Strengthening the Trickling Down Mechanism in Malaysia & Preventing Likely Negative Shocks

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Reducing Poverty & Offsetting Potential Negative Shocks

- When a developing country is able to grow very quickly for a sustained period, say, for 30 years, then the poverty rate will plunge downward steadily. This was true for Malaysia for the 1970 to 2000 period, and true for China in the 1980 to 2010 period. Many economists have described this situation as poverty reduction by the "trickling down" mechanism.
- For Malaysia today, the average economic growth rate for the last twenty years has been lower than in the previous 20 years, about three percentage points lower. And, one outcome is that the government has identified improvement in the income of the B40 to be one of its key objectives.
- The first question is: What could be done to make the "trickling down" mechanism much more powerful to solve the B40 problem?
- The second question, in light of the present COVID-19 pandemic, is: What are the other likely factors that would cause the income of the B40 to stagnate or, even, to decrease?

Why only strengthen the Trickling Down Mechanism, why not increase the GDP growth rate as well?

- **Two such developments can accomplish both goals**
  - **reduction in the size of the humongous foreign guest program; and**
  - **termination of the monopoly banking system**
- **Complications are that these developments will**
  - **have to incur temporary pain in the short-run to reap the large permanent gains; and**
  - **require that the private society and government must cooperate to minimize the temporary short-term pain**

Low-wage foreign guest workers suppress the wage of low-skilled Malaysian workers, and obviate the need for Malaysian industries to upgrade production technology

- **The Foreign Guest Program, 2017 data**

✓Labor force: 15 million (DOSM)

✓Foreign guest workers: 2.96 to 3.26 million (World Bank) with 1.23 to 1.46 being in the irregular category

✓Number of foreign workers as percentage of Malaysian workers range from 22.3% to 28.9%

✓At minimum, add 1 foreign worker to every 4.5 Malaysian worker; and at maximum, 1 to every 3.5

→ A large infusion of labor will push up GDP but push down wages

- **Trend GDP growth rate = Trend (GDP/L) growth rate + trend L growth rate**

➢Trend (GDP/L) growth rate = trend productivity growth rate = trend rate of technological upgrading

➢Low wage obviates need for technological upgrading = low trend (Y/L) rate

➢A single large infusion of L will cause GDP growth rate to jump in next period, but GDP growth rate will return to trend productivity rate

