# Chapter 7

# Social Protection in Malaysia – Current State and Challenges Towards Practical and Sustainable Social Protection in East Asia: A Compassionate Community

**Ong Fong Sim**
Universiti Tun Abdul Razak

**Tengku Aizan Hamid**
Universiti Putra Malaysia

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# CHAPTER 7

# Social Protection in Malaysia - Current State and Challenges

## Towards Practical and Sustainable Social Protection in East Asia: A Compassionate Community

**PROFESSOR DR. ONG FON SIM**
Universiti Tun Abdul Razak

**DR. TENGKU AIZAN HAMID**
Associate Professor - Universiti Putra Malaysia

# 1. Introduction

The past economic success of Malaysia has fallen into the middle-income trap. The pressure is for Malaysia to move upwards to become a high income country by 2020. Coupled with this pressure is the global economic recession. Like many other countries, Malaysia has introduced/ implemented stimulus packages to ride out the crisis. However, the impact of the present crisis may still be felt long after the recovery in that such measures may constrain future fiscal flexibility, since the resulting future budgets will need to be financed (Asher, 2009). The Malaysian government has recently announced a deficit at 5.6 per cent of GDP for its 2010 Budget, compared with 7.4 per cent in 2009. The budget deficit has multiple objectives; but stimulating the economy remains the most immediate and urgent task whilst providing and facilitating savings for consumption smoothing are also given due attention. The need for social protection is congruent with national and societal development because the experiences of countries successful in economic, political and social terms has shown that economic development and social protection are mutually reinforcing (Garcia and Gruat, 2003). More so, the strategies for closing the coverage gap in social protection should be regarded as one of the strategies to move Malaysia towards a high income country.

With population aging, countries around the world are re-examining their systems of social protection, with many already putting reforms in place. According to Asher and Nandy (2006), globalization has made safety nets even more essential for three reasons: (1) cushioning the burden of restructuring; (2) increasing legitimacy of reforms; and (3) enabling risk taking by individuals and firms by providing a floor level income in the event that risk taking ventures fail to materialise. More importantly, an improved coverage will foster social cohesion and sustainable economic development.

### 1.1. Overview of Demographic Profile

Malaysia is a multi-ethnic country with a population of 27.7 million in 2008 (Department of Statistics, 2009), made up of three major ethnic groups - the Malays, Chinese and Indians. Malaysia is classified as a medium income country with PPP per capita GDP of USD 14,081 in 2008 (IMF, 2009). Although Malaysia is not currently an aged society, the proportion of the older population (defined as 60 years or older) is forecast to reach 9.9% by 2020. According to Kinsella and Wan (2009, p. 13), Malaysia's aged population will increase by 269% between 2008 and 2040, ranking it the fourth fastest aging nation after Singapore, Colombia and India respectively.

Malaysia still has time since the older population aged 60 years and over will only outnumber the younger population aged 15 years old and below by 2045. However, this could be seen as added pressure on the government to provide jobs for the large number of young adults entering the labour market and at the same time, providing some form of protection for the elderly. This is all occurring at a time when Malaysia is striving to move the country out of the middle income trap to become a high income country by year 2020, the year that one out of ten Malaysians will be an older person.

According to the Malaysian 2000 census, 6.2 per cent, or 1.4 million of its 23.3 million people, were aged 60 or over and this figure is projected to be 6.7% (or 1.9285 million) by 2010 (Table 1). The total fertility rate has been decreasing from 4.9 in 1970 to 2.4 in 2005. The age structure for the past four censuses (1970, 1980, 1991 and 2000), shows that the proportion of younger age groups (15 years and below) has been decreasing, while the proportion of older persons has been rising. In addition, the sex ratio of persons aged 60+ shows that the feminization of aging will put further pressure on Malaysia as women suffer from a disadvantaged financial position which raises great doubts about their ability to provide for old age. As the present retirement age is only 55 and 58 for private and public sectors, respectively, the impact of demographic aging is likely to be felt even earlier than the official age of 60, with ramifications for financial preparedness and social protection, demand for health care, community care, long-term care and other related services. There is great uncertainty about what ages people will reach and therefore the resources needed for old age protection will have to be actuarially determined. Associated with this uncertainty are the major issues of (1) feminization of aging, women are living longer and they tend to have lower income and are less exposed to the formal labor market; and (2) health expenditure will rise with age and hence the implications on health financing.

**Table 1. Older Persons in Malaysia, 1947 – 2020**

| Year | Older Population (60+) | | | Growth Rate Percent Change (per annum) | |
|---|---|---|---|---|---|
| | Number (n) in Thousands ('000) | Percent (%) | Sex Ratio (men per 100 older women) | Older Population | Total Population |
| **1947** | 243.8 | 5.0 | 120.0 | - | - |
| **1957** | 288.0 | 4.6 | 113.2 | 1.8 | 2.9 |
| **1970** | 546.0 | 5.2 | 109.0 | 6.9 | 5.1 |
| **1980** | 745.2 | 5.7 | 97.6 | 3.6 | 2.6 |
| **1991** | 1068.5 | 5.8 | 89.7 | 3.9 | 3.6 |
| **2000** | 1451.7 | 6.2 | 91.4 | 4.0 | 3.0 |
| **2010** | 1928.5 | 6.7 | 96.2 | 3.3 | 2.3 |
| **2020** | 3116.7 | 8.9 | 95.5 | 6.2 | 2.0 |

*Source:* Department of Statistics, Malaysia, 2006; 2007.

The life expectancy of Malaysians has improved over the years. In 2005, the life expectancy at birth was 71.4 for males and 76.2 for females while life expectancy at 60 was 17.2 and 19.6 for males and females respectively. The two major characteristics of population aging in Malaysia are the feminization of aging and the rapid rise in the number of the old-old and the oldest-old. This begs the question of what ages will people reach? Moreover, each cohort of older Malaysians is varied in terms of live experiences, expectations and life styles, contributing to the heterogeneity of the aged population in terms of demographic as well as social characteristics which present different needs and demands.

## 1.2. Labor Force Participation and Employment

Economic participation among the elderly is one way to ensure financial security in old age. Tables 2 and 3 show the labor force participation by age and sex. A drop in labor force participation can be seen for 2008 compared to 2000 among the age groups of 15-19 years and 20-24 years. This reveals a growing late entry into the labor force due to education opportunities as more and more Malaysians gain access to tertiary education. Among the age groups 55-59 and 60-64, the labor force participation rate has also been dropping steadily, with the year 2000 registering a higher participation rate than 2008. In 1975, the labor force participation rate was 60.3% among those aged between 55 to 59 years and it dropped to 49.6% in 2005 after three decades. A sharper drop occurred for the 60 - 64 age group in which the participation rate fell from 50.9%

in 1975 to 37.2% in 2005 and 36.7% in 2008. Since continuing to work is a good way to secure financial sustenance, the drop in labor force participation for these two age groups is disturbing. It could mean that more of the labor force is now in the formal sector for which retirement occurs in the late 50s. In terms of labor force participation for females, the rate remained rather consistent throughout the years with around 44% to 47%. For the men, the rate shows a slight decline from 65.4% in 2000 to 62.6% in 2008.

**Table 2. Labor Force Participation Rates by Age Group, 1975 - 2008**

| Age Group | Labor Force Participation Rates (LFPR) by Age Group and Year | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | **1975** | **1980** | **1985** | **1990** | **1995** | **2000** | **2005** | **2008** |
| **15-19** | 47.0 | 41.9 | 36.1 | 40.7 | 32.5 | 27.2 | 20.6 | 18.4 |
| **20-24** | 75.1 | 73.8 | 74.4 | 76.9 | 75.4 | 73.7 | 66.8 | 64.9 |
| **25-29** | 72.1 | 71.5 | 72.8 | 75.3 | 75.5 | 79.7 | 80.6 | 80.6 |
| **30-34** | 73.3 | 71.7 | 72.4 | 73.8 | 73.8 | 77.0 | 78.0 | 78.5 |
| **35-39** | 75.8 | 73.5 | 73.9 | 73.5 | 74.3 | 75.5 | 75.8 | 76.3 |
| **40-44** | 75.0 | 74.7 | 74.9 | 74.6 | 73.3 | 75.6 | 75.1 | 75.2 |
| **45-49** | 75.2 | 73.3 | 73.7 | 74.4 | 72.0 | 74.2 | 73.6 | 72.8 |
| **50-54** | 71.0 | 69.4 | 66.2 | 68.6 | 65.8 | 67.7 | 67.0 | 67.2 |
| **55-59** | 60.3 | 57.1 | 54.3 | 52.4 | 50.7 | 52.2 | 49.6 | 47.7 |
| **60-64** | 50.9 | 48.6 | 44.6 | 44.4 | 41.0 | 42.2 | 37.2 | 36.7 |
| **Total** | **66.7** | **65.0** | **64.5** | **66.5** | **64.7** | **65.5** | **63.3** | **62.6** |

*Source:* Department of Statistics Malaysia, 1978; 1983; 1988; 1991; 1996; 2001; 2005; 2009.

