Summary of Policy Dialogue: The OECD Economic Survey Malaysia 2026 – Stepping Up Reforms to Sustain Higher Incomes

Malaysian Institute of Economic Research

On 29 July 2026, MIER convened a Policy Dialogue to discuss the findings of the newly released OECD Economic Survey: Malaysia 2026. The report was presented by Dr. Jens Arnold of the OECD, and the dialogue was chaired by Tan Sri Dr. Sulaiman Mahbob. The event was attended by MIER's Chairman, members of the Board of Directors and Fellows, together with officials from the Ministry of Economy, and representatives from academia, think tanks, and industry associations. The dialogue provided a platform for exchanging views on the survey's key findings and their implications for Malaysia's economic policy and reform agenda.

Dr. Jens Arnold introduced the Survey, which the OECD had launched the previous day, and traced Malaysia’s macroeconomic record over the past decade. He put much of the recent momentum down to capital drawn in by the global AI boom, particularly in semiconductors and digital services. Prudent monetary policy and fuel-price measures had kept inflation in check, and he expected growth to hold up despite a tight labour market.

The OECD observes that Malaysia is approaching high-income status, having recorded stronger growth in GDP per capita than most of its regional peers over the past two decades. According to the report, sustained structural reforms have been instrumental in this progress. In particular, robust inflows of foreign direct investment into high-value sectors including semiconductors, electronics, data centres, and artificial intelligence (AI) infrastructure have contributed to broadening the country's industrial base. The OECD projects Malaysia's real GDP growth at 4.9% in 2026 and 5.0% in 2027, underpinned by a recovery in private consumption and continued investment in technology-related industries. Inflation has remained subdued, ranging between 1.1% and 1.9% in recent years. However, the report anticipates a modest increase in inflationary pressures through 2026, reflecting the pass-through effects of higher global energy and commodity prices.

Fiscal Policy and Public Finance

Deficit and debt rules. Under the Public Finance and Fiscal Responsibility Act, the federal deficit is to fall from 3.7% of GDP in 2025 to 3.0% by 2028. Gross public debt, however, reached 64% of GDP in 2025, above the 60% ceiling.

Long-term risk. The OECD identifies population ageing as a key long-term fiscal challenge. Rising expenditure associated with an ageing population, limited social protection coverage particularly pension coverage, which currently extends to fewer than 40% of the working-age population - and increasing healthcare and education costs are expected to place growing pressure on public finances. The report warns that, in the absence of comprehensive structural reforms to address these demographic and fiscal challenges, Malaysia's public debt could exceed 100% of GDP by 2060.

Subsidy reform. The OECD noted that replacing broad-based fuel subsidies with targeted cash transfers delivered through the PADU social registry helps improve the efficiency of public expenditure by better targeting assistance to lower-income households while reducing fiscal leakages associated with universal fuel subsidies.

Revenue. The OECD noted that Malaysia's government tax revenue is low at only 12.6% of GDP. The OECD recommends bringing back a broad-based consumption tax such as GST or VAT, widening a personal income tax base that currently reaches only 15% of workers, and tightening tax administration.

Fiscal Sustainability

Fiscal sustainability was a central theme of the presentation. Dr. Arnold noted that Malaysia's fiscal space has narrowed at a time when demographic ageing is expected to place increasing pressure on public finances, particularly through higher pension, healthcare, and social protection expenditures. Against this backdrop, he outlined three key policy priorities:

1. Replace broad-based fuel subsidies with targeted assistance for vulnerable households, leveraging mechanisms such as the PADU social registry to improve the efficiency and equity of public spending.
2. Strengthen domestic revenue mobilisation through the introduction of a broader-based consumption tax to enhance fiscal resilience.
3. Continue fiscal consolidation while safeguarding public investment that supports productivity, economic transformation, and long-term growth.

1.2 Structural Reforms and Productivity

OECD noted that productivity growth has cooled. Barriers to market entry and a heavy regulatory load are part of the reason: Malaysia scored 2.74 on the OECD’s 2026 Product Market Regulation index, pointing to tighter restrictions than the OECD average.

The country also scores high on the FDI Regulatory Restrictiveness and Services Trade Restrictiveness indices, reflecting foreign-equity caps and local-incorporation rules for cross-border digital services. Easing these would make it far simpler to scale cloud services and adopt AI.

