Show Us the Money, Equitably

The recent report by Nomura Global Research last 9th January 2019, was painful to read to say the least. It stated Malaysia has poor earnings growth prospect and is one of the worst in the region while also stating they have not seen neither improving macro momentum nor reforms coming through which could lead to improvement in earnings growth.

Alliance Bank chief economist, Manoharan Mottain, at the Kingsley Strategic Institute's Malaysia Economic and Strategic Outlook Forum 2019, vented his frustration that Malaysia is seen to be lacking in concrete ideas and clarity in economic policies, eight months after the fateful 9th May 2018 that changed Malaysia. He added there is no action yet on how to transform job structure from low-skilled jobs to high-skilled variants. Everyone seems to talk about the importance and the need to have high-skilled jobs but no concrete measures are being taken. What is more appalling is Mottain's claim that there is lack of communication between the government and the investing fraternity.

The silver lining is when the Prime Minister recently announced the government is establishing a body similar to the New Economic Action Council (NEAC) to accelerate decisions in relation to the country's economy. Many placed high hopes in this yet to-be-named action council to help ease the anxiety of the business community, hopefully providing clues and hints about our economic direction.

YAB Tun Dr Mahathir also mentioned the coordination between the ministries including his o office is not aligned. The Edge Weekly December 31, 2018 article heading, "*The economy needs fixing but who is really in charge?*" accurately sums it up.

It takes our 93 year old Prime Minister to set things straight. Again.

Diversification

On economic growth, there is no question that Malaysia should **enhance its industrialisation economy and not rely solely on her commodity revenue.** The current economic model that has successfully brought Malaysia to where it is now is not sustainable.

Malaysia should spread the risk with a portfolio of diversification. We can no longer rely on our mining and plantation commodity sectors. Furthermore, primary commodities are price prone and coupled with demand fluctuations, can be risky for Malaysia.

Rapid technological advancement can change primary commodities quite drastically with changes coming from technologically superior countries. Malaysia learned the hard way with the introduction of synthetic rubber. If we do not learn from our mistakes and not act on the rapid development in alternative energy technologies, it will be deja-vu all over again for this country.

The ultimate source of economic development in the long run is productivity. Malaysia's Total Productivity Factor (TFP) has been 1.8% on average. We have been consistently lower than the ASEAN Average since 1990 and less than OECD countries since the global recession. The 11th Malaysia Plan Mid Term Review 2018-2020 (11MP MTR) aims to boost the annual growth rate of TFP to 2.3%, and diversification is needed to upgrade the economy's productive capabilities. A more diversified economy has greater productive capabilities.

The notion of diversifying into activities related to current practices especially with natural resources may well be gone. We have been in the past encouraged to diversify from producing oil into petrochemicals, for example. As Prof. Ha-Joon Chang of the University of

Cambridge said in his *Economic Diversification and Economic Development* paper, after the first few stages, where you diversify into is no longer obvious. Do we go from synthetic fibre to garments and on to fashion design; or from pharmaceuticals to medical equipment to biotechnology?

What we need is a continuous and coordinated series of unrelated diversification, at least until we reach a certain level of development. Prof. Chang added countries become good at certain industries only because they decide as much and not because they are destined to do so, by making the necessary investments in machines, research and skills.

Will it take the current Government of the day one term in office to fully establish these new industries? Realistically, a longer time frame will be required. Nevertheless, it is imperative that the Government **balance between supporting the new industries and supporting the existing industries including our primary commodities.**

Embracing the digital economy

South Korea is ranked as no. 1 as the world's most innovative economy according to the 2019 Bloomberg Innovation Index as revealed at the World Economic Forum in Davos, January 2019, followed by Germany and Singapore at no. 6. Unfortunately Malaysia was not mentioned. Malaysia needs an economy that is driven by innovation an economic growth that is translated into meaningful improvement in living standards, one that is able to reduce our vulnerability to technological changes.

Malaysia has been successful in the electrical and electronics (E&E) sector after much investment and resources poured into the industry in the last 50 years. Some of the ingredients that helped us get where we are now are already in place for a similar transformation of the digital economy. **Malaysia needs to create an ecosystem for its digital economy that incorporates reforms to its infrastructure, policies, skills and public finance.**

Penang Trade Zone (PTZ) that was founded in 1969 became the global manufacturing hub in E&E with the establishments of world's leading semiconductor companies into PTZ. Malaysia has since moved up the value chain moving closer to regional distributed production networks. In 2016, Malaysia became the first country in the world to establish a Digital Free Trade Zone (DFTZ). DFTZ is a trade zone that promotes e-commerce growth for SMEs with state-of-the-art platforms and committed investment from Jack Ma, CEO of Alibaba, the largest e-commerce company in the world.

To ensure a sustainable growth in the digital economy, the Government needs to address key barriers related to digital entrepreneurship. It is imperative that Malaysia fosters entrepreneurial economy.

