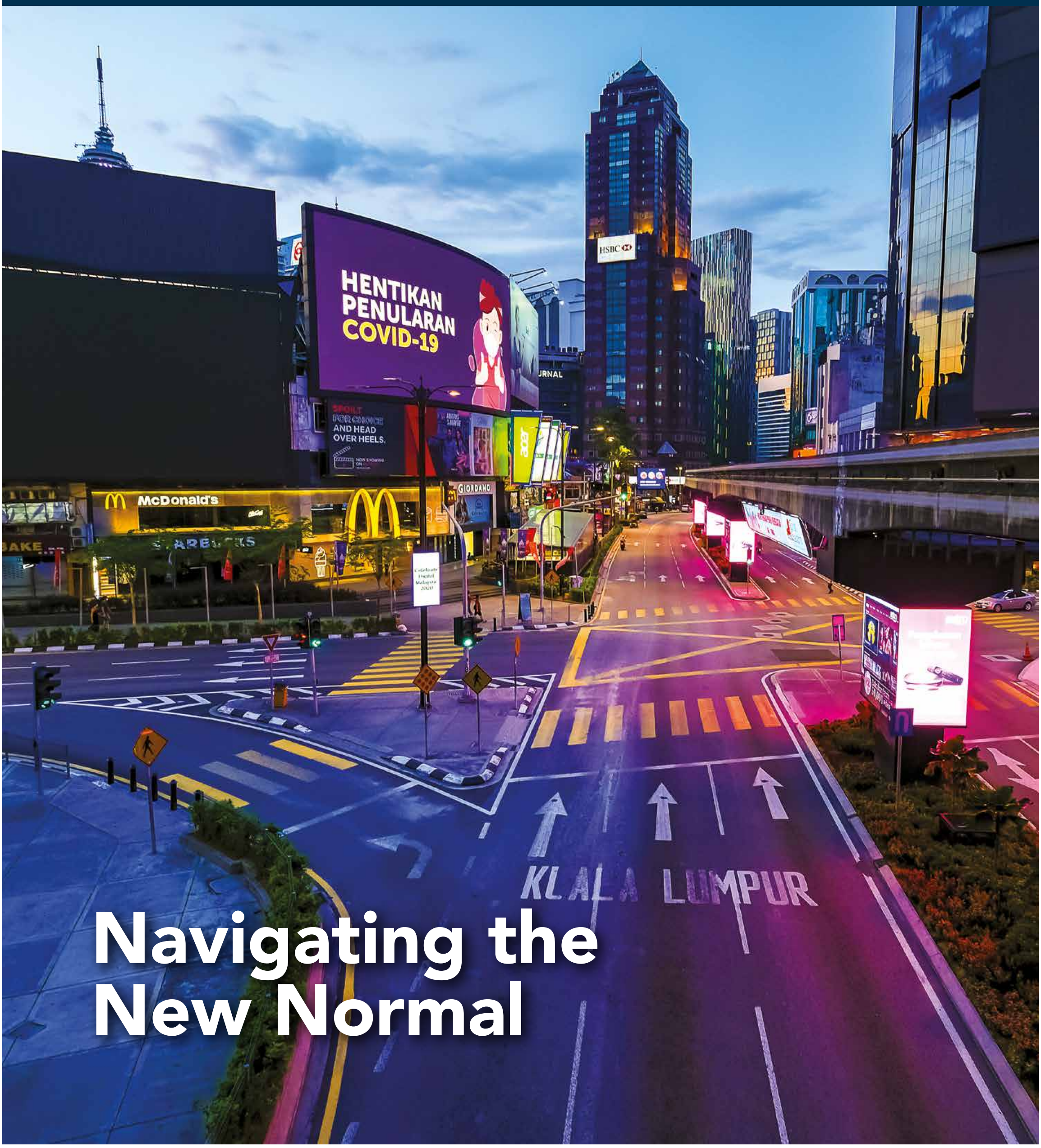
ISSUE 08 - APRIL 2020

DEVELOPMENT DIGEST

FEATURED WORK FROM THE WORLD BANK GROUP GLOBAL KNOWLEDGE & RESEARCH HUB IN MALAYSIA



Navigating the New Normal

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Global Knowledge & Research Hub
in Malaysia

ABOUT DEVELOPMENT DIGEST

The Development Digest is a half-yearly publication that features key works from teams based at the World Bank Group Global Knowledge and Research Hub (the Hub) in Malaysia.

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Two Crises and a Transition

In a few months' time, our World Bank Group Global Knowledge and Research Hub in Kuala Lumpur will be crossing a threshold: starting a new five-year term of operations against the backdrop of two global crises and a development transition. COVID-19 and global warming are the dual crises, both posing profound risks to human life and economic conditions on our planet. The transition is Malaysia's own journey towards becoming a more prosperous high-income country, and one where the benefits of economic growth are shared more widely with all segments of society. Naturally, the former two topics have important implications for the latter long-term aspiration of the Malaysian people.

Looking ahead, our Hub is well-positioned to respond to these challenges during its second phase of work in the country. Under prior agreement, it is adopting a new name, **The World Bank Group Inclusive Growth and Sustainable Finance Hub**, for the coming five-year period and has been mandated to focus its energies on promoting the two themes in its title, inclusive growth and sustainable finance, as well as the all-important and cross-cutting theme of good governance. Other important aspects of its mandate are to sustain its two work streams of carrying out innovative knowledge and research activities, and to maintain a healthy balance between conducting work of global significance and supporting the more internal development priorities of the Malaysian government, albeit with a distinct shift of emphasis toward the second area of work.

In view of the unanticipated intrusion of COVID-19 onto the global scene in early 2020 and with severely disruptive consequences for all countries including Malaysia, our Hub will necessarily in the short term re-align much of its work program towards supporting the Malaysian government in efforts to address the global pandemic. Our Hub teams are collaborating with the World Health Organization (WHO) to aid the Malaysian Ministry of Health to analyze ways of increasing hospitalization capacity; providing just-in-time policy advice to key institutions in the country on options for mitigating the economic impact of the global pandemic; and producing a series of research products addressing various aspects of the COVID-19 crisis. The World Bank Group also stands ready to make concessional financing available to Malaysia, if requested and as appropriate, to fund any part of its national response effort.

This crisis will undoubtedly slow the pace of Malaysia's transition to high-income and developed nation status. Along with extending the time horizon for achieving this milestone, Malaysia will have to press ahead with its medium-term agenda to also improve the 'quality' of the transition. This approach will require a larger focus on achieving higher levels of economic inclusion and income equality; and on improving the effectiveness of institutions and service delivery particularly in the human development sectors of health and education.

Significantly enhancing the childhood learning outcomes of Malaysian students from pre-school to 12th grade, especially in math and science, will be a crucially important outcome for boosting productivity growth in Malaysia's labor market and its efforts to spur technological innovation in the country. On this topic, our Hub is currently finalizing a flagship report on Malaysia's expected high-income development transition, and is also engaged with the Ministry of Education in an activity that aims to strengthen the math and science skills of students in the general education system.

The crisis of global warming and its climate change consequences will also have an impact on the development journeys of Malaysia and all countries through various channels, including rising sea levels, extreme weather events, and possible reductions in international demand for fossil fuels. With respect to this environmental crisis, Malaysia has positioned itself as a global pioneer in the area of sustainable finance. In recent years, our Hub has supported the efforts of the Malaysian government to promote this essential development agenda. The issuance of the first ever Green *Sukuk* – an Islamic Green Bond – and the development of the necessary regulatory framework in 2017 is a great example of this type of collaboration. Other important work is ongoing with Malaysian authorities to develop a new green taxonomy to help classify financial assets.

Even amidst the COVID-19 lockdown, our Hub has been pro-active in this area. It recently co-organized with the Global Green Finance Leadership Program and Tsinghua University, a sustainable finance webinar on 'Environmental Financial Disclosure by Financial Institutions and Green Bond Issuers' that attracted more than 1,700 participants from around the world.

Navigating these crises and achieving Malaysia's overall development ambitions will require improvements in governance and the quality of institutional effectiveness. The Malaysian government made governance one the central pillars of the Mid-Term Review of the 11th National Plan, and is planning to implement a new public sector reform strategy as part of the next five-year National Development Plan. Our Hub team is supporting these national public sector reform efforts and others covering the areas of public procurement and local governance. At a broader level, our team is also engaged in producing a new global report on anti-corruption strategies that aims to inform policymaking related to public transparency and accountability in all countries in the world.

As a global development institution, the World Bank Group is extremely proud of our relationship with Malaysia and the Malaysian people. It is one that stretches back more than six decades to the early days after Malayan independence in 1957. We are thrilled that this long-standing development partnership continues to flourish through the work of our Hub in Kuala Lumpur, and we look forward towards the next five years of collaborating, innovating, and researching together for the benefit of Malaysia and all developing countries seeking to achieve higher levels of development progress.

Firas Raad
Country Manager for Malaysia, World Bank Group

Malaysia in 2020: Navigating Overlapping Shocks

Firas Raad

Malaysia is no stranger to external shocks affecting its macroeconomy. Over the past two decades, it was buffeted by the 1997 Asian Financial Crisis (AFC), the 2001 global slowdown after 9/11, and the 2008 Global Financial Crisis, each shock affecting the Malaysian economy in different ways. The first one resulted in the steepest economic contraction in Malaysia's history – reversing growth to negative 7.35% in 1998. The country surmounted this massive crisis through prudent policymaking, and drew important lessons to protect itself from the latter two economic shocks.

This latest global COVID-19 crisis is particularly unique, given the context in which it emerged and the dual threats it poses to states and societies across the world. Prior to COVID-19's global spread during the last two months, economic growth in almost all countries had already slowed on the back of trade tensions between the United States and China. Against this softening economic backdrop entered the COVID-19 virus.

What began as a localized epidemic in Wuhan, China has now transformed into an international public health crisis and an international economic crisis creating supply and demand shocks in over 180 countries. Amidst this unfolding global pandemic, international oil prices, too, began to plummet in early March adding additional fiscal pressure on oil-producing countries including Malaysia.

The public health shock created by COVID-19 first evolved slowly and then expanded rapidly in March of this year.

Within four weeks after February 27, the cumulative number of infections has skyrocketed upwards. These trends are already placing the Malaysian health system, particularly the public hospitals, under considerable strain. A third 'tsunami wave', in the words of Ministry of Health Director General Datuk Dr. Noor Hisham Abdullah, if not prevented through more expanded testing, case isolation, and enforcement of public compliance, could easily flood Malaysian healthcare facilities and result in numerous fatalities, not least among the elderly and persons with chronic health conditions.

COVID-19's shock to the Malaysian economy has deepened with the mounting public health crisis.

Initially, the effects of the crisis were felt in the electrical and electronic products (E&E) sector, which is closely tied to the Chinese market; and in the tourism and retail sectors due to a significant drop in incoming tourists. These effects widened recently, resulting in broad-based disruption to all economic activities in the country including the financial and currency markets.

Looking forward, recent projections by the World Bank indicate that substantial economic pain will be inescapable in all countries in the region. In our latest regional economic update **East Asia and Pacific in the Time of COVID-19** launched on March 31st, economic growth in developing East Asia and Pacific countries is estimated to slow to 2.1% in 2020 under a base case scenario; and to negative 0.5% in a lower-case scenario. For Malaysia, economic growth in 2020 is forecasted to drop to negative 0.1% under the base case and negative 4.6% under the lower-case scenario.

Along with significant economic retrenchment, the global pandemic will have a large impact on poverty in the region, with 24 million fewer people escaping poverty in 2020 under the base case scenario than was forecasted in the pre-COVID-19 projections. These estimates were generated under continuously changing conditions and based on available data as of March 27.

The World Bank East Asia and Pacific Economic Update urges countries to take immediate action to strengthen containment, boost healthcare capacity, and implement targeted economic measures to lessen the impact on households, businesses and workers – including the injection of greater liquidity and repayment flexibility into the financial sector. The report also promotes the importance of countries adopting an integrated approach towards containment and macroeconomic policies, and international cooperation and public-private partnerships to ensure the production and supply of key medical supplies across international borders.

In line with these recommendations, the Malaysian government issued two economic stimulus packages and placed the country under a 'Movement Control Order' (MCO) for an initial two weeks – now extended to mid-May. The MCO, through banning public gatherings and mandating home-based learning and work for all students and workers (except those involved in essential services), seeks to limit further widespread diffusion of the virus. Public compliance with Ministry of Health testing policies and movement restrictions will be crucial to preventing a new and sweeping wave of infections from gathering momentum.

The economic stimulus packages, on balance, contain the right elements for mitigating the impact of the COVID-19 crisis. The second and larger economic package, announced on March 27, rightly prioritizes supporting front-line workers in the healthcare system and purchasing medical supplies. It also contains important additional measures to protect the income of vulnerable Malaysian households through cash transfers, help individuals and businesses smoothen out their debt repayments, and provide support and wage subsidies to Malaysian businesses. The goal of the wage subsidy measure is to encourage struggling companies in the private sector to retain their employees during this downturn.

Although this second package is prescribing the right economic medicine for the COVID-19 crisis, there may be questions about gaps in the medication and the appropriate dosage of some of the measures. Specifically, how best to support medium-sized, small, and micro-enterprises will require further thinking and action, and the relatively modest size of the wage subsidy may prove insufficient to prevent job layoffs by firms in weaker financial positions. If the public health crisis continues unabated and requires an extension of movement restrictions, a third economic stimulus may be necessary.

In retrospect and taking the long view, Malaysia has seen many economic crises in its day. With enough determination, clear-eyed thinking, careful policymaking – and capitalizing on its prior experiences – it will be able to weather this unusual storm.

This article was first published in the Star, and has been re-published on the World Bank's *East Asia and Pacific on the Rise* blog, on April 1st. To access the blog, visit **bit.ly/msiacovidwb2020**

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Smart Containment and Mitigation Measures to Confront the COVID-19 Pandemic

Norman Loayza

In the World Development Report 2014 - Risk and Opportunity, we put a spotlight on pandemics. There, we warned that most countries and the international community were unprepared for a risk of this nature. Many months into the COVID-19 pandemic, and it is now clear that we are facing an acute public health, economic, and humanitarian crisis.

What makes managing this health emergency so challenging is that if unattended, it could lead to countless numbers of fatalities – yet if drastic measures to contain the spread of the virus are imposed, it can produce a deep recession with business closures, mass unemployment, and poverty. As The Economist writes in a March 26 article, "the trade-off between saving lives and saving livelihoods is excruciating".

However, as Francisco Ferreira reminds us in a recent blog post, this "trade-off is real – but its terms are not fixed in stone." The objective of public policy in the face of the pandemic should be easing this trade-off: reducing the fatalities from COVID-19 while preserving people's livelihoods.

In advanced countries, the lives-versus-livelihoods trade-off can be eased with immense resources. For example, the United States will spend around US$5,700 per capita to tackle the crisis, while Denmark will spend about US$7,500 per capita.

Poor and developing countries face a very different situation: short of money and low in government capacity, they carry the burden of precarious health systems, overcrowded cities, and informal labor markets.

This dire situation calls for pragmatic and effective solutions, tailored to the reality of poor and developing countries. Broadly speaking, public policy approaches to face the pandemic can be divided into two categories:

- relief and recovery economic policies; and
- containment and mitigation public health measures.

I will address the first category only briefly here: relief and recovery measures should include a set of policies to increase public health care capacity (procuring emergency hospital space, breathing ventilators, medical protective equipment, and testing kits); protect the poor and vulnerable (scaling up both targeted and untargeted cash transfers); provide temporary support to affected businesses (granting subsidies and tax reductions); and ensure the continuity of public services. I will devote the rest of this article to containment and mitigation measures.

In the 2014 World Development Report, we propose some principles for effective risk management that form the basis for the recommendations that follow. The first is that preparation is the key to resilience, even during a crisis. The second is that coping with adverse systemic shocks requires a whole-of-government, whole-of-society integrated response. The third is that public actions should consider the realities of each country, making sure that the unintended costs do not outweigh the potential benefits.

With poor and developing countries in mind, let me share some thoughts on what not to do and what to do regarding containment and mitigation measures.

The Problems with Lockdowns

I have serious doubts about the efficacy of lockdowns. I recognize that governments have had difficult choices to make on the best approach for their countries to contain the spread of the disease. Surrounded by uncertainty as to the threat of the virus and the prevalence of the infection in their countries, some governments chose lockdowns. With the benefit of more evidence and time, I believe we can make better choices.

Using clear-headed cost-benefit analysis, Julian Jamison concludes that "We should practice sustained yet moderate social distancing – but not a lockdown". Jamison's conclusion applies to advanced economies, but they are even more relevant to poor and developing countries where lockdowns tend to be indiscriminate and disorganized. In Ideas for India, Debraj Ray and S. Subramanian argue against a comprehensive lockdown and in favor of a "reasonable alternative" whereby young adults are allowed to work and the elderly are insulated and cared for in their own households. Such measures can be guided by antibody testing when possible.

Let me summarize why I think lockdowns are ineffective and excessively costly, especially in developing countries.

Lockdowns are ineffective in containing the spread of the disease when:

- They are imposed in cities with pervasive overcrowded dwellings and neighborhoods. There, instead of social distancing, the result from a lockdown is social compression: "Confining people in cities such as Lagos, Mumbai, or Manila where half of the population may live in slums, will force them to be crammed in a room with six or eight people without easy access to water or soap".

- They produce massive displacement of people, especially from urban to rural areas, spreading, rather than containing, the contagion of the virus. This is happening in India and Kenya, for instance, where migrant workers who depend on daily labor are escaping cities in lockdown in massive numbers and returning to their hometowns.

And lockdowns are excessively costly in economic and human terms because:

- They can lead to mass unemployment and bankruptcies. Most developing-country governments do not have the means to support people and businesses in a deep recession. They have large levels of external debt, low tax revenues, and high credit risk – a situation worsened by the pandemic-related drop in commodity prices.

- They can put the families of informal workers, especially daily laborers, at the risk of starvation, crime, and disease. From South Asia to Africa to Latin America, hundreds of millions of informal workers, without unemployment insurance, paid leave, or savings, would rather work and face the risk of infection than starve.

- They may create the conditions for unbridled domestic violence. Being in close quarters with an abusive spouse or parent is dreadful. It can be even worse when police protection is unavailable as police resources are diverted to enforcing the lockdown. In Hubei province in China, the initial epicenter of the coronavirus outbreak, official reports of domestic violence tripled during the quarantine. "Women and children who live with domestic violence have no escape from their abusers during quarantine, and from Brazil to Germany, Italy to China, activists and survivors say they are already seeing an alarming rise in abuse".
- They can be manipulated to suppress political opposition and legitimate social unrest in authoritarian and dictatorial regimes. In several countries, governments have declared states of emergency and deployed the armed forces: "The greater worries lie elsewhere, in the abuse of office and the threats to freedom. Some politicians are already making power grabs…".
- The opportunity cost of the loss of public and private resources due to lockdowns is immense in poor and developing countries. This loss implies, for instance, a diminished ability to provide other vital services in health care, education, and safety. This, added to the loss of jobs and income, can significantly worsen poverty and vulnerability.