On state-owned enterprises, OECD suggested scaling back preferential treatment for SOEs and lifting their governance standards would give private firms a fairer footing and sharpen competition.

Despite Malaysia's generally favourable investment climate, Dr. Arnold observed that productivity growth has remained below expectations. To strengthen productivity and enhance long-term economic competitiveness, the OECD proposed a series of structural reforms:

1. Easing restrictions on market entry to foster greater competition, innovation, and integration into global value chains.
2. Enhance product market competition through the gradual removal of price controls and the simplification of business regulations to improve market efficiency.
3. Promote competitive neutrality by strengthening the governance of government-linked companies (GLCs) and ensuring a more level playing field between GLCs and private enterprises.
4. Rationalise support for micro, small, and medium-sized enterprises (MSMEs) by focusing assistance on innovation, digitalisation, productivity enhancement, and export readiness.
5. Strengthen public sector governance and accelerate digital transformation to improve the quality, efficiency, and transparency of public service delivery.

1.3 Education and Human Capital

Malaysia has made significant progress in expanding educational attainment, with average years of schooling rising from 5.8 years in 1970 to 10.4 years in 2024. Nevertheless, skills mismatches and weaker learning outcomes suggest that further reforms are needed to improve education quality.

Spending on early-childhood education remains modest next to primary and secondary schooling. Making preschool free and universally available for children aged three to five would help narrow socio-economic gaps and raise productivity over the long run.

Dr. Arnold argued, education is central to Malaysia’s transition into the high-income nation. He pointed to falling learning outcomes, with Malaysia placing in the bottom third of countries in the 2022 OECD PISA assessment, and to persistent skills mismatches. His recommendations were:

1. Expand free and compulsory preschool and improve the coordination of early-childhood education.
2. Strengthen teacher incentives and school autonomy to lift outcomes.
3. Raise TVET quality and align it with labour-market needs, with more input from employers.
4. Close skills gaps by deepening links between universities and industry and giving universities greater autonomy.

1.4 Climate Change and Energy Transition

The OECD noted that climate-related risks are becoming increasingly significant for Malaysia, with the country facing more frequent floods and heatwaves. Dr. Arnold observed that the current policy response remains fragmented, characterised by uneven implementation of adaptation measures, limited availability of climate risk information, low levels of insurance coverage against climate-related losses and the continued use of broad-based fuel subsidies, which weaken incentives for emissions reduction. To strengthen climate resilience and support the transition to a low-carbon economy, the OECD recommended that Malaysia:

1. Finalise the National Adaptation Plan (MyNAP) to put adaptation on a firmer governance footing.
2. Improve climate-risk data and flood mapping to inform planning.
3. Widen access to natural-disaster insurance while protecting vulnerable households.
4. Consider making natural-hazard cover mandatory in property insurance.
5. Move gradually from fuel subsidies towards carbon pricing, with support for those least able to absorb the cost.

2.0 Dialogue Session

The discussion was marked by active participation from the invited experts and centred on several recurring themes.

2.1 Education Quality, Human Capital and Future Skills

Education emerged as one of the most extensively discussed topics during the dialogue. Participants viewed Malaysia's declining performance in the Programme for International Student Assessment (PISA) as indicative of broader structural challenges in the education system, particularly with respect to teaching quality, teacher professional development, and curriculum effectiveness. The discussion also raised concerns regarding school instructional hours, teacher competency, the selection and leadership of school principals, and the decline in higher education enrolment.

In response, Dr. Arnold emphasised that improving the quality of education is more important than increasing the quantity of instructional time, noting that longer school days alone are unlikely to produce meaningful improvements in learning outcomes. Instead, he advocated reforms aimed at:

1. Better teacher quality and continuous professional development;
2. Stronger incentives and a more attractive career path for teachers;
3. Greater school autonomy, matched by clearer accountability;
4. More public spending on education; and
5. Wider access to quality early-childhood education.

On TVET, Dr. Arnold emphasised the importance of ensuring that curricula remain responsive to evolving labour market demands and aligned with employers' skills requirements. Drawing on the experiences of Finland and Germany, he mentioned that vocational education should be recognised as a pathway of equal standing to university education with stronger links between training institutions and industry.

Overall, the discussion reflected broad consensus that education reform should prioritise improvements in learning quality, strengthen teacher quality and professional development, and ensure closer alignment between the education system and the future needs of the labour market. Participants agreed that these reforms are critical to enhancing Malaysia's long-term productivity, competitiveness, and human capital development.

