

AN ALTERNATIVE BUDGET STRATEGY FOR MALAYSIA

On the last Friday of October every year, it has become a tradition in Malaysia for the Finance Minister to present the Government's Budget for the following calendar year. This year, the 2003 Budget will be presented earlier on Friday, 20 September. Besides, the 2003 Budget will also contain development allocations for 2004. It will be the first time the Budget will make fiscal commitments for the following two years.

According to Datuk Seri Dr. Mahathir Mohamad, he will step down as Prime Minister and Finance Minister in October 2003. This means that the 2004 Budget will also be announced by him, which will also affect spending in 2005. Thus, the future of the budget and the country will be determined by Dr. Mahathir for two years after he steps down in October 2003.

Thus far, most people do not closely follow the Budget. For them, what is important are new taxes imposed on them, whether directly or indirectly. They also want to know if existing taxes are reduced or scrapped.

Less attention goes to Government allocations for future spending. Part of this is current or operating expenditure which is generally difficult to avoid or reduce. Development expenditure – referred to as capital expenditure elsewhere -- are one-time investments which are not recurrent or regular.

In reality, development expenditure does not necessarily advance development, for example, if spent on buying submarines or mega building or luxury projects which are not needed; instead, these burden the state, and ultimately, the people.

For example, last month, it was announced that the Bakun Dam project had been awarded to a consortium led by a small company with a joint-venture with Sime Darby -- which has no experience in dam building -- and a foreign company.

In fact, the Bakun Dam project has been criticized in terms of its engineering as well as its environmental and economic implications. Recently, it was found that the Bakun Dam's water volume would be much

greater than previously anticipated, perhaps due to logging in the dam's vicinity.

In fact, Dr. Mahathir previously cancelled it in 1990, citing environmental considerations. Then Deputy Minister and Finance Minister Anwar Ibrahim cancelled it for a second time for its economic impact besides other considerations. Now, this mega-project has been revived, imposing a huge, heavy and useless burden on the Malaysian economy and people who will have to bear this burden for years to come.

The electricity to be generated by the Bakun Dam will be too much to sell in Sarawak and Sabah. Hence, electricity will be sold at a price much cheaper than cost to a bauxite smelter – a highly polluting industry rarely found in developed countries, and usually cited in backward countries desperate for industry regardless of its adverse consequences.

The people will bear all the costs and effects of this general Malaysian Government attitude to cronies and foreign investors. The residents of the dam area have been relocated on 1.2 ha per family, which they have to pay for – miserable compensation even condemned by Suhakam recently. As the Malay saying goes, while the forest monkey is suckled, projects for the ordinary people cannot secure funding.

The people of Sarawak will certainly be angered by the Terengganu public, who have lost billions because the previous State Government invested in the Perwaja project, which lost well over RM10 billion. Besides the Bakun project, First Silicon – with Sarawak government investment of RM6 billion – now only has 15 workers, down from 150 last year!

Previously, before the 1997-8 economic and political crisis, some large projects -- such as the Bakun Dam -- were supposedly privatized. However, now, it is clear that only profits and profitable assets are being privatized at discounted prices, especially to cronies. It cannot be denied that many more people were given some shares in privatized enterprises at discounted prices to disguise the favouritism taking place.

After the 1997-8 crisis began, public money has been used to finance Danaharta and Danamodal to the tune of almost RM50 billion in order to bail out the financial system, especially some banks and finance companies

which had lent on dubious grounds -- as politically directed or due to corrupt bank managements.

Besides that, the recently closed CDRC – Corporate Debt Restructuring Committee – was abused in order to bail out several crony conglomerates using government and people’s funds, not only at present, but also by reducing future government revenues. It is clear that pirates within and outside the government intend to privatize profits while asking the government to take over debts and losses to be borne by the government and public.

Government revenue includes both taxes and other income, mainly from state-owned enterprises such as Petronas, which is internationally acknowledged as having been well managed.

