Sustainable fiscal position for Malaysia:

A PROPOSAL FOR REFORM

By: Dr Azura Othman
(CEO of the Chartered Institute of Islamic Finance Professionals (CIIF))

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Malaysia needs more fiscal space to manoeuver and safeguard growth under current challenging economic condition. The current persistent deficit and high leverage has raised concerns about the sustainability of Malaysia's fiscal position. Amid the above concerns, measures that have been taken by the Government thus far – mainly in the form of subsidy rationalization and the introduction of the Goods and Services Tax (GST) – although required, have not been popular among the masses, and ineffective if the Government does not reign in its operating expenditure and borrowing. Increasing borrowing further via bond issuance or long-term government borrowing increases vulnerability, adds interest payment burden on future taxpayers and creates adverse distributional implications.

When fiscal sustainability is not strong, the economy is exposed to deteriorating fiscal position if external shocks were to hit the country or the expected economic growth is not forthcoming. Additionally, there has been growing uncertainty on the adequacy of current policy regimes that are anchored on the interest-based debt system to provide a sustainable solution to economic stability.

It appears that current policy regimes have not managed to stimulate stable and strong recoveries. Rather than looking at the conventional policy prescriptions in alleviating the budgetary imbalance, such as introducing new or increasing taxes, or introducing expenditure restriction or fiscal stimulus, it is high time that policy makers look at a holistic approach in reforming the way fiscal policy tools have been utilised to stabilize the economy. Therefore, this study proposes an alternative fiscal framework that comprises a simpler and more equitable tax structure, and an interest-free public financing.

The aim of the reform in the tax structure is to increase tax revenue through greater tax compliance and at the same time the imposition of tax is based on the financial capacity of the taxpayer. The flat tax system on income and wealth is simple as there will be only one rate of tax that applies to all and those are the only taxes to be levied. The imposition of tax on wealth provides additional revenue to the Government and most importantly it is a tax imposed on the more able segment of the population. Income alone may not be a sufficient measure of wellbeing or taxable capacity. It is the possession of wealth that adds to the capacity to pay tax over and above the income it yields. Wealth represents a wider tax base and so the rate of tax can be kept low.

The policy reform is also suggesting an interest-free public sector financing policy to circumvent the divergence between the financial and real sector of the economy created by the interest-based financial system, as a result of interest being payable notwithstanding the outcome of the economic activities that the loan finances. A financing policy based on a system of risk sharing regress from pure profit maximisation incentive and cultivates a system that is devoid of externalities, setbacks and pursuits of certain groups at the cost of others within the society. The proposed policy reform suggests that the Government's development expenditure will be financed through issuance of risk sharing instruments in small denominations to the public.

The partnership between Government and the public in development projects will not only mobilise high idle private savings in Malaysia to productive use, it also allows private savings, which is currently generating 2% to 3% return, to a potentially higher return based on the return to the real sector of the economy. The cost to the Government of rising financing via risk sharing instruments would not be much higher than the current rate of return paid on debt instruments; instead it provides a better impetus to the growth of the economy by mobilising idle funds.

Based on financial data of the Malaysian government from the years 1970 to 2013, a simulation of a new tax revenue stream and federal government liability position under the proposed policy configuration are generated. With the use of a fiscal sustainability indicator and fiscal sustainability test, the fiscal sustainability position of the existing and the proposed fiscal framework for Malaysia is assessed. The fiscal sustainability test involves testing for unit root and cointegration of the government revenue and expenditure as well as error correction model to analyse the relationship of the two fiscal variables. Using Dynamic Ordinary Least Squares (DOLS), the study evaluates the viability of the proposed fiscal policy framework vis-à-vis the existing fiscal framework in terms of providing a more sustainable fiscal position for Malaysia. The results show that the current fiscal position of Malaysia is empirically sustainable but "weakening" in recent years. Similar fiscal assessments were applied to time series of simulated data on tax revenue and government expenditure, which is based on a proposed fiscal framework comprising a flat rate tax system on income and wealth only, and a public sector financing policy that utilizes equity participation shares issued to the general public. It is empirically shown that under the proposed fiscal framework, the fiscal sustainability is stronger. This was indicated by the results of the fiscal sustainability indicator that gradually moves further below unity over time. The fiscal sustainability test and the results of the coefficients of the DOLS equation corroborated the above findings. Therefore, it can be concluded that a case for fiscal reform is justifiable.

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The aim of the reform in the tax structure is to redistribute wealth and increase tax revenue through greater tax compliance whilst maintaining the simplicity, fairness and participation of everyone in the economy. It is also aimed at inviting public participation in the development of the nation through risk-sharing financing by the government. Among the benefits of the proposed fiscal framework is the equilibrium of competing interests that puts the financial impact outcome in its proper perspective. Not only that it provides a better fiscal sustainability position, the policy tools provide an incentive structure for closing the gap between the financial and real sector of the economy and at the same time enhance rule compliance and social solidarity through the mutual sharing of risks and return that are needed to achieve economic justice.

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Azura Othman, Abbas Mirakhor (2014), Risk Sharing and Public Finance, Journal of Islamic Business and Management, Vol. 4 No. 1 pp. 55-72