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PERSPECTIVE

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Malaysia's 2016 Budget: Pursuing Fiscal Consolidation while Skirting Critical Growth Concerns

By Evelyn S. Devadason[*]

EXECUTIVE SUMMARY

- Whilst possessing a number of visible hand-outs, the 2016 Malaysian Budget continues the process of fiscal consolidation aimed at minimizing the budget deficit and curtailing federal government debt.

- While the pursuit of fiscal consolidation is positive, the efficacy of the budget is questionable.

- No solutions have been offered to deal with the 'real' and structural issues facing the domestic economy, which include the slowdown in exports and sluggish growth in consumption and investment.

- Going forward, the decline in oil revenue and the implementation of GST mean that the government's fiscal situation will be more closely linked to the health of the economy than in the past.

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INTRODUCTION

The 2016 Budget for Malaysia was tabled on 23 October, 2015. It has drawn much interest as it is the first budget under the *11th Malaysia Plan* (2016-2020), which is the last medium-term plan in the nation's journey to 'high income' status as laid out in its *Vision 2020*. Themed 'Prospering the Rakyat', the 2016 Budget continues to be guided by the 'people economy',[1] a concept coined in the previous budget. This budget's allocation for 2016 amounts to RM 265 billion, with 81 per cent for operating expenditure and 19 per cent for development expenditure.

The Budget has five priorities, the first three of which are economic – strengthening economic resilience, enhancing productivity, and empowering human capital. The fourth and fifth are more social, and are for advancing the bumiputera agenda and easing the cost of living for the Rakyat. The priorities, their proportion of the total budget allocation, and key strategic initiatives are set out in Table 1.

Of key interest is the fifth priority, which – in essence – is about providing a little something for everyone at the individual and household levels. Planned measures include: cash support for low income families; tax relief for middle-income households; increase in the minimum wage; extension of the Goods and Services Tax (GST) zero-rated list; extra funds for affordable housing projects; and higher development spending, among others (Table 2). The estimated cost of these measures which are set out in Table 2 is RM 11,925 million. It is therefore considered a 'populist' budget by many.

As a result, this Budget continues the tradition of other budgets passed since 2008, which have dedicated substantial amounts to various types of cash transfers. Notwithstanding this, the 2016 Budget can also be considered as prudent – with conservative fiscal goals. It also continues another tradition – this one beginning in 2010 – of pursuing fiscal consolidation, with the aim of reducing the fiscal deficit and avoiding new debt.

Table 1: Priorities and Strategies in Budget 2016

Priority	Strategic Initiatives
Strengthening Economic Resilience Proportion of the total - 42%	- Boosting domestic investment - Invigorating capital market - Energising small and medium enterprises (SMEs) - Improving infrastructure - Building efficient transport system - Rural infrastructure development - Upgrading telecommunication infrastructure - Promoting and strengthening economic activity (promoting tourism, modernising agriculture, strengthening exports)

[1] The people economy focuses on wage earners, small businesses, the informal sector and the citizens (rakyat) (MOF, 2015).

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Enhancing Productivity, Innovation and Green Technology Proportion of the total – 1%	- Accelerating innovation and entrepreneurship - Leveraging advancement in technology - Inculcating green technology
Empowering Human Capital Proportion of the total - 34%	- Strengthening quality of education - Transforming Technical and Vocational Education and Training (TVET) - Empowering youth, community and non-governmental organizations (NGOs) - Empowering human capital through quality Workforce
Advancing Bumiputera Agenda Proportion of the total - 11%	- Empowering Bumiputera - Intensifying development in Sabah and Sarawak
Easing Cost of Living for Well-Being of Rakyat Proportion of the total – 12%	- Raising living standards of low-income (B40) households - Increasing disposable income of middle-income (M40) - Improving welfare and progess of Orang Asli Community - Providing affordable housing - Improving quality of healthcare services - Ensuring welfare of the less fortunate and persons with disabilities - Strengthening natural disaster management - Increasing public safety and security - Extending Bantuan Rakyat 1Malaysia (BRIM) - Appreciating contribution of civil service

Source: Ministry of Finance.

