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Pre-Budget 2016: Strengthening Growth, Enhancing Inclusiveness, Ensuring Fiscal Sustainability

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In a nutshell

- Budget 2016 will be tabled at a time of global economic uncertainty, with an uneven recovery in the United States (US) economy, a protracted moderation in China's economy which poses significant risk to Asian export-dependent countries as well as financial market jitters over the impending US interest rate hike. Volatile capital flows following a rush to secure US dollar-denominated assets have caused sharp gyrations in exchange rates, hurting business and consumer sentiment in Malaysia. At the same time, weak commodity prices have taken a toll on the ringgit, which has depreciated significantly against the greenback in the past several months. Plunging crude oil prices as well as crude palm oil (CPO) prices – despite a slight rebound recently – have dented business sentiment and trimmed overall government revenue.
- Based on the government's rhetoric, the focus of Budget 2016 will be on strengthening economic growth, ensuring fiscal consolidation and enhancing economic development inclusiveness to maximise the benefits of economic expansion to the *rakyat.* Strengthening economic growth is critical as Malaysia faces global headwinds amid decelerating growth in the Chinese and US economies. Weaker domestic activities as a result of languishing consumer spending and moderating investment activities will also complicate the task of achieving Malaysia's trend growth rate of 5% per annum (p.a.) and a budget deficit target of 3.2% of gross domestic product (GDP) in 2015.
- For Budget 2016, MARC feels that the government will have to address the issue of shrinking revenue as the entire impact of the 60% plunge in oil prices will be reflected in the government's full-year financial position. While government revenue has been growing at a compound annual growth rate (CAGR) of 8.4% post Global Financial Crisis (GFC), it will likely see a contraction in 2016 if crude oil and natural gas prices remain depressed. However, revenue from the Goods and Services Tax (GST), if it meets the government's forecast, may help reduce the fall in the overall government revenue in 2016. The challenge for the government, then, would be identifying expenditure cuts to avoid derailing fiscal consolidation efforts in place until 2020.
- While slowing GDP growth momentum calls for less restrictive fiscal measures, overall efforts to consolidate the government's financial position should be continued and emphasised in order to maintain the country's sovereign rating. While an international rating agency has recently revised its outlook on Malaysia's sovereign rating to "Stable" from "Negative", the government should continue to undertake budget-strengthening measures in order to meet its target of balancing the budget by 2020. In particular, addressing the problem of "leakages" as highlighted every year in the Auditor-General's annual reports should be continued.
- With inclusiveness a key priority, we believe the Budget should continue to focus on alleviating the financial burden on the middle- and lower-income group by addressing the rising cost of living which continues to accelerate despite meager increases in consumer and home prices in recent times. In particular, the implementation of GST in April 2015 and continued subsidy rationalisation have exerted upward pressure on the cost of living. Despite the moderation in residential home prices in recent quarters (Malaysian House Price Index or MHPI 1Q2015: 4.1%, 2014: 10.7%), prices remain elevated and continue to hurt consumers' pockets. As such, efforts to increase supply of affordable homes under various government programmes should be accelerated. In relation to this, MARC notes that while information on current launches, take-up rates and future plans are available, there have been limited updates on the status of completion of these programmes, raising concerns on the speed of their implementation.
- In dealing with high property prices, additional measures should be imposed on top of the measures already implemented by Bank Negara Malaysia (BNM). For instance, measures to increase the stamp duty rate for third properties onwards could further reduce speculative activities. At the same time, the government could also consider reviewing property developers' practice of giving "rebates" that essentially enable buyers to secure properties with 100% financing. Such incentive schemes, while helping home buyers with their downpayments, will cause home prices to rise at a more rapid pace as the cost of the rebates are normally factored in the selling price of the property.
- MARC applauds efforts by various authorities to minimise risks posed by high household debt. Measures such as more stringent loan application procedures and lower loan-to-value (LTV) ratio limit have to some extent reduced the pace of increase in household debt. A possible long-term measure to address household indebtedness is to provide, and perhaps make mandatory, more robust education on financial planning for the younger generation. While presently some higher learning institutions provide such courses, they are not compulsory.

