



Failure of goods and services tax in Malaysia

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Abstract

Malaysia introduced goods and services tax in the year 2015 replacing sales and services tax (SST). The tax proved to be a money machine and yielded the much needed income when the government revenue suffered due to a fall in petroleum prices. But it was alleged to be causing price rise and the new government which came to power soon abandoned it. VAT or GST being a very a scientific tax and more superior to SST could be reintroduced in the future after making modifications in its design. Introduction of equity in the tax rate, raising of threshold limit, spreading public awareness on the benefits of it, etc. are some steps the government can take up in the endeavor.

Keywords: Malaysia, GST, VAT, failure, tax rate, price rise JEL: E31 H22 H23 H25 H69

1. Introduction

Malaysia introduced goods and services tax or GST from April 1, 2015. The then Prime Minister Najib Razak as also the Minister of Finance in his 2014 budget speech defended the decision to implement the new tax and said "More than 160 countries have already implemented GST. This clearly demonstrates that GST is proven to be a transparent, effective and fair tax system" (Government of Malaysia, 2013: para 106). But just after three years in existence, the news that Malaysia was going to adopt sales and service tax again and abandon GST or VAT had caused disbelief among academicians and policymakers around the world and specially so in India which was also to bring in the tax very soon. What went wrong of such a scientific and popular tax needs careful examination as lessons of VAT implementation are an area of keen interest among academicians and tax experts.

The paper is divided into five sections. The second section examines the GST design of Malaysia while the following section studies the relevance of the hypothesis that VAT is a money machine. The fourth section looks at the reasons for the dislike in the new tax while the last section concludes.

2. GST design in Malaysia

GST or goods and services tax is simply a value added tax that levies not only on goods but also services ^[1]. Unlike sales tax, the tax is levied in different stages of value addition till the point of sales to final consumers and so it involves multi-stage taxation. The benefits of VAT are well known and the Malaysian government portal on GST listed them as greater tax compliance, reduction of price due to removal of cascading effect, lowering of business cost by reducing input tax, greater transparency, etc ^[2]. On the negative side, the tax is difficult to administer and tax payers have to be well aware of the system. Another issue is the large tax revenue it generates which often makes the government raise tax rate to fund larger government expenditure. This has been one of the reasons why the tax is yet to be implemented in the US ^[3]. Other concerns like price rise and distributional effects are also sometimes debated.

The tax was implemented at a low rate of 6 percent which is perhaps one of the lowest tax rates currently prevailing in the entire world. A very low VAT rate is not desired as it gives more benefit to the rich than the poor. Instead a lower VAT rate for the goods consumed by the poor along with a higher rate for other goods is more desirable. Many EU countries have very high tax rates and even India has a multiple tax rate ranging from 5% to 28 %. Malaysian GST has a threshold limit of RM 500,000 and it is not levied on some goods that would have impacted the common man, viz. rice, flour, sugar, cooking oil, public transport, health services, education, rental of residential building, etc ^[4].

3. VAT: A money machine

VAT has been a success in terms of revenue generation in Malaysia also. Prior to the introduction of GST, revenues from company income tax, petroleum income tax and non-tax revenues from PETRONAS dividend were the three biggest source of revenues. They generated 54.93 percent of the total receipts of the country in 2014 (Table 1). Sales and services tax contributed only 7.81 percent. The scenario completely changed after GST replaced sales and service tax. It contributed 19.4 percent of the total revenues and became the second most important tax in 2016. In fact, petroleum prices in 2016 fell and revenue of PETRONAS dividend dived to just RM 16,000 million from RM 26,000 million in the previous year while income tax from petroleum operations fell from RM 11,559 million to RM 8422 million ^[5]. Similarly, petroleum royalty fell from RM 5142 million to RM 3661 million. Together the fall of revenue from these three items was RM 14, 618 million. During the year the surge in GST collections was from RM 27,012 million to RM 41,206 million reducing the impact of decline in oil prices to a large extent. GST collections further increased to RM 44290 million in 2017 where total non-tax revenue witnessed a slight decline. This validates again the hypothesis that VAT is a "tax machine" and the Malaysian Prime Minister even described GST as the the saviour of Malaysia's economy (*The Malaysian Times*, 2016).

