社会经济研究中心

SOCIO-ECONOMIC RESEARCH CENTRE

CTIM 2023 Budget Seminar

Tax Reform: The Future of Malaysia’s Tax System

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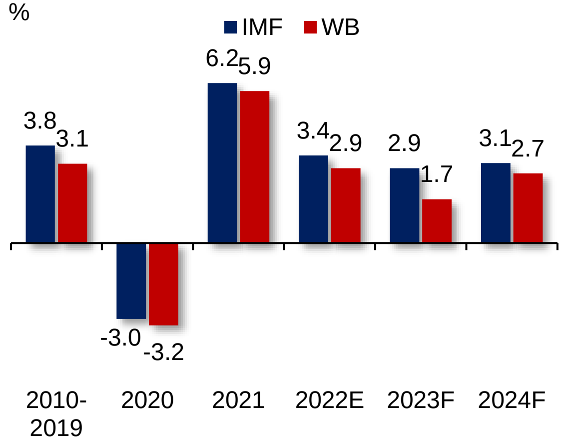
Executive Director
13 March 2023

Global recession fears receded, but headwinds still persist

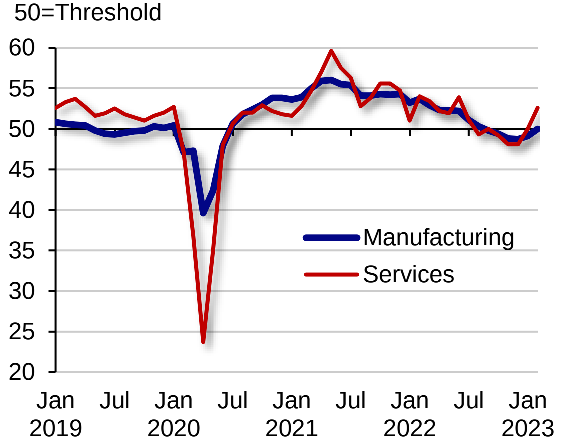
2023: Weaker global economic growth

Global growth estimates



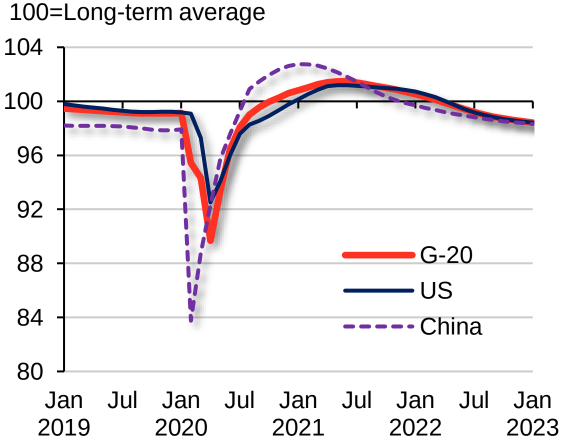
Manufacturing & services activities appears stabilising

Global PMI for manufacturing & services



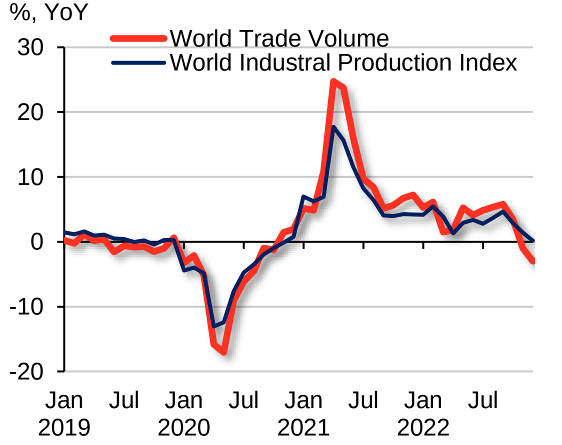
CLI for G-20 remained below long-term average

Composite Leading Indicator (CLI)



WTO: World trade remains subdued in 2023 (1.0% vs. 3.5% in 2022E)

World trade volume & industrial production



Global economy: Slightly less gloomy but headwinds persist

- A "mild and shallow' recession in the US
- China's reopening eases global recession risk
- Global inflation may have peaked but pressures continue
- Central banks' subtle monetary shift, not pivot to rate cuts

Upside risks

- Strong labour market conditions and wage growth
- China's consumers release strong pent-up demand
- Pause in global monetary tightening amid cooling of inflation

Downside risks

- Escalation in Russia's war in Ukraine
- Higher-than-expected interest rate level
- Tighter global financing conditions worsen debt distress
- Significant assets repricing on worse than expected economic slowdown
- Deepening geopolitical fragmentation

Source: International Monetary Fund (IMF); World Bank (WB); S&P Global; Organisation for Economic Co-operation and Development (OECD); CPB Netherlands

Backdrop for the preparation of the 2023 Budget

STILL CHALLENGING GLOBAL OUTLOOK

2023 global growth to slow to 1.7% from 3.0% expected six months ago, as the potential sharp and long-lasting slowdown of advanced economies will hit developing countries hard with heavy debt burdens and weak investment.

JAN 2023, World Bank

Global inflation will fall in 2023 and 2024 amid subpar economic growth, with 2.9% in 2023. Downside risks include potential escalation in the Russia-Ukraine war, tighter global financing costs and further geopolitical fragmentation.

JAN 2023, IMF

SLOWING ECONOMIC GROWTH MOMENTUM

Malaysia's real GDP growth

%, YoY

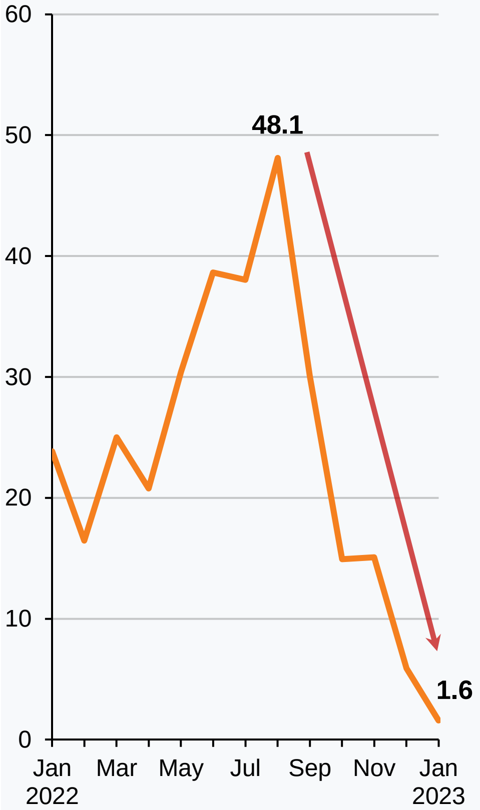
Monthly GDP

%, YoY

EXPORTS DECELERATE SHARPLY

Export growth

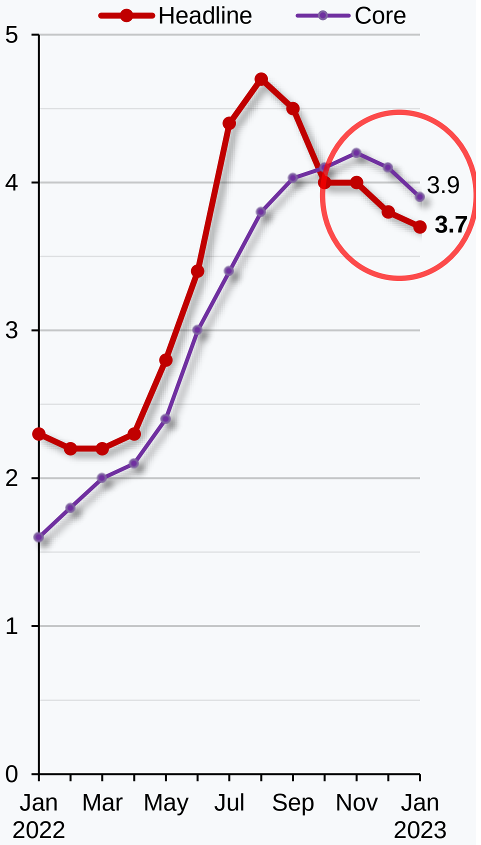
%, YoY



INFLATION PRESSURES REMAIN ELEVATED

Headline and core inflation

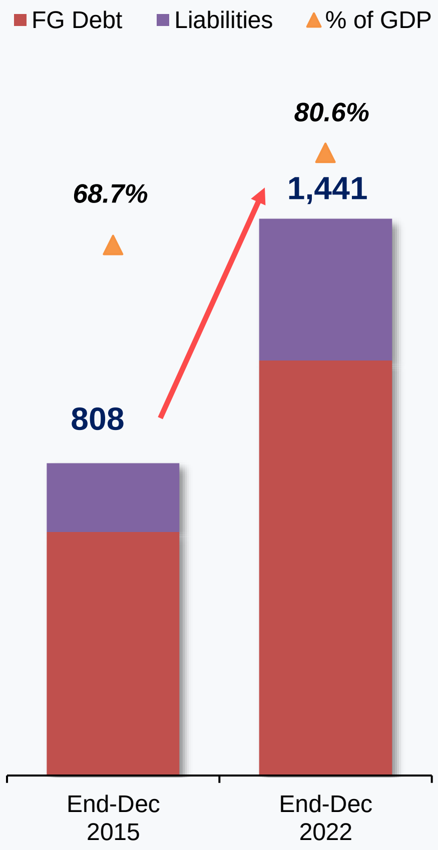
%, YoY



UNPRECEDENTED HIGH LEVEL OF DEBT AND LIABILITIES

Debt and liabilities

RM billion



Note: Liabilities in 2015 cover government guarantee only.

2023 Budget and Economic Prospects

- **New Budget 2023** aims to:

  i. **Reinforces economic resilience**;

  ii. **Addressing immediate concerns about cost of living pressures**; and

  iii. **Implementing reforms for growth and business sustainability**.

