

Moving Up the Value Chain: Subsidies – Rationalising Economic Welfare?

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The views and opinions expressed are solely those of the presenter

Key messages

1. Subsidies are prevalent: Not true advanced economies do not have subsidies; is true they tend to be more specific & targeted
2. They have both productive and unproductive cause & effects: One person's subsidy is another's incentive, and *vice versa*
3. They can take direct & indirect forms: The broader & indirect ones are often more costly and damaging



Key messages

4. Subsidies are easy to give but notoriously difficult to remove: For this reason alone extreme caution must be exercised
5. Malaysia needs a radically different approach to the subsidies: One that is more informed, comprehensive & efficient
6. The debate ought not to be about being subsidy-free but subsidy-effective; i.e. subsidies that are growth & welfare positive




Subsidies are prevalent

EATING OUT

Growth of food subsidies in India

Year	Food subsidy* (Rs Crore)	Annual growth (%)
2002-03	24176	38.2
2003-04	25160	4.1
2004-05	25746	2.3
2005-06	23071	-10.4
2006-07	23828	3.3
2007-08	31260	31.2
2008-09 (Prov)	43668	40.0

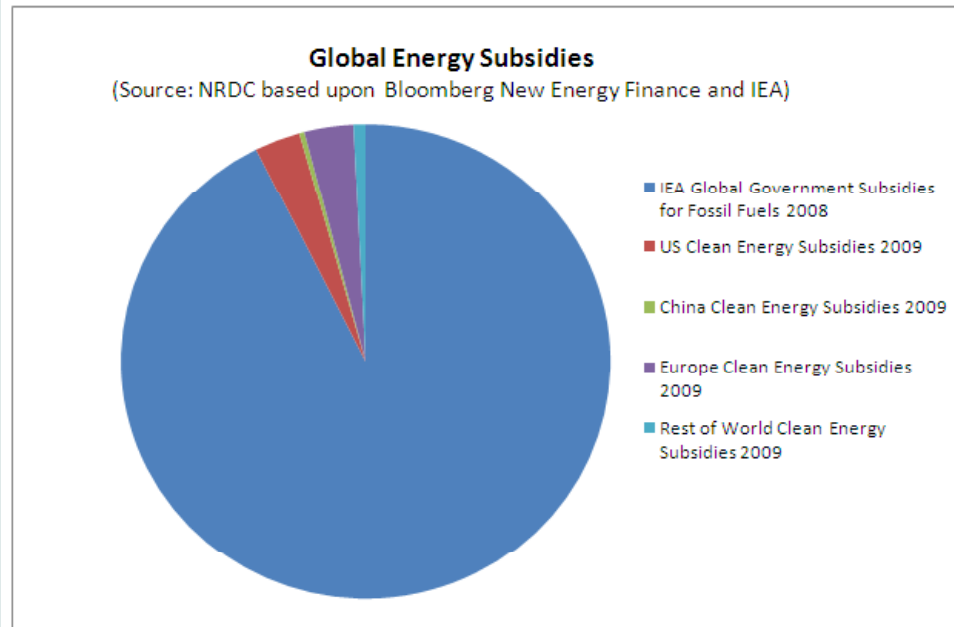
Source: Dept of Food & Public Distribution * The subsidy amount is in respect of wheat & rice only



WHERE DO WE DRAW THE LINE?



