REFSA Notes

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PRE-BUDGET 2022 STATEMENT

Frederik Paulus
Economic Advisor, REFSA

Jaideep Singh
Researcher, REFSA

Hafiz Noor Shams
Visiting Fellow, REFSA

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Budget 2022 is the first national budget in which the current opposition parties have direct and meaningful roles in influencing and formulating government policy. The Memorandum of Understanding (MoU) signed between the government and the Pakatan Harapan (PH) opposition allows for a more collaborative approach in designing measures to combat the Covid-19 pandemic and promote economic recovery.

2021 has been as difficult a year as 2020, despite early expectations of a strong V-shaped economic recovery. Unfounded rosy projections had left Malaysia unprepared for what followed, with the government having to take harsh measures to combat the pandemic. Fortunately, one good thing came out of the mistakes: the flare-up of the pandemic pressured the government into vaccinating the population as quickly as possible. The eventual success of the vaccination programme now creates genuine optimism, and a better foundation for economic recovery in 2022.

But recovery is not a given. For recovery to take place, premature fiscal consolidation must be avoided. Fiscal policy must remain greatly expansionary until recovery is secured, and this can be done by providing support to workers and businesses in sectors that have been hard hit by the pandemic. Based on the pre-budget statement released by the Ministry of Finance (MoF) and the list of requests published by the PH Economics committee, the budget should indeed end up containing many such measures. In particular, we are supportive of the following measures that have been mentioned so far:

More spending on healthcare, education and women,

COVID-19 funding to aid businesses and households,

Improve work hiring incentives,

Investments in growth sectors,

Reinforce our social safety protection network.

Budget 2022 will be the first federal budget falling within the 5-year period of the 12th Malaysia Plan (12MP). This fact makes this budget critical in shaping Malaysia's post-pandemic economy. Within this context, it is worthwhile to note that in recent years the **federal budget has become a short-term exercise that largely ignores longer-term planning**. Next year's budget would do well to **introduce multi-year plans** in different ministries, not just to implement 12MP measures, but also to drive the transformation our economy needs, such as reforming the labour market and building out a comprehensive national social safety net.

Additionally, the 12MP introduces strategies aimed at remediating long-standing pain points in the economy. However, as highlighted in our recent podcast commentary, there are very few concrete measures to address these problems. Indeed, the 5-year plan contains mostly statements of intent. Our hope is that the **budget will bring about more concrete measures and policy**, particularly in the following areas:

1. Building Malaysia back better after Covid-19, in healthcare, education and industrial policy among others,

2. Creating a comprehensive social safety net that formalises informal employment,

3. Reducing reliance on foreign labour.

Beyond these broad topics, this paper aims to highlight some specific and perhaps less familiar topics connected to the budget, both on the expenditure and revenue sides.

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AN EXPANSIONARY BUDGET REMAINS KEY

After a difficult start to the year, **a large expansionary budget remains necessary to support the economy**. As we outlined in our Projek Muhibah Strategy 3, the fiscal component of the multiple support packages thus far was relatively small, even if the proposed measures were effective. After more than 18 months of depressed business activity, households and businesses have long spent the support provided previously, but their income and revenue has not yet fully recovered. Therefore, **further targeted support is required**.

SUPPORT VULNERABLE GROUPS, ESPECIALLY WOMEN

The pandemic and associated lockdowns are inherently regressive, and it is no coincidence that lower income households have been particularly badly impacted by the recent health and economic crises. They are less likely than higher income households to be able to work remotely, less likely to have health insurance, and more likely to have lost their job (or face precarious employment) due to business closures.

Moreover, they may be forced to care for dependents, such as children who have been out of school, ill relatives or the elderly, with limited resources for outside help. On top of that, they are now also confronted with rising prices, including for staple goods. The upshot is that these **low income households need more cash support, far beyond what they have already received as part of the Bantuan Prihatin Rakyat payouts**.

Special consideration should be given to women. Women are more likely to have given up on work to care for family members, whether their children or other relatives. As a result, their labour force participation has dropped relative to the pre-pandemic period (56.1% in Q4 2019 compared to 55.4% in Q1 2021). As we move towards national recovery, it is crucial that women are supported to promote resilience. In line with that, the upcoming budget must also be gender-responsive, as part of the goal to promote gender equity by ensuring resource allocation and policy designs are made with an awareness that the budgets have on both men and women.

