



Institute of Strategic and International Studies
**Economics, Trade
and Regional Integration**

Institute of Strategic and International Studies
**Social Policy and
National Integration**

Policy issues in advancing social and economic progress

Discussion: “Creating fiscal space for constructing Malaysia’s social protection floor”

Calvin Cheng
Fellow, Economics

Lee Min Hui
Senior analyst, Social policy





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4 The role of social services

Why invest in a social protection floor?

- ▶ **There are both economic and social rationales for social protection, but both are intertwined.**
- ▶ **Economic: human capital, inclusive growth, and economic stability reasons.** Higher human capital accumulation leads to higher productivity, wages, long-run growth. Greater aggregate demand stabilisation during economic downturns supports macroeconomic stability. Reducing poverty reduces strain on public and social services.
- ▶ **Social: social inclusion and cohesion, socio-political stability, inclusion, and enhances capabilities.** Social protection promotes social cohesion and inclusion, which supports socio-political stability. Expands choice sets by restoring freedom for individuals to achieve desired functionings.

Why now?

► **Individual choice increasingly eroded by rising global inequality, routine-biased technological change, and lingering impacts of Covid-19 on education and skills.**

- **Rising income and wealth disparities increasingly constrain equality of opportunities** in access to education, social capital networks, and constrain social mobility.
- **Rapid advancement in technology (including AI) and routine-biased technological change** threaten job quality and pathways to a decent standard of lifetime wellbeing.
- **These trends intersect with the pandemic’s lingering impacts on education, jobs, and skills.** Covid-19 jobs impacts, human capital scarring and learning losses were socioeconomically stratified.
- **Malaysia now in a relatively good position to invest in its future.**

Source: Cheng (2022). “Post-Covid-19 recovery and quest for ‘good jobs’”.

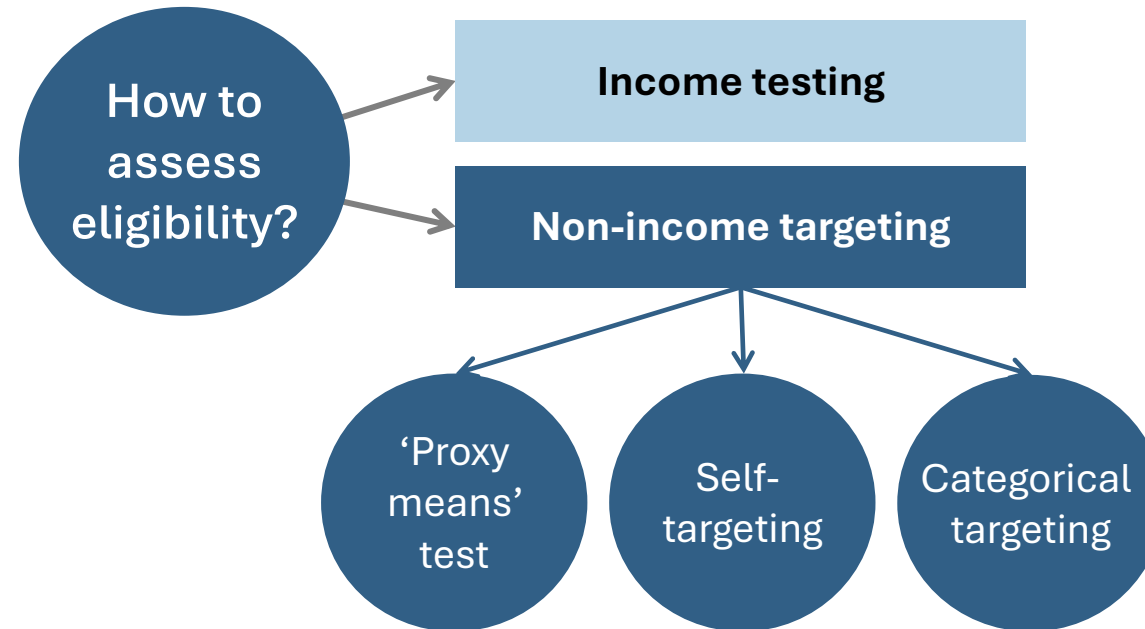
2 Social transfers

A SPF still requires good targeting and programme design

Why targeting (still) matters

► Moving away from targeting ‘incomes’ to targeting lifecycle vulnerability’ still requires targeting.

► So how can we assess who is eligible for benefits?
Benefit targeting mechanisms

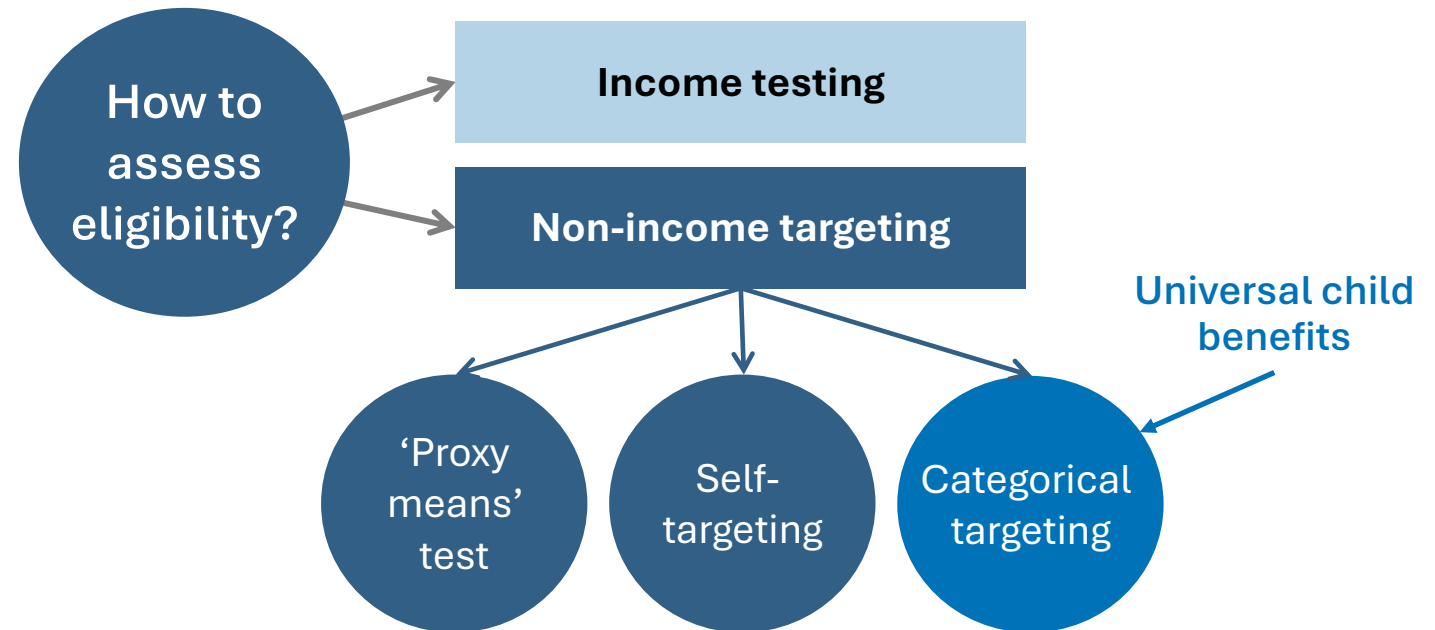


Source: Author’s illustrations based on Cheng (2023) and Barr (2020).

Why targeting (still) matters

► And even ‘universal’ benefits require targeting.

► So how can we assess who is eligible for benefits?
Benefit targeting mechanisms



Source: Author’s illustrations based on Cheng (2023) and Barr (2020).

Why targeting (still) matters

- ▶ And even ‘universal’ benefits require targeting.
- ▶ Once we even start to ask questions about who should and should not be eligible for benefits, we are already targeting.
- ▶ ‘Universal’ benefits are in fact categorically targeted (e.g. we target to reach all within a category: all families with children, everyone who has an IC)
- ▶ And if we ARE targeting, this means we still have to worry about all the issues that arise with targeting mechanisms. E.g. How are we going to assess eligibility? Do the indicators we are using to assess eligibility meet the gold standard of being accurate, non-manipulable, and easy to observe?

