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# Does Malaysia still need margin controls two years after GST? - Hafiz Noor Shams

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JUNE 5 — Price controls exist in Malaysia and its existence is most obvious to the public during festive seasons. The Ministry of Domestic Trade usually imposes a price ceiling on selected items like chickens and eggs for a period of time.

Some items have its price ceiling fixed throughout the year. Putrajaya can and does control supplies of various items through the issuance of licences, which is an indirect means of managing prices.

Since at least 1946 when the Price Control Act was enacted, price controls have existed in this country. But in 2011 the government's ability to intervene in the market has widened significantly after the Price Control and Anti-Profiteering Act replaced the previous law.

The original colonial act granted the government the ability to set price ceilings on all goods and some services linked to the goods. The newer 2011 act gives Putrajaya wider powers to set the price ceiling, establish the price floor, fix the selling price and limit the profit margin of any goods and services sold. This is in addition to the powers previously provided under the old law.

In the past two years, the regulation of profit margin — the anti-profiteering part of the law — has been used most intrusively which has affected the well-being of small and medium businesses adversely.

The government imposed the margin control in 2015 ahead of the implementation of the goods and services tax (GST) in April 1 that year. The margin regulation — called the Mechanism to Determine Unreasonably High Profit for Goods as part of the 2011 law — was designed to curb price hikes arising from GST implementation.

This meant that while the law granted the government the power to regulate profit margins at any time, the actual implementation was meant to be a temporary measure aimed at softening upward price pressures caused by the GST.

Prices did increase despite the government's attempt to moderate inflation through non-market means and political rhetoric that goods would actually be cheaper post-GST. Inflation as measured by the Consumer Price Index surged to 1.8 per cent year-on-year in April 2015 from 0.9 per cent year-on-year in the previous month.

By July 2015 it had climbed to 3.3 per cent, although an increase in retail fuel prices contributed to the rising inflation. Without the margin control, it is arguable that prices would have risen faster on average.

But at the same time, small and medium businesses have suffered greatly from the regulation, particularly in 2015 and 2016 when the restriction was at its severest. During these two years, businesses' profits were capped based on a naïve formula that forced businesses to absorb the GST-related cost hikes. Failure to adhere to the formula would result in the violator being heavily fined.

The regulation defined "excessive profits" — profiteering as it is labelled — simply in terms of absolute profit: a business could not profit from an item higher than the profit it enjoyed on January 1 2015. For example, if a business's profit on an item sold on January 1 2015 was RM10, then its future profit from the item in the relevant period could not exceed RM10.

One of the many problems linked to this regulation is that January 1 is only one day of operation and New Year's Day is not a typical day. A better approach would have been to take the average margin over several days, weeks or even months instead in order to take into account a wider variety of business conditions.

Despite the complexity of determining economic conditions throughout the year, the ministry was content that that one day out of 365 days would define the operation of an entire year. There was no flexibility.

In fact, when costs rose businesses would have to absorb it. Profitability would go down since the absolute profit could not increase beyond that 1st January level. Businesses were prevented from passing the rising costs to the consumers in a fair way.

The margin control — or the anti-profiteering regulation — may sound beneficial to consumers in the short run. Yet such protection is harmful in the long run and has caused business closures, especially among small and medium businesses.

The closures of small and medium businesses will limit competition by leaving only big corporations behind to monopolise the market.

Small businesses have their own roles to play in any economic reality. It fills niches not catered by large businesses to address consumer needs. The nature of small businesses may cause them to be more reliant on margins of profitability rather than on volume. When you are a small business relying on this, the strict margin control would be disastrous.

And indeed, the regulation is more burdensome to small and medium businesses than to large corporations. Cost of compliance alone can make a big difference in deciding whether a shop would be able to stay open or close for good. A large corporation can have a whole department tasked to oversee compliance and documentation matters. Small businesses are not able to.

This along with other factors have caused some businesses to shut down. Ongoing research by the Institute for Democracy and Economic Affairs is determining how badly small and medium businesses have been affected by the regulation.

The regulation might have also affected the incentive to start new businesses. In 2016, based on data from the Companies Commission the number of new businesses established fell by 7.2 per cent to 43,000, after falling 5.3 per cent in 2015. In contrast, the 2014 figure rose by 6.2 per cent.

It is hard to ascertain what share of those figures was caused by the margin control and how much was caused by other factors. But given persistent business complaints, the regulation is now a contributing factor to the ongoing difficult operating business environment.

Only in 2017, was the formula calculated in a more realistic way in terms of sales percentage. This allowed for cost increases experienced by businesses to be passed to the consumers. The regulation was also further liberalised to cover only items related to food, beverages and household goods. However, other weaknesses remain.

This regulation was meant to be a temporary measure. Yet more than two years after the GST came into force, the margin controls are still in force. The regulation was supposed to expire in June 2016 as upward price pressures created by the GST subsided.

By June 2016, inflation stood at 1.6 per cent and the biggest contributor to price changes was no longer the tax but fluctuation in fuel prices. However, the ministry found it necessary to extend the regulation by six months.

A similar but thicker regulation was introduced in December, this time without stating any expiry date. The continued operationalisation of the regulation breaks the promise that the government gave in 2014 that this would be a temporary measure.

The 2017 extension is unnecessary and there is a case for its abolition from the perspective of economic growth. The economy is growing but only slowly. The 2016 GDP grew 4.2 per cent down, from 5 per cent in 2015 and 6 per cent the year before. Recovery from the previous 2015-2016 economic slowdown appears fragile. It will be a struggle to go beyond 4.5 per cent this year.

The economy could get a growth boost and that could come in the form of a more liberal regulatory environment. The government should give small and medium businesses a break by abolishing the margin control regulation.

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