But such a productive and efficient tax came be abandoned

by the new government which came to power recently and decided to have sales and service tax again. GST tax rate was reduced to 0 % on June 1, 2018 while sales tax and service tax were introduced from September of the same year. In the revised estimates of 2019 both sales tax and services tax added together is expected to contribute RM 26800 million which is RM 17490 million lower than what GST was contributing in the year 2017. This should be a huge setback for the people involved in implementing the new tax. Before going more into the Malaysian GST failure, a little bit of literature review on the topic may be helpful in throwing more light into the events unfolding in the country. Grandcolas (2005) had examined VAT failure in some countries and the reasons were grouped into three: (1) opposition from political parties and the promise to repeal it if elected, (2) poor planning, and finally (3) wrong choice of threshold limit. Out of these three, the first point could be an important reason for VAT failure in Malaysia as well. The

opposition till the run up to the elections had opposed it and expressed their intension of removing it if they were elected. Abolition of GST was then like writing on the wall as the opposition had come to power. The biggest opposition coalition party known as Pakatan Harapan in its election manifesto promised to repeal GST and bring back SST within 100 days in office (CNA, 2018). The major allegation against the tax was that it would raise price level. A rally with a theme “Anti GST-Until it is dropped” was organised in the capital city of Kuala Lumpur on May 1, 2014 saying that it would simply make lives much costlier and make the common man suffer (*Today*, 2014). Another charge levelled against GST is that common people would be left to bear the profligacy of the government. The government said that price of some goods may increase by less than 5.8 % but a majority of the goods included in CPI or consumer price index may also fall ^[6].

Table 1: Revenue of Malaysia (RM Million)

		2014	2015	2016	2017	2018	2019(RE)	2014	2015	2016	2017	2018	2019(RE)
1	Income tax (a to d)	118996	103985	102308	108563	122486	127538	53.94	47.46	48.16	49.26	52.60	48.44
	<i>a. Individual</i>	24423	26321	27566	28945	32605	35224	11.07	12.01	12.98	13.13	14.00	13.38
	<i>b. Company</i>	65240	63679	63625	64465	66474	70760	29.57	29.07	29.95	29.25	28.54	26.87
	<i>c. Petroleum</i>	26956	11559	8422	11761	20082	17883	12.22	5.28	3.96	5.34	8.62	6.79
	<i>d. Withholding and others</i>	2377	2426	2695	3388	3325	3671	1.08	1.11	1.27	1.54	1.43	1.39
2	Excise duty	12925	11890	11705	10112	10779	10485	5.86	5.43	5.51	4.59	4.63	3.98
3	Sales tax	10939	5223	103	47	3971	15470	4.96	2.38	0.05	0.02	1.71	5.88
4	Service tax	6278	3038	103	15	1473	11330	2.85	1.39	0.05	0.01	0.63	4.30
5	GST	0	27012	41206	44290	20336	0	0.00	12.33	19.40	20.09	8.73	0.00
6	Others	15068	14292	13918	14631	15016	15187	6.83	6.52	6.55	6.64	6.45	5.77
7	Total tax revenue (1to 6)	164205	165440	169343	177658	174061	180010	74.43	75.51	79.72	80.60	74.74	68.37
8	PETRONAS dividend	29000	26000	16000	16000	26000	54000	13.14	11.87	7.53	7.26	11.16	20.51
9	Petroleum royalty	6532	5142	3661	4415	5184	5760	2.96	2.35	1.72	2.00	2.23	2.19
10	Others	18367	20325	20345	19105	19934	20456	8.32	9.28	9.58	8.67	8.56	7.77
11	Total non-tax revenue (8 to10)	53899	51467	40006	39520	51118	80216	24.43	23.49	18.83	17.93	21.95	30.47
12	Non-revenue receipts	1667	1290	2114	1977	6213	2075	0.76	0.59	1.00	0.90	2.67	0.79
13	Revenue from federal territories	855	892	958	1251	1491	999	0.39	0.41	0.45	0.57	0.64	0.38
14	Total revenue (7+11+12+13)	220626	219089	212421	220406	232882	263300	100.00	100.00	100.00	100.00	100.00	100.00

Source: Ministry of Finance Malaysia. Retrieved from <https://www.treasury.gov.my/index.php/en/>

Note: Figures in the last six columns are percentages of the total revenues. It is reported that Petronas will pay a dividend of RM 54 million to government in 2019 comprising a special dividend of RM 30 million and normal dividend of RM 24 million (See Adilla and Yusuf, 2019).