Source: Cheng (2023) “How should we target social benefit and transfer programmes?”.
Barr (2020).



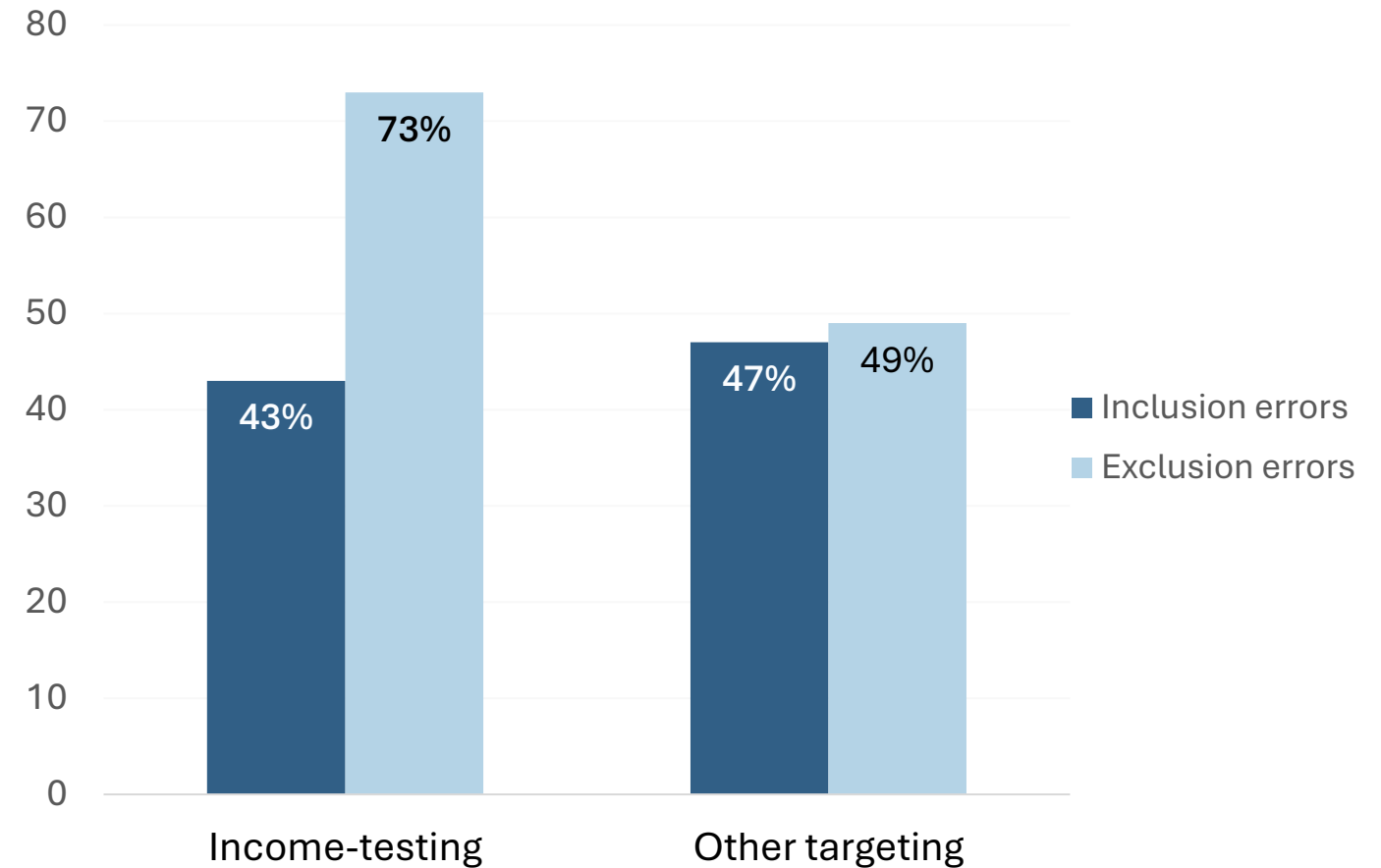
Why targeting (still) matters

- ▶ This also means that we **still need to think about targeting errors.**

Source: Author's estimates reproduced from Cheng (2023) "How should we target social benefit and transfer programmes?", using data from Devereux et al. (2017).

Note: Other targeting includes proxy-means, self-targeting, and categorical targeting

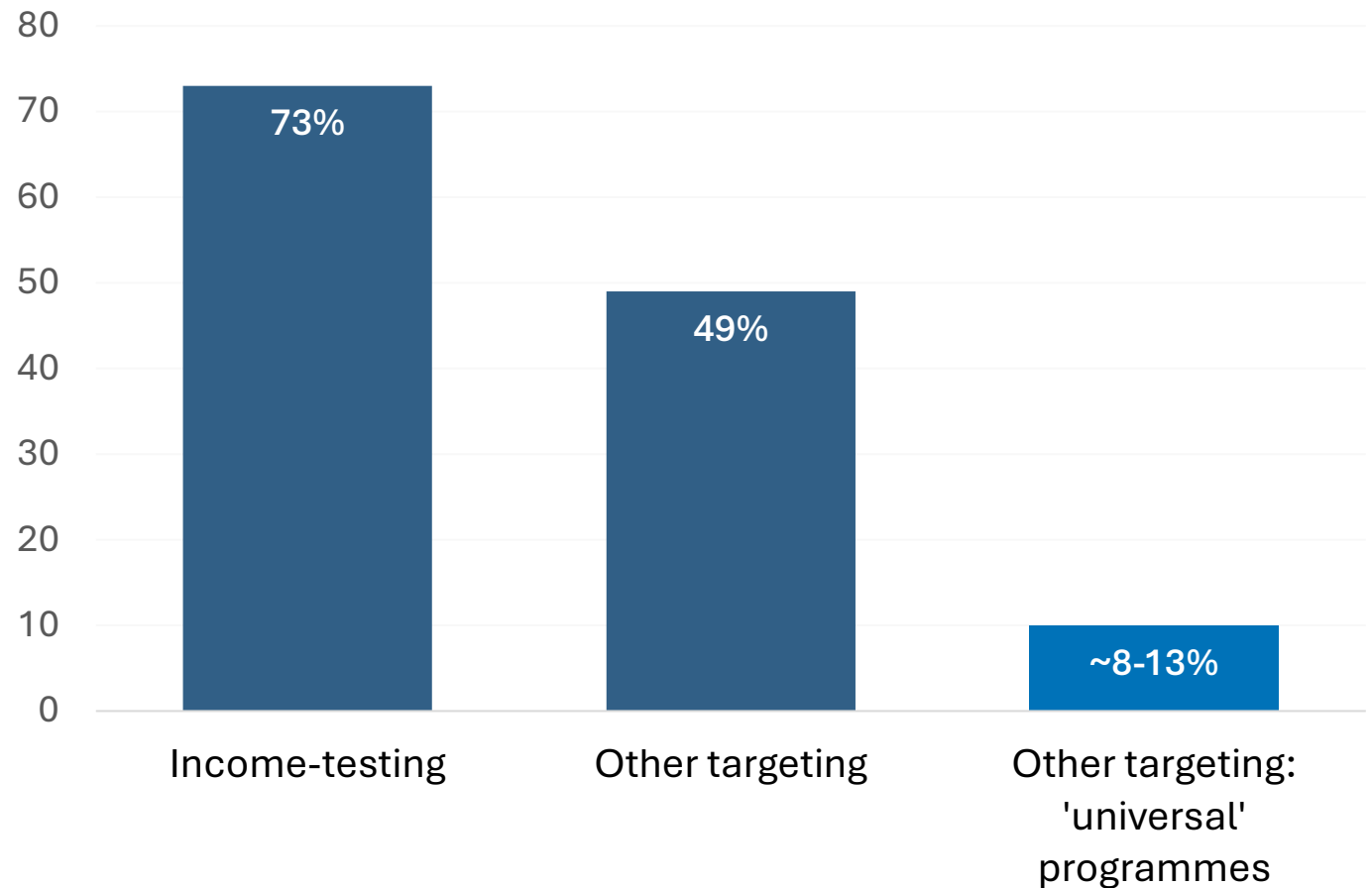
Average targeting errors (%) by targeting mechanism



Why targeting (still) matters

- ▶ Because even ‘universal’ programmes still have non-zero exclusion errors.