- We note that basic medical expenses now constitute a large part of individuals' expenses. With the cost of healthcare in Malaysia rapidly increasing, we are of the view that all medicines should be classified as zero-rated products. While the list of medicines classified as zero-rated has been expanded from 2,900 to more than 4,000, most of these medicines are actually the same drug, with the difference being the manufacturer and/or dosage size, according to the Pharmaceutical Association of Malaysia (PhAMA). As such, the list does not include some of the new drugs used to treat critical illnesses. The association estimates that with the implementation of GST, total expenditure on medication per year will increase by RM180 million. Therefore, classifying all medicines as GST zero-rated goods will help the man on the street cope with the basic cost of healthcare and higher cost of living. Such a measure will be in line with the government's aspiration to ensure the implementation of GST does not burden the middle- and lower-income group.
- On the bond market, as mentioned in our previous pre-Budget reports, MARC continues to feel that a more liquid secondary market is needed to reduce liquidity risk premiums, which would in turn encourage issuers of bonds rated A and below to enter the primary market. This would help address the lackluster bond origination activity in this segment. We are also of the view that the government should allocate funds to invest in investment-grade bonds that are rated A and below. A fund management unit can also be set up to manage the fund and be monitored by government institutions with a proven track record such as Khazanah Nasional Berhad.
- MARC concurs with the government's view that there is a need to further promote retail participation in the bond market. Aside from foreign investors, the Malaysian local bond market is dominated by big pension funds, insurance companies and financial institutions. In view of this and the fact that bonds are relatively safer investments than equity, efforts to promote retail participation should be continued. On this note, we welcomed the government's initiatives in Budget 2015 to facilitate retail participation by proposing that Malaysian Government Securities (MGS) and Government Investment Issues (GII) be listed and traded on Exchange-Traded Bond and Sukuk (ETBS). However, we have not seen any significant developments since the announcement. We hope the government can accelerate the development of these products and provide more clarity and progress updates in the coming Budget 2016.
- MARC is of the view that the rising cost of living and increasing operating government expenditures in the past several years call for further long-term measures, including a more comprehensive financial safety net for the *rakyat*. Rapid increases in medical costs, for instance, burden not only the *rakyat* but also put a strain on the government's healthcare expenditure in the long run. Therefore, efforts such as raising the penetration rate of medical insurance will benefit both parties as has been seen in many advanced countries. This can be done by, say, allowing members to withdraw from the Employees Provident Fund (EPF) to purchase medical protection after they are no longer covered by employee medical benefits. Alternatively, a small proportion of the funds allocated for the 1Malaysia People's Aid (BR1M) can also be used to purchase medical insurance. This would enable Malaysians to save on medical costs during their golden years and help ease the government's increasing medical expenditure in the future. If the government allows EPF withdrawals for investment in unit trusts (under the current ruling), we do not see any compelling reason why withdrawals are not allowed for the purpose of purchasing medical insurance which would undoubtedly benefit the *rakyat* and the government in the future. In addition, many medical coverage plans have investment elements attached to them (unit-linked insurance) which provide some returns to policyholders.
- Another way of providing a financial safety net is through an unemployment insurance scheme which had been partially discussed in Budget 2015. In the US, unemployment insurance has benefitted workers who have lost their jobs due to retrenchment. In Malaysia, however, such a comprehensive scheme has yet to be developed, although there was a brief description of an Employment Insurance System to provide retrenched workers with financial aid in Budget 2015. MARC is of the view that such an insurance scheme would not burden the government as it only involves a very small contribution that can be absorbed by both employers and employees. As such, a comprehensive framework should be developed for such insurance schemes.

Economic Conditions Surrounding Budget 2016

Budget 2016 will be tabled at a time of global economic uncertainty, with an uneven recovery in the US economy, a protracted moderation in China's economy which poses significant risk to Asian export-dependent countries as well as financial market jitters over the impending US interest rate hike. Weaker growth in the emerging economies has also exerted pressure on international trade and led to sluggish export performance for Malaysia in the first eight months of 2015. Volatile capital flows following a rush to secure US dollar-denominated assets have caused sharp gyrations in exchange rates, hurting business and consumer sentiment in Malaysia. At the same time, weak commodity prices have taken a toll on the ringgit, which has depreciated significantly against the greenback in the past few months (Year-to-date, or YTD: -20.4%). Plunging crude oil prices as well as CPO prices – despite a slight rebound recently – have dented business sentiment and trimmed overall government revenue.