Worse than a lockdown is a series of repeated and uncertain lockdowns. The risk of second and third waves of infection is large in populations with low immunity. The prospect of repeated and uncertain lockdowns can devastate the economy and worsen human suffering beyond comprehension. Whether or not they have tried lockdowns as a first line of defense, countries around the world, especially poor and developing countries, should turn instead to sustainable smart containment and mitigation measures.

Smart Containment and Mitigation Measures

Although there is much uncertainty regarding the science around COVID-19, including its epidemiology, there is some evidence that can help guide smart containment and mitigation measures. Smart containment and mitigation measures are especially relevant where lockdowns are ineffective and excessively costly. They are also important for countries that are considering sensible exit strategies from their lockdowns to prevent a second wave of infection. Some of these actions may seem simple, but they are not always easy to implement in poor-country contexts.

- **Practice effective personal and public hygiene.** Thoroughly washing hands with soap and water or using a hand sanitizer that is strong enough is a powerful defense. Yet, in many poor countries, people don't have access to water

(2.2 billion people, according to WHO 2019) and cannot afford to buy enough soap and sanitizer. Consider the following recommendations:

- » Conduct massive, imaginative, and persuasive public campaigns for people to wash and clean their hands properly.
- » Install public hand-washing stations where water is scarce. This was done in West Africa during the Ebola crisis, installing simple devices (two buckets and some chlorine) in public buildings and schools.
- » Install and maintain sanitizer dispensers in public places, such as schools, public transport, restaurants, banks, and shops.
- » Disinfect public places frequently and extensively.

- **Protect the most vulnerable to the disease.** The elderly (and people with certain underlying health conditions) seem to be the most vulnerable to COVID-19. In theory, we would want to insulate the elderly while enabling the young to keep the economy going. In practice, cocooning the elderly may be a high-risk and socially unacceptable strategy. However, some forms of less drastic insulation may be feasible. Consider the following recommendations:
  - » **Household-level shielding for the elderly (and possible other vulnerable people).** Incentives can be provided for the elderly to stay at home and their family members to practice safe behaviors around them. Dahab et al. (2020) offer some general principles and practical procedures to shield high-risk populations. The government can help by providing information to the families and cash transfers to the elderly as support and incentive for suitable behavior.
  - » **Social shelters for the elderly.** This can be designed for families that cannot provide for the safety or the insulation of their elderly relatives. Providing these shelters is a challenging task for any government, especially for those with low capacity. The international community, including charitable organizations, could help with this responsibility. Ideally, these shelters should be run by people who have acquired immunity to the coronavirus (which, of course, implies antibody testing).
- **Isolate people who are currently infected.** Targeting, tracing, and monitoring those who are currently infected and those who may have been exposed to the coronavirus are best practices that have allowed South Korea and Japan to control the outbreak while avoiding lockdowns. Proper testing is needed to make targeting, monitoring, and case tracing feasible (see the next point). While testing

is procured, other complementary measures can be implemented. Consider the following recommendations:

» **Self-quarantine.** With the information provided by antigen testing, residents and international travelers can be ordered to self-quarantine. In some cases, it may be necessary for the government to provide the incentive and support of a cash transfer.

» **Social-quarantine.** If household conditions are not propitious for self-quarantine, the government can consider providing sheltering facilities for people who are infected but are not in need of critical medical care. They would also get a cash transfer, possibly to help support their families. Ideally, these places for social-quarantine would be run by people who have acquired immunity to the coronavirus.

» **Employ digital data.** Enforcing self- and social-quarantine can be facilitated by the use of digital data devices, such as mobile phone apps. They can also help in tracing contacts and in providing information on coronavirus hotspots.

» **Require face masks in public.** The government can procure large supplies of masks, distribute them for free, and make their use mandatory in certain public places, such as public transport, shops, and markets. This is important because a large portion of individuals carrying the coronavirus are asymptomatic. Since the primary purpose of wearing masks is protecting others, social enforcement can make this practice feasible and prevalent. After initial reluctance, the US Center for Disease Control now "recommends wearing cloth face coverings in public settings where other social distancing measures are difficult to maintain (e.g., grocery stores and pharmacies)"; and some countries in Europe, including Austria, have made this practice mandatory (Financial Times, April 2, 2010).

- **Test, test, test.** Mass testing for the coronavirus is an indispensable piece of information for smart containment and mitigation strategies. The antigen test signals who is currently infected by the coronavirus and is likely contagious to others. The antibody test indicates who has been exposed to the coronavirus in the past and is likely to have developed immunity to it. Reliable, rapid, and scalable tests are currently being developed, with promising signals. Right now, the bottleneck for mass antigen and antibody testing is technological in advanced countries. Once this bottleneck is resolved, the challenge for developing countries will be large-scale implementation. De Walque, Friedman, and Mattoo recommend starting with targeted testing in the near term and, as capacity expands, scaling up testing to comprehensive levels. Consider the following recommendations:

» **Antigen testing.** Apply the antigen test to susceptible groups to determine who should be quarantined, who should be traced for potential infection (contact tracing), and what areas could be treated to prevent contagion hotspots. Since this test is available, obtain antigen testing kits from international companies and agencies. International organizations and aid agencies could provide knowledge, materials, and funding to obtain them.

» **Antibody testing.** When this becomes available, apply the antibody test first in a representative sample to determine the acquired immunity profile of the population (by area, age, gender, and other salient characteristics) and whether or not "herd" immunity is likely to have built up. Then, scale up the test to obtain individual information to guide decisions on work and employment, access to public services, and contact with vulnerable groups. Enlist the help of international organizations to deploy and implement the test.

» **Implementation capacity.** Prepare and improve the implementation capacity of the public health care system to administer the new antigen and antibody tests, as soon as they are developed. This can involve enlisting the help of medical students and other university students, for instance.

The benefits of smart containment and mitigation efforts can be substantial. In their theoretical study of the macroeconomics of epidemics, Eichenbaum, Rebelo, and Trabandt analyze the gains of conditioning containment policies on people's health status, so that infected people would not work, susceptible people would work but less than they normally do, and recovered people would work more. This "smart" containment policy significantly eases the lives-versus-livelihoods trade-off: it decreases the infection rate to less than half and the severity of the recession by more than 5 percentage points.

In practice, to approach and improve over this scenario, we need the knowledge that infection and immunity tests can provide, the ability to isolate people who are infected, the capacity to shield vulnerable populations, and a set of reasonable measures to diminish contagion. While the gains of smart containment and mitigation measures could be large in advanced countries, for developing countries they could literally be a matter of life and death.

This article was first published on the World Bank's *Let's Talk Development* blog in April 2020. To access the article and full citations, visit: **bit.ly/pan2020covidmynl**

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The Right Policy Mix Can Help Malaysians Make Ends Meet

Richard Record

For economists who study Malaysia, one of the most striking aspects they notice is the disconnect between two perspectives. On the surface, this country is by all means, an impressive economic story with high rates of growth, rapid poverty reduction, low and stable inflation, and is on the cusp of achieving high-income status. On the other hand, there are persistent and growing concerns about the quality of growth and its inclusiveness.

Nowhere is this debate more apparent than when the low rate of consumer price inflation – less than 1% in 2019 – is contrasted against the fact that so many Malaysians are worried about the cost of living. And these pressures will have become much worse since the impact of the COVID-19 pandemic. The latest edition of the Malaysia Economic Monitor investigates this matter.

Even before the shock of the COVID-19 pandemic, many Malaysian households were struggling to make ends meet.

For example, those with lower incomes spend a higher share of their family budget on food, and so will experience a higher rate of inflation when food prices rise faster than prices of other items.

Secondly, the consumer price index (CPI) doesn't include costs that have a high investment component, such as the cost of buying a home. Property prices have risen rapidly in Malaysia during the last few years, which isn't captured in the CPI. Thirdly, living costs vary quite dramatically across Malaysia. It is not unusual for an item to cost almost twice as much in one state as in another. And while wages in urban areas are generally higher compared to rural areas, these differences are usually not enough to fully offset the higher costs that urban residents face. People are also subject to various memory biases. For example, a rise in prices catches our attention more than stable or declining prices. And we notice price changes for frequent out-of-pocket purchases more than the goods and services that we buy less often.

Closer analysis shows that despite low and stable inflation in recent years, different households live with different rates of inflation.

In fact, the "cost of living" is most likely a catch-all term that reflects a host of issues that affect the budgets and well-being of families across Malaysia. We find that a key driver of this concern is the relatively slow wage growth, particularly among the young, and those who lack the necessary education and skills to thrive in today's changing economy. Further, the impact of movement control restrictions and a desire for social distancing has exposed the segmented nature of the labor market between jobs that can and cannot be done from home. Heavy household debt burdens and the need to put aside a significant share of income for vehicle loans, student loans, or mortgage payments further squeezes income and leaves little scope for buffers in the event of an income shock, exacerbated by the fact that there is a shortage of housing that is affordable to low- and middle-income households. With these factors combined, it's no surprise that a large share of Malaysians feel that they are falling behind.

It is important to look beyond the symptoms to treat to underlying problems of Malaysia's cost of living challenge.

In the report, we identify a mix of short-term measures that could help to alleviate hardships among low- and middle-income households, as well as important structural reforms that will take more time, but will address the root causes that make it hard for so many Malaysians to make ends meet.

Towards this end, continued reevaluation of price controls is essential to identify and resolve the underlying causes of undue price increases for selected commodities. For commodities with sharp price increases, a focus on market competition and curbing monopoly power is appropriate. In addition, price controls should be aligned with the consumption patterns of low-income households.

Easing the income shortfalls among low- and middle-income households could entail deepening existing social safety nets. Replacing fuel subsidies with a transportation allowance that is income-targeted but does not require ownership of a motor vehicle would help. Sustainable household income growth needs to be grounded in accelerating labor productivity, and in realigning investment and hiring incentives – a reform area that should be addressed in the longer term.

An important first step to improving financial well-being is to raise awareness regarding prudent personal and household financial management, and provide lower-income households and young adults with access to tolls and advice on how to make sound financial decisions. In the longer term, such efforts would need to be complemented by measures to strengthen consumer protection and encourage more responsible behavior by financial institutions. The unexpected shock of the COVID-19 pandemic has also highlighted the limited savings that many Malaysian households have as a precaution for employment shocks.

Policies to address the shortage of affordable housing could be improved through a sharper focus on principal residences for low- and middle-income households, better affordability measurement, and evidence-based housing supply data and analytics. With that in place, housing policies, shaped over a longer period, could prioritize increasing the supply of affordable housing for low- and middle-income households through new construction and rehabilitation of existing units. Stronger coordination among various public and private stakeholders is also needed to ensure an adequate supply of affordable housing.

None of this will be easy, but with the right combination of policies, it is possible to address the deep causes that make so many Malaysians concerned about the cost of living.

This article was first published on the World Bank's *East Asia and Pacific on the Rise* blog. To access the article, visit **http://bit.ly/mememblog**

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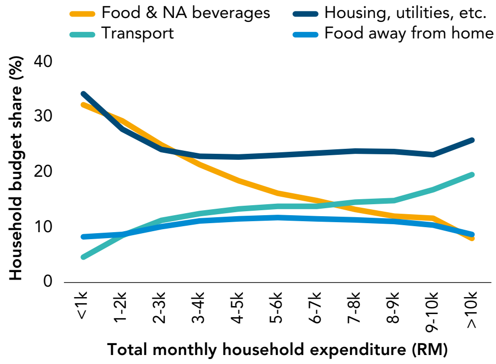
Malaysia's Cost of Living Challenge

4 KEY FACTORS

1 Consumer Price Inflation

- Overall, **price increases for most goods and services have been low and stable.** However, individuals experience higher or lower real price changes based on their income levels and consumption patterns.
- **Living costs also vary significantly across Malaysia** as the purchasing power of a ringgit varies from place to place.

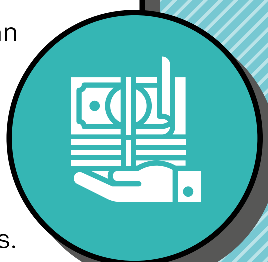
Low-income Malaysians are vulnerable to food price increases



Source: DOSM 2017a

2 Inadequate Income

- A growing number of Malaysians, especially in urban areas, are **dissatisfied with their living standards.**
- **Younger workers face stagnant growth in employment income** despite rising education qualifications.

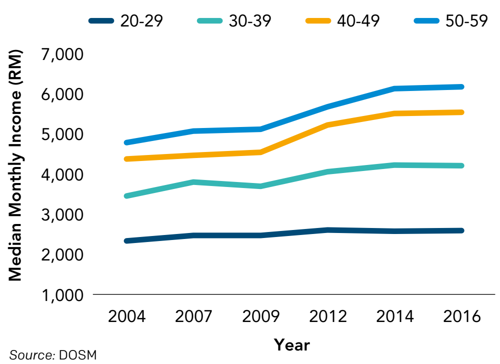


30%
Malaysians report **not having enough money for food** at times in the past 12 months

23%
Malaysians report having **insufficient money for shelter**

Source: Gallup World Poll

Since 2004, real growth in income for 20-29 year-olds with post secondary education has been marginal

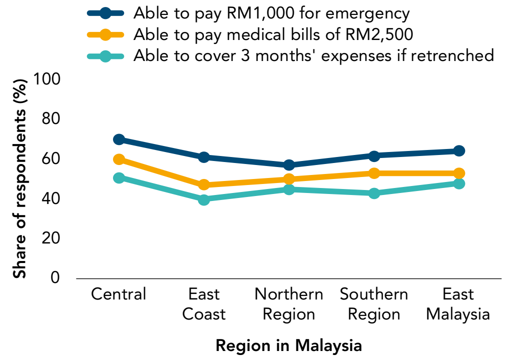


Source: DOSM

3 Poor Financial Wellbeing

- A majority of households **do not have adequate financial savings**
- **Financial pressures** are felt by most working adults regardless of age group and location

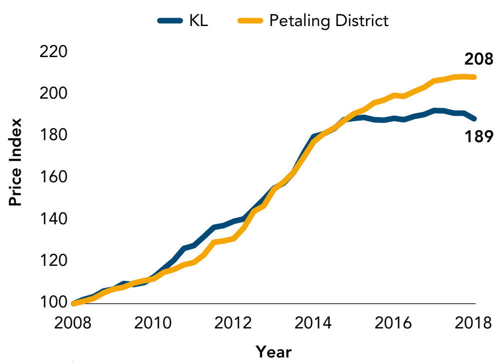
Malaysians are unprepared for unanticipated expenses



Source: AKPK, 2018

4 Lack of Affordable Housing

Prices for high-rise units on the decline in Kuala Lumpur due to supply-demand mismatch



Source: Urbanmetry, 2019.

- Households earning less than **RM7,000 face a critical shortage of affordable housing.**
- **The supply of affordable housing does not meet demand** in key urban areas such as Kuala Lumpur and Petaling District.

In the New Economy, Knowledge is King

Smita Kuriakose

Shifts in global trade patterns, coupled with rapid technological changes are presenting challenges to sustaining growth. Therefore, a transition to a more knowledge-based growth model is now ever more urgent in the current uncertain global context.

The economic shocks of the COVID-19 crisis has spelled major impacts for firms across the globe. In the short term, the crisis threatens to cause numerous bankruptcies and layoffs in the private sector, particularly among SMEs. Once mobility restrictions and mandatory lockdowns are removed, thus allowing businesses to reopen - many firms, including both larger corporations and SMEs, will have not escaped unscathed and may face the risk of insolvency.

Firms may stand a better chance during times of crises by harnessing technological and innovative capacity to adapt. Innovative capacity can help firms to pivot to new ways of generating revenue.

In the current crisis, some businesses are repurposing their production lines, and regulatory authorities need to strike a balance to support them as they make these shifts.

For example, textile companies are switching production lines from producing garments to making hygienic masks and medical robes, cosmetic companies are making hand sanitizers, hotels are becoming quarantine centers, distilleries are creating disinfecting alcohol, and automotive companies are evaluating options to produce urgently needed medical devices, such as ventilators.

Building up capacity and capabilities to produce simple products is comparably easy and can be achieved quickly. However, a lack of technological capability in producing complex medical equipment has become a major hurdle for factories looking to shift their production lines. There is a role for strengthening research capacity and helping countries develop science and technology policies that would help increase capacity to reverse-engineer, adopt, and adapt technologies to local needs.

Such belief is ubiquitous among policymakers alike. In order to chart a fruitful path forward to begin this transformation, a clear definition of what an innovation-led knowledge economy is necessary.

First, incentives to develop entrepreneurship with the efficient use of existing and new knowledge can be encouraged by a supportive economic and institutional ecosystem. Second, raising an educated and skilled talent pool is important to cultivate professionals that can create, share, and use knowledge effectively. Third, as innovation brings forth new ways to improve processes across varieties of interlinked sectors and industries, effective communication, dissemination, and processing of information is vital to ensure adaptation. And finally, this growing stock of global knowledge can be leveraged by a system of firms, research centers, universities, and other organizations to adapt to local needs, and in turn, create new technologies.

As Malaysia continues to strive toward high-income status, making the transition to becoming an innovation-led knowledge economy is key.

Malaysian policymakers must find ways to facilitate and accelerate this transition. Policies and institutions that can encourage innovation, technology adoption, and productivity growth can create an enabling environment.

We often continue to operate under the old paradigm that innovation is primarily about applied science and research and development (R&D). In this 'linear' approach, science generates R&D and then is transformed into innovations in the market by businesses. This biased and simplistic view of innovation policies results in an under-investment of public resources that facilitates the adoption of existing technologies - which is a key challenge for most firms especially in Malaysia. Firms adopting innovation is one part of the solution. They need to build teams with the right skills to be able to effectively function in an innovation-led knowledge economy.

To attract investments that would increase high-quality jobs, firms must invest in skills and R&D, and effectively embrace integrated technologies and solutions.

Therefore, an effective interface between industry and research is important. The incentives for public research institutions and universities need to be aligned towards collaborating effectively with industry to undertake industry-relevant research.

Malaysia's commitment to harnessing and advancing science and technology was first reflected in the formulation and implementation of the First National Science and Technology Policy (1986-1989). The commercialization of public research began with the Sixth Malaysia Plan (1991-1995), which emphasized that public R&D programs should become more market-oriented, by exploiting the commercialization of research and technology as well as striving to export research and technology of Malaysia. It also greatly emphasized the importance of improving intellectual property rights in Malaysia as one of the key components to advance the overall innovation environment in Malaysia.