For example, ensuring child care centres, childcare workers, schools and teachers can continue to operate, with additional wage subsidies or grants, will allow women to get back into the workforce. Childcare subsidies can be given to the B40s/M40s and those who have lost their jobs. Special allowances or wage subsidies should be created for parents who have special needs children. These incentives will not only ensure that vulnerable groups stay afloat, but they will also help create conditions for stronger business, and, by extension, **economic recovery through an increase in households' purchasing power after 1.5 years of depressed demand**.

More comprehensive social protection for workers is also necessary. Job losses have forced many workers to resort to gig work, where their income is much less certain, because the alternative was not to earn any income at all. Worse, a majority of Malaysians have inadequate savings for retirement. Not all eligible workers are registered for EPF, and only about half are registered under the Employment Insurance Scheme (EIS). The budget should **provide incentives for workers to join these schemes to improve their social security**. Moreover, by spreading the coverage of future payouts over a larger number of contributors, it would be possible to either enhance the coverage or reduce the amount of the individual contributions.

SUPPORT FOR BUSINESSES

The previous support packages announced during the pandemic have mainly focused business support on loan guarantees, the interest payment moratorium and subsidies for wages and hiring. This time, the **budget should aim for larger, but better targeted, outright cash support to those businesses that need it**. The loan moratorium and support through loan guarantees etc. are effective up to a point, but at this stage, most affected companies' liquidity positions are exhausted, and those same companies will not be eligible for loans to guarantee in the first place. **Outright cash support could be part of a policy mix that also includes soft loans extended by financial institutions, complemented with government guarantees.** More direct business support would be particularly beneficial for sectors that have been heavily affected by the country's lockdowns, including tourism and hospitality, entertainment and sports.

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INCREASE SPENDING ON HEALTHCARE

The pandemic challenged the capacity and the capability of the public health sector, which has suffered from years of underspending. Despite that, the pandemic proves only the public health sector can provide leadership during a public health crisis, with the private health sector incapable of doing so, as observed during the early days and at the heights of the Covid-19 pandemic.

The Covid-19 challenge only highlights what many have known for years. As REFSA has previously highlighted, Malaysia regularly spends below what other upper-middle income countries spend on public healthcare. According to World Bank data, Malaysia's 2018 total healthcare spending (public and private) relative to GDP was 3.8%, which is lower than 6.8% seen among upper-middle income countries in the same year. Additionally, out-of-pocket healthcare spending in Malaysia was 35.1% of total health expenditure in the same year, higher than upper-middle income countries' average of 32.9%.

	Malaysia	Upper-middle income average
2018 Total healthcare spending relative to GDP	3.8%	6.8%
2018 Out-of-pocket healthcare spending	35.1%	32.9%

If upper-middle income countries are the benchmark, then this suggests **total healthcare spending in Malaysia needs to be raised by approximately 3 percentage points.** Here, the public health system should be the driver in pushing the figure up.

The need to raise the spending level is all the more important given Malaysia's demographic profile, which is ageing. The necessary preparation needs to be carried out as soon as possible before the demography gets decisively older.

INCREASE SPENDING ON EDUCATION

Education is another segment requiring urgent attention. The pandemic over the past two years has deeply disrupted the learning process, and that risks lowering children's potential for years to come. The government must **provide greater funding to the education sector**, particularly from preschools to secondary schools, to catch-up with lost time and ensure better learning outcomes. Investment should be made to enable face-to-face learning during the pandemic.

Additionally, in the face of a greater automation trend, it is imperative to **provide Malaysian workers with upskilling or reskilling opportunities.** This can be done by opening more places in the tertiary public education system for new students. Spending should be directed at hiring competent teaching staff and providing facilities required for face-to-face learning sessions. Furthermore, to encourage upskilling and reskilling, the government should provide tax incentives and merit-based scholarships for those interested in returning to schools.

CONTROL EXPENSES AND INCREASE REVENUES

The economic damage wrought by the pandemic has been met—rightly—by a historic surge in spending by governments around the world, funded by borrowing. Malaysia is no exception. It has had to raise the debt ceiling last year, and has signalled its intention to do so again this year. While it is of critical importance not to start down the path of austerity that risks undoing the country's fragile economic recovery in this budget, it would nonetheless be **prudent to start laying the foundation for greater revenue collection in 5-10 years down the road.** In the meantime, all programmes, especially long standing ones that have become institutionalised, should be reevaluated, to ensure that money is being spent in the most effective ways.

