

# 1<sup>st</sup> KUALA LUMPUR ROUNDTABLE

*JULY 2019 REPORT*





## Preamble

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The Kuala Lumpur Roundtable (KLR) is a panel of economists, policy experts and corporate figures with the ambition to act as the conscience of the nation and the advocates for reform in Malaysia. Its mission is to improve the wellbeing of all Malaysians as well as to showcase Malaysia as a successful example of economic development. The KLR contributes to this mission through providing constructive recommendations to the government after critical deliberations on the country's current economic, social and governance challenges. This report, and those following it, serves as the primary output of the KLR. It aims to summarize each KLR discussion by highlighting the most pertinent issues and presenting the reader with the conclusions reached at each Roundtable discussion. The targeted audience of this report are senior members of government (cabinet members, senior officials) as well as members of the Parliament across the political spectrum.

This report would not have been possible without the productive discussions and valuable insights from the participants of the First Meeting of the Kuala Lumpur Roundtable, who included Tan Sri Datuk Clifford Francis Herbert, Firoz Abdul Hamid, Dato' Kong Sooi Lin, Emeritus Prof. Datuk Dr. Mohamed Ariff, Prof. Tan Sri Dato' Dr. Noor Azlan Ghazali, Dato' Dr R. Thillainathan, Tan Sri Dr. Ramon Navaratnam, Tan Sri Datuk Dr Rebecca Fatima Sta Maria, Tan Sri Dato' Mohd. Sheriff Mohd. Kassim, Prof. Yeah Kim Leng, and Tunku Zain Al-'Abidin<sup>1</sup>. IDEAS members also participated in the First Meeting of the Kuala Lumpur Roundtable discussion, including: Senior Fellows, Dr Carmelo Ferlito and Dr Renato Lima de Oliveira; Chief Executive Officer, Ali Salman; Research Director, Laurence Todd; and, Research Manager, Wan Ya Shin.

The Institute for Democracy and Economic Affairs (IDEAS) provides secretarial and research support for the KL Roundtable<sup>2</sup>.

<sup>1</sup> The full list of members of the Kuala Lumpur Roundtable is available in the Appendix. The report does not necessarily reflect a consensus amongst the participants on any or all issues.

<sup>2</sup> This edition of the Kuala Lumpur Roundtable Report was prepared by Azam Wan Hashim, Nur Sabrina Sabu, Lamia Mounavaraly, and Idris Azim. Norhayati Murni Misran led the production and design of the report.