Average exclusion errors (%) by targeting mechanism



Source: Author’s estimates using data from Devereux et al. (2017).

Note: ‘Universal’ programmes include Mongolia’s universal child benefit, and universal social pension programmes in Nepal, Brunei, Mexico City, Botswana



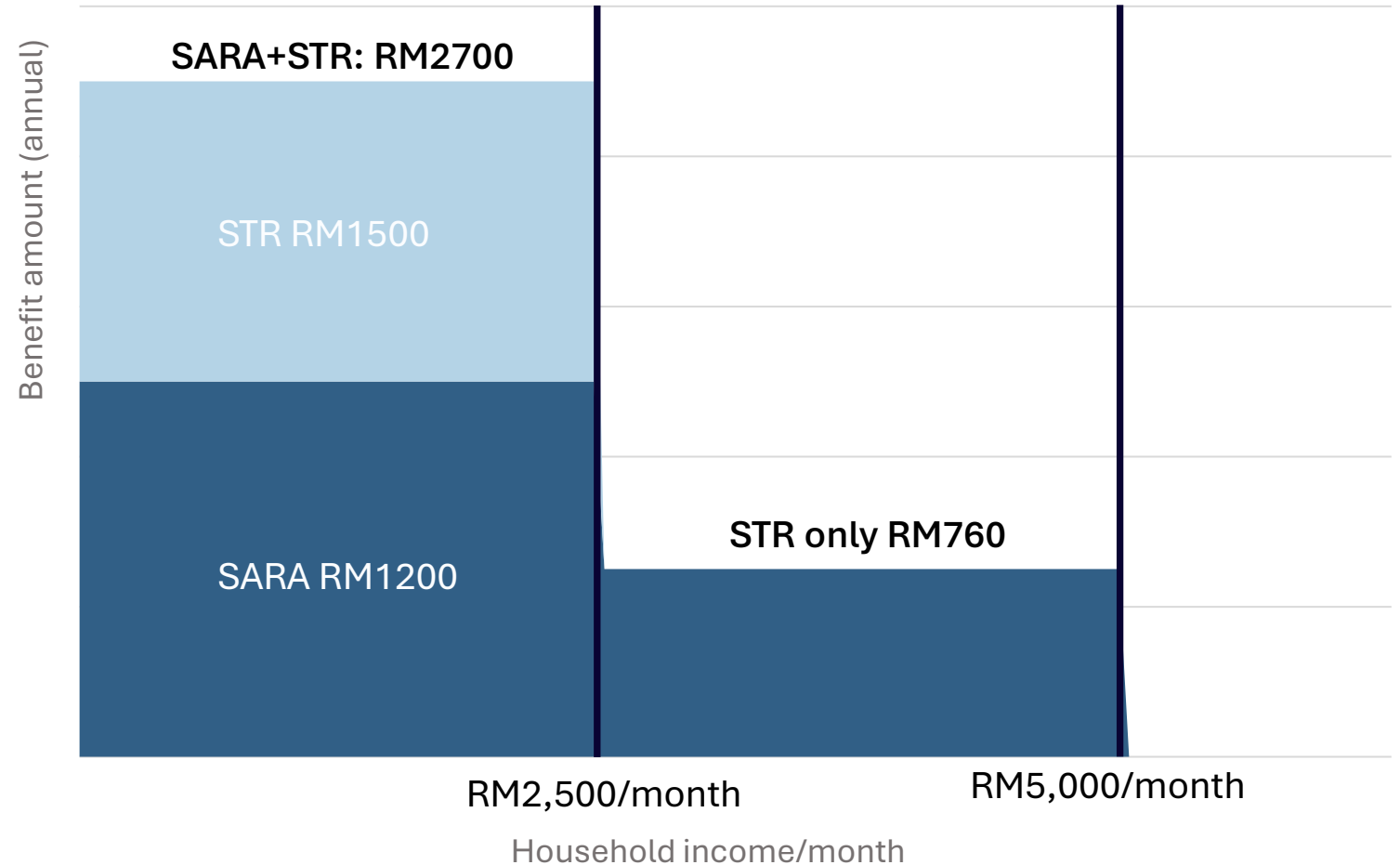
Good policy design can make social transfers better

- ▶ **Bottom line: we still need to worry about getting better at targeting and making good programme design choices.**
- ▶ **Recall: our goal is to improve wellbeing and restore social and economic functionings – subject to practical constraints:** cost efficiency, preserving work incentives, and ensuring social protection remains responsive to economic conditions.
- ▶ **Good policy design choices can help us meet these goals while optimising within those constraints.** This means reducing making social transfers more accurate, fairer and more responsive to prices and growth shocks.
- ▶ **Plus, some components of the SPF will likely still need to be income tested –** even if only for political reasons and only in the medium-term, and especially if social transfers will be used to offset/target fuel subsidies. So we need to get better at income-testing too.

Benefit cliffs and maintaining work incentives

- ▶ Benefit cliffs create high effective marginal tax rates at the thresholds, which can disincentivise additional work or encourage underreporting of income at eligibility thresholds.

- ▶ Large benefit cliffs exist at RM2,500 and RM5,000 income thresholds
Benefit levels by transfer programme for a family with 2 children

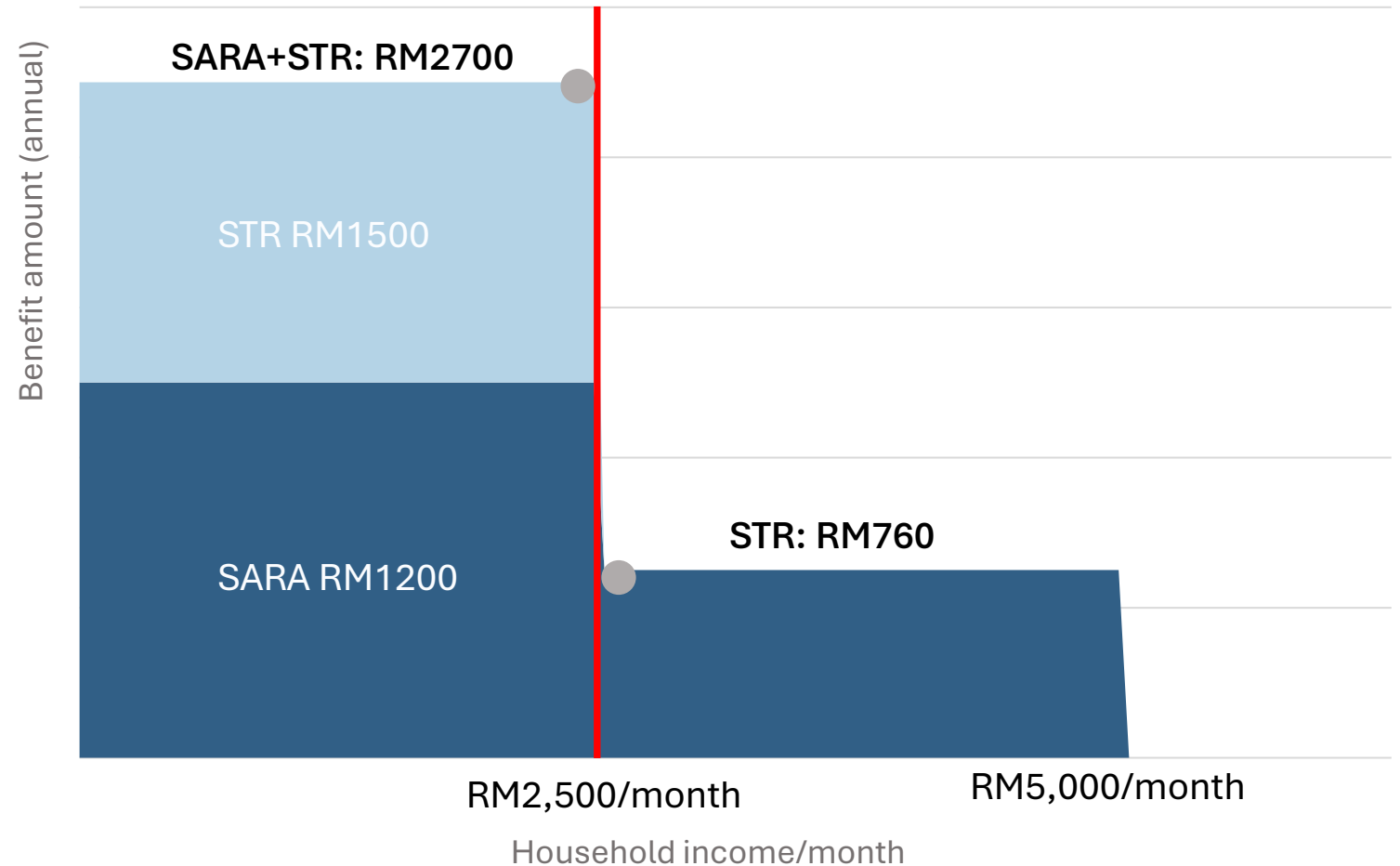


Source: Author's illustration using STR benefit data from ecentral.my

Benefit cliffs and maintaining work incentives

- ▶ Benefit cliffs create high effective marginal tax rates at the thresholds, which can disincentivise additional work or encourage underreporting of income at eligibility thresholds.

