

Malaysia's Long-term Fiscal and Tax Challenges

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Financing the transition to higher-income status is becoming a priority across Developing EAP

As incomes continue to grow, a key challenge in meeting rising societal expectations across developing EAP is to find ways to finance their higher-income, increasingly middle-class agendas

- **Basic services:** Improved availability and quality of basic services for those already in/ aspiring to be in the middle class
- **Skills development:** Better learning outcomes and enhanced skills to ensure that people can participate productively in increasingly skills-intensive economies
- **Connectivity:** Improved access to digital technologies so that people can make the most of new and emerging technologies
- **Social protection:** Enhanced social protection systems in line with the evolving demographic trends

Raising government revenue, however, entails multiple challenges

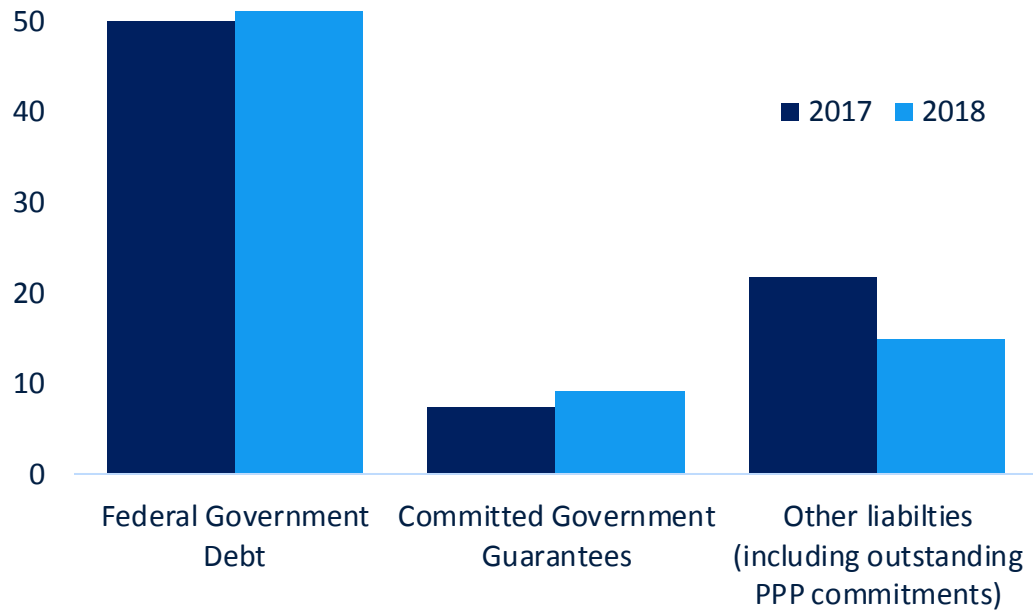
Revenue mobilization is low in developing EAP relative to both high-income countries and middle-income economies in other regions (some have even seen their revenues decline recently), reflecting several interrelated constraints:

- **Structural constraints:** Largely a function of the difficulties of raising taxes in economies with large informal sectors
- **Policy constraints:** A number of design features have resulted in complex tax systems, including large exemptions associated with different types of taxes along with fiscal incentives for investors
- **Institutional constraints:** Mainly due to high tax administration costs and low tax compliance

Malaysia's comparatively high level public debt continues to exert constraints on fiscal policy space

Federal government debt as a share of GDP has increased slightly in 2018 ...