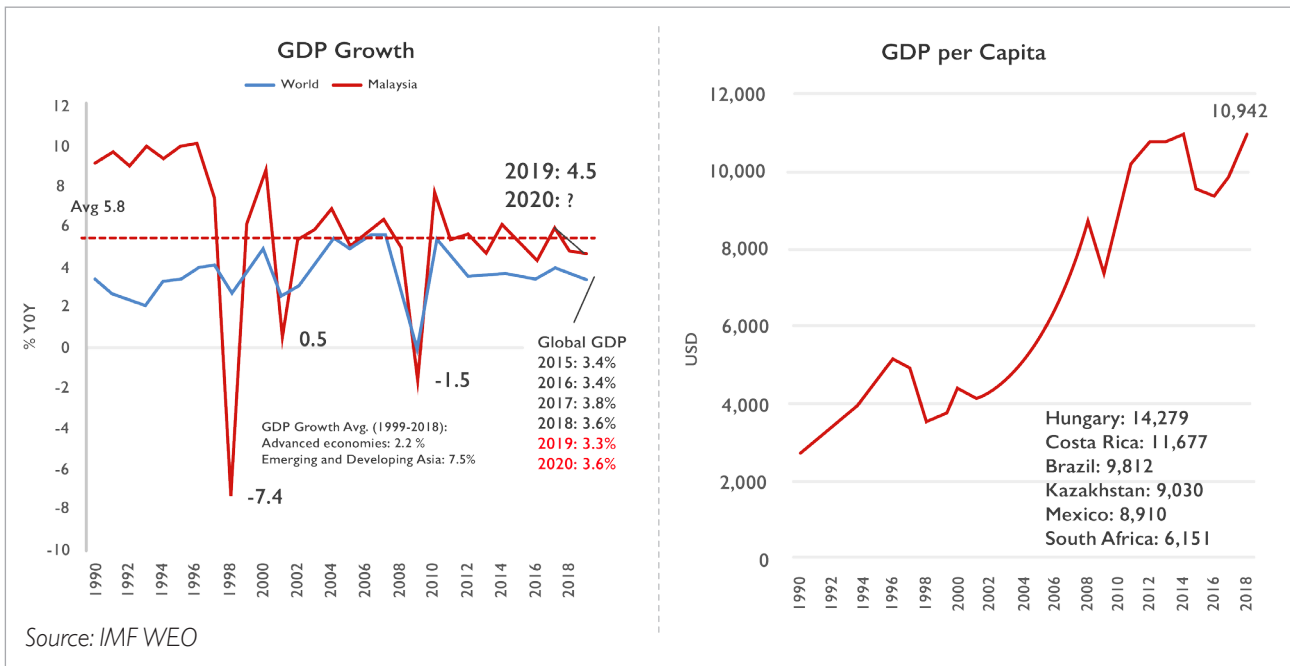
## Introduction

This first session's primary focus was *Shared Prosperity*, taking both a long- and short-term perspective. It emphasized the idea that continued focus on growth is important and should be achieved through commitment to free trade policies and fiscal reforms. This perspective should be supported by more effective investment in human capital following the idea that Malaysia needs to create prosperity before sharing it. Overall, the panel agreed on the need for greater community engagement, reduced government involvement in business, as well as less dependency on foreign labor to promote growth towards 4IR and capital-intensive production. To approach the next ten years under the vision of shared prosperity, the government has to undergo significant institutional reform.

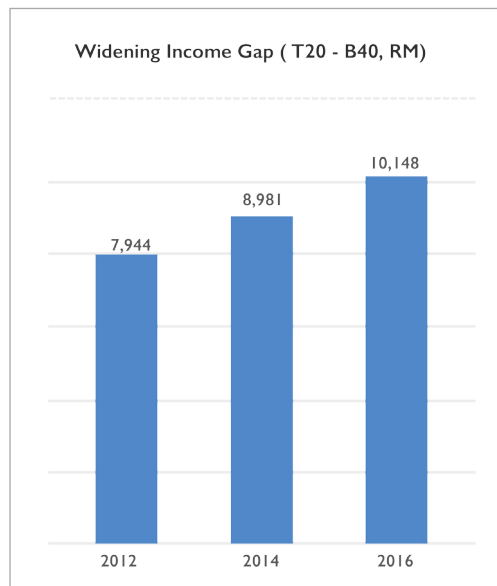
This roundtable believes that reforms should be on the top of the agenda. In order to prevent malfeasances of the past, institutional reforms should strive towards achieving greater decentralisation and balance of power. To initiate the process of reform, it is imperative to evaluate how strong our institutions are and who needs to be engaged in the discussion.

# Economic Growth and Shared Prosperity

**Malaysia has experienced commendable headline growth and development.** The country's average GDP growth rate from 1990 - 2018 has been 5.8%, markedly higher than that of advanced economies at 2.2%. Since the 2008 recession, the economy has shown consistently robust GDP growth that remains above the global average. Malaysia's GDP per capita continues to grow at a strong pace and surpasses similar economies such as Brazil, Mexico, South Africa and Kazakhstan. Looking towards the next five years, Malaysia looks to be on track to becoming a high-income nation by 2024.



**Yet, the fruits of economic progress have not been shared equally.** Although the headline figures exhibit commendable levels of sustained economic growth and increasing incomes, recent voices have highlighted the country's unequal distribution of prosperity. While incomes for all groups have increased over the years, the total income share of the bottom 40% (B40) has not changed by much, growing from 14% in 2000 to 16.4% in 2016. Nominally, the income levels of the B40 have grown at a much slower pace than the rest of the country. Income disparity between the T20 and the B40 has grown wider each year, with the difference in average monthly household income from RM7,944 in 2012 to RM10,148 in 2016. Greater disparity can be seen when looking at the income shared, where the top 10% of households having a greater income share than nearly the bottom 60% of all households in Malaysia.



**There is also a noticeable difference in the level of infrastructure and income between the East and West Coast of Malaysia.** Intra-state income inequality is largely contained, with Gini coefficients within states remaining below the national average. However, there is clear income disparity between states especially along geographical divides. Infrastructure development has been focused within states that command the highest economic contributions (Selangor, KL, Johor, Pulau Pinang), but more effort is needed to encourage the development of the rest.