Beyond the general need for a path to fiscal sustainability, the need for additional revenue is driven by specific issues, in particular the **risk of a near-term implosion in operating expenses (OE).** The majority of the budget is allocated to OE, but by law, any government borrowing is only allowed to finance development expenditure (DE). By extension, OE is financed out of government revenues, primarily taxes.

The Covid-19 special bills allowed the government to borrow to finance the measures contained within, which are effectively OE (wages for healthcare staff, procurement of vaccines, etc.), but for a period limited in time. The risk therefore is that, when the special bills run out, OE will have to reduce proportionately. In addition, **debt service payments are also expected to increase** because of the larger amounts of borrowing, reducing the room for manoeuvre in OE even further. Hence, in order to avoid a potentially damaging reduction in government spending, new measures to raise additional revenue are required.

LAY THE FOUNDATION FOR A BROADER TAX BASE

Currently, the revenue breakdown of the government is as follows. Tax revenue (direct and indirect) only covers about half (50%) of the total budget. Non-tax revenue, which includes items like investment income, covering revenues from Petronas and petroleum income more broadly, makes up between 20-25% of the budget, depending on the situation. The rest, about 25-30% is made up of borrowing[1].

Taxes provide the most stable revenue base for the government, but **Malaysia's tax base is quite narrow**, meaning very few people or corporations pay tax. According to MoF's revenue report as part of Budget 2020, only about 2.5m of Malaysia's 15m workers were eligible to pay tax in 2017, and fewer than that would have actually paid. Similarly, only about 62% of Malaysian companies were registered with the tax authorities the same year, with just under 8% of them liable to pay tax.

While it is too early to start raising taxes, it is **not too early to start putting in place measures that will broaden the tax base**, with a view to increasing the overall portion of taxes in the government's revenue over the next five to ten years. Three measures in particular are worth mentioning.

The first is the introduction of a ***Tax Identification Number*** (TIN), which the government has mentioned in its pre-budget statement. The TIN could then be a requirement for the opening of bank accounts, major purchases of assets or financial transactions, especially internationally. Introducing a TIN does not in itself raise taxes, but would be a step forward in ensuring taxes due are collected, and also in tracking assets being moved overseas.

The second is to ***review tax exemptions*** granted to corporations in return for investment and job creation in Malaysia, especially those with *pioneer status*. Such exemptions form a standard tool in attracting FDI, but they are meant to be limited in time. However, in most cases these exemptions have been continually renewed, leading to a situation today where some companies have been enjoying them for over 40 years. Beyond the loss of revenue, chances are also that many of the pioneer status companies are now in industries that are no longer a good basis for future economic growth. Therefore, it would be high time for a review and recalibration of those incentives.

The third is the ***introduction of new taxes***, in particular a ***capital gains tax*** (CGT). If such a tax had been set at the prevailing corporate or individual income tax rates, it would have brought in an additional RM4.0 billion every year based on the growth of the Malaysian equity market between 2015 and 2020, assuming a quarter of those gains were realised. This is only an estimate based solely on the equity market. CGT could also be levied on other assets when the gains are realised, like debt or shares in privately held companies.

REDUCE THE RELIANCE ON PETROLEUM INCOME

Petroleum-related revenue makes up about a fifth of government revenue, and with the price of oil rising above $80 a barrel recently, it will provide a welcome windfall for the government. However, the **increase in revenue is also offset in part by outdated fuel subsidies**, and with the ever more pressing need for renewable energy, demand for and hence the price of fossil fuels can be expected to decrease structurally in the future. Reducing the dependence on petroleum income is therefore imperative.

Phasing out fuel subsidies would be a good place to start. Although alleviating the cost of fuel constitutes a genuine benefit for low-earning households (both directly and indirectly), fuel subsidies are regressive overall, since wealthy households consume more of the subsidy, while every household pays for it equally. Hence, increasing the overall financial assistance to low-earning households to deliver the same benefit as the fuel subsidy, while removing the subsidy for higher-earning households would be a more effective way to spend the money. In addition, it would also remove a source of volatility in government expenditure.