- ▶ Going from RM2,500 to RM2,501/ month triggers huge loss in benefits
Benefit levels by transfer programme for a family with 2 children

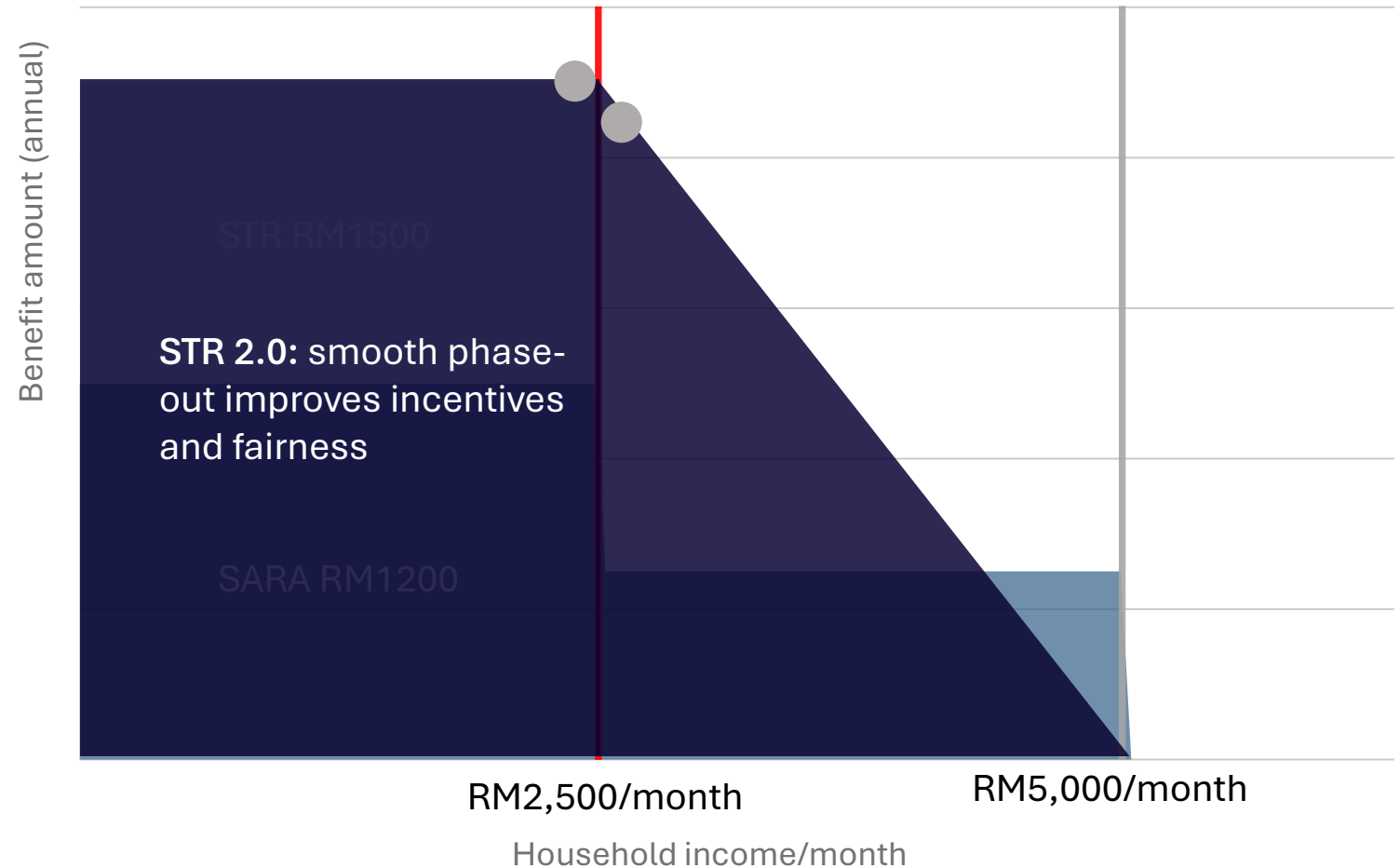


Source: Author's illustration using STR benefit data from ecentral.my

Benefit cliffs and maintaining work incentives

- **Changing cliffs to slopes:** a gradual phase-out removes perverse incentives and makes additional work more attractive, while also making benefit system more fair.

- **Making benefits gradually phase out improves work incentives**
Benefit levels by transfer programme for a family with 2 children