- **Ministry of Finance (MOF)** expects **the economy to slow to 4.5% in 2023** (2022: 8.7%) from an estimated 4.0%-5.0% in the original Budget due to:

  i. **Slower global economy**;

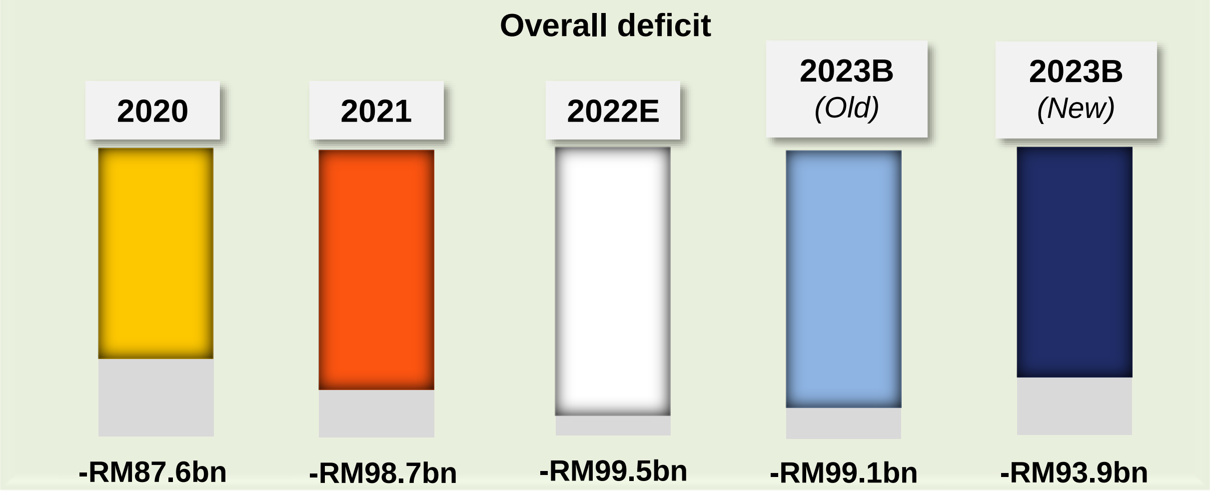
  ii. **Normalisation of domestic demand**; and

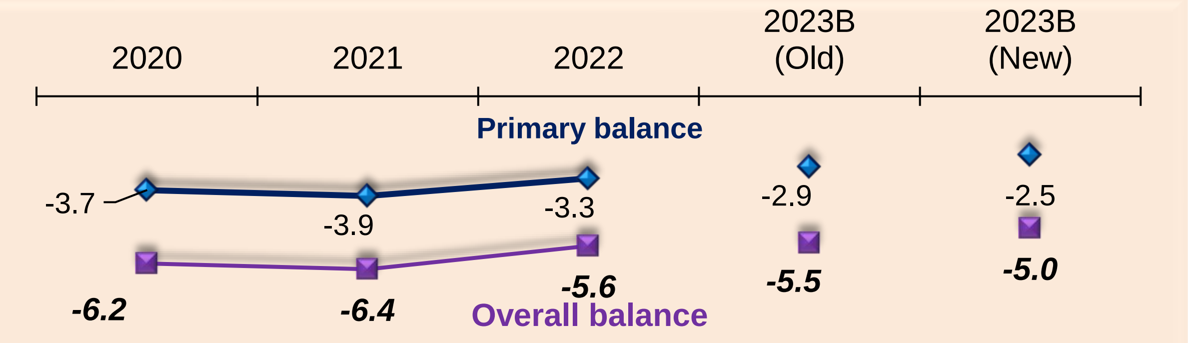
  iii. **Decelerating exports**

Budget: Developing Malaysia MADANI

The Budget and the Economy

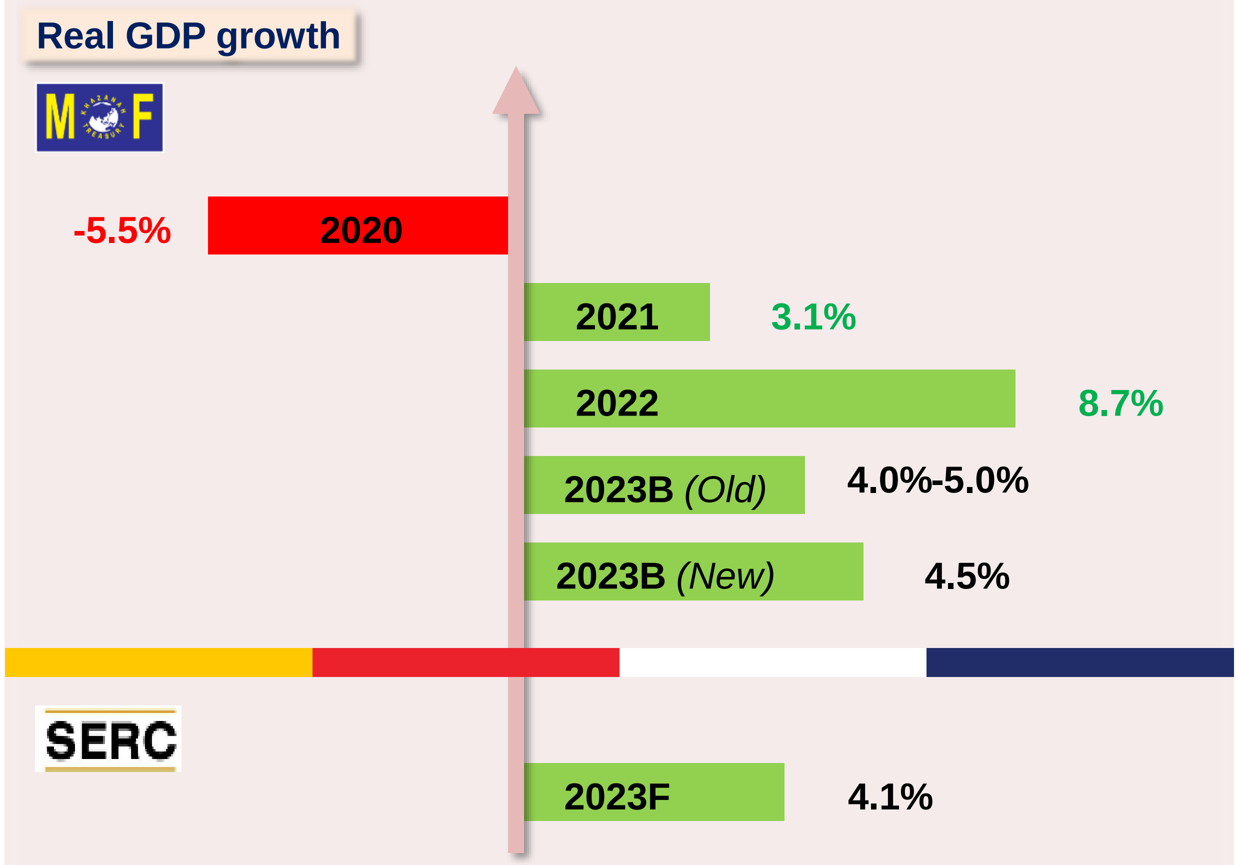
26th consecutive year of budget deficit since 1998





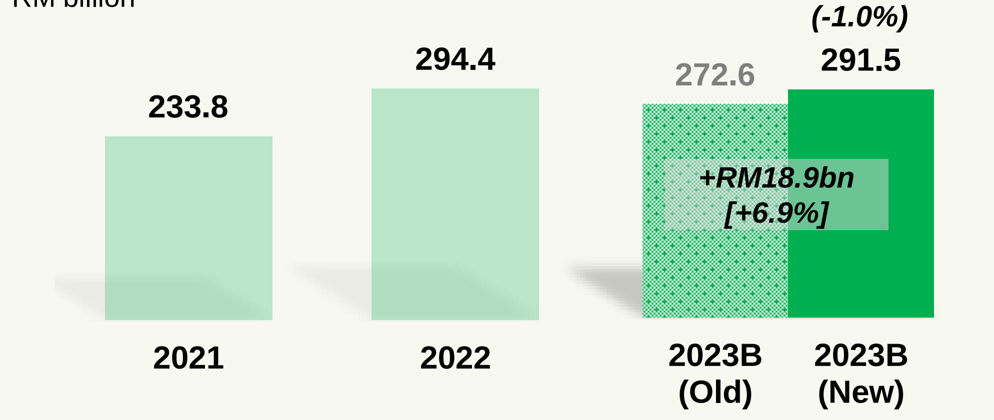
Note: Primary balance excludes debt service charges.

The economy will grow at a slower pace of 4.5% in 2023



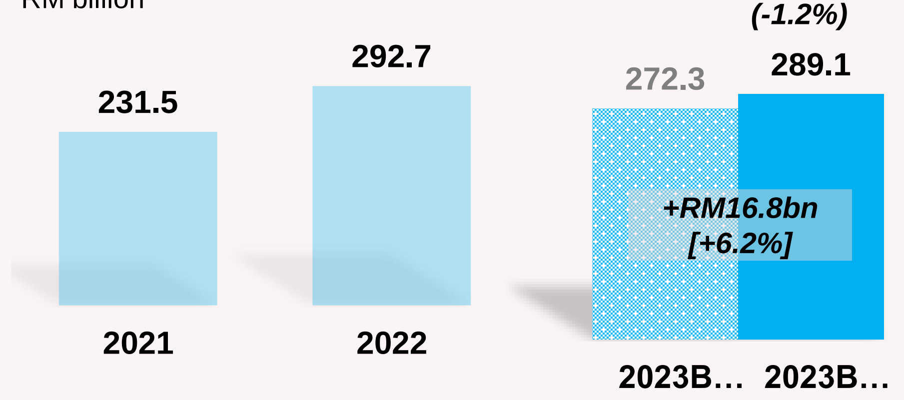
Budgetary operations snapshot

TOTAL REVENUE

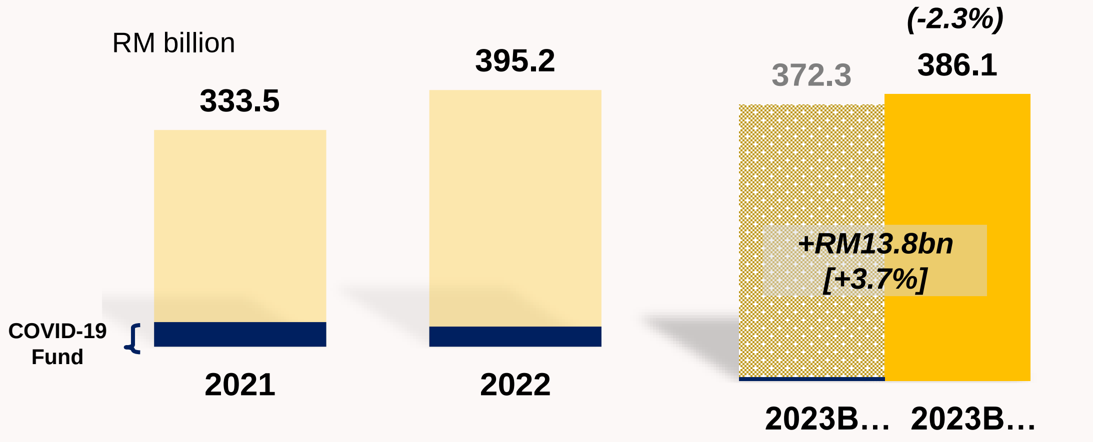


OPERATING EXPENDITURE (OE)

