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# **LONGEVITY RISK AND SOCIAL OLD-AGE PROTECTION IN MALAYSIA:**

## Situation Analysis and Options for Reform

Amjad Rabi, Norma Mansor,  
Halimah Awang and Nurul Diyana Kamarulzaman

**Social Wellbeing Research Centre (SWRC)**

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## **About Social Wellbeing Research Centre**

The Social Wellbeing Research Centre (SWRC) (*formerly known as Social Security Research Centre*) was established in March 2011 at the Faculty of Economics and Administration (FEA), University of Malaya to initiate and carry out research, teaching and dissemination of evidence-based knowledge in the area of social security, including old age financial protection in order to enhance the understanding of this critical topic to promote economic development and social cohesion in Malaysia.

The interest in social security and old-age financial protection is ever growing in view of an ageing population. Malaysia is also subjected to rising life expectancy and falling fertility rates, the perceived inadequacy of current social security provisions, coupled with the added fear that simply more expenditure may not be conducive to the development and growth objectives of the society. This calls for innovative policy solutions that may be inspired by international experience based on an empirical grounding in national data and analysis.

To support the research in social security in general and old-age financial protection in particular the Employees Provident Fund (EPF) of Malaysia has graciously provided an endowment fund to create the nation's first endowed Chair in Old Age Financial Protection (OAFPC) at University of Malaya. OAFPC has the over-riding objectives to help formulate policies to promote better social security and improve old age financial protection, and to also formulate policies to promote economic growth in an aging society for consideration by the Government of Malaysia.

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## CHAPTER 1 : INTRODUCTION

Social protection is an important policy tool for the realization of human security and achieving equity and social justice. The Universal Declaration of Human Rights posits the right to social protection in Article 22, which guarantees the right to social security. Further, article 25 recognizes the right of everyone to a standard of living adequate for the health and wellbeing of himself and of his family, including medical care and necessary social services, and the right to security in the event of unemployment, sickness, disability, widowhood, old age or other lack of livelihood in circumstances beyond his control. Other international legal instruments and standards, to which Malaysia is signatory, highlighted the right to social security (UN, 1948).

At national level, Malaysia's commitment to social protection is demonstrated clearly in the current five-year development plan, the Eleventh Malaysia Plan 2016-2020, where human capital development was identified as a critical enabler for driving and sustaining Malaysia's economic growth and supporting the transition of all economic sectors towards sustainable and inclusive economy (Economic Planning Unit, 2016). A further explicit commitment was restated during the midterm review of the Eleventh Malaysian Plan, conducted in 2018, specifically it mentions:

*“Enhancing social protection and wellbeing for households, in particular the B40 households, a framework for an integrated and comprehensive social protection system will be established. The implementation of social protection programmes across different agencies will be coordinated through a central council. The council will obtain data from various databases and guided inputs from industry and academia. In addition, big data analytics will be deployed to generate value and insights for improving the Social Protection Floor. The targeting of recipient eligible for assistance will also be refined to be more need-based, which will include socio-demographic and geographical factors. Furthermore, mechanisms will be identified to extend social security protection to households working in the informal sector.”* (Economic Planning Unit, 2018)

Currently, Malaysia has a range of public social protection arrangements including contributory and non-contributory schemes. The contributory



schemes, which cover the formal social protection schemes include the Civil Service Pension Scheme (KWAP), the Employees Provident Fund (EPF), the Social Security Organisation (SOCSSO), the Armed Forces Fund (LTAT). Non-contributory arrangements, or social assistance, are mostly poverty-targeted and administered by the Ministry of Women, Family, and Community Development (MWFCD) as well as MoF. In addition to public schemes, Zakat, the Islamic welfare institution, collects and distributes cash and in-kind assistance to specified needy categories at states level.

As Malaysia moves towards high income nation status, Malaysia should move away from the charity-model (poverty targeting) into a more inclusive system when addressing the issue of poverty. Such plans and efforts to create an effective social protection, as stated above in the midterm review of the 11<sup>th</sup> Malaysian Plan, are aligned with the Sustainable Development Goals (SDGs). Specifically, they will contribute to achieving the third target of SDG 1 (the complete elimination of extreme poverty in the world through the establishment of social protection systems and measures for all), SDG 8 (sustained, shared and sustainable economic growth; full, productive employment and decent work for all), and SDG 10 (the reduction of inequalities between countries and within them).

This paper highlights critical issues currently facing the existing social protection arrangements for the old-age citizens. It provides a set of strategies and options for creating coherence between the different providers to close the coverage gap among post-working age population, at the same time ensure fiscal sustainability of the next 15 years. The paper starts with trend scanning of Malaysia's demographic and poverty profile. Against this background, which established the demand for old-age protection, a thorough baseline review of the existing social old-age protection programs is conducted. Together, these two chapters highlight the demand and supply for old-age protection in Malaysia with emphasis on gaps and inefficiencies. In the last chapter, the paper proposes a framework for creating synergies between the different arrangements to close the coverage gaps and achieve more impactful and efficient system of social old-age protection. A costed set of recommendations are presented.

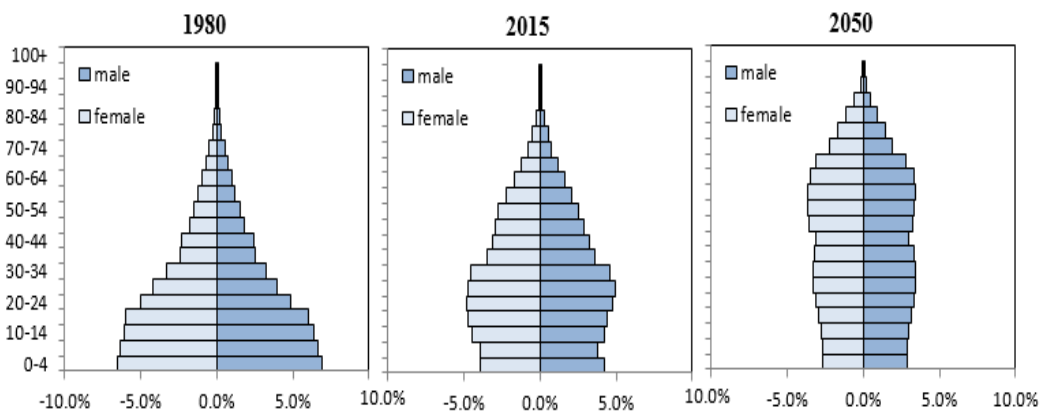
## CHAPTER 2 : LONGEVITY AND OLD-AGE POVERTY

### 2.1 Demographic Transition

Over the last 10 years, Malaysia's population grew at a rate averaged 1.53 percent annually, which is higher than that of South East Asia (1.178 per cent). The growth rate is projected to remain positive for a relatively long period until 2070 (UN, 2019)- a year projected to mark the beginning of declining population for the first time in Malaysia's history.

Despite of the relatively strong population growth up until now, Malaysia has seen significant changes in its population structure. Currently, the mean characteristic of the Malaysia's population is its broad middle section of its population pyramid, providing favorable demographic profile for the labor market.

**Figure 1:** Population Pyramid, 1980 - 2050



Source: Author's calculation based on data from UN (2016)

This change in population structure have three main potential consequences:

1. While population growth will continue to increase over the next few decades, number of children will decrease.

**Table 1:** Population in Million, from Independence 1957 to 2050

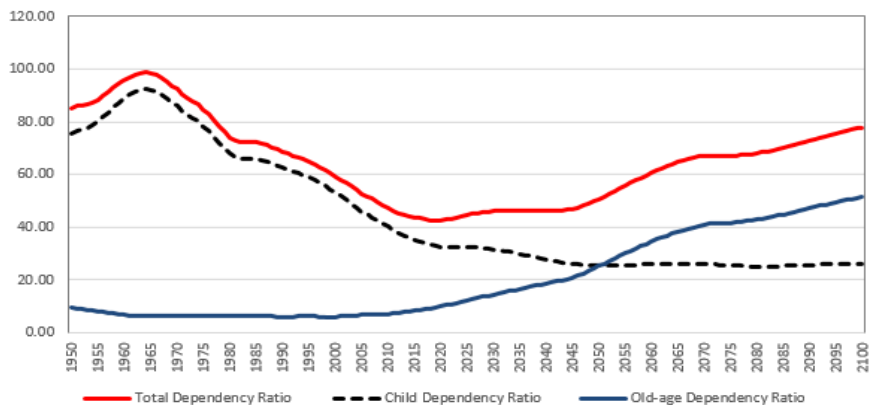
	1957	2017	2050
<b>Population</b>	7.443 million	31 million	40.7 million
<b>Children (under 18)</b>	3.68 million	9.056 million	8.344 million

Source: Based on data from (UN, 2019)

The likelihood of steady and possibly increased population growth, despite the declining fertility rate<sup>1</sup> can be explained by a phenomenon called the “demographic momentum,” which occurs due to the fact that more women are in their reproductive years.

2. The reduction in young dependency ratio (the ratio of children under 15 years of age per working-age person) will be taken over by the rapid increase by the old-age dependency ratio (the ratio of elderly over 65 year-old per working-age person). In fact, the year 2050 will mark a point when old-age dependency ratio will exceed that of young dependency ratio for the first time in Malaysia (in other words, elderly persons over 65 years-old will exceed pre-working age persons age 15 and below).

**Figure 2:** Number of Dependents per 100 Persons of Working Age (15-64), 1950-20100

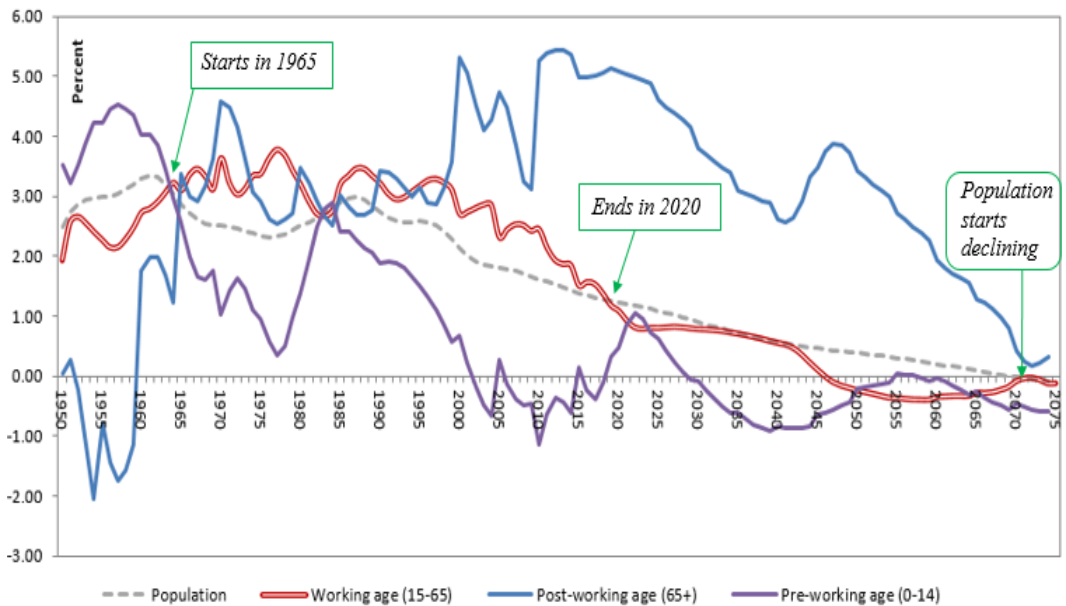


Source: Author’s calculation based on data from UN (2019)

<sup>1</sup> Since independence of 1957, Total Fertility Rate (TFR) decreased by almost 70 percent, from 6.1 children per woman to 1.97 children per woman in 2017. It is expected to decline further and reach 1.73 children per woman by 2050 (UN, 2019)

- While up to this point Malaysia has enjoyed a favorable demographic profile started in 1965, during which the working-age population expands at a higher rate than the general population, **Malaysia is now at the end of this favorable demographic period**, widely referred to as the “demographic window of opportunity”<sup>2</sup>.

**Figure 3:** Population Growth Rates by Major Age Groups, per cent, and Demographic Window of Opportunity (start and end period), 2000-2100

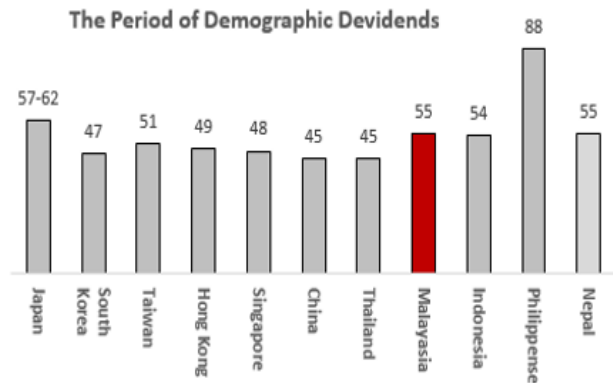


Source: Author’s calculation based on data from UN (2016)

<sup>2</sup> The expansion of the working-age population, and the concomitant enlargement of the labor force, is a favourable condition for sustained economic growth path if the country create sufficient jobs to absorb the rapid entry to the labor marker as Malaysia indeed did successfully over the period of its demographic window of opportunity.

**Table 2:** Length of Demographic Dividends, Years, Selected Countries

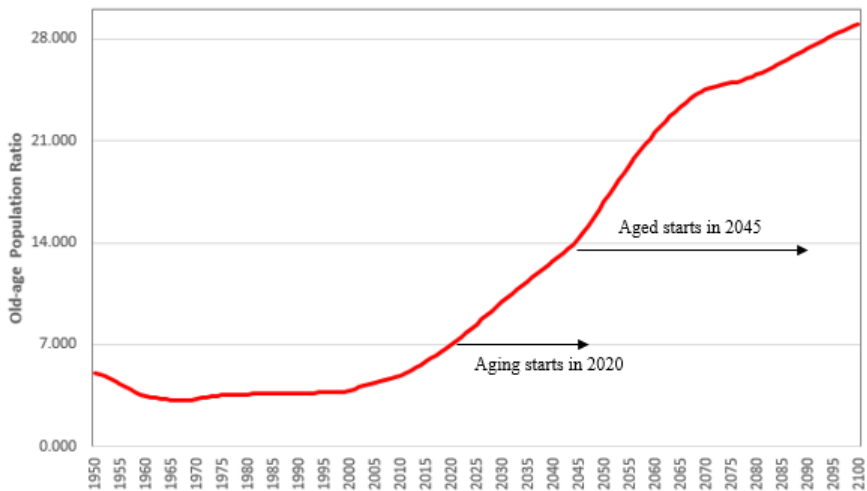
	Year		Length
	Start	End	
Japan	1930-35	1992	60
South Korea	1966	2013	47
Taiwan	1963	2014	51
Hong Kong	1961	2010	49
Singapore	1964	2012	48
China	1965	2010	45
Thailand	1968	2013	45
Malayasia	1965	2020	55
Indonesia	1971	2025	54
Philippense	1964	2052	88
Nepal	1991	2046	55



Source: For Malaysia and Nepal, own Calculation Based on data from UN (2016). For other countries, Oizumi (2013) based on UN (2013)

Malaysia's population has been **aging at a very high pace** than that of other countries. The author's calculation indicates that Malaysia will be considered as an 'aging nation', defined when post working population (65+) constitute 7 percent of the total population, by 2020. It will reach an 'aged nation, defined when post working population (65+) constitute 14 percent of the total population by 2045.