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Table 2: Populist Items in Budget 2016

No.	Populist Items
1	Cash Support: • Cash handouts of 5.9 billion ringgit under the Bantuan Rakyat 1 Malaysia (BR1M) program. • Monthly financial assistance for children from poor families (RM 100 to RM 450) and for poor senior citizens (RM 300). • Monthly allowances for employed persons with disabilities (PWD) (RM 350), unemployed PWD (RM 200) and bedridden PWD (RM 300)
2	Tax Relief: • From RM 1,000 – RM 2,000 for each child under the age of 18 years; • From RM 3,000 – RM 4,000 for individual taxpayer whose spouse does not have income. • RM 1,500 tax relief for family members who support/ care for their parents. • From RM 6,000 – RM 8,000 for each child above 18 who is studying at a local or foreign institution of higher learning. • From RM 6,000 – RM 8,000 for disabled children above 18 who are studying at local or foreign institutions of higher learning.
3	Minimum Wage: • Increase in monthly minimum wage to RM 1,000 from RM 900 ringgit in Peninsular Malaysia, and to RM 920 from RM 800 in Sabah and Sarawak. • Setting a minimum starting salary of RM 1,200 for civil servants.
4	GST: • GST exemptions on an additional 4,400 brands of medicine, lentils, and some types of baby milk powder. • GST relief for some equipment for oil and gas sector, and on some imports for companies in maintenance and repair in the aerospace industry.
5	Housing Projects: • 175,000 house units will be built under 1Malaysia People's Housing Project (PR1MA), and sold 20 percent cheaper than market prices. • 10,000 units will be built by Syarikat Perumahan Negara Berhad (SPNB) under the Rumah Mesra Rakyat programme, with a RM 20,000 subsidy given for each unit. • 100,000 houses will be built by Under the 1Malaysia Civil Servants Housing Programme (PPA1M), priced between RM 90,000 and RM 300,000. • 22,300 apartment units and 9,800 terrace houses will be built under the People's Housing Project (PPR) by the Urban Wellbeing, Housing and Local Government Ministry. • RM 200million is also allocated under the First Housing Deposit Financing scheme, for first-time buyers. • RM 60million will be allocated for the Orang Asli Development Department for the construction of houses for Orang Asli community.

Source: Ministry of Finance.

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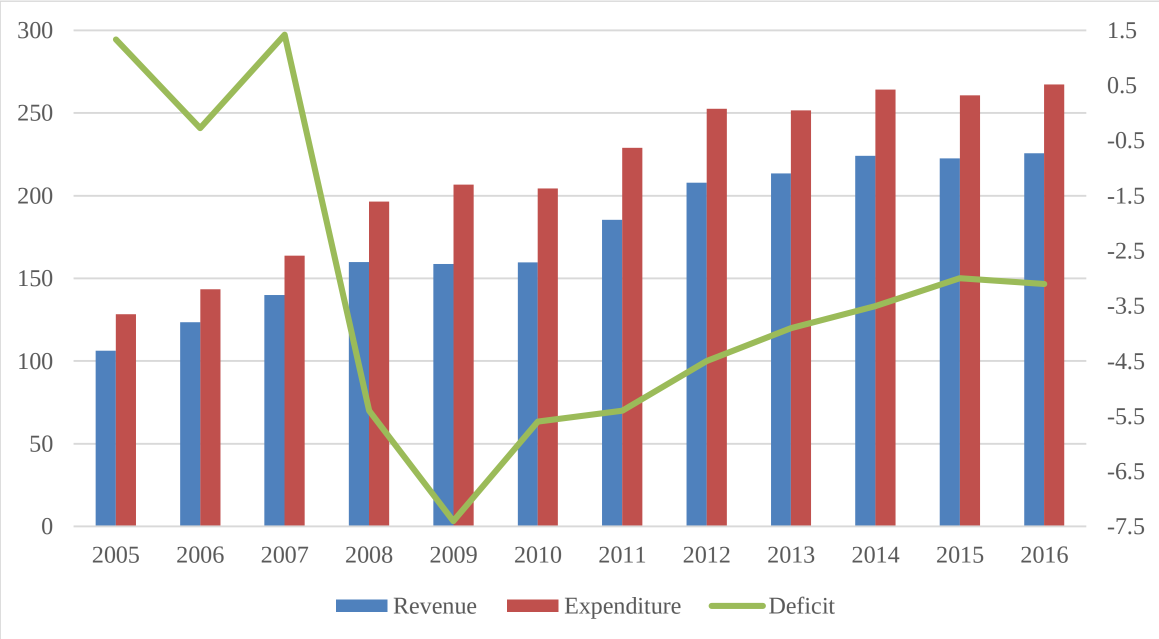
THE FISCAL POSITION

In the 2016 Budget, the fiscal deficit is to be maintained at 3.1 per cent of gross domestic product (GDP) next year, down from 3.2 per cent in 2015 (as per revised budget on Jan 20, 2015) and 3.4 per cent in 2014 (Figure 1). These projections are based on real GDP growth of 4-5 per cent in 2016 and 4.5-5.5 per cent in 2016. The aim is to progressively reduce the deficit and attain a balanced budget by 2020. Should this be achieved, Malaysia would have had, by then, 23 consecutive years of budget deficits.

