

Big versus small government involvement

THEEDGE MALAYSIA | SEPTEMBER 10, 2012

Lawrence Summers, the former US Secretary of the Treasury, says the selection of Paul Ryan as the Republican vice-presidential candidate clearly puts the scale and scope of government involvement in the US economy as the central issue in the 2012 US presidential election.

American voters will have to decide on two quite distinct packages of economic policies in this election. The choices are clear but they are not easy ones to make. They are about having either a big or a small government, or more aptly, about the desirable size of the government in relation to the overall economy. It is also about the foundations that will determine their future economic growth.

American voters cannot take their responsibilities lightly because of the dark and heavy financial cloud hanging over them. The *Financial Times* highlighted the trigger points as follows: On Jan 1, 2013, the Bush-era tax cuts will expire, just as the automatic fiscal tightening measures, agreed last year, start to kick in.

This equates to US\$400 billion in tax increases and almost US\$200 billion in spending cuts, or more than 4% of GDP. Then, in early 2013, US will also hit the US\$16.4 trillion debt ceiling, which means the US Treasury cannot issue more bonds unless Congress raises the debt ceiling limit.

All this means that the US economy will be financially squeezed and growth prospects dimmed if no major breakthrough is made.

What are the economic choices offered by the two parties?

The Democrats believe in a larger role of the government in the economy. The interest of workers



MY
Say

BY MAHANI ZAINAL
ABIDIN

should be looked after because they are an important factor for economic growth (and also because they are key supporters of the Democrats). The party favours minimum wages to help the low-paid workers. Social spending, which includes student loans, healthcare and social security, is an integral part of the government programmes to help the poor and the marginalised.

Democrats support a progressive tax structure where high-income individuals pay higher taxes to fund public programmes. However, President Barack Obama promises to extend the Bush-era tax cuts for households earning less than US\$250,000 a year. But for the wealthy, there will be no more tax cuts and a strong possibility of higher taxes.

Republican economic policies are almost the exact opposite. Republicans believe free enterprises will bring high economic growth and innovation. In their view, the government should create a business environment where capital and talent will be used optimally and produce the best results.

They oppose raising the minimum wage because this will hurt businesses. Wages should reflect the free market and workers should be paid what they are worth.

A key element of the Republican economic policy package focuses on tax. They want to maintain the Bush-era tax cut because people and companies, not the government, know how best money should be spent. They also want less regulation. This is all understandable because their backers are big businesses and the rich.

The economic reality has not followed the script drawn by the Democrats and Republicans. Since president Ronald Reagan, taxes have been cut, meaning

less revenue for the government. But this has not been matched by a reduction in spending. In fact, spending, including social and military spending, continues to increase. What America has now is a low tax rate and huge government spending, leading to massive borrowing by issuing government debt.

The choice of the economic policy package (and leadership) is more fundamental than tax cuts and social spending. It is also about the foundation and drivers for sustained long-term economic growth. It is true that the private sector must be given enough space and flexibility to unleash its entrepreneurial spirit and innovation. But sustained and inclusive growth requires investment in people, education and infrastructure. Intervention measures are also necessary to equalise uneven opportunities.

If these investment deficiencies are not corrected, there is a warranted fear that the US will be left behind by China.

Since Malaysia's Budget 2013 will be announced at the end of September and the 13th general election is around the corner, we can draw some lessons from the American situation.

The fact that the rising cost of living has not been matched by corresponding wage increases form a major focus of our economic policy and budget measures. There are now many demands for more social spending and measures to mitigate the higher cost of living such as the continuation of subsidies, education support and direct transfer to the poor and low-income group. Expanded support programmes for affordable housing will be popular.

As the US case has proved, it is almost impossible to cut social spending once it is introduced because

CONTINUES ON PAGE 72

Evaluate new social spending carefully

FROM PAGE 69

social, environmental and health programmes become essential obligations. Therefore, new social spending should be evaluated carefully and decided judiciously because once introduced, it is extremely difficult to remove.

The US experience also shows that it is very hard and unpopular to increase taxes. Besides objection from individual taxpayers, Malaysia has to keep its tax rate in line with its competitors if it wants to continue to be attractive to businesses. Our efforts to broaden the tax base through the Goods and Services Tax (GST) have yet to be implemented.

Learning from the US, we should also be cautious in financing the revenue gap by issuing debt papers. The US can chalk up high debt because it has the global reserve currency, a luxury not afforded to many other countries.

Managing a nation's budget is in many ways like that of a household's — namely balancing spending and revenue. In the long run, to balance the budget or preferably have a surplus, Malaysia must have strong growth, profitable businesses and a population with high income. For this, we also need to choose the foundation and driver for economic growth by deciding on the suitable size of government. This decision should not be overwhelmed by the popular demand for social spending and subsidies.

In the GE13, economic policy choices are important and our decisions will have a bearing on the great key questions for the next generation of Malaysians. **E**

Datuk Mahani Zainal Abidin is chief executive of the Institute of Strategic and International Studies (ISIS) Malaysia