

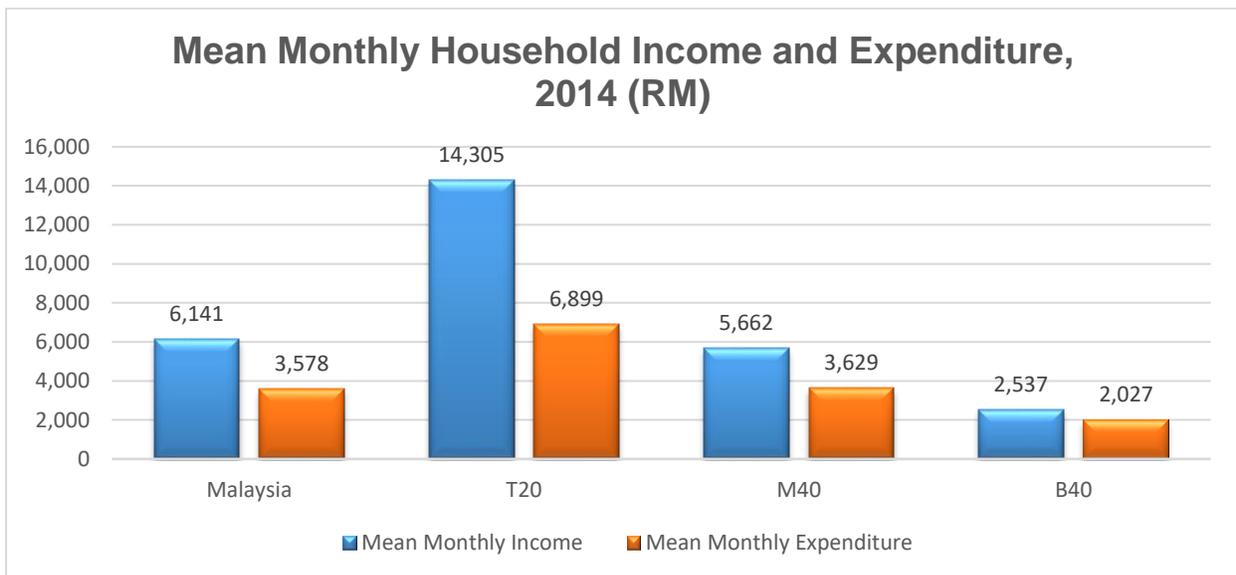
Be Prepared for Subsidy-Free System

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According to the Department of Statistics Malaysia, low income group in Malaysia also known as B40 (Bottom 40%) group spends almost 80 percent of household income on routine essential expenses whereas T20 (Top 20%) and M40 (Middle 40%) spend about 64 and 48 percent respectively. The gap between household income and expenditure of B40 shows the cost of living is high and there is limited room for future savings.



Source: Department of Statistics Malaysia (Household Income & Expenditure Survey 2014)

Consumer price index data shows 30 percent of average Malaysian's expenditure is on foods and non-alcoholic beverages. Those living in rural areas and income group below RM3,000 spend almost 40 percent on foods.

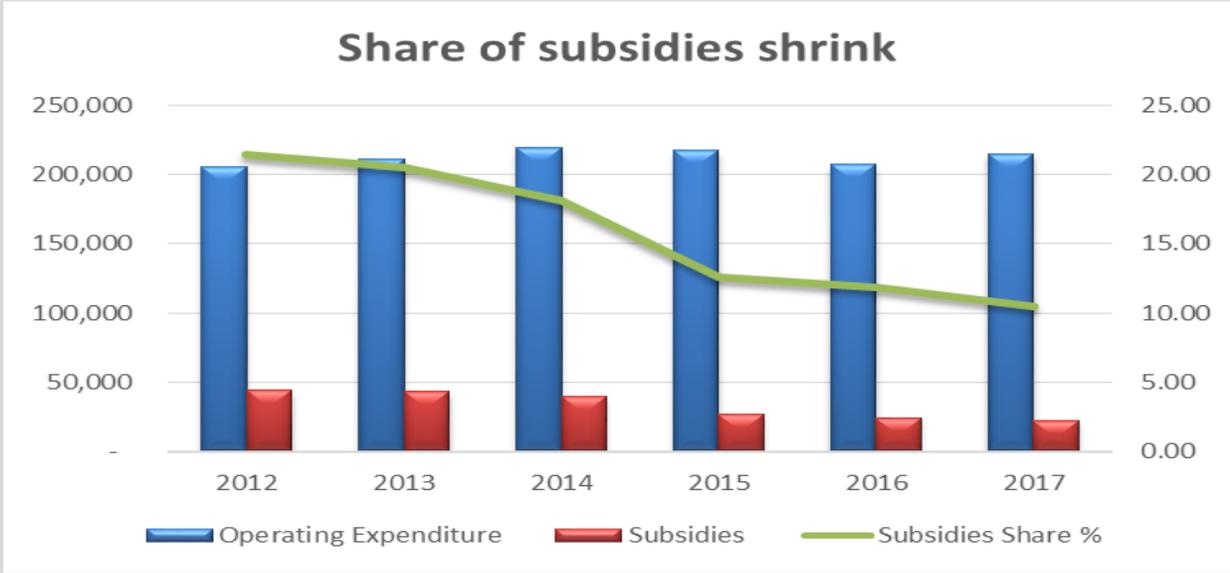
¹ The views and opinions expressed herein are those of the author and do not necessarily reflect the views of MIER.