Figure 1: Fiscal Performance, 2005-2016



Notes: (1) Revenue and expenditure are in RM billion (left axis). (2) Deficit is expressed as percentage of GDP (right axis).

Source: Ministry of Finance, Malaysia.

Figure 1 further shows that growth revenue has been somewhat sluggish over the past five years. This is expected to continue given the prevailing economic climate and lower oil prices. [2] The slowdown is attributed to China's slower economic growth, volatile international capital markets and prolonged low commodity prices. The government expects to counter the declining revenue in 2016 with an estimated RM 39 billion derived from the newly introduced GST[3] (see also IMF, 2015) and higher income tax collection from the corporate sector, totalling RM 74 billion.

In efforts to achieve fiscal consolidation, government expenditure is projected to slow down in 2015 and then increase marginally in 2016. A challenge for the government will be to manage its operating expenditure, which is estimated to take up 95 per cent of its revenue in 2015 (*The Edge Weekly*, 19-25 October 2015). Furthermore, fiscal consolidation pursued through subsidy rationalisations has tapered down, with subsidy

[2] The share of oil-related revenue to total revenue was 30 per cent in 2014 (MOF, 2015).
[3] The GST, at 6 per cent, was introduced on 1 April 2015.

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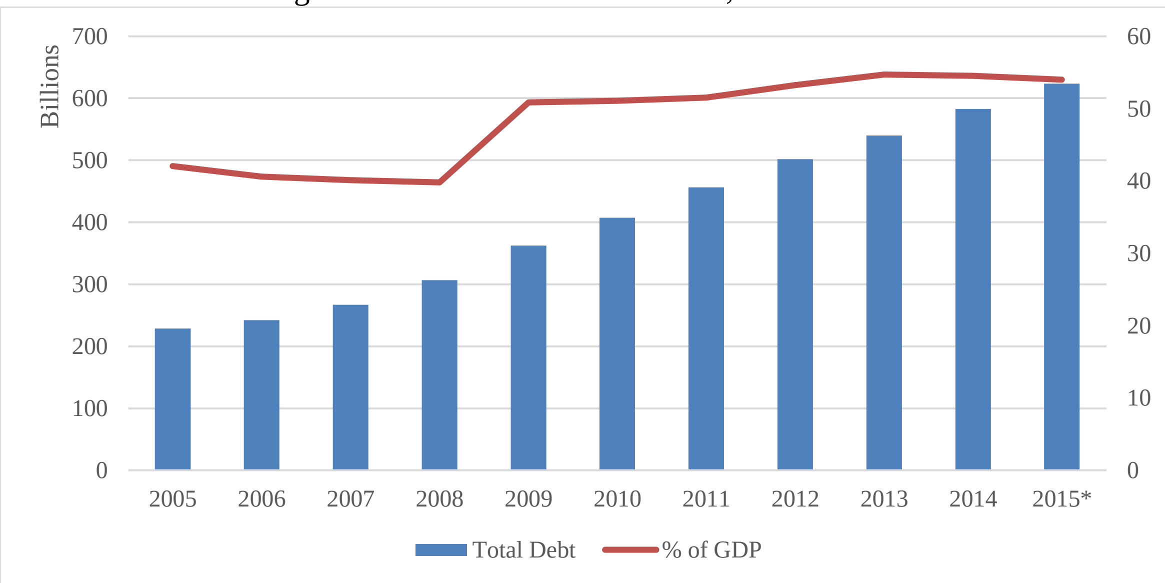
allocations falling marginally to RM 26.1 billion in 2015 (*The Malay Mail*, 23 October 2015). Although subsidy reductions for sugar, flour, cooking oil, RON 95 petrol, diesel, liquefied petroleum gas (LPG), and revisions on gas price and electricity tariffs had been phased in gradually in the previous years, the 2016 Budget does not seem to propose any significant reductions in subsidies. It remains unclear where further reductions in subsidies are going to take place. Nevertheless, as with the introduction of the GST, the previous elimination of fuel and food subsidies is considered a decisive reform by the Malaysian govenrent.