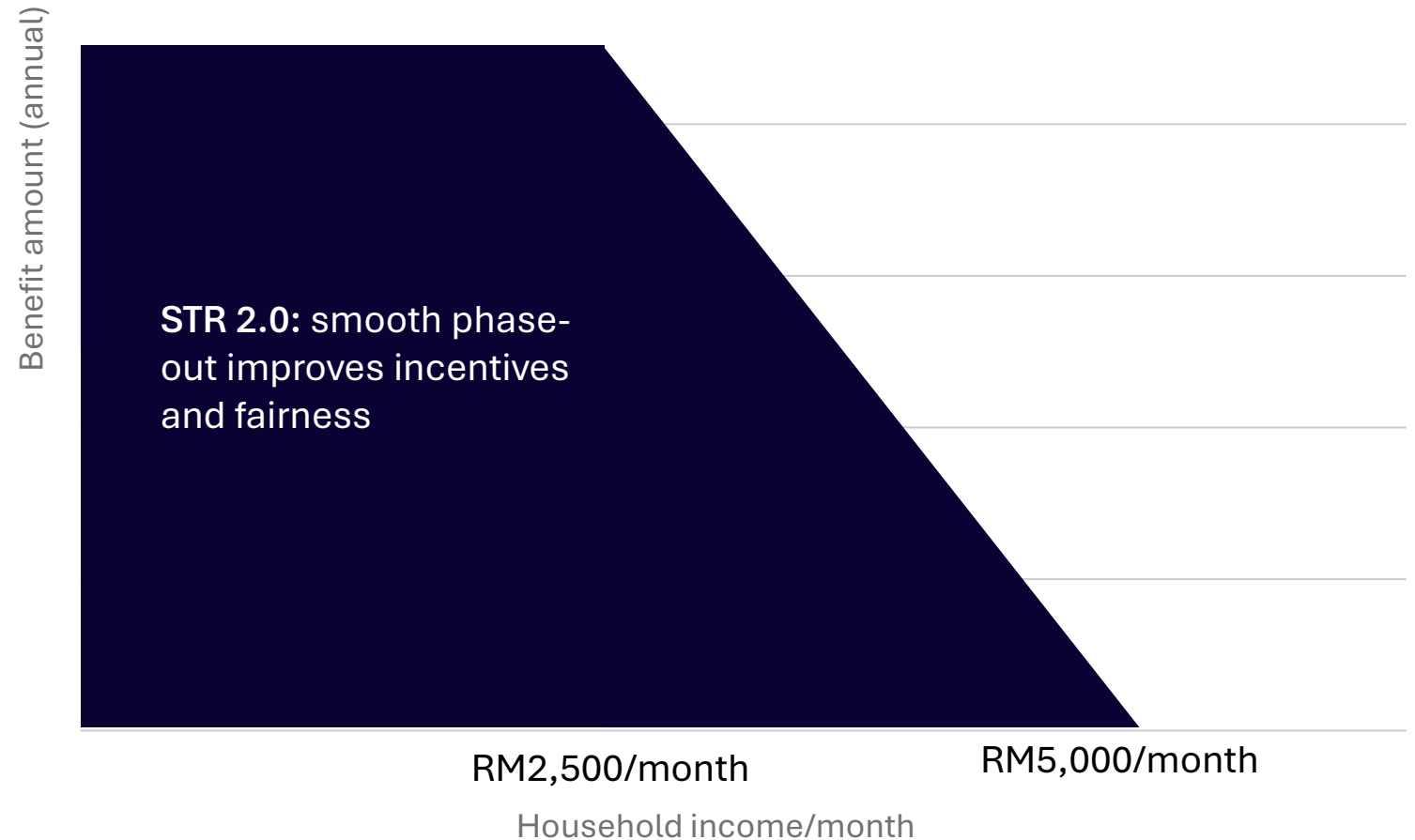


Source: Author's illustration using STR benefit data from ecentral.my

Benefit cliffs and maintaining work incentives

- ▶ **Changing cliffs to slopes:** a gradual phase-out removes perverse incentives and makes additional work more attractive, while also making benefit system more fair.

- ▶ **Making benefits gradually phase out improves work incentives**
Benefit levels by transfer programme for a family with 2 children



Source: Author's illustration using STR benefit data from ecentral.my

Making the benefit system more responsive

- ▶ **We need a systematic rules-based way to allow benefits to increase in line with inflation** – whilst making the social protection system more responsive to macroeconomic shocks.
- ▶ **Currently, STR (and other benefits) are adjusted year-to-year in an ad-hoc, non-transparent, and irregular way.** This creates uncertainty and unpredictability in how benefits are set.
- ▶ **Creating rules-based mechanisms for benefit adjustment that reflects current economic conditions will make the benefit system more responsive and fairer.** This will entail linking benefit amounts to a specific high-frequency price index like consumer price inflation (CPI) or a specific ‘cost of living reference’ index.
- ▶ **‘Index-linking’ means the real value of the benefit will increase in line with costs.** This increases certainty, maintains the real purchasing power for beneficiaries, and limits political interference in benefit-setting (e.g. Bolsa Familia in Brazil).

Source: Trujillo, Cheng, Arimbi, Nogueira (2023) “Using index linking to safeguard vulnerable communities during economic uncertainty”.

Making the benefit system more responsive

► Case study - Argentina's Universal Child Allowance (AUH):

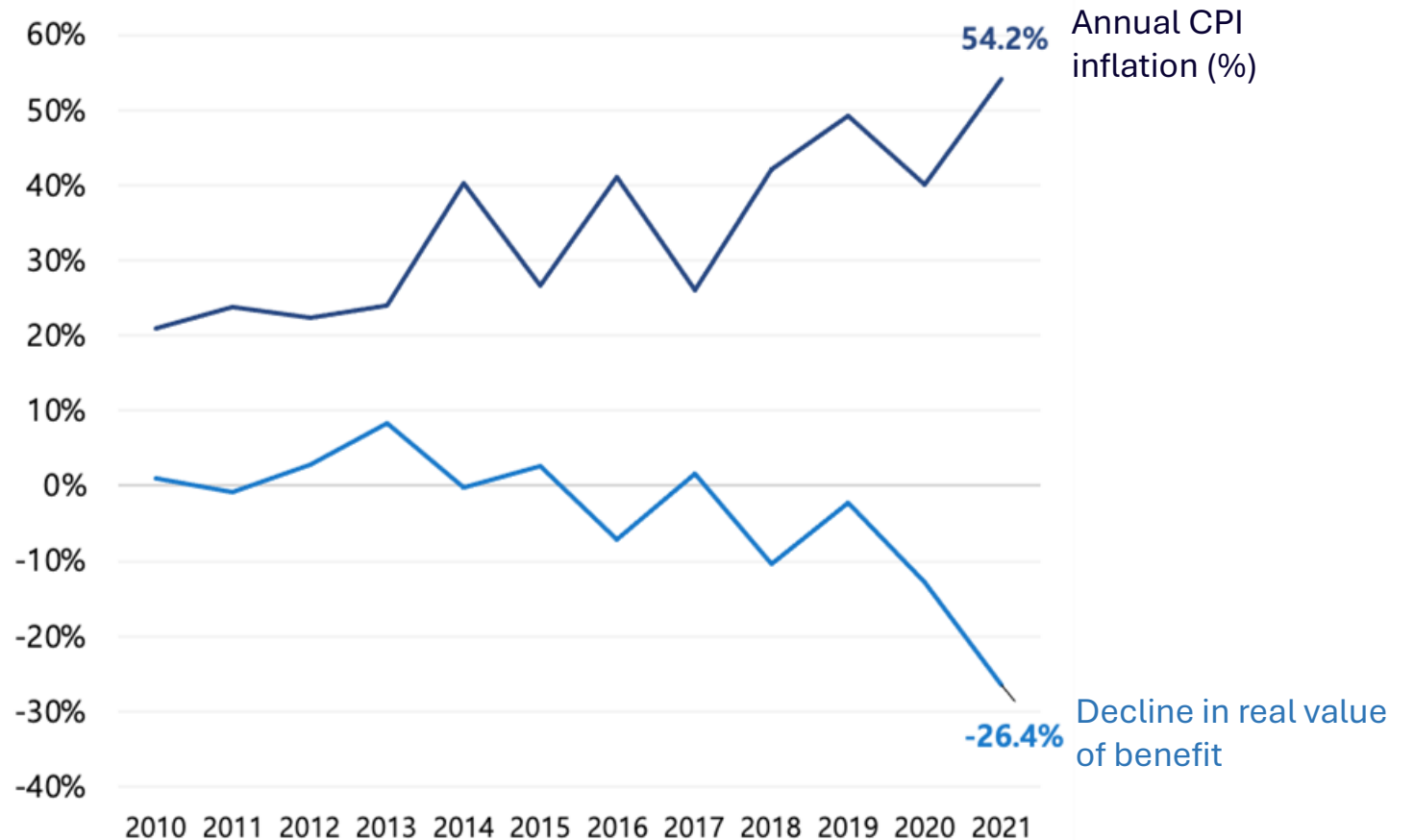
Allowance (AUH):

High inflation eroded the purchasing power of benefits, forcing beneficiary families to cut back on essential items, increasing vulnerability.

Source: Charts from Trujillo, Cheng, Arimbi, Nogueira (2023) "Using index linking to safeguard vulnerable communities during economic uncertainty". Note: AUH = Asignación universal por hijo

► Argentina: a quarter of purchasing power of benefits lost to inflation

CPI (%) and benefit gap (real value of benefits as % of nominal value)



Making the benefit system more responsive

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Source: Trujillo, Cheng, Arimbi, Nogueira (2023) “Using index linking to safeguard vulnerable communities during economic uncertainty”.

Reducing targeting errors

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- ▶ **Combining targeting mechanisms can make targeting more accurate.**
- ▶ **Paper outlines some good ways to decrease targeting exclusion errors**, including reducing complexity, compliance costs and information asymmetries. When beneficiaries have better access to information and simplified processes, participation rates increase, and targeting accuracy improves.
- ▶ **Combining targeting mechanisms:** combining targeting methods can increase accuracy by up to 15 per cent per additional mechanism (Coady et al. 2004).

Source: Reproduced from Cheng (2023) “How should we target social benefit and transfer programmes?”. Coady et al. (2004).
Devereux et al. (2017).

3 Financing

**In the longer run, we probably
also need more progressive taxes**

Financing considerations

- ▶ A VAT-style consumption tax like **the GST will likely be necessary within the next couple of years.**
- ▶ **A VAT style tax like the GST is not just efficient, but also inevitable.** Has many desirable attributes: transparent, efficient and stable long-term revenue stream.
- ▶ **Other alternatives not particularly appealing nor sufficient.** Relying on oil revenues probably bad. Smaller piecemeal tax changes not sufficient to plug the gap. Corporate taxes probably cannot go up that much – Malaysia already amongst the highest rates in a low-tax region.
- ▶ **Primarily an implementation and change management challenge.** This will require effective communication, gradual reintroduction (potentially at revenue-neutral rates of about ~4%), and a more efficient tax refunds system.