## GDP Concept

**Malaysia has put great emphasis on strong GDP growth as the primary indicator for the nation's prosperity.** Although GDP has been widely utilised for its ability to compare Malaysia's economic performance against other countries, it is an imperfect instrument in measuring economic well-being and equitable development. It is crucial to effectively analyse a range of measurements showing economic growth, inclusivity and sustainability, and not be misled by popular macroeconomic figures. The use of a Gini coefficient, for example, while useful in measuring economic equity, is also not a comprehensive measure of economic development. When comparing Gini coefficients of all the Malaysian states, Perlis achieves one of the highest levels of income equality but, upon closer inspection, also has one of the lowest levels of per capita income.

**Ensuring an equitable distribution of the country's prosperity requires a shift in focus from headline growth figures towards improving the standards of living for all.** There is a need to move away from an overemphasis on the "Ease of Doing Business" model to prevent isomorphic mimicry, i.e. the risk of topping international economic rankings while harbouring high economic inequality, low quality human capital and spatially isolated development. Improvements in the standards of living should focus on addressing the social and geographic disparities in economic development present within the country.

**To ensure a fair assessment of economic development and shared prosperity, a multidimensional tool must be adopted to comprehensively measure facets of development such as educational attainment, human capital growth and economic inequality.** Although Malaysia has shown positive economic growth in the past years, this headline growth has hidden the unequal distribution of growth that has been concentrated along territorial boundaries and ethnic groups. The multidimensional measurement of development should also track the progress of the nine strategic challenges for Malaysia to overcome to achieve Vision 2020. It is paramount for the measurements to also assess the quality of growth alongside the quantitative headline figures such as unemployment and GDP per capita.

## Shared Prosperity and New Malaysia

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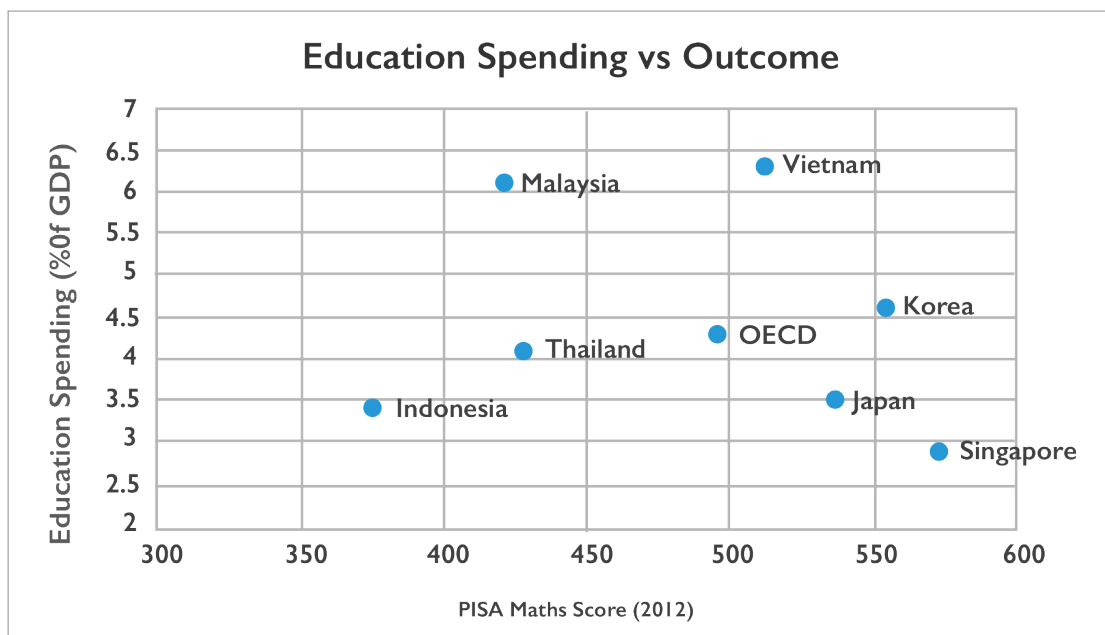
**With Malaysia's future growth aspirations shifting to a "shared prosperity" approach, traditional economic models must be accompanied by a focus on the equitability of growth.**

The desire to improve wealth distribution in the country will depend on the principles of achieving strong macroeconomic growth first. Within this effort to achieve growth, the shared prosperity vision must emphasize B40 growth and be characterised by the equal opportunity for all communities, the elimination of the structural barriers to growth, and lead to realise improvements in the standards of living.