**Figure 4:** Post-Working Population as Percent of Total Population, 1950-2050

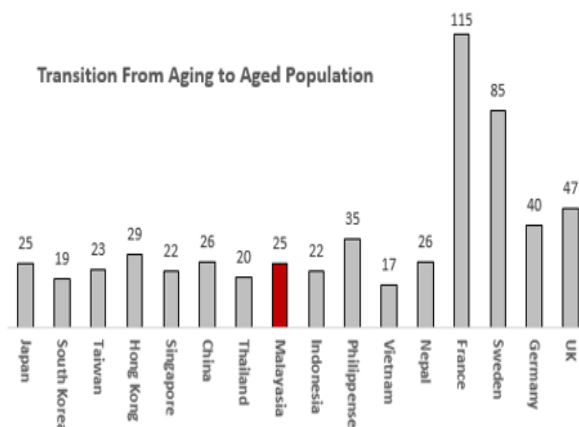


Source: Author's calculation based on data from UN (2016)

In comparison with other countries, the speed of aging is indeed alarming. While it took France, for instance, 115 years to move from aging to an aged phase, Malaysia is doing this in only 25 years. However, it seems that the fast aging society is a common feature in Asia.

**Table 3: Speed of Aging, Years, Selected Countries**

	Year		Length
	7%	14%	
Japan	1970	1995	25
South Korea	1999	2018	19
Taiwan	1994	2017	23
Hong Kong	1984	2013	29
Singapore	1999	2021	22
China	2001	2027	26
Thailand	2002	2022	20
Malaysia	2020	2045	25
Indonesia	2023	2045	22
Philippense	2035	2070	35
Vietnam	2016	2033	17
Nepal	2028	2054	26

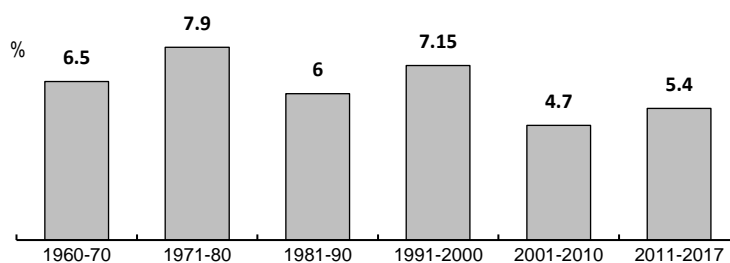


Source: For Malaysia and Nepal, own calculation based on data from UN (2016). For other countries, Oizumi (2013) based on UN (2013).

## 2.2 Old-Age Poverty in Malaysia

Malaysia is one of Asia's great economic success stories, sustaining rapid and inclusive growth for almost fifty years, with real GDP growing at an average of 6.5 percent annually since 1970 (World Bank, 2018).

**Figure 5: Real GDP Growth, Percent, 1960-2017**

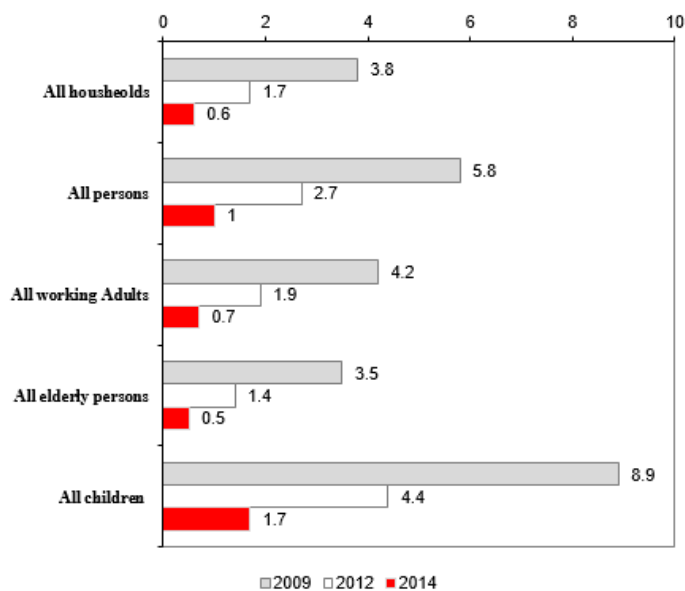


Source: (World Bank, 2018)

The resilience generated by this economic transformation has resulted in Malaysia developing into an upper middle-income country, with per capita income already exceeded USD10,000 in 2018 (IMF, 2019) with a further aspiration to transition into a high-income economy.

This solid economic performance translated into significant gains and placed Malaysia among the leaders in developing countries that have made sustained and rapid progress in tackling poverty and improving the quality of life of the population (UNDP, 2013). Between 1970 and 2014, the incidence of absolute poverty decreased from almost 50 percent of the population in the 1970s to only 0.6 percent in 2014 (Economic Planning Unit, 2015). More recent decrease in the incidence of poverty was also coupled with an overall income distribution improvement. Gini coefficient declined from 0.441 in 2009 to 0.401 in 2014. Mean monthly household income of the bottom 40 percent of the households' income group increased at higher rate than the income of the overall population (Economic Planning Unit, 2016). Like many countries, poverty in Malaysia has an age dimension with children in particular facing highest incidence of extreme poverty (Redmond , Praino , & Sidiquee , 2017).

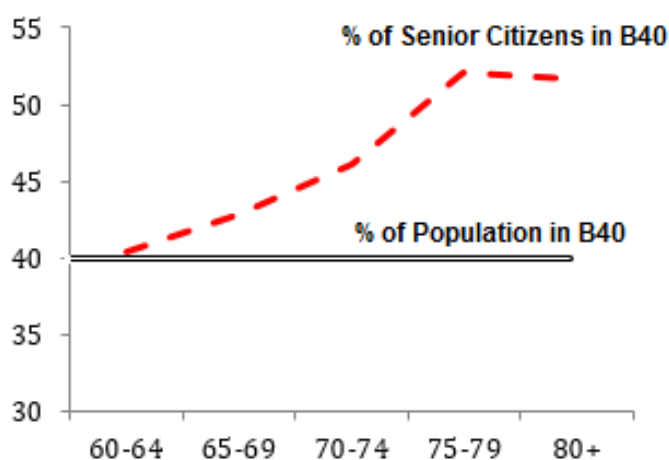
**Figure 6: Absolute Poverty Rate by Age Groups, 2009, 2014**



Source: Based on data from (Redmond , Praino , & Sidiquee , 2017)

It is to be noted, while absolute poverty rate among the elderly seems low, it is important to go beyond the low poverty line<sup>3</sup>. Using a relative threshold, the Khazanah Research Institute (KRI) computed that households headed by an elderly person is particularly vulnerable. They are significantly overrepresented, at 60.5 percent, among the lowest 40 percent of the population in terms of income, B40 (Abdul Hamid , Ho Wai Son , & Ismail, 2019). Similar findings were highlighted by other studies. For instance, one study showed that as citizens get older, the vulnerability increases significantly (World Bank, 2014).

**Figure 7:** Senior Citizens Representation among B40 Group, 2012



Source: based on data from (World Bank, 2014).

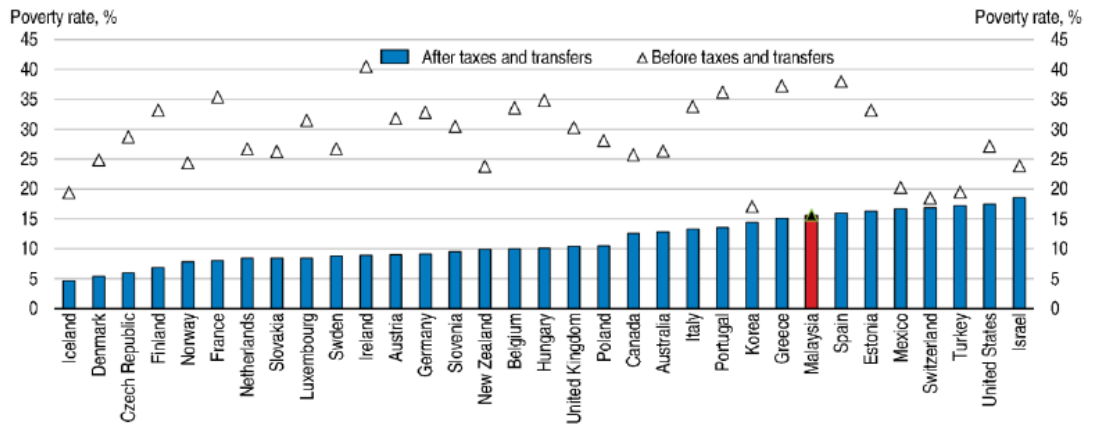
While there has been no evaluation of Malaysia’s public anti-poverty programs, comparison of poverty indicators before and after government redistributive interventions (taxes and transfers) can provide a broad view of impacts. The relative income poverty rate (based on an unadjusted 50 percent of median income), has declined slightly from 17.4 percent in 2007 to 15.6 percent in 2014 (Koen, et al., 2017). The modest impact reflects the low redistributive impact of Malaysia’s tax-and-transfer arrangements in contrast

<sup>3</sup> The low poverty line has been subject to heated public debate in Malaysia. You may see statement by Professor Philip Alston, United Nations Special Rapporteur on extreme poverty and human rights, on his visit to Malaysia, 13-23 August 2019. <https://www.ohchr.org/EN/NewsEvents/Pages/DisplayNews.aspx?NewsID=24912&LangID=E>



with some other countries that have effectively reduced poverty and inequality significantly through redistributive policies.

**Figure 8:** Relative poverty before and after taxes and transfers in Malaysia and OECD countries, 2014 (or latest available data)



Source: (Koen, et al., 2017).

## **CHAPTER 3 : SOCIAL OLD-AGE PROTECTION IN MALAYSIA**

Malaysia has a range of public old-age social protection arrangements including contributory and non-contributory schemes. Contributory formal social protection schemes include the Civil Service Pension Scheme, the Employees Provident Fund (EPF), the Social Security Organization (SOCSO), and the Armed Forces Fund (LTAT). Non-contributory arrangements, or social assistance, are mostly targeted at the low-income groups and administered by the Ministry of Women, Family, and Community Development (MWFCD) as well as Ministry of Finance (MoF). In addition to public schemes, Zakat, the Islamic welfare institution, collects and distributes cash and in-kind assistance to specified needy categories at the state level.

### **3.1 Non-Contributory Social Assistance to Senior Citizens**

#### **Overview**

Currently, a large number of agencies involved in provision of social assistance programs in Malaysia, which is highly fragmented and with overlapping objectives. In addition to traditional social protection providers such as: Ministry of Women, Family and Community Development (MWFCD) on social welfare; Ministry of Human Resources on labor programs; Ministry of Finance (MOF) on financing, the last wave of expansion of social assistance programs included agencies that are not usually seen as a social protection agency<sup>4</sup>. This fragmentation is a key feature that characterizes Malaysia's social assistance, with more than 110 programs under more than 20 ministries and agencies (BNM, 2018).

The Government Transformation Program (GTP), launched in 2009, came in the context of sluggish national and international economic growth due to the global financial crisis. Therefore, the public finance management strategy was focused on fiscal consolidation, particularly by reducing the untargeted regressive fuel subsidy. Cash transfers were seen as an attempt to offset welfare loss resulted from removal of subsidies on the poor. The most notable

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<sup>4</sup> For instance, Inland Revenue has been administrating the BR1M/BSH implementation.

cash transfer was the Bantuan Rakyat 1Malaysia (BR1M/BSH), introduced in 2012 as an income support program for B40 households. While introduced as one-off payment, BR1M/BSH expanded far beyond its originally stated remit, broadening the recipients base to those in the middle 40 percent of the population as well, and the fiscal cost has grown substantially.

A key point to make is that the rapid evolution of the social assistance cash transfer programs in Malaysia over the past decade has the design feature of being relevant to countries at early stages of development more than a natural and systematic expansion of programs parallel to the degree of development of Malaysia. As countries get richer and level of extreme poverty reduced (the case for Malaysia with extreme poverty rate at 0.4 percent in 2016 (Department of Statistics Malaysia, 2018), the tendency is generally to move away from narrowly-defined poverty-targeted social safety nets into other instruments that are more socially inclusive and less stigmatizing (e.g. social pension, tax credits, child grants).

### Extent of Coverage

Social Assistance targeted at senior citizens is mostly provided by MWCFD, which is the lead agency for social support programs targeting extreme poverty and workforce participation support for vulnerable groups. MWCFD currently provides social assistance through 11 different programs, the Bantuan Orang Tua (BOT) program provides monthly cash assistance to eligible old-age citizen.

**Table 4:** MWCFD’s Social Assistance to Old-Age Citizens

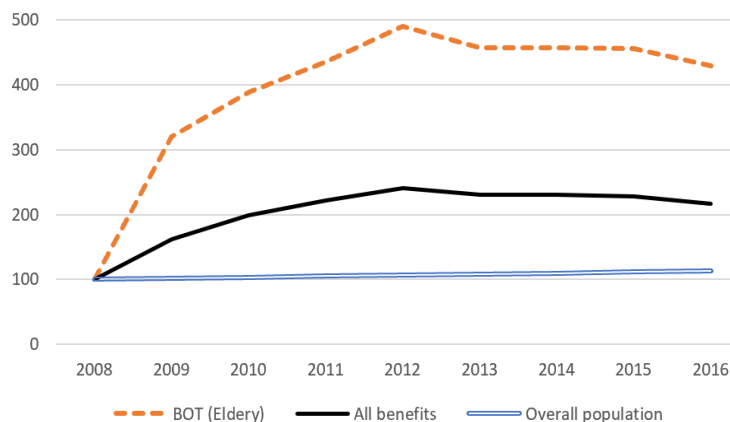
Name	Benefit	Eligibility Criteria & Conditions
Senior Citizen Aid (Bantuan Orang Tua, BOT)	RM 350 per month per old-age citizen	-No fixed income to sustain livelihood -No family or no family members providing support -Means-tested according to investigation officer -Age 60 +

Source: (MWCFD, 2018) and (UPM, 2017)

The MWCFD’s social assistance programs witnessed significant expansion, currently covering 462,322 recipients- doubling the coverage between 2008 and 2016 (MWCFD, 2018). In particular, the BOT program registered the

largest increase (4.2 folds between 2008-2016) and currently covers a total of 133,352 old-age recipients (MWCDF, 2018).