**Table 3. Principal Statistics of Labor Force by Sex, 1985 - 2008**

| Year | LFPR (%) | | | Labor Force ('000) | | |
|---|---|---|---|---|---|---|
| | **Total** | **Male** | **Female** | **Total** | **Male** | **Female** |
| **1985** | 65.7 | 85.6 | 45.9 | 5,990.1 | 3,896.7 | 2,093.5 |
| **1990** | 66.5 | 85.3 | 47.8 | 7,000.2 | 4,489.8 | 2,510.3 |
| **1995** | 64.7 | 84.3 | 44.7 | 7,893.1 | 5,203.1 | 2,690.0 |
| **2000** | 65.4 | 83.0 | 47.2 | 9,556.1 | 6,156.2 | 3,399.9 |
| **2005** | 63.3 | 80.0 | 45.9 | 10,413.4 | 6,700.9 | 3,712.5 |
| **2008** | 62.6 | 79.0 | 45.7 | 11,028.1 | 7,074.6 | 3,953.5 |

*Source:* Department of Statistics Malaysia, 2009.
*Note:* Labor Force (15 - 64 years) who are either employed (employer, employee, own-account worker or unpaid family worker) or unemployed (active or inactive).

Projecting the population size into the next decade, by 2020 the number of economically active persons (between 15-64 years) will grow to 21.6 million compared to the present 18.4 million. Malaysia therefore needs to generate this number of jobs or livelihoods. According to Ragayah et al. (2002), the estimated working population not covered by any formal retirement scheme was about 30% or 2.88 million persons in 2000. Based on this estimate, we would not expect many changes to occur in terms of coverage of social protection within the next ten years unless Malaysia embarks on drastic changes, leading to the transformation of the Malaysian economy and implements social protection reforms.

### 1.3. Health and Health Care Financing in Malaysia

Based on the epidemiology pattern of Malaysians, the common types of illnesses are non-communicable diseases such as diabetes and hypertension, overweight and obesity problems, and an increasing number of all types of injuries (home, workplace and road traffic). The alarming increase in the incidence of non-communicable diseases reflected problems associated with changing lifestyles. There is also evidence of improved health seeking behavior, which refers to Malaysians' awareness of and access to health care (Table 4).

**Table 4. Estimated National Prevalence of Health Problems/ Diseases in NHMS*-II and NHMS-III, 1996 & 2006**

| No. | Health Problems / Diseases | NHMS-II (1996) | | NHMS-III (2006) | |
|---|---|---|---|---|---|
| | | **Prevalence** | **95% CI** | **Prevalence** | **95% CI** |
| 1. | Overall Diabetes Mellitus (>30 yrs) | 8.3 | 7.8 - 8.7 | 14.9 | 14.4 - 15.5 |
| 2. | Hypertension (>30 yrs) | 29.9 | 29.1 - 30.7 | 42.6 | 41.8 - 43.3 |
| 3. | Hypercholesterolemia | n/a | n/a | 20.6 | 20.1 - 21.3 |
| 4. a) | Underweight (Adult) | 25.2 | 24.5 - 25.7 | 8.5 | 8.2 - 8.9 |
| b) | Overweight (Adult) | 16.6 | 16.1 - 17.1 | 29.1 | 28.6 - 29.7 |
| c) | Obesity (Adult) | 4.4 | 4.1 - 4.7 | 14.0 | 13.6 - 14.5 |
| 5. | Asthma (Adult) | 4.1 | 3.8 - 4.4 | 4.5 | 4.3 - 4.8 |
| 6. | Smoking (Adult) - Current | 24.8 | 24.1 - 25.4 | 22.8 | 22.3 - 23.3 |
| 7. | Alcohol Consumption (>13 yrs) - Current | n/a | n/a | 7.4 | 6.9 - 8.0 |
| 8. | Home Injury | 2.5 | 2.3 - 2.7 | 6.5 | 6.2 - 6.8 |
| 9. | Road Traffic Injury | 2.5 | 2.3 - 2.7 | 4.4 | 4.2 - 4.6 |
| 10. | Workplace Injury | 3.0 | 2.7 - 3.3 | 4.8 | 4.5 - 5.1 |
| 11. | Recent Illness / Injury | 29.5 | 28.8 - 30.3 | 23.6 | 22.9 - 24.3 |
| 12. | Health Seeking Behaviour for Recent Illness (<14 days) | 42.5 | 41.4 - 43.6 | 58.1 | 57.1 - 59.1 |
| 13. | Hospitalization | 7.2 | 7.0 - 7.5 | 5.0 | 4.8 - 5.2 |

*Source:* Institute for Public Health, NIH, MOH, 2008.
*Note:* * National Health and Morbidity Survey.

*1.3.1. Financing for Health Care*

In Malaysia, studies such as the National Health and Morbidity Surveys (NHMS, Ministry of Health), Household Expenditures Surveys (Department of Statistics Malaysia) and the National Household Health Expenditures Survey (University of Malaya) have been used to estimate national spending on health care. Multiple factors have led to escalating health care costs, which are usually financed through "general taxes, compulsory contributions to social security (public and/or private), voluntary contributions to private formal or informal insurance schemes and direct out-of-pocket payments" (Institute for Public Health, 2008, p.66). To date, allocations from the government have been a feature in annual government budgets and form an important source of health care funding. The government has been spending around 7% of general government expenditure on health care since 2004. While many countries in the region such as Thailand, Japan and Cambodia have instituted a national health insurance scheme, Malaysia has yet to introduce such a scheme, although the intention to do so was expressed in the Eighth Malaysia Plan (2001-2005).

The main challenge with respect to the national health insurance scheme lies with the pricing aspect. Again, linking health care and aging, it is clear that there is a positive correlation between the cost of health care and age, with rising age needing more care. Continuing to fund health care from the federal budget will put a strain on the government since more Malaysians are becoming aware of available health facilities and their rights to obtain proper care. This is occurring alongside an increase in out of pocket expenses by individuals. Based on past studies, the estimates for out-of-pocket (OOP) health expenditure were somewhere between RM2.8 billion to RM3.82 billion in 1996, while the Malaysia National Health Accounts reported figures as high as RM14 billion in 2002, with a per capita spending on health of RM555 (IPH, 2008, p. 69). The lower income groups are not burdened by high health care cost since they tend to seek care services from government clinics and hospitals. The NHMS-III survey shows that the higher the income group, the more they spend on OOP health expenditure, in which about 87% of the amount goes to private facilities. Public health care facilities are so cheap that it was estimated medical charges amounted to only about 2% of the operating budget for government hospitals and clinics (IPH, 2008, p. 89). Besides the government and individual spending, multinationals and large local corporations also provide coverage for medical care in the form of reimbursement for out-of-pocket expenses and health insurance for hospitalization benefits as well as health promotion pur poses.

### *1.3.2. Medical Insurance*

Medical insurance is a fairly recent development in Malaysia and it is not yet a significant source of financing. Naturally, it appeals more to the urban people who have the ability to purchase it. In view of the speculation about a national health care financing scheme, medical insurance might become a program that could be made mandatory for all Malaysians although how this will affect older persons is at the moment unclear. At present, private medical and health insurance (MHI) is gaining in coverage, due in part to the broadening range of MHI products and providers, and also to consumers' awarenss of health promotion and protection. The most frequently seen type of MHI covers is the hospital and surgical insurance policy. These make up about 63% of total MHI premiums written. This is followed by critical illness policies at 28% (which provide lump sum benefit payments upon the diagnosis of an insured illnesses), hospital income (6%) and long-term care (2%) policies. Bank Negara Malaysia (2006, p. 58) estimated that 15% of the total population have MHI protection, mostly individuals below the age of 45 years.

### *1.3.3. Long-Term Care (LTC)*

Malaysia as elsewhere has a range of institutional care services. There are the residential homes provided by the government in the form of long-term care facilities for the destitute. The private sector offers LTC faciltiies, motivated by profit in which the ability to pay applies, and non-government organizations also respond to the needs of older persons for LTC. Institutional care often refers to shelter provided in old people's homes (*Rumah Seri Kenangan*) of which there are eleven (two in East Malaysia) administered by the federal government. Perhaps the most obvious governmental effort in the provision of formal long-term care (LTC) has been the setting up of homes for chronically ill people who are destitute. At present there are two such centres (Rumah Ehsan), one in Kuala Kubu Baru, Selangor and the other in Dungun, Terengganu, with a total capacity of about 150, providing care, treatment and protection to destitute patients. *Private Nursing Homes* are fairly commonly seen in long-term institutional-type care. They are found in major urban areas and tend to reflect market forces of supply and demand. The types of care nursing homes provide differ from home to home but the basic facilities remain largely the same. Nursing homes run by private organizations are monitored by the Ministry of Health or the the Social Welfare Department. These nursing homes offer 24-hour nursing care for people with different needs. As in many countries, the quality of care is inconsistent.