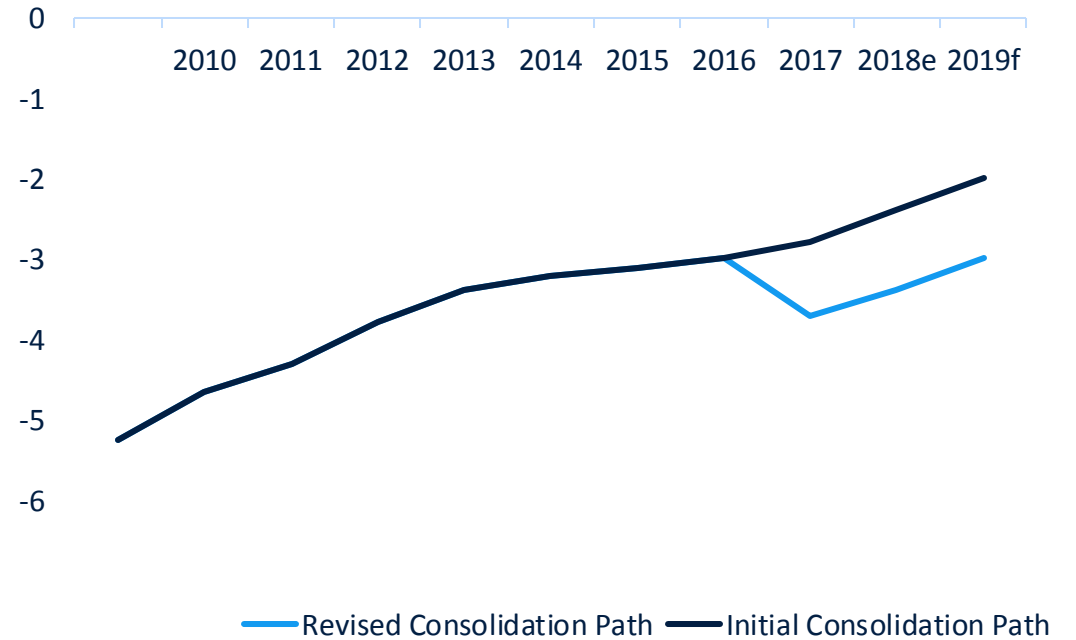
Federal Government Debt and Liabilities, Percentage of GDP



Source: World Bank staff calculations based on MOF Data

... reflecting mainly the upward adjustment in the fiscal deficit amid several fiscal policy changes

Federal Government Overall Balance, Percentage of GDP

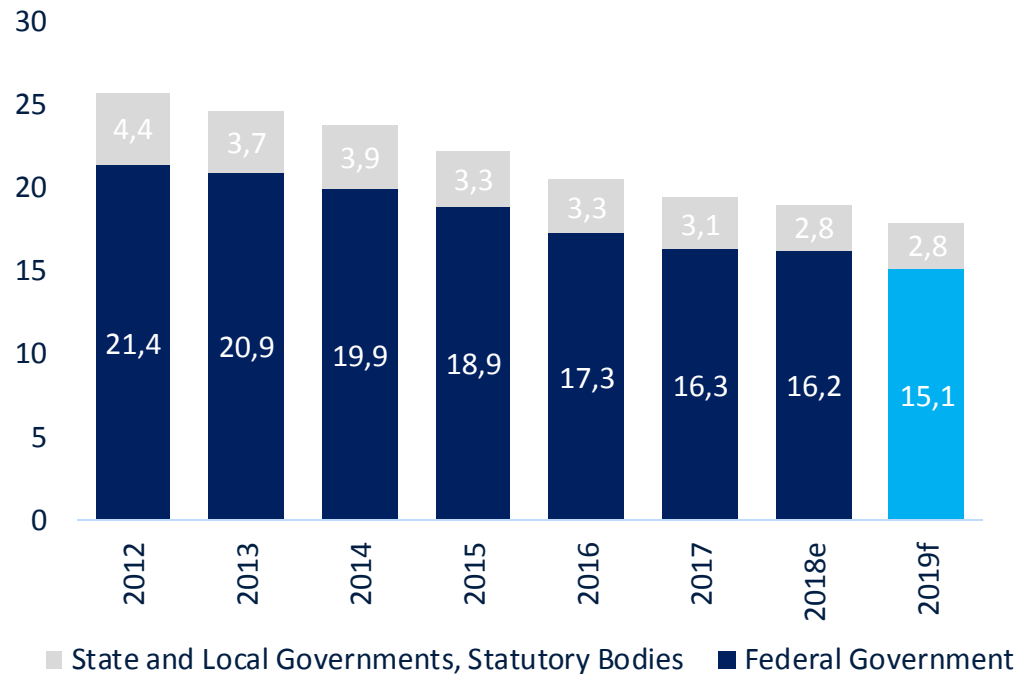


Source: World Bank staff calculations based on MOF Data

Government revenue has been on a downward trend, and is well below the average for middle- and high-income economies

Government revenue has been on a steady downward trend since 2012 ...