**Figure 9:** Growth of MWCDF’s Social Assistance Programs between 2008 (base year =100) and 2016



Source: Own calculation based on data from (MWCDF, 2018)

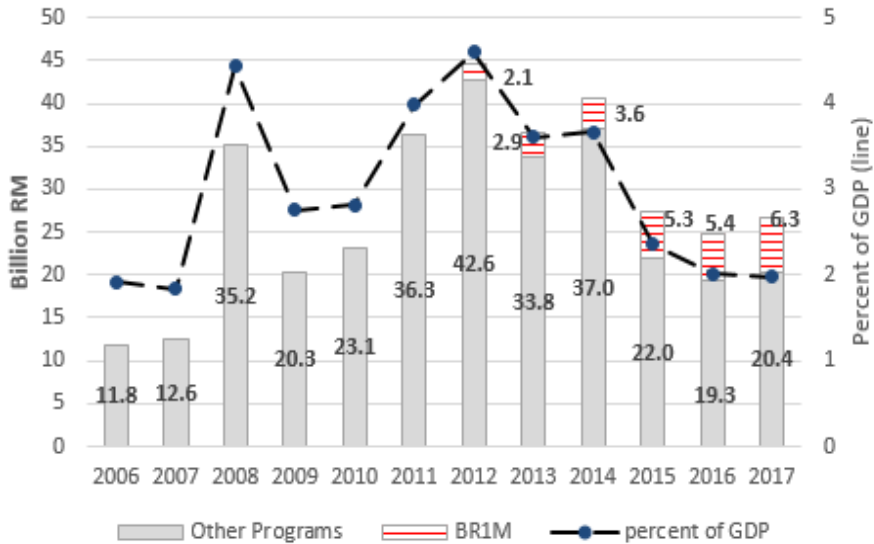
The introduction of BR1M/BSH in 2012 has changed the social assistance coverage landscape. While initially introduced as one-time cash payment to ease cost-of-living pressures after the fuel subsidy reduction, it has significantly increased its coverage and becomes more periodic. Starting 2014, old-age citizens in the B40 income cutoff have been singled out as one of the eligible populations targeted by BR1M/BSH. Since its introduction, BR1M/BSH has become the largest single cash transfer program targeted to a very large population segment. The administrative data in 2018 showed that a total of 4 million household beneficiaries and 3.1 million single beneficiaries received BR1M/BSH payment (BNM, 2018), this constitutes a 63.2 percent of the overall population for the same year. R1M/BSH administrative statistics shows that 28 percent of BR1M/BSH recipients in 2016 were senior citizens age 60 and above, this corresponds to **54 percent of all Malaysian age 60 and above receive BR1M/BSH.**

### Financial Trends

The subsidy rationalization in 2015 reduced overall social assistance spending from a peak of RM 44.7 billion (4.6 percent of GDP) in 2012 to

RM26.7 billion (1.97 percent of GDP) in 2017 (BNM, 2018). Parallel to the shift away from fuel subsidy, BR1M/BSH expanded significantly over the past few years, totaling an expenditure of RM 6.3 billion (0.42 percent of GDP) in 2017 (BNM, 2018).

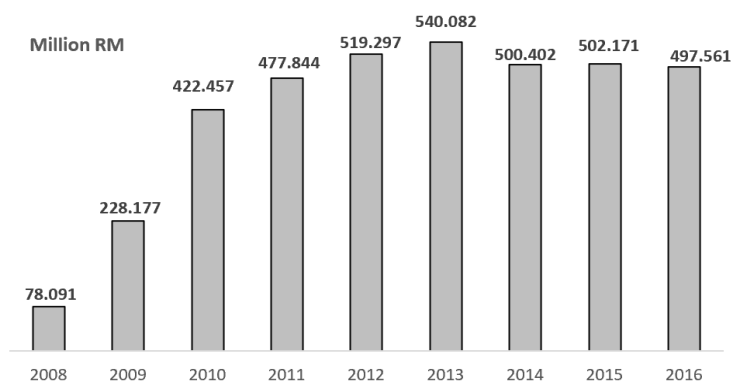
**Figure 10:** Allocation to Social Assistance in Malaysia in Billion RM (Left Axis) and as a Percentage of GDP (Right Axis), 2006 – 2017



Source: based on data from (BNM, 2018).

Parallel to the increase in covered population discussed earlier, allocation to MWCFD’s social assistance programs increased significantly by more than four folds between 2008 and 2016 (MWCFD, 2018). The highest increase in allocation was to the BOT program, which increased by 6.4 folds between 2008 and 2016, which constituted 32.54 percent of MWCFD’s social assistance budget.

**Figure 11:** Expenditure of MWCDF's Old-Age Social Assistance Programs, Million RM, 2008 - 2016



Source: based on data from (MWCDF, 2018).

### Lessons Learnt

Focusing on the social assistance specific issues, some key lessons can be highlighted, including:

1. The errors of targeting (especially the exclusion error) in social assistance programs are a key factor that contributed to their weak redistributive power (discussed earlier, see figure 8). While inclusion error understandably gets higher with higher coverage, it is very alarming in particular to see **high level of exclusion error, especially among the most in need**. For instance, BR1M/BSH's coverage totaled 63.2 percent of the population in 2018 (BNM, 2018) (UN, 2019), significantly higher than its target group, the B40 (this can be viewed as an inclusion error of 23.2 percent). Nevertheless, the significant increase of inclusion error did not translate into minimizing exclusion error. In a UNICEF study on urban poverty in 2018, about 34 percent of households with income below RM4000 (the eligibility criteria for BR1M/BSH) did not receive BR1M/BSH (UNICEF, 2018). Even among households live in extreme poverty (income below monthly income of RM1000), 33 percent did not receive BR1M/BSH (UNICEF, 2018).
2. This highlights that targeting complexity has a price in terms of exclusion error: many vulnerable people are less educated, and more likely to have weaker ability to comply to requirements of complex eligibility-

determination processes, they end up not taking up the benefit and excluded. **Avoiding complexity should be a policy objective in any attempt of reforming the social assistance programs in Malaysia.**

3. Furthermore, fragmentation across many different social protection programs in Malaysia covering multiple contingencies make it very difficult for beneficiaries to know which benefits they are entitled to, resulting in further exclusion of those in needs at the same time, those with better access to information might benefit from multiple programs at the same time, which is seen in the high inclusion error. Therefore, **a simplified institutional arrangement, at least at the service delivery level, can contribute to higher reach out to those most in need.**
4. As the exclusive targeting of the poor/B40 seems to have been ineffective, the pattern of vulnerability and their coverage in the existing social assistance framework can be looked at for lessons learnt. Analyzing the different groups' representation in B40 reveals that old age population are over represented among this group. As discussed earlier, 60.5 percent of old-age citizens age 60 and above are among the B40 (Abdul Hamid , Ho Wai Son , & Ismail, 2019) and **as citizens get older, the vulnerability increases significantly with age** (World Bank, 2014)<sup>5</sup>. The social assistance programs coverage is broadly in line with this pattern. As indicated earlier, the largest benefit category in MWCFD recipients is the elderly benefit, BOT, which has seen a significant increase by 4.3 folds between 2008-2016 (MWCDF, 2018). BR1M/BSH administrative statistics in 2016 shows that 28 percent of BR1M/BSH recipients in 2016 were senior citizens age 60 and above, this corresponds to 54 percent of all Malaysian age 60 and above receive BR1M/BSH.

**Against this background, old-age can be seen as an underlying vulnerability that can be used to consolidate some of the fragmented social assistance programs and link it to the contributory social arrangements in Malaysia.**

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<sup>5</sup> This is consistent with the fact that EPF saving has been shown to be inadequate, especially with a withdrawal age of only 55 (see page 22-23)

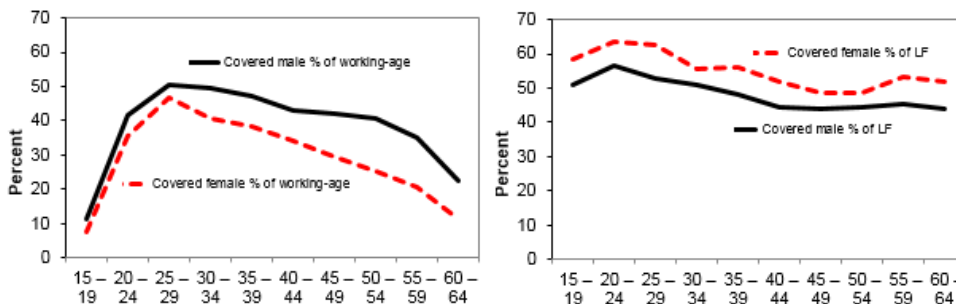
### 3.2 Contributory Old-Age Protection for the Private Sector Employees

Old age protection for the private sector labor force participants are managed by the Employees Provident Fund (EPF).

#### EPF's Extent of Coverage

The EPF scheme is a mandatory retirement saving plan for private sector employees. At the same time, public sector employees, the self-employed, and foreign workers may opt to join the scheme on voluntary basis. As of September 2018, total number of EPF members is 14.09 million (EPF, 2018). However, active members<sup>6</sup> totaled only 7.19 million members (EPF, 2018), which represents slightly more than one-half of the overall labor force and almost one-third of the population in the working-age in Malaysia.

**Figure 12: The EPF Contributors as a percentage of Labor Force and Working-Age Population by Sex and Age Groups, 2018.**



Source: Own calculation based on data from (EPF, 2018), (Department of Statistics, 2011-2017) and (UN, 2019).

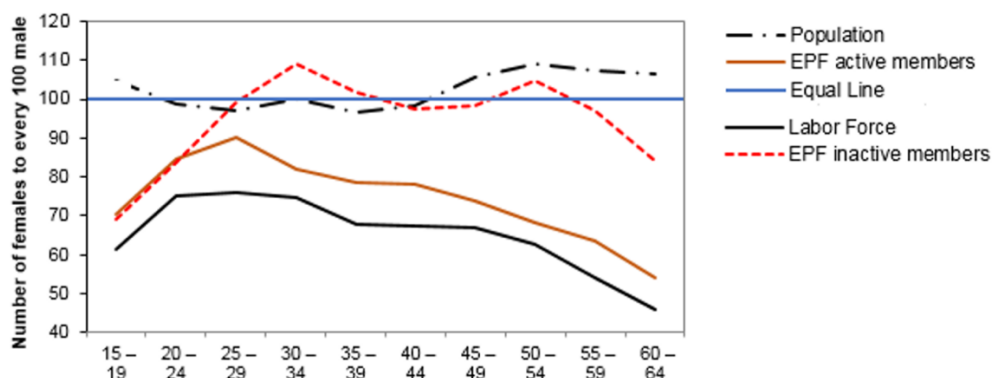
Figure 12 shows that the social insurance coverage in Malaysia has a gender dimension. It further shows that this gender gap is wider for the working-age population (active and inactive in labor market) compared with only those who are in the active labor force (only those who participate in labor market). As a result, participation in the labor market is a key determinant whether an individual is protected or not. This is an inherent problem from the labor market in Malaysia where there are participation rates differentials between male and female working-age populations as discussed in section earlier. This

<sup>6</sup> Those who contributed at least once over the last 12 months.



can also be seen in next figure, which shows that EPF's active membership mirrors the general labor force pattern where the sex ratio (female to male) peaks at age 25 before it started declining.

**Figure 13:** Number of Women to 100 Men by Labor Force Status, 2018.



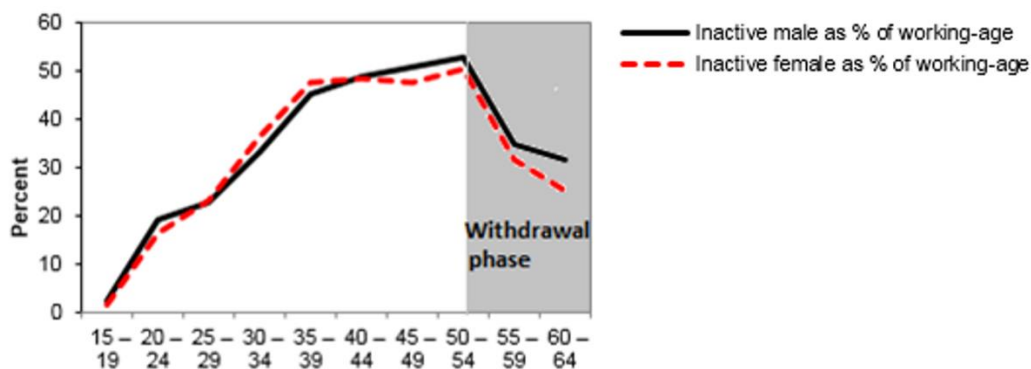
Source: Own calculation based on data from (EPF, 2018), (Department of Statistics, 2011-2017) and (UN, 2019).

Both figures point out that coverage gap starts widening between males and females starting age 25 and remains throughout the labor productive years. Low female labor force participation rates, as discussed earlier, is one reason for this, but the overreliance on insurance model (which is based on participation in the labor market) without any government intervention results naturally in a **bias in the system against the female population**, who has lower labor participation rates, have discontinued contributory record, and engaged more in the informal labor market. Therefore, an intervention by the government, such as a social pension, will correct for the discriminatory labor market and results in protection in old age for all citizens. It is also to be highlighted that out of the 2.5 million self-employed in Malaysia, only 90,000 contribute to the EPF (EPF, 2018)- a large coverage gap that provides another justification for government intervention.

In addition to the gender dimension, coverage gap has also an age dimension as coverage of both sexes decline as members get older. Figure 14 shows that contribution inactivity among members in EPF increases with age. While the female increase in inactivity can be partially contributed to maternity and

child caring period, male contribution inactivity is likely resulted from an increased informality in the labor market and not due to unemployment<sup>7</sup>.

**Figure 14:** Inactive EPF’s Members as Percentage of Working Age Population, 2018.



Source: Own calculation based on data from (EPF, 2018) and (UN, 2019).

This increase in informality in labor market by age is puzzling and counter intuitive<sup>8</sup>. A possible justification might be the high contribution rates, discussed in next section, create incentives for people to work in the informal sector.

### EPF’s Benefit levels and Eligibility Conditions

EPF is a fully funded, defined contribution retirement saving scheme. Each member has two sub-accounts: account 1, also known as retirement account, constitutes 70 percent of contributions and can be only withdrawn at age of 55. Account 2 constitutes 30 percent of contributions and gives members some flexibility to withdraw before age of 55. Types of pre-retirement withdrawal allowed in account 2 includes: member’s and children education, purchase/building house, reducing mortgage loan, medical costs for critical illness for member and his/her dependents, and withdrawal of savings of more than RM1 million. Members are also eligible to receive two types of additional benefits: (a) death benefit of RM 2,500 to be paid to

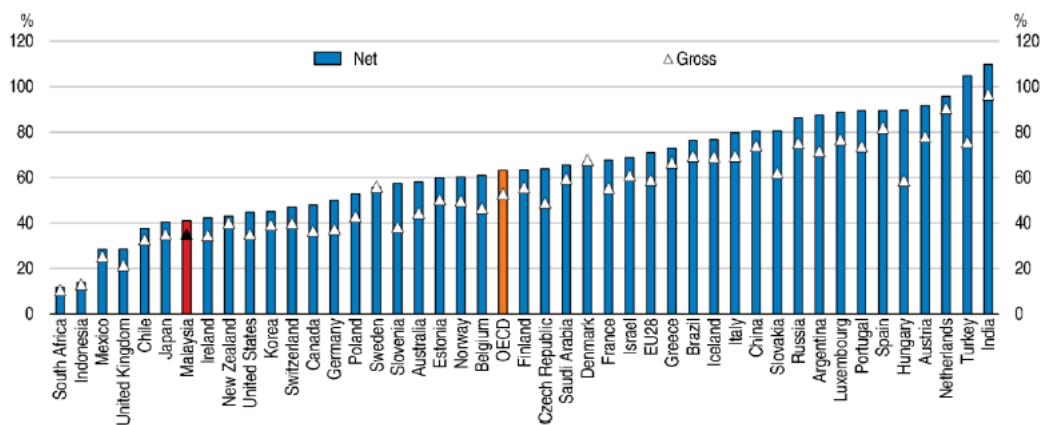
<sup>7</sup> Laborforce surveys showed that unemployment in Malaysia declines by age (Department of Statistics, 2011-2017).