4. Did GST led to higher prices in Malaysia?

An allegation against the GST was that it resulted in price rise and made the common people suffer. To examine at the validity of the statement we look at the trend of monthly cost of living index or consumer price index (CPI) along with some important sub items between June 2014 to December 2016. Figure 1 shows CPI along with three important sub-items, namely, Food & Non-Alcoholic Beverages (FNAB), Housing, Water, Electricity, Gas & Other Fuels (HWEG) and Transport (TR) which carry weights of 30.3, 22.6 and 14.9 respectively in April 2015. We notice that consumer price index has an increasing trend though there have been fluctuations from time to time. HWEG has a smooth long term increasing trend while TR has seen wide fluctuations. The FNAB which carry the largest weight is higher than CPI throughout the period and can be the main factor the increase in CPI and transport cost for the major fluctuations.

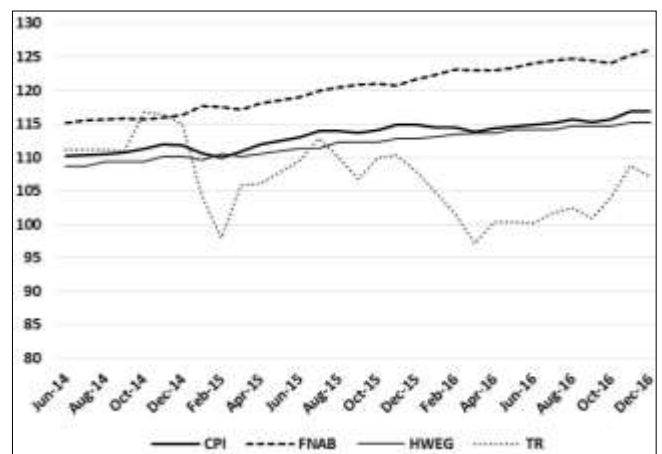


Fig 1: CPI and price index of selected sub-groups (2010=100)

CPI= Consumer Price Index, FNAB=Food & Non-Alcoholic Beverages, HWEG=Housing, Water, Electricity, Gas & Other Fuels, TR= Transport
 Data source: Department of Statistics Malaysia. Press Release, Consumer Price Index Malaysia (Various issues).
 The CPI declined from 110.6 in January 2015 to 109.9 in February 2015. Since then the CPI has gradually increased.

It is seen that the increase in March 2015 has been largely due to increase in Transport cost which saw a rise by 7.8 points and carry a weight of 14.9 percent (Table 2). Various literature review said that fluctuations in petrol prices has been largely responsible for the variations in transport cost. On the other hand, food and non-alcoholic beverages witnessed a decline in February and March 2015 but witnessed a jump in April 2015. This coincides with