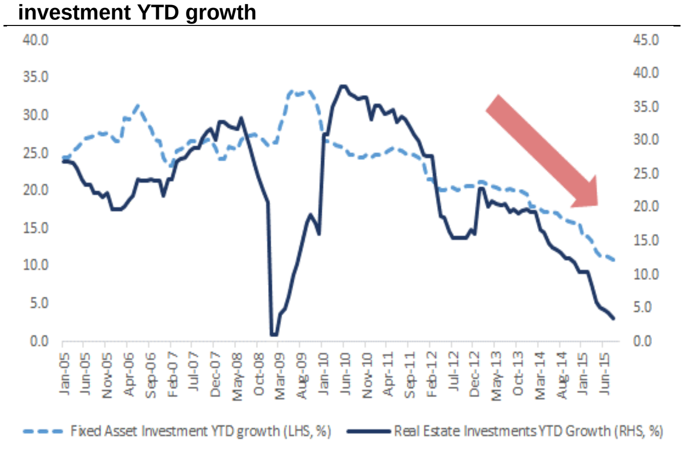
Based on the government's rhetoric, the focus of Budget 2016 will be on strengthening economic growth, ensuring fiscal consolidation and enhancing economic development inclusiveness to maximise the benefits of economic expansion to the *rakyat*

A more challenging global economic environment

The Malaysian economy will continue to face headwinds from waning global economic momentum that has led to weak commodity prices and affected external trade performance as well as domestic demand. Global crude oil and CPO prices will be key determinants of Malaysia's external trade performance, a crucial support for headline growth. We foresee the 2H2015 GDP performance to be weaker than the first half of the year judging by the momentum of the export sector and private consumption and investment. Externally, there is still a risk of global crude oil prices remaining depressed based on expected supply/demand conditions, although the recent recovery sparks some hope that the price is now nearing its bottom.

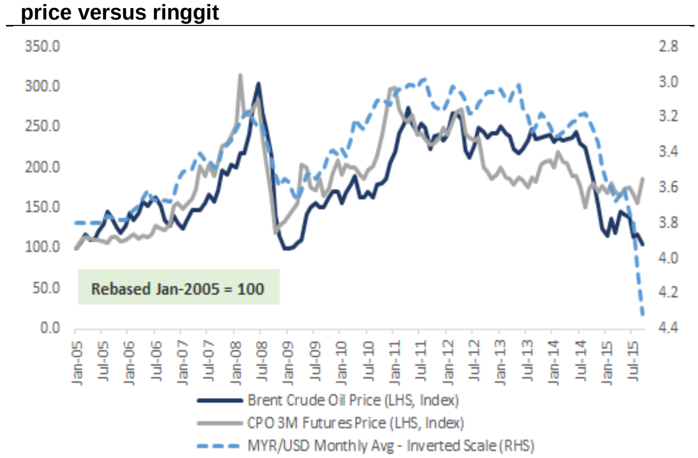
Malaysia's economic prospects are clouded by China's shaky economy amid a growth slowdown in fixed asset investments (11% in the first eight months, the slowest in 15 years) and real estate investments (a mere 3.5% growth in the first eight months), slumping equity prices (-40% from mid-June peak) and ballooning debt (corporate and household debt at 207% of GDP). While measures such as five interest rate cuts, reductions in reserve ratios and a 3.5% devaluation of the yuan in August have slowed the pace of deceleration in the economy, there remains a possibility that China will miss its 7% growth target for this year. In addition, China has adopted a very cautious approach in fiscal policy expansion in order to avoid creating further economic imbalance. This will put a toll on Malaysian exports to China, which accounts for 13% of its overall exports.

Chart 1: China's fixed asset investment and real estate investment YTD growth



Source: CEIC, MARC Economic Research.

Chart 2: Brent crude oil price and crude palm oil 3-month futures price versus ringgit

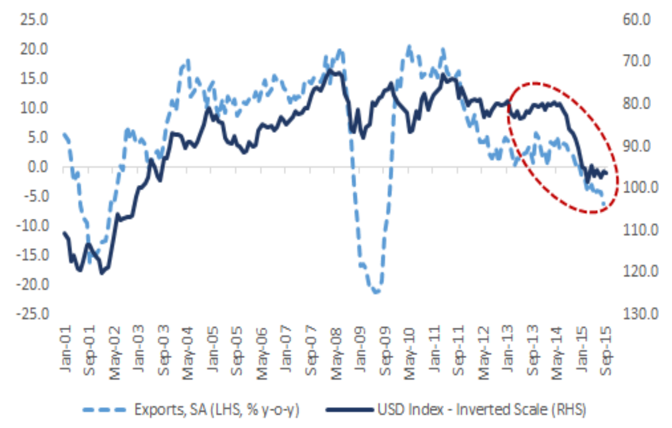


Source: Bloomberg, CEIC, MARC Economic Research.