(74.9% of total expenditure in 2023)

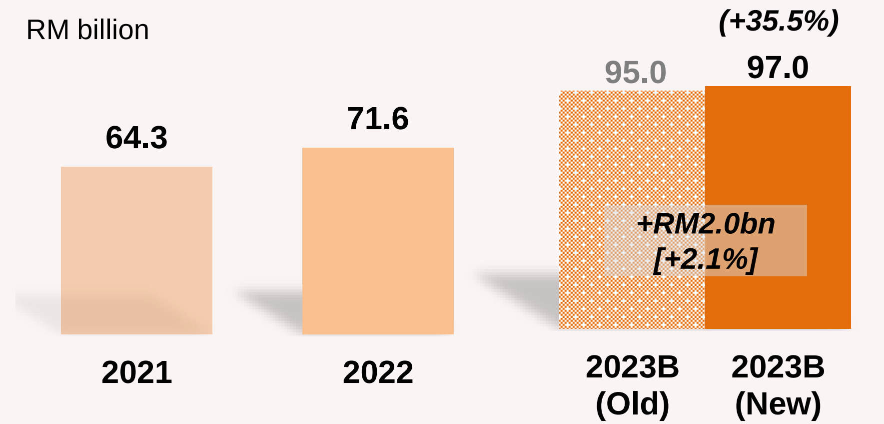


TOTAL EXPENDITURE*



DEVELOPMENT EXPENDITURE (DE)

(25.1% of total expenditure in 2023)



Source: MOF

** Includes the COVID-19 Fund: 2021 (RM37.7bn), 2022B (RM23.0bn), 2022E (RM28.8bn) and 2023B (Old) (RM5.0bn)*

( ) indicates changes compared to 2022

[ ] indicates changes compared to old budget

Bloated subsidies – Transition to targeted subsidies

- **Subsidies and social assistance set a record high of RM67.4 billion in 2022**. These bloated subsidies continued to add pressure on the already-constraint fiscal balance sheet.
- As the blanket subsidies for petrol, diesel, water, and electricity also benefitting many of the M40 and T20 households, **it is fiscal prudence and equitable to move towards a targeted subsidy rationalisation scheme**.
- **Subsidies and social assistance are budgeted to remain substantial at RM58.6 billion (20.3% of total operating expenditure) in 2023** though it marks a decline of RM8.7 billion from RM67.4 billion in 2022.

Selected budgeted subsidy and assistance (RM billion)	**2021**	**2022**	**2023**	
			7 Oct 2022	24 Feb 2023
Major Cash Assistance (BAP, JKM, BKM)	8.6	9.5	11.1	11.1
Petrol, Diesel and LPG	11.1	50.8	23.6	25.6
Cooking Oil (COSS)	2.2	2.4	0.5	0.5
Electric	-	9.8	*	6.8
Poultry and Egg Prices	-	1.8	*	*
Other Consumption Subsidies	1.2	1.5	1.1	1.1
Others (education, transportation, agriculture)	14.3	15.6	18.7	18.7
Total	**37.3**	**91.4***	**55.0**	**63.8***

Note: The Government will continue subsidising prices of chicken eggs until June 2023 with total cost of RM1.28 billion.
** Discrepancies in total amount of "subsidies and social assistance" in operating expenditure were due to subsidies under the special COVID-19 Fund.*
Source: Ministry of Finance (MOF)

What do people think about Budget 2023? Mixed feelings

Man in the street:

“It is a BORING budget”; “Why does it tax me so much?”; “More cash handout is needed”.

Bankers:

Well-being for rakyat; “No one is left behind”; sustain better economic prospects; ESG; prudent, targeted and inclusive approach; expansionary nature.

Industry/SMEs:

A fine balance; prudent but disappointed (no announcement of GST implementation); falls short on tax cuts (higher threshold of preferential rate for SMEs); concerned about Capital Gains Tax; Luxury goods tax

Economist/Market strategist

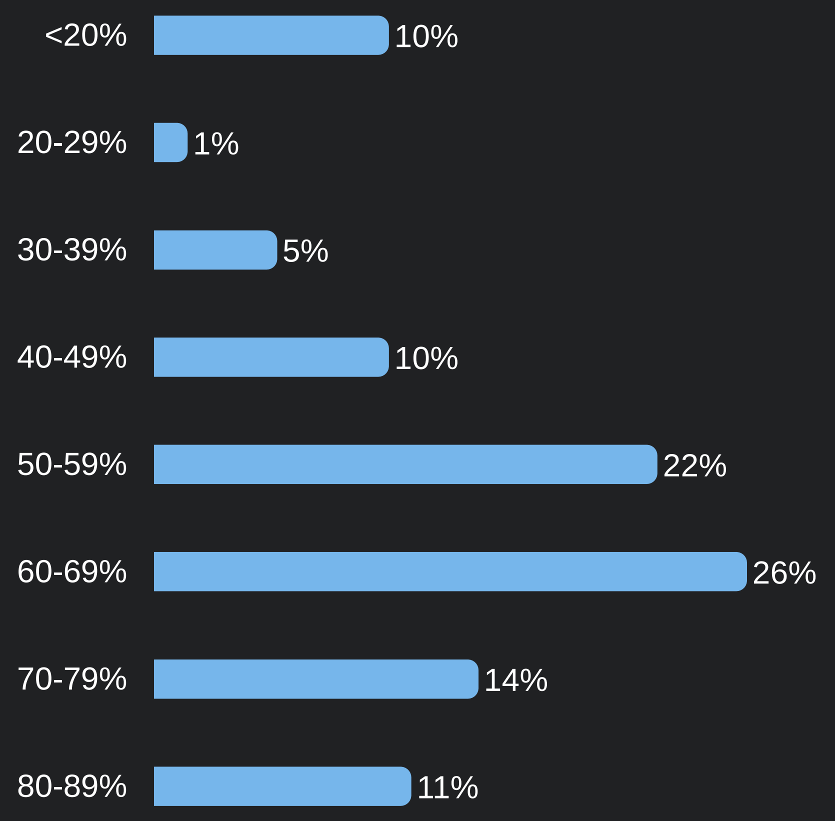
A balancing act; Taxing the rich; Wealth transfer; Neutral; From Peter to Paul.

Construction and property sector:

Unfriendly budget; Understandable on a tight budget, but no non-financial incentives are provided; Affordable housing is a myth.

How did you score the Budget 2023?

Anonymous Pool
Source: Independent



Malaysia will slow in 2023, but not in recession !

“CONSUMPTION”

Can private consumption hold the fort?

- ➢ Waning consumption driven factors
- ➢ Rebuild savings

“CONFIDENCE”

Confidence, NOT hope

- ➢ Can Malaysia reform for better?
- ➢ Can the Government restore investors’ confidence?
- ➢ Not “OPTICS” but real changes

“COSTS”

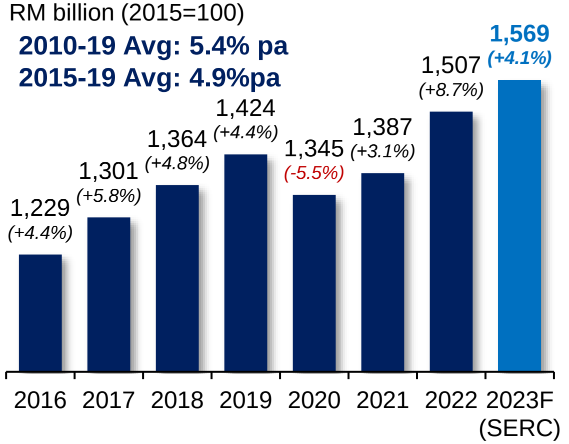
Inflation, business costs, high debt and higher interest rate

- ➢ Cost of living pressures reduce disposable income
- ➢ Increased business costs dampens profit margin
- ➢ Prices pressures persist – subsidy rationalisation

The Malaysian economy has risen above pre-pandemic level, albeit slower in 2023

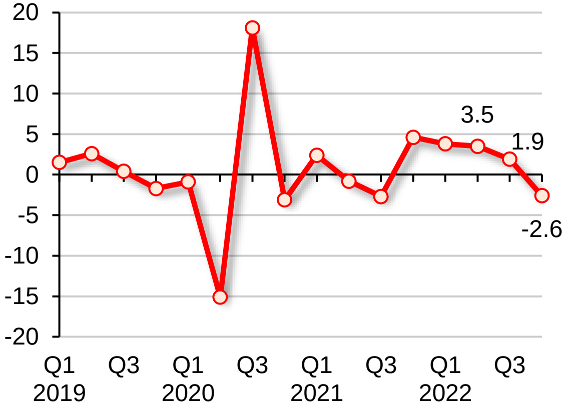
The Malaysian economy has bounced back but headwinds persist

Gross Domestic Product
RM billion (2015=100)



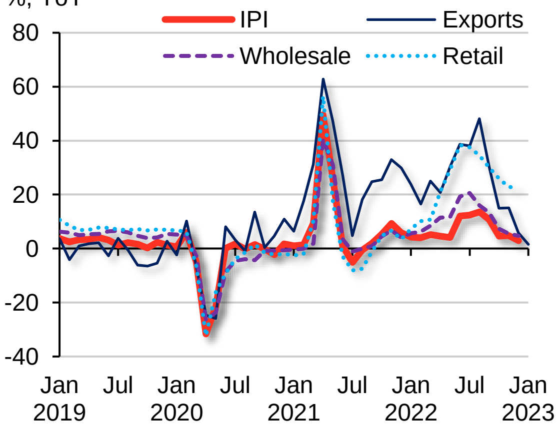
However, the growth momentum has moderated in recent quarters

GDP growth
%, QoQ, seasonally adjusted



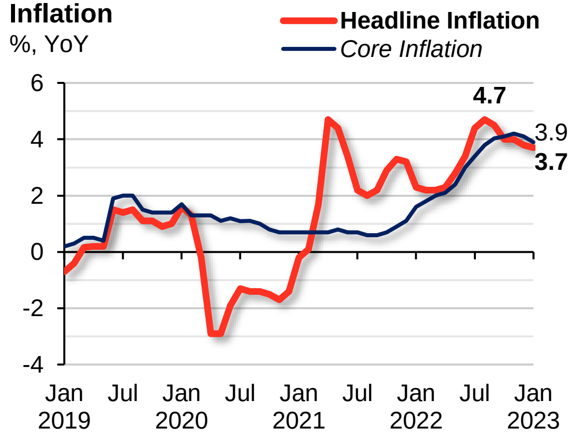
High frequency data showed either normalisation or deceleration growth

