Fiscal policy in malaysia economics essay

Malaysia follows an explicit fiscal policy rule that disallows an operating deficit in any given year. This aims at making a credible commitment to long term fiscal sustainability by applying discipline to annual budgets. As mentioned before in this report, the implementation of Economic Transformation Plan to move towards high income has proven to be vertically taken off with most targets has been achieved and exceeded within the span of more than 2 years. Based on the executive report by bank Negara Malaysia (BNM), Malaysia is moving from a resource based economy into more service centric economy as most of high-income nations globally.

Fiscal policy can be further explained as the use of government spending and taxation to further influenced the economy. It is typically to promote a sustainable growth of economy in the long run as well as stabilizing the macroeconomic post crisis such as expanding spending, tax cutting to further stimulate a recovering economy. In the longer term, the government can foster a sustainable economy by improving infrastructures, providing better education and scholarship to boost the professional participation among the public, encourage public participation in corporate as well as academic.

In the short term the fall in exports was offset by an unprecedented fiscal stimulus programme launched over two rounds started in 2008. In the total government’s countercyclical measures amounted to an estimated RM67, 000, 000, 000, which were allocated to support private enterprise. The second package which was announced on March 2009, set aside RM 5, 000, 000, 000 to support firms that need access to working capital, with specific involvement in tourism, aviation and auto industries. As such, Malaysia is sought to speed up the implementation of existing infrastructure projects such as the extended rail of Light Railway Transit (LRT), Mass Rapid Transit (MRT), targeting in particular the expansion of high speed broadband network, and also airport upgrades.

Although Malaysia has relatively low debt to GDP ratio of around 50%, the global issue of sovereign debt with Greece in early 2010 is likely to put pressure on Malaysia to introduce fiscal tightening measures to prevent increased lending cost. The fiscal deficit target for 2010 has been revised to 5. 3% taking into consideration RM12, 000, 000, 000 supplementary budget and the revised 2010 GDP. The 2009 budget gap reached 7% of GDP, largely due to fiscal stimulus plan. The level of government expenditure is forecasted to decline faster with the government promising to introduce an efficiency drive and reduce the subsidies on fuel, food and education. This measure would help to reduce the structural and fiscal deficit, ensuring the government’s consolidation efforts have a permanent impact. The spending target set for 2010 is RM 201, 700, 000, 000 in 2010 and the fiscal deficit is expected to decline to 5. 3%.

Formulation of Fiscal Rules

Basically there are 3 major types of fiscal policy rules. First is the balanced-budget or deficit rules comprises of 3 balance between the overall revenue and expenditure; or limit on government deficit as proportion of GDP. Another one is balance between structural and expenditure, and balance between current revenue and current expenditure. The second type of fiscal policy rules is the borrowing rules which prohibits on government borrowing from domestic sources as well as prohibits government borrowing from central bank; or limit on such borrowing as a proportion of past government revenue or expenditure. The third and last fiscal rule is debt or reserve rules which limits on stock of gross government liabilities as a proportion of GDP and target stock of reserves of extrabudgetay contingency funds (such as social security fund) a a proportion of annual benefit payments.

In achieving a strong commitment to fiscal sustainability as well as in ensuring the sustainable long term growth, Malaysia is facing implementation constraint; however there is need to adjust the existing procedure to result in enhancing its efficiency. Flexibility can be incorporated into fiscal rules by expanding the horizon for budget formulation including the application of fiscal rules; to cover the course of a business cycle would provide the economy with improved shock-absorptive capacity. For instance, the rule on the annual operating budget for Malaysia could be modified from one year to allow an operating deficit during an economic downturn while observing the balance over the course of a business cycle. It often takes awhile to implement the spending measures, and may be in effect even longer than needed. This would require a medium-term fiscal framework for planning and forecasting.

Second, the government can introduce contingency measures during the budget process. It can be either to add stimulus or withdraw as it required. This could include the elimination of a surtax and introduction of a stabilization fund. Although a cut increase in capital spending is effective, but it should be used only as a last resort. This can be triggered during budget execution if actual budge performance deviates significantly from the planned path. Similarly, the scope of stabilizers can be improvised by a more progressive tax system. For instance, tax on high-income household at a higher rate than off the lower income household. There are two types of taxes that can be imposed which are levied to transfer fund from private to public use namely direct taxes levied from income, profit and wealth as well as indirect taxes such as excise duty, sales taxes, quit rent and so on.