The US – another important export market for Malaysia– is also facing its own challenges, despite a robust labour market in the past one year (non-farm payrolls, or NFP, averaged 198K per month YTD). The rise in NFP has slowed to 136K and 142K in the last two months, raising questions on the sustainability of its growth momentum in the near term. Personal consumption expenditure (PCE) inflation remains tepid (0.3% in the 12 months through August 2015) and exports are now being challenged by the strength of the USD, which benefitted from capital inflows following the prospects of an imminent rise in interest rates. As of end-September, the USD has strengthened by 6.7% against the basket of six major currencies since the end of last year, and was up by 12.1% from a year earlier.

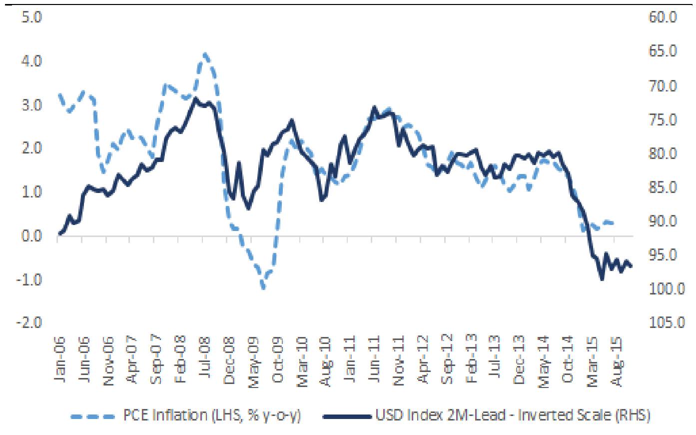
All these will have an important bearing on trade-dependent economies like Malaysia.

Chart 3: US exports and USD index



Source: Bloomberg, CEIC, MARC Economic Research.

Chart 4: US PCE inflation and USD index, 2-month lead



Source: Bloomberg, CEIC, MARC Economic Research.

Slowing domestic economy

The moderation in domestic demand, although not as sharp as predicted, is evidenced by the slower pace of private consumption and private investment in 2Q2015 after a brief spurt in spending in the run-up to the GST implementation in April 2015. While headline consumer price inflation has been more moderate than expected following several cuts in pump prices since late last year (December 2014 to February 2015 and August 2015 to September 2015), the rising cost of living continues to squeeze consumer spending. In particular, home prices remain elevated, although the pace of growth has moderated in recent quarters.

A breakdown of consumer price index (CPI) components also reveals that while headline inflation was dragged down by lower transportation costs on a decline in pump prices, other components experienced stronger growth across the board, suggesting that consumers will likely continue to tighten their belts going forward. Notable increases were seen in the health sub-component, particularly in other medical products (6.3%), pharmaceutical products (6.0%), and medical products, appliances and equipment (5.3%) in the past five months post-GST. Rising import prices on the back of a significantly lower ringgit (-20.4% YTD against the USD) is also discouraging consumers from purchasing imported goods.

The pace of investments also languished in 2Q2015 amid global economic uncertainty. Of concern is the pace of private investment growth which decelerated to 3.9% in 2Q2015 from 11.7% in 1Q2015, pulling the overall gross fixed capital formation (GFCF) growth down to 0.5%. A notable decline was seen in the pace of investments in machinery and equipment which contracted by a sharp 7.5% in 2Q2015 (1Q2015: +5.8%).

Critical issues facing the government and *rakyat*

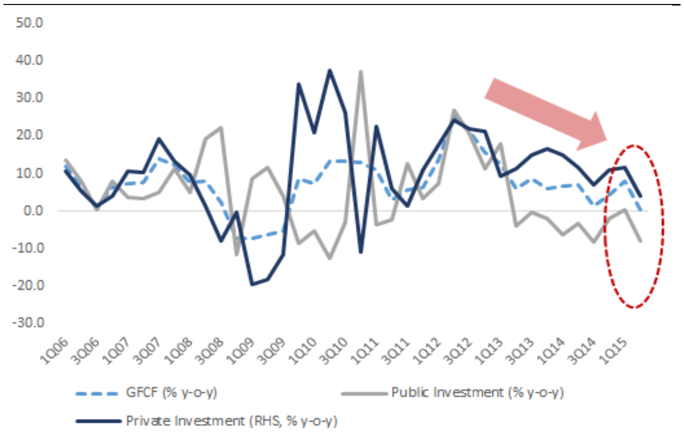
The government has identified several critical issues that need to be dealt with in the near term: supporting economic growth amid global and domestic headwinds, consolidating its fiscal position and ensuring inclusive economic growth with a focus on reducing the impact of the rising cost of living.