The following editions of the Plans have continued these efforts to this day, driving R&D competitiveness and moving towards a knowledge-based and innovative economy, which have led to some good results. However, there is space to improve coordination between these myriad activities, which could help maximize returns and improve the likelihood of the government's goals being achieved.

Ultimately, more space needs to be made for the private sector to thrive if innovation is going to meet its promise of driving Malaysia's growth to high-income status.

These government programs working to establish the country's knowledge economy have done well at planting the seeds of innovative activity and entrepreneurship.

However, dominance of government activity is circular. Government agencies' overlapping mandates and activities makes it difficult for the private sector to find its role. In the absence of private-sector solutions, the government steps in to address problems as they emerge – in education, skills building, workspaces, mentorship, and networking.

With the proper structural reforms as a foundation, all these issues could conceivably be addressed by a more agile and innovative private sector. A market-based approach would ensure supply-side factors – skilled labor and capital – align with the demands of the knowledge economy. When these are aligned, the path towards an innovation-led knowledge economy can be paved.

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BOX 1

The COVID-19 Crisis and Global Value Chains: What Does it Mean for SMEs in Malaysia?

The global economic system has grown to be increasingly integrated. Almost 50% of global trade today involves Global Value Chains (GVCs) that have been an important source of growth and poverty reduction.

The global economic disruptions that have ensued due to the current COVID-19 pandemic will likely affect countries that heavily rely on trade in goods and services and that are deeply inserted in GVCs, such as Malaysia. This makes Malaysia particularly vulnerable to supply shocks, since vital sources of inputs may be shut down or countries may start imposing export restrictions. Moreover, the recent growth of GVCs means that, even more than in past crises, the COVID-19 shock is affecting many locations suddenly and simultaneously. This leads to a mutual amplification of reverberations, as the health of any economy must depend on the health of other economies supplying inputs or buying outputs, directly or indirectly.

GVCs are becoming more knowledge-intensive and reliant on high-skill labor, with investments in intangible assets (e.g. R&D, brands, IP) increasing from 5.5% to 13.1% of revenue across value chains since 2000. Moreover, technology and innovation have, on balance, boosted trade and led to the emergence of new traded goods and services. In fact, in 2017, 65% of trade were in categories that did not exist in 1992. Malaysia is deeply embedded within GVCs and has sought to upgrade its position in them. This is particularly true of the E&E sector. Accounting for 98.5% of total firms in Malaysia, and the bulk of production and employment, small and medium-sized enterprises (SMEs) are a crucial component of Malaysia's economic growth strategy.

New technologies associated with the 4th Industrial Revolution (Industry 4.0) are transforming production processes by reducing the importance of low wages in determining competitiveness. The COVID-19 pandemic has increased the benefits SMEs could derive from using new technologies – e.g. for remote work, and online business platforms. E-commerce and digital payments should also be further encouraged through regulatory reforms and measures to foster innovation. It is thus imperative that Malaysia focuses on building its capabilities in terms of skilled workforce and adoption of technologies, especially amongst SMEs, across the board.

In response to the Industrial Revolution 4.0, the government has launched the Industry4WRD: National Policy on Industry 4.0 to drive digital transformation in various sectors in Malaysia, aiming to be an Industry 4.0 hub in Southeast Asia. In order to achieve this ambition, firms, especially SMEs, would need to aggressively adopt new technologies and effectively participate in GVCs. Measures to boost jobs and private investment, particularly by SMEs, through increased digital adoption are an important step in this direction.

Expanding Old-age Income Protection to Informal Workers

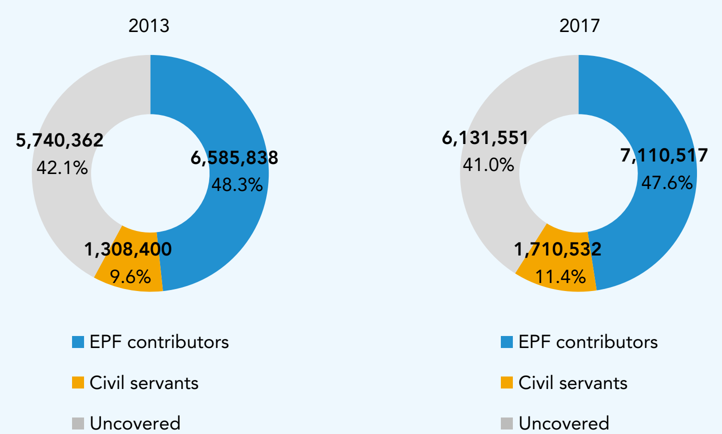
Amanina Abdur Rahman, Mark Dorfman, Achim Schmillen

The "standard" employment relationship worldwide is defined by long-term wage employment for a single employer. It forms the basis for risk-sharing policies related to income security during old age. However, the changing nature of work worldwide – and in Malaysia – challenges the effectiveness of risk-sharing policies based on this model. As populations around the world age ever more rapidly, it becomes more important to deepen financial protection for those who already make their own pension contributions, while expanding the coverage of risk-sharing policies to workers currently outside the pension net, including informal and gig economy workers. With the spread of the COVID-19 pandemic and the associated economic slowdown, this will likely have adverse effects on the future savings of all workers including those in informal jobs, reinforcing the need to strengthen old age income protection.

Various indicators show high prevalence of non-standard forms of work in Malaysia. According to the Labour Force Survey, the share of own-account workers among all workers increased from 16.4% in 2010 to 19.4% in 2018. The rise in self-employment has been particularly pronounced for women, for which the share of own-account workers increased from 11.6% in 2010 to 19.5% in 2018.

The most important institutions providing either annuitized benefits or retirement savings in Malaysia are the retirement scheme for pensionable government employees administered by the Retirement Fund (KWAP); the pensions scheme for the armed forces administered by the Armed Forces Fund Board (LTAT); and the mandatory retirement savings plan for private sector workers and non-pensionable government employees, administered by the Employees' Provident Fund (EPF).

Figure 1. Share of uncovered labor force, 2013 and 2017



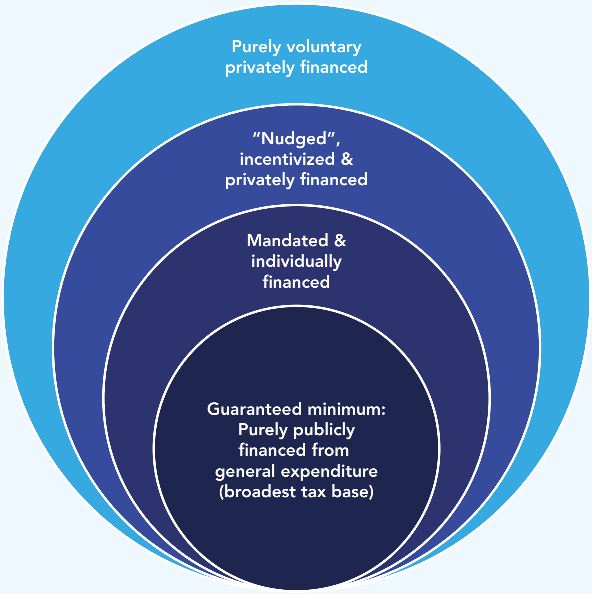
Source: Authors' calculations based on Department of Statistics Malaysia, EPF and Public Service Department.

In 2017, 11.4% of the labor force comprised civil servants or members of the armed forces while 47.6% contributed to EPF, suggesting that 41% of the labor force were uncovered by EPF, KWAP, or LTAT. Although workers contributing to the EPF are technically "covered", many move in and out of standard employment; hence, their contribution histories tend to be inadequate to support their retirement.

Strengthening the Social Protection System

Figure 2 illustrates a comprehensive policy package comprising four layers from the World Bank's recent White Paper "Protecting All – Risk-Sharing for a Diverse and Diversifying World of Work". A guiding principle is progressive universalism; i.e. gradually expanding coverage of

Figure 2. Comprehensive package of protection from risk and uncertainty



Source: World Bank

risk-sharing instruments that are appropriate to diverse situations, giving priority to the poorest when using public funds.

The first (innermost) layer should largely comprise non-contributory social assistance programs with broad coverage, plus any publicly financed premium subsidies for those who voluntarily participate in contributory schemes. Ideally, the guaranteed minimum would be available to those in need, set at adequate benefit levels, incentivize work, be responsive to changing circumstances, and be sustainable.

As a second layer, mandatory contribution-based social insurance should not fully depend on formal wage employment. Ideally, the guaranteed minimum combined with mandated social insurance should ensure an adequate retirement income for everyone. However, a sustainable "contributory" system may require increased general revenue financing as the proportion of the elderly increases. In the outer layers, additional insurance is achievable through voluntary savings schemes supported by government incentives and "nudges", and purely unincentivized savings for those who can afford it.

Expanded coverage of social assistance and the provision of social insurance and incentivized savings imply a strong role for government, and could entail additional fiscal expenditures. Progressive universalism calls for gradual expansion of social protection systems in line with the prevailing fiscal space.

Where Does Malaysia Stand?

Malaysia is still some way from achieving a comprehensive policy package. Challenges are exacerbated by demographic trends. The number of elderly is growing, and they rely on support from working-age households whose relative size is stagnating.

The elderly in Malaysia depend upon multiple sources of support for their livelihood in retirement, including labor income, family support, public transfers, etc.

The first layer of protection is provided by the *Bantuan Sara Hidup* program, which has broad and progressive coverage but lacks depth, and – in more narrowly targeted form – by the *Bantuan Orang Tua* (BOT) program – which targets those aged 60 and above with no source of income – and other Department of Social Welfare programs. In 2016, the BOT benefit was RM300 per month per beneficiary, and BOT covered about 133,000 beneficiaries or about 4.7% of those over 60. This places Malaysia among the group of countries in East Asia and the Pacific where benefit levels and coverage of non-contributory pensions is lowest.

In terms of the second layer, the two main schemes are the pension scheme for civil servants and the retirement savings plan administered by the EPF. For many EPF members, the average EPF balance is too small to support meaningful old age income protection, the benefit can be withdrawn at too young an age relative to remaining years of life, and most lump-sum benefits are used up in a few years, exposing some retirees to poverty soon after retirement.

Beyond the insufficiency of existing EPF balances, the average EPF balance will be affected both by the expected rise in unemployment during the COVID-19 pandemic which reduces the number of active EPF contributors, and by the measures introduced by the government to provide immediate financial relief in the period of economic slowdown during the pandemic. These measures include a reduced employee contribution rate for eight months from April 2020 to the end of the year, as well as the ability to withdraw RM500 per month for 12 months starting April 2020. While these measures serve their purpose of providing immediate relief and sustaining consumption during the pandemic, they will lead to lower EPF balances to be tapped into at older age.

Malaysia faces a dual agenda of deepening financial protection for those already contributing to retirement savings schemes, while expanding coverage to reach the labor force currently outside the pension savings net.

Given these challenges in adequacy, for those already in EPF, there is a need to continue reforms which strengthen income protection in old age and align the system with increased longevity in Malaysia. There is also a need to encourage longer working lives, and look at options for reducing the contribution burden on labor while providing adequate old age benefits. These measures will become even more important given the temporarily higher unemployment, reduced contributions, and more flexible early withdrawals from EPF balances during the COVID-19 crisis.

In terms of coverage expansion, there is a need for innovation to bring informal workers currently uncovered into some formal pension arrangement. A first step would be expanding old age protection through a modest non-contributory social pension, coupled with strengthened efforts to incentivize participation in contributory schemes. Such a social pension should be supported through budgetary transfers. The relevant parameters would also need to be developed, taking into account fiscal constraints, the targeted threshold for eligibility, the anticipated benefit level(s), and the anticipated indexation (ideally one that is automatic, nondiscretionary, and adjusts for changes in consumer prices).

In terms of eligibility. a universal, non-contributory, and flat social pension for all elderly over a certain age would ensure some financial protection for all. It would, however, inevitably provide benefits to some who do not need them. An alternative option would be providing a social pension for all those without an existing pension or with an EPF account balance below a certain threshold. This option would be cheaper, but could create disincentives for low-income workers to contribute to EPF during their working lives. The third option would be to target the social pension according to household income or other measures of household welfare. This option would be most closely aligned with the objective of reducing reduction elderly poverty while controlling fiscal costs. However, it would be advisable to adopt a targeting approach and threshold which allowed for relatively wide coverage of the poor and vulnerable elderly. A final option would be to pre-fund a social pension by making a lump sum deposit into an EPF account on their behalf early in their working lives, and letting compound returns generate an accumulation by retirement equivalent to a modest social pension.

Complementary to a social pension, efforts to increase participation in second-layer retirement savings schemes (such as EPF) could involve a mixture of incentives and stronger infrastructure for the self-employed and informal workers.

One method for providing old age protection to informal workers is by encouraging participation in voluntary insurance arrangements. Most such successful policy innovations globally draw on insights from behavioral economics. Policymakers have been increasingly resorting to behavioral “nudges” to coax people to save and insure.

In all countries – including Malaysia – mandatory payroll-tax-financed benefits increase incentives to evade or underreport incomes. Policymakers have been experimenting intensively with alternatives to a payroll tax mandate: making participation the lowest-effort, default option that people can take. Additionally, retirement savings schemes needs to be credible, efficient, and transparent to ensure public confidence. As a result, many countries have been using technology to support robust and efficient delivery systems, so that informal workers can readily enroll and check their account status on their smartphones and receive benefits directly to their bank or mobile-money accounts.

Concluding remarks

In Malaysia, there have already been efforts to expand social protection coverage to informal workers via voluntary insurance. According to EPF, in 2017 there were about 100,000 members of the *Skim Simpanan Persaraan 1Malaysia* (SP1M) scheme for the self-employed (now known as *i-Saraan*) that offers a 15% Government contribution of up to RM250 per year. Total savings of SP1M were about RM500 million. Another effort to encourage voluntary insurance has been the introduction of Private Retirement Schemes (PRS) in 2012. As of 2018, there were 416,913 PRS members, with 40 percent of these members aged 30 and below.

The aggregate take-up rate of voluntary insurance has been relatively low, likely in part due to the relatively low financial incentives. Given that the challenge in encouraging participation is not unique to Malaysia, alternative incentives or adjustments to these schemes – including changes in the nature or size of matching contributions – intended to boost participation would need to incorporate global experiences on behavioral "nudges" and weigh the fiscal costs and potential incentive effects. Increasing voluntary insurance or contributions – both through EPF and private schemes – will become even more crucial during the eventual recovery phase from the COVID-19 crisis.

Overall, expanding old age protection in Malaysia to cover all elderly regardless of the type of employment may gradually be achieved through a modest social pension and by ensuring that voluntary pension savings is efficient, transparent, and supported by carefully considered incentives. To achieve the maximum benefit and increase the likelihood of providing the guaranteed minimum for all, the design of the schemes would need to be carefully coordinated.

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Celebrating 10 Years of the Malaysia Economic Monitor

Min Hui Lee

Over the past decade, the Malaysia Economic Monitor (MEM), has provided an analytical perspective on the policy challenges facing the country as it set its sights on becoming a high-income and developed economy. With over 21 reports published, the MEM has grown to become an important asset informing the country's growth and development.

The report's journey over the years has also been helmed by many economists, in close cooperation with numerous government stakeholders, and remains a cornerstone of the World Bank's partnership with Malaysia. As we look back on the past, we speak to some of the economists behind the MEM.

Philip Schellekens

Senior Economic Adviser to the Office of the CEO at the International Finance Corporation, IFC

Previous Senior Economist for Malaysia

Just a few months after joining as country desk for Malaysia, I received a request from the Economic Planning Unit to organize a brainstorming session with the World Bank on how the country can become a high-income nation by 2020. We held a three-day event with the highest echelons of government, where we invited the best and brightest to share cross-country experiences adapted to local context. The high-level brainstorming session marked a turning point in relationship with the government. In May 2009, Malaysia re-opened its doors to the World Bank.

We rapidly expanded our engagement in the country and developed a vibrant program of advisory services. During that same year, I started the Malaysia Economic Monitor series. The idea for the MEM, as it would become known, emerged from conversations with my predecessor, Albert Zeufack. Thus, the MEM series was born: an outlet for independent analysis that would be published, discussed and hopefully eventually adopted.

The MEM has been an important asset for Malaysian policymakers from day one. The series received high-level policy attention because it was squarely anchored to that objective. The reports turned out highly successful in promoting discussion about public policy, and this was achieved through our substantial efforts through media outreach and roadshows, and helped by the government's interest in our findings.

The initial request of the Malaysian government for the World Bank to establish a local presence in KL – a few months after the publication of the controversial MEM on Brain Drain – bears testimony to the close relationship that was developed. It is fair to say that the introduction of the MEM series along with the synergetic scaling up of the advisory program laid a solid foundation for a fruitful collaboration between the government of Malaysia and the World Bank.

Rafael Munoz Moreno

Program Leader, Brazil

Previous Country Economist for Malaysia

The report evolved quickly from a way to communicate high quality Bank analysis into an instrument to engage the Bank and the Malaysian society into difficult policy discussions. It has managed to maintain a fine balance between independence and government engagement, pushing for (more inclusive) policy reforms.

The MEM will continue to play an important and relevant role in the future as long as we stick to the three reasons I think make it so successful:

i. to bring high quality evidence to hard policy questions: we should never compromise our quality and rigor

ii. the World Bank has the credibility to engage multiple stakeholders during the preparation: we should continue reaching out and giving the voice to all parties

iii. we touch on hard policy issues: not shying away from difficult topics

Among the reports I have led, there have been many memorable topics but the one I was eventually fonder of was on immigrant labor. I think its main impact was to bring evidence to a topic that was basically muted at the time. The treatments were highly ideological and were hard to translate into practical policies. The MEM brought the topic to the surface, and as expected, generated a huge public debate, with many interesting angles, such as impact on trade relationships, job competition, skills composition, or even crime. Its main achievement was to start shedding light and evidence into a topic that was often neglected but that was essential to the development model of Malaysia.

Malaysia Economic Monitor Issues 2009-2019

Shakira Teh Sharifuddin

Senior Economist, Malaysia

Over the years, the MEM has grown from strength to strength covering a wide range of topics including productivity, education, transportation and women's potential - and some of the recommendations made were taken up by the government. The MEM has also opened up opportunities for us at the Bank to engage with various ministries and establish our readiness to provide support to them while expanding engagement with state governments and universities across the country.

