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Consumption taxation will eventually return

By Calvin Cheng

A consumption tax similar to GST will eventually need to return

Tax (GST) would be zero-rated effective June 1, partially fulfilling a promise made by the new administration on the campaign trail.

While GST has yet to be fully abolished — it is currently merely zero-rated — the reality is that the future will necessitate a steady and sustainable source of revenue. As such, even if the GST Act is fully repealed in the coming months, the eventual need for a similar consumption-based tax in the near future seems inevitable.

Based on government statistics, the planned reversion to the old SST system is anticipated to result in an annual shortfall of RM20 billion versus the GST. This signals a return to an over-dependence on oil-related revenues and direct taxation. But in view of the demands of the future, these may not be ideal revenue streams.

First, going back to a dependence on oil means once again subjecting government finances to the vagaries of global oil prices. This would be a step backwards. While current global oil prices remain elevated, providing us with a brief reprieve, lessons learnt as recently as the oil slump in late 2014 hint that a return to dependence on oil-related revenues is definitely not a sustainable long-term solution.

Second, reverting to more direct taxation (corporate and individual income taxes) for revenue has weaknesses too.

Corporate profits, and thus corporate tax revenue, can be sensitive to external factors such as business cycle fluctuations and exchange rate volatility — potentially declining at the very time the government needs to increase counter-cyclical spending. Malaysia already has one of the highest corporate tax rates in the region, and further relying on corporate tax revenues would need even higher tax rates, adversely affecting competitiveness and foreign investment.

Demographic shifts also threaten to diminish income tax revenue. Since the 1970s, the number of elderly Malaysians have more than tripled — and by 2030, Malaysia is expected to become an aged nation.

As the bulk of the productive working-age population ages towards retirement and the labour force continues to shrink, the tax base increasingly narrows and income tax revenues necessarily fall — along with revenues from other payroll-funded initiatives including Socso and the new Employee Insurance Scheme. As old-age dependency rises, a dwindling future generation of workers have to sustain an ever-growing number of non-working retirees.

Third, while promised structural reforms and wastage cuts are commendable, long overdue, and will likely lead to substantial cost-savings, spending needs are almost certainly bound to grow in the future amid economic development and socio-demographic shifts.

As Malaysians get richer, there will be growing demand for more comprehensive and inclusive social protection, as well as for better public services. Moreover, the aforementioned ageing problem will necessitate a tremendous amount of government spending and investment in the coming years on both healthcare services and other aged-related social spending.

As for now, the current favourable economic environment — benign inflation, buoyant oil prices, an anticipated temporary boost in consumer spending — provides short-term relief for the government's fiscal health.

Yet, people should understand that inflation will eventually rise even without GST, and a consumption boom (likely just another instance of front-loading before the SST reinstatement) cannot last forever. Believe not those who confidently declare that this GST cut will 'spur' enough economic activity to make up for lost revenues through higher income tax receipts.

Amid these challenges, governments all over the world have shifted away from direct taxation towards consumption-based taxation.

By some estimates, 90 per cent of the world population now lives in a country with some kind of consumption tax.

Even resource-rich countries are recognising the need to move away from a reliance on volatile commodity-related revenue — just look at examples of consumption taxes in oil-rich Saudi Arabia and the UAE, or even diamond-rich Botswana.

As such, in Malaysia, a consumption tax similar to GST will eventually need to return.

If the new administration is cognisant of this eventual need, it may hold back from a full repeal; keeping legislation and GST-reporting infrastructure intact even as they revive the SST. This would provide some flexibility to reintroduce a 'new' consumption tax in a few years (probably under a different name) but this time, with much more finesse.

The initial implementation of GST back in 2015 was less than ideal: The starting rate was probably too high to be inflation-neutral, communication efforts were lacklustre, compliance enforcement was tame — and unlike implementation in many other countries, it was not offset by a cut in income taxes to make it more politically acceptable. The success of a 'new' GST in the future would therefore hinge on the competence of its implementation.

Ultimately, money has to come from somewhere. If not from a consumption tax, it must be from higher payroll taxes, corporate taxes or from oil-related revenues. Or if not raised from revenue — then it must come from higher government borrowing.

After all, you can't have your cake and eat it too.

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