Aside from minimizing the deficit, containing federal government debt is the other objective of fiscal consolidation. As at 2015, federal debt stood at 54 per cent of GDP (Figure 2), below the self-imposed debt ceiling of 55 per cent of GDP (MOF, 2015). In international terms, this is considered a manageable level of debt. However, many argue that the real picture of indebtness is visible only when "off-balance sheet" items are considered. When these are accounted for, federal debt is estimated to reach close to 70 per cent of GDP, which has stoked concerns among portfolio investors. Furthermore, the government disclosed that it has to make off-balance sheet payments of RM 4.76 billion to RM 11.62 billion annually from 2015-2020, for nine government-owned entities established *via* the Finance Ministry Incorporated (MKD) (Zachariah, 2015).

Figure 2: Federal Government Debt, 2005-2015



Note: (1) *Based on the third quarter of 2015. (2) The left axis depicts federal government debt in RM billion, while the right axis refers to the percentage of federal government debt in GDP.

Source: World Development Indicators.

As the off-balance sheet debt only harbours future risks, for now, it is maintained that the government is still on the right track towards fiscal consolidation. The focus then shifts to the efficacy of the budget. The key question is whether the 2016 Budget has adequately addressed issues that plague the domestic economy.

The Budget appears not to be 'pro-growth', as short-term stimuli is not the answer for some of the long-term macroeconomic problems of the country. Further, no solutions have

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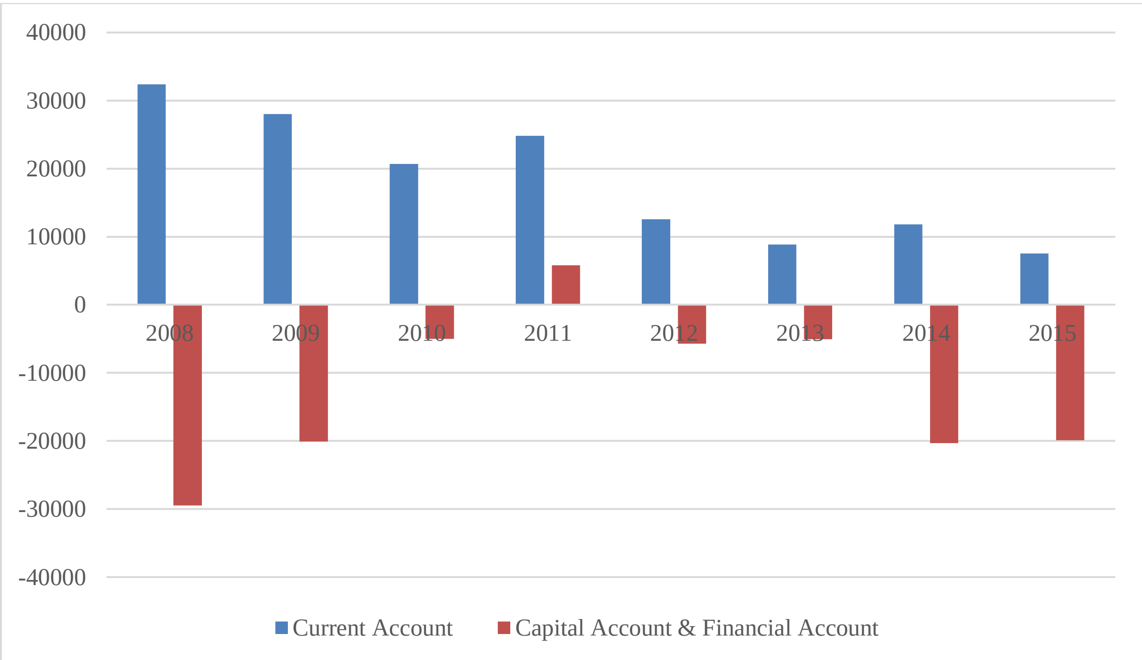
been proposed for the 'real' and structural issues facing the economy – namely the slowdown in exports and sluggish growth in consumption and investment. The declining trends in these growth determinants are largely related to the issues of: loss of competitiveness (for exports); revenue-constrained households (for consumption); and shattered business confidence (for investment). The latter two can constitute formidable policy challenges as they relate to the behaviour of consumers and investors. Menon (2012) and Menon and Thiam (2015) also argue that some of the domestic problems – particularly the structural regression of the manufacturing sector and the decline in private investments – relate directly to policy distortions. These issues are assessed in the next section.

