Creating more pathways to the middle class next step in Malaysias shared prosperity journey, World Bank says

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Malaysia Economic Monitor: Towards a Middle-Class Society
Malaysias economy is projected to grow by 5.7 percent in 2014 and 4.7 percent in 2015, with robust domestic growth, yet a less favorable external outlook, according to a new World Bank report. The Malaysia Economic Monitor, launched today, supports enlarging the middle class as critical to reducing income inequality and promoting shared prosperity in Malaysia.
"Malaysia has used its rich natural resources and high economic growth to lift millions of households out of absolute poverty," says Ulrich Zachau, World Bank Country Director for Malaysia. "It now has the opportunity to transform from a middle income country into a middle class society-fulfilling the aspirations of lower-income families and workers to join a dynamic, better educated, higher-earning middle class that is already becoming the engine of Malaysias economic growth."
Enlarging Malaysias middle class means creating pathways for an "aspirational group", families that are not poor or at a meaningful risk of falling into absolute poverty, but not sufficiently well-off to consider themselves "middle class". This group now comprises the majority (51 percent) of Malaysian society. Largely urban and with smaller families, many in the aspirational group are better educated and wealthier than poor and vulnerable households, but currently have neither the human nor financial capital to join and remain in the middle class. Most strikingly, only 16 percent of the aspirational group have post-secondary educations compared to 55 percent of the middle/upper-class group.
"Most higher-paying, middle-class jobs require a bachelors degree or at least a diploma," says Frederico Gil Sander, Senior Country Economist for Malaysia. "Expanding access to post-secondary education is therefore a cornerstone of creating pathways to the middle class."
Although some gaps between ethnic groups remain, income inequality within groups now explains over 95 percent of overall income inequality. Gaps in access to post-secondary education are also more pronounced between income groups. While the agenda of closing gaps between ethnic communities is not yet complete, broad policies such as boosting pre-primary enrolments and raising the quality of the poorest-performing schools, are likely to have the largest payoffs.
"Malaysia has been successful not only in stimulating the economy (with average GDP growth of 5.3 percent from 2011 to 2014), but also in boosting shared prosperity," said Minister in the Prime Ministers Department Dato Sri Wahid Omar. "All households experienced income growth, but growth was higher for those at the bottom. Moving forward, the Government will ensure such economic growth will translate into greater well-being for the people. This will be a key focus of the Eleventh Malaysia Plan."
Malaysia can also make fuller use of tax and transfers to reduce inequality, according to the report. Malaysias tax system has progressive features and Government transfers help reduce poverty-thanks to transfers, almost 50,000 households have been lifted from absolute poverty in 2014. However, the impact on inequality is small: In Malaysia, inequality of market incomes (as measured by the Gini index) is 0.43; after taxes and transfers it remains at 0.41. For OECD countries the inequality index after taxes and transfers is 0.32, 0.14 points less than the market based inequality index of 0.46. More progressive taxes, with higher tax rates for the upper income brackets, and more generous and targeted social safety nets can help reduce inequality further in Malaysin-while meeting fiscal objectives.
Low oil prices present a short-term positive but also a key risk to the outlook: Malaysia has taken advantage of low oil prices to eliminate fuel subsidies, a welcome step and a triple win: for the economy, as resources are freed up for more productive purposes; for equity, as regressive benefits are removed; and for the environment. In the short term, the fiscal impact is estimated at about 0.3 percent of GDP gain, assuming crude oil prices recover to USD 75 per barrel in 2015. However, if oil prices fail to recover or fall further, this poses significant risks. LNG prices are expected to fall in tandem with crude oil prices and the current account could narrow further. Moreover, losses in oil-related revenues could exceed savings from subsidy rationalization, and greater pressure on PETRONAS cash flows may lead to a meaningful slowdown in capital expenditures or a revision of its dividend policy.
The Malaysia Economic Monitor series provides an analytical perspective on the policy challenges facing Malaysia as it grows into a high-income economy. The series also represents an effort to reach out to a broad audience, including policymakers, private sector leaders, market participants, civil society, and academia.

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