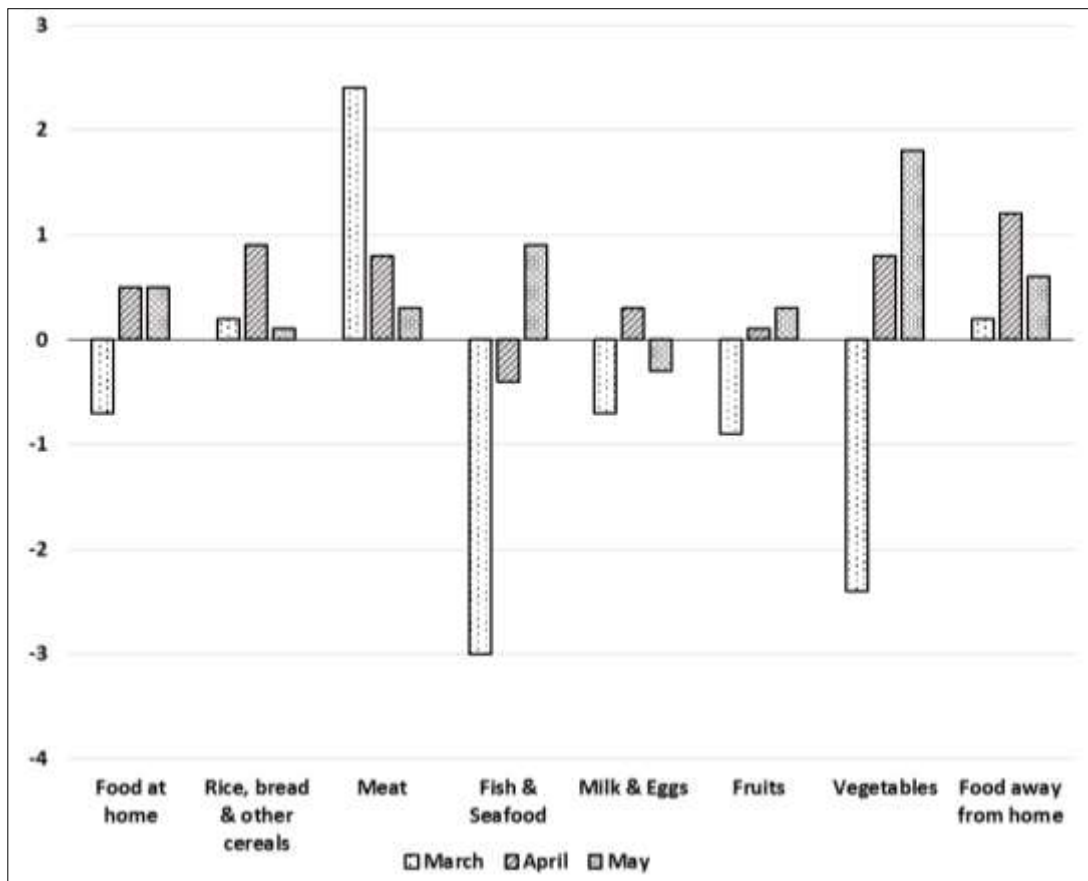
the introduction of GST in place of SST. Fig.2 gives the change in percentage points of the major components of food and non-beverages indices for the months of March, April and May 2015. In March 2015 there was decline in prices of Food at Home, Fish & Seafood, Milk & Eggs, Fruits as well as Vegetables. In the next month there was increase in all almost all items the highest being Food Away from Home which carry a weight of 14.5 points.

Table 2: Components of Consumer Price Index of Malaysia

	Weight	Feb.	March	April	May	June
Total	100	-0.7	1	1	0.4	0.7
Food & Non-Alcoholic Beverages	30.3	-0.2	-0.4	0.9	0.5	0.5
Alcoholic Beverages & Tobacco	2.2	0	0	2.9	-2.1	0.2
Clothing and Footwear	3.4	-0.4	0.4	0.8	0.1	-0.3
Housing, Water, Electricity, Gas & Other Fuels	22.6	1	-0.4	0.4	0.8	0
Furnishings, Household Equipment & Routine Household Maintenance	4.1	-0.2	0.1	2.3	0.4	0.6
Health	1.3	0.4	0.4	2.1	0.3	0.5
Transport	14.9	-6.2	7.8	0.3	0.2	3.2
Communication	5.7	0	0	3	0.1	0
Recreation Services & Culture	4.6	0.4	-0.2	1	0.2	0.1
Education	1.4	0.6	0.1	0.6	-0.1	0.2
Restaurants and Hotels	3.2	0.2	0.4	2.2	0.5	0.6
Miscellaneous Goods & Services	6.3	0.5	0.3	2.7	0.3	0.2
Non-Food	69.7	-0.9	1.6	1	0.4	0.8

Data source: Department of Statistics Malaysia. Press Release, Consumer Price Index Malaysia (Various issues).

Note: It indicates change in percentage points over the previous month's CPI.



Data source: Department of Statistics Malaysia. Press Release, Consumer Price Index Malaysia (Various issues).

Fig 2: Consumer price index of selected food items in 2015 (2010=100)

The rise in CPI of Malaysia specially in 2015 may be due to various reasons but three points stands out. Rising food import can be a major factor for the rise in food prices. Malaysia imported food items worth RM 45.4 billion in

2015 and their prices in the international market has risen and a stronger USD can cause further problem (Hamid, 2017). Besides, transportation cost rose from March and continued to remain high though it went down a little in the

latter part of the year. GST may be also a major reason. Narayan (2018) gave the opinion that GST in Malaysia was not revenue neutral generating much more revenue than SST which would have an impact on prices. Other factors like cut in subsidies, raising of electricity tariff, weakening of Ringgit thus increasing food import bill, etc. aggravated the situation.