In the first edition of the MEM, "Repositioning for Growth" talks about the challenges Malaysia needs to address to become a high-income economy and as the country stands at the cusp of becoming a high-income economy within the next few years, it still faces the same set of challenges! Some insightful feedback I received came from one of the Assistant Governors at the Central Bank of Malaysia who shared that we should continue to highlight the recommendations and analyses of previous MEMs, even from editions that were published many years ago as it remains relevant in current policy dialogues.

I have had the opportunity to work on several editions of the MEMs and each edition was memorable in its own way. One of the most rewarding editions was on Making Ends Meet. Personally, since joining the Bank, I have always wanted to work on a topic that is more household-centric and this edition looking at the cost of living issue in Malaysia in greater detail was a chance for me to do so. We also had great collaboration with colleagues from the Poverty Global Practice who provided great analyses on the topic, and a great counterpart from the Ministry of Domestic Trade and Consumer Affairs (KPDNHEP). One of the key features of the MEM is that it is made with a broader audience in mind, and as such, the recommendations and messages embedded in the report tend to reach a wider audience. It is great to see the MEM has evolved from its humble beginnings back in 2009 to where it is right now.

Millennial Money Matters

Zainab Ali Ahmad and Kenneth Simler

The phrase 'young and broke' is a term that millennials cannot seem to shake off. Having often been criticized for living beyond their means, millennials have had to grapple with numerous stereotypes. Their incomes aren't growing, many spend beyond what they can afford, and are unable to save enough.

In 2018, one in four bankrupt borrowers in Malaysia belonged in the 25–34 age group, due mainly to defaults on personal financing and motor vehicle loans. Credit cards have also become a source of borrowing for Malaysian millennials, allowing prolonged outstanding balances and a rapid build-up of debt, which has only been exacerbated by high credit card interest rates.

One can make the argument that the world has changed. Today's millennials operate in a markedly different economic landscape compared to what their parents lived in. Millennials, aged 24-39, now make up a large bulk of the world's labor force, but many are riddled in debt and command poor financial knowledge and management. This raises the question if millennials are particularly prone to the cycle of debt and why this is the case.

To understand the issues surrounding millennials in debt, we explore three key factors, namely lagging income growth, poor financial management, and low financial literacy.

We begin by looking at their earnings. Younger Malaysian workers haven't been enjoying as much income growth as their older counterparts.

To cite an example, a look at employment income trends between 2004 -2016 found that median employment income among men aged 20-29 was 70% that of counterparts aged 40-49% in 2004, but by 2016, this ratio had eroded to 58%.

We see more and more millennials being highly educated and qualified. However, this has not translated into better employment earnings – potentially due to a lack of work experience and qualities that employers are seeking for. These have inevitably led to financial constraints for younger millennials at the start of their time in the labor force, aggravated by other key factors such as lagging income growth and low wages for new entrants.

Across Malaysia, poor financial management is a shared problem, regardless of age group. Statistics by the Department of Statistics Malaysia and Organisation for Economic Co-operation and Development show a staggeringly low gross household savings rate in Malaysia – standing at 1.5% of adjusted disposable income. This is much lower compared to countries such as the U.S. (7.8%) and Chile (9.6%).

In fact, the Credit Counselling and Debt Management Agency (AKPK) has reported that about half of Malaysian working adults do not have enough savings to cope with unforeseen personal financial shocks such as emergencies, medical bills, or job loss.

A majority of working Malaysian adults with reasonable financial behavior ratings have also reported experiencing considerable financial pressures.

This issue is even more pronounced for millennials as they are especially prone to poor financial management and behavior. AKPK reported that millennials form the majority of Malaysians who spend well beyond their means for reasons like impulse-buying behavior, a desire for instant gratification, and ready access to personal loans and credit card financing.

In a 2015 survey by the Asian Institute of Finance, approximately 40% of millennials admitted to spending more than they can afford. However, as circumstances change over time, so have perceptions on what constitutes a want and a need. For example, motor vehicle purchases are considered a necessity for those who live in the suburban areas of Selangor and travel to work in the Kuala Lumpur city center. On the flip side, this is considered a luxury to those living and working in the center as they enjoy easy access to public transportation.

Low levels of financial literacy amongst the youth are also a big concern. A 2017 study by the Global Finance Literacy Excellence Centre found that only 36% of those in Malaysia between the ages 15 -34 were financially literate, compared to 51% in Myanmar and 66% in Singapore. Another survey by Vase.ai also found that approximately 60% of millennials who put aside part of their income have savings that amount up to three months' worth of income or less.

As such, it is important that financial knowledge and management be incorporated into learning, whether at home or at school.

This will become a more urgent need in the future in an environment where Malaysian millennials are placing less importance on saving money, believing that they will have time to save up later.

Short-term policies to boost financial literacy and improve financial well-being among millennials should focus on raising awareness of prudent personal financial management among individual borrowers, promoting good financial practices for working adults, and expanding financial programs and tools that are available to the public. Other medium- and long-term policy considerations include enhancing productivity and income for younger workers, integrating financial education in primary and secondary school curricula, as well as reinforcing national savings schemes through the Employees Provident Fund (EPF).

At its core, debt is not a challenge that is exclusive only to millennials, but the figures show that this generation is more likely to be stuck in a cycle of debt. In the face of many economic challenges, much can be done policy-wise to prevent an entire generation from being entrenched in debt.

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Malaysia Doing Business 2020: Pursuing Reforms at the Top

Varun Eknath

Slowly but surely, we are seeing more developing countries catching up in the ease of doing business. This is a signal for the world's top performers that in order to remain competitive, they need to sustain the best possible pace of reforms, and as of now, the potential for these economies remains largely unexploited.

What this means for Malaysia, a developing economy and a global leader in the World Bank's Doing Business 2020 rankings, is that tapping into this potential could benefit the economy by further improving its business climate and fostering entrepreneurial activity, job creation, and investments.

Malaysia has seen a steady improvement in its business climate for domestic SMEs, moving up three places to a global rank of 12th out of 190 economies in the latest rankings.

The consistent efforts to make regulations more efficient, accessible, and simple have facilitated a conducive business environment for Malaysia's local entrepreneurs. These demonstrate the government's commitment to the expansion of business opportunities, innovation, job creation, and reassurance for aspiring entrepreneurs and others in the private sector.

As a result of adopting international regulatory good practices, Malaysia's significant achievements include:

- The second-best global performer on the **dealing with construction permits** indicator, taking local businesses only nine procedures to obtain all required permits and authorizations to build a warehouse. The overall time to complete this process is three times faster than the regional average. During the past year, Malaysia also streamlined the process to obtain construction permits, by eliminating the requirement for a road and drainage inspection by the Kuala Lumpur City Hall.
- Globally, the second-best performer in the world in the **protecting minority shareholders** indicator. Malaysia's legal framework has strong rules and requirements for the protection of minority shareholders.
- The fourth best global performer in the **getting electricity** indicator as the process for a business to obtain a permanent commercial electricity connection is now 23 times cheaper and substantially faster than the regional average.

Encouragingly, a total of 29 reforms have been implemented since 2003-2004, highlighting the country's ongoing efforts to shorten the gap between its performance and international good practices.

However, once a country reaches the cohort of top global performers, the scope for further improvement becomes more challenging, as the gap between its performance and regulatory good practices grows smaller.

But there is still space for potential reform. These include:

- **Starting a business:** Over the years, although the country has implemented seven reforms to make it easier to start and operate a business, it continues to be cumbersome for local entrepreneurs. Malaysia ranks 126th on this indicator, taking 8.5 procedures and 17.5 days.
- **Paying taxes:** Malaysia ranks 80th on this indicator. Domestic companies spend an average of 174 hours annually to comply with fiscal obligations, slightly more than the OECD high-income average of 159 hours.
- **Legal rights and enforcing contracts:** In the last five years, there have been no reforms in these areas for Malaysia. As such, improving on these indicators is crucial as it can enhance regulations that protect the rights of lenders and borrowers, and improve the efficiency of the judicial system. For instance, over the last five years, the time needed to enforce a contract in Malaysia has taken 425 days, whereas the required time in some countries in the region have reduced – from 440 to 420 days in Thailand, and from 471 days to 403 days in Indonesia.

In its pursuit of becoming a high-income and developed economy, Malaysia stands on strong fundamentals in terms of its business environment and existing pace of reforms. Moving forward, sustaining competitiveness, and continually creating the conditions for its entrepreneurs to thrive would require that policymakers use the findings of this latest study to benchmark progress, stimulate policy debate, and identify potential challenges, good practices, and lessons learned.

Continuing this overall reform momentum and reinforcing efforts to address the remaining challenges where local entrepreneurs still face difficulties is key to ensuring efficiency and supporting the freedom to do business. This is no easy task for any country, but identifying these areas as untapped potential represents an opportunity for new reforms that can sustain Malaysia's position as a global leader in Doing Business.

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Waqf: Providing Alternative Finance for Sustainable Development

Mohamed Rozani Osman and Ahmad Hafiz Abdul Aziz

In the global community's run towards facilitating sustainable development, financing such initiatives remains a core concern for all leaders. Today, Islamic finance provides an alternative solution to the conventional modes of financing we see. With the rise of Islamic social finance tools such as *waqf* (Islamic endowments), more contributions can be made towards the objectives of ending extreme poverty and promoting shared prosperity – the World Bank's twin goals – in a sustainable way.

Looking back in time, *waqf* has played an instrumental role in both socioeconomic development and the alleviation of poverty for over 1,400 years throughout Islamic history. It has also been a major provider of social services that are today financed by the state. These services include the provision of education, healthcare, and infrastructure development, as well as social assistance to the poor and vulnerable. Further, *waqf* institutions have also supported improvements in income and wealth equality as affluent individuals and families released property into the service of people in need of support.

Understanding how *waqf* works is important. In *waqf*, the donor declares an asset inalienable, meaning it cannot be sold or disposed of in any other way. Meanwhile, the proceeds are periodically spent for the beneficiaries designated by the *waqf* founder.

Looking ahead, *waqf* institutions have the potential to expand available long-term financing for development, supporting various types of projects that ultimately expand the productive capacity of an economy.

This is important for many reasons, including the fact that approximately $71 trillion will be needed globally by 2030 for investments in roads, rail, electricity, water, and other basic infrastructure, according to estimates by the Organisation for Economic Co-operation and Development (OECD), most of which are core development challenges in the Muslim world.

Waqf could also potentially fill existing investment gaps. In 2019, the Standing Committee for Economic and Commercial Cooperation of the Organization of the Islamic Cooperation (COMCEC) stated that infrastructure spending required over the period of 24 years for countries under the Organization of Islamic Cooperation stands roughly at $7.2 trillion with an investment gap of $1.6 trillion. By capitalizing on important features of *waqf* such as risk-sharing, asset-backing, and financial partnerships, there remains much potential for this Islamic social finance tool to bridge long-term financing gaps.

However, the potential of *waqf* remains largely unrecognized due to the critical challenges of liquidity management and the shortage of viable investment opportunities. The portfolio of existing *waqf* assets is highly biased in favor of physical assets. It is thus common for *waqf* portfolios to be heavily weighted in land assets, but lightly weighted in liquid assets – it is currently common in factors of production like land, while short on others such as in capital, labor, and organization. To date, large parcels of *waqf* land have remained undeveloped due to lack of sufficient funds and entrepreneurial initiatives. Moving forward, these issues need to be addressed if we are to realize the potential of *waqf*.

In recent times, many models have been proposed to maximize the impact of *waqf* to address the economic and social issues of the disenfranchised and make them economically independent.

Such institutions can help achieve these goals by providing good education, offering health facilities, and providing opportunities to be included in the financial system. To that end, *waqf* institutions can be of great assistance as they can provide financing to the low-income group not only for their basic needs but also to start small-scale businesses, thus providing the low-income groups with permanent sources of income.

Moving forward, *waqf* institutions could be made more impactful by getting them involved in the Islamic capital market. Providing professional services such as portfolio management to *waqf* institutions would help them manage assets efficiently. As such, the *waqf*-linked *sukuk* and *waqf*-based shares issued in Indonesia and Malaysia respectively are good examples to be replicated. Continuing innovation in finance is needed to bridge high net worth and middle-income philanthropists with social needs. Future areas of involvement for *waqf* include social investment and disaster risk financing. In either case, *waqf* assets could provide key donor support funding to ensure viability.

To go in-depth, one of the World Bank's reports on **Maximizing Social Impact through *Waqf* Solutions** discusses the enabling legislation and regulatory frameworks of selected jurisdictions, and considers the factors that both facilitate and hamper the development of *waqf* in respective jurisdictions. Here, advanced technologies like blockchain present a way of addressing the trust and transparency deficits affecting the *waqf* sector

Ultimately, there remains a role for *waqf* to contribute to these core development goals sustainably. With the partnership of key stakeholders such as the Malaysian government, we may see the full potent force of *waqf* in impacting sustainable development in years to come.

For the full report on '*Maximizing Social Impact through Waqf Solutions*', visit **bit.ly/waqfsolutionsmywb**

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BOX 2

Harnessing Islamic Social Finance During a Pandemic

In response to the increasing spread of COVID-19 and the shock the pandemic poses to Malaysia's economy, the Prime Minister of Malaysia in his second announcement of the PRIHATIN Economic Stimulus Package has urged for the leveraging of Islamic social finance tools, for example: *zakat* (alms), *waqf* (endowment), and *sadaqah* (charity). These tools are aimed at the redistribution of wealth, and are to be utilized to help facilitate access to funding and build entrepreneurship capability among B40 micro-entrepreneurs. They can be leveraged to address the basic needs of the extremely poor and the destitute. By focusing on low-income groups, these practices seek to create a social safety net, enabling greater financial inclusion to occur.

To that end, in the run towards mitigating the shock brought on by COVID-19 in Malaysia, a social finance program will be introduced by participating Islamic banks in collaboration with some State Islamic Religious Councils (SIRCs) and implementation partners. The program is designed to mobilize social finance contributions towards providing seed capital that is packaged with microfinancing for the purposes of enabling eligible micro-entrepreneurs to start and grow businesses and generate sustainable income.

For the first phase, the Federal Territory Islamic Religious Council (MAIWP), in collaboration with Bank Islam Malaysia Berhad (BIMB) and SME Corp., will pilot the Program to Support the B40 Segment in Generating Sustainable Income and Achieve Financial Resilience (iTEKAD) beginning May 2020. The initial program optimizes *zakat* and microfinancing arrangements and will include cash *waqf* in the later stages. The implementation of the program involves onboarding and educating recipients as well as monitoring successful outcomes.

As of today, the total amount allocated by all SIRCs amount up to roughly RM120.68 million. The fund will be used to give financial assistance to all eligible recipients (*asnaf*), micro- small and medium enterprises (MSMEs), those in need of support, and also for the purpose buying medical equipment.

The World Bank stands ready to partner with Malaysian institutions to further deepen the role of Islamic social finance in the areas of product innovation, technical research, and capacity building. As we move ahead, there remains a large playing field for Islamic social finance to achieve the twin goals of eradicating extreme poverty and boosting shared prosperity.

In 2019, the World Bank, the Global University of Islamic Finance (INCEIF), and the International Shari'ah Research Academy for Islamic Finance (ISRA) launched a report on '**Maximizing Social Impact through *Waqf* Solutions**'. The report presents an overview of the *waqf* landscape and highlights the potential of its institutions, sharing best practices around the world that apply modern management techniques competently and transparently. The report also further deepens the discussion on the building blocks of *waqf*. Here, we also suggest that advanced technologies like blockchain could potentially address the trust and transparency deficit affecting the *waqf* sector.

Becoming More Equal in East Asia Pacific by Reducing the Trade-offs Between Work and Home

Victoria Kwakwa

No country can achieve its full potential without the equal participation of women and men. Yet worldwide, women still have only 75% of the legal rights of men. Holding back employment and entrepreneurship opportunities for half the population in this way limits the potential for economic growth and development.

A new World Bank report – **How Large Is the Gender Dividend?** – estimates that gender inequality costs the East Asia and Pacific Region (EAP) about US$40-$50 trillion in human capital wealth. This deficit is the difference in the lifelong earnings between men and women.

Globally, human capital wealth could increase by about one-fifth if there were gender equality in earnings, and women's human capital wealth would more than double.

To reap the gender dividend in EAP, countries must improve women's access to jobs and business opportunities.

The EAP region is making good strides. **Women, Business and the Law 2020,** which tracks data on the laws and regulations that restrict women's economic opportunities, looks at reforms made from 2017-2019.

In this period, Thailand introduced new legislation that mandates equal remuneration for men and women who perform work of equal value; the Philippines extended the duration of paid maternity leave from 60 to 105 days; Fiji introduced five days of paid paternity leave; and Timor-Leste explicitly accounted for periods of absence due to childcare in pension benefits, to mention a few remarkable steps.

But much more needs to be done. A key element of boosting women's economic participation is reducing the trade-offs women are forced to make between their household and market roles, and this is one of five priority areas of our World Bank gender strategy in the East Asia Pacific region. Affordable and reliable childcare is essential to reducing this trade-off.

Developing options for affordable childcare has the potential to improve women's access to good jobs and narrow the gender gap.

This can be a win-win for employees and their families, employers, and economies. That's why, among other things, we are starting a pilot project in Cambodia's Kampong Speu province to establish and operate 25 childcare centers for pre-school-aged children of garment sector workers. Kampong Speu has 116 garment factories and provides wage employment for over 112,000 workers, 84% of whom are women.

To help inform the policy choices countries make, we have been systematically analyzing women's labor force participation. For instance, in Indonesia, we examined the ways in which the lack of childcare constrains women's labor force participation.

Our findings show that urban women with access to childcare are able to return to the labor market two years earlier after childbirth, and that an additional public preschool per 1,000 children is associated with a 14% increase in the likelihood of employment.

Similarly, in Malaysia, our research found that between 2008 and 2015, for every pre-school that opened, an additional 89 women entered the labor force.

In addition, through a rigorous analysis of the impacts of pre-school (age 1-5) childcare on women's labor market outcomes in Vietnam, we found that not only does childcare have a strong effect on women's labor market participation, it also increases their probability of working in a formal wage-earning job, which can improve their annual wages and overall household income.

Our gender work in Vietnam has helped lead to a transformation of the labor code from a gender-biased one to a law that influences norms and promotes equal participation of men and women in the labor market.

For example, the former code requires that the state and employers organize or build daycare facilities and kindergartens where a large number of women are employed or cover part of childcare expenses incurred by female employees. The code broadens this to include fathers and sons, stipulating that the state and employers shall develop plans and measures for day care and kindergartens in areas with large number of workers, and that the state and employers shall assist and support in child care services for employees. It also reduces the pension age gap between men and women.

As we mark **International Women's Day 2020,** we are sharing inspiring stories of pioneering women across the EAP who are breaking barriers and creating change for the decade ahead.

