The State of the Nation: Pressure to target subsidies grows as 2022 bill surges to RM71 bil

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WITH food protectionism on the rise and seen as a growing threat to rising global inflation, it is hardly a surprise that Finance Minister Tengku Datuk Seri Zafrul Aziz was nudged by a panel session moderator “to send chickens down to Singapore” at the World Economic Forum in Davos, referring to Malaysia’s decision to restrict exports of chickens by 3.6 million birds a month from June 1 to safeguard local supplies and prices.

Being a net exporter of commodities, Malaysia is “still okay” in terms of food security as well as inflation, Zafrul told a panel titled “Global Risks in an Era of Turbulence” on May 26. There is also a sizeable subsidies bill: “We usually subsidise to the tune of RM30 billion, [but] this year it’s RM71 billion.”

The biggest portion of subsidies is fuel, which the government said last month was poised to reach RM28 billion in March and RM30 billion in April. Some RM12 billion could be going to the top 20% income group (T20), our back-of-the-envelope calculations show, given that Bank Negara Malaysia’s research in 2014 shows that only 4% of blanket fuel subsidies go to the bottom 20% (B20) versus 42% to T20.

Capped at RM2.05 per litre (46.7 US cents), the price of RON95 fuel in Malaysia is the 10th cheapest in the world — according to data on globalpetrolprices.com, which tracks more than 170 countries.

RON95 fuel in Malaysia is cheaper than 62 US cents per litre in Saudi Arabia, Opec’s biggest producer. The price for Octane-95 across the Causeway is US$2.249 per litre, the tenth most expensive in the world, and more than double even Malaysia’s premium RON97 fuel, which is being sold at RM4.70 per litre (US$1.07).

Indeed, Malaysia’s headline inflation of 2.3% in April is low compared with 4.5% in South Korea, 7.5% in the eurozone and 8.3% in the US.

Yet, a RM71 billion subsidy bill for 2022 is close to the RM75 billion earmarked for development expenditure in Budget 2022 last November and 30% of the projected federal government revenue.

While Malaysia benefits as a net exporter of oil palm as well as oil and gas, the consensus among those watching the economy is that subsidies need to be more targeted — especially now that there is a growing need to keep food prices down to help the lower-income group, which is more affected than the rich when food prices rise.

Food inflation rose to 4.1% in April, up a sixth straight month from 1.9% last October, and had been above headline inflation since the start of this year. In January, food inflation was 3.6% while headline inflation was 2.3%, data from the **Department of Statistics of Malaysia** shows.

“Assuming the government remains committed to the 6% budget deficit to the GDP target this year, some recalibration may be needed to compensate for the increased subsidy bills,” says Suhaimi Ilias, chief economist at Maybank Investment Banking Group.

If blanket subsidies are not replaced with targeted subsidies or additional cash handouts to the lower-income groups, the obvious choices for policymakers would be to get extra dividends from Petronas and/or review development spending allocations to focus on the more critical public projects.

Instead of going for a "complicated two-tier or multi-tier fuel pricing system that is based on vehicle engine capacities" and the like, Suhaimi reckons the best way to implement targeted subsidies is to give additional cash handouts to mitigate the inflationary impact of fuel price hikes.

"The existing cash aid programme, in a way, is already means-tested, since recipients must be registered with the IRB [Inland Revenue Board]. So, eligible recipients must update their income information regularly to qualify for cash assistance. This will also minimise exclusion/inclusion errors," Suhaimi adds.

"Revamping fuel subsidies is important from at least three aspects — fiscal sustainability, supporting the country's commitment to reduce carbon emissions and equality, given that half of the monetary benefits of fuel subsidies go to the T20 and only 15% to B40."

That Malaysia had attempted to rationalise fuel subsidies twice in the past 15 years shows that current system is costly and unsustainable, given that the subsequent reversals had more to do with politics, experts say.

"Everyone agrees the current system is unsustainable and needs to be improved. Whatever the new mechanism that the government implements and its timing, consideration ought to be given to balancing the welfare of the people and what is best for the Malaysian economy as a whole," an economist says, adding that "policies are always about managing trade-offs and minimising the spillovers".

A 20 sen increase in the RON95 ceiling could result in RM3 billion to RM4 billion in savings that could be passed on as targeted cash transfers to the lower income, says another local economist who is among those who do expect no change in subsidies before the 15th General Election (GE15).

"In a way, GE15 is an overhang when it comes to policy," the economist adds, noting that revenue measures such as the implementation of a wider consumption tax would also help boost government coffers and the capacity to provide targeted aid. That said, timing and the speed at which subsidies are lifted would need to be balanced against the potential impact on economic recovery.

Frederic Neumann, HSBC's chief Asia economist and co-head of global research (Asia), agrees that policymakers in Malaysia still have room to manoeuvre, thanks to benefits from higher earnings from commodity exports.

"Still, over time, questions will grow over the efficiency of such [sizeable blanket subsidies] spending, with funds ultimately offering better long-term returns if invested in infrastructure, education, healthcare and social welfare for vulnerable groups. Better targeting of subsidies would thus help economise on spending and free up resources that will ultimately help Malaysia's long-term growth," Neumann tells The Edge in an email reply.

While a more targeted subsidies regime "could come with some near-term economic cost", Neumann says it would "offer long-term benefits, with the latter greatly outweighing the former".

He adds: "Saved funds could be redeployed to more productive economic use, offering considerable long-term returns. In the short term, however, the drag on local demand would rise, owing to higher costs of energy and other subsidised items. But given Malaysia's strong growth prospects at the moment, the near-term costs are well worth bearing to secure an even brighter future for Malaysia." At Davos, Zafrul told the audience that Malaysia was confident of its GDP growth projections of between 5.3% and 6.3% this year, and he mentioned that Bank Negara had just raised interest rates.

Without specifically referring to export curbs, Zafrul also said it was "only natural" to react to fear, as the human brain is hard-wired to acknowledge immediate threats, more so when it comes to basic needs such as food. As "having enough to survive the day is political in nature", Zafrul concurred that food inflation, which was being exacerbated by disrupted supply chains, would command the attention of policy-makers globally, "many of whom are politicians".

While politicians are often accused of focusing too much on the short term at the expense of long-term benefits to appease the electorate and win votes, Zafrul noted that they were also "under pressure to act quickly and deliver tangible benefits while they are in office to be re-elected".

This may mean more action and aid to douse food inflation, as witnessed by how Malaysia's Cabinet meeting was brought forward to May 23 to discuss the cost of living and food supply issues. The same issues are expected to dominate discussions on May 30.

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