Comments on Penang Institute's *GST and You* Workshop to discuss "Implementing Goods and Services Tax in Malaysia" by Lim Kim Hwa and Ooi Pei Qi

Wing Thye Woo (胡永泰)

Penang Institute, George Town

University of California, Davis

Fudan University, Shanghai

Central University of Finance & Economics, Beijing

wtwoo@ucdavis.edu

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What Must be Done?

- Malaysia must address its worsening budget deficit problem which is now 4% of GDP, about RM 40 billion
- 2 ways to solve problem:

  #1 raise taxes

  #2 raise efficiency in govt expenditure (i.e cut expenditure without reducing govt services)
- # 1 alone is dangerous → empowers govt to engage in unrestrained tax-and-spend
- So best answer is either
  - # 2 → US govt shutdown; or
  - a mixture of #1 and #2; how much of each?

What can be done to improve expenditure efficiency?

- Annual auditor’s report be given teeth by punishing identified malfeasance (*action after fact*)
- Open tender system for govt procurement instead of opaque process (*action before the fact*)
- Enhance project supervision & monitoring, i.e prevent roof from falling in the first place (*action during the fact*). Important to punish monitors if failure occurs subsequently

Considerations in Raising Taxes

- **Effectiveness** of GST is undoubted. Despite leaks, Chinese revenue went from 11% of GDP in 1993 to 25 % today
- **Equity**: balance regressive GST with progressive income tax. So never just one tax instrument.
- **Pitfalls** in soaking the rich and punishing the poor
  - We live in a globalised world → flight of financial & human capital → even slower GDP growth in Malaysia, so regressiveness in one instrument might have to be accepted
  - Social instability over social injustice
- Implementing GST on the business sector. Low ability to monitor→ corruption. (False receipts in China→ Execution for economic sabotage)

Why Worry? GST is a replacement tax, the Sales Tax and Service Tax will be terminated

- Sales Tax is generally 10%, 5% for fruits, foodstuffs, timber, building materials, cigarettes and tobacco, and liquor and alcohol.
- Service Tax of 6% for restaurants, hotels, parking lots, golf courses, clubs, discoes, insurance agents, phone companies, and professional services like accountants, lawyers and consultants.
- ***GST is a replacement tax that is NOT revenue neutral.*** Govt has now replaced its left hand in your pocket with its right hand, but the right hand will now take more money from the pocket than before.
- **If more money is justified, could society be better off if the govt's hand were in another person's pocket instead?**

Malaysia Case: There is another pocket

- It is possible to raise more revenue w/o soaking the rich and w/o taxing the poor more.
- The key is to broaden the revenue base even more in a way that will also improve revenue equity and production efficiency
- Require state investment agencies and GLCs to hand more of their profits to their owner (the govt) rather than to keep the retained earnings to enlarge their empires by buying up private firms

Behavior of State Investment Agencies & GLCs

- The old days: manufacturing sector
  - Technology acquisition; Perwaja "direct reduction process" technology from Nippon Steel, Proton "automotive technology" from Mitsubishi
  - Potentially exportable, so international benchmark for quality of product can be done
- Today: empire-expansion into nontraded services e.g. buying over medical and real estate firms
  - No technology transfer, and no external benchmark → what market failures are GLCs addressing?
  - Driving out the more efficient private sector
  - Contributing to capital flight → lower investment
- **Take away the retained earnings to stop the bureaucratic empire-building because it will lower the long-term growth rate**

My Recommendation for Malaysia

- Technical issue: GST introduction must be accompanied by:
  - improvements in expenditure efficiency
  - broadening the revenue base to scoop up the vast monopoly profits of the state investment agencies& GLCs – to improve revenue equity & economic efficiency
- Two deep philosophical issues
  - Automatic right to your money?
  - Role of state sector? GLCs crowding out of the more efficient private sector → lower growth rate