In addition to institutional shelter provided by the government and private organizations, there are other retirement homes known as *Rumah Sejahtera,* administered by the Central Welfare Council for Peninsular Malaysia (MPKSM). These homes come under the supervision of the Department of Social Welfare, which disburses grants on a regular basis. In reality, these homes can be considered as LTC facilities for residents without reliable dependents.

## 2. Current Status of Social Protection

The social protection schemes available in this country can be described as multi-pillar, with reliance on certain pillars depending on an individual's occupational history, although Malaysia has not moved towards the full five pillars as outlined by the World Bank. The major formal social protection schemes include the Civil Service Pension Scheme, the Employees Provident Fund (EPF), the Social Security Organisation (SOCSO), the Armed Forces Fund (LTAT) and the Workers' Compensation Scheme. There are also the public welfare programmes administered by the Ministry of Women, Family, and Community Development which can be classified into social assistance (means-tested) and social pension schemes. In addition, some discussion will be made on the non-formal pillar, which comprises homeownership, personal savings, and other financial or non-financial assets.

## 2.1. Formal Social Protection Schemes

### *2.1.1. Pension Scheme*

The civil service pension, a non-contributory social security scheme, is designed for old age protection for public sector employees. Before 1991, pension expenditures were wholly borne by the federal government through annual allocation from the federal budget. This was a "pay-as-you-go" plan. In 1991, the Pension Trust Fund Act 1991 (KWAP, under Act 454) was introduced with an initial fund injection of RM500 million allocated from the Federal Government to provide a better return of investment for the scheme. The contributors to the fund are the federal government which allocates 5% of its annual emolument budget, while employers (local authorities, government agencies and statutory bodies) contribute 17.5%.

Upon retirement, a public sector employee is entitled to a lifelong monthly payment calculated based on the number of years of service and the last drawn basic pay (excluding all additional allowances enjoyed during employment). In addition, there is also a lump sum gratuity payment, the quantum of which is based on the number of years of service. Besides the lump sum gratuity payment, some agencies give an additional payment known as a "Golden Handshake", in recognition of service. In the past, the amount of pension paid was 50% of last drawn basic pay, equivalent to about one third of gross salary. From January 2009, employees who have served more than 30 years are entitled to 60% of the last drawn basic pay, while those who serve less than 30 years continue to receive the previous 50%. This improves the replacement rate. An employee who has served for at least 10 years is entitled to receive a life-long monthly pension upon retirement. However, the amount of pension is one-fifth of the last drawn basic pay. This rate also covers those who are forced to retire due to injuries or sickness suffered in the course of performing their official duties.

This scheme also provides financial protection to the dependents of public sector employees who die in service or after retirement. This is known as a derivative pension, in which offers the same amount of monthly pension payment is given to the dependent. In 2002, the derivative pension was extended to a widow/widower who remarried, a provision which was not accorded earlier. In 2004, this was further extended to cover parents of personnel who die without leaving a widow/widower or children. The benefit given to this category of beneficiaries is in the form of a once-off ex-gratia payment since 2009. In terms of coverage, the derivative pension has become more inclusive compared to when it was first introduced.

Pushing back the retirement age of 55 years to 56 years in 2001 and then to 58 years in 2007 has, to an extent, provided a means of extending financial security to a later age. By so doing, a person who opts to retire at a later age will also stand to gain in terms of the amount of gratuity and the monthly pension payment since the formula for pension payout is based on the last drawn salary. Table 5 shows the number of pensioners and pension recipients and the size of the civil service. Based on the number of people in government service in 2008, the pension scheme in Malaysia covers only a small percentage of the labor force, at about 11%, or 4% of the total population. In this sense, it can be regarded as a scheme that has limited coverage in terms of population size.

**Table 5. Number of Pensioners and Size of the Civil Service, 2000 – 2008**

| Year | Number of Pensioners & Pension Recipients | Number of Civil Servants | Value of Pension(RM million) | Current Pension Expenditure as % of total Current Expenditure |
|---|---|---|---|---|
| **2000** | 433,847 | n/a | n/a | n/a |
| **2001** | 452,930 | n/a | 4.711 | 7.4 |
| **2002** | 392,265 | n/a | 5.134 | 7.5 |
| **2003** | 411,293 | n/a | 5.870 | 7.8 |
| **2004** | 430,414 | n/a | 6.060 | 6.6 |
| **2005** | 451,938 | 1,090,737 | 6.809 | 7.0 |
| **2006** | 470,883 | 1,142,783 | 7.001 | 6.5 |
| **2007** | 496,280 | 1,225,586 | 8.248 | 6.7 |
| **2008** | 511,883 | 1,244,365 | 8.372 | 6.5 |

*Source:* Department of Public Service Annual Reports, various years.

The pension system can be seen as a financial contract that averages about 55 years, from the time the employee is employed (say at age 25 years) till age 75 years (the life expectancy of Malaysians). Taken together with the derivative pension that for the dependents' lifetimes, this contract poses a challenge in terms of the sustainability of the scheme. A further challenge is adequacy, since many pensioners are believed to receive an amount that could hardly be considered sufficient. Therefore, the major challenges of the scheme are the coverage, benefits level and sustainability of the scheme since this is a defined-benefits scheme in which benefits are clear while the sponsor bears any risk. Essentially, retirement pensions are aimed at consumption smoothing and also poverty prevention in old age, since pensions payment represent a lifelong benefit to employees. It matches Pillar 1 of the World Bank pension taxonomy, although the coverage is not likely to increase significantly and therefore its role as social protection is limited in scope.

### *2.1.2. Employees Provident Fund (EPF)*

The EPF is a trust fund established under the EPF Ordinance, 1951, later amended to the EPF Act 1991. The EPF is a defined contribution plan based on a prescribed rate of contributions by employees and employers, accumulated as savings in a personal account with full withdrawal upon retirement. The EPF provides a long-term retirement savings route for employees in the private sector and non-pensionable employees in the public sector, as well as those who are self-employed (beginning 2005) to save for old age.

In 1968, EPF began to allow members to make partial withdrawals of up to one third of their accumulated savings. Significant changes introduced in 2008 include the "Beyond Savings" initiative and the restructuring of members' investment choice through the Basic Savings structure. The Beyond Savings initiative gives members greater choice and the flexibility to manage their EPF savings. Previously members could only invest 20% of their savings in excess of RM50,000 in Account I for approved investments, through approved external fund managers. Members can now invest savings in excess of the basic savings amount. EPF has introduced a variable basic savings amount at prescribed age intervals. The main purpose of this basic savings balance is to ensure minimum savings of RM120,000 at the age of 55 years, which translates into a monthly amount of at least RM500 over a period of 20 years, until the retired person reaches the age of 75. However, taking into consideration the rate of inflation, RM500 can hardly be described as sufficient. At best, it could only serve to meet bare necessities.

#### *2.1.2.a. The Rate and Base Structure*

The EPF rate of contribution has been well documented by Asher (1994). From December 1980 to December 1990, the rate of contribution for employer was 11% and the employee contributed 9%, resulting in savings of 20% on net wages and 18% on gross wages. This rate has been more or less stable. As a response to the economic crisis, in 2009, the employee contribution rate was reduced to 8%, while the employers' contribution remained unchanged at 12%. In the past, contributions for employees over the age of 55 years were not compulsory. Effective 1 February 2008, the liability period for mandatory contributions to the EPF for both the employers and employees was extended from age 55 to 75, at contribution rates of 5.5% for employees and 6% for employers. This contribution rate is a minimum and and employees and employers can choose to contribute more than this prescribed rate. This move has resulted in a two-tier contribution rate, one for those who are younger than 55 years and another for those 55 years or older. The rationale behind the introduction of this two-tier rate structure is to encourage people to work after retirement and at the same time to avoid over-burdening employers and employees.

Under the present structure, there are two accounts. Full withdrawal from Account I can take place upon reaching the age of 55, or if the employee becomes incapacitated, leaves the country or dies. Members are allowed to invest up to 20% of the savings in this account at their own risks, while the minimum investment amount is RM1,000. Savings in Account II are designed to help members to make early preparations for a comfortable retirement. Withdrawals are allowed when the employee reaches the age of 50, for making a down payment for a first house or settling the balance of a housing loan, to finance education for self (since January 2001) and children (since 1 April 2000 for university education and 17 January 2006 for diploma education) where the amount withdrawn is limited to tuition fees or Account II savings balance, whichever is the lower, and to pay medical expenses for members and members' children for a list of approved critical illnesses. The amount is limited to the actual medical costs or Account II savings balance, whichever is the lower.