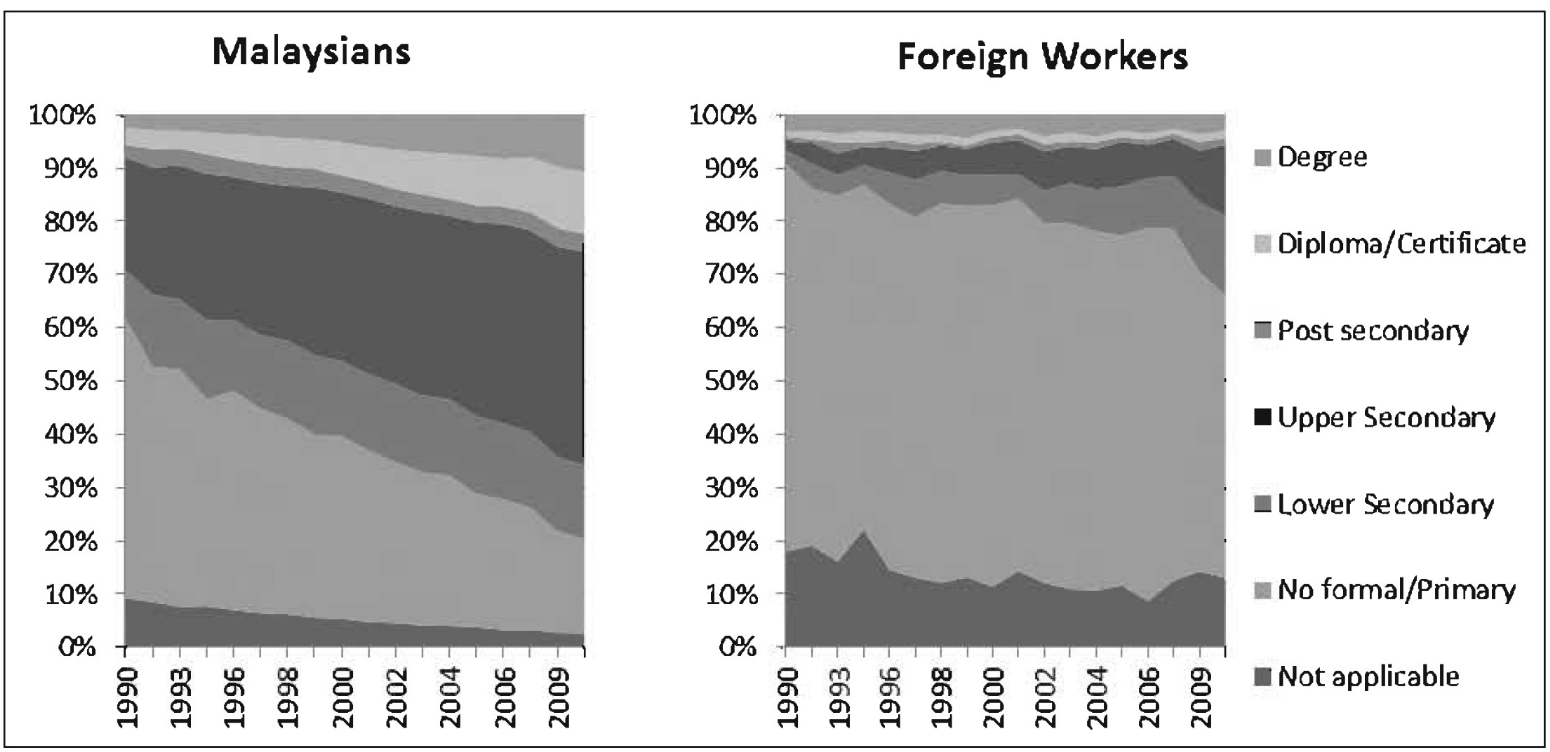
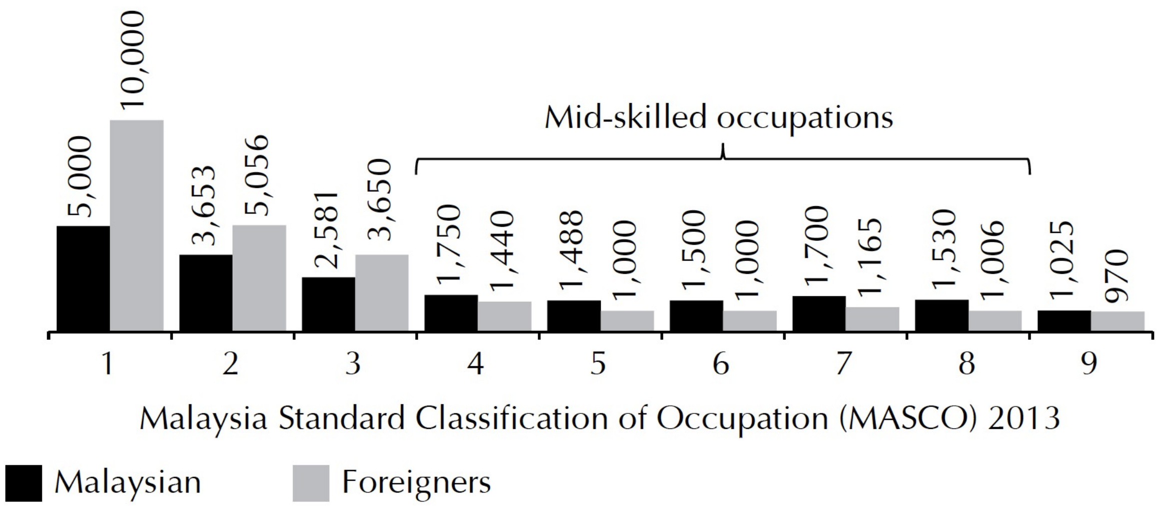


Figure 8. Distribution of Malaysians and foreigners by education over time
Source: **Authors' calculations with Department of Statistics, Labor Force Survey**

