

Reducing Subsidies Must Be Balanced With Growth Inducing Measures

By Dr Mahani Zainal Abidin *

The Malaysian Government has finally ended weeks of speculation and has announced that the price of petrol will rise by 78 cents to RM 2.70 per litre and diesel by RM 1 to RM 2.58. A monthly price adjustment mechanism will be set in place where a subsidy of 30 cents per litre will be maintained. Yet, one only needs to listen to the emotive debate that preceded the reduction of fuel subsidies to realize that this very contentious public policy issue is far from over.

The rise in fuel prices and electricity charges (from 1 July) will have major implications, with the cost of living in Malaysia becoming dearer being the most immediate one. Some economists have predicted that inflation could rise as high as 6% and warn of slower economic growth.

While no one likes to pay more for anything, it is important that we take a step back and put things into perspective.

Subsidies are to help the poor, and to stabilise prices against price shocks. Furthermore, subsidising the production of certain goods helps to promote domestic industries. But, whichever way you argue it, the skyrocketing global food and commodity prices are placing a heavy toll on the nation's finances.

Many believe that subsidies do more harm than good because they act against the functioning of an efficient market. Subsidies raise the important issue of inequity and regression: it is the tax-paying citizens who have to ultimately foot the bill.

This is the quandary faced by any government that wished to help its poorest citizen to have affordable goods and services. This praiseworthy objective can only be met at the price of weaker economic growth. The deployment of subsidies is also beset by loopholes through which richer citizens who could afford to pay the market price of goods are able to gain more from these subsidies.

Subsidies also disguise the true cost of scarcity as industries tend to overproduce to meet the artificial demand that they create. This encourages wastage that, along with growing government budget deficits will blunt national competitiveness.

No one can deny that Malaysia has perhaps reached the "tipping point" where maintaining the previous scale and level of subsidies will seriously endanger our future prosperity. The unpredictable and volatile commodity prices movement is a global phenomenon, and Malaysia cannot hope to escape this trend.

The Government's response is to restructure the subsidy system. Subsidies are given for production while those for consumption are capped and replaced by direct cash payments to

target groups. Rebates of RM625 and RM150 will be extended to owners of small cars and motorcycles, road taxes will be reduced, fleet cards issued for subsidised diesel for fishermen, boat owners and transport operators and RM5.2 billion will be set aside for food and rice cultivation.

The dismay felt by some is perfectly understandable as the timing and quantum of increase were unexpected. It is probably better if the increases were staggered but Malaysians will have to deal with the new reality. In the long run, the new system will help move our country towards an efficient and competitive economy.

Nevertheless, the Government needs to be accountable on several matters. There are still crucial issues that need clarification to avoid greater fallout from the petrol price increase. Addressing these issues will help resolve some long-standing public policy problems.

High on the agenda is how to lessen the burden of the lower income groups. Targeting only those under the poverty line of RM691 is awfully inadequate and outdated. The target groups must include the lower income and fix income earners. Even if the lack of information on the target groups can be overcome, the hard part is to decide on the eligible income levels, which should take into account family size.

Even if the target groups are satisfactorily resolved, we are then faced with the problems of implementation including possible abuses. It seems unfair when a rich man, who owns a small car for the use of his children or maid receives a rebate. Teething problems are to be expected at this initial stage but we need to sharpen the implementation tool going forward.

Next is the public transport system, which is found to be wanting. The fuel price increase adds an extra urgency to the goal of enhancing the public transport services. The Government must quickly fulfil its promise that the money saved will be used to improve the public transport system. Calls to increase fares, issued by the associations of taxi drivers and bus operators have added another dimension to this issue. When subsidy is reduced, should price controls still be maintained? Allowing price and wages to adjust is another critical part of an efficient and competitive economy.

Many SME believe that they are the group made worst off out of this restructured subsidy system. On top of the petrol price hike, the 26% and 18% increases of the electricity tariff on commercial and small business users is a genuine cause of concern. Can productivity improvement by the SME be sufficient to absorb the increase in cost of production? Halving interest rates on loans to SME and increasing the loan amount indicates the sensitivity of the Government to the plight of the SME.

The assurance that the public sector will cut unnecessary expenditure is welcomed. This could be extended to getting the best value for Government contracts by increasing transparency and accountability in awarding the contracts via competitive bidding.

The restructuring of the subsidy system shows that the Government is prepared to face reality. It is now the turn of the public and business sector to choose how to effectively consume and produce. This is about choices for all concerned. The likely higher inflation and slower economic growth demand responses from all quarters – the Government must introduce measures to boost growth, business must increase competitiveness and productivity and the public must spend effectively.

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