One of these women is Shera Ann Bosco from Malaysia. A retired military officer, Shera is the co-founder of CARING MOMS, a platform that connects women to a network of individuals and corporations, providing them access to a wide range of opportunities, skills, guidance, and empowering them to be economically independent.

It offers a safe environment for them to transact, learn, interact, and gain support to start-up and mature their businesses, and it serves as a source of income for many stay-at-home and single mothers, or women who are only able to work from home. Shera's own challenges as a working mother in need of childcare for her son inspired her to start CARING MOMS.

I invite you to read her story and those of other inspiring women from across the region. Each of them is working, in their own way, toward #EachForEqual in the East Asia and Pacific region.

This article was first published on the World Bank's *East Asia and Pacific on the Rise* blog, in conjunction with International Women's Day 2020. To access the blog, visit **bit.ly/iwdeap2020my**

To access the East Asia and Pacific's International Women's Day stories, visit **http://bit.ly/iwdeap2020all**

VICTORIA KWAKWA is Vice President for the World Bank's East Asia and Pacific region.

BOX 3

Breaking Barriers in Malaysia: Shera Ann Bosco

For International Women's Day 2020, we're getting to know the pioneering women across East Asia Pacific who are breaking barriers and creating change for the decade ahead. Shera Ann Bosco is a former military officer who then co-founded CARING MOMS, an organization empowering woman with economic development.

Tell us about yourself.

I joined the military to fulfill my mother's wish. Back in the 90s, women enlisting in the military was not very popular. But I wanted to make my mother's dream come true and when the opportunity presented itself, I had her full support. She stood by me right from the day I attended the selection interview till the day I retired.

Life in the military is something I enjoyed, and I still miss it. I miss the camaraderie and the bonds I shared with the people I met. Being a woman didn't matter as long as you worked hard and delivered results.

As I enjoyed my command on every level, I realized that I had a little boy to care for at home who was now going to school. I realized he was not given the proper care at his after-school daycare. It was also not easy for me to leave my job due to its nature.

It was then that I started to reach out to stay-at-home moms by creating a Facebook group, hoping to find a suitable 'halfway home' for my son. Upon starting the group, my co-founder Umesh Narasimhaiah and I saw that the membership only began to grow. It was then that we realized we had touched a pain point. Women yearned for economic and financial independence, and this Facebook group quickly became a platform for them to provide their services and receive remuneration from it. We then began our mission to empower women economically and in 2018, I officially retired from the Malaysian Armed Forces to fully serve the underserved, marginalized, and displaced women in society.

What inspires you?

It's truly the simple things that inspire me. My biggest inspiration is of course my mother. I see what a selfless and kind person she is. I think if we can all be like her, the world would be a beautiful place to live in. Then, my son, who's the reason we even started CARING MOMS. I always tell people, CARING MOMS was started by a 7-year-old boy who needed a good daycare. Then of course all the empowering success stories. CARING MOMS has seen hundreds, maybe thousands of women who have now successfully achieved financial independence.

Their success is the fuel that keeps us going.

How do you see Malaysian women breaking barriers? What does that mean to you?

Malaysian women are highly capable. I know this because I see how strong they are. There should be no barriers preventing them from moving forward. Most of the time, barriers and obstacles are only in the mind. All women should not feel limited in the things they can do. They can develop confidence and unlock their maximum potential given the right environment and leaders. Once they know that, then a world full of limitless possibilities awaits them.

Do you have a favorite quote or saying?

That's really easy. "*To win in the 21st century, you have to make others become more successful than you*". This quote is from Jack Ma. I live by these words and have seen it do amazing things in my life.

Where do you see Malaysia and women in 25 years?

In 25 years, women will be working in various industries. There would be more female pilots, more female ship captains, maybe even a prime minister. More businesses would be helmed by women.

It goes without saying that in the future, we would have more women representation in the government. I believe women will bring Malaysia forward.

What do you think is needed in Malaysia for more equality between men and women?

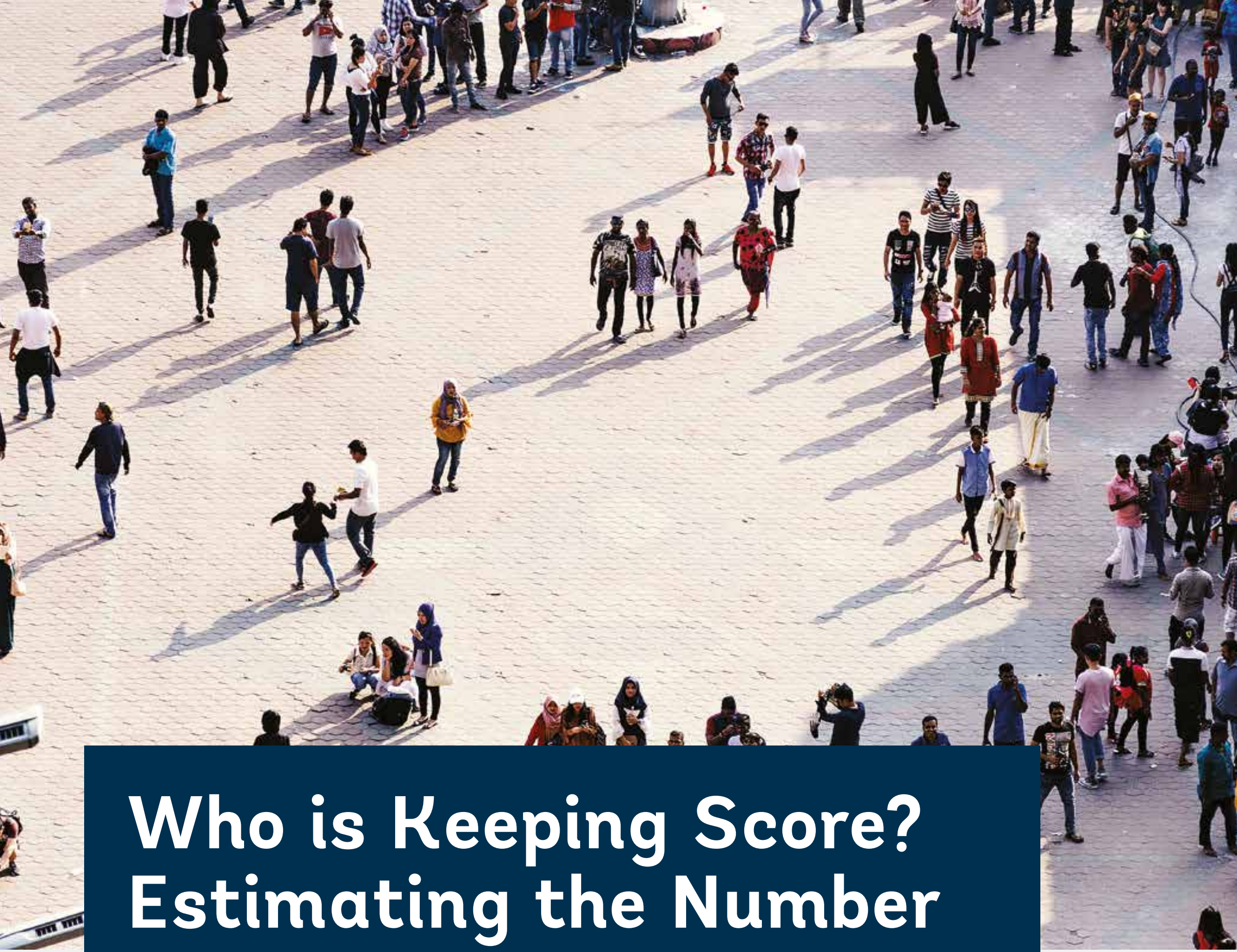
I see that the Malaysian government is already doing its best to uplift women. I believe all women earn their seats by merit, not just to fill quotas. We all have our strengths and weaknesses and we must learn how to recognize it and appreciate each one as a person that can contribute to society.

If you could use one word to describe women in Malaysia, what would it be?

Fearless.

What is your big hope for Malaysian women in the future?

That they be given every opportunity they deserve regardless of their skin color, race, or religion.



Who is Keeping Score? Estimating the Number of Foreign Workers in Malaysia

Soonhwa Yi, Kenneth Simler, Wei San Loh and Zainab Ali Ahmad

When it comes to taking up 3D jobs – dirty, difficult, and dangerous – foreign workers are at the forefront. In Malaysia, they fill labor shortages in low-skilled, labor-intensive sectors, and in turn, help create higher-skilled jobs for local workers as well as enabling Malaysians to specialize in higher-skilled jobs.

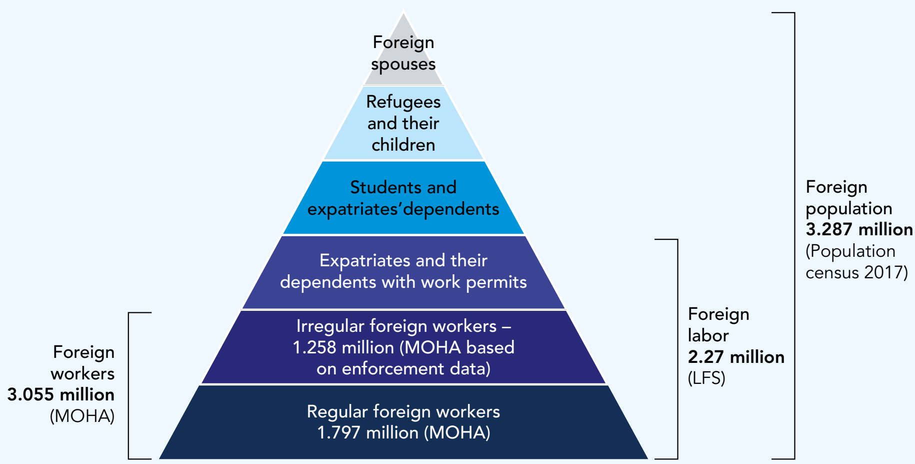
These are the jobs few Malaysians want: cleaning offices and residences, pouring concrete, and tending oil palms under scorching heat, to name a few. Thanks to foreign domestic helpers, more Malaysian women are relieved from domestic work and can pursue higher-paying careers today. With foreign labor as a key contributor to Malaysia's economic growth, a better understanding of their numbers can facilitate a more rigorous analysis of their impact on the economy and formulation of evidence-based policies to manage foreign workers and harness the benefits of foreign labor.

However, existing estimates of the number of foreign workers range widely from 2 to 5 million. The latest Labor Force Survey (LFS) reports, albeit imperfectly, that in 2019 foreign workers made up 15.4% of Malaysia's total labor force, or 2.43 million people.

This challenge stems from the presence of irregular foreign workers – those without work permits or in violation of their work permits because of changing jobs or overstaying. Official statistics capture the irregular foreign worker population only partially (see Figure 1). For example, the LFS undercounts foreign workers because it samples households, thus excluding those living in communal housing where many foreign workers reside. Estimates of irregular foreign workers from the Ministry of Home Affairs (MOHA) are also incomplete because the estimates come from MOHA's work permit enforcement activities.

Given the importance of foreign workers to the Malaysian economy, making better use of administrative data can help support the formulation of evidence-based policies.

Figure 1. Official statistics suggest more than 2 million foreign laborers work in Malaysia



Several reports have presented estimates of the size of the irregular foreign worker population, but without reporting a clear methodology. Publicly-reported estimates of the number of irregular foreign workers in 2017 range from 1.2 to 4 million. Most of these reports are vague about how the estimates were derived, but it is widely believed that irregular foreign workers outnumber regular foreign workers.

As such, a more systematic use of existing administrative data can improve the quality of foreign labor estimates. In its recent report "**Who is Keeping Score? Estimating the Number of Foreign Workers in Malaysia**", the World Bank employs three approaches that use administrative data to estimate the number of irregular foreign workers:

- **The "residual" method** compares the total non-citizen population (based on the Department of Statistics Malaysia's projections from the 2010 Population and Housing Census) with estimates of the lawfully-residing non-citizen population, which are based on visa issuance data such as work permits, student passes, expatriates and their dependents, and social passes.

- **The "build-up" method** counts the various groups of irregular foreign workers based on data related to deportees, amnesty, refugees, visa issuance, and medical examinations required for work permits.

- **The "remittance data" approach** uses outward-remittance transaction data to identify remitters who are potentially irregular foreign workers, mapping remitter information with the foreign worker management system. This method has its own limitations, as not all foreign workers use official money transfer service providers to send money home, especially those in remotely located plantation estates.

Using these methods, the World Bank report estimates that:

- The total number of foreign workers in Malaysia ranged from 2.96 to 3.26 million foreign workers in 2017.
- Among these, an estimated 1.23 to 1.46 million are irregular foreign workers.

Moving forward, the government can narrow the estimates further by estimating net inflows of foreigners by type of visa, including tourists entering without visas, identifying the characteristics of foreign workers at the district level, and mapping various administrative data and reports with unique identifiers of individuals.

In sum, policies on foreign labor should be underpinned by evidence, and the use of administrative data helps the government to achieve this. Various agencies are involved in formulating foreign worker policies, reflecting the multi-faceted nature of foreign worker issues. It is thus important to put in place an integrated management information system which brings all components related to foreign worker management into one system and allows easier data compilation. The first step to narrow the range of current estimates is a necessary one that can help Malaysia quantify the impacts of foreign workers on the economy and develop evidence-based policies to address them.

For the full report on '*Who is Keeping Score? Estimating the Number of Foreign Workers in Malaysia*', visit **bit.ly/foworkermy2020**

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Communications is Key to Policy Success

Joshua Foong and Clarissa David

Public policies are not created and adapted in a vacuum. Some are created out of demand while others are delivered out of necessity even if they don't enjoy public support. Tough reforms are necessary to realize long-term gains, but gaining public support and effective implementation requires clear, concerted, and careful stakeholder management. This is where communications can be a useful tool to facilitate a country's reform efforts.

It is without a doubt that in the recent COVID-19 outbreak, the necessity of good communications from government takes greater emphasis. The strategic and deliberate use of communications can help build public trust and confidence in institutions, which is vital to ensure policy success. Francis Fukuyama's commentary in April 2020 titled "The Thing That Determines a Country's Resistance to the Coronavirus" stated that "the crucial determinant in performance... (is) the state's capacity and, above all, trust in government".

When the public trusts state institutions, the state has reservoirs of political capital on which it can draw on to propose and explain difficult reforms that may result in long-term gains, but at the cost of some short-term difficulties, at least for some key stakeholder groups. This will help ease efforts to quickly build public support, increase compliance for more people to stay at home, and rally efforts to uphold the public health service. This has been the observation for countries like Malaysia, South Korea and Singapore who have been battling the outbreak.

Taking a longer view, establishing an effective communication system is important for the effective design, promulgation and implementation of policy. A good example of a government developing an effective communication system as a policy tool is in the United Kingdom, where the Government Communications Service (GCS) operates across the civil service to deliver communications and socialize policies. GCS brings together more than 4,000 professionals across 25 ministerial departments, 20 non-ministerial departments and more than 400 agencies and public bodies. It recently published its inaugural Communication Plan for 2018/2019, which coordinates the delivery of 140 integrated communication campaigns nationwide.

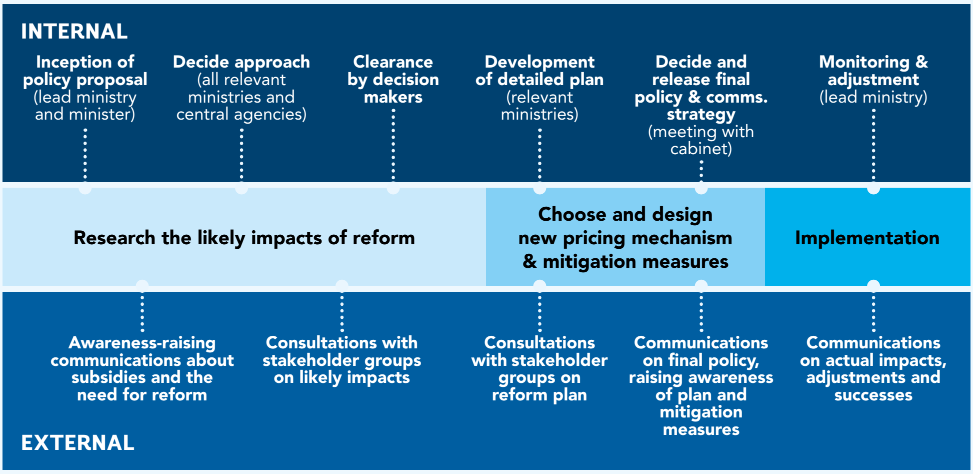
Government communications units need to engage with many different audiences with varying levels of involvement suited for specific periods in the reform process. A recent paper by the IMF, entitled Frontiers of Economic Policy Communications, states that in order to be more effective and strategic, "communications need to be increasingly integrated with operations, drawing on an in-depth understanding of policies and their future path."

Listening to stakeholders, acknowledging their concerns, and responding to them with action is a core part of the policymaking process. Ultimately, citizens are the principal beneficiaries of reforms. Thus, being attentive to their voices is vital not only to ensure buy-in but also as a source of input and feedback on the actual design and substance of the policy proposals. In this area, the Porto Alegre municipality in Brazil was a forerunner when it pioneered participatory budgeting in the 1990s. Since then, this model has been emulated around the world, with more than 2,700 governments implementing some version of it today.

Institutionalizing public participation sends a signal to stakeholders that they are formally involved in the development and policy process.

It encourages citizens to engage directly and actively through formal platforms. These channels

Figure 1. A timeline for communicating policy changes



Source: IISD (2013) - Guidebook to Fuel Subsidy Reform for Policy Makers in Southeast Asia)

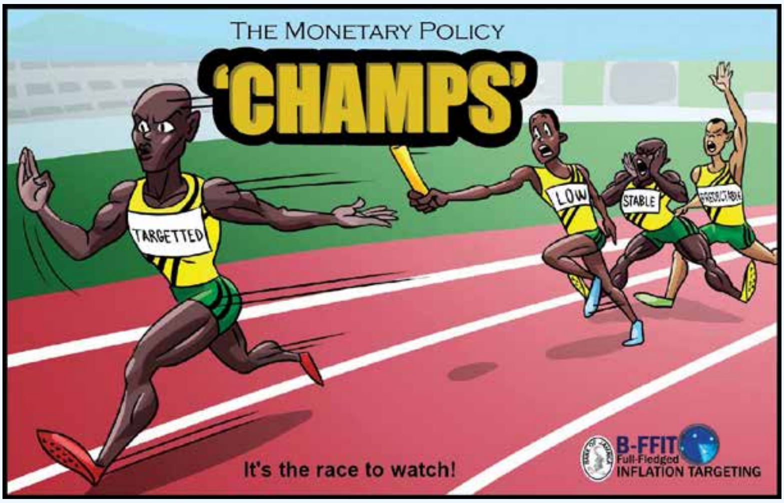
may include a range of mechanisms to facilitate dialogue such as public consultations, roundtable discussions, town hall meetings, as well as digital means such as social media.