- ***To support economic growth in the face of global headwinds***

  As mentioned in our previous budget reports, sustaining GDP growth at a respectable pace is needed to offset the impact of other pressing macro issues such as moderating pace of private consumption, declining revenue growth and high government debt level. Anecdotally, the labour market and investment momentum move in line with headline growth. The increasing number of layoffs announced by companies in different sectors (namely oil & gas, airline, banking) suggests that the overall growth momentum has been on a downtrend. With real GDP growth set to come under pressure in 2016, more measures – both from the fiscal and monetary sides – are needed to support the overall economy. This, of course, comes with challenges as Malaysia is in a fiscally tight position while the monetary policy is constrained by high household debt.

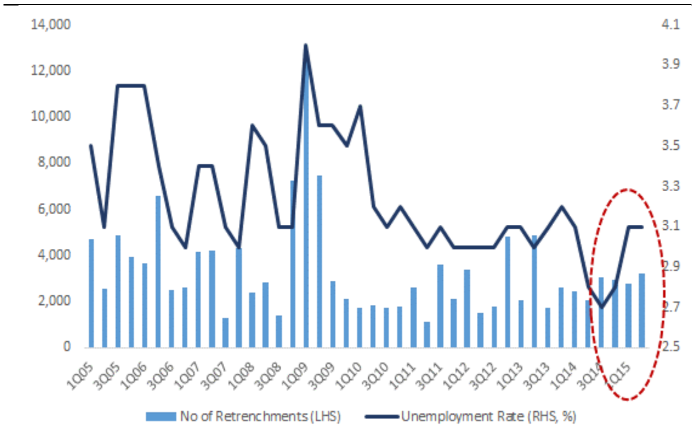
  Another issue is Malaysia's nominal GDP, which has not been as robust as in previous recovery cycles despite the relatively decent headline real GDP growth. This is of concern because the government's fiscal health is largely dependent on tax revenue which hinges on the health of the economy, while its ability to improve its debt position will also depend on nominal GDP growth.

Chart 5: Investment growth – public and private investment



Source: CEIC, MARC Economic Research.

Chart 6: Number of retrenchments and unemployment rate



Source: CEIC, MARC Economic Research.

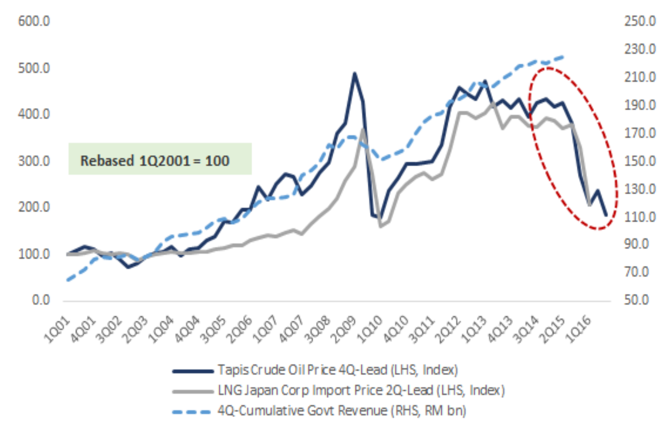
- ***To deal with the impact of lower oil revenue on government coffers***

  Government revenue will most likely be lower in 2016 as the entire impact of the 60% plunge in oil prices will be reflected in the government's full-year financial position. Based on the expected average Tapis price of USD55-65 per barrel between 2H2015 and 1H2016 as well as the natural gas price of USD7-12 per million British Thermal Unit (MMbtu) within the same period, historical correlation suggests that the government revenue could moderate to slightly below RM200 billion. Notwithstanding this, GST revenue, if it meets the government's forecast, may help reduce the drop in the overall government revenue in 2016. The challenge for the government, then, would be identifying expenditure cuts to avoid derailing fiscal consolidation efforts in place until 2020.