IPI; Exports; Wholesale; Retail growth
%, YoY



Headline inflation has peaked but price pressures continue to linger, especially core inflation

Inflation
%, YoY



Source: Department of Statistics, Malaysia (DOSM)

The Malaysian economy

- The economy would continue to grow, albeit slower in 2023 (2023E: 4.1% real GDP growth vs. 8.7% in 2022)
- “Normalisation” of private consumption
- Weaker exports and softening commodity prices

Upside risks

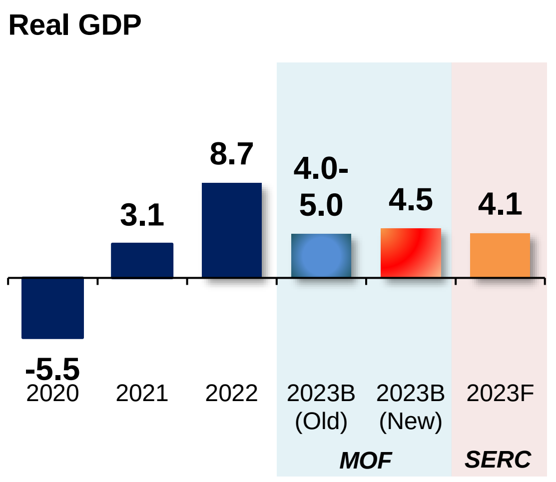
- Continued recovery in labour market and better income prospects
- On-going and new public infrastructure projects
- Higher tourism activity

Downside risks

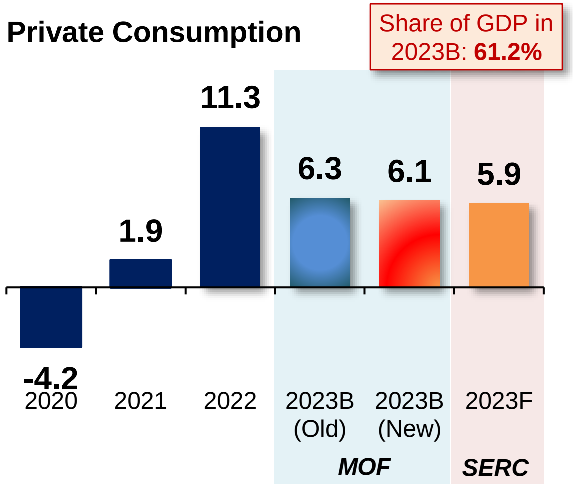
- Slower global growth; slumping exports
- Cost pressures (cost of living and business costs)
- Lag impact of higher domestic interest rates

Domestic demand will drive the economy in 2023

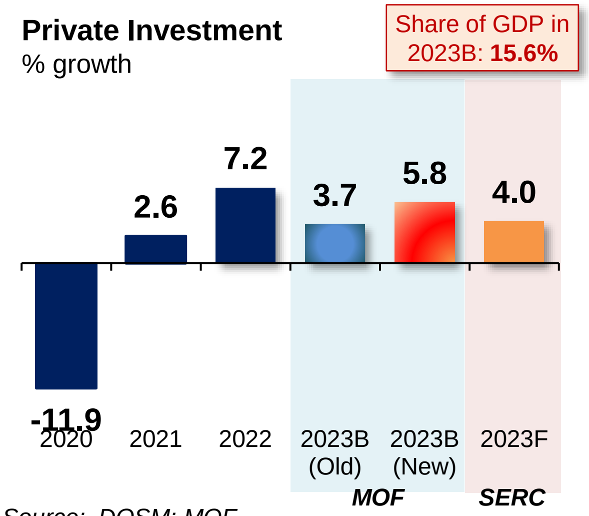
Real GDP growth will slow in 2023 …

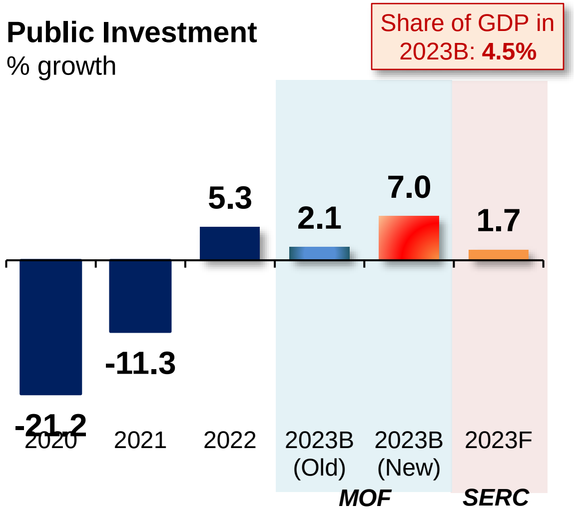


… supported by income and job growth …



… and moderate growth in private investment and public investment

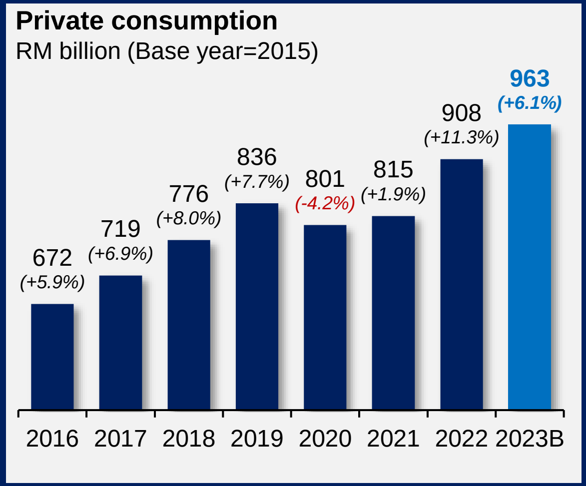


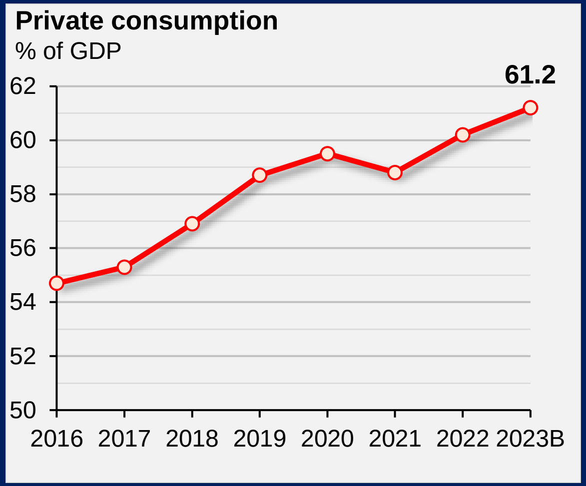


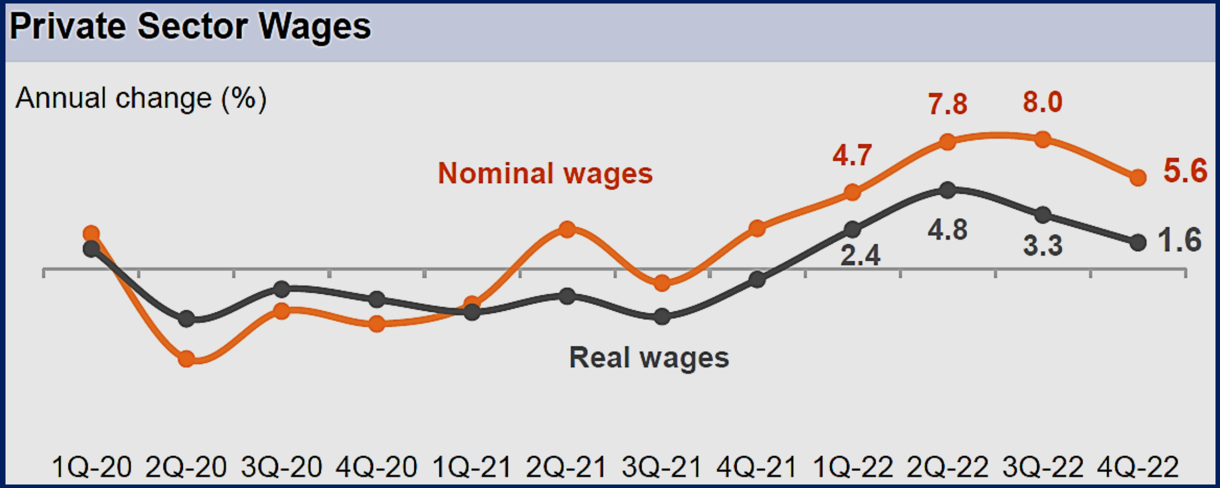
Source: DOSM; MOF

- The economy is expected to normalise to an **approximately 4.5% growth in 2023** (2022:8.7%). This is supported by domestic demand while exports will slow markedly. Risks to growth remain (Prolonged geopolitical conflict, climate-related disasters, rising cost of living and the lag impact of higher interest rates).
- Stable labour market conditions and sustained economic and social activities, particularly in tourism-related sectors following the reopening of China's international border is expected to support **private consumption growth**, albeit at a **moderate pace of 6.1% in 2023** (11.3% in 2022).
- **Private investment is anticipated to increase by 5.8% in 2023,** mainly in the manufacturing and services sectors following the Government's efforts to enhance good governance, reduce business costs, and facilitate faster investment approvals.

Can private consumption (61.2% of GDP) hold the fort in 2023?







Waning support factors

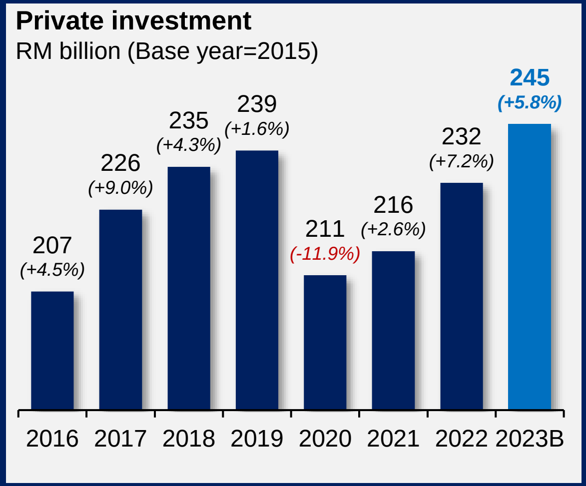
- **Pent-up demand**: Normalisation of spending; and waning effect of the EPF withdrawals.
- **Reduced spending power**: Inflation and cost of living pressures as well as the weakening Ringgit.
- **Credit**: High household debt burden (81.9% of GDP), tighter lending conditions; and the lag impact of higher interest rate.