#### *2.1.2.b. Coverage*

Table 6 shows the coverage of the EPF Scheme. The important distinction that needs to be made with respect to coverage is the number of active members and total number of contributors. The difference is the total number shows the number of those who have contributed at some point in time. They may no longer be active contributors for various reasons such as unemployment or a shift to self-employment.

Table 7 provides the density of contribution and the average savings by age group. It is desirable to examine the amount of average savings at age 54 since this will give us a clear indication of the amount of savings available for retirement (Table 8).

**Table 6. Coverage of the EPF Scheme, Malaysia, 1980 - 2008**

| Year | Number of Active Members (in Millions) | As Percent of Total Members (%) | As Percent of Employed Population (%) | As Percent of Labor Force (%) |
|---|---|---|---|---|
| **1990** | 2.94 | 49.6 | 44.0 | 41.8 |
| **1995** | 3.99 | 51.4 | 50.9 | 49.0 |
| **2000** | 5.03 | 50.5 | 56.3 | 54.7 |
| **2005** | 5.26 | 47.4 | 52.4 | 50.5 |
| **2008** | 5.71 | 47.3 | 53.6 | 51.8 |

*Source:* Employees Provident Fund, 1994; 1998; 2004; 2005; 2008.

**Table 7. Profile of Active Members by Age and Sex, 2008**

| Age Group | Total | | % of Total Active Members | Total Savings (RM Million) | % of Total Savings | Average* Savings (RM) |
|---|---|---|---|---|---|---|
| | Male | Female | | | | |
| < 16 | 813 | 421 | 0.02 | 0.62 | 0.00 | 499.89 |
| 16 - 25 | 828,790 | 768,160 | 27.99 | 9,341.13 | 3.64 | 5,849.35 |
| 26 - 30 | 592,360 | 552,158 | 20.06 | 24,765.59 | 9.65 | 21,638.44 |
| 31 - 35 | 468,520 | 372,722 | 14.74 | 37,711.27 | 14.70 | 44,828.08 |
| 36 - 40 | 395,953 | 286,043 | 11.95 | 45,748.93 | 17.83 | 67,080.94 |
| 41 - 45 | 328,935 | 225,435 | 9.72 | 47,690.97 | 18.59 | 86,027.33 |
| 46 - 50 | 266,261 | 172,771 | 7.69 | 47,304.11 | 18.44 | 107,746.37 |
| 51 - 55 | 188,079 | 99,372 | 5.04 | 33,056.35 | 12.89 | 114,998.22 |
| 56 - 60 | 75,949 | 32,194 | 1.90 | 7,243.23 | 2.82 | 66,978.28 |
| 61 - 65 | 26,710 | 8,374 | 0.61 | 2,495.31 | 0.97 | 71,123.98 |
| > 65 | 13,238 | 2,934 | 0.28 | 1,165.34 | 0.45 | 72,058.96 |
| **Grand Total** | **3,185,608** | **2,520,584** | **100.00** | **256,522.84** | **100.00** | **44,955.17** |

*Note:* *Average is used since EPF does not provide information on median savings.

**Table 8. Members' Average Savings at Age 54**

| Year | Active Members | | | Inactive Members | | |
|---|---|---|---|---|---|---|
| | Number of Members | Total Savings (RM) | Average Savings (RM) | Number of Members | Total Savings | Average Savings (RM) |
| 2003 | 39,238 | 3,625,832,417 | 92,406.15 | 97,287 | 1,684,391,472.14 | 17,313.63 |
| 2004 | 39,535 | 3,915,853,224 | 99,047.76 | 98,677 | 1,757,913,099.13 | 17,814.82 |
| 2005 | 42,881 | 4,585,383,416 | 106,932.75 | 107,537 | 2,029,849,511.08 | 18,876.35 |
| 2006 | 47,438 | 5,427,045,812 | 114,402.92 | 108,097 | 2,321,761,533.00 | 21,478.50 |
| 2007 | 48,501 | 5,876,552,582 | 121,163.58 | 124,094 | 2,553,084,268.98 | 20,578.79 |
| **Values based on 2000 prices (CPI 2000=100)** | | | | | | |
| **Year** | **Active Members** | | | **Inactive Members** | | |
| | **Number of Members** | **Total Savings (RM)** | **Average Savings (RM)** | **Number of Members** | **Total Savings** | **Average Savings (RM)** |
| 2003 | 39,238 | 3,477,170,692 | 88,617.43 | 97,287 | 1,615,330,216 | 16,603.76 |
| 2004 | 39,535 | 3,699,128,085 | 93,565.91 | 98,677 | 1,660,620,392 | 16,828.85 |
| 2005 | 42,881 | 4,207,038,845 | 98,109.62 | 107,537 | 1,862,364,598 | 17,318.84 |
| 2006 | 47,438 | 4,805,813,043 | 101,307.24 | 108,097 | 2,055,989,988 | 19,019.86 |
| 2007 | 48,501 | 5,100,437,378 | 105,161.53 | 124,094 | 2,215,898,905 | 17,860.95 |

*Source:* EPF Annual Reports, various years.

The real values over the period of 2003-2007 shows a decline in the balances of active members. Although the increase in nominal balances from 2003 to 2007 is 31.2% for active members, in real terms, the increase in the balance is only 18.7%. Comparing the balances of active and non-active members, it is obvious that the inactive members have a much lower level of balance to be carried into their retirement years. The levels of balances, at year 2000 prices, showed that the inactive members are worse off in 2007 compared to 2006 even after the payment of a dividend of 5.8%% in 2007. Since the EPF saving scheme is not inflation-indexed, the balances for inactive members will deteriorate further in years ahead. Unless there are other sources to boost their retirement resources, they may become financially vulnerable as they age.

The growth in annual contributions from 1975 to 2008 is dependent on several factors notably the rate of unemployment, the level of wages and wage structure, and the rates of contribution. With the drop in the rate of employee contributions in 2009, the annual total contribution may see a corresponding drop in the same year. Between 1975 and 2008, the amount of contribution has been increasing, with a substantial increase (83.5%) in 2000 compared to 1995 (Table 9). The total balances, as a percentage of GDP has remained high since 2000.

**Table 9. EPF Annual Contributions, Withdrawals and Balances, 1975 to 2008**

| Year | Annual Contribution (RM million) | As % of Gross National Savings | Total Withdrawals (RM million) | Withdrawal as % of annual contributions | Total Balances (RM million) | Total Balance as % of GDP |
|---|---|---|---|---|---|---|
| 1975 | 331 | n.a | 100 | 30.2 | 3,916 | n.a |
| 1980 | 1,068 | 6.8 | 199 | 18.6 | 9,129 | 17.1 |
| 1985 | 2,730 | 13.8 | 798 | 29.2 | 23,967 | 30.9 |
| 1990 | 4,139 | 12.5 | 1,738 | 42.0 | 46,179 | 39.9 |
| 1995 | 10,324 | 14.1 | 3,160 | 30.6 | 98,489 | 45.2 |
| 2000 | 17,040 | 13.6 | 9,991 | 58.6 | 180,764 | 57.9 |
| 2005 | 24,367 | 14.0 | 13,432 | 55.1 | 262,725 | 50.3 |
| 2008 | 34,543 | 12.7 | 21,741 | 62.9 | 344,640 | 46.5 |

*Source:* Employees Provident Fund, 2004; 2008, Bank Negara Malaysia, 2008.

*2.1.2.c. Dividend Returns to Members*

The rate of return on savings in the EPF is dependent on an investment strategy which is constrained by regulations. The EPF ensures that members' savings are secure, and it guarantees a minimum 2.5 per cent dividend annually. Over the years, the EPF has been paying dividends to members at varying rates. In 2008, the dividend was only 4.5%, lower than the Consumer Prices Index (CPI), resulting in a negative real return for the first time in decades (Table 10).

**Table 10. Dividend Rate and CPI**

| Year | Dividend Rate | CPI | Difference |
|---|---|---|---|
| **1975** | 6.60 | 4.5 | 2.10 |
| **1980** | 8.00 | 6.7 | 1.30 |
| **1985** | 8.50 | 0.4 | 8.10 |
| **1990** | 8.00 | 3.1 | 4.90 |
| **1995** | 7.50 | 3.4 | 4.10 |
| **2000** | 6.00 | 1.6 | 4.40 |
| **2005** | 5.00 | 3.0 | 2.00 |
| **2008** | 4.50 | 5.4 | -0.90 |

*Source:* EPF Annual Reports, various years.