General Government Revenue¹, Percentage of GDP

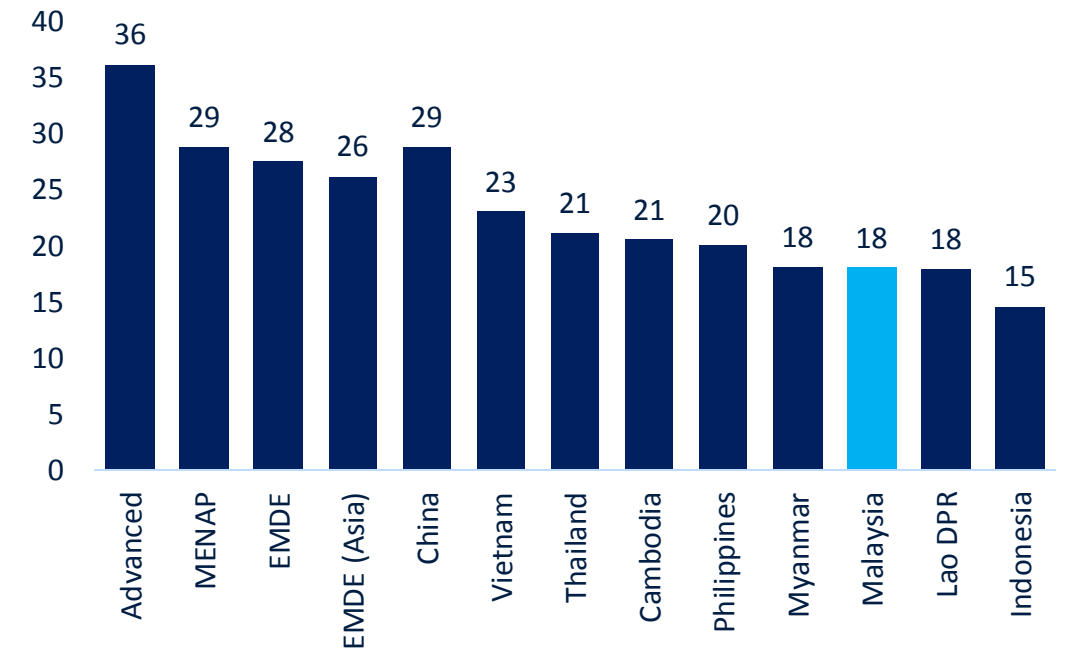


¹ Excludes one-off contributions expected from KWAP and Petronas in 2018 and 2019.