Unfortunately, although Petronas’ net income to date exceeds 400 billion, it appears that Petronas now only has about 50 billion in reserves. Part of the rest has been invested in projects within and outside the country which should provide a net income stream. However, a considerable amount has also been used to cover huge losses by other government owned enterprises, or to finance projects which no one else will finance by other means.

Several billion ringgit has been wasted to bail out Bank Bumiputera several times over, before it was sold at a discounted price to Bank of Commerce, owned by the Renong group controlled by UMNO top leaders. Petronas has been directed to finance the building of Daya Bumi, KLCC and Putrajaya (RM20 bn). Petronas also had to finance Malaysia’s F1 track and the Sauber F1 team, besides taking over Konsortium Perkapalan (previously owned by Mirzan Mahathir) and Proton.

Currently, royalties due under the Petroleum Development Act of 1974 are not paid by the Terengganu State Government since it was taken over by PAS, but have instead become a political instrument of the UMNO leadership. Such abuse of power threatens the spirit of the federal constitution and the Petroleum Development Act, and has raised doubts about the authorities’ real attitude to the rule of law. To reduce the further abuse of Petronas, it should be answerable to Parliament, and not just the Prime Minister.

The Prime Minister cum Finance Minister has announced his intention to abolish petrol and other fuel subsidies. It cannot be denied that such subsidies have been greatly abused. For example, the diesel subsidy was ostensibly introduced to help poor fishermen. However, most diesel was bought for factories, lorries, buses and taxis, while only big boats use diesel engines.

Energy conservation and environmental protection should be encouraged with appropriate public policies, but there are few serious indications that the current government has such intentions and priorities. Higher taxes on luxury cars, for example, can reduce the importation of expensive cars and the waste of petrol by large fuel-inefficient engines, besides reducing environmental pollution, which has reached dangerous levels, especially in the Kelang Valley.

Furthermore, it is clear that, to date, the federal government has not seriously tried to reduce inter-state inequalities. Hence, although Terengganu has the second highest GDP per capita in the country, it has also had the second highest poverty rate in the peninsula before PAS recaptured the state government in late 1999.

Fiscal allocations by the federal government to the states have not sought to reduce inter-state inequalities. There are no additional allocations for the poor states (as measured by state GDP per capita), or to states with high poverty rates, or to large states (such as Pahang, Sabah and Sarawak).

Only Kedah has clearly benefited under Dr Mahathir's administration, though this has not greatly benefited the ordinary people of the state, half of whom rejected the BN in the 1999 general election. The people in the states which voted in opposition governments – such as Sabah before, Kelantan and Terengganu – have been scapegoated. According to central government propaganda, high poverty in these states has been blamed on opposition party rule, though poverty rates were higher while the BN ruled, though government expenditure in these states have had to be cut under opposition rule due to reduced federal government financing.

Federal government injustice can also be seen in other regards. The Budget involves two aspects, namely revenue and spending. The main source of government revenue is taxes. A blind economist has shown what the sighted have not seen. According to Dr Ismail Muhd Salleh, post-tax income

inequality was greater than pre-tax inequality, while the tax structure became more regressive over the 1970s.

Unfortunately, this regressive impact has worsened since the mid-1980s, after the then Finance Minister began reducing the income tax and estate duty rates on companies and the rich. Both these taxes are progressive. Hence, direct taxes now are less progressive than before. Thus, the overall tax structure is even more regressive today compared to the 1970s, when it was already regressive.

Now, almost half of government revenue comes from direct taxes, whereas indirect taxes account for only 27%. The current government's intention to balance the contribution of both types of taxes by 2010 will make the overall tax impact even more regressive.

There is a big possibility that the income tax rate – on companies and individuals – will be further reduced this year, with further regressive consequences. While taxes on those with moderate incomes have been reduced slightly, especially before elections, the tax rate on the rich has been reduced far more.

Malaysians are unfortunate. As the Malay saying goes, after falling down, the ladder has fallen on them. The budget is also regressive in terms of spending as well, and has favoured those other than the ordinary people, let alone the poor.