Staying connected and being engaged is key to effective policymaking. Continued dialogue with stakeholders throughout the formulation and implementation of policy can increase public understanding of the expected policy-trade offs while building public support and trust in institutions along the way (Figure 1). Without effective communication, it may not be possible to implement essential but difficult reforms and attempts to do so can lead to undesired political implications.

An example of effective communication is the recent natural gas pricing reform in Ukraine. Faced with the need to reform price subsidies for natural gas, the government engaged conducted public opinion research and focus groups across the country. Citizen feedback was used to design compelling messages for an awareness-raising campaign, improve consumer knowledge, facilitate public debate, and shape public opinion about the importance of reforms. The campaign was launched with evidence-based messaging about the need to reform gas price subsidies, efforts to mitigate the impacts of price increases especially for poor households, and improvements to national social assistance programs. The impact of these efforts was far-reaching: enrollment in assistance programs increased significantly from around 1 million low-income households in 2014 to 6.5 million in 2017, many adopted energy efficiency measures, and the government committed to continuing the reform process.

In Jamaica, the government implemented a communications strategy to support the transition to full-fledged inflation targeting over the medium term. Prior to the implementation of the measure, the Bank of Jamaica strengthened its communications capacity and conducted public relations campaigns to explain to the public the benefits of price stability – contributing

Figure 2. Bank of Jamaica's inflation-targeting relay advert



significantly to the credibility of the policy transition. In particular, the authorities used radio advertising and billboards to convey powerful messages through formats inspired by Jamaica's popular culture, including reggae music.

> **Fundamentally, effective communications campaigns enable policymakers to stay engaged with stakeholder groups and the broader public throughout the policy process.**

The two examples above demonstrate that engagement with the public prior to and during the implementation of complex and sometimes unpopular reforms is essential, particularly when policies result in significant push-back from vested interests.

Citizens around the world are increasingly connected, with information more easily shared and disseminated. This has increased the demand for government transparency in all areas, including on economic policy decisions. It has elevated the role of public discourse and public opinion in policymaking, giving citizens a greater voice in their own governance. Policymakers should consider communications as a policy tool that can be used effectively to increase the odds of success for the reforms they propose.

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Do More Rules Lead to More Corruption? Evidence Using Firm-level Survey Data for Developing Countries

Yew Chong Soh and Mohammad Amin

We hear all too often that regulation creates opportunities for corruption. If true, a practical way to fight corruption and its harmful effects would simply be to deregulate. However, is it in fact the case that more regulation increases corruption?

Economic theory is somewhat ambiguous and offers two contrasting views or theories on this. First, the public choice theory posits that regulation is pursued for the benefit of politicians and bureaucrats. Politicians use regulation both to create rents and to extract them through campaign contributions, votes, and bribes. In some cases, the main beneficiary of regulation is the industry while in others, it is the politicians and public officials. According to this theory, more regulation equates to more corruption.

Second, the public interest theory argues that markets are prone to frequent failures and regulation is intended to correct for these deficiencies. Of course, corruption may still arise as implementing rules requires bureaucrats who may be corrupt, but this is a different issue altogether.

Economists resolve such theoretical ambiguities by letting the data talk. While there have been some empirical attempts at estimating the impact of regulation on corruption, they have been limited in several ways. For instance, they mostly employ macro-level indices of corruption based on the subjective opinions of experts, which are prone to perception bias.

The Manual on Corruption Surveys prepared by the UN argues that corruption measures based on the actual experience of individuals with corruption (obtained from survey data) are far superior than the corruption measures based on the opinions and perceptions of experts. Other regulation indices are measured by laws on the books rather than actual regulatory burden. However, there is reason to believe that it is regulatory implementation rather than heavy-handed regulatory policy that is responsible for bribery.

In a recent study, we attempt to address some of these problems in estimating the corruption-regulation nexus. The study uses firm-level survey data for 132 mostly developing countries collected by the World Bank's Enterprise Surveys (ES) on the actual regulatory burden and corruption experienced by the firms. On the corruption front, the study uses overall and petty corruption.

Overall corruption is defined as bribes typically paid by firms (as a percentage of their annual sales) to public officials to "get things done."

Petty corruption arises when firms pay bribes to solicit the following: obtaining connections to electricity or water, a construction permit, an import or operating license, or inspections or meetings with tax officials.

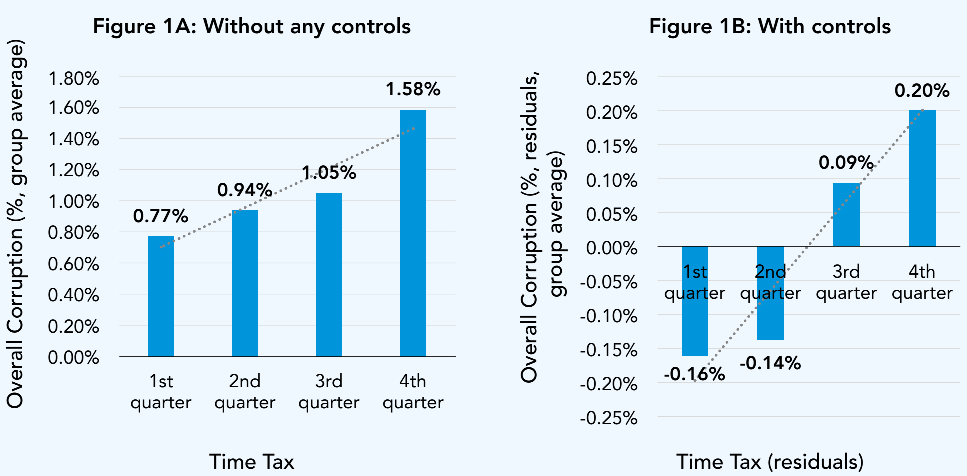
To assess regulatory burden, the study looks at the percentage of a firm's senior management's time that is spent dealing with business regulations (Time Tax).

The study finds that greater regulatory burden does indeed lead to higher overall and petty corruption. For the baseline specification, the overall bribery rate rises by about 0.03 of a percentage point for each percentage point increase in the regulatory burden. So, moving from least to highest regulatory burden in the sample under study leads to an increase in overall corruption by 2.7 percentage points. This is a large increase, given that the mean level of overall corruption in the sample is 1.1%.

The finding is robust to various controls, specifications, and estimation methods including OLS (cross-section and repeated cross-section estimation), logit, and Poisson. Figure 1 illustrates the relationship graphically. Due caution is taken to ensure that it is indeed regulation that affects corruption and not the other way around; and that it is regulation and not some other determinant of corruption that regulation is proxying for.

The findings have important implications for policymakers. Deregulation is indeed a powerful tool for controlling corruption. Policy reform has helped reduce opportunities for corruption in many countries. Where governments must impose regulations to correct for market failures or achieve redistributive goals, policymakers should carefully consider the demands that a new policy might place on institutional capacity. Without institutional capacity, well-intended policies can lead to poor outcomes and even greater corruption.

Figure 1. Relationship between regulation and corruption



Source: Enterprise Surveys, World Bank.

Note: Figure 1B represents a partial scatter plot. It is based on residuals obtained from regressing overall corruption on country and industry fixed effects (Y-axis) and from regressing Time Tax (as defined above) on country and industry fixed effects (X-axis). Only the latest round of ES data (baseline sample) is used.

The study is a starting point and there is much left to explore. First, the issue of how much corruption depends on laws on the books vs. effective implementation is important. If it is the case that it is the implementation rather than the heavy-handed laws on the books that affect corruption, we can focus exclusively on effective implementation and not worry about the quantum of regulation as far as corruption is concerned. Second, petty corruption that arises in specific transactions is likely to be better correlated with regulations that are specific to those transactions rather than the overall regulatory burden on the firms. In which case, we may find even bigger effects of corruption than found in the study referenced above. Third, it is conceivable that the strength of the corruption-regulation relationship may vary across different types of firms and countries. A rigorous analysis of the issue will help shed light on exactly how regulations affect corruption. We look forward to more research along these and related lines in the future.

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Playing Catch-up: Growth and Development in Sabah

Mahama Samir Bandaogo and Alyssia Thien Nga Maluda

Reflecting on Sabah's current levels of development, many locals tend to bring up stories of the state's glory days, reminiscing a time when the economy was among the best performers in Malaysia. However, recent economic data paints a different picture: in 2018, the state recorded the fourth-lowest GDP per capita, the highest poverty rate and the second-highest unemployment rate in the country.

At a recent conference organized by the Institute for Development Studies (IDS) in collaboration with the World Bank Group in Kota Kinabalu, this was a core topic of discussion. The speakers, representing public authorities, businesses, and civil society organizations, spoke candidly about how Sabah - given its endowment of natural resources of vast forest and valuable minerals such as oil and gas - should be experiencing faster economic development.

But instead, the state has the highest poverty rate and some districts across the state have double-digit poverty rates: Beluran at 12.1%, Kota Marudu at 13.1%, and Tongod at 14.6%. The speakers blamed this lag in development on a range of factors, including insufficient federal fiscal transfers to the state leading to gaps in public infrastructure, higher trade costs as a result of federal cabotage policies, the lack of oil and gas refineries taking away high-paying jobs, and the influx of illegal immigrants, which has been perceived to impact the labor market.

While Malaysia today is on track to transition to a high-income economy within the next several years, Sabah trails behind in the federation, as echoed by the speakers. As such, we look at why it is important to support a reform agenda in Sabah.

In recent years, Sabah has made remarkable progress; but while this may be the case, the state still has much catching up to do.

Thus far, we have seen that faster rates of growth (compared to Malaysia as a whole) has contributed to an increase in its average annual income per person. In 2018, Sabah's average income was estimated at RM25,861, which is 58% of the average income in Malaysia, an increase of 5% from 2015. This rise has also led to a reduction in the poverty rate from 16% to 3% in 2017 over a span of 10 years. These changes were underpinned by a reallocation of labor from the agricultural sector to the more productive services sector.

However, despite narrowing the income gap, the average income in Sabah remains far below the nation-wide average, estimated at RM44,587. At 2.9%, the state's poverty rate stands out amongst all other states (recorded below 1%). The struggle with high unemployment and limited labor productivity is prevalent and in 2018, Sabah recorded an unemployment rate of 5.8%.

There are also considerable gaps in basic and digital infrastructure in Sabah. For instance, more firms reported experiencing electricity outages compared to the rest of the country, and fewer firms boast a digital presence. For Sabah to catch up to Malaysia and achieve shared prosperity, the state will need to adopt a comprehensive reform agenda anchored by creative solutions to overcome these challenges.

To that end, the Bank is conducting an analytical study focused on the state's growth and development, in collaboration with the state Economic and Planning Unit to support Sabah's economic transformation. The Bank will also provide technical assistance for investment promotion in collaboration with the state investment promotion agency.

As part of the study, we analyze the four broad fundamental pillars that support and facilitate economic growth, namely:

- Capital accumulation
- Human capital growth
- Productivity
- Institutions governing economic activities in the state.

We will first assess the macroeconomic environment, past and potential future drivers of growth, undertaking a sector scan, and providing a descriptive profile of poverty in Sabah. We also analyze the impact of state and federal spending in the state and explore new sources of revenue that can be channeled for investment in public infrastructure and in human capital. Regulatory constraints impeding private sector development and firm productivity will be assessed using recently collected firm level data.

However, it is important to note that all reforms can be well-designed and implemented only if public agencies and civil servants are well-equipped and prepared. As such, any analysis of the public sector will have to identify the bottlenecks and constraints that hinder the ability of the of the state government to implement policies and priority programs.

With this upcoming report, the Bank aims to contribute to the policy debate on Sabah's economy with the hopes of igniting an economic transformation for a more successful and prosperous state for all Sabahans.

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The Fight Against Corruption: Taming Tigers and Swatting Flies

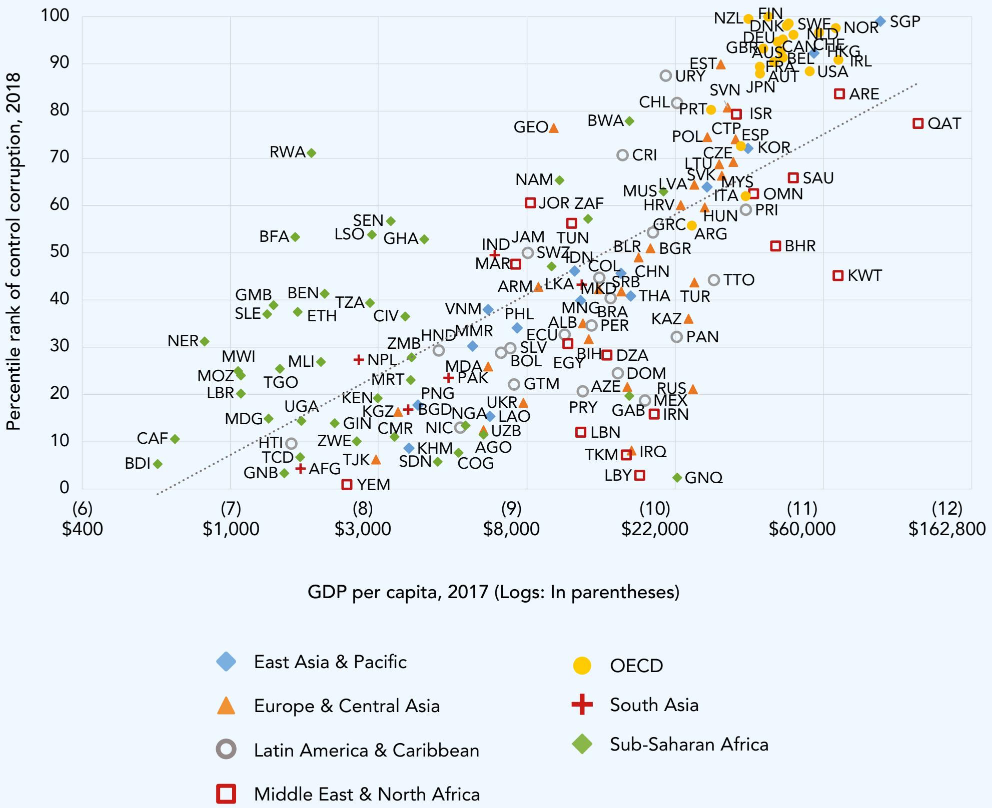
Lay Lian Chuah, Norman Loayza, and Bernard Myers

Corruption robs the public of precious resources, distorts incentives to engage in productive activities, destroys confidence in public institutions, and spurs political instability. It disproportionately harms the poor and vulnerable. Corruption is the result of perverse incentives, concentration of power, and lack of accountability. Countries are not condemned to suffer from corruption. They can break the vicious cycle with a comprehensive approach that tackles country-specific governance gaps. This approach should include streamlining rules and regulations; building a meritocratic and well-paid civil service; promoting transparency in public employment, procurement, and services; enabling citizen voice and government accountability; and enforcing anti-corruption laws and penalties.

Transparency International defines corruption as "the abuse of entrusted power for private gain". The costs of corruption are widespread. The consensus is that it undermines growth and progress as it siphons resources away from the provision of public goods, distorts incentives for productive activities, and destroys people's trust in institutions.

Corruption is pervasive, but seems more widespread in poorer countries and regions. However, even across countries in the same region and levels of economic development, we see large differences (Figure 1). This shows that there is hope even for poor countries to resist and fight corruption.

Figure 1. While corruption is pervasive around the world, it is particularly prevalent in poorer countries and less developed regions



Source: World Bank (2019a) World Development Indicators and World Bank (2019b) Worldwide Governance Indicators.

Note: Control of corruption reflects perceptions of the extent to which public power is exercised for private gain, including both petty and grand forms of corruption, as well as "capture" of the state by elites and private interests. The estimates are in percentile rank terms. GDP is converted to constant 2011 international dollars using purchasing power parity rates. Data labels use the International Organization for Standardization (ISO) country codes. OECD includes countries that have been high-income members of the Organisation for Economic Co-operation and Development (OECD) for more than 40 years. Developing countries are grouped in geographic region as presented in the legend.

In 2013, PRC Premier Xi Jingping called for the tackling corruption at all levels, "fighting ...tigers and flies". Analogous to tigers and flies, we categorize corruption into two forms in our discussion: (i) grand corruption which involves acts committed by high level government and distorts policies or the central functioning of the state. A more extreme form of grand corruption is 'state capture', where the whole state apparatus is manipulated to extract public resources for private gain, and (ii) petty corruption which involves bribes demanded by low- to mid-level officials for accessing public services.

Why should we care about the "grabbing hand"?

Corruption has a negative and sizable impact on economic growth. How corruption affects economic and social development can be explained below:

- **Corruption distorts the incentives for competition, innovation, and allocation of resources.** In an environment where the most corrupt firms win contracts and conquer markets, firms are not incentivized to offer a better product at a lower price, but to engage in bribery and collusion, consequently (mis)allocating valuable resources for this purpose. Entrepreneurs with low moral scruples and powerful connections are the ones who tend to participate and thrive while efficient ones either stay away or are forced out from the markets.

- **Corruption exacerbates poverty and inequality.** The poor cannot afford to pay the bribes to facilitate bureaucratic procedures and access public services, hence are unable to access such services (e.g. education, health) which are technically "free". Micro and small entrepreneurs resort to informality because the costs of formalization include onerous procedures or hefty bribes. In contrast, economically powerful and politically well-connected elites can induce and benefit from grand corruption, for example, the Gupta family in South Africa, and Ben Ali family in Tunisia. This widens the social and income gap. In a worldwide sample of countries, a worsening of measured corruption by one standard deviation can decrease GDP per capita growth by about one percentage point and increase the Gini coefficient of inequality by 11 percentage points. The effect is worse when other areas of governance are weak, when the political regime is dictatorial, and when widespread corruption is entrenched.

- **Corruption distorts public investment decisions.** Investments are likely to be diverted into projects which have greater rent-seeking opportunities rather than ones that have true welfare benefits such as basic health and education. Not only does it distort investment decisions, it decreases the quality and quantity of public goods and services in important areas such as education, health, infrastructure, law, and security. For example, poor quality roads that fracture at the first storm, substandard medical services and medications that hurt rather than cure, and inefficient courts that take years to resolve a simple dispute, hurt society.

Corruption can make the difference between countries being potentially prosperous but are actually problem-ridden, e.g. Zimbabwe, and countries that are realizing their potential in terms of growth, stability, and equality, like Singapore.

What makes a "grabbing hand"?