Subsidies are prevalent: Energy subsidies

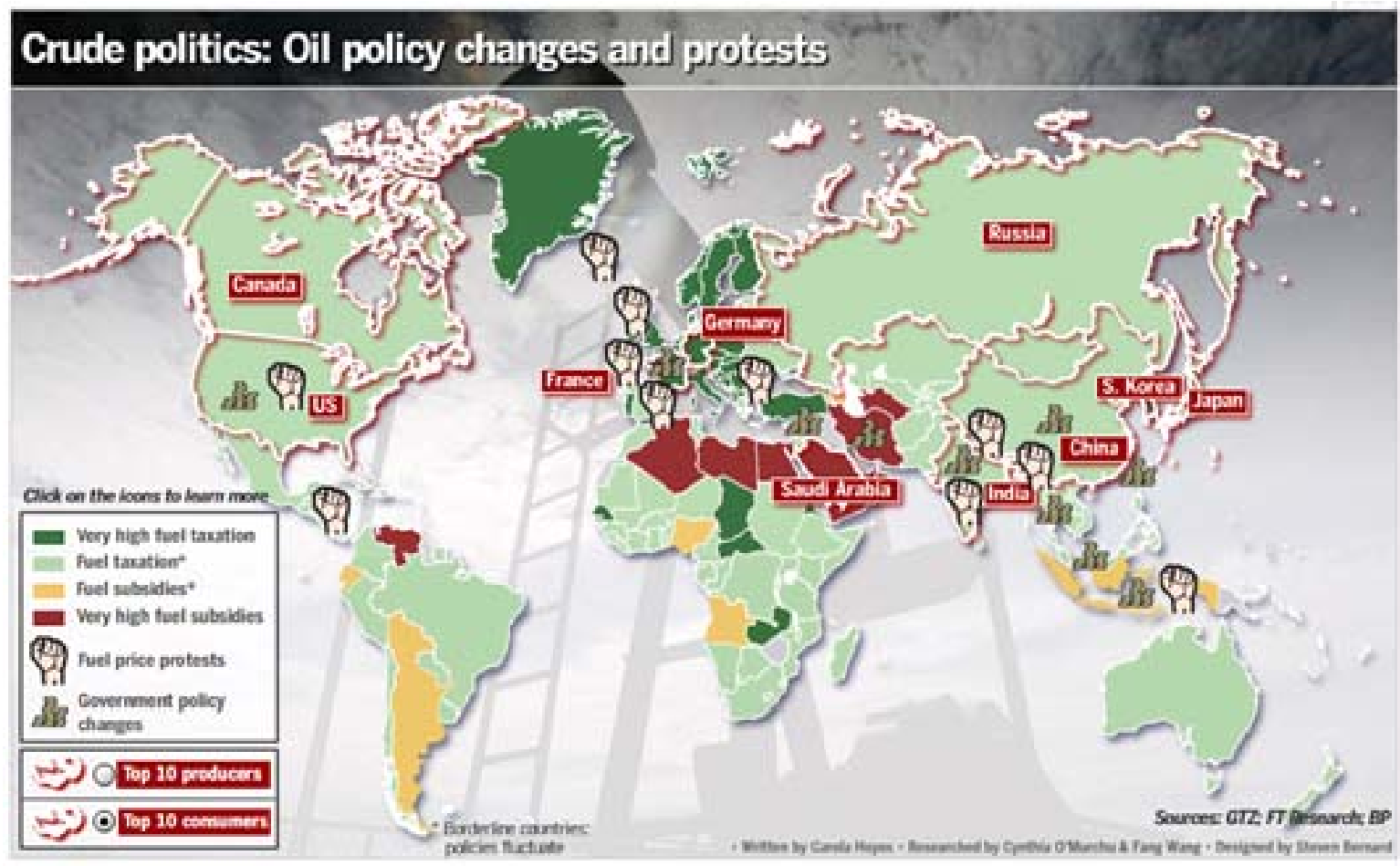


- Governments around the world spent US\$557b to subsidise production and consumption of fossil fuels in 2008, up from US\$342b, according to IAEA
- Malaysia will spend an estimated US\$3.2b for petrol, diesel and liquefied petroleum gas subsidies in 2010

The effect of these subsidies is to “reduce prices of fossil fuels below levels that would prevail in an undistorted market, thus leading to higher levels of consumption than would occur in their absence.”