Weight by Group Category and Price Indexes, 2016				
Type of Price Indexes	Main Groups	Urban	Rural	Income Below RM3,000
Food & Non-Alcoholic Beverages	30.2	29.1	36.3	38.6
Alcoholic Beverages & Tobacco	2.9	2.8	3.7	3
Clothing & Footwear	3.3	3.3	3.8	3.4
Housing, Water, Electricity, Gas & Other Fuels	23.8	24.5	19.9	25.1
Furnishings, Household Equip & Routined Household Maintainence	3.8	3.9	3.6	3
Health	1.7	1.7	1.5	1.6
Transport	13.7	13.7	13.5	10.2
Communication	5.2	5.4	4.5	3.8
Recreation Services & Culture	4.9	5	3.9	3.2
Education	1.1	1.2	0.7	0.7
Restaurants & Hotels	2.9	2.9	2.3	2.2
Miscellaneous Goods & Services	6.5	6.5	6.3	5.2

Source: Department of Statistics Malaysia

In October 2016, the Malaysian government reduced the subsidy on cooking oil price. It is part of the rationalization program in order to adjust federal government's balance sheet while improving market efficiency and to curb the smuggling of subsidized cooking oil into neighboring countries.

The government spends about 20 percent of operating expenditure on subsidies and social assistances in 2013. In the latest 2017 Budget, government is expected to spend about RM22 billion on subsidies and social assistances. That is approximately 10 percent of total operating expenditure.



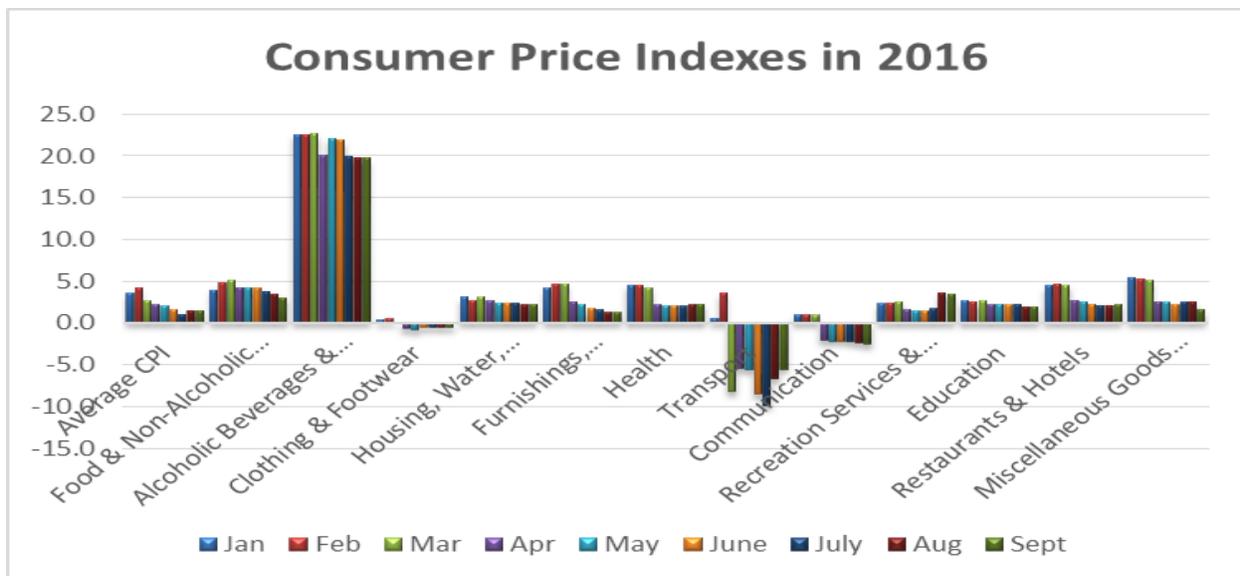
Source: Annual Economic Report Ministry of Finance