Employment of low wage foreign workers allow employers to keep salaries low



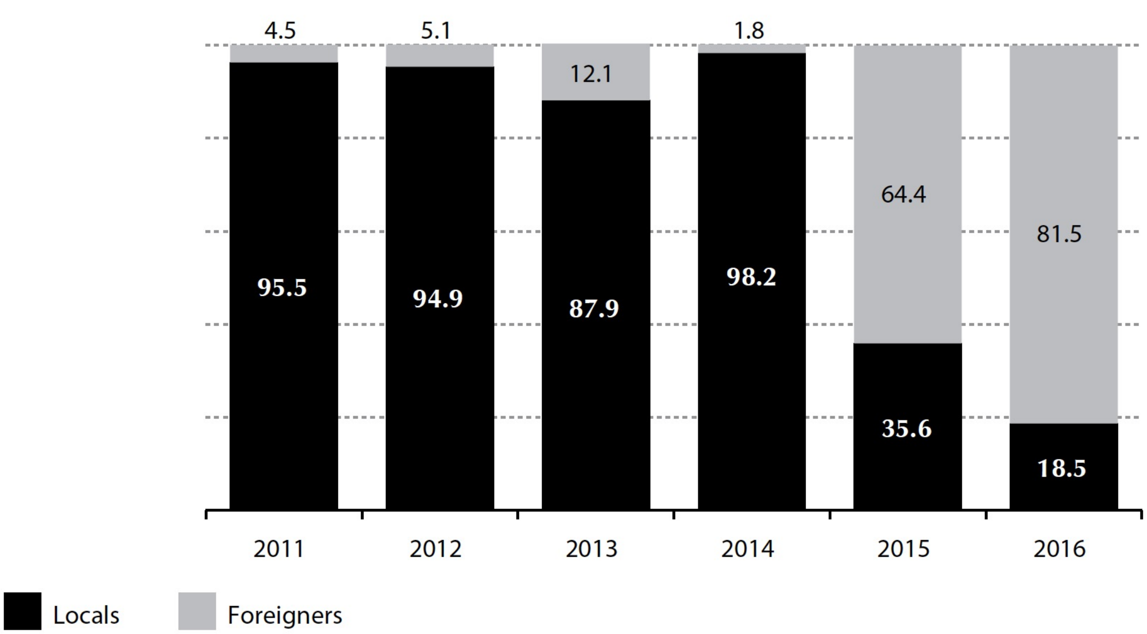
*High-skilled workers: Occupations Classification 1 to 3; Midskilled: 4 to 8; Low-skilled: 9

Note: 1. Managers; 2. Professionals; 3. Technicians and associate professionals; 4. Clerical support workers; 5. Service and sales workers; 6. Skilled agricultural, forestry, livestock and fishery workers; 7. Craft and related trade workers; 8. Plant and machine operators and assemblers; 9. Elementary occupations

Businesses that employed mid-skilled and low-skilled workers, (4) to (9), want to substitute foreign labor for local labor

Possible that in group (1) if the foreigner was not there, the 5k job would not have existed?

In the past two years, a large share of net jobs created went to foreigners



*Defined as net change in employment

GDP grew 4.4% in 2016, and the large infusion of foreign labor in 2016 helped push 2017 growth to 5.8%, but GDP then returned to trend growth rate, registering 4.8% in 2018 and 4.3% in 2019

Equilibrium moves from "Low Wage-Low Productivity Cycle" to "High Wage-High Productivity Cycle"

- Termination of Foreign Labor Guest Program will cause some SMEs to shut down
- Government to give unemployment benefits (including medical care) and re-training to laid-off workers
- Government to speed up private sector's switch to more capital-intensive production with temporary tax incentives
- Government adjustment assistance to be financed by borrowing that will be repaid by additional tax revenue generated by the new higher trend GDP growth rate

Break the Monopoly Banking System to strengthen the Trickling Down mechanism with Small and Medium Banks to support the establishment, upgrading, and expansion of the Small and Medium Enterprise (SME) sector

- **It is unnatural for a capitalist market like Malaysia to have no private local commercial bank that is in the small and medium sized category. There should be a distribution of banks of different sizes, each size having a core group of borrowers, e.g. big banks serve corporations and SMBs serve SMEs, with latter earning lower returns because of higher cost in servicing SMEs.**
- **Forbidding small and medium-sized banks would reduce credit to small businessmen to establish, SMEs, expand SMEs, and upgrade production technology. Ending the present monopoly banking system could cause owners like EPF to pay lower dividends but this would be temporary. A more dynamic economy is win-win in the long-run.**

In light of COVID-19 experience, what Potential Negative Shock that could increase poverty in Malaysia?