THE GROWTH PROBLEM

Malaysia forecasts its current account surplus to reach RM 11.3 billion (0.5-1.5 per cent of gross national income) in 2016, extending a negative trend observed over the years. The current account surplus has narrowed substantially (Figure 3) through the trade channel, amidst weak global growth and dependence on commodity exports. Based on current trends, exports are expected to further contract by 0.7 per cent in 2015, and subsequently recover at just 1.4 per cent in 2016. Malaysia's deteriorating credit profile has also affected the capital and financial account. While capital flows have been historically volatile (IMF, 2015) and therefore generally anticipated, the narrowing current account surplus is indeed disturbing. \

Figure 3: Components of Balance of Payments (RM million), 2008-2015



Note: (1) The values represent the yearly averages for the four quarters. (2) For 2015, it is the average of the three quarters.

Sources: Department of Statistics, Malaysia; Bank Negara Malaysia.

Although the slack in exogenous elements has indeed contributed to the narrowing current account surplus, the slowdown in exports can only be partially attributed to weak global demand. The World Bank (2014) has provided several reasons why sluggish external demand is not the main culprit for the position of the current account. First, Malaysia's export growth had been slowing down even before the Global Financial Crisis (GFC), suggesting that structural, instead of cyclical factors, are at play. Second, supply-side factors are found to contribute to the post-crisis decline in export market shares. Third, declining competitiveness of the export sector[4] has also a major role to play, as nearly 60 per cent of the demand for Malaysian value-added comes from overseas.

While the budget does allocate funding to shore up export growth under the first priority (Table 1), the measures remain palliative, given the inherent structural problems in the export sector. Generally, there seems to be a lack of clarity on how to regenerate and improve the competitiveness of the industrial sector. In this regard, the pump-priming measures for small and medium enterprises (SMEs) in the current budget, such as tax exemptions for increasing exports and flexibility for complying with value-added production in the period 2016-2018, can be helpful in the short-term, but need to be accompanied by more structural measures to enhance the competitiveness of local industries on the global market.

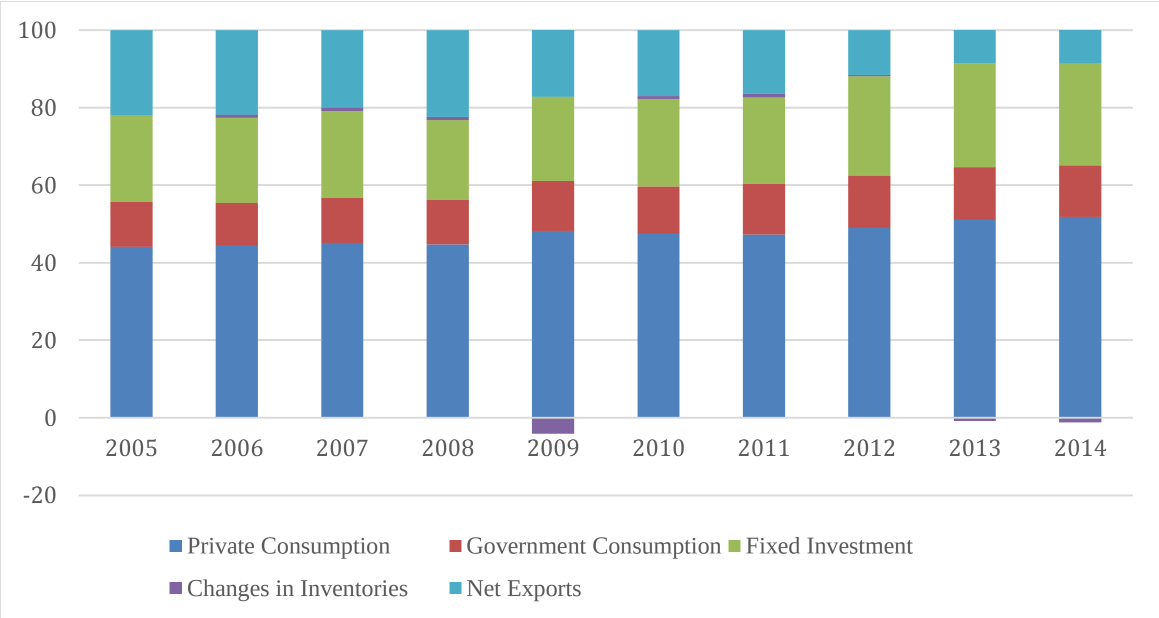
While exports are expected to continue to remain sluggish, in the medium-term, rightfully, consumption and investment will have to drive the domestic economy. However, the government should not place such high hopes on private consumption to spur economic growth for the following reasons. Private consumption growth has already been strong (ADB, 2013), providing major contributions to GDP (Figure 4), even when consumer sentiments were weak. Thus, it is most unlikely that handouts and wage hikes in Budget 2016 are going to translate into stronger private consumption in the medium-term. Furthermore, private consumption is already facing headwinds from sagging consumer confidence, the implementation of GST, slowing growth in credit to households, and signs of softening in the labor market (ADB, 2015). Specifically, a rise in leveraged spending has left households in debt (Barua, 2015). For example, household debt[5] stood at about 88 percent of GDP in 2014 (Dhesi, 2015); one of the highest ratios in Asia, despite stricter financing rules.[6] If these trends continue and dampen private consumption spending, it will certainly affect GST collection and subsequently government revenue.