The EPF remains the major pillar of social protection for the formal sector workers in Malaysia. There are advantages and disadvantages in the EPF scheme, which remains largely unchanged as noted by Asher (1994). Like the CPF in Singapore, the EPF places the responsibility for old age income security firmly on the working individual who has to save for later life. However, the financial viability of the scheme and real rate of return are being publicly questioned. As inflation diminishes the true value of the savings, adequacy will be a key issue in the future.

*2.1.3. Social Security Organisation Schemes*

Through the Employees' Social Security Act (SOCSO) of 1969, the Social Security Organisation was established. It is a central government agency that operates the Employment Injury and the Invalidity Pension Schemes. It covers workers who earn less than RM3,000 (previously RM2,000) per month and is financed by contributions from both employees and employers. Once an employee is covered, he/she is covered even if his/her salary has exceeded the limit of RM3,000. The rate of contribution for the Employment Injury Scheme is 1%, to be contributed by the employer and employee at 0.5%, respectively. For the Invalidity Pension Scheme the contribution comes solely from the employer at 1.75%. New developments in SOCSO include old age pension for private sector and self-employed workers as well as unemployment benefits. This clearly is a move towards social protection reforms.

Table 11 shows that the number of members has been on the rise since 1975 and the number grew to 11.16 million and 11.75 million in 2005 and 2008, respectively. As the coverage increases, so does the number of beneficiaries and the amount of cash payouts. The increase in the number of members from 2000 to 2005 was about 25% while the payout increased by 141% in the same period. In 2010, the government announced that some 206,585 recipients of Socso pensions will receive monthly payments increased by between 0.6% and 11.3% (The Star, Tuesday, March 2, 2010).

**Table 11. Statistics of the Social Security Organisation, Malaysia, 1975 - 2008**

| SOCSO | Number of Registered Employees | Number of Registered Employers | Number of Industrial Accidents Reported* | Number of Beneficiaries | Amount of Cash Paid (RM in Thousands '000) |
|---|---|---|---|---|---|
| **1975[a]** | 608,847 | 18,902 | 40,979 | n/a | n/a |
| **1980** | 1,706,070 | 41,710 | 51,340 | 14,405 | 4,126 |
| **1985** | 2,904,782 | 69,256 | 61,724 | 35,471 | 21,077 |
| **1990** | 4,578,943 | 106,086 | 121,104 | 116,202 | 95,253 |
| **1995** | 7,422,191 | 274,017 | 114,134 | 182,763 | 245,478 |
| **2000** | 8,877,304 | 415,523 | 95,006 | 228,705 | 591,819 |
| **2005** | 11,155,232 | 578,390 | 61,182 | 264,640 | 883,893 |
| **2008** | 11,747,607 | 612,953 | 58,321 | 278,482 | 1,131,516 |

*Notes:* [a] Peninsular Malaysia Only,
* Excludes occupational diseases

Under the Employment Injury Insurance Scheme, the benefits provided include medical benefit, temporary disability benefit, permanent disability benefit, dependent's benefit, death benefit, and rehabilitation benefit. The Invalidity Pension Scheme covers invalidity or death irrespective of how and where it happens. In terms of coverage, the Invalidity Pension Scheme provides 24 hour protection and offers a pension even after the age of 56. In order to obtain a full pension, the member must at least have made at least 24 contributions. Full pension is 50% of the last drawn pay plus 1% for every 12 contributions over and above the minimum/ basic 24 contributions subject to a maximum of 65%. This pension is for life. Other benefits under this scheme include constant attendance allowance, provision of artificial limbs and other appliances, funeral benefit and a survivor's benefit. The yearly contribution to this scheme is about RM1.8billion while the payout is about RM1.13 billion. This raises the issue of future sustainability in addition to the issue of adequacy.

### *2.1.4. Workmen's Compensation Scheme*

Since April 1993, foreign workers were no longer covered under SOCSO. Instead, foreign workers are now covered by the Workmen's Compensation Scheme. Only foreign workers are covered under this scheme in respect of compensation for employment injury, as well as non-employment injury, as a result of the Workmen's Compensation (Foreign Worker's Scheme) (Insurance) Order 1993. This Act applies to foreign workers whose earnings are not more than RM500 per month and all foreign manual workers, irrespective of their wage. Casual workers, domestic maids and family workers are not covered under the scheme. Unlike SOCSO, this scheme operates as a law governing the terms and amounts of compensation in the case of death or accident. The employer is solely responsible for providing this social insurance, through private companies.

### *2.1.5. Armed Forces Fund (LTAT)*

The LTAT was established in August 1972 by an Act of Parliament. Similar to EPF, LTAT is a defined contribution scheme for members of "other rank"[1] in the armed forces. The scheme is mandatory, for the ranks specified and the current contribution rate is 10% of monthly salary paid by the individual, while the government contributes 15%. This scheme also has a voluntary feature, in that military personnel with officers' rank are able to contribute to the scheme, which acts as a saving scheme with a minimum contribution of RM25 per month (but with no contributions from the government). All members, whether mandatory or voluntary contributors are entitled to disablement benefit and their dependents will also receive death benefits. Mobilizing members to save is the first major objective of the Armed Forces Fund, the second

[1] Other ranks are military personnel below commissioned officers in rank. This includes warrant officers, non-commissioned officers and privates.

objective being to promote socio-economic development and to provide welfare and other benefits for the retiring and retired personnel of the armed forces.

Upon reaching the age of 50, members are to withdraw the entire sum of savings with no option for monthly payments. This savings scheme also allows members to withdraw money to purchase a low-cost house once in a lifetime. The amount permitted for withdrawal is capped at 40% of the balance in the account or a maximum of RM100,000 whichever is the lower.

**Table 12: Armed Forces Fund Board Members' Contributions, Total Asset and Dividend and Bonus, 1995 – 2008**

| Year | Members' Contribution Account (RM Million) | Total Asset (RM Million at cost) | Dividend and Bonus to Members |
|---|---|---|---|
| **1995** | 2,906.7 | 3,522.9 | - |
| **2000** | 3,679.6 | 4,755.1 | 10.00 |
| **2005** | 4,168.1 | 5,457.6 | 15.75 |
| **2008** | 5,851.5 | 7,168.4 | 16.00 |

*Source:* LTAT Annual Report, various years.

### 2.2. Social Assistance Types Schemes

Under the "Caring Society" concept, the Malaysian government has instituted many welfare programs with some dating back to colonial days. The Department of Social Welfare, Malaysia under the Ministry of Women, Family and Community Development is responsible for administering most of the federal-based financial assistance programs. These financial assistances are meant to cover two major groups: the productive and the unproductive poor. The former include children, dependents of the sick, prisoners and detainees, poor families, single parent families and their dependents, ex-residents of welfare institutions, while the latter cover the sick, the elderly and the severely disabled. The major intention of the coverage for the former group is to provide assistance until they become productive and independent. For example, children aid amounts to RM100 per child up to a maximum of RM450 per household a month, aiming at easing conditions of poverty for the recipients until the age of 18. In 2005, the total number of beneficiaries for children assistance was 19,346, amounting to slightly over RM43.7 million. The figure has grown over the years and is expected to reach RM80 million in

2010. For the disabled workers, an allowance of RM300 per month is given. In 2005, the number of recipients for the scheme was 11,167 and the amount paid out was RM21.2 million. In addition, there is also a disaster relief fund which is capped at a maximum of RM5,000. A total of 10,158 people benefited from the aid for natural disasters in 2005, and the amount paid out was RM4.8, million. Older persons (aged 60 and above) who are destitute, not able bodied, and without next of kin to depend on for support are eligible for a social pension which amounts to RM300 per month. The number of recipients has increased over the years, from 9,212 in 2000 to 23,256 in 2005, costing RM31.3 million, an increase of 152% in recipients over a span of 5 years (Ong, Phillips & Tengku-Aizan, 2009). In 2006, the amount of monthly assistance was increased from RM135 to RM200 a month, and again increased to RM300 in 2008. In addition to the financial assistance programs described above, the Social Welfare Department also give out help in the form of artificial limbs and so on. Obviously all these aids are means tested and there are eligibility criteria to be followed. According to Ragayah (2004), there is a tendency for this benefit to be biased towards the urban poor due to the accessibility issue. Funding for these schemes comes from the federal operational budget, which sustainability could be a major issue in the future.