An attempt is made here to examine theoretically how far the assertion of GST increasing price level is true. It is not only a fear that existed in Malaysia only but also in many countries that implemented the new tax. Soo Han (1987) examined the impact of VAT implementation in Korea in July 1997. It was observed that the increase in both wholesale price and consumer price was lower in 1977 than in 1976, a year before the new tax was introduced. The increase in 1977 was much higher in food & beverage than in non-food items which was caused largely by agricultural failure. The issue of price rise was examined thoroughly by Tait (1988) on a sample of thirty-six countries including Korea which had implemented value added tax. Price rise according to him can happen for a number of factors but the increase attributable to the new tax was not observed in majority of the countries. Most of them implemented VAT not as a new tax but as a replacement for some tax like wholesales tax, production tax, etc. Further, it was also designed as an equal yield tax for majority of them. Terkper (1996) analyzed the failure of value added tax in Ghana and identified apprehensions of price rise as one of them. But there was a number of possible factors that could have influenced price rise along the new tax, viz. increase in excise tax on fuel products, poor food harvest, depreciating value of local currency for a country which depend on heavy imports, etc.

An official who is in charge of GST implementation in Malaysia in an interview with the magazine *The Edge Malaysia* said a slight one-time increase in price was possible but denied that VAT was causing high inflation in the country^[7]. Theoretically, a one-time rise in price is indeed possible when the tax is able to bring more tax payers in the tax net as greater tax compliance is enforced. Otherwise, a tax which is not new but a replacement for sales and service tax and with a 6 percent tax rate is not likely to lead to high price level. When VAT was reintroduced in Ghana after it was given up earlier, the tax rate was brought down from 17.5 % to 10% which is even higher than that of the Malaysian VAT. There was, however, massive campaign to make the common people understand what a value added tax is (Chapman, 2001). This highlights the importance of more public campaign in Malaysia too which is always of great significance in VAT implementation.

It is likely that GST caused price level to rise one time as known from the higher tax revenue it generated which soon stabilized. However, the level of price rise as seen from the CPI curve does not seem to be high. The government could have done more to explain this or should have made some changes in the tax design to make it more acceptable. It is a generally accepted fact that value added tax or GST or whatever name it may be given is a very scientific tax having a lot of advantages over sales tax^[8]. It is also known that switching over from sales tax to it has not always been easy and should be done after a careful planning. Business and the public should be given awareness of its benefits. Riar (2019) commented that as the reintroduction of GST is

a possibility with more rates introducing more equity in it along with a raising of threshold limit. It is true that multiplicity of tax rates is not preferable but a solution is there by reducing the tax rate further or to have two tax rates - one at a lower rate and another at a higher rate. This will reduce the burden faced by the common people and bring progressivity in the tax system also. In fact, India has many and so also does many European countries. The tax should come back but one never knows the future as VAT is yet to be introduced even in the US which seemed contended with retail sales tax.

4. Conclusion

Malaysian government might have taken the right decision to introduce GST in place of sales and service tax given the benefits it has over the latter. The tax, however, became unpopular and subsequently withdrawn which could be due to a number of factors, viz. price rise, political opposition, lack of flexibility in the design, etc. VAT implementation requires proper planning and management as it can be an unpopular tax specially during the early years. A slight one-time increase in price is common and it can also cause confusion among businessman as it is a complicated tax. But if the people are convinced that GST will be of great benefit in the long run, its success is most likely. Once people are persuaded and agree to it, the political parties will also support it. If it is to be reintroduced again in the future, efforts should be made to design a GST more acceptable to the people by including all the stakeholders in its planning.

Notes

1. GST and VAT are used interchangeably in this paper.
2. Details of GST are available in the Malaysian government portal www.gst.customs.gov.my
3. See Nepram (2018) on the debate for and against introduction of VAT in the country.
4. See the 2014 budget speech or the GST web portal.
5. The oil price fell from US \$100-\$140 a barrel during 2010-14 to as low as US \$ 27.10 in Jan 10, 2016 (See Yeap, 2018).
6. See the 2015 budget speech, paras 68 and 69.
7. See Yen and Lee (2016).
8. See Kathryn (2015) and Zodrow (1999) on the advantages of VAT.

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