

The Budget: Understanding the Scope of Government Participation in the Economy

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Malaysia's Public Sector

(RM mil.)

Year	Operating	Development	The Budget	GNP
2006	107694	34961	142655	555199
2007	123873	37865	161738	607212
2008	128799	39227	168026	661729

Bgt/GNP

2006	75.49%	24.51%	100.00%	25.69%
2007	76.59%	23.41%	100.00%	26.64%
2008	76.65%	23.35%	100.00%	25.39%

Malaysia's public sector financing characteristics

- ◆ The public budget is roughly a quarter of GNP (since 1967, rising to 1982 (48%) and since stabilising back at the $\frac{1}{4}$ of GNP mark)
- ◆ Tax revenue pays about half of the budget (from only about a million or so taxpayers or 4% of the population or 9% of working population)
- ◆ Indirect taxes roughly less than 15% of the budget
- ◆ Thus the people pays only about 65% of what government provides in public services
- ◆ Government charges for services amount to about 10% of the GDP, implying that on the average people pay only 40% (i.e., $\frac{10}{25}$) of what is costs government to provide (in other words the government gives a 60% discount for its services)

Tax Cuts

- ◆ Looking towards private sector investments
- ◆ The Nobel Laureate Joseph E Stiglitz demonstrated (1987) that the marginal tax rate of the more able should be non-positive
- ◆ One might imagine that Malaysia in a sense subscribes to this view and for this reason tax has been kept moderately low without being politically incorrect

Private Sector Investment

- ◆ 1% cut in corporate tax each year to 25% flat rate target
- ◆ Every dollar of tax savings is one dollar of potential private sector investment
- ◆ Technically, the shadow price (opportunity cost) of public investment is $\sum d/(1+v)^t = d/v$ when sum to infinity where d is the rate of one dollar of private sector returns and v is the social discount rate
- ◆ Thus if $d/v > 1$ public investment is expensive and if $d/v < 1$ public investment is cheap relative to the private sector.

Geography (Space)

- ◆ Sabah & Sarawak RM4 billion and RM 1 billion for electrification
- ◆ RM12 billion for public transport in Klang Valley and Penang
- ◆ The two regional growth centres (Northern corridor and Sultan Iskandar)
- ◆ These are more spatially targeted than the more general incentives in the past for private investments in “promoted” areas

Turn-around in Agriculture: New agriculture

- ◆ In 1970, agriculture was 30.8% of the GDP. By 1990, down to 16.3% and 2005, 8.2%.
- ◆ The government did not neglect agriculture as agriculture receives roughly 1/5 of the total development money in the 5-year plans (except in 4th plan, 1981-85, it was 12%)
- ◆ Agriculture is not equated to poverty as it used to
- ◆ Too many govt. agric agencies put a strain on the public allocation
- ◆ Tertiary education institutions should train farmers not extension officials just like in the public school systems

Responsibility to the less able

- ◆ Put money directly into the pockets of the poor
- ◆ Most of the remaining 5% hardcore poor are in the 65 years and older age-group. Thus poverty eradication programmes aimed at making the poor more productive is less sensible today
- ◆ The govt. continues to do this by broadening direct assistance to the poor (particularly in health and housing). We need to broaden this to cover public transport
- ◆ A reduction in petrol subsidies can be channeled towards good quality but affordable public transport
- ◆ Help finance NGOs in the citizen support role

Corporate Social responsibility (CSR)

- ◆ Academic literature is very critical about CSR
- ◆ RM50 million for CSR???
- ◆ Private sector is profit oriented (its obligation to stock holders)
- ◆ Corporations should either lower costs competitively (and therefore lower prices) or pay taxes to finance public services
- ◆ CSR that enjoys public incentives robs the electorate of its social choice – selection of social services should belong to elected Parliamentarians and not the corporate boardroom

Town Planning and the Landscape

- ◆ RM120 m. to clean up the rivers
- ◆ RM1.1 b. for nationwide flood mitigation
- ◆ The Malaysian Inst. of Planners (MIP) town planners asked for the Town Planners act, 1995 (Act 538) claiming that architects cannot guarantee a functional developed landscape citing flooding among other things that needs to be avoided
- ◆ Twelve years later the MIP has not delivered and should answer or at least do a post-mortem on this

Individual social responsibility

As a citizen
(member of society)

... Do you see yourself as a contributor
or as a welfare recipient of public
monies?

Retirement Income

- ◆ People live longer so more money needed for retirement
- ◆ Thus the workforce must plan their retirement early by balancing current spending with future income needs
- ◆ Warga emas (senior citizen) RM2 bil. bond issue at 5% return but you need to have the EPF money to invest
- ◆ Insurance allowance decoupled from EPF contributions – more retirement savings
- ◆ But EPF withdrawals may eat into it

If your taxable income is RM20,000
(someone earning say around RM3000 monthly)

- ◆ The tax bill is RM475 a year
- ◆ Less RM350 rebate, the tax due is RM125 or RM10.42 a month
- ◆ For this one gets free public schooling for the kids, economical health care in public hospitals, protection from police and military etc.
- ◆ When petrol was highly subsidised, the amount received each month is much more than RM10.42 a month
- ◆ Is it then true that someone at this salary range is actually a recipient instead of a contributor (in other words a welfare case?)

Social Choice:

Primary and secondary stage of public delivery

- ◆ When the middle class is small (i.e. when society comprises largely rich and poor people) there will be more public services funded by taxes from the rich but consumed by the poor. The rich do not use public services but buy them very exclusively (rich and poor don't mix)
- ◆ When the middle class becomes large, they demand higher quality services that tax money cannot pay for. Thus they prefer and can afford to buy from the market.

Bonus for government servants

- ◆ A bonus is worth 8.33% ($100/12$) of annual salary
- ◆ The government implemented 7.5% to 35% salary increase for 6 mths. in 2007
- ◆ Thus our top ranking civil servants experienced a pay-cut this year
- ◆ One mth. bonus = RM10000
Six mths. of 7.5% increase is $6 \times 750 = 4500$
or a loss of RM5500 this year

New pay without bonus

pay rise	35%	25%	15%	7.5%
basic pay	1000	2000	5000	8000
mthly rise	350	500	750	600
6mths rise	2100	3000	4500	3600
difference	1100	1000	-500	-4400
mthly dif	91.67	83.33	-41.67	-366.67
adj payrise	9.17%	4.17%	-0.83%	-4.58%
mth bonus	2.1	1.5	0.9	0.45

The Budget is Efficient

- ◆ Efficiency is defined by prices that reflect the latest information
- ◆ Market goods are priced by information on demand that matches supply, i.e., relative to scarcity (public goods cannot match market efficiency)
- ◆ Public goods are priced based by information of what society needs/wants and what society can supply from available resources
- ◆ Institutional set up (its strength and effectiveness) aims at avoiding free riding and delivery to the target consumers of the public good
- ◆ Budget process (dialogues) is nearly a year long process of information assembly

Government tenders

- ◆ Necessary when goods cannot be bought “off the shelf” in the market
- ◆ Tenders are efficient provided that specs are fixed and does not change
- ◆ Tender bidders process a lot of information reflected in the price bids
- ◆ Open tender allow for more information processing due to more bidders...versus
- ◆ Close tenders that can shorten the bidding cycle saving tendering cost
- ◆ Price negotiations/ specs change should not occur after tender awards