<sup>8</sup> One would expect younger generation would engage more in informal labor arrangements and as they get older, they land in a more stable careers.

immediate family members with a condition that member dies before age 60; and (b) incapacitation benefit of RM 5,000 to be paid to member when he/she is declared as invalid before age 60 by a medical specialist.

A major design issue is the lack of annuitization. EPF statistics show that more than **two-third of EPF contributors withdraw retirements saving as a lump-sum at time of retirement, currently at age of 55** (EPF, 2018). Inadequacy is another concern, with also **two-third of EPF members age 54 have less than RM 50,000** (EPF, 2018), which represents only about 1.2 of annual per capita income as of 2017. The combination of inadequacy, early age of withdrawal, and lump sum withdrawal result in old-age vulnerability. In this regards, reports suggest that **50 percent of members exhaust their saving within 5 years** (EPF, 2018), which amounts pressure on the social assistance benefits as discussed earlier. In comparison with other countries, the OECD estimated the net replacement rate for an average income is at 41 percent, much lower than an OECD average of 68.3 percent (Koen , et al., 2017).

**Figure 15:** Pension Replacement Rate, Selected Countries, 2014 (except Malaysia 2012)



Source: (Nixon, Asada, & Koen, 2017)

## EPF's Financing and Financial Trends

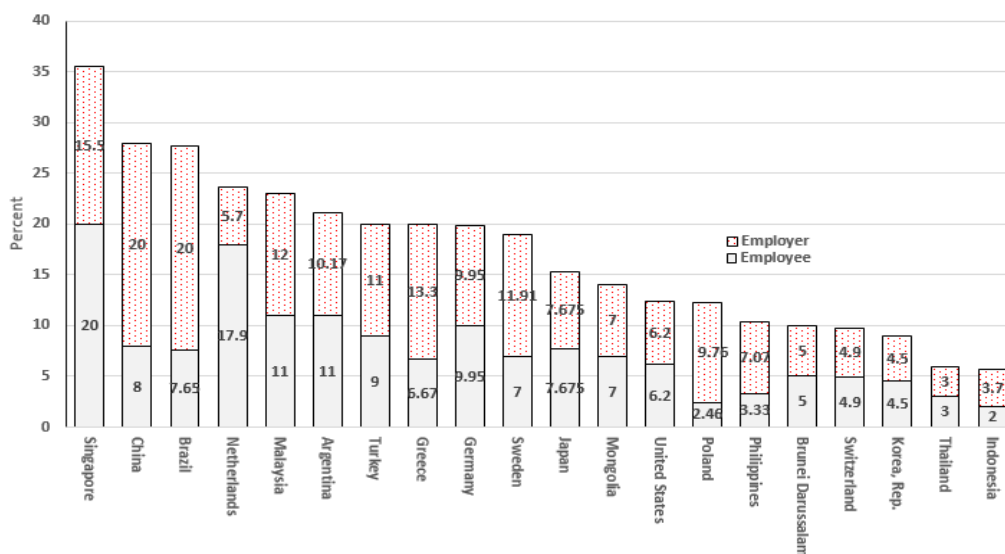
Both Accounts of EPF are financed by one contribution rate collected from both employees and employers. Table 5 shows contribution rate for various categories of EPF member.

**Table 5: EPF's Contribution Rates**

Category	Salary	Age < 60 years		Age 60 – 75 years	
		Employee	Employer	Employee	Employer
Malaysian employee	< RM5,000	11%	13%	5.5%	6.5%
	> RM5,000	11%	12%	5.5%	6%
Foreign workers	NA	11%	RM5	5.5%	RM5
Self Employed	NA	Maximum contribution RM60,000 in a year			

In comparison with other countries, Malaysia's contribution rate for retirement protection is relatively high. Figure 16 compares Malaysia with selected countries.

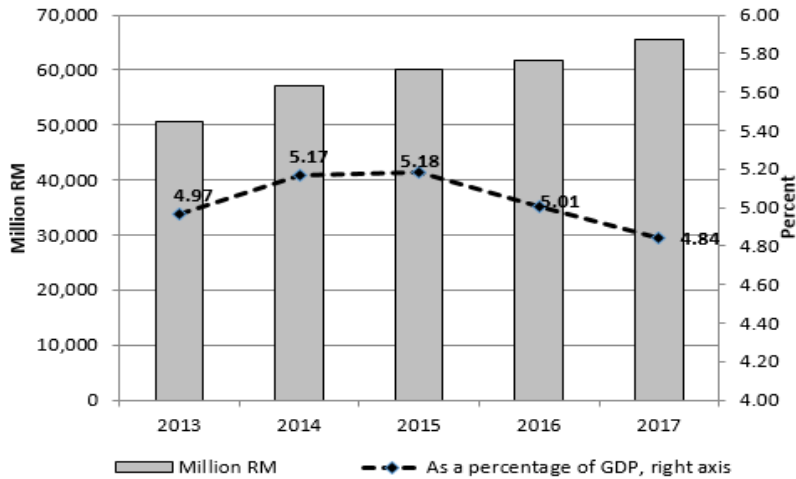
**Figure 16: Contribution Rates, Selected Countries, 2014**



Source: (World Bank, 2018)

Over the period 2013 and 2017, total contribution collected increases modestly in RM, but has been relatively stable as a percentage of GDP.

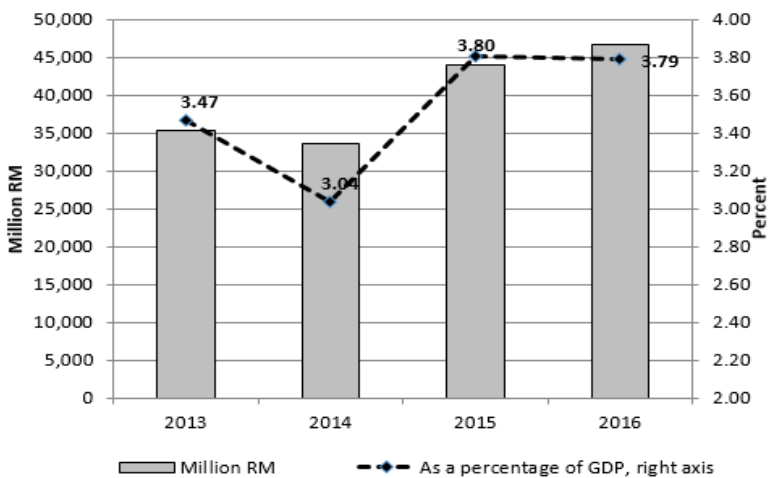
**Figure 17:** EPF’s Total Annual Contribution in Million RM and as a Percentage to GDP (right axis), 2013-2017



Source: (EPF, 2018)

Similarly, withdrawal has also increased in RM, but has also been relatively stable as a percentage of GDP.

**Figure 18:** EPF’s Total Benefits in Million RM and as a Percentage to GDP (right axis), 2013-2017



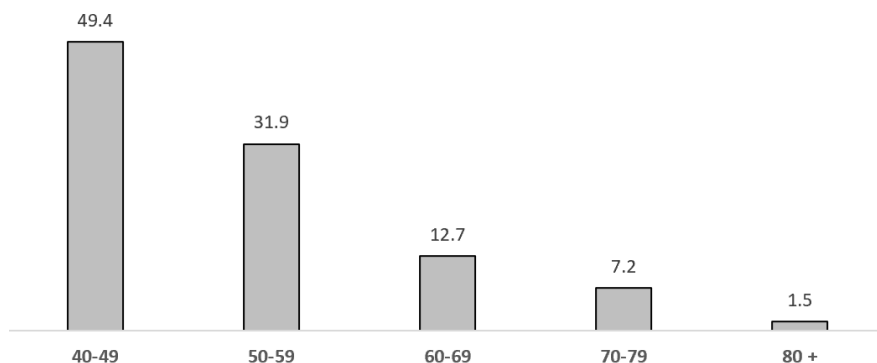
Source: (EPF, 2018)

As contributions continue to exceed withdrawals, the accumulated assets are still in the buildup phase. As of June, 2018, the accumulated assets totaled RM 813.18 billion (EPF, 2018), which is 55.47 percent of GDP for the same year, or a multiple of 16.4 of the annual contributions of 2017 (EPF, 2018). However, over the period of 2013-2017, contributions grew at an average annual rate of 6.75 percent, compared with an average annual rate of 9.37 percent for withdrawals over the same period (EPF, 2018).

The rate differential indicates that the buildup phase will end soon- a situation that requires an attention, especially if it is looked at in view of broader structural changes such as demographic pressure and expected changes in the labor market in view of young generations' preference for flexible work arrangements. To mitigate this risks, three modifications are needed:

1. Increase in minimum age of withdrawal: although Malaysia's minimum retirement age is 60, members have the option to withdraw their retirement savings in lump-sum at age 55. An increase in minimum withdrawal age will not only allow the assets buildup phase to extend, it further provides better protection for members against the longevity risk as they can now accumulate more saving. In this aspect, it is worth highlighting that 75 percent of members have less than RM50,000 in accumulated saving at age 54 (EPF, 2018), which is clearly insufficient old-age protection when life expectancy at age 55 is currently 79.03 years (UN, 2019). Not surprising, the preliminary findings of the Malaysian Aging and retirement survey (MARS) indicated that EPF's saving declines rapidly with age as shown below.

**Figure 19:** Percentage of Population with EPF's Saving by Age, 2019



Source: (Social Wellbeing Research Center (SWRC), 2019)

The savings inadequacy is mainly caused by two factors: low wages and pre-retirement withdrawals. EPF database shows that 68 percent of its active members are earning salary of RM 3,000 or below (EPF, 2018). Pre-retirement withdrawals such as housing related withdrawals, health withdrawal, education withdrawal, and age 50 withdrawal further contribute to the erosion of the retirement savings.

2. Address the issue of increase in contribution inactivity by age discussed earlier (see Figure 14).
3. Encourage active contribution by older workers (age 60+): the number of older workers in Malaysia is relatively small. According to the Nikkei Asian Review, Malaysia has the smallest proportion of older workers compared with other Asian countries (Nikkei Asian Review, 2018). EPF's data reveals that out of 2.45 million members aged 60 – 75, only 213,478 (9 percent) actively contribute to the EPF and only 33,391 (1 percent) contributed regularly with 12 contributions in 2017 (EPF, 2018).

### **3.3 Old-Age Protection for the Public Sector Employees**

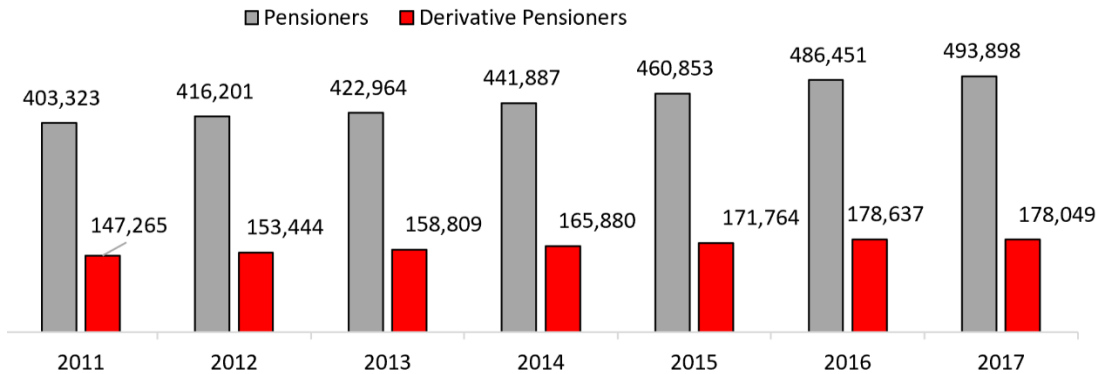
Old-age social protection for the civil service is provided by the Public Service Pension Scheme (Kumpulan Wang Persaraan, KWAP).

#### **KWAP's Extent of Coverage**

KWAP is a non-contributory, defined-benefit Civil Service Pension scheme provided by the Government of Malaysia under the Public Service Department (JPA). Scope of coverage include three main areas: Retirement benefits (which comprises a monthly pension, a gratuity, and a cash award for accumulated leave), Survivors' benefits (derivative pension, derivative gratuity, and dependent's pension), and Disability pension.

As of 2017, there were approximately 1.6 million civil servants covered under KWAP (KWAP, 2018). In terms of beneficiaries, a total of 700,000 received a civil service pension as of July 2018, of which, 76 percent, were former public servants, while the remaining receive survivors' or dependents' pensions (KWAP, 2018).

**Figure 20: KWAP's Civil Service Pensions Disaggregated between Pensioners and Dependents' Pensions, 2011-2017**



Source: (KWAP, 2018)

### Benefit levels and Eligibility Conditions

The current retirement age for civil servants is 58 years old<sup>9</sup>. A civil servant may apply for optional retirement upon or after attaining the age of 40 years, with not less than 10 years reckonable service. However, early pension payments will commence only at age 45 years for female officer and 50 years for male officer. Description of the different pensions' entitlements are provided below:

**Table 6: KWAP's Pension Entitlements**

No	Pension Benefits	Description
1	Gratuity	A lump sum payment made to all retirees based on the following calculation: 7.5% x service length (month) x last drawn salary
2	Pension	A monthly payment made to a retiree based on the following calculation: 1/600 x service length (month) x last drawn salary The above is subject to maximum 60% from last drawn salary (which is equivalent to a 30 year (360 months) cap)

<sup>9</sup> This is for those appointed after July 2008. For those appointed between October 2001 and July 2008, age of retirement is at 56. Appointment prior to October 2001, the age of retirement is 55.



No	Pension Benefits	Description
3	Gantian Cuti Rehat (GCR)	Cash in lieu of accumulated leave is a one-off payment made for the retiree based on the following calculation: 1/30 x leave accumulated (maximum 150 days) x (last drawn salary + fixed allowance)
4	Medical Benefits	Free medical benefits similar to what the retiree was entitled to while in service, in any government hospital and clinic.
5	Pensioners card	A card used as identification of pensioner which provides medical benefits and also part of the discount card under certain provider / outlet.
6	Disability pension	An additional pension paid to retirees if he/she was asked to retire due to health matters caused by his/her job scope or due to accident while travelling. The pension is given depending the degree of the retiree's disability.
7	Pension adjustment	All retirees will receive adjustment on their monthly pension base on an increase of 2% annually, beginning from January every year.

In addition to pension entitlements to civil servants, his/her surviving dependents are also entitled for a variety of benefits if the officer passed away.

While the scope of benefits provided are quite comprehensive, **benefit adequacy has been a concern**. As of 2017, almost 9 out of 10 of pension recipients received an amount of less than RM 3,000 a month (KWAP, 2018). This reflects the weak wage basis as 52 percent of civil servants (members) with earning less than 3000 a month (KWAP, 2018). An attention to this issue is needed, especially noting that in 2016 a total of 176,721 civil servants received social assistance under BR1M/BSH. A possible solution is the integration of a social pension (discussed later), which will provide old-age protection for those low wage earners in the civil service.