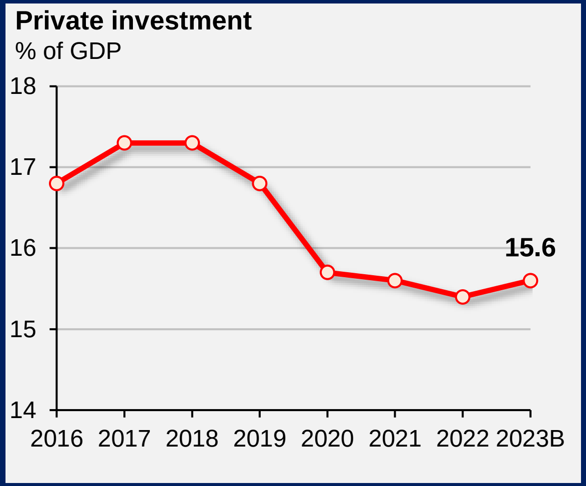
Mitigating factors

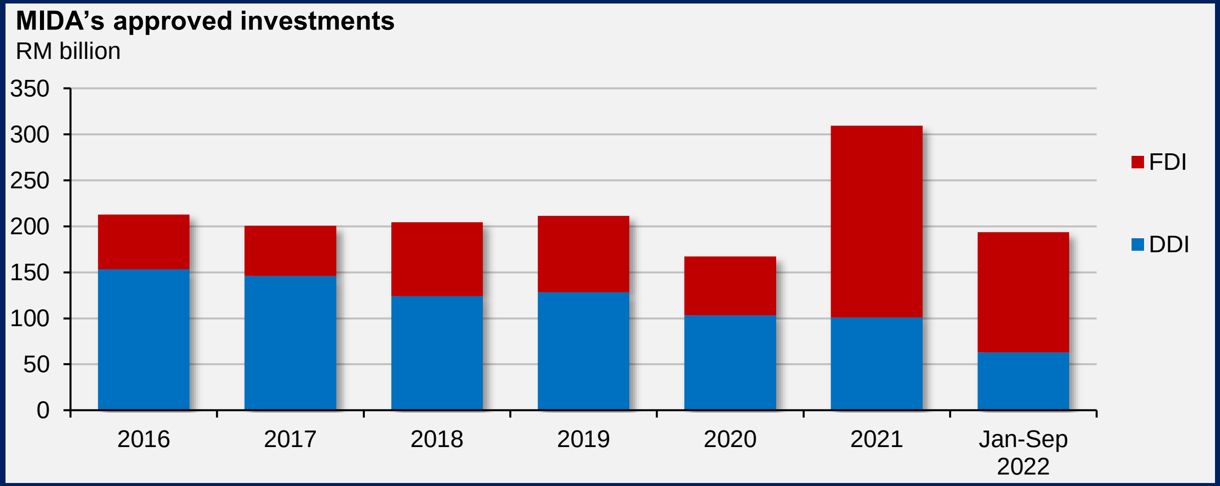
- Stable unemployment rate (2023E: 3.5%-3.7%; 3.6% in 2022) and improved wages.
- Anticipated boost from a revival of China's tourist arrivals.
- Continued cash handouts and special payment for civil servants.
- A 2 percentage points reduction in personal income tax rate for chargeable income exceeding RM35,000 to RM100,000 (tax savings between RM300 and RM1,300) for 2.4 million tax payers, releasing RM900 million (net from tax adjustments for higher income earners); e-wallet for 2 million youth @ RM200 each, releasing RM400 million.
- Subsidies on electricity tariffs, petrol, diesel, LPG, chicken, eggs, etc. **BUT, not for long – targeted subsidy is on the way!**

Source: DOSM; MOF; BNM

Private investment has yet returning to pre-pandemic level







(Why) Is Private investment Weak?

- Business investment is not just a key determinant of long-term growth, but also a highly cyclical component of aggregate demand.
- Uncertainty about the future state of the economy and a lack of profitable investment opportunities.
- A stronger recovery of investment would seem to depend on a reduction in economic uncertainty and expectations of stronger future growth.

2023 Budget's action plan

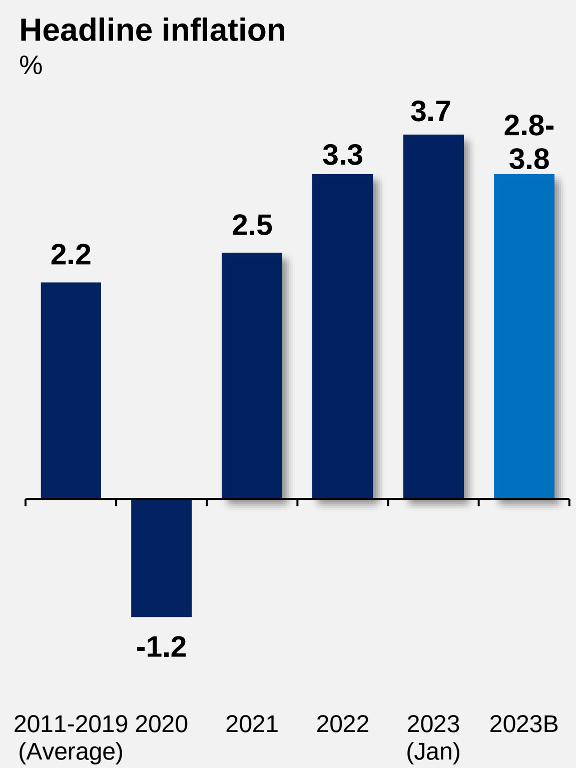
- Attracting & facilitating meaningful investment - empower PEMUDAH; expediting approvals.
- Strengthening Investment Ecosystem - New Industrial Masterplan 2030 (expect to roll out in September 2023); upgrading local talent to meet industry requirements - TVET to pioneer new form of PPP; matching grants; trainers and training module.

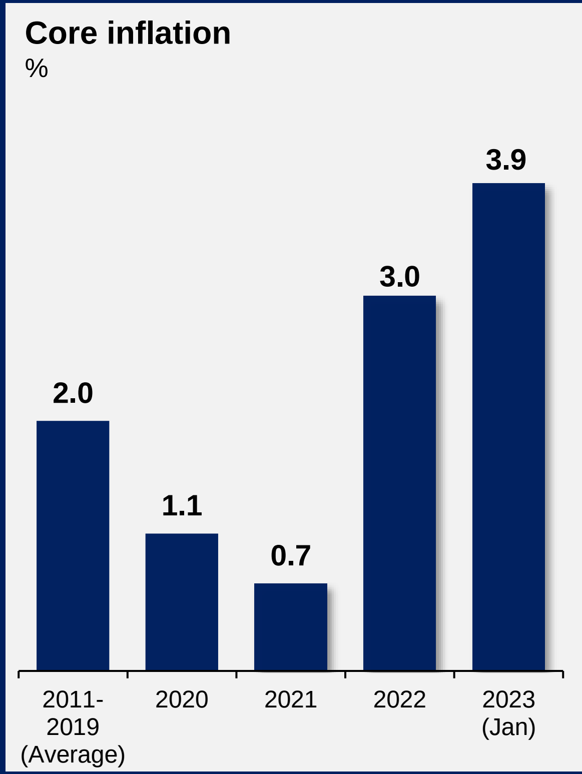
Potential and impactful investment

- EV, Green and sustainability (renewable energy, reuse manufacturing, smart agriculture, hydrogen & carbon sequestration), bio-tech and medical tech, telcos and transportation.
- **Multi-stakeholders approach to facilitate private investment.**

Source: DOSM; MOF; MIDA

Headline inflation has receded, but renewed price pressures remain





Drivers of inflation

- Continued cost pressures (wage cost, electricity tariffs, amended Employment Act)
- Subsidy rationalisation
- Partly driven by demand pressures due to sustained consumption and spending
- Impact of the weakening Ringgit

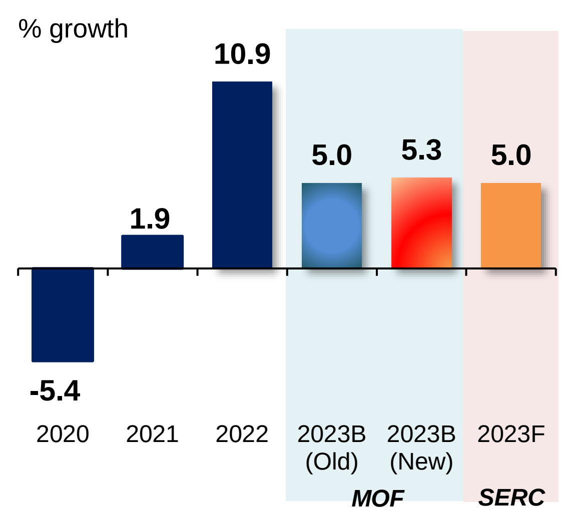
Offsetting factors

- Softening commodity and energy prices
- Normalisation of consumer spending
- Lag impact of higher interest rate

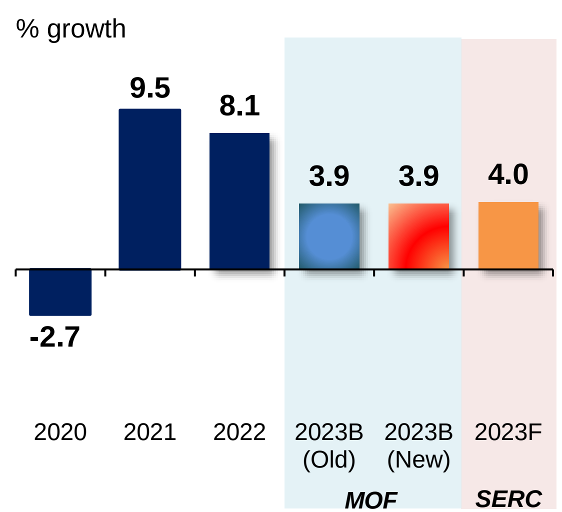
Source: DOSM; MOF

Almost all sectors will slow in 2023

Services sector (58.7% of total GDP)