Government expenditure is usually divided into three sectors – economic, social and security. Besides the salaries of the military and police, which need to be improved, most other security expenditure flows abroad to arms and equipment suppliers and their agents, usually from among the ranks of the cronies, as recently exposed in the case of arms purchases from France through a company controlled by the Defence Minister's aide.

According to The Arms Bazaar, by Anthony Sampson, illicit payments in the arms trade range between 15% and 40%. Some years ago, Malaysia bought Hawk fighter jets at twice the unit price paid by Indonesia, then considered one of the most corrupt countries in the world! While there were some different specifications for the Malaysian Hawks compared to the Indonesian ones, surely such differences cannot justify paying twice the price paid by that corrupt government! Malaysia boleh!

The recent two year conviction of Ezam Mohd Nor clearly shows once again how the Official Secrets Act and discretionary powers of prosecution have been used to cover up abuses by ministers and chief ministers. Those who expose corruption and abuses are jailed and disqualified from standing in elections after release, while those who have clearly done wrong remain free, safe and rich.

Economic sector spending has mainly enriched cronies given lucrative contracts for infrastructure construction. And if there is the possibility of securing large profits by operating it, the project will be privatized. But if it does not realize profits, the government will nationalize it, as in the case of the LRT companies (Putra, Star), IWK and MAS, involving billions of ringgit of public money.

MAS was supposedly bought back by the government at its 1994 sale price, i.e. RM8 per share, when in fact, MAS's current debt is, by now, far greater, while its net worth is much less.

MAS's catering department – which should be quite profitable – has been quietly sold at a discounted price to a company controlled by family members of the Deputy Prime Minister.

Although security and economic sector spending are more likely to benefit the rich, especially the cronies, many people believe that the government's social spending is progressive, reducing inequality and mainly benefiting ordinary people.

The share of social spending has declined relatively after the 1970s, especially in the 1990s. For example, security spending first exceeded education spending in the 1990s, curiously, after the end of the anti-communist counter-insurgency with the 1989 Hadyai Peace Treaty and the end of the Cold War.

Education spending favours the children of the well to do more than others. Although much is spent on education with the people's money, the spending is clearly less than efficient, beneficial and progressive. Very little is allocated for pre-school education or for education outside of the government's schooling systems, although human resource development is very important for raising productivity.

Only 8 percent of those of university age attend university, while about 7 percent more attend post-secondary level courses. This ratio is less than in Thailand, let alone Japan, South Korea, Taiwan Province of China, Singapore, or even the Philippines.

Spending per student at the tertiary level is 5 times spending at the secondary level and 8.5 times spending at the primary level – compared to ratios of 1.8 and 2.1 for Australia, and 2.6 and 4.4 for Singapore respectively.

Many have to pay high fees for private tertiary education, which is not closely monitored to protect the interests of the students and their families. In fact, education, especially tertiary education is widely considered to be a sort of business or investment opportunity, rather than for the pursuit of knowledge for social progress.

Education policy should be conceived and implemented wisely, not impulsively. For example, while most Malaysians agree with efforts to improve the quality of English language education, there is no international consensus among educationists that primary school teaching in English of Science and Mathematics constitute a better step to improve command of English, Science or Mathematics. Efforts to improve the quality of teaching, especially for the English language, should be seriously implemented, including rehiring experienced retired teachers and improving the quality of television programming.

To introduce successful reforms, careful preparations are necessary. Otherwise, the introduction of change will be arbitrary, and ultimately doomed. Allocations to improve students' command of languages, science and mathematics should be increased to overcome existing weaknesses.

Government health spending has been praised internationally. Although the government does not spend much on health, compared with education, spending for prevention, primary care, hospital services and cheap medicines have been achievements of the government's health services since the 1960s.

However, several developments since the mid-1980s in the direction of privatization, increased patient fees, market prices for medicines and the

like are undermining primary health care, which should be further improved, besides privatizing segments to enrich certain cronies. For example, RM160 million was spent annually on hospital support services until 1996, compared to over RM440 million per year from 1997, after being privatized or contracted out to three companies with close links to the country's top political leaders.