- ***To ensure a continuous effort on fiscal consolidation amid lower revenue***

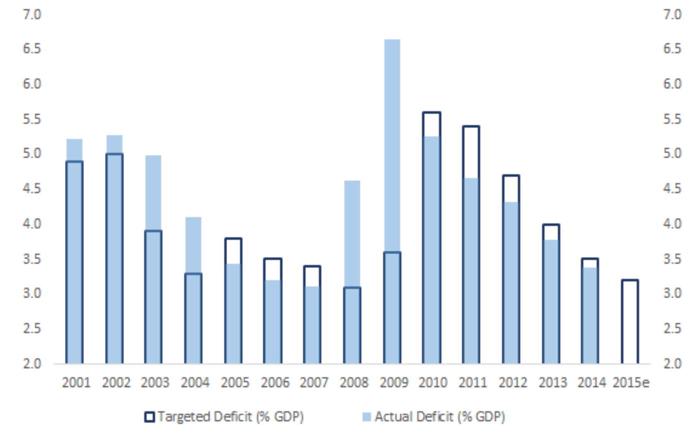
While slowing GDP growth momentum calls for less restrictive fiscal measures, overall efforts to consolidate the government's financial position should be continued and emphasised in order to maintain the country's sovereign rating. While an international rating agency has recently revised its outlook on Malaysia's sovereign rating to "Stable" from "Negative", the government should continue to undertake budget-strengthening measures in order to meet its target of balancing the budget by 2020. In particular, addressing the problem of "leakages" as highlighted every year in the Auditor-General's annual reports should be continued.

Chart 7: Tapis crude oil price and LNG Corp Japan Import price versus 4Q cumulative government revenue



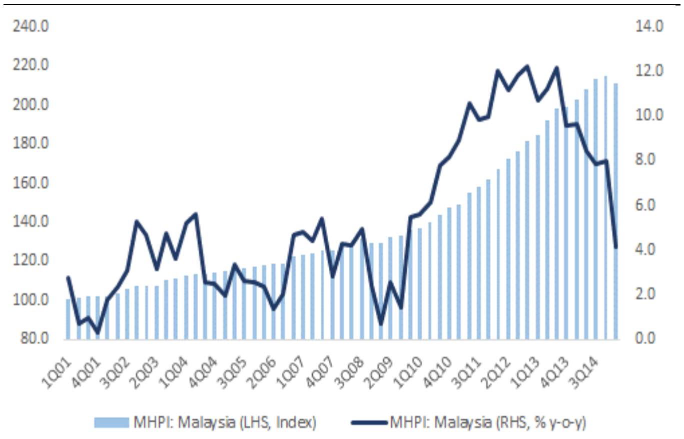
Source: Bloomberg, CEIC, MARC Economic Research.

Chart 8: Actual versus targeted fiscal deficit



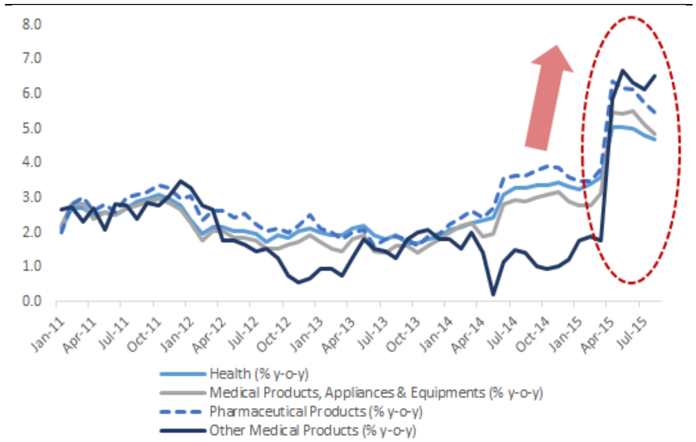
Source: MoF, CEIC, MARC Economic Research.

Chart 9: MHPI index and growth



Source: CEIC, MARC Economic Research.

Chart 10: Healthcare price and selected breakdowns



Source: CEIC, MARC Economic Research.

- ***To continue addressing the issue of rising cost of living***

With inclusiveness a key priority, we believe the Budget should continue to focus on alleviating the financial burden of the middle- and lower-income group by addressing the rising cost of living which continues to accelerate despite meager increases in consumer and asset prices in recent times. In particular, the implementation of GST in April 2015 and continued subsidy rationalisation have exerted upward pressure on the cost of living. Despite the moderation in residential home prices in recent quarters (1Q2015: 4.1%, 2014: 10.7%), prices remain elevated and continue to hurt consumers' pockets. As such, efforts to increase supply of affordable homes under various government programmes should be accelerated.

- ***To craft a long-term financial safety net plan for rakyat***

MARC is of the view that the rising cost of living and increasing operating government expenditures in the past several years call for further long-term measures, including a more comprehensive financial safety net for the *rakyat*. Rapid increases in medical costs, for instance, burden not only the *rakyat* but also put a strain on the government's healthcare expenditure in the long run. Therefore, efforts such as raising the penetration rate of medical insurance will benefit both parties as has been seen in many advanced countries. It will also benefit both the *rakyat* and the government in the long term as new generation insurance products also act as investment tools.

