reliance on foreign labour. However, the implementation of reforms identified in the White Paper is now unclear since a new government, Perikatan Nasional (PN), is now in power.

Box 3: What are the key recommendations in the FELDA White Paper that should be followed through

1. Restructure FELDA subsidiary companies to dispose non-core and non-strategic assets and winding up non-active companies.
2. Identify an affordable crop and livestock replacement program with the potential of generating fast and consistent cash flow to alleviate the effect of falling commodity prices. The program to be carried out through government agency and private sector collaboration.
3. Increase settler's participation in management, investment and business activities through the Felda co-operative to produce more professional farmers.
4. Expand adoption of automation technology in cultivation and harvesting to improve productivity and reduce production leakage. This will reduce reliance on low-skilled foreign workers and attract new generation of settlers into plantation activities.

A comprehensive action plan to realise the recommendations outlined in the White Paper is still yet to be produced by the new government. The PN administration has so far set up a task-force aimed at resolving issues in FELDA and is expected to present a report in August 2020. Some have speculated that the new proposal will include taking FGV private and it remains to be seen if the White Paper recommendations will be followed through with sustainable actions for FELDA.

Conclusion



The role and functions of FELDA must be re-examined in the light of international and domestic developments. There is no doubt the previous model worked in its initial decades in providing a way for poor Bumiputera to get a head start in palm oil but as we suggest in this report, changes both domestically and internationally, suggest that the model is no longer applicable going forward. The world has changed and it's time to review and see how we can revitalise FELDA.



The outlook for palm oil remains highly uncertain. The Malaysia palm oil industry is not resilient to adapt to macro changes and Malaysia cannot dictate the trends in palm oil prices despite being the world's second largest producer. Palm oil prices depend on the global price which has fallen because of the end of a commodity super cycle and global demand for palm oil is unpredictable.



Previous efforts to diversify FELDA income through commercialisation have not been successful in improving productivity and socioeconomic outcomes. The strategy of corporatisation was not well suited to the subsequent changes in the palm oil price and has not succeeded in diversifying the revenue of the FELDA settlers – instead, the proliferation of FELDA subsidiaries has resulted in holdings in unrelated business areas.



Demographic shifts further undermine the current FELDA model. The FELDA model has not resulted in a sufficiently attractive prospect for subsequent generations to continue working on the plantations. This shift necessitates a re-examination of the current FELDA model.



The White Paper published by Pakatan Harapan is a step in the right direction but a clear timeline for implementation is needed. The government should confirm the status of the White Paper and future policy direction for FELDA, including commitment to a clear timeline and implementation plan.



Fundamental reform of FELDA – beyond the White Paper – is needed. The White Paper does not go far enough to address the fundamental challenges facing FELDA highlighted in the paper. Rather than continuing to focus only on preserving FELDA, the government's focus should prioritise the welfare of the settlers, including through ensuring incentives for innovation and upgrading are better aligned – including through introducing more competition. Adaptation may take time, so a sustainable strategy is urgently required.