**Table 13. Social Welfare in Malaysia**

| Type of Assistance | 2000 | | 2005 | |
|---|---|---|---|---|
| | Cases | RM | Cases | RM |
| Children Aid | 8,026 | 15,285,432 | 19,346 | 43,660,680 |
| Senior Citizen Aid | 9,212 | 10,278,238 | 23,256 | 31,342,805 |
| General Aid | 54,867 | 41,431,049 | 95,345 | 85,456,351 |
| Launching Grant | 249 | 453,630 | 264 | 583,230 |
| Disabled Worker's Allowance | 5,384 | 5,856,140 | 11,167 | 21,228,600 |
| Disaster Aid | 11,937 | 5,816,631 | 10,158 | 4,834,250 |

*Source:* MWFCD, 2007; DSWM, 2001.

### *2.2.1. Zakat*

For the Muslims, there is another form of assistance that is based on Zakat or tithing through Islamic institutions such as the State Islamic religious councils (Majlis Agama) or Baitulmal. Of the two general kinds of zakat (zakat on self - fitr; zakat on wealth -

mal), zakat mal (2.5% of ones total wealth) makes up the bulk of voluntary contributions which amounted to over RM800 million in 2007. In Malaysia, each state has its own zakat agency although there are efforts to standardize the collection and distribution of money. The coordination of Islamic affairs is organized by the Department of Islamic Development Malaysia (JAKIM) and a Department of Waqf, Zakat and Haji was established in 2004 (Pusat Pungutan Zakat, 2007). Principally, Zakat reaches out to needy people but faces limitations in scope and size since it is applicable to Muslims only.

### 2.3. Other Savings Schemes

Although the capital market in Malaysia is not as developed as in other advanced countries the number of unit trust funds has increased over the years. The number of approved funds increased from 67 in 1995 to 127 in 2000 (Ragayah et al., 2002), with the number of investors rising from 6.8 million in 1995 to 9.6 million in 2000. These unit trusts include the government guaranteed schemes under the *Permodalan Nasional Berhad*, such as the National Unit Trust (ASN) and the ASB (Bumiputera Unit Trust), which are only open to the indigenous population, and the *Amanah Saham Wawasan 2020* (open to all Malaysians between the ages of 12 and 29) and the *Amanah Saham Malaysia* (also open to all Malaysians). In order to raise the income of the hardcore poor (those with income equal or less than half the poverty line), the government launched the Bumiputera Unit Trust (ASB)-PPRT loan scheme in 1992. This programme enabled each hardcore poor household to obtain a RM5,000 interest-free loan to participate in the ASB scheme.

In the 2008 Budget, a RM2 billion bond (Merdeka Savings Bonds) based on Syariah principles with a 3-year maturity was proposed for those aged 55 years or older and not employed on a full time basis. This is intended to encourage savings by providing a guaranteed 5% p.a. return for the elderly. From 2008 to 2009, approximately RM4 billion worth of bonds have been fully subscribed. In 2009, Bank Negara also introduced another general savings scheme known as Sukuk Simpanan Rakyat with similar terms as in the Merdeka Savings Bonds except that it is open to all Malaysian citizens aged 21 years and over. It has a more flexible early redemption and RM5 billion worth of bonds was fully subscribed.

The 1 Malaysia Retirement Scheme, administered by EPF, a voluntary savings scheme for non-formal sector workers was announced in the 2010 Budget. This scheme is to encourage the self-employed to save for old age. For all contributions the government will contribute 5% subject to a maximum of RM60 per annum over the next five years.

Besides these specific schemes introduced by the government, there are other private insurance schemes (especially life and medical insurance) and savings that Malaysians, regardless of age could subscribe to. The reality of the situation is that there is a high correlation between the various pillars of protection since it is those who are in the formal sector (under mandatory pillars) who would also have the ability to save (under the voluntary schemes). Therefore, the question remains: “How would those in the informal sector have access to protection?”

### 2.4. Informal Social Support

A majority of the older Malaysians live in extended family households (49.2%) in 2000 although the figure has dropped from 57.8% in the 1991 Census. This pattern of living arrangement has been steadily decreasing with a concomitant increase in the number of nuclear family households. The breaking of the family unit and dispersion of its members, driven by job opportunities in the formal sector in a globalised economic system, has led to the need for new forms of intergenerational interdependence. Even though extended households have become less common today, an older person can still expect care from his or her family, whether through direct or indirect support. In this regard, intergenerational transfer and support remains strong in Malaysia. A nationwide study in 2005 by Tengku Aizan and her colleagues (2005) found that monetary assistance from sons and daughters is the most common source of income for the elderly but the mean value is low (Table 14). Regardless, the frequency and size of intergenerational exchange involved is difficult to estimate. The contributions of the elderly in providing care for grandchildren and in performing household chores, for example, are equally difficult to quantify.

**Table 14. Sources of Income for Older Malaysians, 2005**

| Sources of Income | Percent (%) | | Mean Value per Month Ringgit (RM) |
|---|---|---|---|
| | Male | Female | |
| Wage income | 27.6 | 11.7 | 566.41 |
| Side income | 4.9 | 3.8 | 431.53 |
| Rent (Land) | 1.6 | 1.4 | 286.19 |
| Rent (House/Room) | 2.2 | 2.7 | 1,623.08 |
| Daughters | 46.2 | 50.4 | 162.50 |
| Sons | 55.0 | 60.3 | 183.38 |
| Grandchildren | 3.2 | 6.5 | 128.32 |
| Relatives | 0.9 | 2.1 | 113.49 |
| Agriculture | 1.2 | 8.9 | 371.27 |
| Pension | 20.4 | 12.2 | 558.11 |
| Welfare assistance | 2.7 | 5.7 | 134.39 |
| Business | 2.6 | 2.5 | 1,003.87 |
| Dividends / Shares / Royalty | 1.1 | 0.6 | 125.00 |
| Total | n = 1477 | n = 1503 | 551.10 |

*Source:* Tengku Aizan et al., 2005.

Based on a recent survey conducted by Ong et al. (2008), retirees who responded to the survey stated incidence of intergenerational transfer from children to parents, although many of them also stated that 50% to 60% of their retirement income comes from their present economic activity. Although this household survey is an exploratory study, it strongly points to the need to include economic activity as a possible source of old age financing.

### *2.4.1. NGOs*

Various senior citizen’s clubs and associations are found in most urban localities and there is an umbrella organization known as the National Council of Senior Citizens Organizations Malaysia (NACSCOM). Together with the Gerontological Association of Malaysia (GEM), the GoldenAge Welfare Association of Malaysia (USIAMAS), the Central Welfare Council of Peninsula Malaysia (CWC) as well as a number of pensioners’ associations (e.g. civil service, police and the armed forces), the voluntary sector provides many types of service, such as home help, home visits, long-term shelter, day centers, leisure-based activities and policy advocacy for older persons in the country. Due to funding, human resource and geographical constraints, these services are often limited in frequency, scope and coverage.

### *2.4.2. Fiscal Incentives and Other Assistance and Subsidies*

Tax exemption is provided for the cost of medical treatment of aging parents, capped at RM5,000 a year. The health benefits enjoyed by civil servants have been extended to include their parents. Therefore, care for older persons is expected to be carried out by the family, and the government will only step-in when there are no dependents available. There are the usual concessions in public transport and travel. In addition, in the Budget 2010 the government has allocated provisions in the form of subsidies for a plethora of consumable items including petrol, diesel, cooking gas, wheat, bread, sugar, flour, rice, text books, scholarships, education, health, welfare and highway tolls which are aimed at reducing the burden of the cost of living. Due to these subsidies, and the controlled prices for essential items, the rate of inflation has been kept to a minimum which does not reflect the current economic situation facing not only Malaysia but the whole world. Partly due to the low inflation rate, wages in Malaysia have not improved over the years. This has been singled out as one of the major causes for the middle-income trap that Malaysia is now facing. Recently the government has been considering the removal of subsidies and the imposition of a goods and services tax (GST). While GST is intended to give the Malaysian government the fiscal "space", how this will affect Malaysians and social protection is hard to predict.

## 2.5. Summary

The previous section provided an analytical description of the current pillars of social protection in Malaysia. Roughly about two thirds of all employed persons are covered under the EPF, the government pension scheme, SOCSO or other savings schemes. Agricultural workers, own account workers, small business operators, petty traders, independent contractors, free lancers, owner-drivers, casual employees and so on are left unprotected. For Pillar 1, the pension system that provides coverage for civil servants, the size and scope of the scheme are limited since it covers only a small percentage of the population. The primary social protection pillar is the EPF, a defined contribution scheme that has a wider coverage and scope, although it has both advantages and disadvantages. The other schemes are SOCSO, Workmen Compensation, voluntary savings schemes as in the Amanah Saham savings schemes, designed for various target groups. Pillar zero which is in the form of direct cash transfers to the elderly and the needy population are administered by the government and are means-tested with specific eligibility criteria. Pillar 3 a voluntary pillar that covers private saving schemes and private investment such as in the unit trusts, suffers from a lack of data. Therefore it is difficult to estimate the size and the extent of coverage. However, those who subscribe to pillar 3 are also likely to be employed in the formal sector, for which a social protection scheme is already in place. Pillar 4 which refers to informal family support, and to other financial or non-financial support, has the same limitation in data.