Source: Cheng (2023) “Why we should welcome back GST”. Cheng (2018) “Consumption taxation will eventually return”

Financing considerations

- ▶ **We know the GST is a regressive tax** – but so are all consumption taxes including the current SST.
- ▶ **Lower-income individuals spend a larger share of their income on consumption** and as such any increase in a consumption tax will hit lower-income families harder. This argument is often used by anti-VAT proponents to oppose a new GST.
- ▶ **But this ‘regressivity’ is more than offset by increased spending on social transfers and services (e.g. health, education).** In other words, higher tax revenues can (and do) fund more progressive non-contributory benefits.
- ▶ **Plus this ‘regressivity’ is not unique to a VAT/GST, all consumption taxes including the SST is regressive.** The solution is to use higher revenues to fund more progressive spending, and to show the general public that this is being done transparently.

Source: Cheng (2023) “Why we should welcome back GST”. Cheng (2018) “Consumption taxation will eventually return”

Financing considerations

- ▶ **But in the long run, a GST/VAT by itself will not be sufficient to address inequality and meet the growing demands for public spending on essential services and strategic priorities.**
- ▶ **We still need to enhance the progressivity of Malaysia's tax-and-transfer system for wealth and income redistribution –** something that a consumption tax and universal transfer in combination is not well placed to achieve.
- ▶ **While social protection improves income security and monetary inequality –** they will not do a lot to reduce long-term inequality of opportunity and unequal social capital endowments.
- ▶ **Likewise, a GST/VAT will form the base of a broad-based and long-term revenue stream** but will not truly achieve the equality-promoting impacts of progressive taxes on income and wealth.

Source: MICPA and Deloitte (2021). Tax Working Group, New Zealand (2018)

Financing considerations

- ▶ **Progressive taxes on income and assets still crucial in the long run** for redistribution and reducing inequality without significantly distorting economic incentives.
- ▶ **Direct taxes on capital and assets:** Malaysia currently does not have a comprehensive capital gains tax regime.
- ▶ **Not treating labour and capital income equally raises fairness concerns** about the taxation of labour versus capital income and creates incentives for wealthy individuals to evade taxes.
- ▶ **It also leaves a significant source of progressive revenues on the table**, with large opportunity costs for equality and economic growth.

Source: MICPA and Deloitte (2021). Tax Working Group, New Zealand (2018)

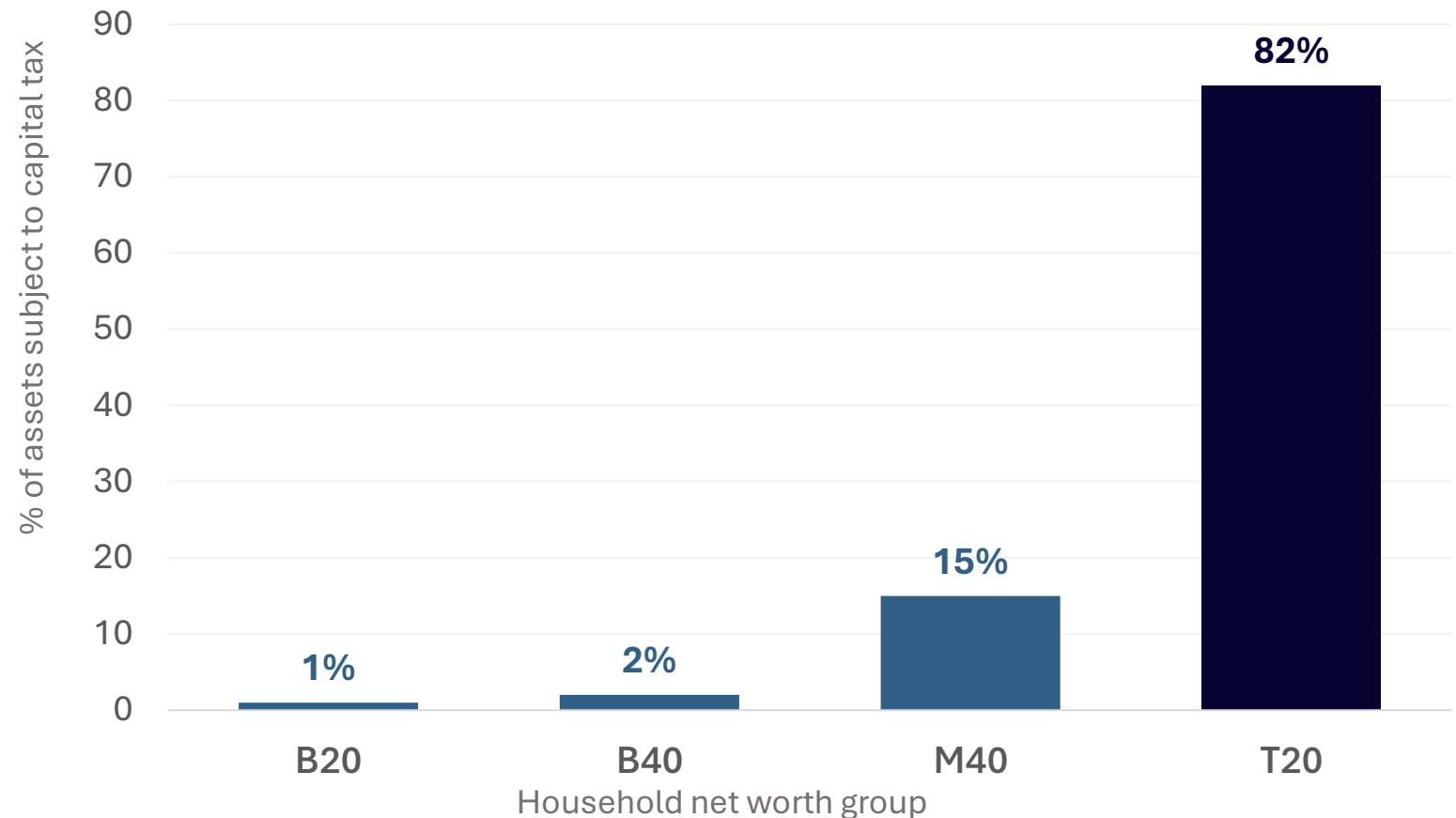
Financing considerations

- ▶ **Progressive taxes on income and assets still crucial in the long run for redistribution and reducing inequality without significantly distorting economic incentives.**

Source: Chart recreated from Tax Working Group, New Zealand (2018) "Tax Working Group Information Release". Treasury, Statistics New Zealand.

- ▶ **NZ data: Top wealth quintile holds 82% of capital assets that would be subject to a capital gains tax**

New Zealand household assets by household net worth quintile



4 Social services

**The impacts of social transfers
may be limited in a context
where social service provision
is inadequate**

The role of social care support

- ▶ Social care support is often overlooked in discussions about social services, even though it can be a **valuable complementary intervention to social transfers.**

- ▶ **Social care support is required across the lifetime, constituting a productive investment for younger populations and preventative measure for older persons.**