Subsidies are prevalent: Fossil fuels



Anatomy of Subsidies



Price

- Minimum for producers
- Max for consumers

Cash

- Investment
- Inputs
- Output
- Purchases

Income

- Tax deductions
- Supplements
- Govt spending



Current Status of Subsidies in Malaysia

Federal Government Operating Expenditure by Object 2009 – 2011

	RM million			Change (%)			Share (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Emoluments	42,778	48,828	45,582	4.3	9.0	-2.3	27.2	30.6	28.0
Debt service charges	14,222	15,888	18,517	11.1	11.7	16.6	9.1	10.4	11.4
Grants to state governments	4,895	4,858	5,510	12.1	-0.8	13.5	3.1	3.2	3.4
Pensions and gratuities	10,146	10,810	12,296	1.2	6.5	13.8	6.5	7.1	7.6
Supplies and services	26,372	23,590	28,232	4.7	-10.6	19.7	16.8	15.5	17.3
Subsidies	20,345	24,933	23,704	-42.1	22.5	-4.9	13.0	16.4	14.6
Grants to statutory bodies ³	12,024	11,891	13,185	-4.5	-1.1	10.7	7.7	7.8	8.1
Refunds and write-off	555	1,115	1,083	-22.6	101.0	-2.8	0.4	0.7	0.7
Others	25,731	12,453	14,736	121.0	-51.6	18.3	16.4	8.2	9.1
Total	157,067	152,158	162,805	2.3	-3.1	7.0	100.0	100.0	100.0
% of GDP	23.1	19.6	19.4						

¹ Revised estimate.

² Budget estimate, excluding 2011 tax measures.

³ Includes emoluments.

Note: Total may not add up due to rounding.



Current Status of Subsidies in Malaysia

Subsidies in Malaysia

Year	Operating Expenditure (OE) (RM million)	Subsidies	
		Value (RM million)	Share to OE (%)
2004	91,298	5,796	6.3
2005	97,744	13,387	13.7
2006	107,694	10,112	9.4
2007	123,084	10,481	8.5
2008 ^a	153,499	35,166	22.9
2009	157,067	20,345	13.0
2010 ^b	152,158	24,933	16.4

^a From 2008, subsidies include fuel subsidies, various other subsidies, incentives, assistance for food security programmes, scholarships and education assistance as well as welfare programmes.

^b Estimate.

Source: Ministry of Finance, Malaysia.



Current Status of Subsidies in Malaysia

Allocation for Major Types of Subsidies (RM million)

Components	2010
Liquefied petroleum gas (LPG), diesel and petrol	10,000
Assistance for education	7,101
Other welfare assistance	2,327
Interest rate differential subsidy and electricity	1,514
Paddy, rice, sugar and flour	2,031
Cooking Oil Price Stabilisation Scheme	828
Incentives	629
Others	503
Total	24,933

Source: Ministry of Finance, Malaysia



Positive & Negative Consequences

POSITIVE	NEGATIVE
Significantly assists poor/ low-income households	Poor targeting allows higher-income households to also benefit
Stimulates demand for socially desirable goods & services eg. health and education	Often promotes over-consumption & wastage, rising costs, low quality etc.
Helps create positive externalities like food & energy security, exports	Caters to powerful special interest groups who can use and abuse public funds



Positive & Negative Consequences

POSITIVE	NEGATIVE
Attracts more capital and human resources than otherwise	Reduces incentives for entrepreneurial risk-taking, innovation & so forth
Can, if designed, act as demand stabilisers in economic downturns	Can cause large fiscal deficits and be financially unsustainable
Leads, if properly targeted & executed, to an inclusive and productive society	Leads, if badly targeted & executed, to dependency and non-resilience



Subsidy Rationalisation Framework

- Conduct subsidy rationalisation in a context of rising & well-distributed disposable incomes
- Counter any contraction in aggregate demand & output
- Recognise & progressively improve social safety nets for the poor, disadvantaged, etc.
- Target, implement & monitor subsidies with view to effectiveness, efficiency and sustainability
- Ensure that other fiscal measures (taxes, government spending cuts, etc.) are not “bunched” but phased-in
- Make certain subsidy rationalisation occurs in a wider context & eco-system of good governance