Source: World Bank staff calculations based on MOF Data

... reaching a relatively low level by international comparison

General Government Revenue², 2019f, Percentage of GDP

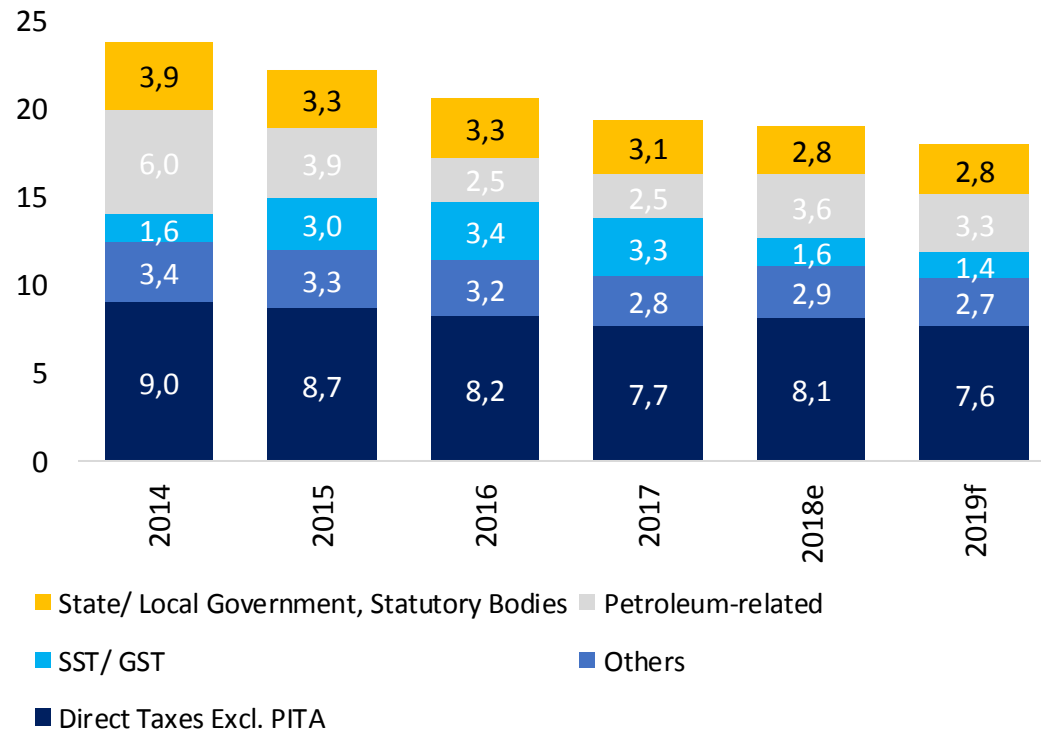


² Excludes one-off contributions expected from KWAP and Petronas in 2018 and 2019.

Source: World Bank staff calculations based on IMF and MOF Data

Government revenue has been declining across direct taxes, consumption taxes, resource-related and state/ local government revenues

General Government Revenue¹, Percentage of GDP



Contributing factors :

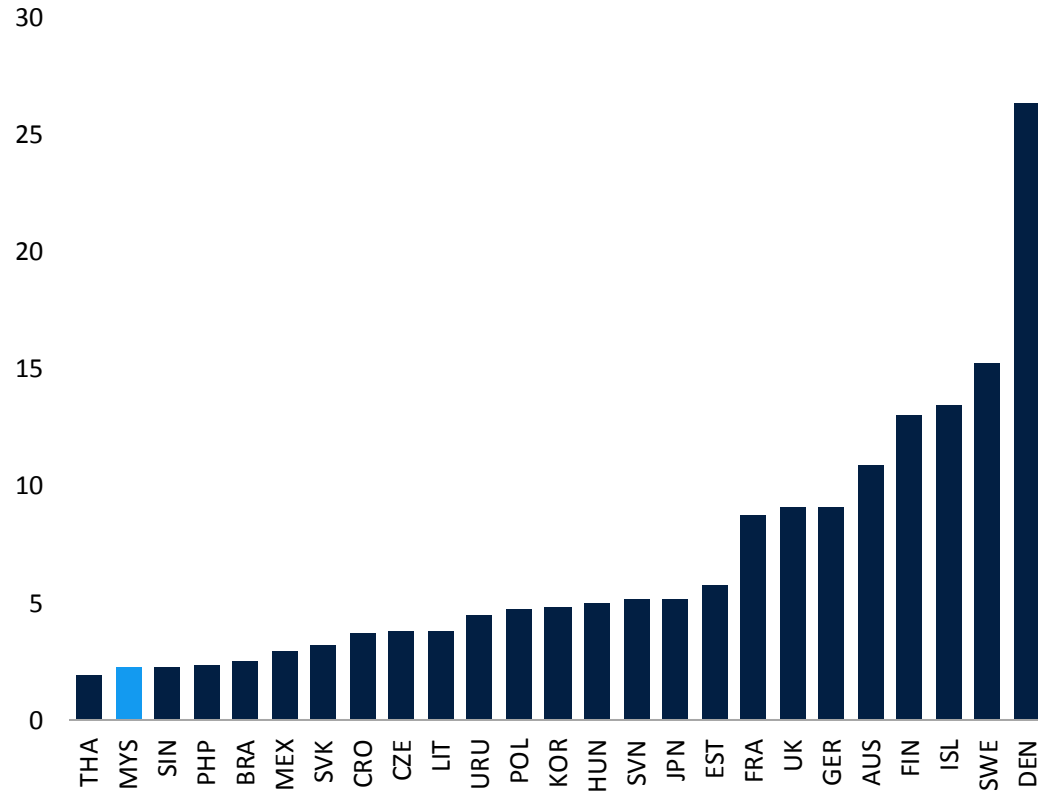
- **Reduced contribution from oil-related revenue** due to lower oil prices (but with increased reliance in 2018 and 2019)
- **Declining collections of corporate income and consumption taxes**
- **Lower state/ local government revenues**

