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There seems to be more excitement than usual about the coming Budget 2004, and it's not difficult to figure out why. Already, the two buzzwords in the run-up to this Friday, when the budget will be announced, are "farewell" and "election".

Budget 2004 is to be the last budget that Prime Minister and Finance Minister Datuk Seri Dr Mahathir Mohamad will table in Parliament as he is retiring from government after Malaysia hosts the Organisation of Islamic Conference summit next month. On top of that, with the general election due by November next year — and there is speculation it could be as soon as in the next nine months — there is a strong likelihood that the coming budget will favour the general public or electorate.

"(The market) is talking about a historic grand last supper party with Dr Mahathir," observed Wong Chee Seng, economist at the Development Bank of Singapore (DBS), in a report last Wednesday. At the same time, there has also been talk that there will be no big surprises from Budget 2004. This is because the government has already provided a host of concessions, incentives and bonuses in the past few years to boost economic growth, and the latest stimulus package amounting to RM7.3 billion was announced less than four months ago on May 21.

But whether or not there will be big surprises, most analysts concur that the coming budget will be expansionary and favourable to most businesses and individuals. Many think Mahathir, who has been hailed as the father of modern Malaysia and Malaysia Inc, will want to exit the stage with a budget that will be well remembered by businesses and society at large.

In addition, past trends suggest that budgets preceding or immediately following general elections tend to favour consumers and corporate citizens through tax cuts, and appeal to the moral concerns of certain sectors in the electorate by raising the traditional "sin" taxes on tobacco, alcohol and gaming industries.

"History suggests that prior to general elections, budgets are generally people-oriented and business-friendly, with either a cut in business costs or greater goodies for consumers, or both. The stance is generally expansionary and has played a critical role in keeping growth momentum humming," said Wong.

Lee Heng Guie, head of economics at CIMB Securities, observed in a report on Aug 6 that the budgetary stance in those

years prior to general elections was generally "people-oriented" and "business-friendly". In Budget 2000, which was tabled in Parliament on Oct 29, 1999, a month before the nation went to the polls, the personal income tax rate was reduced by 1.0 per cent, he said.

In Budget 1995, which was tabled on Oct 28, 1994, about six months before the general election in April the following year, there was a reduction in both the corporate tax rate (to 30 per cent from 32 per cent) and personal income tax rate (by two to three percentage points), he added.

So, will the combination of Mahathir's farewell budget and the impending general election produce a grand affair on Friday?

"Our view: yes and no," said Wong of DBS. "Yes, history will repeat itself and Budget 2004 will retain an expansionary focus. No, contrary to the suggestions of some market observers, we don't think Mahathir will splurge on an over-priced supper that leaves big holes in the next government's pockets. The new budget will have enough goodies to keep everyone happy, with businesses likely to enjoy a bigger serving than consumers," he said.

For the public at large

Another round of personal income tax cut may perhaps be the easiest way to win the hearts of most people, but few analysts think the government can afford to take this route.

"We don't expect a reduction in personal tax rate for two reasons: so far, the ongoing policy measures are deemed appropriate to enhance domestic consumption.

"These include the lowering of EPF [Employees Provident Fund] rates for a year from June 1, 2003, to May 30, 2004, lower BLRS [base lending rates] and a half-month bonus payment to civil servants," said Lee of CIMB. Another reason is that the government is expected to face its seventh straight year of deficit spending in 2004, and a tax cut would work against its revenue consideration, he explained.

Wong of DBS, too, doesn't expect a cut in the personal income tax rate for the same reason. "Our view is that the government dished out enough goodies to consumers in the last two stimulus packages, but they will not be totally ignored in this budget," he said. He reckons there will be another one-month bonus for civil servants. "This feel-good factor alone is strong enough to jack up private consumption growth by 0.8 to

serve up generous helpings?

1.2 percentage points in 2004,” he said.

However, there are other ways to appease the tax-paying public. “[It] is timely to further streamline the existing personal income tax band. Through raising the threshold taxable income level subjected to higher marginal tax rates from the current RM250,000 to, say, RM350,000, it would make the taxation system more conducive towards rewarding greater work efforts and enhancing productivity,” said Lee of CIMB. “In addition, the government could consider providing higher personal tax relief as well as relief for spouse and children.”