Malaysians workers still lack the necessary skills to prosper in the digital economy. Human capital is the biggest barrier to fully developing the digital economy in Malaysia. *World Bank Malaysia Economic Monitor: Data for Development, June 2017*, has identified the lack of digital skills as a critical factor to economic transformation for Malaysia.

Malaysia's education system is still lagging in its preparation of adequate and relevant graduates for its high-tech industries, let alone the demands of the digital economy. Studies show that there is an inadequate creation of skilled jobs, high youth unemployment and graduate underemployment in the country. The Department of Statistics, Malaysia (DOSM) reported that in 2017, 13.2% of Malaysians are youth; 40% of the total unemployment is youth ("youth" refers to persons aged between 15-24 years). Consequence of persistent youth unemployment can be severe as one's youth should be a period in an individual's life when his/her human capital increases as a result of job experience, leading to future productivity.

Technical, vocational education and training (TVET) is still taboo to many and unpopular with students and industries alike. **There is an immediate need to elevate TVET as a viable education option, not as a fall-back bottom-of-the-list choice. TVET pathways should be equally valued and cultivated.**

For medium-to-long term, Malaysian Government needs to commence fostering partnerships between universities and learning institutions, private sectors, industry players and centers of excellence, including international institutions such as TUM International GmbH, Korea Research Institute and Creativity Centre (KRIVET), Taobao University, and Alibaba Global Initiatives.

As a short-term measurement, Malaysian start-ups can recruit talents from abroad. Optimize the budget allocated in the Budget 2019 to streamline TVET's strategic goals and management of its activities into one single entity empowered by a TVET Commission. Among them include:

- RM206 million for development and training programmes in polytechnics and community colleges;
- RM20 million to raise youth competency via TVET-sponsored boot camps.

A concerted effort between the different ministries, the Department of Skills Development (JPK), and Malaysian Qualification Agency (MQA) to develop a standard definition, accreditation and rating system of TVET within a comprehensive Malaysian Qualifications Framework (MQF) will provide TVET the necessary social recognition and affirmation that makes it an attractive option for students. Tying TVET to digital entrepreneurship could help rebrand it as a favourable option. Obtaining industry captains in their respective fields in the TVET training curriculum development, and possibly delivery too, will further solidify TVET graduates into the real world.

Access to capital is a major constraint to growth for businesses in Malaysia. The *World Economic Forum, Global Competitiveness Index 2017-2018, Country/Economy Profiles, "Malaysia"*, Executive Survey identified access to capital as the biggest obstacle to doing business in Malaysia. Many entrepreneurs get financing from abroad, usually from Singapore.

The RM2 billion set aside by the Government-linked investment funds (GLIFs) as announced in the Budget 2019 to co-invest on a matching basis with private equity and venture capital funds in sectors in strategic sector and new growth area such as digital economy will provide the boost that it needs.

GLIFs such Malaysia Venture Capital Management (MAVCAP), Malaysia Debt Venture (MDV), Malaysia Industry-Government Group for High Technology (MIGHT), and Cradle Fund should be more aggressive, supportive and focused in providing financing to technologists, technopreneurs and digital entrepreneurs.

The Government also announced in the Budget 2019 the creation of a Co-Investment Fund with a grant of RM50 million. It is to enable the government to co-invest with private investors to finance the development of new businesses, especially for the small, medium and medium enterprises (SMEs).

Government should also provide space to private-sector angel investors and venture capitalists (VCs) to ensure a vibrant entrepreneurship ecosystem. We need more "big players" to sustain the market, cultivating an environment to encourage VCs that could support niche markets such in the digital economy sector.

Inclusivity and wealth inequality

The 11MP MTR is very clear and firm in stating the nation's vision to become a *developed and inclusive* nation. To ensure a firmer foundation for a more sustainable and inclusive growth in the long term, it is necessary to have some temporary trade-offs on economic growth.

Growth patterns that lack inclusiveness and encourages inequality generally fail. More often than not, the reason for this failure is not solely economic. Malaysia is cognisant of this fact and has outlined one of the six pillars highlighted in the 11MP MTR to enhance inclusiveness towards an equitable society.

Inequality weakens the economy, undermines democracy and divides society. Nobel laureate Prof. Joseph Stiglitz in one of his writings discussed how inequality undercuts economic performance, lowering demand and increasing instability. He uses the United States of America as an example to emphasize his point. As a government of 1%, for the 1%, and by the 1% works to enrich the 1%, through corporate welfare and tax benefits, fewer resources are available for investments in infrastructure, education, technology – investments that are needed to keep the economy strong and growing.

Those who lack sufficient opportunities to reap its benefits fuels social polarisation which may lead to political instability, short-sighted decision making with serious long-term consequences for economic performance.

The "Yellow Vest" protest in France is not so much about the fuel tax as it is about the French government's lack of apathy towards the plight of the middle class. Similar frustrations in the United Kingdom in 2016 resulted in BREXIT.

There must be a well-defined strategy and agenda with delicate series of succession and pacing of reforms to ensure an effective pursuit of economic and social progress. It is not so much of knowing where you will end up but finding out how to get there.