**The vision of *Shared Prosperity* revolves around improving social cohesion through inclusivity in economic empowerment and development of human capital through needs-based affirmative action.** The participants of the first KL Roundtable reiterated the importance of economic growth, inclusivity and environmental sustainability when asked of their vision of the new model of *Shared Prosperity*. The KLR saw *New Malaysia* as defined by a new set of policy tools that ensure the empowerment of economic growth, social harmony, economic inclusivity, environmental preservation and good governance. Fundamental economic drivers should be open for all members of society to pursue opportunities for economic advancement, regardless of their race, ethnicity, location or background. Government policies should also address both B40 and M40 needs, particularly through more active engagement and consultations with these groups, with the ultimate aim of having macroeconomic growth that permeates and is realized on the ground. Finally, the values of *Shared Prosperity* should also be emulated in social development policies, especially through the equal and inclusive development of human capital through education.

## Education and Human Capital

**One of the main challenges to achieving lasting economic growth and prosperity lies in the country's ability to invest effectively in education and human capital development.** As Malaysia moves towards a high-income economy, its continued growth will depend more on its ability to improve human capital and productivity. Malaysia's current level of educational spending surpassed that of the OECD average, yet our lagging PISA scores indicates that the outcome of investment has been ineffective at achieving high quality education. Other Asian nations such as Singapore, Japan and Korea have invested lesser GDP in education but have managed to obtain better outcomes.