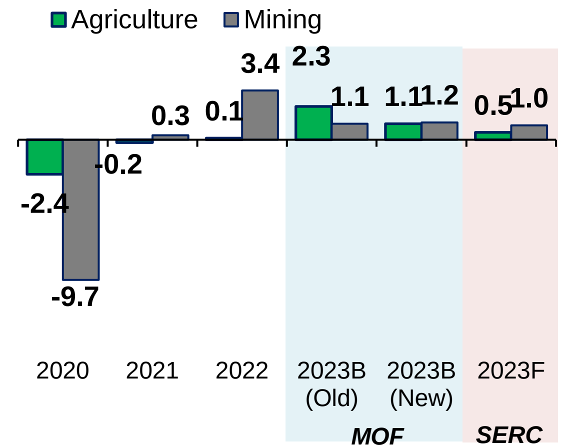


Manufacturing (24.1%)

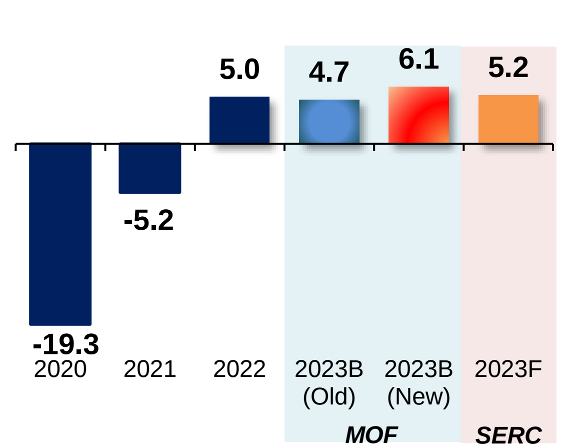


Agriculture (6.4%); Mining (6.2%); and Construction (3.6%)

Agriculture and Mining, % growth



Construction, % growth



Source: DOSM; MOF

Note: % in parenthesis refers to share of GDP in 2023B (New)

Services

- Driven by the **wholesale and retail trade** (wider usage of e-commerce and rapid transition to digitalization); **real estate and business services** (higher demand for professional services, particularly engineering, legal and accounting); **information and communication** (wider digital adoption).

Manufacturing

- Supported by expansion in all subsectors across both export- and domestic oriented industries despite moderating economic activities.

Agriculture

- Improvement in oil palm (higher CPO output due to improved labour supply), livestock and fishing (concerted efforts to strengthen food security) subsectors.

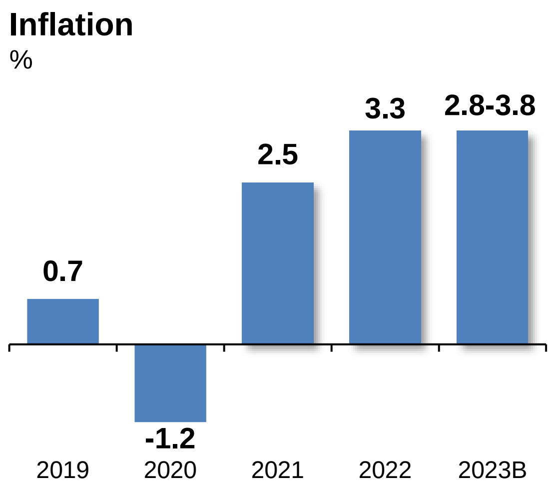
Mining

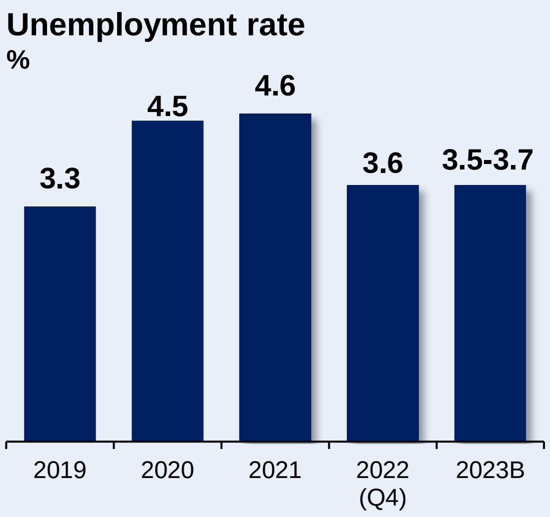
- Higher natural gas output (completion of new pipeline projects in Sarawak); higher demand from major trading partners; new demand from domestic industrial and petrochemical segment.

Construction

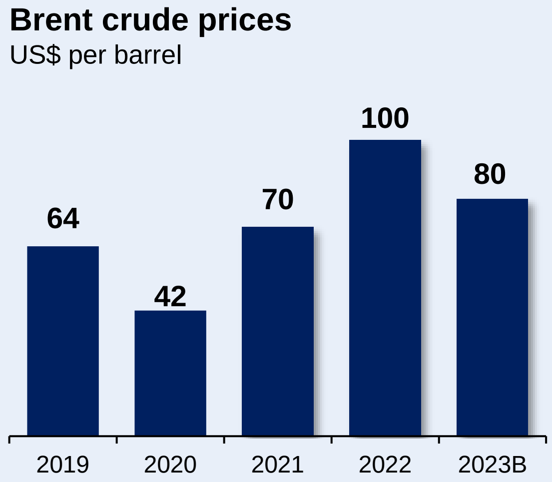
- The implementation of new projects such as upgrading the Klang Valley Double Track (KVDT) Phase 2 and the acceleration of ongoing infrastructure projects, which include East Coast Rail Link (ECRL) and Light Rail Transit Line 3 (LRT3) and fifth-generation cellular network (5G) rollout.

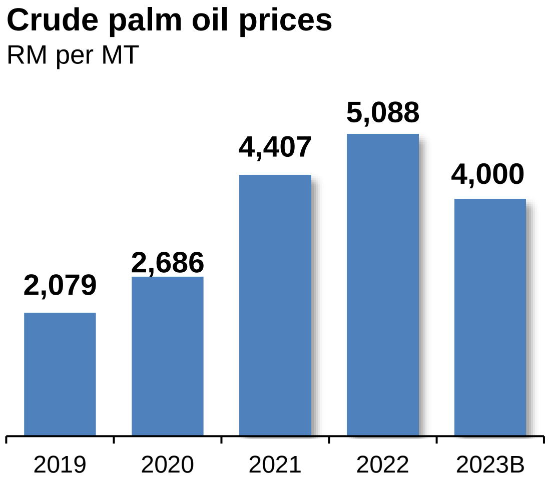
2023 Budget: Inflation, jobless rate and commodity prices

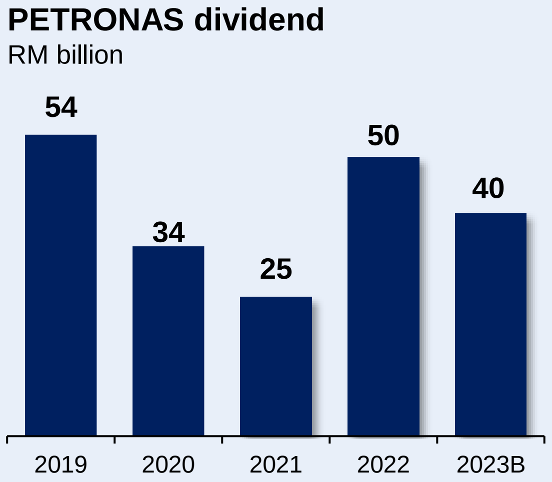




Price pressures remain amid softening commodity prices







Source: DOSM; MOF; World Bank; MPOB

Upside and Downside risks to Malaysia’s growth prospects in 2023

UPSIDE RISK

- Fiscal support for **inflation** and **cost of living**
- Efforts in **mitigating the downside risks**
- **Strong improvement in tourism sector**
- Continued **improvement in the labour market**

DOWNSIDE RISK

- **Inflationary pressure**
- **Climate-related disasters**
- **Prolonged geopolitical conflict**
- **Rising recessionary risk**

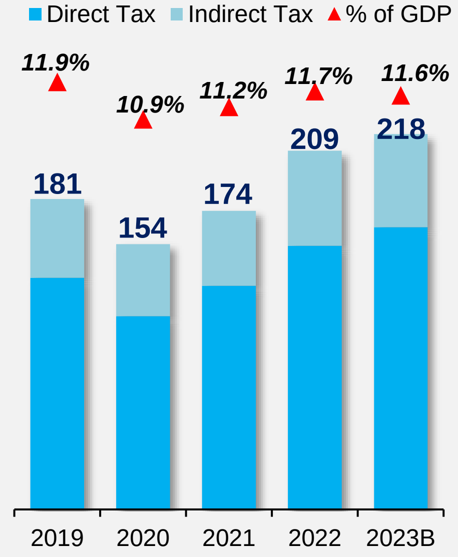
Malaysia has limited fiscal space

Narrowed Revenue Base

Tax Revenue (% of GDP), 2021

Cambodia	**16.5%**
Singapore	**14.0%**
Thailand	**14.0%**

Tax Revenue
RM billion

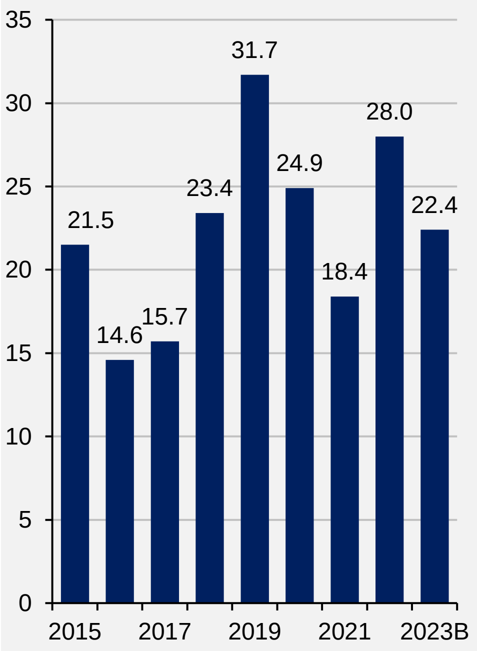


High Dependency on Oil-related Revenue

Avg. **23.4%** in 2020-2023B

Avg. 21.4% in 2015-2019

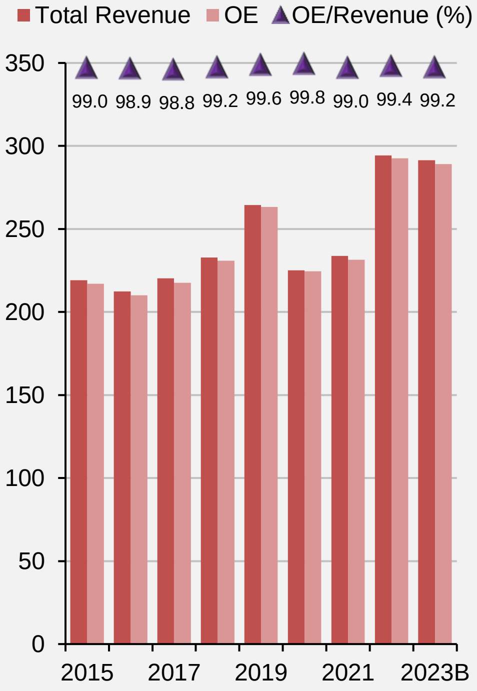
Petroleum-related Revenue
% of total revenue