¹ Excludes one-off contributions expected from KWAP and Petronas in 2018 and 2019.

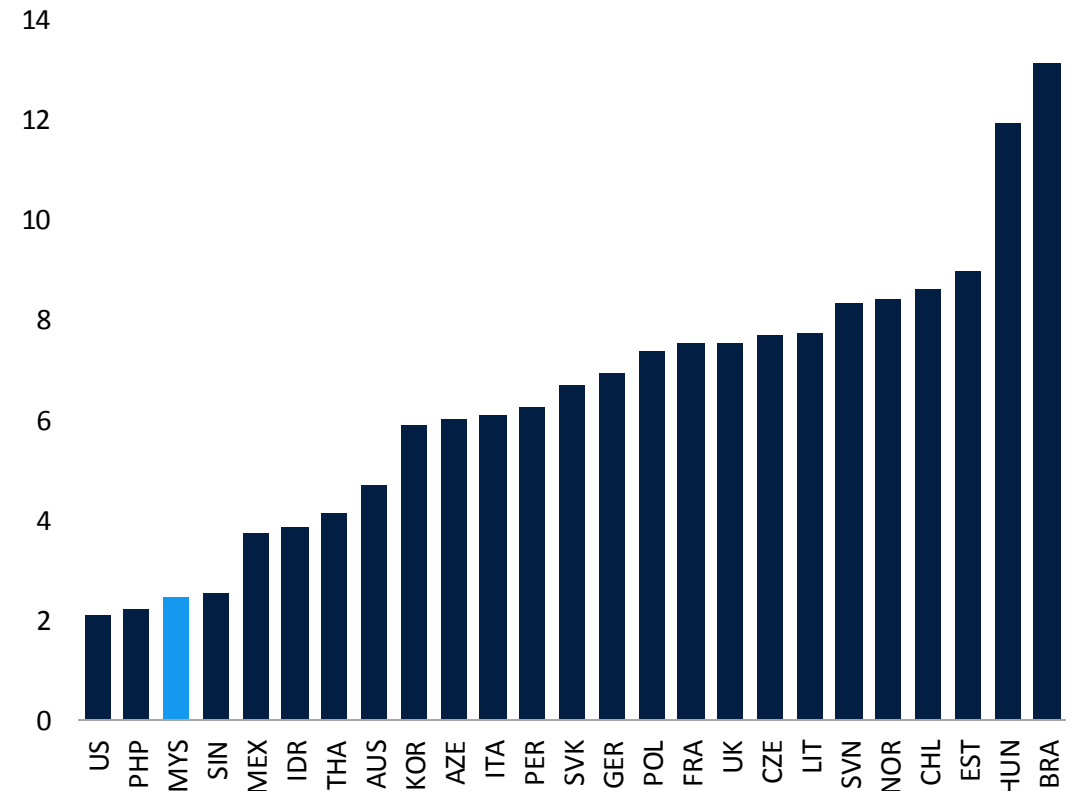
Source: World Bank staff calculations based on MOF Data