### **KWAP's Financing and Financial Trends**

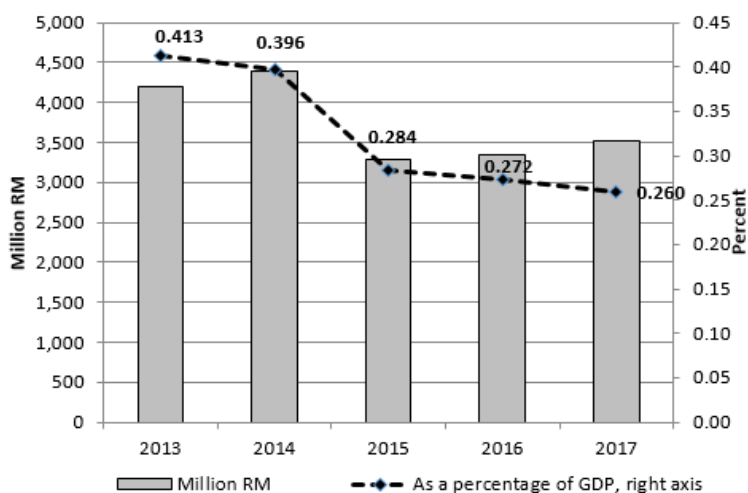
KWAP's contributors to the retirement fund are from 3 primary sources:

1. Federal Government: annual contribution of up to 5% from the total annual budgeted emolument of its employees;

2. Statutory bodies, local authorities, and agencies: monthly contribution of 17.50 percent of the pensionable employees' basic salaries;
3. Employees: no contribution. However, the share of pensionable employees' contribution to contributory schemes like EPF and LTAT, will be transferred to KWAP upon the employees' retirement or switch to pension scheme.

As of 2017, total contribution amounted to RM 3.514 billion (KWAP, 2018), which represents 0.260 percent of GDP for the same year.

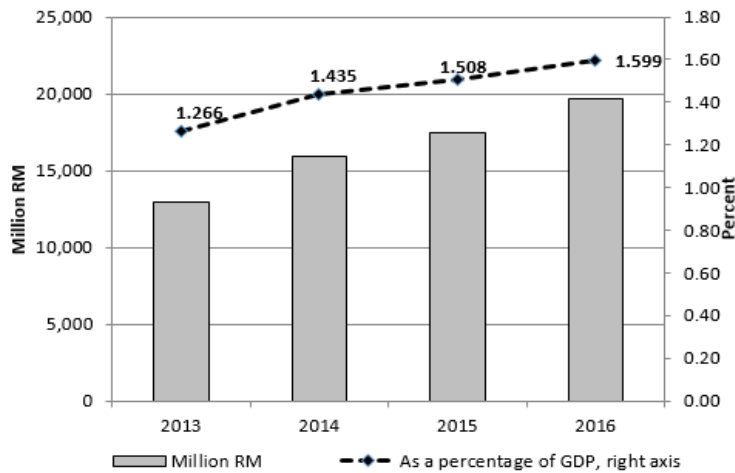
**Figure 21:** KWAP's Total Annual Contribution in Million RM and as a Percentage to GDP (right axis), 2013-2017



Source: based on data from (KWAP, 2018)

In the other end, the benefits paid exceeded significantly the contributions collected on annual basis. As of 2016, total benefits paid (pension and gratuity payments) totaled RM19.7 billion (KWAP, 2018), which is 1.6 percent of GDP for the same year and a multiple of 5.88 of collected contribution in the same year.

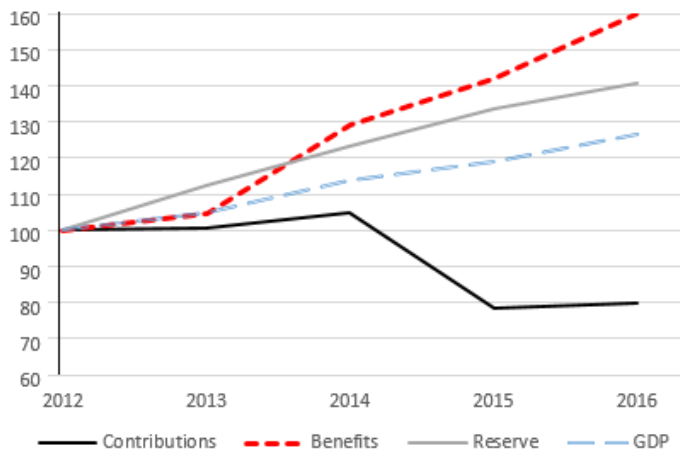
**Figure 22:** Total Benefits in Million RM and as a Percentage to GDP (right axis), 2013-2016



Source: based on data from (KWAP, 2018)

While this differential between contributions and benefits amount pressure on KWAP’s reserve, the overall reserve continues to grow, benefiting from the investment income. As of end 2016, the total fund size was MYR125.0 billion (KWAP, 2018), which is a multiple of 6.35 of paid benefits for the same year. Nevertheless, growth in benefits has exceeded all other growth components of the system, which indicates the sustainability concerns of the system.

**Figure 23:** Growth of KWAP’s Benefits, Contributions, and Reserve between 2012 (base year =100) and 2016



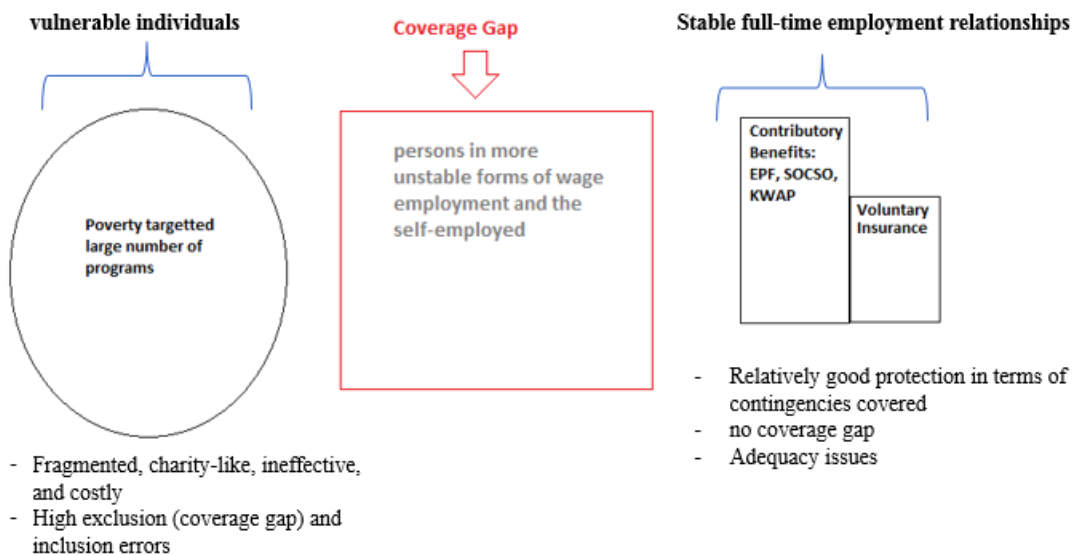
Source: based on data from (KWAP, 2018).

# CHAPTER 4 : INTEGRATED SOCIAL PROTECTION SYSTEM

## 4.1 Framework

The main feature of the fragmentation of the existing social protection, discussed earlier, is the prioritization of two population groups at opposite ends of the income scale: first group include salaried employees in the formal sector (public and private), particularly those in stable full-time employment relationships, who enjoy a relatively good protection in terms of contingencies covered and no coverage gap (with limitation of adequacy discussed earlier). The second group, vulnerable individuals living in poverty are targeted with many programs under the social assistance arrangements. Despite of the large number of programs, these arrangements excluded a significant share of those who are targeted by these programs. Apart from these two groups, coverage of other groups of workers, especially to persons in more unstable forms of wage employment and the self-employed, is not automatic, and therefore, significant coverage gaps exist despite of efforts that have been exerted to extend coverage of the formal contributory arrangements.

**Figure 24:** Social Protection Coverage in Malaysia is at Two Ends

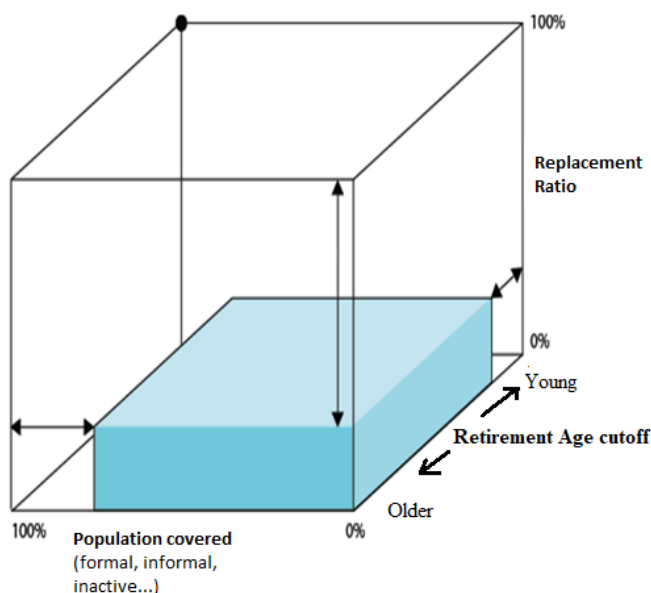


Against this background, consolidation of existing arrangements into a coherent social protection system requires that the new system ensures the following broad objectives:

1. **Coverage** over contingencies (extend of coverage) across all groups (formal, informal, vulnerable etc.).
2. **Adequacy** of benefit.
3. **Cost** containment and economic growth friendliness.

These three objectives can be presented in a cube diagram, where coverage (population and age cutoff) represent the two base dimensions. The third dimension, height, represents the generosity of the system in terms of benefit level expressed as a percentage of wage. The volume represents the overall cost of the system.

**Figure 25:** Representation of the Objectives of Building a Coherent Social Old-Age Protection System



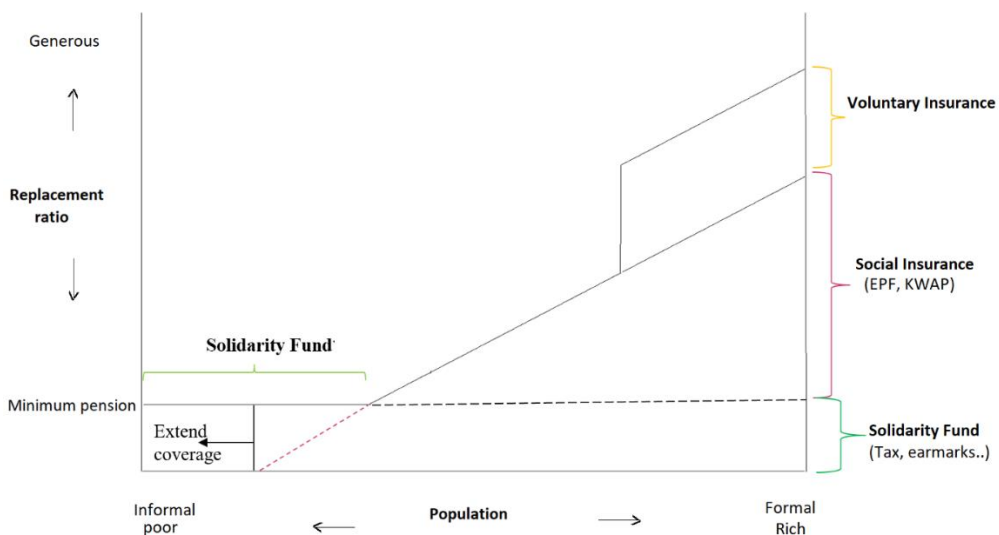
It is to be noted that the above objectives are conflicting with each other: you can achieve any two objectives without impacting each other, but not the three together. For instance, high coverage (the base) and generous benefit (height) will make the cost increase (the volume). While closing the population coverage gap (the width in the graph) is a key objective in Malaysia's

commitments to ‘no one left behind’, the section presents a set of recommendations for balancing the other objectives. In this regards, two more objectives are critical to operationalize full population coverage while ensuring cost containment of the system:

1. The overall system should promote social solidarity, inclusivity, and cross-subsidization (working to non-working, the ‘haves’ to the ‘have-nots’).
2. The overall system creates synergies and coordination between the different arrangements to ensure efficiency, impact, and coverage.

Operationalizing these set of guiding principles, the paper adopts a two-dimensional framework for consolidating and coordinating Malaysia’s fragmented social old-age protection arrangements and closing the coverage gap.

**Figure 26:** Integrated Social Old-Age Protection System



In the horizontal dimension, a coherent Social Old-Age Protection Floor (SOAPF) containing a basic social security guarantee, which is provided at minimum level to ensure universal access to old-age pension. The vertical dimension accounts for the progressive achievement of higher levels of protection within an integrated and comprehensive social security mechanisms currently exist in Malaysia. By better coordinating, and

emphasis on creating synergies between contributory and non-contributory programs, the overall integrated system will be more effective to not only reduce inequality, but also enhance economic security for the entire old-age population while maintaining incentive structure for saving and participation in the labor market within Malaysia's overall fiscal envelope.

## 4.2 Recommendations

### **Recommendation 1: Shift away from charity-based social assistance approach into a developmental model.**

The rapid evolution of the social assistance cash transfer programs in Malaysia, most notably BR1M/BSH, over the past decade has the design feature of being relevant to countries at early stages of development more than a natural and systematic expansion of programs parallel to the degree of development of Malaysia. As countries get richer and level of extreme poverty reduced (the case for Malaysia with extreme poverty rate at 0.4 percent in 2016 (Department of Statistics Malaysia, 2018)), the tendency is generally to move away from narrowly-defined poverty-targeted social safety nets into other instruments that are more socially inclusive and less stigmatizing (e.g. social pension, tax credits, child grants). Malaysia seems to have moved in an opposite direction with the proliferation of charity-like programs. Malaysia needs to move away from narrowly-targeted and stigmatizing approaches towards particular groups, or the poor, by looking at the underlying causes of poverty. In other words, instead of explicitly target poverty, which is not observable and can be manipulated as the evidence suggests in Malaysia and other countries (Kidd & Wylde, 2011), this recommendation proposes to target the underlying vulnerabilities to poverty.

In this regard, risks associated with life cycle such as old-age can be targeted with the social assistance consolidated programs and provide benefits universally to such vulnerable lifecycle stage. This proposed shift, from narrow poverty targeting into categorical targeting, converges with the momentum gathering in support of universalism, as per the intense social debate focusing on Universal Basic Income (UBI)<sup>10</sup>.