2.2 Social Protection and an Ageing Society

Demographic change and social protection emerged as another key area of discussion. Several participants questioned whether Malaysia's existing social protection system is adequately prepared to meet the challenges associated with population ageing. The discussion focused on the adequacy of retirement income, the long-term sustainability of the Employees Provident Fund (EPF), the growing prevalence of informal and gig employment, and the evolving role of families in providing care for older persons.

In response, Dr. Arnold stressed the importance of preparing early for demographic transition through comprehensive reforms to the social protection system. He advocated a multi-pillar approach that combines a tax-financed basic layer of social protection with the existing contributory pension scheme, drawing on the experiences of Thailand and other countries that have expanded social protection coverage through similar models. He further observed that the rapid expansion of gig and other non-standard forms of employment presents significant challenges for social protection systems that were originally designed around stable, formal employment and regular contribution patterns.

The discussion reflected broad agreement that Malaysia should strengthen and modernise its social protection system to address the needs of an ageing population while adapting to structural changes in the labour market. Participants generally concurred that reforms should aim to enhance both the adequacy and sustainability of social protection while extending coverage to workers in non-traditional forms of employment.

2.3 Productivity, the Labour Market and Competitiveness

Productivity and competitiveness were also recurring themes throughout the discussion. Participants examined productivity challenges from multiple perspectives, including the regulatory environment, investment climate, labour market dynamics, and digital transformation. Questions were raised regarding the importance of policy consistency, the efficiency of licensing and regulatory processes, the role of digital nomads and foreign investment in supporting economic growth, and whether Malaysia's education system should evolve to better prepare workers for emerging forms of employment, including the creative economy and gig work.

In response, Dr. Arnold reiterated several key policy priorities for raising productivity and strengthening long-term competitiveness. He emphasised the need to:

1. Structural reform that strengthens competition;
2. More investment in education and skills;
3. Greater capacity to innovate; and
4. Simpler rules and better incentives for firms to invest in technology and people.

GDP-based measures of productivity have their limits, he conceded, but remain the most widely used yardstick for comparison across countries.

The shared view was that higher productivity will come from coordinated reform across education, regulation, innovation and the labour market, not from any single measure.

2.4 Climate Resilience and Energy Transition

Climate change and environmental resilience generated substantial discussion, particularly in relation to flood risks, renewable energy development, and the broader direction of Malaysia's energy transition. Participants highlighted several practical challenges, including the technical limitations of solar and hydropower capacity, the affordability and accessibility of disaster insurance, the complexities surrounding disaster claims, and the need to balance emissions reduction objectives with energy security considerations.

Dr. Arnold acknowledged these challenges and emphasised that the expansion of renewable energy capacity should proceed in a gradual and pragmatic manner, taking into account technological developments and system readiness. He also noted that strengthening disaster risk financing would require a collaborative approach involving both public and private sector stakeholders, with greater government efforts directed towards protecting vulnerable communities and supporting risk-informed planning.

The discussion concluded that building long-term climate resilience requires a coordinated policy approach that integrates energy transition strategies, disaster risk financing, innovation, and sustainable infrastructure development.

Overall Reflections and Conclusion

The dialogue reflected broad agreement with the OECD's emphasis on structural reform as Malaysia moves closer towards high-income status. While participants generally welcomed the report's recommendations, they stressed the importance of adapting international policy lessons to Malaysia's specific demographic trends, institutional capacities, and socio-economic context.

The discussions highlighted several priority areas requiring sustained reform efforts, particularly education quality and teacher development, fiscal sustainability, social protection, productivity enhancement, and climate resilience. These areas were recognised as critical to ensuring that Malaysia's transition towards high-income status is supported by inclusive, sustainable, and long-term economic progress.

Closing the session, MIER Chairman Tan Sri Mohd Effendi Norwawi welcomed the report as a useful impetus for reflection and reform. The dialogue, he said, had produced valuable material for policymakers, above all on public-sector reform, education and teacher quality, which he regards as fundamental to Malaysia’s long-term development and he hoped the ideas discussed would feed into future policy. Dr. Arnold ended by acknowledging that the OECD’s advice will not always match local conditions; the Survey, he said, is meant to offer evidence-based options that governments can adapt to their own priorities and context.