Malaysia also trails many upper-middle- and high-incomes countries in the collections of personal income and consumption taxes

Personal Income Tax, Percentage of GDP, Average 2012 - 2017



Tax on Goods and Services, Percentage of GDP, Average 2012 - 2017



Source: World Bank staff calculations based on IMF Data

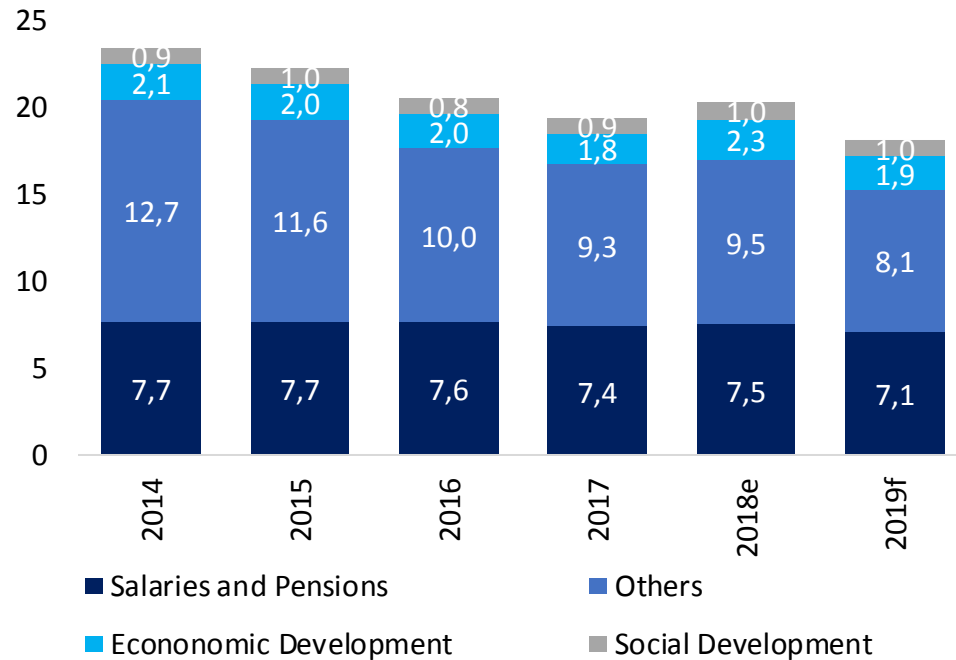
And there are high costs of tax incentives associated with attracting investments

- Currently, Malaysia offers **more than 100 different types of incentives** to promote investment, mainly in the forms of Pioneer Status, Investment Tax Allowance and Reinvestment Allowance
- The cost of incentives ranged between **RM10 – 15 billion per year** over the last 5 years (or 6 – 9% of government tax revenue)
- A previous study by the World Bank suggests that over **80% of firms would have invested without incentives**, as Malaysia's competitiveness lies more in its attractive cost proposition and the favorable investment ecosystem

Near-term fiscal consolidation efforts will be primarily driven by expenditure rationalization