Appendix

Subsidiary companies incorporated by FELDA						
1951-1960	1961-1970	1971-1980	1981-1990	1991-2000	2001-2010	2011-2020
Pontian United Plantations Berhad (PUP)		MSM Perlis Sdn. Bhd.	Pontian Hillco Plantations Sdn. Bhd.	Felda Enterprises Sdn. Bhd.	Incosetia Sdn. Bhd	MSM Malaysia Holdings Berhad
MSM Prai Berhad		Felda-Johore Bulkiers Sdn. Bhd.	Blossom Plantations Sdn. Bhd.	Yapidmas Plantation Sdn. Bhd.	F.W.Q. Enterprises (Pvt.) Ltd.	Grand Performance Sdn. Bhd.
		Delima Oil Products Sdn. Bhd.	Redefined Land Sdn. Bhd.	Ladang Kluang Sdn. Bhd	Fortune Plantation Sdn. Bhd.	Felda Global Ventures Plantations Sdn. Bhd.
		F.S. Oils Sdn. Bhd.	Felda Travel Sdn. Bhd.	Allied Engineering Consultancy Services Sdn. Bhd.	Felda Global Ventures North America Sdn. Bhd.	FGV Downstream Sdn. Bhd.
		Pontian Materis Plantations Sdn. Bhd.	BJ Corporation Sdn. Bhd.	Felda Plantations Sdn. Bhd.	Langsat Bulkiers Sdn. Bhd.	FGV Shares Service Centre Sdn. Bhd.
		Rawajaya Sdn. Bhd.	Pontian Subok Plantations Sdn. Bhd.	Felda Engineering Services Sdn. Bhd.	Fore River Transportation Corporation	FGV R&D Sdn. Bhd
		Kilang Kelapa Sawit Pontian Sdn. Bhd	FGV Grains Terminal Sdn. Bhd.	Felda Holdings Bhd.	Felda Global Ventures Indonesia Sdn. Bhd.	FGV Plantations (Malaysia) Sdn. Bhd.
		Sabahanya Plantations Sdn. Bhd	Sri Kehuma Sdn. Bhd.	FGV Refineries Sdn. Bhd.	Asian Plantations (Sarawak) Sdn. Bhd.	PT.Temila Agro Abadi
		Pontian Fico Plantations Sdn. Bhd.	MSM Logistics Sdn. Bhd.	FGV Kernel Products Sdn. Bhd.	Twin Rivers Technologies Holdings, Inc.	FGV Capital Sdn. Bhd.
		Pontian Orico Plantations Sdn. Bhd.		FGV Marketing Services Sdn. Bhd.	FGV Sugar Sdn. Bhd.	Fgv Biotechnologies Sdn. Bhd.

		Pontian Pendirosa Plantations Sdn. Bhd.		Tanah Emas Oil Palm Processing Sdn. Bhd.	FGV USA Properties, Inc	FGV Lipid Venture Sdn. Bhd.
		Malaysia Cocoa Manufacturing Sdn. Bhd.		FGV Bulkers Sdn. Bhd.	FGV Kalimantan Sdn. Bhd.	FGV Myanmar (L) Pte. Ltd.
		FGV Fertiliser Sdn. Bhd.		FGV Palm Industries Sdn. Bhd	Twin Rivers Technologies Holdings-Enterprise De Transformation De Graines Oleagineuses DuQuebec Inc	GasPlas AS
				Feltex Co. Ltd	Felda Global Ventures Perlis Sdn. Bhd.	MSM Trading & Distribution Sdn. Bhd.
				FGV Agri Services Sdn. Bhd.	Asian Plantations Milling Sdn. Bhd.	Asian Plantations Limited
				Felda Farm Products Sdn. Bhd.	Asian Plantations (Sarawak) II Sdn. Bhd.	PT. Citra Niaga Perkasa
				FGV Prodata Systems Sdn. Bhd.	Kronos Plantation Sdn. Bhd.	FGV Cambridge Nanosystems Limited
				Felda Properties Sdn. Bhd.	Asian Plantations (Sarawak) III Sdn. Bhd.	FGV Green Energy Sdn. Bhd.
				Felda Construction Sdn. Bhd.	FNI Biofuel Sdn. Bhd.	FGV Applied Technologies Sdn. Bhd.
				FGV Rubber Industries Sdn. Bhd.	Felda Global Ventures Livestock Sdn. Bhd.	FGV Green Rubber Sdn. Bhd.
				FGV Transport Services Sdn. Bhd.		

				FGV Transport Services Sdn. Bhd.		MSM Sugar Refinery (Johor) Sdn. Bhd.
				FGV Security Services Sdn. Bhd.		MSM Trading International DMCC
				Twin Rivers Technologies Manufacturing Corporation		PT Bumi Agro Nusantara
				Sutrajaya Shipping Sdn. Bhd.		FGV-CVC (Cambodia) Co. Ltd
				Plantation Resorts Sdn. Bhd.		FGV Logistics Sdn. Bhd.
				Felda Rubber Products Sdn. Bhd.		South Asian Farms Sdn. Bhd.

Source: FGV Holdings Berhad Annual Report 2018.

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