As mentioned earlier, GDP growth is necessary. It measures how well our national economic performance is performing. We need this to ensure the living standards progresses well. But growth alone is not enough for constantly rising median living standards.

The Khazanah Research Institute (KRI) paper, *Improving Income Inequality: Fact or Fiction?*, in November 2018 stated that the level of income inequality in Malaysia has been declining. In fact the Gini coefficient for Malaysia has shown that Malaysia has improved from 0.51 in 1970 to 0.40 in 2016 (with 0 being totally equal and 1 being totally unequal). But ironically, Malaysian public perceptions on the ground show otherwise.

The real income gap between the rich and the poor has widened. The economic realities faced by Malaysians are very different depending on where they live. Gini coefficient measures the relative gap. Relatively, the gap has narrowed between the "haves" and "have-nots". But when compared on the absolute term, the income gap has widened. In 1970, the Top 20 household (T20) earned RM3,300 more than Bottom 40 households (B40). In 2016, the T20 household earned RM13,200 more than the B40.

Studies show wealth disparity is higher than income disparity. Wealth inequality remains high and widening. The *World Inequality Report 2018* shows that the global wealth inequality is extreme and on the rise. If this trend continues with no affirmative and effective actions put in place, the Report forecasts that by 2050, the top 0.1% wealthiest in the world would be on average 400 times wealthier that the global middle class. What is more worrying is that in Malaysia more than half of Malaysians have no financial assets, more than a quarter of Malaysians have no property assets; and about 12% of Malaysians have no wealth, as the study by Dr Muhammad Khalid in his *Colour of Inequality* book shows.

Improving the country's Gini coefficient to 0.385 to improve the overall income inequality as expounded in the 11MP MTR is not the sole target of the Government. It also plans, and rightly so, to uplift the B40 household to the middle class. The Government is targeting to increase the B40 household mean monthly income to be RM4,430 and the median monthly income to be at RM4,790. This is not only to help raise the income of the B40 household, but also to raise its purchasing power.

Taxation

The 11MP MTR made many people anxious as some anticipated new taxes will be introduced and the existing ones increased as part of the Government's efforts to boost the country's coffers. When the Budget 2019 was finally tabled at the Parliament, some sighed with relief while others were disappointed.

Malaysia's Tax revenue in 2017 accounted for 80% of the RM225 billion revenue. 53% of the Tax revenue was from Direct Tax. As the Chief Economist, Economic Research at MARC, Nor Zahidi Alias said, our revenue base has to be widened and we need to look at new taxes, apart from a wider scope of SST.

Tax structure and assets prices are currently pro-rich, and this contributes to the widening wealth gap. It favours capital owners and not wage earners. Net proceeds from financial assets are privileged over wage earners. It is bizarre to think that there is no taxation from capital gains stemmed from short-term speculation in the stock market, whilst for the long-term serious investors are taxed on dividends received. Capital gains from financial transactions are mostly non-taxable and income is taxed on a progressive scale, but tax on dividends is uniform across the board regardless of the amount.

We need to consciously move away from the tax system that benefits the rich at the expense of the poor. Government policies, especially via a pro-rich taxation regime must be revisited. There is a need to reform the tax structure from fiscal measures that facilitate the acquisition of wealth for the non-poor, while encourage income maintenance for the poor. The tax reform should be attentive to impacts on aggregate demand, and especially those that have larger multiplier.

WID in its *World Inequality Report 2018* states that tax progressivity is a proven tool to fight against rising income and wealth inequality. It reduces post-tax inequality and diminishes pre-tax inequality, by giving top earners less incentive to capture higher shares of growth via a aggressive bargaining pay rises and wealth accumulation. Progressive taxation plays a major role in reducing inequality and can be associated with rapid and sustained growth. It not only improves the distribution of income, but also stimulates the economy.

The government should be fairer in instituting progressive tax on real property gain tax (RPGT). This includes transfer of properties among family members. As Dr Muhammad Khalid succinctly puts it in his *Colour of Inequality* book, how is it that when Middle 40 household (M40) tax payers who sell their house to finance their children's education must pay tax but transfer of houses from a rich father to his son escapes any taxation?

Currently, we do not impose any inheritance tax. Inheritance plays a major part in preserving inequality and asset accumulation. The exemption on inter-generational transfer of properties would increase the gap of inequality between the rich and the poor. Even monies received as death gratuity is fully exempted from income tax. If this continues, our wealth gap will continue to widen further and will lead to social instability. An increase in the inheritance tax may induce some of the wealthy to consume more, and this may also stimulate the economy. This tax reform is also recommended by the WID in its *World Inequality Report 2018* as one of the tax policies reform.

Indirect tax (which accounts to about 25%-30% of the total tax revenue) on goods and services, for e.g. excise as well as taxes on goods and service affect more on poor consumers than the rich. But taxes that do not impact the high-income earners, such as real property tax and tax on luxury goods are lax.

Individual income tax should aim at creating a fair tax system that removes the escape clauses for the rich. It must increase progressivity of the tax system and improves the efficiency of the economic system.

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