Similarly, government expenditure has been on a broad downward trend since 2013

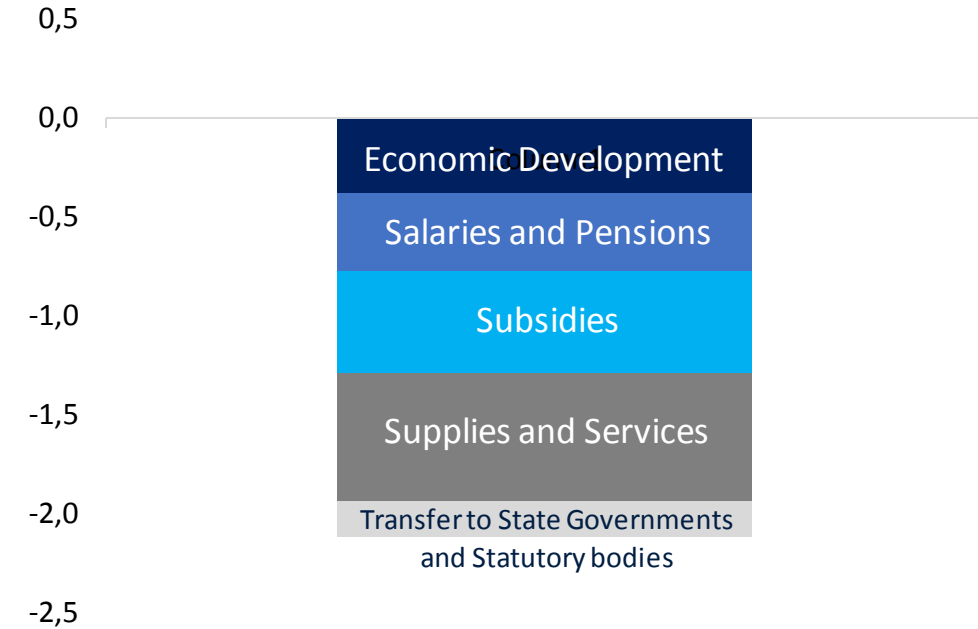
Federal Government Gross Expenditure¹, Percentage of GDP



¹ Excludes the one-off payment of outstanding income tax and GST refunds in 2019
 Source: World Bank staff calculations based on MOF Data

Broad-based declines in federal government operating and economic development outlays are expected in 2019

Change in Federal Government Expenditure² between 2018e and 2019f, Percentage of GDP

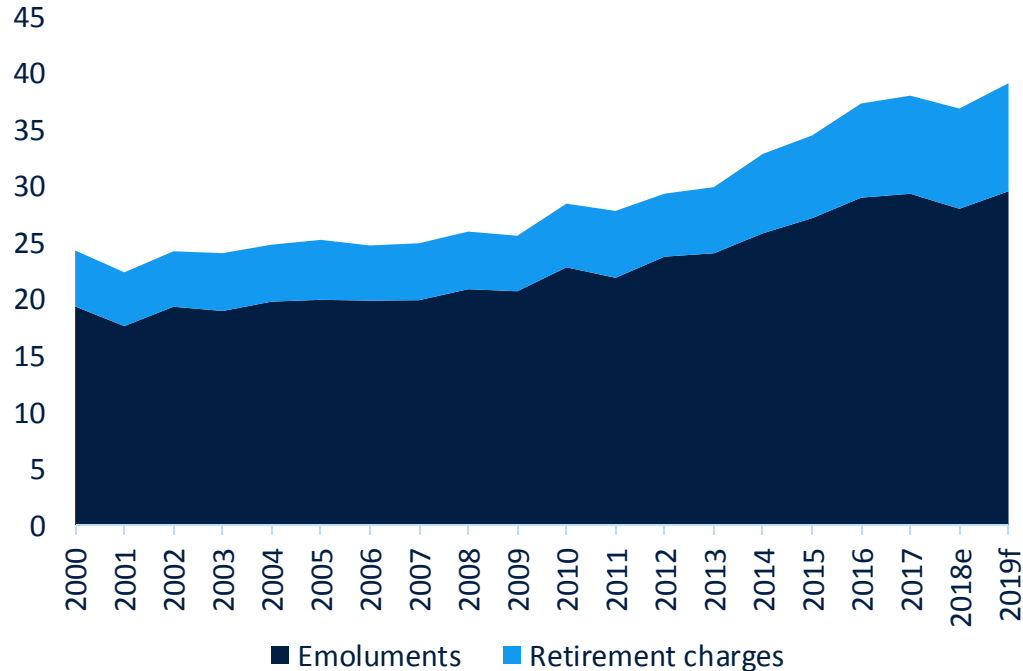


² Excludes the one-off payment of outstanding income tax and GST refunds in 2019
 Source: World Bank staff calculations based on MOF Data

Expenditure on civil service services and pensions has continued to dominate public spending

The share of civil service wage bill has continued to increase...