Social care needs across transition periods



Pregnant women and children up to two years



Children 2-17



Working parents



All persons above 65

Intensity of social care needs vary according to



Disability and illness



Gender



Old age

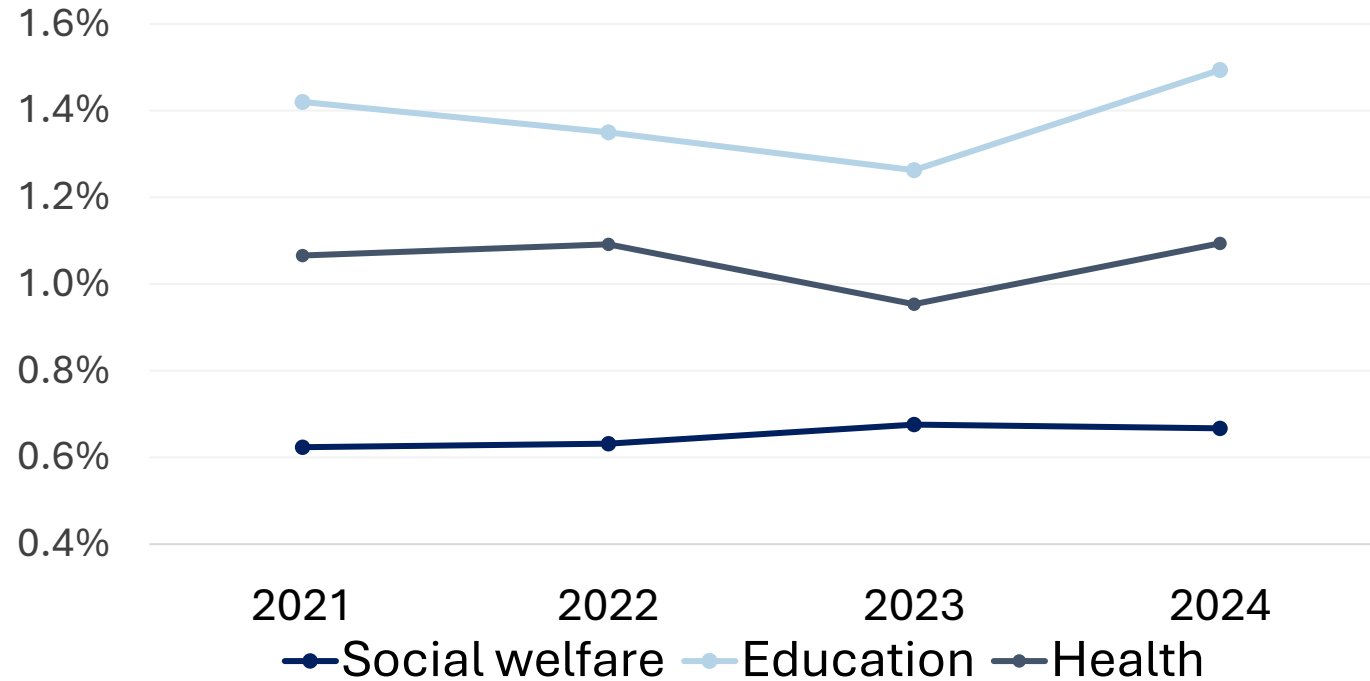
The role of social care support

► When compared to domains like healthcare and education, **care-related social services stand as one of Malaysia's most inadequate support systems.**

► **Spending on health and education in Malaysia is already low for its level of development – but it is still 1.5 times and twice higher than the share of expenditure allocated for social care.**

% share of total government expenditure

Allocation for programmes under MWFCDD, MOE, MOHE and MOH

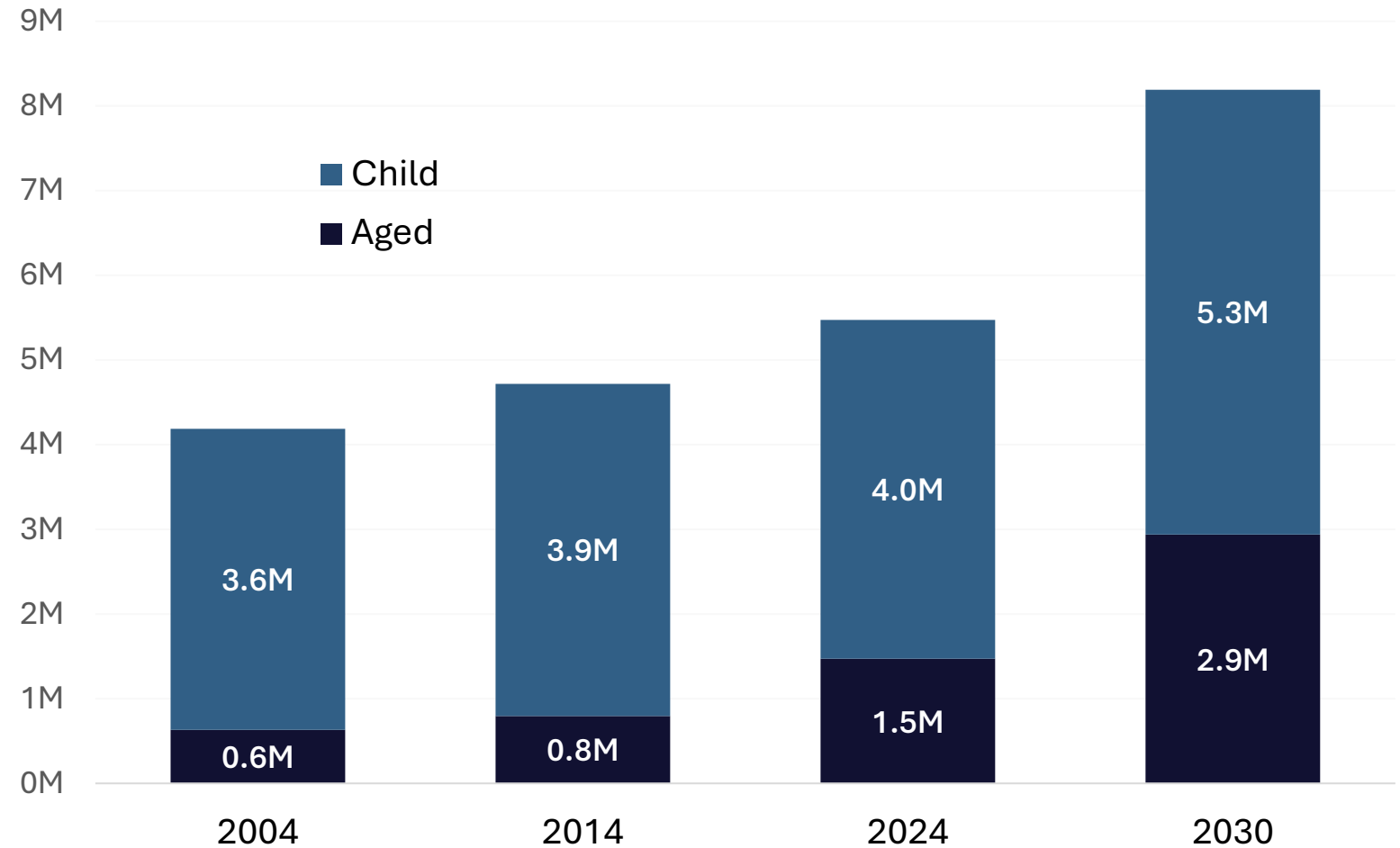


Source: XXX

The role of social care support

► Demographic shifts will increase care needs, leading to an exponential surge in the demand for care.

Estimated number of persons needing care, individuals



Source: Lee et al. (2024). "Building a cradle-to-grave care economy for Malaysia."