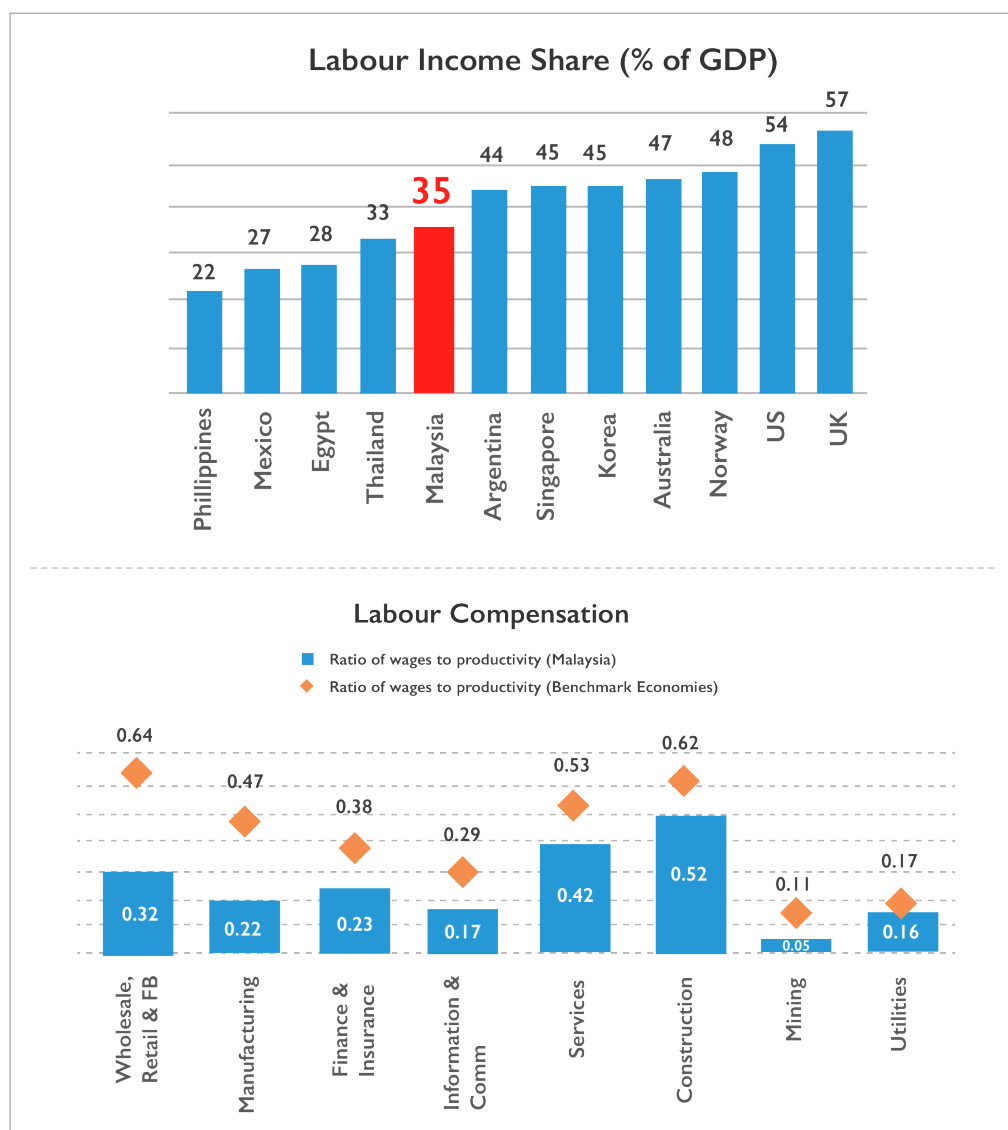


**Educational reforms must be at the forefront of government initiatives to correct the deficiencies in educational attainment.** Malaysia must firstly lessen the education divide to grow the human capital necessary to achieve long-term growth. Similar to income disparities, there is a clear educational divide between rural and urban communities, which must be addressed to prevent a cycle of poverty within the rural communities of Malaysia. In addition, the aim of investing in human capital is to incentivise a shift from labour-intensive to capital-intensive production. This shift away from unskilled cheap labour is particularly crucial for the modernisation of agricultural industries, which are concentrated in low-income areas and have persistently relied on labour-intensive production methods. To achieve this goal, the education system has to nurture the development of dynamic and adaptable skills, emphasizing on industry-desired STEM subjects, as well as provide adapted training opportunities and improving business participation in education.

**Brain drain was identified as a key cause of Malaysia's human capital deficiency.** According to the Malaysian Employers Federation, about one million Malaysians are currently working outside of Malaysia. Finding ways and incentives to retain this talent and convince them to participate in Malaysia's system is essential, especially when considering the potential of talented human capital to act as a multiplier of growth.

## Productivity Growth, Wages and the Cost of Living

**Increases in productivity and human capital growth have not resulted in a fair increase in labour income.** Whilst the average income of the B40 and M40 have increased over the years, labour income makes up only 35% of the total share of GDP. Malaysia's level of labour compensation is low when compared to similar aspirational economies, which illustrates that the gains from economic growth have not been equitably shared amongst the workers. This has led to a rising concern from workers that wages have not been rising sufficiently to meet the rising costs of living.



**Wage levels are a key indicator to the equitable distribution of economic gains.** The economic theme of shared prosperity would also have to address the issue of stagnating wages with minimal disruption to industries. The KLR recommendations to promote and ensure a fairer income for Malaysian workers include labour policy reforms, reducing the importation of cheap foreign labour, and utilizing private-sector initiatives to provide better returns to employees.

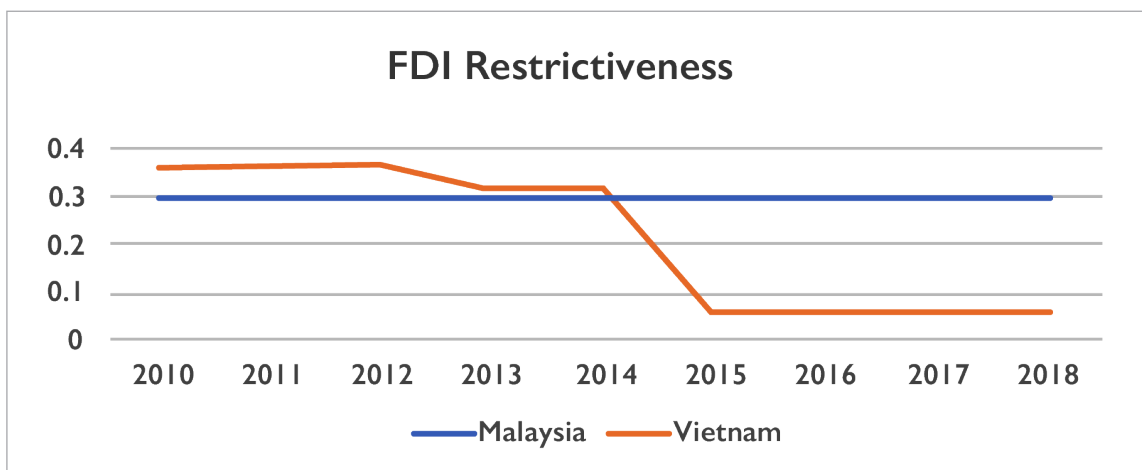
**Addressing the complex issue of cost of living requires a multidimensional approach.** The government must be effective at mitigating the challenges of rising living cost as the country aims to achieve sustainable and equitable growth of income. It is important to suitably define the targets to address the issues due to the differing economic contexts between Malaysian states. As a way to promote private-sector led increase in wages, the government should provide regular and transparent analyses of the suitable wage levels across the different territories in Malaysia, with clear definition between a minimum standard of living versus a decent standard of living that goes beyond necessities.