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<sup>10</sup> While this recommendation suggestion to provide benefit universally, it is not the same as UBI. It can be a step towards a UBI by prioritizing first key population groups i.e old age, children, etc. This is in line with the IMF suggestion 'that a gradual approach to reform would be desirable, possibly focusing first on universal

This shift will achieve key objectives:

1. Reduce the exclusion errors associated with poverty targeting: as discussed earlier, the available data shows that BR1M/BSH has suffered from a large exclusion error (many deserving citizens did not receive benefit, as discussed). This is not unique to Malaysia; evidence shows that poverty targeting carries a very significant exclusion error risk. For Instance, Mexico's Oportunidades was found to exclude 70 percent of the poorest 20 percent of eligible households, Brazil's Bolsa Família had an exclusion error of 59 percent (Fiszbein, Schady, & Ferreira, 2009). Findings of another study shows that exclusion and inclusion errors in Bangladesh, Indonesia, Rwanda and Sri Lanka amounted to somewhere between 44 percent and 55 percent when 20 percent of the population is covered and between 57 percent and 71 percent when 10 percent is covered (Kidd & Wylde, 2011). In China's Minimum Livelihood Guarantee Scheme (also known as Diabo), cities that have used more targeting have been shown to be less likely to reduce poverty (Ravallion, 2007).
2. Administrative simplicity and efficiency: the simplicity of categorical targeting (i.e. social pension) proposed reduces the administrative burden currently placed on many agencies to verify documents and assess complex eligibility criteria. For instance, universal programs have little need for periodic reappraisal of eligibility. Whereas, targeted programs require periodic retargeting to assess ongoing eligibility. This retargeting process automatically implies more cost and complexity from an administrative perspective. Not surprising, an ILO review concluded that the universal schemes reviewed exhibited the lowest average administration cost at 2.5 percent of the total program costs. Whereas, targeted programs had an average administration cost of 11 percent (Ortiz, Durán-Valverde, Pal, Behrendt, & Acuña-Ulate, 2017). In addition to cost, complexity has a price in terms of coverage. As many vulnerable people are less educated, and more likely to have weaker ability to comply to requirements of complex eligibility-determination processes, generally associated with targeted programs, they end up not taking up the benefit

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coverage of subgroups of the population, such as children and the elderly.' (see IMF. 2017. IMF Fiscal Monitor: Tackling Inequality. See: [Chapter 1: Tackling Inequality](#))



and excluded. This partially explains the high exclusion error among the poor as the case of urban poor access to BR1M/BSH discussed earlier where almost 4 out of 10 deserving beneficiaries did not receive BR1M/BSH (UNICEF, 2018). Furthermore, fragmentation across many different social protection programs in Malaysia covering multiple contingencies make it very difficult for beneficiaries to know which benefits they are entitled to, resulting in further exclusion of those in needs at the same time, those with better access to information might benefit from multiple programs at the same time.

3. Dignity, solidarity, and social cohesion: programs that are exclusively for the poor is stigmatizing. Studies cited that the screening process involved in determining eligibility to mean-tested, or proxy-means tested, benefits as being stigmatizing. For example, in India Thozilurappu Paddhathi (the “work guarantee scheme”; National Rural Employment Guarantee Act – NREGA) is often referred to as Thozhiluzhappu Paddhathi (the “lazy work scheme”) (Walker, 2014). As noted by another study, ‘stigma – stigmatization – is an important mechanism through which shame is induced’ (Roelen, 2017). It is reasoned that the social ‘othering’ that occurs through targeting generates strong ‘in’ and ‘out’ group dichotomy, especially in contexts where notions of ‘deserving’ and underserving poor prevail, say for example in the Anglo-Saxon social model’ (Roelen, 2017). In contrast, categorical targeting removes the screening procedures that aim to determine eligibility (who is ‘in’ and who is ‘out’). It further creates the sense of community as all group benefit for such inclusive programs. It removes the risk of deserving low-income families self-excluding themselves from their entitlements as a result of shame at being ‘on benefits’. Further, the broad-based consensus that universal approaches create may help create social cohesion and citizenship. Universalism signals a clear message from the state that all citizens have a stake in society.

It is to be noted that while universal approaches hypothetically cover all individuals within a category (e.g. all above age 70 receive social pension), a form of targeting is implicitly built in:

1. Self-selection targeting: the low level benefit amount (as this is a floor level benefit that can be complemented with other contributory schemes as in

26) coupled with other administrative measures, are likely to result in less than 100 per cent take up, as higher income groups may not claim the benefit.

2. Categorical targeting: the lifecycle approach recognizes that poverty is positively correlated with old-age groups (as discussed earlier). Therefore, categorically targeting old-age groups is pro-poor, even if non-poor households receive the same benefit amount.
3. With the inclusion of financing mechanism such as tax, the overall impact (transfer and tax combined) is a net transfer from the rich household to the poor household.

### **Recommendation 2: Consolidate all Old-Age Social Assistance Programs into a Social Old-Age Protection Floor (SOAPF) Funded Through a Solidarity Fund**

As discussed earlier, the main feature that characterizes Malaysia's social assistance programs is its fragmentation across many small programs. Administration costs tend to accrue in absolute terms in social protection programs, which means that administrative efficiency of a program may 'benefit from efficiencies of scale as the scheme grows in size. A sufficiently large scheme will, therefore, typically exhibit relatively lower administration cost percentage as compared to a smaller scheme' (Ortiz, Durán-Valverde, Pal, Behrendt, & Acuña-Ulate, 2017). This is in addition to issues discussed earlier that the complex fragmented social assistance programs in Malaysia covering multiple contingencies, many times same contingency covered by different programs, makes it particularly difficult for beneficiaries, and many of them with low education attainment, to know about the existence of such programs and to which benefits they are entitled.

Building on recommendation 1, which recognizes the complexity and problems associated with the charity approach of exclusively targeting the poor, this recommendation aims at consolidating all programs targeted at senior citizens in Malaysia into one Social Old-Age Protection Floor (SOAPF) as described in graph 26 presented earlier.

Old-age protection is a major concern in Malaysia. As discussed earlier, as citizens get older, the vulnerability increases significantly with age. This lack of protection has placed a significant pressure on the social assistance programs (the largest benefit category in MWCFD recipients is the elderly benefit, BOT, which has seen a significant increase by 4.3 folds between 2008-2016 Further (MWCFD, 2018), 54 percent of all Malaysian age 60 and above receive BR1M/BSH). A spell over of this pressure is on the contributory system (EPF and KWAP)<sup>11</sup>, which all identified issues related to lack of social pension as discussed earlier. Old-age should be considered as an underlying vulnerability that can be used to consolidate fragmented social assistance programs and link it to the contributory social arrangements in Malaysia (as we will discuss later).

This refocus of existing fragmented programs into SOAPF is aimed at addressing the roots of vulnerability, and ensure that individual instruments complement one another to achieve comprehensive coverage and cumulative benefits with other instruments (contributory level as in figure 26) to individuals and households to promote equitable growth and reduce social exclusion.

#### Benefit Amount, Coverage, and Cost of the Proposed SOAPF:

The benefit amount proposed in RM400 a month for every senior citizen age 70 and above. While the proposed amount is low in value as a stand-alone benefit, it is meant to complement existing old-age income security instruments as presented in graph 26, but also not to reduce the incentive structure to contribute to higher protection arrangements provided by EPF, SOCSO, and other saving/insurance products.

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<sup>11</sup> Even SOCSO's long-term invalidity pension is faced with pressure due to the issue of old-age limited coverage. With weak old-age protection (inadequate savings under EPF and absence of social pensions), applicants often trying to receive invalidity pensions from SOCSO to meet their old-age protection needs. SOCSO received over 14,000 applications for invalidity pensions in 2017, with only 40 percent getting their invalidity certified<sup>11</sup> (SOCSO, 2018). Even if applicants are certified as not invalid, increasing invalidity pension applications has also raised administrative costs for screening them (SOCSO, 2018).

A model is elaborated to cost the SOAPF in the annex. The following table summarizes the key:

**Table 7: Costing Results: Number Beneficiaries in thousands, Overall Cost in in Billion RM and Percentage of GDP, 2010-2034**

	2020	2024	2028	2034
<b>Demographic, 000</b>				
Population	32,366	33,969	35,429	37,295
Old-age population age 70+	1,396.4	1,718.9	2,104.2	2,742.5
<b>Macroeconomic</b>				
GDP, current prices, billion RM	1,635,134	2,130,054	2,744,862	3,962,567
Laborforce, 000	15,415	16,380	17,176	18,195
<b>SOAPF</b>				
Beneficiaries, 000, age 70+	1,117.1	1,375.1	1,683.4	2,194.0
Total Expenditure, Billion RM	5.50	7.35	9.81	14.56
Total Expenditure,% of GDP	0.34	0.35	0.36	0.37

Source: Study calculations, see annex 2

It is to be noted that over the projection period, benefits are assumed to maintain real value in RM (indexed with inflation). However, as the economy is expected to continue to grow in real term (economic growth is positive), benefit level will decline in relative value (relative to GDP per capita income) over the projection period. At later stage, a periodic review of the real value of the benefit can be introduced to ensure coherence and relevance, this is in addition to the automatic indexation with inflation already built in the projection.

#### Financing: Solidarity Fund

One of the guiding principles discussed earlier is to ensure that the **overall system** promotes social solidarity, inclusivity, and cross-subsidization (working to non-working, the ‘haves’ to the ‘have-nots’). Therefore, **a solidarity fund is recommended to be established to finance the proposed SOAPF**. The financing of the solidarity fund comes from three streams of income:

1. **Fiscal-neutral reallocation of existing resources:** currently, there are many programs offered social assistance to the elderly. Since the SOAPF provides cash transfer to seniors, no need for these programs. Treasury allocation to these programs can be channeled to the solidarity fund. Estimating the actual reallocation of resources require an in-depth analysis of government outlays, which should be done relatively easily. However, a rough estimation suggests somewhere between RM1.00-2.30 billion a year<sup>12</sup> can be redirected to the solidarity fund proposed.
2. **A 2 percent of existing contribution to EPF and KWAP** is dedicated to the solidarity fund: As it is proposed that all EPF and civil servants<sup>13</sup> members to benefit from the SOAPF, a contribution of 2 percent will bring around RM 0.5-0.75 billion.
3. The remaining balance can be funded through increased budgetary outlays to this purpose.

Alongside the introduction of SOAPF, monitoring and evaluation are central to the strategy. Systematic and frequent monitoring can address the problems that might arise in the execution, such as: delays in delivery, exclusion of eligible population, corruption, or other issues. Collecting and analyzing real-time information will not only help identifying problems related to program implementation, but will also create a great database that can be used for further improvement of the program.

Further, collecting the empirical evidence on the effect of the system will be crucial to build broad political and public support for the expansion and continuation of the system. For solid impact evaluation, it is necessary to collect baseline information at the inception of the proposed system to be able to compare and measure the impact. Not surprisingly, cash transfers in other countries are found to have positive institutional externalities (Fiszbein,

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<sup>12</sup> BNM estimated that fiscal allocation of social assistance programs targeted to the senior citizens amounted to RM 0.837 million. In addition, 28 percent of BR1M/BSH recipients in 2016 were senior citizens, which might bring the total allocation to RM1.512 billion. Changes to BR1M occurred since 2016, so a lower bound brings both numbers to RM1 billion, where an upper bound might go as high as RM2.3 billion a year.

<sup>13</sup> Please see proposed recommendation on moving KWAP's members to EPF.

Schady, & Ferreira, 2009). Through their emphasis on monitoring and evaluation, cash transfer programs have strengthened a results culture within the public sector. It is expected that establishing a robust monitoring and evaluation system for social protection schemes will have cross-sectoral external effects to strengthen other policy implementation.

### **Recommendation 3: Strengthen the lifetime consumption-smoothing vehicle and old-age protection through creating synergy between EPF, KWAP, and the SOAPF**

A key function for any old-age protection mechanism is the income/consumption-smoothing over the individual life, where it shifts resources from individuals' period of activity to cover the needs of their period of post-working age.

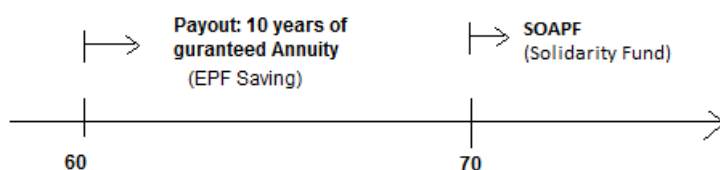
As discussed earlier, EPF's role as protection for longevity risk through consumption smoothing over member's lifetime is constrained with key design problem i.e. the lack of annuitization of accumulated assets over the post working-age years. This lack of annuity is largely due to inadequate saving, a result of another design problem of pre-retirement withdrawal or early age of withdrawal at age of only 55. The low age of full withdrawal at age 55, coupled with low wage base for most members, lead to a low level of accumulation at age 55, which in turn translates into low annuity levels-unattractive for many members. As Malaysians enjoy an increased life expectancy, which is estimated that an individual age 55 in year 2015-2020 will live 24.3 years more (UN, 2019), the risk of old-age poverty is significant and requires the consumption-smoothing function as a necessity protection against this uncovered risk.

This recommendation proposes firstly to **raise the age of withdrawal to 60 years old**. At the same time, **introduce annuity payment structure for members**. As discussed earlier, it is to be noted that savings for many members will be insufficient for any meaningful amount of life annuity. As shown in graph 26, it is recommended to create synergy between EPF and SOAPF to ultimately provide life coverage for all. Two scenarios of are presented:

Scenario 1: This scenario is a combination between installments and the social pension. Precisely:

- At age 60, a mandatory portion of saving is paid out in monthly installment for 10 years (between age 60 and 70). This should be a minimum amount such as only RM 60,000 (to make a monthly payment of almost RM500 a month)
- If s/he survives, from age 70 and onward, s/he will be receiving the SOAPF.
- Members are allowed to withdraw the excess of the mandatory amount.

**Figure 27:** Creating Synergy between EPF and the SOAPF - Scenario 1



While this scenario provides a minimum old-age protection, it is practical and less problematic in terms of public reaction. However, it must be highlighted the need to package the proposed adjustments together (increase withdrawal age, installments, and social pension) for mitigating political risks associated with the changes proposed.

A more challenging scenario is also presented below.

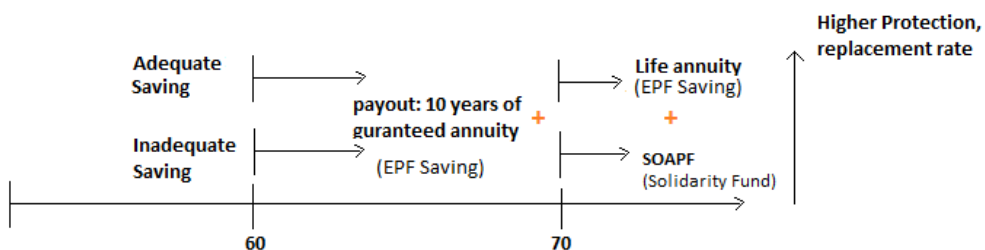
Scenario 2: A more complex scenario that requires further assessments of support environment to implement (such as assessment of investment strategies, risks, and other areas), is to **add a life annuity** component. Precisely:

- Similar to scenario 1, at age 60, a mandatory portion of saving is paid out in monthly installment for 10 years (between age 60 and 70). This should be a minimum amount such as only RM 60,000 (to make a monthly payment of almost RM500 a month)
- If s/he survives, from age 70 and onward, s/he will be receiving the SOAPF.
- For members with adequate funding at age of 60, in addition to the monthly annuity-certain payments for next 10 years (up to age 70), a mandatory portion of saving will also be paid out in the form of a life

annuity from age 70 and onward. The member, from age 70 and above, will also receive the SOAPF, both provide high level of coverage.

- Members are allowed to withdraw the excess of the mandatory amount.