The main danger in this regard have been plans by certain elements to further privatize health services and introduce a new health financing system. Several insurance companies and foreign health maintenance organizations (MHOs) have already begun to offer profitable services. The now wellknown deceit and abuses by HMOs in the USA have been ignored by the Malaysian authorities. Although the government denies wanting to ape the West, in fact, its model for emulation includes the worst, wasteful and unfair aspects of the US health financing system.

The government seems to be allowing the health services to continue to deteriorate so that those who can afford it will turn to the private sector. However, ordinary Malaysians and other concerned about this big threat have begun to prepare alternatives to protect and advance the people's interests.

Low cost housing allocations have been greatly cut since the mid-1980s. The government scrapped its low cost housing program, ostensibly because the private sector would build low cost houses more efficiently. However, the government has continued to fail to achieve its greatly reduced revised targets.

Dr. Mahathir himself has betrayed the late Tun Razak's promise of a 'house-owning democracy'. For Mahathir, the people could choose between house or share ownership, when most low income families can afford neither.

In Malaysia, the average ratio of houses prices to annual income is around 8 to 10, compared to 4 to 5 in the US, i.e. the economic burden is twice as heavy for inferior housing in Malaysia.

For a long time, subsidized housing has been allocated through BN parties, notably UMNO and the MIC, as a political bait or bribe to attract members, especially in the cities. Some UMNO and MIC leaders now own several low

cost houses, while many low-income families still cannot get their own houses except in squatter areas.

Recently, the smallest ministry, the Welfare Ministry, was divided between two woman ministers. Thus, the government gives the impression that it is concerned about the plight of women and other less fortunate groups. In fact, however, allocations for the two ministries remain very modest, and should be significantly increased to finance needed programs. The tax system can also be used to ensure that living allowances are paid by fathers to their children and wives or ex-wives.

Until now, the government has yet to implement the 1967 cabinet committee proposals for a more comprehensive social security system, and not just compensation for industrial accidents. The present system serves to absolve negligent and irresponsible managements from responsibility for workers' safety and welfare. A more complete and comprehensive system should be developed to care for the unfortunate, such as those who lose their incomes due to economic downturns or the illness or death of a husband or father.

Although several types of social expenditure provide benefits to most people, on the whole, social expenditure has failed to reduce inequalities. Therefore, like taxation, public expenditure too is biased and unfair.

The impact of the tax system has increased inequality, while government spending is biased to the rich, especially cronies, though there maybe some trickle down to others. As the Malay saying goes, while the cronies enjoy the meat and fat, the common folk only get bones and feathers.

Recently, there has been considerable economic analysis that clearly shows that excessive inequality inhibits economic growth. As emphasized by the late Professor Ishak Shari, economic development in Southeast Asia has been far more modest than the earlier economic success of Northeast Asia as inequality in Taiwan Province of China, South Korea and Japan has been much lower than in this region, including Malaysia.

Hence, an alternative budget strategy should have two objectives. First, fiscal strategy should counter economic cycles. During economic booms, there should be budget surpluses, as in the mid-1990s. Conversely, when the economy is in decline, fiscal means should be used to increase the growth rate and stimulate the economy with budget deficits.

However, efforts to increase spending should be targeted. Increased spending in the last four years has been mainly aimed at bailing out influential corporate interests, i.e. crony businesses. The alternative approach must instead privilege the common people's interests.

Hence, the second objective of the alternative budget strategy should ensure that fiscal measures are progressive, and not regressive, as they are now. Progressive efforts should include both aspects of budgetary policy, i.e. taxation and spending. Both are currently regressive and should be made progressive, i.e. fiscal policy should reduce – not increase – existing economic injustice.

Since the early 1970s, the government has published its annual Economic Report when the Budget is announced. The annual Economic Report as well as the five-year plans and the mid-term reviews should also include more comprehensive economic indicators, including items making up the Human Development Index published by the UNDP and many other countries.