## Income Inequality and Affirmative Action

**Addressing income inequality through direct assistance will have to revolve around needs-based affirmative action.** Today, Malaysia's B40 holds only 16% of the country's income. In contrast, the bottom 40% of the population within Nordic countries hold 23-25% of their countries' income. Much research has shown that the New Economic Policy (NEP), which was introduced in 1970 to eradicate poverty and restructure societal imbalance, has been largely ineffective at tackling socioeconomic inequities. One of the objectives of the shared prosperity model is to ensure that the gap between the rich and the poor is reduced regardless of economic class, race or geographic location. To move forward in effectively implementing a model of shared prosperity, redistributive policies will have to address cross-cutting issues of poverty, educational disparity, employment opportunities and gaps in economic development. In order to achieve sustainable development, maximise on the inclusiveness of opportunity and foster national unity, this system of targeted assistance will have to be needs-based and resistant to political capture.

## Free Trade and CPTPP

**Malaysia, as an open economy, has to engage in trade agreements with the global economy and stay competitive, especially within the context of ASEAN.** This calls for structural reforms that aim to decrease the barriers to doing business as well as taking urgent measures in the short-term to pursue joint trade agreements and ratify the CPTPP Agreement. Positive reception towards international trade agreements are particularly essential in the context of the trade war between China and the United States. Malaysia should make an effort to take advantage of the situation as Vietnam seems to be the main beneficiary of the global trade tensions after their liberalisation through the CPTPPA ratification.





## Fiscal Policy and Tax Reform

**There is a call for the government to analyze the current tax system and build upon the defects and deficits of the previous GST administration.** Understanding the faults in the previous implementation of GST is essential as it is believed that this tax was economically efficient, but had been subjected to poor implementation and exploitation. The roundtable considered the GST system as an effective tax system and recognized its removal as being motivated by public commitments rather than economic rationale. The results of the GST removal and SST implementation in 2018 have not resulted in the reduction of the cost of living, as was popularly conveyed in many pre-election campaigns. The reformed GST system should consider differential rates between essential and non-essential products, as well as be progressive in nature through ensuring the taxation of income rather than consumption.

**Although SST had reduced the administrative burden, there remains a need to improve the trust and governance of Malaysia's tax system.** Even with the efficiency of GST systems, the SST tax system was nevertheless effective at reducing the number of businesses who had to comply, from roughly 400,000 under GST to about 80,000 under SST, thus also reducing the administrative burden in auditing monthly returns and claims. The revelations about the previous GST's refund system had exposed the propensity for fraudulence within the governance mechanism of the administrative bodies, resulting in the erosion of trust in the implementation of taxes in Malaysia. Regardless of the specific tax system, this governance gap must be addressed and should be remedied by decreasing the complexity of the tax mechanism through the continuous reforming of taxes.

**This reform also should also be followed by a general tax reform that would compensate the balance sheet further.** As far as the income tax is concerned, it should not be reduced as it is already quite low. Only 15% of Malaysia's 15 million workforce are paying income taxes. In the assessment year 2018, the 5%, 10% and 16% tax brackets were reduced by 2% each, to 3%, 8% and 14%, respectively. Improving the tax system through various initiatives such as reforming the road tax, for example, may be a more effective and progressive way to balance fuel consumption and tax collection than focusing on blanket fuel subsidies. Further innovative and fiscally balanced measures should be pursued when addressing social and environmental issues. The participants of the first roundtable strongly advised the PH government to not give into populist trends when it comes to fiscal policies.

## Better Public Pricing

### **Fiscal reform should be accompanied by an adjustment to the pricing of public services.**

Indeed, even though public revenue is increasing in Malaysia, public expenditure is increasing faster. Finding ways to increase revenue through tax is essential but serious efforts in reducing expenditure are also expected. Providing “free and cheap” services is not the right solution as it does not send the right incentives to the population, particularly to those who can afford to pay higher prices. Price controls on education and healthcare have to be removed to consider public service pricing based on needs and income levels. Charging accordingly to the earning capacity is a solution proposed by the roundtable.

## GLCs

### **Government-linked companies occupy a key position in the Malaysian economy, but to create growth and prosperity, these institutions have to be reformed and thus the structure of those GLCs also need to be revised.**

Both the socioeconomic and commercial aspects of GLCs have to be analysed to provide more clarity on their role in Malaysia’s economy. It is important to make sure that GLCs face a level playing field and compete equally with the private sector. Crowding out of the private sector in certain industry such as telecommunications, energy, and paddy should be addressed by dissolving monopolistic GLCs. Reducing the size and role of GLCs will also encourage competitiveness and avoid monopolies that undermine competition.