Starting on January 2017, there will be no subsidy on cooking oil except for 1 kg polybag packet. The ceiling price of 1 kg polybag will rise by 40 cents from RM2.50 to RM2.90 due to subsidy cut. The subsidy rationalization plan also aims at restructuring income distributions by providing social assistances to targeted groups especially the B40.

By cutting subsidies, Malaysia is transitioning into free market system. One aspect of free market system is price volatility. Therefore, one question remains pertinent to be answered is whether Malaysians in general are ready to accept a free market system and price volatility. Having high and steady income is the best cushion against the shock from skyrocketing and volatile prices.

The latest cut in cooking oil subsidy will directly impact the price of cooking oil to rise. Consequently, the effects of higher cooking oil price will also affect other food-related products. That the prices of food-related products including food in restaurants and stalls, will go up inevitable. This is because businesses will try to maintain profit margins and pass the higher cost to consumers.

The headline inflation was low level for the past 9 months. However, food inflation was higher. For instance, average food inflation is 4.1 percent while the headline inflation recorded only 2.2 percent in the period of January until September 2016. This was before the cooking oil subsidy cut. It goes to show that the price of food rises faster than for other goods. The pressure from higher food cost is inevitable and the low-income group is the most affected.



Source: Department of Statistics Malaysia

The pressure felt by T20 and M40 is less than the B40 due to income level. Increase in cooking oil price has less impact on the consumption pattern of the rich. On the other hand, the poor feel the pinch even with a slight increase in cooking oil price. Those with high income have more room to cushion the higher food prices.

Cooking oil is one of the basic items needed by every household. Price movements of basic goods affect the low-income group more than those in the higher-income bracket. Thus, a slight drop in prices of basic goods will see demand from low-income consumers increase and vice versa.

To continue subsidies for long term is economically inefficient. It is akin to spoon-feeding. Subsidy provision is not sustainable for long term as it could stifle productivity and lead recipients to become over-dependent on the subsidy. The funds spent on subsidies could be used productively, such as building roads, schools, hospitals, providing scholarships and on programs to expand the economy.

The disadvantage of subsidy provision is deadweight loss to the economy where inefficient allocation of resources occur. With the subsidy rationalization plan, the cut in cooking oil subsidy can be used on improving productivity in cooking oil production activities in particular or improving overall productivity in general. For example, to invest in productive infrastructure such as machinery and employing technology to lower production the production cost. Lowering the price of cooking oil by cutting production cost is much more efficient than subsidy.

The subsidized cooking oil for the 1kg polybag can be regarded as an exception as it is aimed for the low income group. However, there is no guarantee that the polybag cooking oil will be purchased solely by the B40 group. Better delivery system might be required for example through a coupon system. Only those under-privileged and low income group

should be given the coupon to purchase the subsidized polybag cooking oil. Plus, the purchase of the polybag cooking oil shall be limited in order to control and ensure fair distribution.

To ensure that the coupon system works efficiently, there must be effective monitoring and screening of recipients. If the coupon system is not transparent, the objective will not be achieved and those in low income group will suffer more.

Ultimately, uplift the income and earning power of the B40 is one way to alleviate pressures from cost of living. The transition towards free market must be balanced or compensated by higher household income. Bantuan Rakyat 1 Malaysia (BR1M) is not an impactful tool to compensate the low income group with the rising cost of living. BR1M is a one-off transfer payment given once a year and the effect is temporary at most.

Apart from BR1M or one-off payment, monthly cash transfer even with smaller value may assist the B40 to adapt with the increased in cost of living in the short term. For the medium and long terms, the government should gradually increase national minimum wage and human capital development via education and skills enhancement.

Nevertheless, subsidy rationalization is a good move for the long term economic development. Prior to that, a smooth transition from controlled-price system to free market system should be put in place. It is better to have stable economic growth coupled with healthier economic development by ensuring market stability, income equality and wealth distributions as well as affordable cost of living.