Malaysia is not capable of competing only by offering lowly paid workers. To avoid excessive wage increases due to excessive labor demand, the government encouraged the entry of foreign workers, which later added to problems with neighboring countries and inhumane policies which have adversely affected our image internationally. Now, certain sectors – such as plantations, construction, domestic help and other such services – once again need foreign workers.

An alternative development strategy should move the economy from this vicious cycle – with low skills, productivity and incomes – to a virtuous cycle with high skills, productivity and incomes. If we do not get out of this situation, it is certain that we will not be able to compete with lower wages in China, India, Bangladesh and Indonesia.

The way out is clear, and the government should prepare a policy, incentives and support to take Malaysia in this direction. Hence, the third objective of this alternative budget strategy would be to accelerate the transition to high value development with able skills and human resources.

The big challenge then is how to achieve these three objectives – counter the cycle, fight injustice, ensure progress -- at once. The Budget should address these challenges with bold measures.

Most of the additional income to the low income group will be spent, mainly on Malaysian goods and services, which will stimulate economic recovery based on increased domestic demand, as is sorely needed.

Other efforts are also needed to increase consumer spending from 47% of GDP currently, compared to 53% in the early 1990s. Since the income tax rate was reduced last year, the government should increase tax allowances, reliefs, rebates and other breaks for the taxable brackets, especially for the vast majority of middle-income taxpayers. Personal exemptions should be raised from RM8000 to RM9000, while exemptions for dependents -- such as children and aged parents -- should also be increased as a budgetary means to strengthen family ties and responsibilities.

The Government should introduce a progressive corporate income tax structure with the first RM20,000 taxed only 20% of the usual rate, while the next RM80,000 should be taxed only 50% of the regular rate. Such a structure will benefit small and medium enterprises, and encourage them not to evade paying income tax. Currently, many small and medium enterprises do not want to get involve with government programs because they fear paying the fixed corporate income tax rate.

Although the corporate income tax rate has begun to be reduced in Singapore, the government should study the tax structure carefully to provide tax breaks and other incentives to companies to invest in priority sectors for development. There is no advantage for Malaysia to get caught in a vicious cycle of competitive tax cuts tantamount to beggaring thy neighbour. A one percent reduction in the corporate income tax rate will reduce government revenue by about RM600 million.

The tax system should be used to encourage healthy behaviour, and to discourage unhealthy conduct. Hence, high taxes should be imposed on tobacco, liquor and gambling. Taxes on liquor and places serving alcohol should be raised, especially in view of the continuing increase in traffic accidents due to drunken drivers.

It is well known that all gaming companies in Malaysia are controlled by cronies of the BN leadership. The practice of BN parties and their leaders to accept gifts – in various forms – from gaming companies and other cronies should be investigated by the Anti-Corruption Agency with a view to prosecution as soon as possible. Taxes on certain types of gaming, which were reduced by the BN government in September 2001, should be restored at once, while all gaming tax rates should be raised for revenue purposes and to discourage such socially undesirable behaviour.

To raise domestic demand and reduce income inequality in the Malaysian economy, also found in the public sector, a uniform wage increase of RM100 monthly for all public sector employees is proposed over two years (2003 and 2004). Current expenditure will consequently rise by almost half a billion ringgit each year over the next two years.

Such a wage increase succeeded in reviving the economy, with less inequality in Europe after the Great Depression of the early 1930s. A uniform increase for all will reduce inequality or the gap between the high and low income in the public sector.

Since the government is the largest employer, this measure will have impacts throughout the economy. If the government pays its lowly paid employees more, this will influence the private sector, which also needs workers.

The EPF needs to be reformed with respect to its management, investment policy and annual rates of return in order to prioritise workers' welfare. Since the mid-1980s, and especially since the 1997-8 crisis, EPF funds have been misused several times at the behest of the authorities (e.g. Makuwasa), e.g. to save crony companies (e.g. Time dotcom) – at great loss, which ultimately have to be borne by EPF depositors.

Productivity gains must also be achieved through major and comprehensive public sector reform. The public sector must be reformed to raise worker morale, productivity and output besides wiping out corruption and abuses of power. The government should be more transparent and accountable. Unfortunately, public sector reform has long been rejected by this government, ostensibly because privatization policy would resolve existing problems. It is now clear that the privatization policy has been a great failure, whereas public sector reform remains very necessary.