One highly-probable outside negative shock would be environment-determined competitiveness

The "Race to Zero" Trend in Large Powerful Countries meets the "Brace for Zero" Attitude in Small Developing Countries

- "Race to Zero" trend = race to scale up climate actions to achieve Net Zero Emissions of Greenhouses Gases (NZE)
- "Race to Zero" trend in EU, North America and Northeast Asia to achieve NZE by 2050-2060
- Scaling up climate actions = Implementing investments in transformative technologies to transition to new growth trajectory of Green Growth
- "Brace for Zero" attitude = Like to escape expenditure on the transformative technology, or delay actions in the hope that cheaperf transformative technologies will become available later
- "Brace for Zero" attitude most developing countries, e.g. no ASEAN country has committed to a date to achieve NZE

Will EU, USA, China, and Japan choose to become Negative Emitters so that ASEAN can remain a Positive Emitter? **Not likely**

- EU-North America-Northeast Asia will impose imports on goods from policies with weak climate action policies → Will environmental-driven competitiveness harm Malaysia?
- Self-interest of Malaysia to now start serious preparation for carbon neutrality to ensure lowest cost of doing so. *<Sunway University is coordinating a 7-nation ASEAN Green Future project to identify optimum nation-specific pathways to decarbonization.>*

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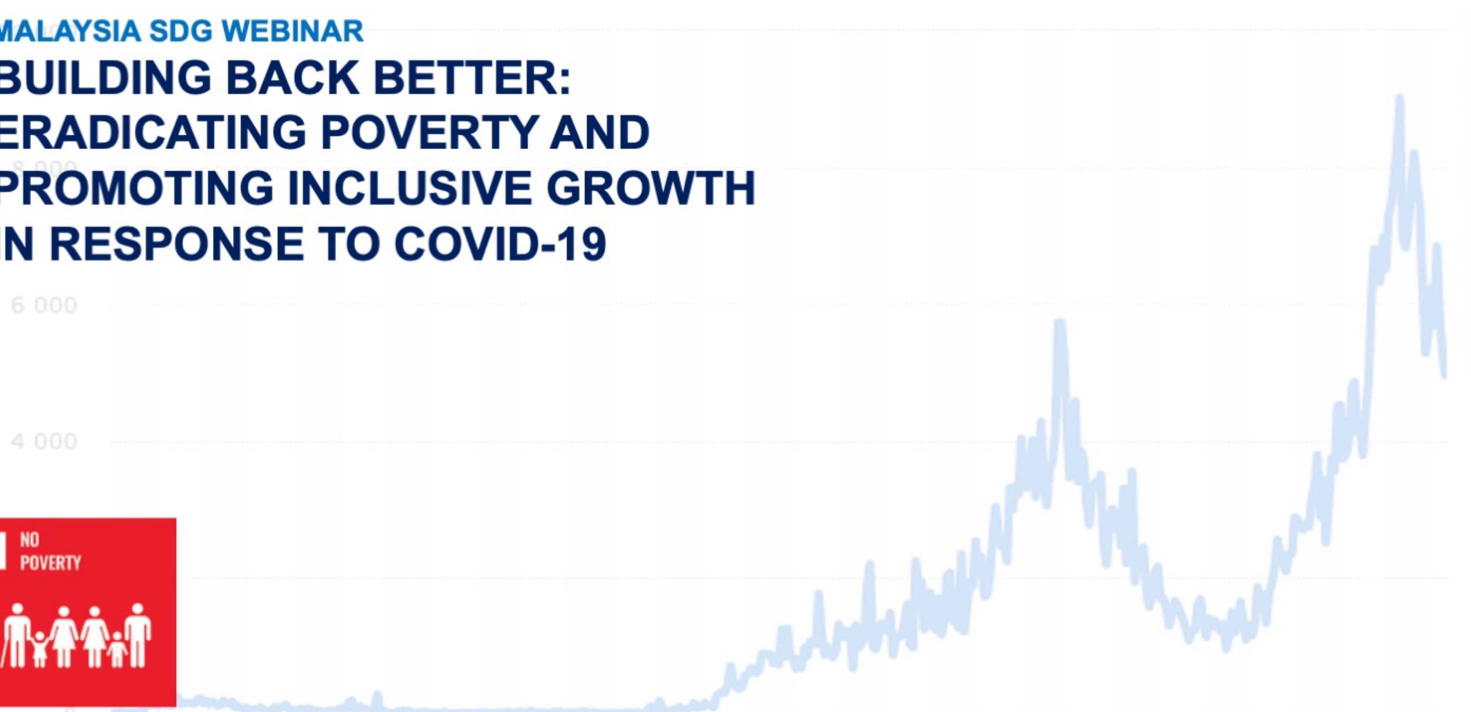
BUILDING BACK BETTER: ERADICATING POVERTY AND PROMOTING INCLUSIVE GROWTH IN RESPONSE TO COVID-19



1 NO POVERTY