## 3. Improving Social Protection: Critical Issues and Challenges

According to Barr and Diamond (2009), pension systems have multiple objectives and the design must not exceed the country's capacity, i.e., the design must fit the fiscal and institutional capacity at the level of economic development appropriate to the country. In moving forward in social protection reform, the Malaysian government must take into account its fiscal capacity. Up to now Malaysia could still afford to use its fiscal capability as indicated by the last budget deficit of 5.6% for 2010. Factors that Malaysia must be cautious about in moving towards closing the coverage gap, relate to the structural adjustment that the country needs in order to achieve its goal of becoming a high income country status by 2020. In other words, any pension reform design must take into account the current and the future capabilities of the country, as well as the delivery mechanism, including the management and the governance issues of reform. Coupled with these challenges is the critical issue of managing people's expectations, in job creation, in health care, and in ensuring quality of life, with at least a comfortable replacement level based on the individual's lifestyle before retirement. In addition, the three dimensions of pension coverage that need attention are: (1) the proportion of potential beneficiaries covered by the pension system as a whole; (2) the risk contingencies covered; and (3) the level of benefits (Asher, 2009, ISSA Paper No. 11). In as much as the schemes are examined separately in order to determine the benefits level, extent of coverage and the risk contingencies, the possible linkages between them are crucial since no one pension design will be adequate. This is advocated under the World Bank's framework of the multi-pillar system.

### 3.1. Issues and Challenges of the Present System of Social Protection

#### *3.1.1. Coverage*

As there is a positive correlation between per capita income and social protection coverage, Malaysia will find it challenging to increase coverage through formal sector employment growth (Asher, 2009). About 30% of the labor force is in the informal sector, representing about 6.5 million people by 2020. They are without formal social protection. Their known source of protection lies with the individual and the family. The informal sector workers are heterogeneous with possible movement within the sector itself. Given this heterogeneity, no single scheme is likely to be able to suit all the informal workers. On the other hand too many schemes, targeting too many specific groups, will not be viable or sustainable in the long run, given the small size of the Malaysian population, besides the issue of not wishing to restrict labor mobility. The single major obstacle that hampers the design of any schemes for the informal sector is the serious lack of data. However, any pension reform must take into account this group of informal sector workers. While they are encouraged to contribute to the EPF on a voluntary basis, the take-up rate is low. Towards encouraging more to contribute voluntarily, the government through its Budget 2010 has announced the establishment of 1 Malaysia Retirement Scheme, a voluntary scheme based on affordability, which begs the question of the density of contribution.

EPF as a saving scheme is the largest saving scheme in Malaysia covering about 50% of the labor force (the civil service pension scheme covers only about 7% of the working population). Therefore, there is likely to be some proportion of the labor force that ought to be contributing, but is not. Administrative and compliance procedures need to be stepped up in order to ensure that those who ought to be covered are contributing. LTAT is another saving scheme for the armed forces and the coverage is restricted to armed forces personnel.

An estimated 5% of the population in 2008 is benefiting from the social assistance and social welfare programs at the federal and state level. These cash transfer programs must be carefully designed and managed so that the system is based purely on need, and is means-tested without regards to ethnicity, religion or political affiliation. Effective and efficient management of these schemes can be a challenge, since the people who are in need are located in different localities, even in the most remote parts of the country. Reaching out to this group will be a challenge.

*3.1.2. The Level of Benefits*

In designing a multi-pillar system of social protection, the level of benefits is important. It is clear that the main objective of pillar zero is to provide the most basic level of need, the subsistence level. Those who are receiving this social pension/assistance scheme, they must be given other forms of assistance so that they are elevated from the poverty trap. This group will continue to benefit from the public health care system, free education and forms of micro credit that will help them to be economically active. Without other forms of assistance, they will continue to be at risk, vulnerable to prolonged poverty.

Although the EPF has the highest percentage of coverage; the benefits level has always been questioned. The average sum of money available at age 55 is not adequate to smooth consumption till age 75 years, or till life ends. Currently EPF is urging that a member must at least accumulate a sum of RM120,000 at age 55. This amount when spread over a period of twenty years is only RM500 a month. For EPF to generate sufficient benefits, the density of contribution and the growth in wages must be considered. Recently there has been much talk and speculation about the wages growth if Malaysia needs, if it is to become a high-income country by 2020. In order to have a high density of contribution, the government may have to re-consider increasing the mandatory retirement age. Another major problem faced by those under the EPF scheme is the cost of health care, in particular for those who do not have sufficient accumulation of savings upon retirement. Unless they are covered by a health care insurance scheme, they will have to seek care from government clinics and hospitals.

In general, the civil service Pension Scheme has achieved a replacement rate of nearly 50%. But for the lower income group, although the replacement rate looks adequate, the amount of money received could border on the household poverty line of RM720 a month. After the salary and pension revisions in 2007 and revised minimum pension amount, civil servants have the better long term protection in terms of income security in later life.

For SOCSO the scheme has the policy of “once a member, always a member”. This enables those who after joining are now earning more than RM3000 a month to continue enjoying the benefits of the scheme. This is a workman’s insurance scheme and not a pension scheme. Data on the amount of benefits are not available and hence it is difficult to estimate the adequacy of the level of benefits. However, the problem that is currently facing SOCSO is the issue of sustainability since the payout is about 80% of contributions received. Over the years the rate of contribution has remained the same while the payout has been increasing.

### *3.1.3. Governance and Management*

Clearly, for the mandatory schemes in Malaysia the issues of management and governance are important since these are related to individual contributors expectations and society’s confidence in the management of the schemes. The investment policy for KWAP, EPF and SOCSO are very conservative, mostly focusing on government bonds and securities. In order to generate a positive real rate of return, the government may need to consider policy change to allow these agencies to invest in high yield investments. To do so, the structure of governance needs to be strengthened. EPF has been excellent in delivering services but the mandate given to EPF in investment policy can be described as narrow, restricting its ability to generate a higher (positive) real rate of return. As seen in certain years, the real rate of return has sometimes been negative.

The structure of the EPF risk system management structure consists of the Ministry of Finance (at the highest level), followed by the establishment of risk policy which is overseen by four members: on one side there are the investment panel and the investment panel risk committees and on the other the board of directors and the board of risk management committee. It is at this level that risk policy is made. At the next level is the committee that is to ensure risk policy implementation and compliance. There are two types of committees: dedicated committees forming the first group consisting of a management risk committee, a management operation risk committee, and a management investment committee, while the second group is made up of an independent risk management and compliance functions committee, the risk management department and the settlement and compliance section. The next level is made up of implementers, who execute the decisions taken. To ensure the proper functioning of these committees, there is the audit board committee comprising internal and external auditors. Briefly, investments by EPF have been conservative and the investments are as follows:

- Malaysian Government securities (96.2 billion),
- loans and bonds (137.3 billion),
- equities (87.9 billion),
- money market instruments (19.0 billion), and
- property (1.6 billion).

There is no predetermined quota for investment in the various portfolios that EPF is permitted to invest in. The equity component of the investment has been rising and in some companies, EPF holds a majority of the equity. In such cases, EPF should be the shareholder with management control. However, EPF is an investor whose mandated function does not go beyond investment.

## 4. Policy Recommendations and Conclusion

In Malaysia, the longstanding principle up till the present day has been that financing social security has primarily been based on individual and family. Given the present state of economic development and the pressure for Malaysia to become a high-income country by 2020, social protection for the purpose of consumption smoothing and poverty prevention is now required, since it is known that countries that have successfully reformed their pension systems have also had sustained economic growth. Malaysia will have to construct a social protection reform plan that will provide adequate benefits to most of the eligible population. This involves the issues of coverage, level of benefits and the issue of governance and management.

Malaysia faces the challenge of implementing social protection reform systems that will (Asher and Nandy, 2006):

- Provide adequate benefits to most of the eligible population;
- Be sustainable financially and fiscally;
- Be affordable by individuals, businesses and the economy as a whole;
- Be robust in riding out cyclical economic crises and turmoil.

Full replacement of income for retirement cannot be obtained purely from one single source (scheme), therefore different tiers must be incorporated so that full replacement can be achieved.