**Figure 28:** Creating Synergy between EPF and the SOAPF - Scenario 2



If Scenario 2 is preferred, it is necessary to keep two separate funds for the accumulation and pay-out phases. That is, at time of retirement, the accumulated assets for each individual should be moved from the accumulation-phase fund (for the active contributors) into the de-accumulation-phase fund (for the retired beneficiaries). This separation is important for eliminating risk-sharing between active contributors and retirees considering potential risks associated with life annuities such as increased life expectancy. Such risks must be addresses separately, given EPF is a defined contribution scheme. However, the added layer of social pension, which is tax-funded, creates the cross-subsidization and solidarity between the working-age and those in retirement phase.

**It is recommended to have the pay-out phase managed by KWAP**, given its experience in running Malaysia’s pension system for the public sector (discussed next). It is to be highlighted that the option to outsource the pay-out phase to the private sector **should NOT be considered**, given the market distortion in the form of asymmetric information about actual life expectancy, which translates into a risk premium that makes the cost higher than a publicly pooled fund. Further, a centralized fund benefit from economies of scale and risk reduction that smaller private life annuity companies will not offer.

**Recommendation 4: Achieve cost-saving and efficient institutional arrangement consolidation while maintaining specialization and comparative advantages of key social old-age protection providers**



Along the consolidation of all social old-age assistance programs into SPF (recommendation 2) and creating the synergies within the contributory bodies (EPF and KWAP) and with SOAPF (recommendation 3), key institutional arrangements modification can result in a more cost effective management of the system while leveraging on the comparative advantage of each institution. It is to be noted that further in-depth analysis needed when it is operationalized. The following table summarize the modification proposed to achieve optimal mix and lean structure that is based on labor division and clear comparative advantages.

**Table 8: Social Old-Age Protection Providers' Refocused**

<b>Scheme</b>	<b>Focus Area</b>	<b>Modifications proposed</b>
1. EPF	Old-age protection	<ul style="list-style-type: none"> <li>- Contribution to account 2 (mortgage, health, tuition needs) is made optional</li> <li>- Mandatory contribution rate is reduced to cover only account 1 (account 1 is 20 percent, inclusive of the 2 percent solidarity fund).</li> <li>- New hires in civil service move to EPF.</li> <li>- De-accumulation phase (recommendation 3) is shifted to KWAP (if scenario two is selected)</li> <li>- Service delivery shifted to a Shared Service Center (see below)</li> </ul>
2. SOCSO	Work injury insurance; disability and survivorship insurance	<ul style="list-style-type: none"> <li>- Service delivery shifted to a Shared Service Center (see below)</li> </ul>
3. KWAP	Old-age protection	<ul style="list-style-type: none"> <li>- Manage the de-accumulation phase (recommendation 3 if scenario two is selected)</li> <li>- New hires in civil service move to EPF.</li> <li>- Service delivery shifted to a Shared Service Center (see below)</li> </ul>
4. SOAPF	Old-age protection	<ul style="list-style-type: none"> <li>- All social assistance schemes are consolidated and managed by a Shared Service Center (see below)</li> </ul>

5. Shared Service Center (SSC)	- One-stop-shop service delivery	<ul style="list-style-type: none"> <li>- Unification of all services provided by social protection providers into one-stop-shop service delivery</li> <li>- Unification of contribution collection and channeling them to designated purposes/schemes</li> <li>- Manage and maintain a unified data system based on MyKad</li> </ul>
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A more detailed discussion on key issues are below:

EPF's focus on old-age protection and contribution rate reduction

For EPF, it is recommended to be solely focused on the old-age protection. While there is a unified EPF contribution rate, EPF members can withdraw up to 30 percent of the total saving for mortgages, tuition assistance, or select health procedures. To accomplish EPF's focus on long-term protection, three measures are envisioned:

- First, the unified contribution rates for each account should be separated (e.g. around 16.1 percent for account 1 and 6.9 percent for account 2). But as a buffer, account 1 contribution rate can be set at 20 percent and account two is set at 3 percent.
- Second, the **contribution for account 2 should be made optional**. While this is a reduction of mandatory contribution rate, up to this point it **will NOT reduce saving for old-age protection**.
- Third, earmark 2 percent of the mandatory contribution rate from account 1 to the solidarity fund.

These three measures will achieve very important aspects, including:

1. The net change is **a reduction of the mandatory contribution rate** by 3 percent (from 23 percent to 20 percent). It is to be highlighted again that Malaysia's contribution rates are already relatively high compared to other countries (see figure 16), especially when considering that fact there is no ceiling on insurable earning. The Lowering the contribution rate will lower the cost of labor and increase Malaysia's competitiveness.
2. Lowered contribution rate will incentivize formality in the labor market and compliance. As noted in figure 14, contribution inactivity in EPF increases with age (for both sexes)- an unusual situation as generally understood that as age increases, especially for male labor force participants,

formality in labor market increase. Likely the high rates contribute to preference of informal arrangement and contractual agreements that are not mandated to pay EPF contributions.

3. Reduction in contribution rate can **neutralize the expected negative public reaction to proposed annuitization and increase in age of withdrawal (recommendation 3). With the introduction of social pension, the package is likely to be tilted towards favorable public reaction, which makes the proposal politically feasible if offered at once.**

Establish a Shared Service Center (SSC) for a unified service delivery (one-stop-shop) for all social protection benefits

Along the consolidation of all social old-age assistance programs into SOAPF (recommendation 1 and 2) and creating the synergies within the contributory bodies (EPF, SOCSO, and KWAP) and with SPF (recommendation 3), it is recommended to establish a Shared Service Center (SSC) as a 'one-stop-shop'. This one-stop-shop will serve the need of all social protection providers (SPF, EPF, SOCSO, KWAP) as the front-line service delivery to the public.

Unification of service delivery is practical and cost saving. As pointed out in recommendation 2, administration costs tend to accrue in absolute terms in social protection programs, which means a sufficiently large scheme usually exhibit relatively lower administration cost percentage as compared to a smaller scheme (Ortiz, Durán-Valverde, Pal, Behrendt, & Acuña-Ulate, 2017). Currently, while EPF and SOCSO serves the same population segment (formal labor force participants), each organization has physical branches staffed with professionals across Malaysia. Combining these offices will be a cost saving measure for both EPF and SOCSO, but also result is significant cost saving and convenience to the public.

In addition to serving the contributory bodies' need, these centers can also provide services to the consolidated social assistance programs, under SPF. This streamlining and simplification will further remove access barrier to information on entitlements, especially those with low education attainment, and will result in reduction in exclusion error associated with complex targeting programs where applicant for such programs must go from agency to agency undertaking parallel (and often duplicative) applications and

assessments. A unified SSC's e-portal can be created to provide a wide range of public services on behalf of SPF, EPF, SOCSO, and KWAP. The proposed SSC is recommended to be led by a managing director overseeing the day-to-day operations at a network of branches as well as the unified e-portal.

On important aspect, SSC will unify the criteria for covered wage and contribution between EPF and SOCSO. This will reduce the double burden on employers to meet separate requirements for accounting and remittance of contributions.

#### Establish a unified database system based on the unique MyKad national identification

As a consequence of fragmented social protection arrangements, a diverse and fragmented set of information management systems across many agencies proliferated in Malaysia to meet the specific needs of each program. To name a few: the e-kasih<sup>14</sup> database, the e-bantuan<sup>15</sup> database, the BR1M/BSH database, the EPF database, and SOCSO database. Running these parallel systems are costly and not necessarily producing the optimal data topography. With the newly established SSC, unification of databases becomes a natural parallel step.

In this effort, the use of Mykad as the base of unification across all programs including the social assistance is a key recommendation. MyKad's built-in chip allows to store and retrieve program specific data and link it to other biometric data already stored in. Given the simplified needs for the SPF as discussed earlier, MyKad provides age information necessary to identify beneficiaries and their dependents. Further, special eligibility criteria such as disability, orphanhoods, and dependents in day-care can be easily added to the bio-

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<sup>14</sup> The E-Kasih is an electronic national database of poor and vulnerable households established in 2007 by the Implementation Coordination Unit (ICU) of the Prime Minister's Office. It collects a sizable amount of information through a household survey of around 25 pages covering approximately the bottom 10 percent of the population

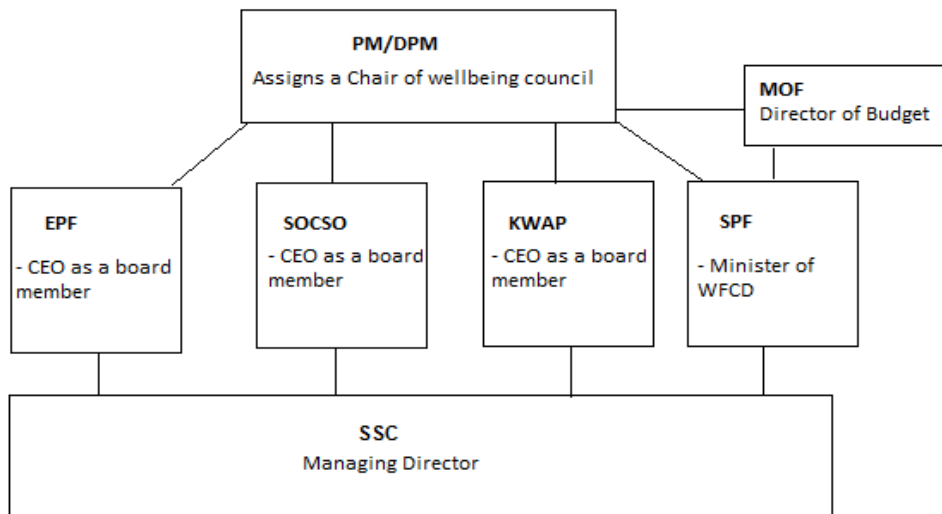
<sup>15</sup> The eBantuan is a registry used by the Welfare Department for its social assistance programs. Data collected through application are validated by social welfare officer, often through home visits and other sources.

data. Another key advantage is its functionality as a payment method (Touch n Go), which can **facilitate disbursement of benefits without the need to open a bank** account. Such simplicity will save banking fees for low income groups as well as achieved full reach in rural communities.

Establish a wellbeing council as a coordination mechanism across all providers

Building on earlier structural changes, a need for a coordination mechanism is highlighted. A council of wellbeing, chaired by PM or DPM with membership includes: Minister of WDCD (for SPF), CEO of EPF, CEO of SOCSO, and CEO of KWAP. Representative from MoF and the managing director of the SSC participate when is needed. The following figure illustrates the structure of the council of wellbeing.

**Figure 29: Wellbeing Council**



The main objective for the council of wellbeing is high level policy coordination for more coherence and timely response to changes and challenges while delivering social protection to citizens. As for the inception period, the council might task a committee to review relevant laws and policies to ensure accommodating policy environment to the recommendations made in this report. The council might establish a research center, or use existing center in Malaysia, to conduct evaluation and operational research to guide future improvement in the system.

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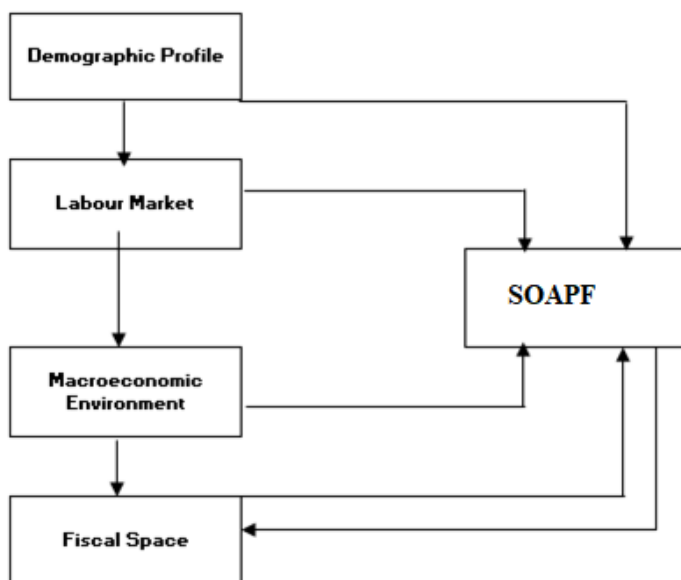
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## ANNEX: PROJECTION MODEL FOR SOAPF

### 1. Projection framework

The projection exercise is divided into two parts: First, projection of the underlying factors (demographic, labor force, and macroeconomic). Second, under a set of specified assumptions on the benefit parameters (eligibility conditions, coverage, benefit level etc., beneficiaries, benefit level, and overall costs are projected for 15 years i.e. till 2034. The linkages and dependency structure of the projection parts are illustrated in the following diagram.

**Figure 30:** Components of the Projection Model



### 2. Projection of the Determinants of SOAPF

#### Demographic model:

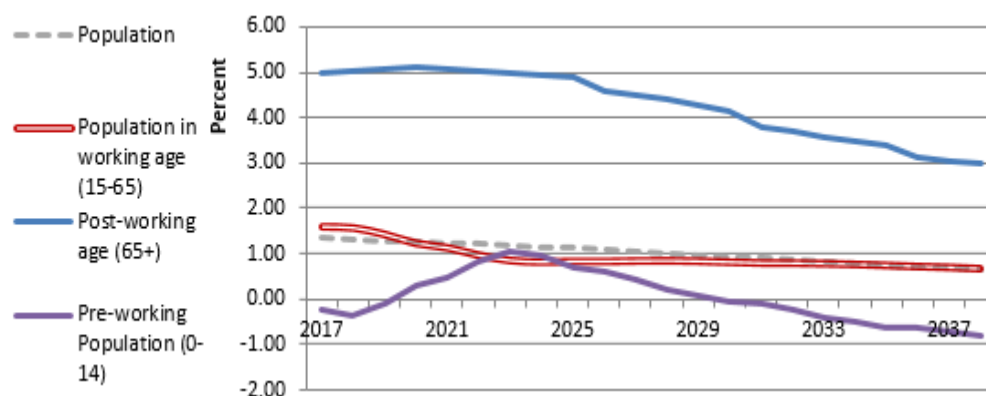
For the demographic projection, the study uses the medium-variant population projection made available by the United Nations Department of Economic and Social Affairs, Population Division (UN, 2019). The data set is disaggregated by sex and single-year age. The following table summarizes the population projection's main characteristics relevant to the study.

**Table 9:** Population Projection (Medium Variant) Main Characteristics, 2020-2034

	Thousands			
	2020	2024	2028	2034
Population	32,366	33,969	35,429	37,295
Pre-working age (0-14)	7,589	7,762	7,865	7,701
Working age (15-64)	22,661	23,637	24,490	25,737
Post-working age (65+)	2,324	2,812	3,342	4,158
	Percentage of Total Population			
Population	100.00	100.00	100.00	100.00
Pre-working age (0-14)	23.45	22.85	22.20	20.65
Working age (15-64)	70.01	69.58	69.12	69.01
Post-working age (65+)	7.18	8.28	9.43	11.15
	Dependency Ratio, Per cent			
Youth DR	33.5	32.8	32.1	29.9
Old-age DR	10.3	11.9	13.6	16.2
Total DR	43.7	44.7	45.8	46.1

Source: calculation is based on data from UN DESA (2019).