We can draw insights from economic theory to explain the drivers for corruption. One classic framework is the "principal-agent" model which shows that informational asymmetry allows the government to act in its self-interest instead of for the greater good. In this model, the people are the "principal", and government, their "agent". The agent is supposed to serve the people and work toward achieving their objectives. In reality, the agent has its own goals and controls information regarding public processes and resources. This model may be a better explanation for corruption in democratic societies.

However, the "power capture" model emphasizes on power asymmetries. A group of people somehow takes over power and exploits it to gain and maintain position and wealth. This asymmetrical power distribution leads to the high-power group imposing its own terms, either by changing the law or going beyond it. This model may apply more closely to dictatorial and repressive regimes, although it can take subtler forms in democratic societies.

Two additional models can also contribute to understanding corruption. One is the benign "efficiency wage hypothesis" – where employees who are well-remunerated are more likely to work harder and abide by the rules. Another is the "corruption as crime" model – where corruption is driven by similar incentives as other crimes, increasing with the size of the loot and decreasing with the probability of detection and the severity of punishment (Becker 1968).

While these frameworks feature the role of incentives, other dimensions such as weak institutional governance, lack of accountability and transparency and concentration of power are equally important in explaining corruption. In most cases, grand corruption thrives in an environment which lacks transparency and accountability over the control of public resources, and in an environment of concentration of power and inoperative checks and balances, resulting in the worst cases in state capture. Transactions associated with grand corruption are secretive and not open to scrutiny; branches of government are usually in collusion or dominated by the executive; and other powerful members of society are bribed or threatened into complicity. In this case, the wage hypothesis breaks down as any increases in compensation will not be successful in curbing grand corruption.

However, implementing a fair and meritocratic compensation structure may curb petty corruption. Public bureaucrats are more likely to engage in corrupt acts when their salaries are too low, the prospects of promotion for honest and dedicated work are minimal, and the probability and severity of punishment are small.

In short, the control of corruption is rightly seen as an element of good governance.

As Table 1 illustrates, control of corruption is closely connected to the other aspects of institutional development in the Worldwide Governance Indicators. Corruption and governance have a two-way relationship – it weakens governance, and is also worsened by bad governance.

Table 1. The elements of good (or bad) governance are closely connected: Pairwise correlations between governance indicators, 1996-2017

	Control of Corruption	Regulatory Quality	Government Effectiveness	Voice and Accountability	Rule of Law
Control of Corruption	1				
Regulatory Quality	0.8910	1			
Government Effectiveness	0.9436	0.9544	1		
Voice and Accountability	0.7933	0.7988	0.7790	1	
Rule of Law	0.9567	0.9129	0.9438	0.8489	1

Source: World Bank (2019b) Worldwide Governance Indicators.

Reforms to Fighting Corruption

Countries can break the vicious cycle with a combination of reforms ranging from modest policy interventions to large institutional changes. These measures must address the underlying incentives for corruption and the conditions that enable corruption to thrive. Examples of reforms undertaken by countries are:

- **Streamline rules and regulations.** A straightforward and predictable regulatory and legal environment can not only promote efficiency and productivity, but can also reduce the room for discretionary and arbitrary decision-making and exercise of power. Georgia for example, was successful in cutting red tape by reducing required business permits from 600 to 50. In doing so, it removed opportunities and incentives for bribery (Figure 2).

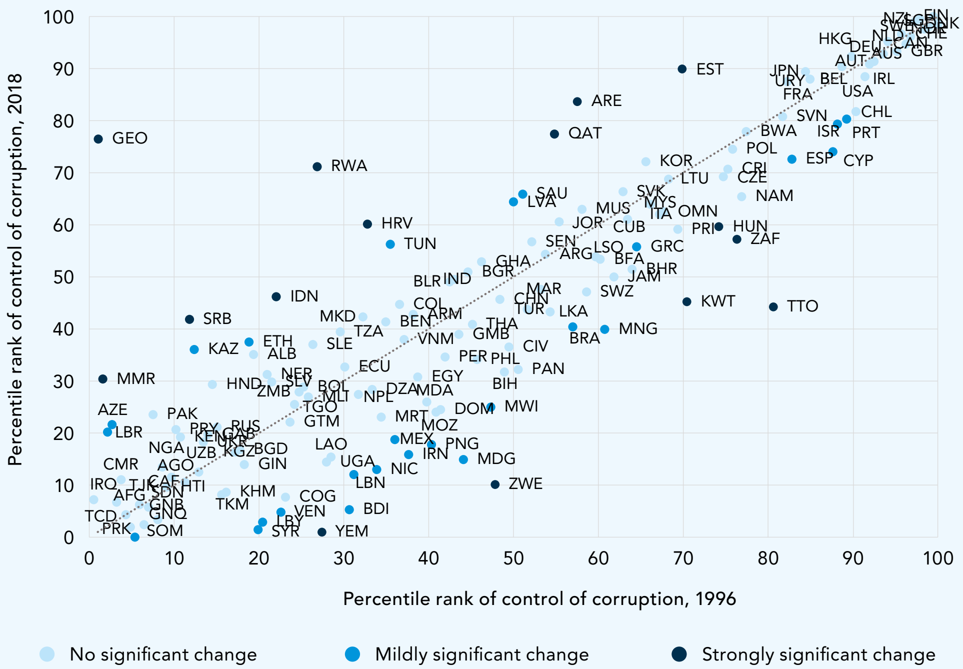
- **Build a meritocratic and well-paid civil service.** Making compensations for public officials competitive and promoting meritocracy in the ranks of the public administration can increase the incentives for honest and dedicated work. Rwanda conducted major civil service reforms which produced results. It eliminated "ghost" workers, increased salaries, and made asset declarations mandatory.

- **Promote transparency in public employment, procurement, and services.** Transparency in government transactions is powerful driver of good governance and an important deterrent to corruption. Information and communication technology (ICT) are less likely subjected to manipulation, hence using it can become a useful and cost-effective way to promote transparency. This was seen in Indonesia when a computer-assisted testing system was adopted in 2013 to ensure a fair recruitment process of civil servants.

- **Enable citizen voice and government accountability.** Democratic mechanisms, checks and balances between the various branches of government, and a free press, are critical elements to deter, detect, and penalize corruption. The recent experience in Malaysia is an example of how democratic forces can be used against grand corruption at the highest sphere of the government (eg. the 1MDB scandal).

- **Enforce anti-corruption laws and penalties.** An independent, agile, and unbiased judicial system is necessary to prevent corruption and stop it as soon as it emerges. When corruption is rampant, specialized institutional anti-corruption agencies within the judicial system may be needed. In Hong Kong, its Independent Commission Against Corruption (ICAC) which is independent, has a clear mandate, and has been successful in curbing corruption.

Figure 2. Uneven progress in the fight against corruption in the last two decades



Source: World Bank (2019b) Worldwide Governance Indicators.

Note: The 45-degree line indicates no changes in control of corruption between 1996 and 2018. Being above (below) the 45-degree line indicates improvement (worsening) in control of corruption from 1996 to 2018. Statistically, the change is strongly significant when the margins of error of the point estimates for 1996 and 2018 do not overlap, mildly significant when neither point estimates are included in each other's margin of error, and not significant otherwise. Data labels use the International Organization for Standardization (ISO) country codes.

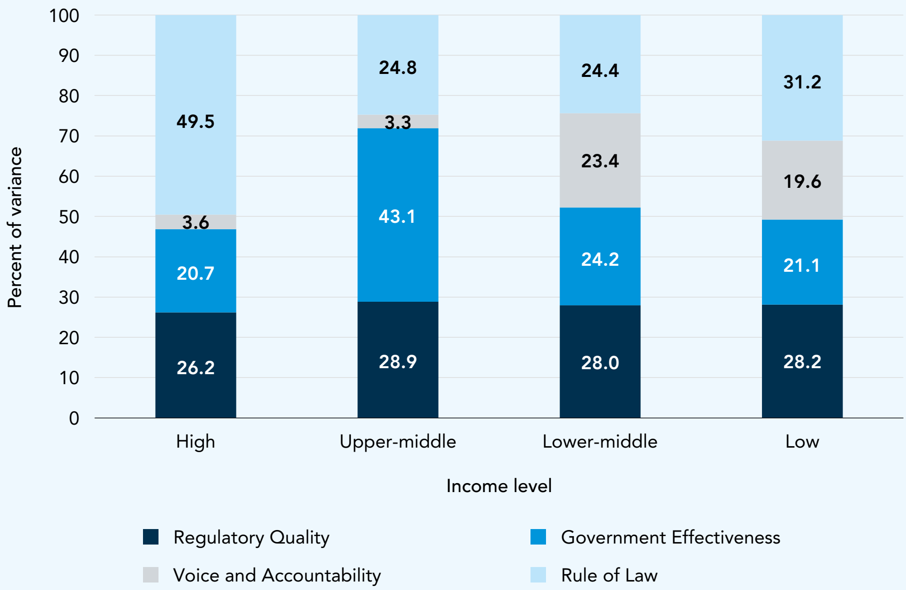
Conclusion

In the last two decades, corruption has fallen in some countries around the world thanks to a concerted and explicit effort to prevent and fight it (Figure 2). However, even in countries where progress has occurred, there are constant threats of falling back.

A comprehensive approach that considers country-specific governance gaps is needed to eradicate corruption. This approach should include improving regulatory quality, the effectiveness of public administration, voice and accountability, and enforcement of the law.

The challenges in improving these areas of governance could differ for countries at different levels of development (Figure 3). In low- and lower-middle-income countries, a balanced approach that seeks to improve all areas may be necessary. In upper-middle-income countries, the greatest challenge is improving government effectiveness, followed by regulatory quality. In high-income countries, the emphasis falls heavily on strengthening law enforcement.

Figure 3. The correlates of corruption vary by country and income level: Variance decomposition of control of corruption into other governance indicators by income level, 1996-2017



Source: World Bank (2019b) Worldwide Governance Indicators.

Note: Variance decomposition was conducted using dominance analysis (Grömping 2007).

There are no "silver bullets" to fight corruption and isolated policy reforms are bound to fail. The entire political, institutional, and administrative ecosystem must be conducive to "tame the tigers and swat the flies" of corruption. It is a battle worth fighting, as the prosperity of nations depends on it.

For the full Research and Policy Brief on '*The Fight Against Corruption: Taming Tigers and Swatting Flies*', visit bit.ly/ttigersrpb

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Using Big Data to Expand Financial Services: Benefits and Risks

Facundo Abraham, Sergio Schmukler, and José Tessada

Advances in data analytics and computational power allow both existing and new financial firms to exploit data in an easier, faster, and more reliable manner, and at a larger scale to provide better financial services. Governments are also exploring ways to use big data more systematically to get a better, bigger picture of the financial system and the overall economy. Despite its benefits, the wider use of big data has raised concerns related to consumer privacy, data security, discrimination, data accuracy, and competition. Hence, policymakers have started to regulate and monitor the use of big data by financial institutions, and to think about how to use big data for the benefit of all.

The finance industry is driven by information. Because financial institutions are in the business of providing funding in exchange for a promise that it will be returned at a later date, they need to acquire substantial data to assess customers' repayment capacity. Furthermore, financial institutions lend and invest using money collected from third parties, which requires knowing their creditors' investment preferences and risk tolerance.

Financial institutions also collect data from their clients as they use financial services. The amount of transactional data collected by financial institutions has grown exponentially, as transactions are increasingly conducted through financial sector providers.

Financial institutions are also required to regularly submit data to regulators, supervisors, and other institutions for monitoring purposes. First, because any losses end up being borne not only by the financiers but also possibly by the general public. Second, because financial institutions can pose systemic risk. A crisis in one institution can lead to instability in the entire industry and the economy.

As a result, financial institutions collect vast and detailed data on their clients' preferences, behavior, characteristics, and risks. These data have immense potential to help financial institutions create new financial products and reach new segments of the population. But systematically using these data for market analysis is very cumbersome, as it involves processing and analyzing an enormous amount of data.

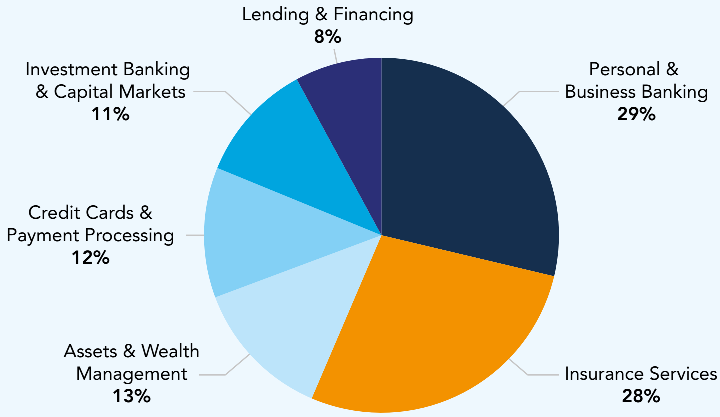
The so-called big data revolution, which has brought new methods to analyze data and higher computational power, is now enabling financial sector participants to collect and analyze data easier easily and quicker than ever. Big data has also allowed financial institutions to augment their own private data with public data and proprietary data sold by other providers. Several financial activities such as personal and business banking, asset and wealth management, and insurance are already using big data (Figure 1).

Potential Benefits of Big Data

Big data has multiple applications in finance. Financial institutions traditionally used the personalized relationships of clients with officers at a branch to understand their needs. However, this can have several limitations, such as when clients are new or when officers are relocated to another branch. Large banks, with millions of clients, can find it particularly difficult to maintain personalized relations with clients.

Nowadays, financial institutions can leverage big data to offer personalized services to millions of customers.

Figure 1. **Investments in Big Data by Financial Sector Industry, 2018**



A wide range of industries within the financial sector use big data.

Source: SNS Telecom & IT (2018)

For example, financial institutions are using big data to conduct targeted advertising and promote cross-selling of their products. Big data allows financial institutions to use a wide range of individual characteristics and segment clients into different groups, providing tailored offers according to their preferences. Some institutions are even using big data to anticipate customers' future needs.

Financial institutions are also taking advantage of big data to expand their customer base. Lack or inadequate credit history is one of the mains reasons behind credit denials. Big data can mitigate this issue by enabling financial institutions to profile prospective borrowers based on the repayment of services other than loans, such as past payments of rent, utilities, or mobile phone plans. New technologies are making it easier to organize these data and report them to credit bureaus and registries.

Other financial institutions are exploiting behavioral data to build alternative credit scores for low-income individuals. Automated credit scoring can not only help expand credit, but also save time and reduce some of the human biases that can emerge in the evaluation process.

Big data can also promote access to finance for small and medium enterprises (SMEs), which may not have been in business long and have limited public information. Large online retailers, such as Alibaba, Amazon, and eBay, are using big data to gather and analyze information on firms participating in their platforms (such as sales and customer ratings) and then provide loans.

Big data is also helping under-served groups by enhancing financial networks. In several emerging economies, mobile money still relies on networks of agents that allow users to deposit and withdraw cash. If poorly managed, agents in these networks can run out of money or not be located close enough to their customers.

Some financial institutions, such as the BBVA Data & Analytics Center and the JP Morgan Chase Institute, are using their unique proprietary data to produce new knowledge that can be used to better understand consumers and provide better and new services.

Using Big Data Can Pose Challenges and Risks

Using big data in financial institutions involves constructing large data sets that include private information submitted by individuals, or by third parties hired to collect consumer data on their behalf. Financial institutions could be tempted to sell their proprietary data. In this context, data privacy is an important concern. Financial institutions need to be transparent and promptly disclose what information they have on consumers and what they are doing with it.

> **Financial institutions need to safeguard the information and data collected, as they could be used to commit identity theft, scams, and extortions. They need to take steps to enhance data security, e.g. strengthening data access monitoring, data masking, and data encryption.**

The use of cloud computing (i.e. the storing, managing, and processing data across the Internet through third-party servers) is an important issue regarding data security. Cloud computing reduces costs and increases flexibility. However, financial institutions might prefer to keep data in-house, as storing it online would make it more vulnerable to hacking (even though in some cases hacking of in-house servers can be just as likely).

Another challenge of relying on big data is that it could lead to biases if used without the appropriate care. In the process of analyzing big data through algorithms, human bias can be introduced in multiple stages, from choosing the model variables to how results are interpreted. Furthermore, models based on historical data can unintentionally replicate biases even when they are not programmed to do so.

Financial institutions might use big data to tailor prices and extract the maximum profit from each consumer. Some financial institutions even use big data to identify vulnerable groups in need of quick cash and offer them financially risky products, such as payday loans.

When using very large data sets it can be hard to know where to start and what to look for. Analytical tools used in big data are also not so good at distinguishing correlation from actual causation. Furthermore, big data is not always completely accurate. Different factors can explain these errors, including the cost of maintaining up-to-date information and individuals consciously providing wrong information to protect their privacy.

Big data could potentially create information asymmetries across financial institutions. Large financial institutions, which start with a big base of consumers and hence have more data, can conduct better analyses and improve their services more easily than small institutions, widening their data advantage and reinforcing their dominant position. This feedback loop can lead to higher entry costs and monopolistic positions. Big data could also widen asymmetries between users of financial services. By making better forecasts, big data could reduce the risk premiums for large firms more than for smaller firms, widening their cost of capital and impairing competition.

Policy Discussion

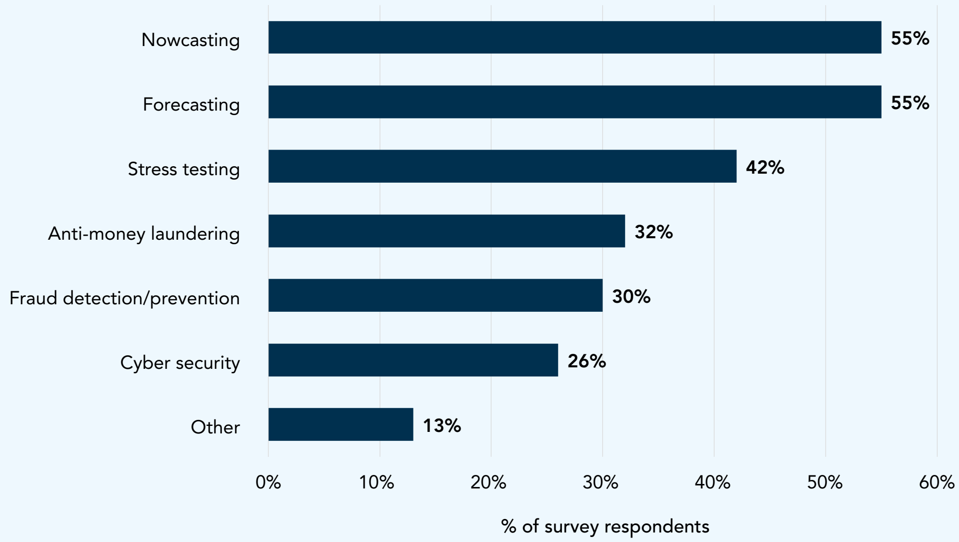
Several countries have issued regulations to enhance consumers' rights over their own data and have increased penalties for data misuse. Policymakers have also started to discuss whether big data can be a source of market power, and whether steps to promote a more efficient distribution of data are needed. Some governments have gone even further, regulating the use of automatic algorithms.