Almost 1:1 Match of Operating Expenditure to Federal Revenue

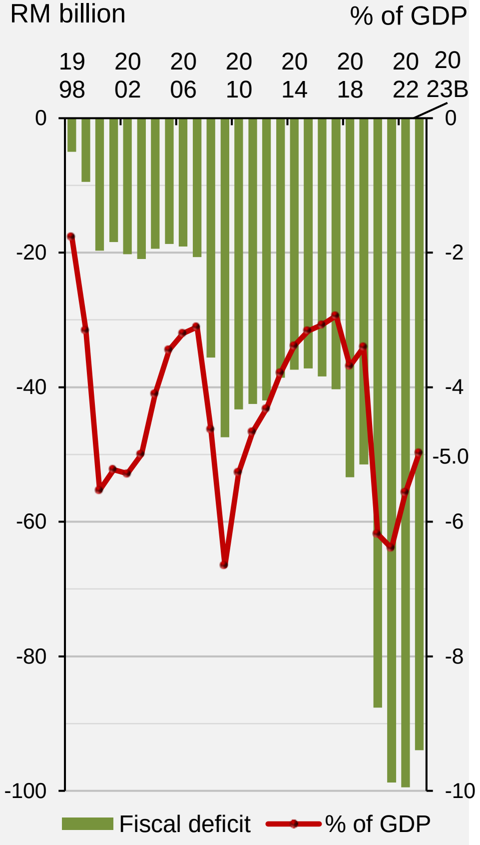
Avg. **99.2%**
in 2015-2022

Revenue and Operating Expenditure
RM billion



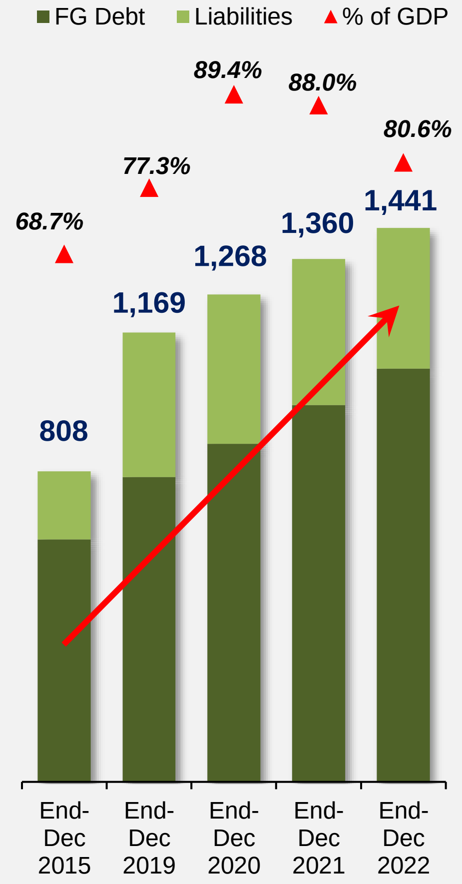
26th Successive Years of Fiscal Deficit

Federal Government's Overall Fiscal Balance
RM billion



Unprecedented High Level of Debt and Liabilities

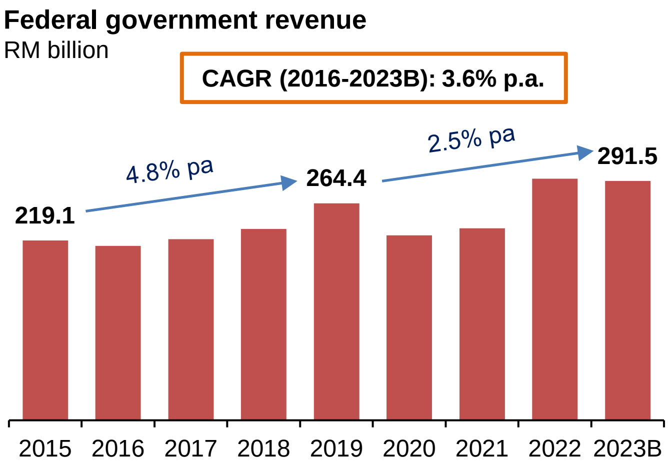
Debt and liabilities
RM billion



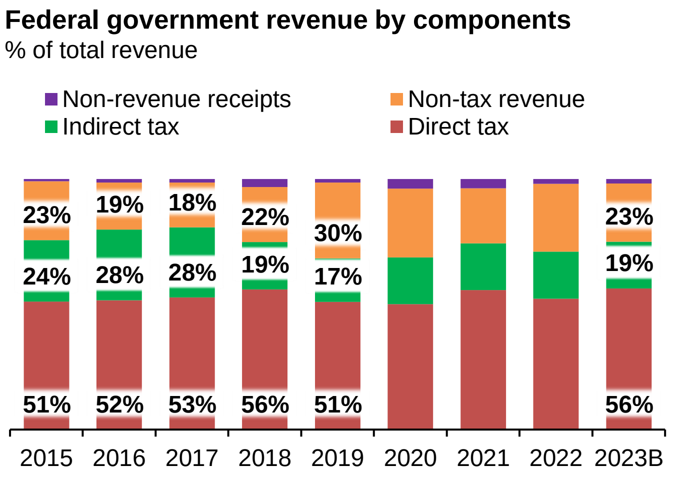
Source: IMF; MOF

Federal revenue structure

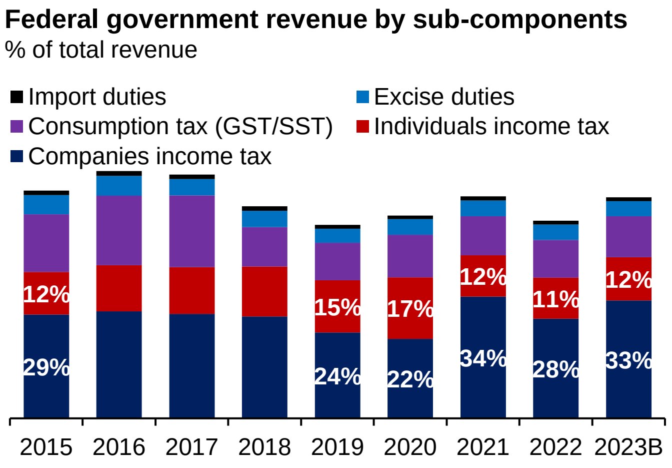
Moderated increases in federal revenue



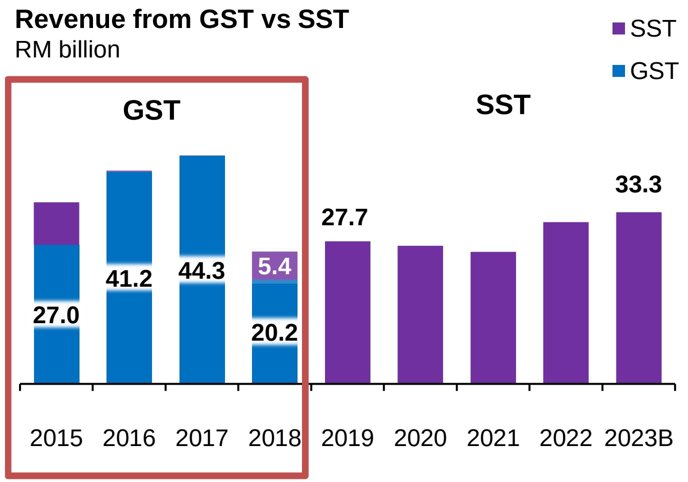
Share of indirect tax has shrunk after 2017 due to the abolishment of GST



Individual income tax share reduced post the COVID-19 while CITA remains strong



Significant revenue shortfall between SST and GST



Federal revenue trend

- Federal Government's revenue collection – only increased by 3.6% p.a. (2016-2023B).
- Higher dependency on direct taxes relative to indirect taxes.
- The abolishment of GST has significantly reduced the contribution of indirect taxes.
- Prosperity tax contributed partly to higher companies' income tax (CIT) in 2022 and 2023B.

The 2023 Budget and beyond

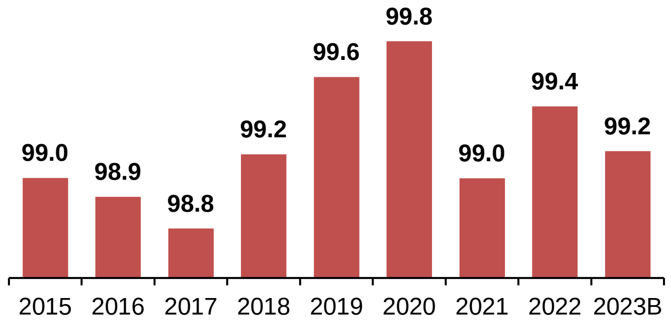
- Committed to widening revenue base – various initiatives, among others minimising tax leakages, enhancing tax compliance and effective auditing through enforcement.
- Taxing the rich; Capital Gains Tax on disposal of unlisted share of corporate shareholders.
- Environment tax.
- Timing – when to reintroduce the GST?

