

# **TOWARDS A FAIRER FISCAL SYSTEM**

**By**

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The existing fiscal structure in Malaysia is antiquated and in need of reform. One objection to the present fiscal structure rests on the fact that the federal government has undue control over fiscal policy and relegates the demands of state governments to a subsidiary position. Another objection with the existing fiscal structure rests on the intertwining of political interests with strictly economic and developmental considerations.

The government should move towards quite a different scenario, and aim to practice fiscal decentralization for two reasons. First, economic considerations such as efficiency and a better allocation of resources will be served if there is greater decentralization, with states taking more control over the running of their fiscal affairs.

Second, it is not optimal to sacrifice fiscal (and economic) efficiency for political advantage. In the process of waging a punishment and reward system, where the ruling party at the federal level more willingly supports those states that are in its hands, the larger economic welfare of the nation is left to slip into a state of second-best equilibrium.

The Malaysian Constitution clearly divides the sources of revenue that the federal and state governments have access to. The federal government has access to direct taxes such as income taxes, property and capital gains taxes, and estate duties. The federal government also has access to import, export, excise and stamp duties; sales, service and gaming taxes; and on sweepstakes and lotteries.

By comparison, the states can earn their fiscal revenue from import and excise duties on petroleum products, export duties on timber and other forest products, for instance. Also, in the list for state governments are incomes from forests, lands and mines and entertainment duties.

It is immediately clear that that the state governments have a narrower choice of options with regard to their sources of fiscal revenue. This implies that that the state governments cannot garner fiscal independence since their sources of revenue are limited.

As if to add to this asymmetry, there is the Petroleum Development Act (PDA) 1974 which is a fiscal policy instrument that reeks of economic irrationality. The PDA stipulates that all states are bound by law to give Petronas sole rights for oil and gas exploration. The Act implies that state governments have no mandate to initiate or develop the oil industry in their own states. Neither do the states have any right to participate in the gains accrued from profits obtained in this industry, beyond the five per cent that is due to them as provided for by the Act.

The fiscal monopoly that the PDA engenders is most obvious in the fact that Petronas is only answerable to the Prime Minister. The law, here, is being used to legitimize the centralization of power in the hands of the government at the expense of the oil-producing states' interests. One would expect the state governments to have some share of voice in the fiscal benefits that accrue within their own boundaries.

Obviously, the incestuous relationship that the Prime Minister enjoys with Petronas is in urgent need of attention, if fiscal reform is to take its first steps forward.

Yet another issue that needs to be addressed is the manner in which the federal government extends fiscal assistance to the state governments. When the federal government decides to allocate grants and other such funds to the states, this must be done on the basis of certain criteria. The set of criteria that the federal government should take into account would include the level of poverty, size of population, geographic area, and the level of development experienced by individual states.

The overall idea behind intergovernmental fiscal transfers should be to bring about equity among the different states and to stimulate the development trajectory of particular states. The ethical question is closely bound with development. Fiscal transfers should seek to target the less developed states. This objective does not always leap before one's eyes when one looks at the manner in which such transfers

have been carried out in the past. In any case, the criteria should be publicly presented and debated so that individual state governments and their respective populace know how much they are entitled to and why.

There are strong economic arguments for fiscal decentralization; and the economic welfare of the nation, considered as a whole, can be improved with a greater degree of decentralization and the efficiency and accountability that comes with it.

The question of fiscal reform has to be reviewed. The fiscal system that Malaysia has inherited and perpetuates is one that is suited to encouraging patronage politics. We must move to a system that is more decentralized and which gives state governments a bigger say in what happens within their boundaries.

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