**Figure 31:** Population Growth Rates by Working Status, 2017 - 2037

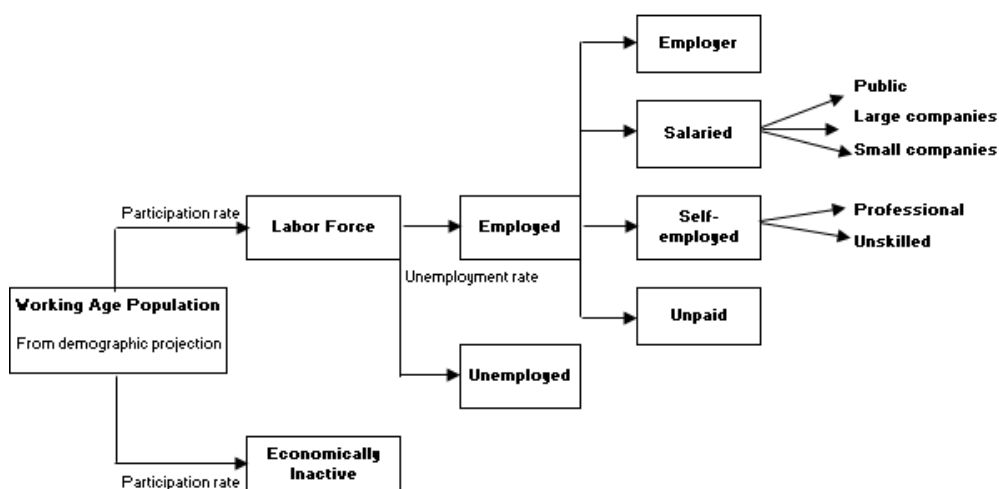


Source: Own calculation based on (UN, 2019)

## Labor Market Model:

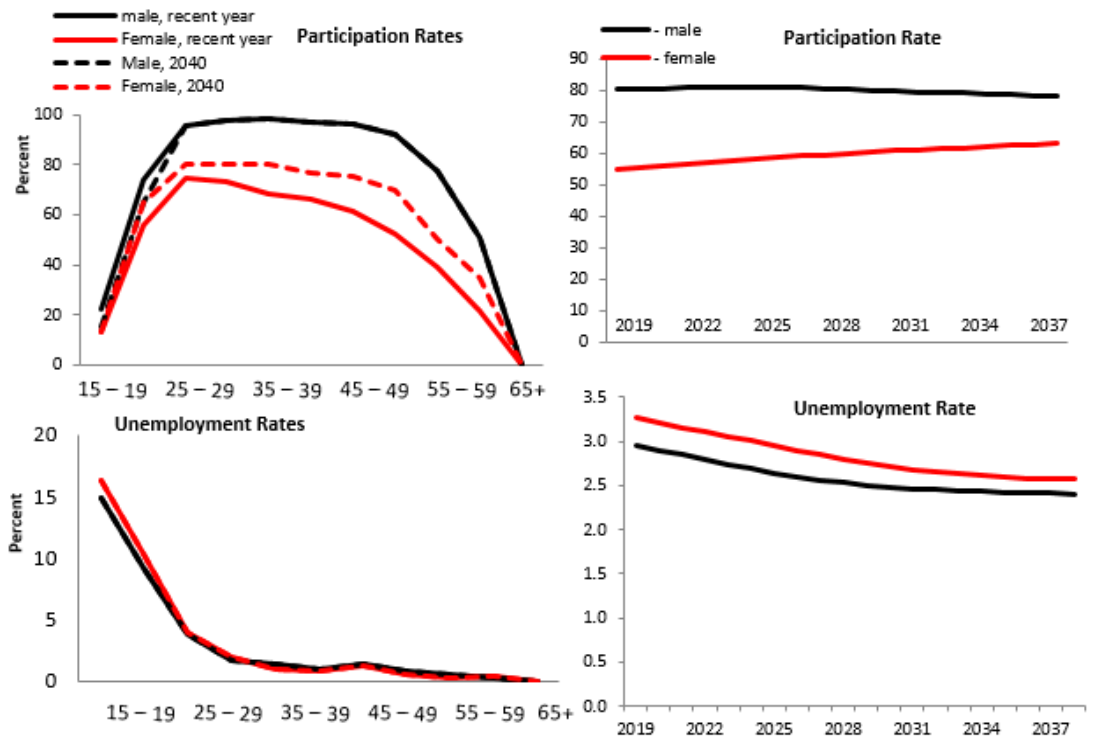
Labor market model is directly built on the population model. The following diagram presents the structural relationships that relate both models (the population model and the labor force model) for each year in the projection period and disaggregation by age and gender.

**Figure 32: Labor Market Model Overview**



Assumptions were made explicitly on participation rates and unemployment rates. For the participation rate, it is largely assumed that the force participation rates by age group of 2017 will stay the same over the projection period for the male working-age population. However, female participation rates are assumed to increase modestly in certain age groups as shown below. For the unemployment rate, it is assumed that age and gender-specific unemployment rates in 2017 are expected to remain the same over the projection period. The overall slight decrease in unemployment rate over the projection period is basically resulted from the change in the demographic structure of the underlying population.

**Figure 33: Labor Market Model's Projection: Unemployment and Participation Rates, by gender and Age-groups**



Applying age and gender-specific participation rates and unemployment rates on the working-age population (obtained from the population projection) for each year of the projection period produces the sought labor force disaggregated by age, gender, and working status (economically active, economically inactive, employed, and unemployed)..

**Table 10:** Summary of the Labor Force Main Projection Results, thousands, 2020-2034

000	Total			
	2020	2024	2028	2034
Working-age	22,661	23,637	24,490	25,737
Economically Active	15,415	16,380	17,176	18,195
Employed	14,941	15,909	16,711	17,730
Unemployed	474	471	464	464
Economically Inactive	7,229	7,248	7,289	7,493
	Male			
Working-age	11,698	12,186	12,605	13,235
Economically Active	9,379	9,825	10,164	10,554
Employed	9,100	9,553	9,899	10,296
Unemployed	278	272	265	259
Economically Inactive	2,302	2,351	2,415	2,631
	Female			
Working-age	10,963	11,451	11,885	12,502
Economically Active	6,037	6,555	7,012	7,640
Employed	5,840	6,356	6,812	7,435
Unemployed	196	199	199	206
Economically Inactive	4,927	4,896	4,874	4,862

Source: Calculation is based on (UN, 2019), (IMF, 2019), (Department of Statistics, 2011-2017) and model assumptions

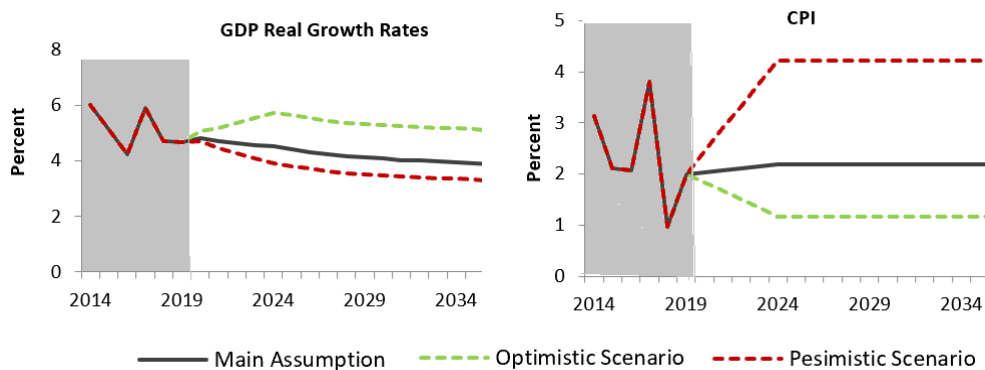
#### Macroeconomic Model:

The model is built on the neoclassical long-run path of economic growth, which decomposes growth into two components: the growth rate of the employed population and labor productivity (reflecting technological progress, human capital, and capital/labor ratio). The growth of employment is fed directly from the labor force model. Over the period of 2013-2018, labor productivity in Malaysia grew at an average annual rate of 3.28 percent. The study assumes that this rate will remain the same over the projection period. For the inflation rate (CPI), the average annual rate over the past 5 years, which was estimated at 2.86 percent, is expected to remain the same over the projection period. GDP deflator is linked to CPI and starting from 2028 the two rates are equated.

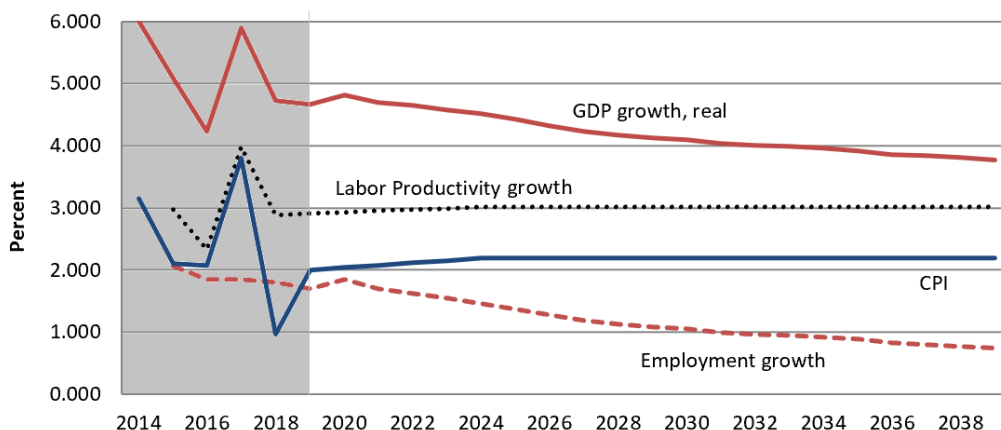
**Table 11:** Summary of Main Macroeconomic indicators, 2020-2034

Economic Indicators	2020	2024	2028	2034
GDP, current prices, billion RM	1,635,134	2,130,054	2,744,862	3,962,567
GDP per capita, current , RM	50,520	62,705	77,475	106,249
Inflation (CPI), percent	2.04	2.19	2.19	2.19
GDP growth, real	4.82	4.51	4.17	3.95
Labor productivity growth, percent	2.93	3.01	3.01	3.01

**Figure 34:** Projection Results: GDP Growth in Real Terms and CPI



**Figure 35:** Projection Results: Growth Rates

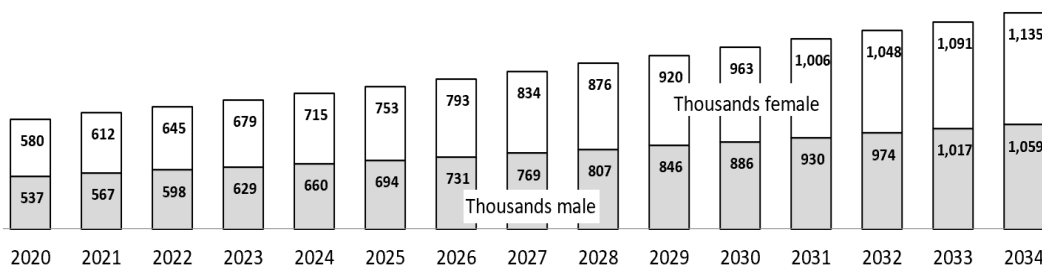




### 3. Projection of the SOAPF

The study proposes a coverage ratio of 80 percent of persons age 70 and above, which is consistent with programs similar to the proposed<sup>16</sup>. Applying this rate into the corresponding age groups that was already projected gives the specific program’s beneficiaries as shown in below graph.

**Figure 36:** Costing Results: Number Beneficiaries in thousands, 2020-2034



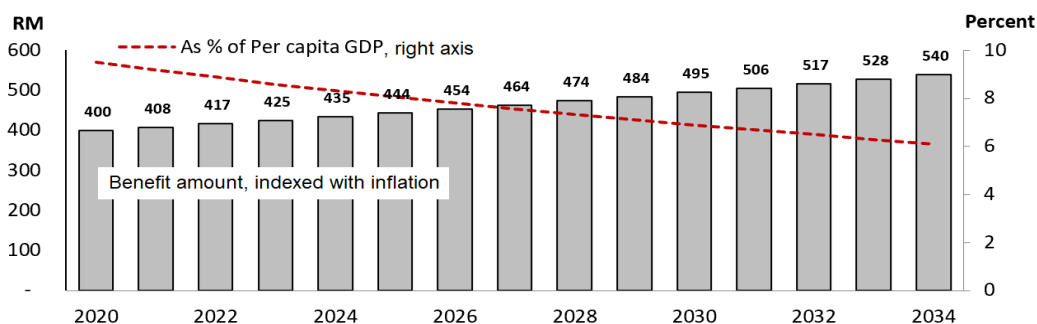
Source: Calculation is based on (UN, 2019), (IMF, 2019), (Department of Statistics, 2011-2017) and model assumptions

Over the projection period, benefits are assumed to maintain real value in RM (indexed with inflation). However, as the economy is expected to grow in real term, benefit level will decline in relative value over the projection period. At later stage, a periodic review of the real value of the benefit can be introduced to ensure coherence and relevance. Below figure traces the benefit level development over the projection period.

<sup>16</sup> These assumptions are meant as a starting point. They (and many other parameters eg benefit amount) can be changed in the costing tool and immediately one can see the cost implication of any change.

Note also that rates above are interpolated between the specified years

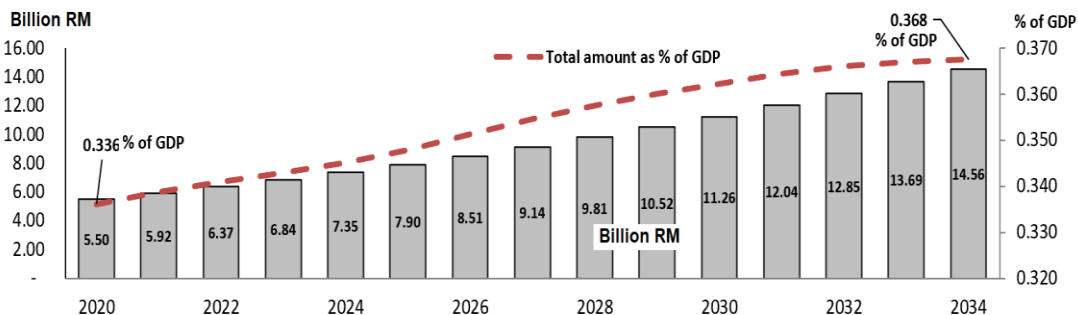
**Figure 37: Costing Results: Benefit Level in RM and as a percent of GDP per Capita**



2020			2021		2026		2031	
RM	% of National Poverty Line	% of GDP Per Capita	RM	% of GDP Per Capita	RM	% of GDP Per Capita	RM	% of GDP Per Capita
400	41.24	9.50	408	9.18	454	7.81	506	6.69

The total benefit amount spent is calculated as the product of the beneficiaries and the benefit amount for each year in the projection period. In line with evidence from international experience<sup>17</sup>, administrative cost is assumed at 2.5 per cent of the benefit amount. The following figure summarizes the overall cost expressed in RM, percentage of GDP, and percentage of Government expenditure.

**Figure 38: Total Expenditure of in Billion RM and as a percentage of GDP (right axes), 2020-2034**



<sup>17</sup> An ILO review across many countries found that administration cost averaged 2.5 percent of the total programme costs for universal schemes (Ortiz, Durán-Valverde, Pal, Behrendt, & Acuña-Ulate, 2017).



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