Our Budget Wish List

- ***Include all medicines in the list of zero-rated products***

Depending on the amount of revenue generated from the GST, the number of goods classified as "zero-rated" or "exempted" will likely be changed from time to time. With the cost of healthcare in Malaysia rapidly increasing (4.9% between April and August 2015), we are of the view that all medicines should be classified as zero-rated products. While the list of medicines classified as zero-rated has been expanded from 2,900 to more than 4,000, most of these medicines are actually the same drug, with the difference being the manufacturer and/or dosage size, according to the PhAMA. As such, the list does not include some of the new drugs used to treat critical illnesses. The association estimates that with the implementation of GST, total expenditure on medication per year will increase by RM180 million. Therefore, classifying all medicines as GST zero-rated goods will help the man on the street cope with the basic cost of healthcare and higher cost of living. Such a measure will be in line with the government's aspiration to ensure the implementation of GST does not burden the middle- and lower-income group.

- ***Make BR1M conditional***

As the amount of BR1M is expected to increase in the near term, MARC is of the view that the allocation should be provided using vouchers for foodstuff and other basic necessities rather than through cash distributions. Alternatively, the government could implement a system where the MyKad can be used to purchase basic items at major grocery stores. It could also implement a system which will allow school children to utilise the money allocated, say, on a monthly basis, for purchasing food at schools. The advantages of such systems include: (1) preventing any misallocation of cash; (2) preventing purchases of non-essential consumer goods such as tobacco and alcohol; (3) encouraging higher school attendance.

- ***Higher stamp duty on third properties onwards***

The first two properties owned by an individual are normally for his or her own use. As such, the current structure of stamp duty charged on the purchases of these properties looks appropriate. However, additional properties purchased by an individual may be meant for investments. Rising residential property prices in the past several years have driven speculative activity in the market, resulting in a vicious cycle of further price increases and speculation. While BNM has implemented several measures to curb speculation in the property market, we feel that additional measures are needed to prevent further excessive price inflation, especially through an increase in stamp duties. We view the National House Buyers Association's (HBA) proposed imposition of a flat rate stamp duty of 5% or more on the property value for third properties and above as appropriate.

- ***Review the practice of giving "rebates" by property developers to home buyers***

With home prices remaining elevated, albeit growing at a slower pace than in recent years (MHPI 1Q2015: 4.1% versus 2014: 10.7%), many property developers are offering incentives in the form of rebates of up to 10% of the property price to buyers, essentially enabling them to buy properties with 100% financing. While this helps home buyers with their downpayments, it also contributes to the price hikes as the cost of the rebates are normally factored in the selling price of the property. Such incentive schemes also undermine BNM's efforts to reduce household debt, which is dominated by home mortgages (30% of total loans). As such, we feel that such practices by developers should be reviewed.

- ***Updates on various housing schemes***

  There is a need to update the status of several programmes (especially on the rate of completion) implemented to increase the access to affordable housing in the past few years. Among them are: (1) 1Malaysia People's Housing (PR1MA), which focuses on the household income group of between RM2,500 and RM10,000 per month; (2) My First Home Scheme (SRP) which was introduced in Budget 2011 to assist young adults earning RM5,000 per month or less to own their first home through a 100% financing scheme; (3) 1Malaysia People-Friendly Home (RMR1M) programme introduced in Budget 2012 to assist those with household income of RM3,000 per month and below to purchase affordable homes and; (4) Youth Housing Scheme introduced in Budget 2015 for married youth aged 25 to 40 with a household income not exceeding RM10,000.

  While information on current launches, take-up rates and future plans are available, there have been limited updates on the status of completion of these programmes, raising concerns on the speed of their implementation. There is also still some confusion on the differences between the programmes. Consolidating the federal agencies that provide affordable housing (i.e. PR1MA, Syarikat Perumahan Negara Berhad or SPNB) would be ideal in creating a one-stop centre for information relating to various government housing programmes.

- ***Greater disclosure on contingent liabilities***

  Clouding the assessment of Malaysia's debt position is the amount of contingent liabilities. While the government provides statistics on the overall amount through an item categorised as 'government guarantees', greater disclosure on the breakdown of contingent liabilities, such as what would be included or excluded from this item category, would improve transparency, which would be positive from the perspective of international credit rating agencies.