*Pillar zero,* financed out of the federal budget, has to remain, but it must only be at the very basic level. It must provide subsistence to a group that meets set conditions. Two errors that should be avoided are: (i) giving aid to those who do not qualify and (ii) leaving out the deserving. Therefore, the management of the social assistance schemes needs a high level of coordination and perhaps the administration should be put under one agency for greater efficiency and effectiveness, monitoring and control. E-kasih is one such recent development towards this end. This pillar is the most effective way to provide for the most basic level of need and would be effective in addressing issues of gender, poverty and longevity.

*The Informal Sector.* Given the situation facing the informal sector, the social protection that is appropriate for it will need to be integrated with development policies and programs. The government has partly addressed the issue of protection for agricultural workers in the 2010 Budget. In order to help these workers and fishermen, the government has put in place RM2 billion in the form of subsidies, grants and assistance to help these groups improve their yield and productivity. For the urban sector, the government will also need to enhance the productivity of urban workers since the rate of urbanization in Malaysia is now about 63%. For small and medium businesses, there are various financing schemes to help their owners and the self-employed. Currently there are available a total of 79 SME funds and grants totaling RM8.8billion. The government intends to consolidates these grant schemes to 33. For micro enterprises, there is a scheme called the Amanah Ikhtiar Scheme that provides funding for micro business owners. Thus far, these efforts are geared towards providing assistance and funding for them to be more productive, and improve their standard of living. This indirectly caters for social protection in old age. Currently, the government is moving in the right direction by stepping up skills training and micro credit facilities to this group as announced in the 2010 Budget. However, there is an urgent need to put in place a social protection system for the informal sector workers. A multi-tiered social protection system involving a mix of risk sharing arrangements among the stakeholders; individuals, families, employers, the government and civil society must be formulated to safeguard against vulnerability to old age poverty (Asher, 2009). The 1Malaysia Retirement Scheme, a pillar 3 voluntary personal pension plan under the multi-pillar taxonomy within the World Bank framework, is based on affordability. It is important to create awareness among the informal sector workers about the need to take charge of one's later life. This ex-ante intervention is a good beginning (Asher, 2009). While this will provide some form of protection in old age, other pillars, such as pillar 4 could be used to meet the replacement level. Should these pillars fail, pillar zero which is means-tested could be relied on to provide for the most basic of needs.

As for Pillar 1 (civil service pension), since it applies to only a segment of the population and about 7% of the working population, the coverage is limited and it can hardly be regarded as a scheme that could be extended in coverage. The system is generous and to a certain extent is inflation indexed with pension revisions when salary revisions for civil servants take place. Because the amount of pension is tied to last drawn salary, a small percentage of retirees live in poverty. In this regard, using the means-tested conditions of pillar zero, the elderly who fall into this category would still need some help in ensuring that they at least receive basic subsistence. As for the young old, they should be encouraged to work. This may involve the help of community and NGOs in providing retraining or learning new skills. The training program administered by the government should be extended to older people, so long as they are still physically fit to be re-trained.

Although EPF reaches out to about 50% of the labor force, it has its own shortcomings, the major ones being the lump sum withdrawal that individuals prefer. They may not have the financial awareness and knowledge to invest for its utilization over the next 20 years. To address this shortcoming, the government can re-examine the annuity system to make it attractive for contributors to subscribe to it. Besides this, the argument about the adequacy of the EPF savings has long been discussed and debated. The pre-retirement withdrawal from EPF may need to be reconsidered so that savings remain as savings for old age. However, withdrawal for housing is felt to be proper, since it is used for asset enhancement, which will contribute towards a comfortable life after retirement. Therefore, for EPF to generate an adequate level of savings for retirement, the Account I should have sufficient density of contribution, if the government is unable to convert EPF payment into an annuity scheme. As for Account II, the amount of contribution should be kept low with restricted permissible withdrawals.

SOCSO is a social insurance scheme that is limited in scope. It is not a proper pension scheme but a workman's compensation scheme, although the scheme does pay out a pension for life. It is to a certain extent covering the cost of health care under circumstances of work-related injury and accidents.

Pillar 3 which refers to voluntary savings schemes is the most difficult to estimate in terms of its coverage, since there is serious lack of data. In moving towards encouraging the use of this pillar for old age protection, the government should consider tax advantages to contributors to make it more attractive.

Pillar 4 for the purpose of consumption smoothing and poverty prevention should be regarded as the last resort, since there is a serious lack of data and we do not have longitudinal research that allows us to study the effects of ex-ante intervention and the ex-post intervention. Older persons can still be a significant and valuable human resource. While the longevity among Malaysians has improved tremendously the mandatory retirement age remains at 55 years for private sector employees and 58 for the public sector. Malaysia needs to rethink the mandatory retirement age with the present life expectancy that Malaysians are enjoying.

In conclusion, Malaysia has to move towards a multi-pillar system of social protection (Appendix 1 and 2). While the present sources of social protection in Malaysia suggest the existence of a multi-pillar system, much of the effort is new, such as the 1 Malaysia Retirement Scheme that addresses the needs of the informal sector. The recommendations given above have to be considered within the broader political and economic structures of Malaysia. Currently the government is facing great pressure to move the economy into the high-income nation category. One of the suggested ways to achieve this is to push up the wage levels of Malaysians. However, this must be pursued alongside improvements in productivity. Once Malaysia achieves the high-income country status, there will be greater fiscal flexibility to sustain the pillar zero assistance and other forms of training and developmental assistance. The current economic growth of 4%-5% will not be sufficient for Malaysia to push forward in social protection reform; it needs a higher level of economic growth, which could be achieved through higher productvitiy improvements and high value-creating economic activities. Therefore the challenges ahead for Malaysia are not only about pension reforms but concern a total structural adjustment for the economy.

## Appendix 1

### Multi-pillar Social Protection Systems for Malaysia

| Pillar | Target Groups | | | Characteristics | Main Criteria | Funding / collateral | Malaysia |
|---|---|---|---|---|---|---|---|
| | Lifetime poor | Informal sector | Formal sector | | Participation | | |
| **0** | **X** | **x** | **x** | "Basic" or "Social pension," at least social assistance, universal or means-tested | Universal or Residual | Budget / general revenues | **Federal and State welfare schemes** |
| **1** | | | **x** | Public pension plan, publicly managed, defined-benefit or notional defined contribution | Mandated | Contributions, perhaps with financial reserves | **Civil Service Pension; Retirement Fund Incorporated** |
| **2** | | | **X** | Occupational or personal pension plans, funded defined-benefit or funded, defined contribution | Mandated | Financial assets | **Employees Provident Fund** |
| **3** | | **X** | **X** | Occupational or personal pension plans, funded defined-benefit or funded, defined contribution | Voluntary | Financial assets | **Bonds and other personal savings schemes, general and/or life insurance;** |
| **4** | **x** | **X** | **X** | Personal savings, homeownership, and other individual financial and non-financial assets | Voluntary | Financial and non-financial assets | **House ownership; financial and non-financial assets, remittances from children** |

*Source:* Holzmann and Hinz (2005), Adapted from Asher and Nandy (2006).
*Note:* The size of x or X characterizes the importance of each pillar for each target group.

## Appendix 2

### Summary Table: Key Provident and Pension Fund Indicators in Malaysia, 2008

| Organisation | Who is Covered? | Contribution Rate | Total No. of Members / Contributors (Million) | No. of Active Numbers | % of Labor Force (11.03 Million) | Contributions Balance (RM Billion) | % of GDP (RM741.2 Billion) | Total Assets (RM Billion) | Pre-retirement Withdrawals |
|---|---|---|---|---|---|---|---|---|---|
| Civil Service Pension | Public servants | Nil | 1.24 | 1.24 | 11.2 | - | 4.9 (emoluments as % of GDP) | | |
| | Pensioners and Pension recipients | Nil | 0.51 | - | 4.6 | - | 1.1 (pension expenditure as % of GDP) | | |
| Retirement Fund Incorporated (KWAP) | Pensionable employees | 17.5% - Employer (Agency, Statutory bodies and Local authorities), employees do not contribute | 0.11 / 493 Employers | - | - | 52.04 | 7.0 | | |
| Armed Forces Fund Board | Members of the other ranks in the armed forces | 10% - Employee<br>15% - Employer (Government) | n/a | - | n/a | 5.85 | 0.8 | 7.17 | |
| Employees Provident Fund | Employed persons under a contract of service | 8% - Employee<br>12% - Employer | 12.07 | 5.71 | 109.4<br>(51.8) | 344.64 | 46.5 | | Total: 18.2 billion |
| Social Security Organization | Employed persons under a contract of service with a monthly salary = RM3,000 | 0.5% - Employee<br>1.75% - Employer | 11.75 | - | 106.5 | 53.87 (2007) | 7.27 (2007) | | No pre-retirement withdrawal |
| Workmen’s Compensation | Foreign workers | Insurance premium RM86 per worker per year | n/a | - | n/a | n/a | n/a | | na |

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