Source: Ministry of Finance (MOF); Bank of Negara Malaysia (BNM) *Note: Transition towards SST in 2018 includes zero-rated GST from 1 Jun to 31 Aug and reintroduction of SST started 1 Sep*

Federal expenditure structure

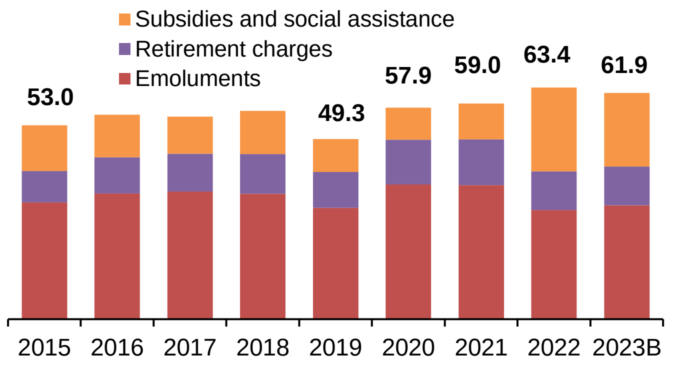
OE well above 99% of federal government revenue on average

Operating expenditure (OE)
% of federal government revenue



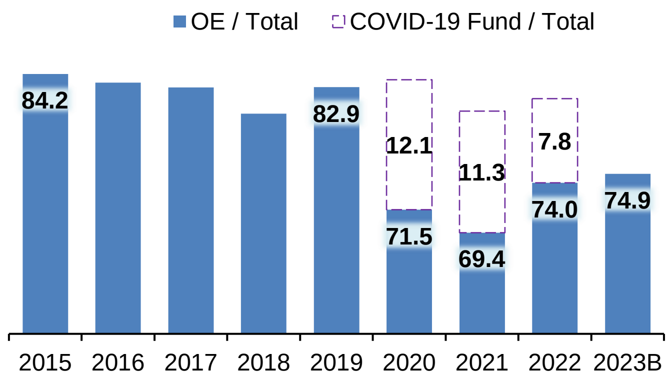
Increasing emoluments, retirement charges, subsidies and social assistance

Emoluments, retirement charges, subsidies and social assistance
% of federal government revenue



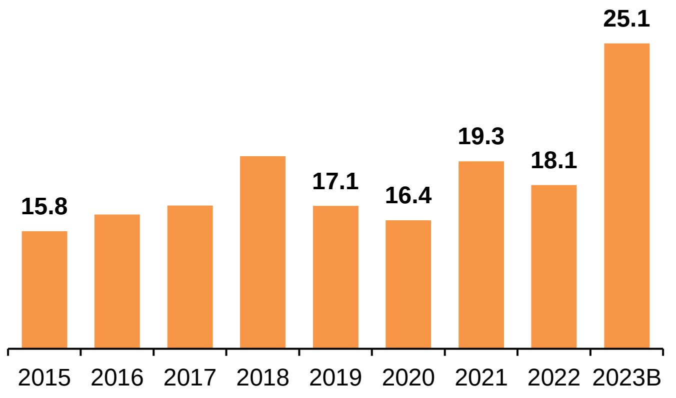
Some OE (e.g. cash aids & subsidy) in 2020-2022 were under COVID-19 Fund

Operating expenditure (OE)
% of total federal expenditure*



A record high development expenditure in terms of its value and share in 2023

Development expenditure (DE)
% of total federal expenditure*



- Operating expenditure – increased by 3.7% p.a. (2016-2023B), higher than the growth of the Federal Government's revenue (3.6% p.a. 2016-2023B).
- Substantial subsidies and social assistance increased by 43.6% p.a. (2021-2023B) due to the pandemic.
- The World Bank: "Rigid expenditures, namely obligations related to salaries, pensions, and interest payments, remain high and constraints to the government's fiscal space, posing a challenge to long-term fiscal sustainability."
- Lower subsidies allocation in 2023 Budget on moderate commodity prices and a gradual implementation of targeted subsidy mechanism, but still higher than pre-pandemic.
- Record high allocation of Development Expenditure in 2023 Budget in aligning with the 12th Malaysia Plan, including a redemption of 1MDB bond worth USD3 billion.

Source: Ministry of Finance (MOF); Bank of Negara Malaysia (BNM)   **Total federal expenditures include operating expenditures, development expenditures and the COVID-19 Fund.*

Features of a good tax reform

Fairness and lower overall tax burden

provide more incentives to work, save, invest and compete

Internationally competitive for businesses

encourage more investments in high technology and value-added sectors, create jobs and raise economic growth potential

Effective, simpler and less complex in administration

minimize compliance costs and reduce business costs as well as discourage tax avoidance and evasion

Revenue adequacy

meet prudent budget spending while maintaining fiscal stability

Issues for consideration

Incentives | Certainty in law | Consistency and Simplicity

a) While corporate income taxes can influence the choice of investment location, **a conducive business-friendly regime and regulatory environment, supported by stable macroeconomic conditions are equally important**.

b) **High tax incidence, compliance and business costs** can affect the cost of producing goods and services and hence, erode the relative international competitiveness.

c) **Sales and other related taxes would impact on tourism and cross-border shopping** as they can influence the tourists' spending on domestic goods and services as well as the hospitality sector.

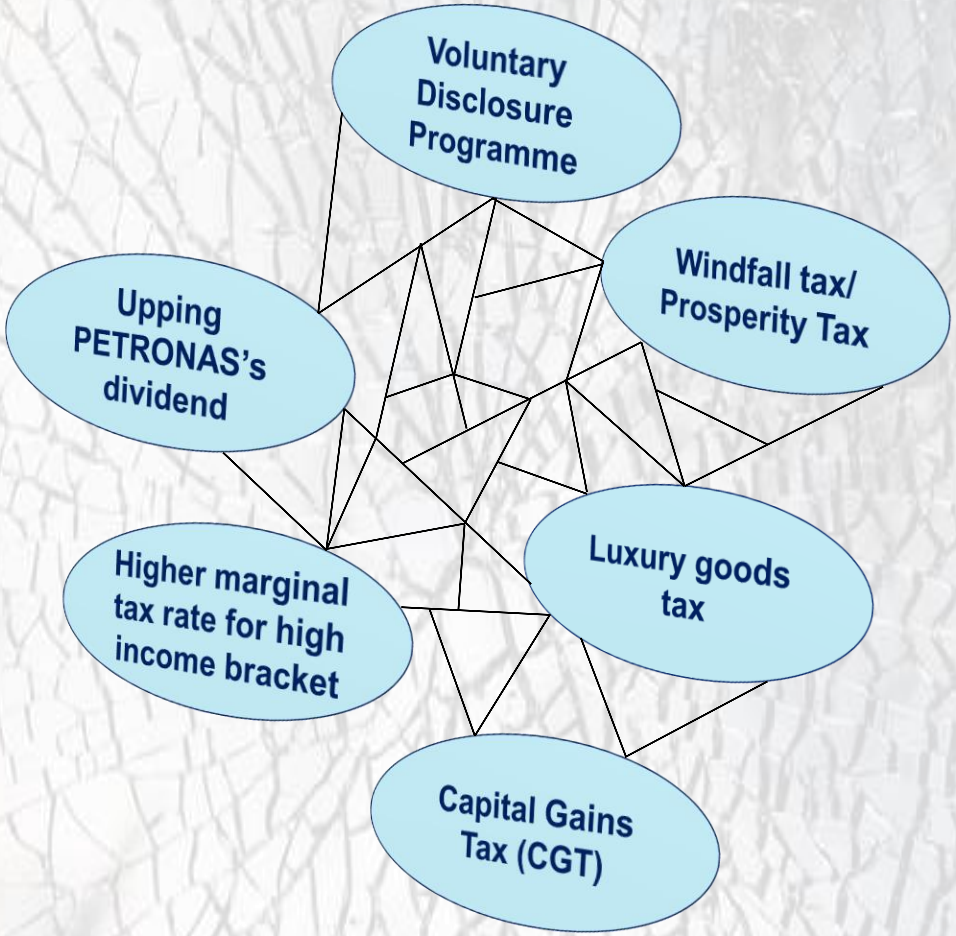
d) **Personal income taxes** can influence the supply of domestic workforce and attract talented workers in the choice of the country in which they work.

e) **Input and raw materials taxes cascading through the production process** can disincentive production and investment as well as penalize exports.

f) **Excessive taxation** such as imposing excise duties on the legitimate industries (cigarettes and liquors) while meant to discourage smoking whist raising revenue, it encourages the consumption of illegal products and rampant smuggling activities. This results in loss of billion ringgit smuggling revenue to the government.

Commit a wholesale tax reform

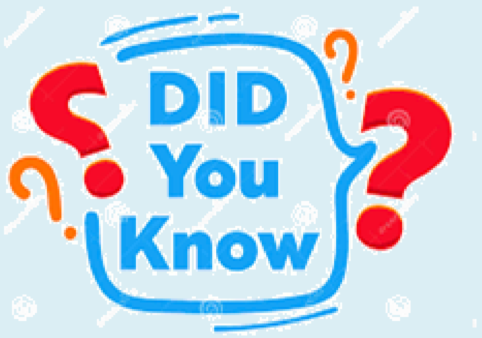
Piecemeal approach to meet revenue shortfall



Tax reform strategies with certain distinctive features

Compliance and enforcement	Simplify the process of filing tax returns; transparency and accountability to enhance trust in Government and tax administration.
Implement a multi-pronged tax reforms to ensure sustainable revenue	Reducing overly dependent on direct taxes and oil related revenue. A broad-base consumption tax, such as the Goods and Services tax.
Tax efficiency	Use a range of digital technologies, data sources and analytics to increase tax compliance, improved efficiency and reduced opportunities for tax evasion and leakages. E-invoicing adoption is one such example of using digital tools to facilitate compliance and track fraud quicker and more efficiently.
Simplify the tax system and curb exemptions	Curbing exemptions can also reduce the tax system's complexity while boosting revenue by broadening the tax base. A simpler tax system with a limited number of rates is critical to fostering taxpayer compliance.

Bolder tax reforms: Trade-offs and Priorities



Only 2.5 million or 14.9% of Malaysia's 16.73 million workforce pay income tax !

Shadow economy: Estimated 21% of GDP or RM300 billion in 2019 !

- Bolder tax reform can be challenging - it produces winners and losers
- No one size fits all approach – depending on circumstances and priorities
- **Strong political leadership and public buy-in is essential**
- Timing can also matter
- GST is a broader, fairer and equitable tax – cover the informal sector
- Capital Gains Tax (CGT) – impact on capital market; capital flight and disincentive to wealth creation
- Global Minimum Tax (GMT) at 15%
- Environment-related and health taxes; pollution and fossil fuel taxes; carbon taxes and pricing schemes are growing in popularity
- But their effectiveness can be enhanced via strengthened design and implementation, and quality monitoring, reporting, and verification
- Taxes on alcohol, tobacco, and sugar-sweetened beverages
- Subsidies rationalisation – 3 Cs (Credible, Comprehensive and Communication)
- Sticks and carrots to incentivize tax compliance
- People are sometimes reluctant to pay their taxes, fearing that these revenue collection will be squandered

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