Short-term gain, long-term pain

Cuts in public spending carved out of development expenditure investments for economic growth

GST is projected to generate about RM3.6 bil within the first nine months and RM17.6 bil during the first two years of implementation

by Lim Wey Wen

PRIME Minister Datuk Seri Najib Razak's budget for 2014, which includes measures to reduce the country's fiscal deficit by managing public spending and increasing revenue collection, has helped Malaysia avert a rating downgrade.

The baby steps to unwind the 27.7% increase in public spending over the last four years have also generated a slew of positive research reports, describing the moves as "fiscally responsible", "realistic", and even "impressive".

However, it did not take long for analysts and economists to realise that the cuts in public spending are carved out of development expenditure, investments that are expected to generate economic growth, which has been on a downward trend since 2010.

Sceptics say Najib's budget measures to address immediate fiscal issues while ignoring the larger problems of non-productive spending and leakages leave the Malaysian economy highly dependent on the performance of its exports and private sector – a risky and vulnerable position to be in.

Stockbroking house JF Apex Securities Bhd, in a research report that calls the Budget 2014 a "realistic and responsible budget", is not convinced by the sizeable allocation for operating expenditure at the expense of development.

"We believe the larger portion of operating expenditure is channelled for the emoluments in view of the sizeable civil workforce as the subsidies portion will be declining in the coming year," says the stockbroking house's research team.

Tan views the budget as a 'crisis budget'

This view is similar to Capital Dynamics Sdn Bhd CEO and fund manager Tan Teng Boo, who called the budget a "crisis budget" as the economy is at a point where its budget deficit is a persistent problem and current account surplus is disappearing.

For the past two to three years, imports have been growing much faster than exports due to strong domestic demand fuelled by low interest rates, cash handouts and unemployment rates that appear to stay low despite economic downturns.

Government debt, excluding contingent liabilities such as government-backed debts, has also inched upwards and is expected to reach 54.8% of gross domestic product (GDP) by year-end, only 0.2% lower than the government's self-imposed ceiling of 55%.

This paints a worrying picture, as the combination of these factors will reduce investor confidence in the ringgit and increase Malaysia's dependence on external demand.

"The rapid erosion of Malaysia's current account surplus has been driven partly by a drawdown of public-sector savings as well as by increased investment," Fitch Ratings says in its post-Budget 2014 report that left its "negative" outlook on Malaysia unchanged.

"The slippage of the current account position into deficit could increase Malaysia's vulnerability to renewed market tensions when Fed tapering becomes more likely," it explains.

Sidestepping fundamental issues

One of the reasons Malaysia is perpetually running a budget deficit is the rising trend of budget allocation for civil servants' emoluments and subsidies, says Capital Dynamics' Tan.

Expenditure for emoluments is expected to reach RM63.6 bil next year, which is 24.2% of the estimated total federal government expenditure. Pensions and gratuities for civil servants will take up RM15.6 bil and subsidies will take up RM39.4 bil, which is 5.98% and 15% of the total federal government expenditure respectively.

These represent a 36.3% increase in emoluments from RM46.66 bil in 2010, a 36% increase in pensions and gratuities from RM11.51 bil in the same year, and a 70.55% increase in subsidies since spending RM23.11 bil in 2010.

Although subsidies have been cut to RM39.4 bil from RM46.7 bil last year, close to 45% of the savings of RM7.3 bil has gone to the RM3.25 bil increase in emoluments as well as pensions and gratuities for the country's 1.4 million civil servants.

"There have been some concerns by a number of quarters that the government could have used the subsidy savings to reduce its budget deficit and achieve the target of 3.5% as well as cap government debt, which is expected to rise further to 54.8% of GDP," says RAM Holdings group chief economist Dr Yeah Kim Leng.

Yeah explains that by a lower government debt-to-GDP percentage would provide a bigger buffer for the economy as the 54.8% projection has the underlying assumption that Malaysia would achieve its projected revenue target.

Given that the goods and services tax (GST), which is projected to generate about RM3.6 bil within the first nine months and RM17.6 bil during the first two years of implementation, will kick in only on April 1, 2015, it is yet to be seen how the government plans to generate the revenue to provide for its RM4.6 bil 1Malaysia People's Aid (BR1M) in 2014.

There were also no announcements on the government review of its mega-projects to reduce public spending.

It is hoped that the recovering external economy, particularly in Europe, will aid in boosting exports and foreign direct investment.

However, the road may be bumpy as Malaysia has slipped to 25th position

Government revenue vs expenditure