> **Beyond regulating big data, policymakers could be interested in collecting, centralizing, and assessing data dispersed among financial institutions, as they could then use that information for policymaking, such as identifying and mitigating gaps in financial markets.**

A recent survey shows that about 60% of central banks are using big data for multiple purposes, including forecasting, stress testing, and combating money laundering (Figure 2). Because it is granular and collected in real-time, big data could prove useful to study localized and short-lived shocks.

Partially disclosing some of these data could increase data access, level the playing field, and encourage competition. However, financial institutions might be reluctant to disclose information used to gain a comparative edge, and forcing them to do so could also discourage them from investing in data-related technologies. Consumers might also raise concerns about the government gaining access to their personal data.

Figure 2. Use of Big Data by Central Banks



Central banks are using big data in a variety of ways to enhance their operations.

Source: Central Banking (2018)

Another challenge would be to integrate these data with other data that the government collects to obtain a more complete picture. International organizations and research institutions, such as academic organizations and think tanks, could help policymakers in these efforts.

Overall, countries would benefit greatly from developing an information system that allows financial and economic information collected by different agencies to be matched and used more systematically. While building this system might be challenging and take time, the developmental benefits might well be worth the costs. A more thorough understanding of the financial sector can prove of immense value in the quest for building a more developed, competitive, and stable financial sector.

For the full Research and Policy Brief on *'Using Big Data to Expand Financial Services: Benefits and Risks'*, visit **bit.ly/rpbbigdatafinance**

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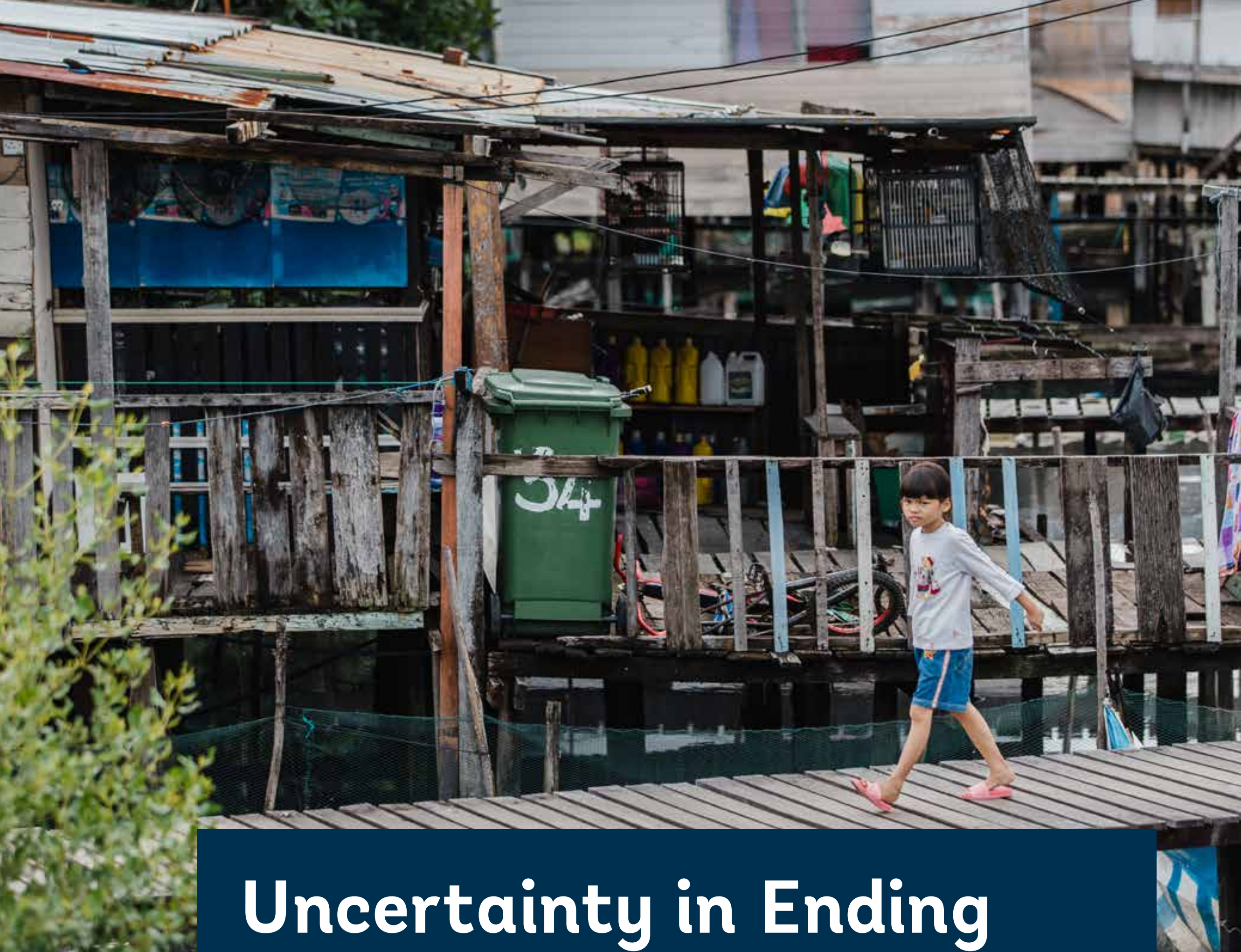


Uncertainty in Ending Extreme Poverty

Fabian Mendez Ramos

Whereas sustained economic growth is considered the primary driver of poverty alleviation, the different ways in which growth interacts with changes in income inequality mean that the future of poverty reduction is highly uncertain.

In a recently published working paper, I use historical (1980-2014) data to model and simulate future paths of income inequality and growth, which, in turn, enable us to quantify country-specific changes in poverty rates and income distribution. Our historical-based simulations estimate that the probability of alleviating extreme poverty below the 3% threshold by 2030 (Sustainable Development Goal 1) at the global level is small – less than 2%.

Furthermore, our results indicate significant variation in future poverty outcomes. For instance, by 2030, the most favorable estimate of poverty headcount at the global level displays a median value of 4.6%, with a standard deviation of 0.5. Conversely, our most pessimistic result shows a median outcome of 8.9% with a standard deviation of 0.9. These median estimates represent approximately 370 and 720 million people around the world subsisting on less than $1.90 a day (2011 PPP).

In terms of country groupings, in relative terms, extreme poverty is expected to decline in the period 2015-2030 in economies with low, middle, and high rates of per capita output growth.

> **In low-output growth economies, the absolute number of poor is expected to increase.**

The model simulations also predict that high-output growth economies – countries with steady growth rates above 4% – will reach poverty rates below a 3% level before 2030. Noticeably, the simulations display a low degree of uncertainty around the expected poverty rates in these high-output growth countries.

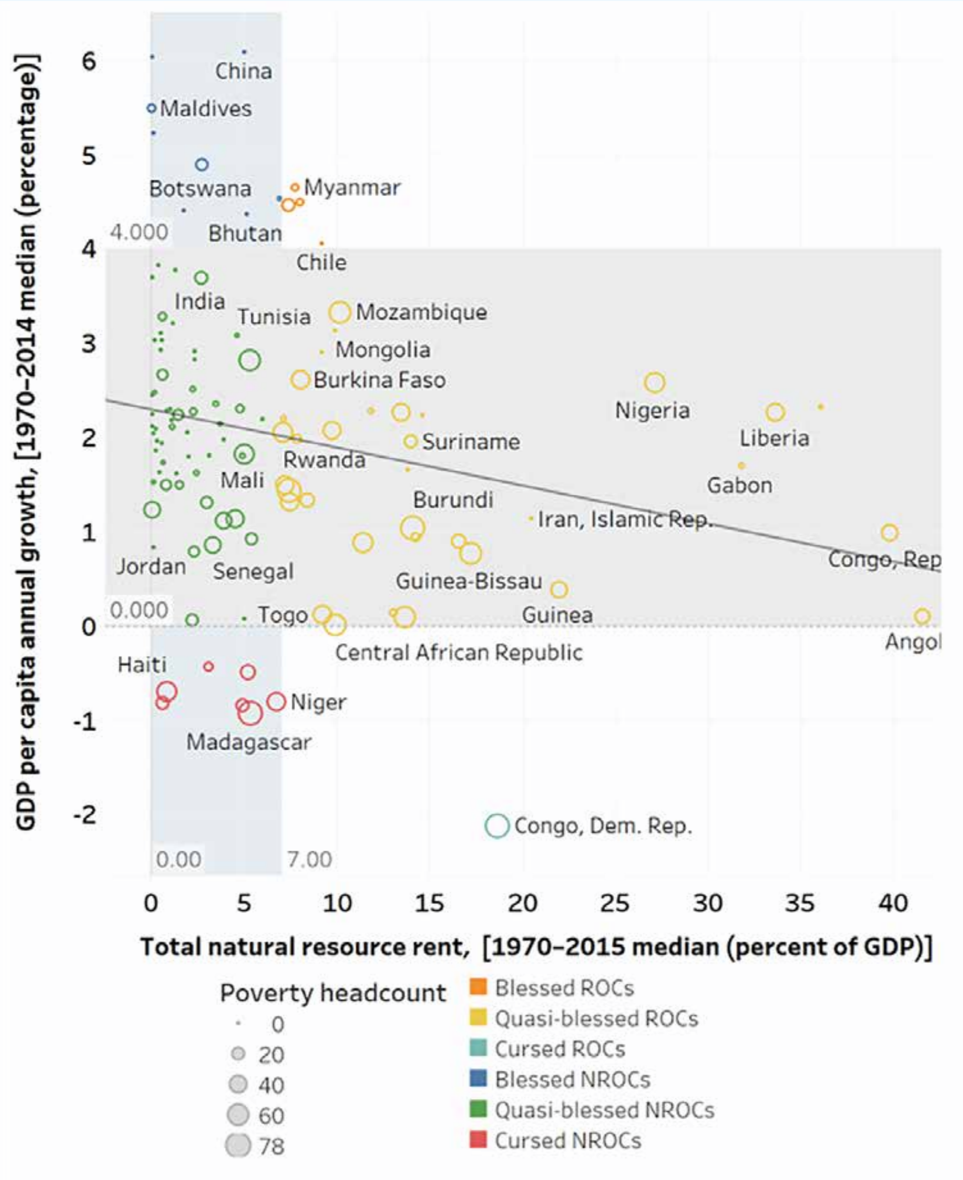
Moreover, non-resource-output oriented – or more diversified – economies, are predicted to achieve and go below the 3% poverty target by 2030. By contrast, several simulation exercises show resource-based economies witnessing an increase in absolute poverty during the period 2015-2030. We find significant dispersion in the estimated paths of poverty outcomes in these resource-based countries, implying that given recent history, it is hardly possible to predict precise estimates of poverty rates in these economies.

Resource-based economies

What is the current and future poverty situation in countries that rely heavily on natural resources? Figure 1 depicts two conditions. First, most countries with abundant natural resource rents in the period 1970-2015 have high rates of extreme poverty. Second, the majority of countries with high poverty headcounts had median annual growth rates of GDP per capita during 1970-2014 below the 4% threshold. In sum, it is quite likely that resource-based countries will keep elevated poverty rates by 2030: The most optimistic and pessimistic simulations show median poverty rates of 9% and 20%, respectively.

Figure 1. Most resource-based countries currently face – and will likely keep by 2030 – elevated poverty rates

GDP per capita growth, natural resource rents, and extreme poverty



Source: Penn World Table 9.0, World Development Indicators, PovcalNet, United Nations, and the author's estimates. Note: Last available observations of poverty rates reported in PovcalNet. The figure is based on the $1.90 a day (2011 PPP) poverty line. ROCs stands for resource-based countries. NROCs means non-resource-output oriented (non-resource-based) countries.

What can resource-based countries do?

> **The main goal in resource-based countries can be the same as for the majority of countries in the world with high poverty rates: to expand the economy more quickly.**

Because of the volatility of resource prices, the primary strategy could focus on providing more stable economic and financial conditions. This strategy can be reached by developing sustainable debt management frameworks, improving investment and business climates, as well as implementing more transparent and accountable rules to administer resource rents. Additionally, these economies can benefit from strengthening their institutions, including those involving risk management backgrounds. Potential reforms include fiscal rules (probably balanced budget designs) for commodity revenues, commodity price hedging, and diversification strategies of the economic activities, among other actions.

Income inequality

What do the simulations suggest about shifts in income inequality? Most changes in relative income inequality are predicted to be on the positive side. The Gini coefficient across the board is generally predicted to decrease on average over the period 2015-2030. Across this 2015-2030 horizon, our estimates of the Gini coefficient at the global level – population-weighted averages – are expected to decline between 0.7 and 1.9 Gini points (in the Gini scale of 0-100). However, some of our country-grouping estimates of the Gini coefficient display substantial uncertainty and downside risks that imply an increase in the level of inequality in the 2015-2030 period; these negative estimates are especially significant in more diversified countries, and in economies with historically high and low rates of output per capita growth.

A multiplicity of historical-based results exacerbate uncertainty. In comparison with point predictions and perfect-foresight methods, our approach considers both the outcome precision of a multitude of historical-based scenarios and the uncertainty – standard deviation of simulated outcomes – embedded in the predictive fan chart generated for each situation. This multiplicity of results and the predictive fan chart and associated uncertainty provide strong incentives for the improved design of policies for poverty reduction and income redistribution. It is crucial to continue thinking in the design of hedging mechanisms against risks under variable economic environments affecting poverty and income distribution.

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Public Policy For Youth

Min Hui Lee

The youth have always been a force to be reckoned with. As more and more of today's young people find their footing in the online sphere and lend their collective voices to social movements, so have a powerful group of agents of change been cultivated. Policies impacting their lives are a shared concern here – and social media platforms provide a space to exercise individual voices on these matters. At the World Bank Group Global Knowledge and Research Hub in Malaysia, we recognize the role of the youth in driving change. Each year, we embark on youth engagement initiatives to educate and empower the youth in public policy-related issues and development challenges from around the world.

World Bank Youth Summit 2019

Established in 2013, the Youth Summit is an annual event hosted by the World Bank Group (WBG) to engage with youth globally on the most pressing topics facing our generation. The primary goals of the Summit are to empower youth to explore innovative ideas to tackle emerging development challenges, provide youth with the tools to build and engage in impactful projects, and promote dialogue between youth, the WBG, and other key stakeholders globally. The latest Youth Summit, held in December, 2019 in Washington D.C., focused on the core topic of 'Smarter Cities for a Resilient Future'.

We speak to two Malaysians on their experience at the Youth Summit:

Nurul Munawwarah

PhD student, Faculty of Economics and Administration, University of Malaya

"I learned lots of new knowledge during the summit and was able to discuss and present on global issues facing different countries. Through the case studies, I also learned how to tackle emerging development challenges."

"Further, the discussions on what constitutes a smart city allowed me to gain new knowledge that I will be using to enhance my thesis focused on policies to improve quality of life in urban areas. I am grateful to have had this opportunity to learn."

Nurul Munawwarah, second from left.

Chancey Lee Pacheco, far right.

Chancey Lee Pacheco

Masters of Public Policy Student at the National University of Singapore

"A key takeaway for me was seeing how big data and artificial intelligence (AI) could be used to collect granular data within a city to inform policies. During the break-out sessions, delegates also had the chance to work in teams to propose their own innovative smart city solutions."

"While the summit held serious and thought-provoking discussions, there were definitely fun moments in-between and during the networking receptions at the end of each day. Overall, it was a great opportunity to learn more from global experts and other delegates about smart city solutions implemented in their home countries to address similar urban development challenges people are facing around the world."

Bringing the Youth Summit to Kuala Lumpur

The local extension of the World Bank Youth Summit was organized to create an opportunity for more young Malaysians to gather and discuss some of the development issues featured at the Summit. With so many just beginning their foray into the world of work, issues such as youth unemployment, the ability to harness technology for growth and development, and opportunities for upskilling were core areas of interest for the 40 delegates present.

Led by Senior Economist, Achim Schmillen and Economist, Amanina Abdur Rahman, for the Social Protection and Jobs Global Practice, the discussion touched on the ways in which we can invest in the youth to prepare them for the future of work and the role of the youth within this. With representatives from youth groups such as the Perdana Fellows and the Young Corporate Malaysians, as well as social entrepreneurships like PinkCollar, we were able to host a vibrant conversation on the role of youth in the future of work.

On the forum (from left): Amirah Dyana Chairil of Perdana Fellows, Zenna Law, Founder of PinkCollar, Valerie Chew of Young Corporate Malaysians and Senior Economist, Achim Schmillen of the World Bank.

Going Virtual

This discussion on the future of work also went online with the Hub's very first virtual workshop in partnership with the International Council for Malaysian Scholars in February this year. The workshop brought together over 30 Malaysian undergraduates studying in different locations around the world including the United Kingdom and Hong Kong.

Here are some of the testimonies from some of our virtual participants from across the world:

Rabiatul Aiynah Binti Hazni

University of Warwick, BSc Economics

"Being someone who is passionate about creating social impact, I feel the workshop has strengthened my desire to work in development. From this virtual workshop, I realized how important it is in investing in youth development. For example, skills that complement technology such as cognitive and interpersonal skills can help ensure that we stay competitive in the future of work. I feel the World Bank has done an excellent job in educating the youth, an initiative they should continue. I only hope these types of sessions will grow and reach out to more students in the near future."

Tracy Goh Xin Yi,

King's College London, Bachelor of Laws (LLB)

"As the organizer of this virtual workshop, my goal was to increase awareness amongst the youth about the changing landscape of the workplace, and the policies set in place to facilitate the rapid integration of technological advancements. The workshop was very helpful in highlighting the role the World Bank plays in addressing development issues while emphasizing the role that youth play in contributing to nation-building. I believe sessions like these are crucial in creating opportunities to learn from experts in the field. While we acknowledge the limitations of virtual workshops, we believe having these sessions are a great tool to ensure youth from around the world have access to such great learning resources."

Edward Soon Rong Wei,

University of Science Malaysia, Mathematics and Economics

"As an economics student and a data enthusiast, I have always been curious about what it's like to work as an economist. During the workshop, I was able to understand the work of economists at the World Bank. Learning about the future of work is very critical for students like me as we generally hold the perception that automation that could potentially replace jobs or depress wages, so learning how to stay above the curve is important."

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