### **To promote GLC reform and improve corporate governance, it is necessary to create an independent institutional body or authority to monitor GLCs.**

Ultimately, the governance standards set by these companies have to improve and the link between GLCs and public procurement must also be scrutinized by an independent body. There is a need to review the seven GLCs and the Acts that govern them, which were once used to promote social causes but are no longer relevant now given that the size and nature of these entities have changed substantially since their establishment. Lembaga Tabung Haji (LTH), for instance, allows a Minister in the Prime Minister’s Department to decide its dividends, boards and investment decisions. Whilst this may seem incongruent to good governance, it is allowable under the Act. The conditions in which the Act were relevant, i.e. when the LTH funds were relatively small and used for pilgrimage, have now changed and so must the Act to accommodate corporate liability law provisions.

### **Promoting SME contributions to the economy will provide a market solution to lift the B40 and M40.**

The roundtable agreed that SMEs have a strong role to play in the equitable growth and development of the economy, and the government should strive to maximise their growth potential. Significant measures have to be implemented to ensure that large state-linked companies do not limit the economic opportunities of Malaysian SMEs.

## Foreign Workers



**Malaysia's importation of low- and semi-skilled foreign labour has inhibited the transition towards a modern and technologically-driven economy.** Although the roundtable agreed that it is imperative to reduce the reliance of employing foreign labour in filling the business demand for labour-intensive production, a short-term solution on foreign workers was not adopted. This dependence is caused by a shortage in the supply of Malaysian low-skilled workers, who do not compete with foreign workers due to their reluctance in pursuing dirty, dangerous and demeaning (3D) jobs. In this respect, foreign workers do not face competition from Malaysian workers in unskilled jobs. A potential short-term solution to filling this gap is by improving the labour conditions of 3D jobs, promote local worker participation, and instituting incentive structures for firms to hire locally.

**As a long-term solution, pushing towards greater automation in line with digitization in some industries is crucial.** To decrease the dependence of low-skilled labour, the country should continue to strive towards the Fourth Industrial Revolution and address the unrestricted importation of foreign labour. The government must also ensure that foreign workers get the same treatment as locals and condemn their exploitation by improving the legal framework for unskilled workers, which will simultaneously improve local working conditions as well as incentivise firms to adopt more capital-intensive production.

## Sustainability



**Malaysia's economic plans have underscored the elements of sustainable development encompassing sustainable economic growth, growth with equitable distribution to all sections of society, access to basic infrastructure and utilities, access to education and healthcare services, and mainstreamed environmental conservation.** In 2009, Malaysia formulated the New Economic Model (NEM) which further fixed Malaysia's commitment to pursue sustainable development based on three pillars, namely high income, inclusivity and sustainability, which mirrors three elements covered by the UN's Sustainable Development Goals (SDGs): namely economy, social and environmental elements. The NEM provides the basis for 5-year Malaysia development plans until 2020.

The theme of the 11th Malaysia plan is "Anchoring Growth on People," where people will be the centerpiece of all development efforts and to ensure that no section of society is left behind in participating and benefiting from the nation's development. In line with this plan, housing is now an issue that needs to be addressed urgently. This involves creating new growth centres to avoid concentration of the population in congested economic centers such as Kuala Lumpur. Connectivity would have to be improved to better the conditions for public and private commuting. Reforming urban transport can be a strong catalyst for achieving the Sustainable Development Goals (SDGs). The government may want to consider Singapore's HDB system as a model for solving the Malaysian housing crisis.

Following the recently announced outline of the Shared Prosperity initiative by the government, this section reiterates and summarises the main points reached at the first KL Roundtable discussion that are consistent to the key messages of the Shared Prosperity 2030 initiative:

## Shared Prosperity 2030

Economic Empowerment	Environmental Sustainability	Social Re-engineering
<ul style="list-style-type: none"> <li>• Educational reforms to correct the divide in educational attainment across rural and urban communities</li> <li>• Increasing effectiveness of public expenditure in education to maximise the outcome of investments</li> <li>• Malaysia has to engage in trade agreements with the global economy and stay competitive, especially within the context of ASEAN</li> <li>• Rationalising fiscal expenditures through decreased subsidies that benefit the rich and tax reforms to prevent leakages in tax collection</li> <li>• GLCs have to be reformed and restructured to create greater distribution of commercial activity, income growth and economic prosperity</li> <li>• Decreasing foreign worker dependence through improving 3D jobs, promoting local participation, providing incentive structures for firms to hire locally and pushing towards automation in labour-intensive industries</li> </ul>	<ul style="list-style-type: none"> <li>• Continue to emphasise sustainable development in the pursuit for economic growth</li> <li>• Improve urban transportation to promote the growth of networked growth centres as an effort to alleviate the population concentration in congested economic centres</li> </ul>	<ul style="list-style-type: none"> <li>• Addressing income inequality through direct assistance has to revolve around needs-based affirmative action</li> <li>• Shifting focus away from headline macroeconomic figures towards improving the standards of living for all</li> <li>• Develop and adopt a multidimensional tool to measure the facets of poverty and development</li> <li>• Increasing employee compensation through labour policy reforms, lessening foreign labour importation and promoting private sector initiatives</li> </ul>

## Policy Messages



**Promote a Malaysian identity in the national instruments of growth** - The roundtable suggests including a multidimensional measure of assessment that involves the nine challenges of the Vision 2020.



**Adopting a needs-based approach for economic policies** - Redistributive policies will have to focus on cross-cutting issues of poverty and income inequality that exists within and among all ethnicities, classes, communities and geographical boundaries.



**Promote civil society interaction in future policies** - To ensure a more holistic measure to achieve economic growth, social inclusivity and sustainable development, the government should include the consultation of various civil society organisations across Malaysia.



**Ensure a fairer income for Malaysian workers** - Income and wage increases should be handled with long-term solutions such as the strengthening of labour policies, reducing the importation of cheap foreign labour, and utilizing private-sector initiatives to provide better returns to employees.



**Addressing the cost of living issue** - Regulatory burdens that have resulted in the increased cost of certain goods and services should be adjusted by relaxing price and import controls, as well as implementing regulation holidays on key areas such as e-hailing and housing.



**Increasing labour productivity** - To promote greater efficiency of education expenditure and improve human capital development, the government should consider decentralising power over the appointments, salaries and curricula in public higher education institutions.



**Reduce GLC influence in the Malaysian economy** - GLCs should focus on new industries, collaborate more with the private sector and focus on their core activities. Government should lessen their role in controlling GLCs. In order, to promote GLC reform and improve corporate governance, it is necessary to create an independent institutional body or authority to monitor GLCs.



**Ratification of the CPTPP to enhance trade with other member countries** - Malaysia should make an effort to capitalise on the benefits of free trade and access to 495 million consumers representing 13.5% of the global GDP.



**Reforming the pricing of public services** - As a means to improve the government balance sheet and include greater targeting of public assistance, the government should consider a restructuring of public service pricing to better reflect the different income levels of its users.



**Introduce a reformed VAT** - The reformed VAT system should consider differential rates, be progressive in nature, simpler in compliance, and its reintroduction should be accompanied by campaigns of its benefit.



**Reducing the size of the public sector workforce** - To lighten the government's operational expenditure, a new scheme should be introduced that allows voluntary early retirement for public sector employees.



**Conduct an analysis of the AP license system** - Evidence has suggested that this system has led to patronage exploitation and ultimately the rising cost of living.

## Appendix

### Full list of KLR members



**Datin Ami Moris**



**Dr. Cheong Kee Cheok**



**Tan Sri Datuk Clifford Francis Herbert**



**Firoz Abdul Hamid**



**Tan Sri Datuk Dr. Kamal Salih**



**Dato' Kong Sooi Lin**



**Tan Sri Dato' Dr. Lin See-Yan**



**Prof. Mahendhiran Nair**



**Emeritus Prof. Datuk Dr. Mohamed Ariff**



**Dato' Yusli Mohamed Yusoff**



**Ng Yeen Seen**



**Prof. Tan Sri Dato' Seri Dr. Noor Azlan Ghazali**



**Dato' Dr R. Thillainathan**



**Tan Sri Dr. Ramon Navaratnam**



**Tan Sri Datuk Dr Rebecca Fatima Sta Maria**



**Tan Sri Dato' Mohd. Sheriff Mohd. Kassim**



**Prof. Yeah Kim Leng**



**Tan Sri Yong Poh Kon**



**YAM Tunku Zain Al-'Abidin**



**Tan Sri Zarinah Anwar**



**Ali Salman (Ex - Officio)**