However, simply reducing petroleum-related expenditure will not be sufficient to minimise the gap created by a long-term decline in petroleum income. Part of it would be addressed by increased tax revenue, as described earlier, but new sources of funding are also required.

One avenue to consider in the short term is the issuance of ***sustainability bonds***. MoF successfully issued a USD Sukuk linked to sustainable activities in April, raising $800m at a lower cost than anticipated, and with significantly more demand for the bonds than were available. The European Union just had a similar successful issue, also resulting in a cost for the bonds slightly below what a comparable conventional bond (not sustainable) would have cost. There clearly is investor demand for these types of instruments at this time, and there is no shortage of climate change mitigation projects to be funded, so it would be sensible to take advantage of these market conditions.

Another worthwhile option would be a ***partial privatisation of Petronas***. While this is by nature a one-time operation, there are two reasons why the timing may be right. First, the pandemic is clearly an extraordinary emergency situation that justifies extraordinary solutions. Privatising part of Petronas would go a long way to pay off the debts incurred for the response to the pandemic, and put the country on sounder fiscal footing to build back better. Second, as highlighted earlier, the demand for fossil fuels may be on the cusp of a secular decline in favour of renewable energy sources, which will reduce the valuation of the oil majors. In other words, it is important to strike while the iron is hot because this window of opportunity will not last forever.

A partial privatisation of Petronas does not mean ceding control over an important public asset. The government could sell just 5% of the shares to raise an estimated RM30bn,[2] while retaining absolute control of the company with 95% of the shares. This is the same philosophy that Saudi Arabia followed very successfully when it sold shares in its national oil company Aramco, completing the largest Initial Public Offering (IPO) of shares ever.

Moreover, a public offering of Petronas shares could be constructed in such a way that the general public benefits, for example by reserving an allocation of shares for retail investors. If soundly managed, the offering could then lead to a deeper and better functioning capital market in Malaysia, which is one of the ingredients required for strong economic growth.

CONCLUSION: A SHORT-TERM BUDGET WITH AN EYE TO THE FUTURE

While remediating the continued impact of the pandemic in 2021 should be the main preoccupation of this budget, it should also aim to include steps to the future direction of the economy and the need to build back better. Budget 2022 therefore requires a balance of short-term and long-term policy considerations. Not only does the budget serve an important role in catalysing the nation's economic recovery in 2022 following a challenging 2021, it also represents the first test of the government's commitment to honouring the 12MP.

With the seeds of cooperation sown in the form of the MoU, the 'Keluarga Malaysia' concept and the whole-of-nation approach described in the 12MP, Budget 2022 is an opportune time to turn slogans and buzzwords into action.

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ENDNOTES

1. For example, according to the government's Fiscal Outlook report released as part of Budget 2021, the revised total expenditure for 2020 was estimated to be RM314.7b (comprising RM226.7b in OE, RM50b in DE and RM38b under the Covid-19 Fund). Meanwhile, the breakdown of revised revenue was estimated to be as follows: tax revenue (RM153.2b, 49% of expenditure) and non-tax revenue (RM74b, 23.5% of expenditure). This suggests a revenue shortfall of about RM87-88b (27-28% of expenditure), which would have been funded through deficit financing (new borrowing).

2. In previous discussions about privatising Petronas, the company was valued between RM600bn to RM800bn. See https://www.theedgemarkets.com/article/listing-petronas-unlikely

ABOUT REFSA

Research for Social Advancement (REFSA) is a progressive, non-profit think tank that promotes social advancement in Malaysia. Since its inception, REFSA has been at the forefront of policy discussions and debates in the important political and socio-economic issues of the nation. Today, our aspiration hasn't changed - we want to power the movement for a just, inclusive and multi-ethnic society.

REFSA NOTES

REFSA Notes is a collection of thoughts, reflections, and ideas from our research team. They aim to provide the groundwork for further discussions, commentary, research agendas, and policy recommendations.

Frederik Paulus is Economic Advisor at REFSA and Senior Fellow at Penang Institute.

Jaideep Singh is a Researcher at REFSA.

Hafiz Noor Shams is a Visiting Fellow at REFSA.

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CREDIT

OTHER INFORMATION

REFSA

Research For Social Advancement

Level 5, Block A,
Wenworth Building,
Jalan Yew, Off Jalan Pudu,
55100 KL

(03) **9285 5808**

www.**refsa**.org