- ***Increase liquidity for bonds rated single A and below***

  We have often highlighted the problem of the illiquid secondary market for papers rated A and below. With the implementation of the Liquidity Coverage Ratio (LCR), we are concerned that its impact on market-making activities could worsen the already poor liquidity of the secondary local private debt securities (PDS) market. The deteriorating market liquidity, particularly for bonds rated A and below, could deter corporates from raising funds through the bond market, which could pose a potential threat to the country's economic growth. To address this, we propose that the government allocate a certain amount (e.g. RM 1.5 billion, which is approximately 10% of outstanding bonds rated A and below) to set up a fund management unit to invest in this bond category. Alternatively, the government could place the funds with existing asset management companies with specified investment objectives to encourage more active trading in lower-rated bonds which provide higher returns.

- ***Enhance retail participation in the local bond market***

  Aside from foreign investors, the local bond market is dominated by big pension funds, insurance companies and financial institutions. In view of this and the fact that bonds are generally safer investments than equity, efforts to promote retail participation should be actively continued. On this note, we welcomed the government's initiatives in Budget 2015 to facilitate retail participation by proposing that MGS and GII be listed and traded on ETBS. That said, we have not seen any significant developments since the announcement. We hope the government can accelerate the development of these products and provide more clarity and information on the progress it has made in the coming Budget 2016. Besides this, we also feel that there should also be more initiatives to educate retail investors about the risks and advantages of investing in bonds.

- ***Encourage new entrants into bond pricing market***

  Making proper assessments on prices of bonds is critical to market players. Currently, Bond Pricing Agency Malaysia (BPAM) is the only local company that provides daily mark-to-market / mark-to-model bond pricing services. Given that information provided by a bond pricing agency (on prices and yield-to-maturity or YTM data) are widely used by bond investors for profit and loss (P&L) valuations and internal risk control, we hope the government can offer incentives to encourage new entrants into the bond pricing business to improve pricing quality, in particular those derived from mathematical models and less liquid bonds.

- ***Encourage long-term investments through education in financial planning***

  MARC applauds efforts by various authorities to minimise risks posed by high household debt. Measures such as more stringent loan application procedures and lower LTV ratio limit have to some extent reduced the pace of increase in household debt. A possible long-term measure to address household indebtedness is to provide, and perhaps make mandatory, more robust education on financial planning for the younger generation. While presently some higher learning institutions provide such courses, they are not compulsory. As such, not many are aware of the risks of being financially over-leveraged. This has partly caused a steep rise in the number of bankruptcies among young people.

- ***Encourage rakyat to build future financial safety net through:***

  Increase penetration rate of life insurance products

  Life insurance take-up rates are still relatively low in Malaysia (less than 60%) as compared with other similarly developed countries. Notwithstanding this, the industry's prospects are encouraging judging by the growth in premiums in recent years. In 2014, the industry recorded a 6.9% growth year-on-year in insurance coverage, while total new premiums in the life sector grew by 9.6% in 2014 to RM8.95 billion. As life insurance is a critical component of individuals' financial safety net, more efforts should be undertaken to increase its take-up rate. This can be done through (1) improving the productivity of life insurance agents by providing support such as training and professional development; and (2) implementing more programmes to educate consumers on the benefits of insurance and the advantages of purchasing insurance at a young and healthy age.

  Increase medical insurance coverage

  As for medical insurance, we would like to highlight again that the cost of healthcare has been increasing every year at a CAGR of 4.8% since 2012. The imposition of GST has further increased healthcare costs, increasing the burden on the *rakyat* especially those who are retired and no longer covered by their employees' medical insurance. Admittedly, the government already heavily subsidises medical costs for the *rakyat*. However, it would be best to assist the *rakyat* to be more prepared for the increase in medical costs during their golden years by allowing them to purchase some kind of medical protection using their EPF funds and from the BR1M granted to them every year. In the longer term, this will enable Malaysians to save on medical costs during their golden years and at the same time help reduce the high medical expenses for the government in the future years.

  Unemployment insurance

  In view of the increasing global economic uncertainty, which to some extent affect the domestic economy, more safety nets are needed for those who are retrenched from their jobs. In the US, unemployment insurance has benefitted workers who have lost their jobs due to retrenchment. In Malaysia, however, such a comprehensive scheme has yet to be developed, although there was a brief description of an Employment Insurance System to provide retrenched workers with financial aid in Budget 2015. MARC is of the view that such an insurance scheme would not burden the government as it only involves a very small contribution that can be absorbed by both employers and employees. In addition, a US-modelled unemployment insurance system based on the concept of 'experience rating' can be adopted to avoid inefficiencies. The system involves a contribution rate that is firm-specific and will reflect the employee's layoff history (i.e. firms pay higher or lower taxes based on the employee's past employment records). This is to avoid moral hazard and to ensure adequate financing of the unemployment system.

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