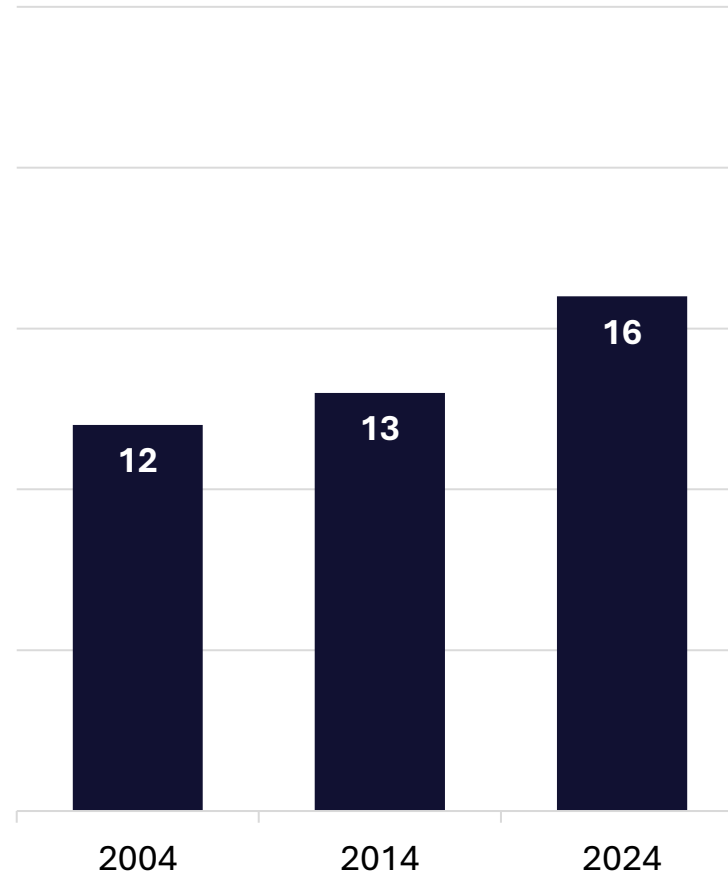


The role of social care support

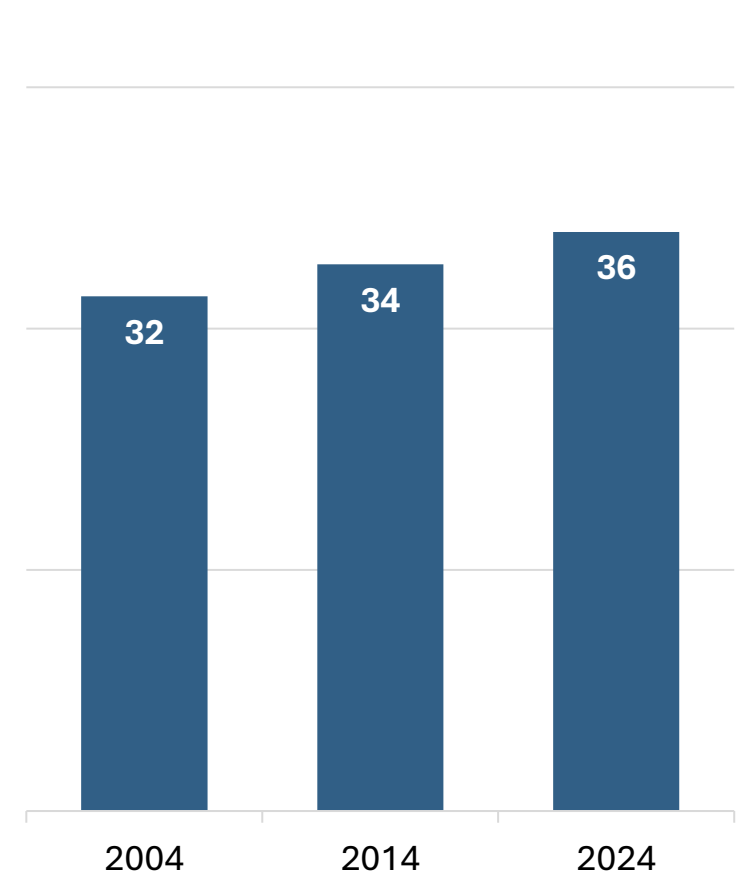
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- ▶ However, **current care infrastructure, both formal and informal, are inadequate** to meet this growing demand for care whether for elderly or children.

Estimated number of public elderly care institutions



Estimated number of public childcare institutions



Source: Lee et al. (2024). "Building a cradle-to-grave care economy for Malaysia."

The role of social care support

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► Social care services would be a comprehensive way to complement the SPF but the public social care system is **limited in coverage and inadequate in quality**, with **private sector taking the lead in providing services**.

Source: Lee et al. (2024). "Building a cradle-to-grave care economy for Malaysia."

► **Public social care services lack accessibility, affordability and quality. This is related to a range of factors, including:**

- Reliance on informal care arrangements i.e. women
- Absence of social care from social protection framework
- Limited care options that meet care preferences i.e. community- and home-based care/workplace childcare
- Gaps in legislation
- Perception of social care as a predominantly women's issue or individual/familial responsibility
- Fragmentation of governance

► **Private care services are accessible primarily to those who can afford it, likely contributing to women's decisions to drop out of work for household obligations.** Of the 3.2 million Malaysians outside the labour force because of domestic work, 98% are women.

Adequacy considerations

1

► **A SPF offers much-needed income security but is it adequate in the face of growing social care needs and limited public services?**

► **We must also consider mitigating factors such as ...**

- Malaysians are living longer but not necessarily in better health – 9.5 years are spent in poor health.
- Multigenerational living is set to decline due to inadequate housing and migration patterns etc.
- Informal caregiving takes a toll on women’s socioeconomic outcomes and gender equality.

► **The adequacy of the universal child benefit may need to be enhanced over time.**

- We estimate that the UCB may cover only 4%-8% of raising a child from point of birth to graduation, taking AIA’s estimations, adjusted for inflation.

Source: Lee et al. (2024). “Building a cradle-to-grave care economy for Malaysia.”, AIA, “Parents, priorities and protection.”

The complementary role of social services

1

► Social care: Public investment in a cradle-to-grave care economy

- **Integrating social care into the social protection framework**
 - Instituting caregivers' allowance for those with long-term care responsibilities i.e. children with disabilities
 - Bridge social protection with social services

- **Invest in community-based care services**
 - Incentivising SMEs in a common area to pool resources towards building shared workplace childcare centres
 - Increasing range of services at the community level i.e. adult daycare centres, home healthcare

- **Establishing policy and governance for social care**
 - Recognise, professionalise and regulate social care workforce
 - Instituting multisectoral governance and coordination to address fragmentation

Source: Lee et al. (2024). "Building a cradle-to-grave care economy for Malaysia."

The complementary role of social services

1

► Social welfare: Buffering social welfare system and workforce

► With social cash assistance programmes integrated, the next step would be to invest in the social welfare workforce to identify and cover exclusion gaps, connect beneficiaries to services

- Malaysia's social worker to population ratio is 1:8,576, trailing far behind other developed countries, covering a wide range of vulnerable groups including children, PWDs, elderly, domestic violence survivors and single mothers
- This prevents social workers from conducting case management and field visits, requiring vulnerable families and individuals to apply for aid physically at Department of Social Welfare offices.

Source: UNICEF. (2023). Factsheet: Professionalising Social Work in Malaysia



Key takeaways

- ▶ **The proposal for a SPF is timely and provides an opportunity to consolidate the various social assistance programmes and initiatives already in place in Malaysia.**
- ▶ **However, a SPF will still require good targeting and programme design.**
- ▶ **In the longer run, Malaysia will also require progressive taxes.**
- ▶ **In implementing the SPF, the impacts of social transfers may be limited in a context where social service provision is inadequate.**
- ▶ **A SPF needs to be met with investments in social services. Beyond health, education and infrastructure, social care is an increasingly urgent consideration for Malaysia.**



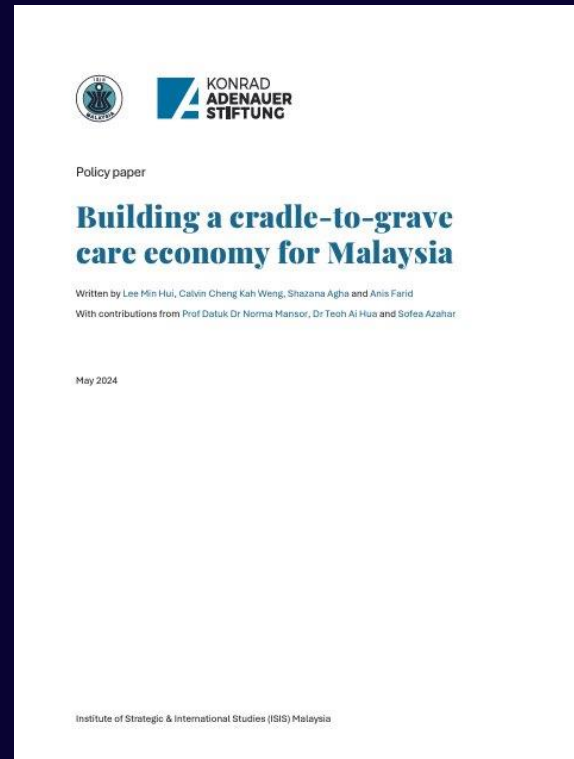
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Thank you.

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► **ISIS Malaysia Policy Paper:
Building a cradle-to-grave care
economy for Malaysia**

**Written by Lee Min Hui, Calvin Cheng,
Shazana Agha and Anis Farid**
With contributions from **Datuk Prof Norma
Mansor, Dr Teoh Ai Hua and Sofea Azahar**



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