Share of Civil Service Salaries and Pensions to Federal Government Expenditure¹, Percentage of GDP

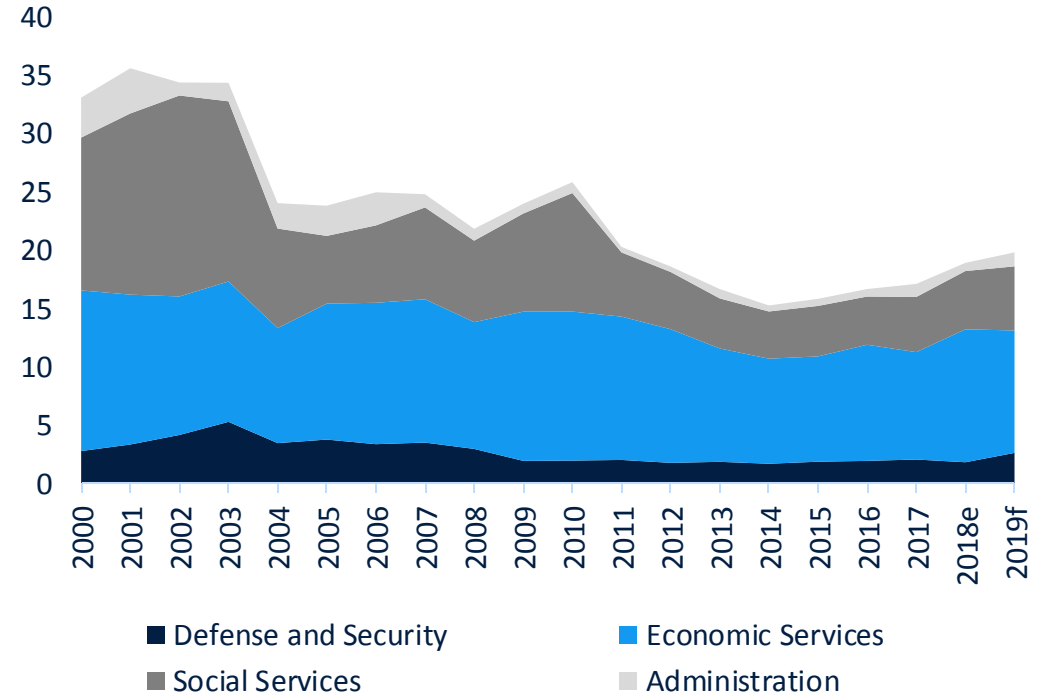


¹ Excludes the one-off payment of outstanding income tax and GST refunds in 2019

Source: World Bank staff calculations based on MOF Data

...amid declines in the share of development outlays

Change in Federal Government Expenditure² between 2018e and 2019f, Percentage of GDP



² Excludes the one-off payment of outstanding income tax and GST refunds in 2019

Source: World Bank staff calculations based on MOF Data

Greater revenue mobilization is crucial to sustainably finance the needs of Malaysia's increasingly middle-class society

Emerging policy priorities

- Expanding and diversifying the tax base by introducing or expanding:
 - Direct taxes, including personal income taxes, property taxes, and/ or wealth taxes
- Reducing unproductive tax expenditures including tax incentives

Foundational Policies

- Strengthen tax administration and compliance through increased adoption of digital technology

Efforts to diversify revenue sources should be paired with better efficiency in public spending

Emerging policy priorities

- Raising the efficiency and productivity of the public service. Some examples include:
 - Gradually doing away of blanket subsidies and improving the targeting mechanism of subsidies and cash transfers
 - Designing strategies to improve the outcomes in the social sector (education and health), which receive the highest allocation of development outlays
 - Improving learning outcomes in school
 - Addressing the current high level of stunting rate among children
 - Enhancing the financial management capacity of state and local governments

Thank you



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