Likewise, investment growth has also been somewhat uncertain. It showed a lacklustre performance in the fourth quarter of 2014. It was noted that the drag on investments came mainly from public investments, due to delayed infrastructure projects. While this is supposed to improve in 2015,[7] the pace of investments disappointingly continued to languish in the second quarter of this year. As for private investments, previously, the private sector-led Economic Transformation Programme (ETP) was the primary driver. Now, there seems to be a turnaround as private investment has started to decelerate to 3.9

[4] This is clearly reflected in the decline in the share of electronics in total manufactured exports from 70 per cent to 50 per cent between 2000 and 2015 (Menon, 2015).
[5] The bulk of the household debt comprised mainly housing loans, followed by financing for motor vehicles, personal loan, credit card outstanding debts and others. The main reason for the rise in the household debts are the spiralling prices of property.
[6] To keep the household debt under control, apart from putting a stop to easy credit, other cooling measures, such as the real property gains tax (RPGT), were also introduced.
[7] Public consumption and investment collectively made up 23 per cent of total GDP in the past decade, thereby raising concerns over the sustainability of the government's fiscal position (Mottain 2015).

per cent in the second quarter of 2015, from 11.7 per cent in the previous quarter (MARC, 2015). There are claims that government-linked companies (GLCs) are responsible for the decline in private investments, as they have crowded out the latter (Menon and Thiam, 2015).

Figure 4: Demand Side Contributions to Growth (%), 2005-2014



Sources: Department of Statistics, Malaysia; World Development Indicators.

Without doubt, the trend in recent years suggests that export performance has been on a relative decline, while consumption and investment continue to grow – albeit at a moderate pace. The latter two, however, should not be taken for granted to compensate for weaker external demand, as recent trends do not indicate a favourable outlook for both domestic demand determinants of growth. Consumer sentiment is already at an all-time low,[8] which pervades all portions of the market. Apart from the GST and subsidy cuts, the weaker ringgit and allegations of financial irregularities at a state investment company[9] have added to the decline in consumer (and investor) confidence. In turn, investor sentiments have also worsened the downward pressure on the ringgit. Having depreciated by 15.3 per cent against the greenback since the beginning of the year, the ringgit is considered the worst-performing currency in Asia (Kok, 2015). The high levels of federal government debt and the household debt signal financial vulnerabilities that warrant close attention.

CONCLUDING REMARKS

The 2016 Budget has without doubt taken into account the downside risks to the domestic economy, following the slowdown in the global economy, declining commodity prices and

[8] The consumer sentiment index has slid to 71.7 (Yap, 2015).
[9] 1Malaysia Development Berhad (1MDB), a government strategic development company set up to drive strategic initiatives (in the areas of energy, real estate, tourism and agribusiness) for long-term development for the country by forging global partnerships and promoting foreign direct investment.

the depreciation of the ringgit. Based on the tight budget situation, it is clear that the government's fiscal health is going to be largely based on revenue, which in turn will be dictated by the health of the economy. Many 'optimistic' assumptions have been made in deciding on the targets for the economy on various fronts in the 2016 Budget. In the event there is any shortfall from those assumptions, the budget and those targets will have to be revised.

On a final note, it appears that the 2016 Budget is not going to make a large impact on the economy, as room for manoeuvring – due to the tight balancing of expenditure and revenue – remains limited. Further, a spending budget alone does not suffice to address some of fundamental domestic problems highlighted in the preceding section, which are critical for economic growth.

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