Trends from past election budgets

ELECTION DATE	RELEVANT BUDGETS	MEASURES
04/22/1982	10/23/1981	Reduction in import duties for certain items, tax exemption for interest earned on savings deposits
08/10/1986	10/25/1985	Hike in sin taxes, tax incentives for manufacturing and agriculture sectors, tax exemption on incomes earned abroad
10/12/1990	10/27/1989	Reduction in development tax, incentives for tourism and housing industries and SMEs
	12/14/1990	Reduction in personal income tax, pay rise for civil servants, higher tax relief for EPF contributions and insurance premiums, higher tax relief for wife and children, extension of reinvestment allowance, reduction in development tax
04/25/1995	10/28/1994	Reduction in corporate tax and personal income tax, tax exemption for income earned abroad for certain industries
11/29/1999	10/23/1998	Hike in sin taxes
	10/29/1999	Reduction in personal income tax and import duties, increase in personal relief, tax incentive for corporate debt restructuring, mergers of insurance companies and stockbroking companies and bond market

For businesses

"This budget will probably favour businesses more than households because the government has already done more than enough for households in the past few years," Wong of DBS tells *The Edge*. While the government has paid attention to the concerns of businesses in the past, he thinks there's greater pressure now



for it to cut the corporate tax rate — which has been at 28 per cent for the past five years — to ensure that Malaysia remains attractive to foreign investors.

Some developed countries in the region, like Hong Kong, Taiwan, Singapore and South Korea, are already offering lower rates or plan to pare these further in the next few years. Singapore has done so much to maintain its competitiveness, by lowering the corporate tax rate to 20 per cent by 2005 and more recently, reducing employers' mandatory contribution to their staff's pension fund, Wong says. Malaysia will have to consider measures to face rising competition from the region, he says.

Economists like Wong, Lee of CIMB and Azrul Azwar of MIDF Sisma Securities think the government may cut the corporate tax rate by one to two percentage points in the coming budget, and possibly further in the next three to five years.

But then again, there remains the same dilemma of reconciling a tax cut, and thus lower revenue, with the Eighth Malaysia Plan's goal of balancing the books by 2005. This is why some economists like Kevin Chew, a research fellow at

the Malaysian Institute of Economic Research, and Joseph Tan of Standard Chartered Bank in Singapore don't think the government will announce a cut in the corporate tax rate this Friday.

"With rising government deficit, a bounce-back in foreign investment applications [in the first five months] and the fact that corporate earnings have surpassed expectations, a reduction in corporate taxes is unlikely next year," says Chew.

Sustaining economic growth

Judging from the theme of the Ministry of Finance's pre-budget dialogues with trade organisations this year — "Mitigating destabilising external environment and ensuring sustainable growth" — the budget will likely include tax incentives and other policy measures to boost domestic private investments.

However, analysts point out, foreign investments still play a pivotal role in fuelling Malaysia's economic growth and the government will want to provide incentives to attract investment in high-end manufacturing and services industries.

"To revitalise the growth of private investment, we expect continued emphasis to be given to foster investments in the key sectors of the economy. These include high-end manufacturing products, ICT [information communications technology], biotech and biochemical as well as downstream resource-based industries [petrochemicals, oil and gas]. Policy measures are likely to be tailored for R&D [research and development], technology and product development, marketing as well as export penetration strategy," said Lee of CIMB.

"Over the course of this year, the government has been making several major policy

announcements that entail the liberalisation, relaxation and rationalisation of rules and regulations as well as incentives. These include the relaxation of the central bank's rules on foreign exchange controls and FIC [Foreign Investment Committee] guidelines on foreign equity.

"The aim is to enhance the effectiveness of existing policy measures. This is in line with the strategy to boost economic competitiveness and improve the delivery system, especially to retain existing and attracting fresh foreign direct investment (FDI) by lowering not only the monetary costs but also the non-monetary costs of doing business in the country. We see the Budget 2004 as another opportunity for the government to make further such announcements," said an economist at local bank-based brokerage, in his report last Thursday.

Analysts also expect the budget to include measures to strengthen the presence of small- and medium-size enterprises (SMEs) in the economy. "Being the backbone of the Malaysian economy, accounting for about 90 per cent of total manufacturing establishments, we can expect other measures to support the development of SMEs to increase their contribution in terms of output and exports, currently dominated by multinational corporations or large local companies," Azrul of MIDF Sisma tells *The Edge*.

All in, if past election budgets are anything to go by, it looks like positive news for most sectors except those involved in "sin" industries like big tobacco and breweries. As the economist at the local bank-based brokerage put it: "Since there was no increase in sin taxes in Budget 2003, we are expecting one this time around — plus the supposed popularity of such a move ahead of the general election." **E**