2010 Budget Blues

M I E R V I E WS

By Mohamed Ariff

To be sure, there are many good things one case say about the Budget 2010 that was recently unveiled. Indeed, the media was abuzz with headline kudos on what the budget had to offer. To say the least, it was a soft, people-friendly, caring budget that bent over backward to avoid undue burden on the people during difficult times. It certainly was not an easy task for the government to devise a budget that would minimise the tax load and at the same time reduce the gap between revenue and expenditure.

The government has plans to trim the size of the deficit relative to gross domestic product (GDP) down to 5.6 per cent in 2010 from 7.4 per cent in 2009, despite an expected 8.5 per cent drop in government revenue next year. It is not surprising that next year's tax collection will be smaller, not only because there are some tax concessions in the new budget but also because next year's revenue will be based on this year's income which is lower than the preceding year's due to the recession.

The government's strategy for reining in budget deficits is to cut government expenditure without having to raise tax revenues. The fiscal plan is to reduce government's operating expenditure and development expenditure by 13.7 per cent and 4.5 per cent, respectively.

There is considerable scope for reductions in the operating expenditure in the light of the recent audit revelations, which point fingers at huge wasteful spending, over-priced contracts and cost overruns. The savings can be substantial, as procurement accounts for roughly 15 per cent of the total.

What's more disturbing is the observation that the share of emolument will increase next year to 31 per cent of the total operating expenditure from 24 per cent this year. Malaysia has one of the fattest civil service bodies in the world relative to population size. More can be saved if the civil service is downsized to be slim and efficient.

The budget does not adequately address such near-term concerns as sedated investor sentiments, weak consumer confidence, and fragile recovery prospects. For starters, 2010 Budget is not expansionary as it is 11.4 per cent smaller than the current year's. Worse still, the planned boost for private consumption - through personal income tax rate cut (from 27 to 26 per cent) and higher tax deduction and relief - has been dampened by such measures as the imposition of RM50 tax on credit cards.

The latter is a wrong measure at the wrong time. If it is meant to generate revenue for the government, it will be self-defeating. It is estimated that there are 11 million credit cards in circulation in the country, with many holding multiple cards. The chances are that the government will end up collecting very little revenue from this tax, as cardholders will likely discard the redundant ones.

If this tax is meant to discourage the proliferation of cards in the system, there is no need for it, as the situation is under control, thanks to central bank oversight and supervision. The credit card situation in Malaysia is nowhere near that of South Korea's or Taiwan's in recent times. Banks are doing a roaring business with credit cards, profiting from both commissions and interest charges, while the delinquency ratio remains amazingly low.

The Real Property Gains Tax (RPGT) is another wrong measure at the wrong time. For one thing, the flat rate of 5 per cent is a retrogressive step, compared to the previous RPGT based on a sliding scale of 30 per cent to 5 per cent that was waived in April 2007. For another, RPGT is likely to endanger the property sector's fragile recovery. Far more dangerous is the unintended negative signals it may be sending to investors as though Malaysia is not a reliable or predictable place to put their money in.

The special treatment given to the Iskander Development Region (IDR) through the lower tax rate of 15 per cent may turn out to be a nonstarter. Experience has shown that tax differentials across the country tend to create more space for tax evasion. The chances of companies establishing "empty shells" in IDR while keeping their real operations elsewhere are high (to take advantage of the tax benefits without having to incur extra logistic costs).

The overarching question of lack of fiscal discipline remains unanswered. Malaysia has had 46 years of fiscal deficits, with surpluses in no more than six. There is a dire need for broadening the country's tax base while reducing the corporate and personal tax rates, so as to stay competitive with Singapore and Hong Kong. Malaysia's corporate tax rate of 25 per cent is way above Singapore's and Hong Kong's 17 per cent, while its personal income tax rate of 26 per cent exceeds Singapore's 15 per cent and Hong Kong's 17 per cent.

Only one-tenth of working population pays tax in Malaysia. One solution would be introduce the General Services Tax (GST) that will force everyone to contribute the country's coffers, as it is a tax on consumption. There is also a need to review the various investment incentives, as these may be either redundant or inappropriate. Studies have shown that such incentives are just icing on the cake, while investors' real concerns relate to things that will keeps their costs low and profits high. Thus, the "ease of doing business" matters a lot more than tax breaks. Malaysia ranks 23, with Singapore, New Zealand and Hong Kong taking the top three slots. We need to focus not on giveaways but on ways and means of making Malaysia a lucrative investment destination.

The writer is the executive director of the Malaysian Institute of Economic Research