All government schools should become single session schools within the next decade. Allocations to increase educational facilities, teacher training and teacher remuneration must be increased significantly. The education system must be restructured to increase skilled, capable and productive human resources. Many more teachers are needed, teachers' salaries, working conditions and morale must be improved, schools and their facilities should become the centre of community life, life-long learning facilities need to be developed, pre-school facilities increased, tertiary education access increased and much more done to ensure Malaysia does not continue to fall back in terms of economic progress, knowledge and ethics.

A new health care financing system is needed. The new system must at least guarantee the Malaysian people's previous health rights. The health system should be principally financed by the government's revenue. Much effort is needed to raise the quality of government health services, both in terms of facilities and medicines, or the morale of doctors, nurses and other staff. Other changes should only be imposed to discourage abuses of freely available services, not to burden those who cannot afford to pay.

Preventive measures must be increased and financed by the government. For example, the incidence of dengue fever has risen recently because urban residents do not want to pay more than property rates for preventive measures after the municipal authorities stopped performing their responsibilities.

The government's housing policy should guarantee affordable housing for all, with subsidies for the poorest. A careful strategy – consistent with this goal – needs to be prepared for at least 70 per cent of urban families to have their own houses by the year 2020.

The neglect of peasant or smallholder agriculture in the last two decades must be replaced by serious efforts to promote new agricultural technologies with credit support, equipment, instruction and other needed help.

Fisheries policy should also be reformed to improve the lot of the fisherfolk and ensure adequate, cheap and uncontaminated fish remains the main source of animal protein for the people.

Small and medium sized enterprises also need similar support appropriate to their different needs.

The government's mega-projects which do not obtain economic returns – such as the Bakun Dam -- should be scrapped at once, and, if appropriate, replaced by other projects with much more benefit, especially for ordinary people. On the other hand, other needed infrastructure and projects -- such as efforts to ensure adequate and safe water supplies – should be emphasized. After IWK's failure and fraud, the government has to invest in improvement of the long neglected sewerage system.

Services which save or ensure high net foreign exchange earnings – such as higher education, medicine, tourism, regional transportation, information and communications technology (ICT) and the professions – should be encouraged with tax incentives, infrastructure provision and other needed facilities as well as reduced regulations and bureaucracy other than efforts to protect the interest of consumers, workers, society and morality.

While efforts to make a success of the MSC must be continued, since so much investment has been made, the government should not only concentrate on one source of new growth while neglecting other sectors such as agriculture. Many investors seek MSC status for its various perks including tax exemption and other privileges. But the MSC's real success is far from assured, and its actual success should be compared against government subsidies and other spending.

The government should encourage new dynamic industries, especially capital-intensive ones using advanced technology to achieve high productivity and value-addition. Appropriate incentives should be developed as part of an industrialization strategy accepted by the people. Although the government has prepared two Industrial Master Plans, implementation has been inconsistent and little reviewed, let alone revised, e.g. after the 1997-8 crisis, or after new awareness of problems after the 2001 recession.

Technology policy in Malaysia has been less than effective. Technology policy should be conceived on the basis of Malaysian realities. The government has claimed many things, but actual progress is unsatisfactory, in fact, rather pathetic.

Since the government has relied heavily on foreign investment thus far, any government is obliged to work hard to retain and attract foreign investment, especially to secure sophisticated technology and foreign market access.

Many studies have shown that foreign investors follow domestic investors into other kinds of industries. Hence, domestic investors should be given far more attention than in the past.

Preparing a budget is a major responsibility. It is easy to promise the world, to give tax breaks and spend in certain areas for short-term political advantage. The Budget Strategy we have proposed, however, is a serious effort to address various problems Malaysia has inherited after years of maladministration and its many consequences. In particular, we need to not only revive the economy after no real growth in 2001, but also create the conditions for more just and sustainable development thereafter. The choice for the people of Malaysia should be clear.