

CHAPTER 4

VISIBILITY OF UNDERGROUND ECONOMY IN MALAYSIA

Introduction

This chapter provides an overview of the Malaysian economy and economic incidences that reflect the visibility of proxy and determinant indicators of UE. The indicators examined are time series data of population, GDP, taxes, inflation rate, economic crises, income background, unemployment rate and crime rate, obtained from national reports (Malaysia Economic Report, Central Bank of Malaysia and Department of Statistic Malaysia). Data gathered from these sources are examined and illustrated descriptively (in tables and graphs) to provide initial views for further proper statistical techniques.

4.1 Country's economic performance

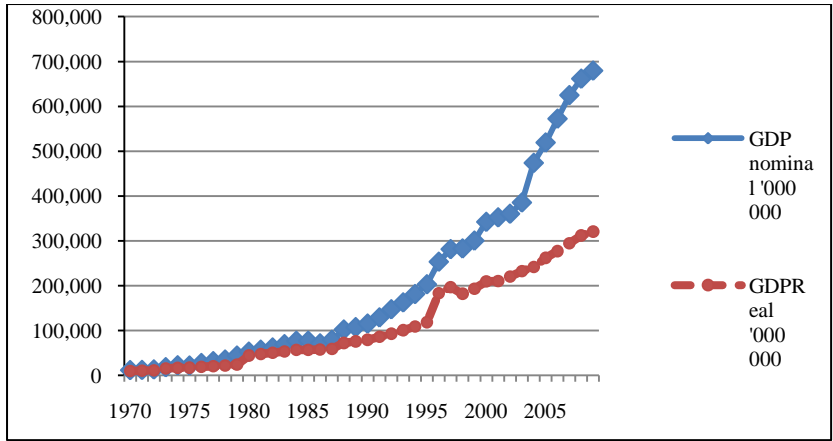
Malaysia is a middle-income country with rapid developing economy in Asia. In 2010, Malaysia ranked the 33rd fastest growing economy in the world. It's economy has also undergone some structural economic transformation mainly from a producer of raw materials and agriculture based in the 1970s' into manufacturing in the 1990s', now into an emerging multi sector economy, focusing on services of knowledge-based industries (Trading economics; <http://www.tradingeconomics.com/malaysia/gdp>. dated 25 nov 2011. and Malaysia Economic Forecast in EconomyWatch Content Team at

http://www.economywatch.com/world_economy/malaysia/economic-forecast, dated 20 November 2011).

4.1.1 GDP

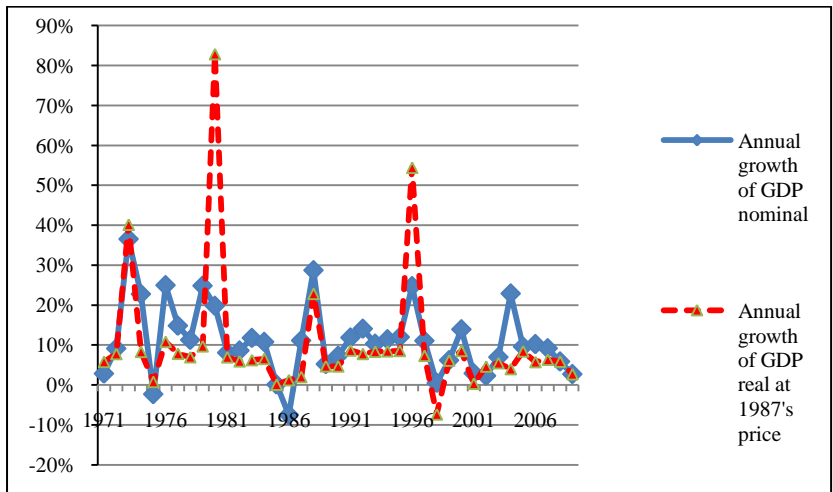
By economic sectors comprising of agricultural, industrial and services, the GDP composition mix transforms from 29.1%, 24.63% and 43.2% (1972) to 9.1%, 41.61% and 49.3% (2010) respectively. The Malaysian economy in 2010 was mainly boosted by services and manufacturing industries at 6.8% and 11.4 % respectively. There are wide varieties of well developed manufacturing industries ranging from vehicles, building materials, furniture, electronics to food processing, placing Malaysia ranked the 23rd position among the world manufacturing countries.

The GDP growth rate over 1970-2000 period is remarkable as summarized in Table 4-1, partly as the positive effect of deliberate implementation of economic policies. However, if UE growth is higher than GDP (Figure 4.3), these policies though meant to correct perceived adverse economic trends, are not likely to sustain. Tucker (1982) states that UE high growth may partly cause policies to be ineffective. The ultimate results are distortion of statistics such as overstated unemployment, understated economic performance, overstated inflation, understated savings and consumption and production. The GDP nominal and GDP real for over 1970-2010 period as illustrated in Figures 4.1 and 4.2 rose sharply with wider gap beginning in the late 1990s till now, reflecting an increasing deflator, mainly the CPI.



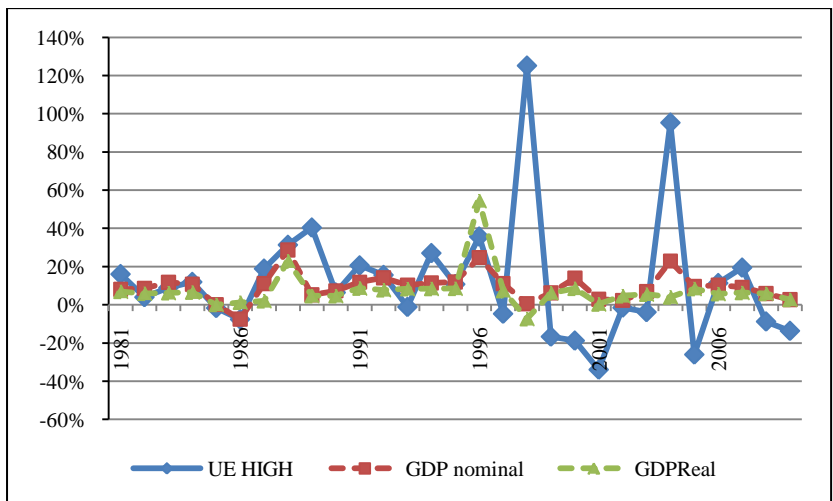
Source: Data gathered from Malaysia Economic Report

Figure 4-1: Absolute value of GDP nominal and GDP real (at 1970's and 1987's price)



Source: Data gathered from Malaysia Economic Report

Figure 4-2: Growth of GDP nominal compared to GDP real (at 1970 and 1987's price)



Source: Data gathered from Malaysia Economic Report

Figure 4-3: Growth of UE estimate (estimate discussed in Chapter 6) compared to GDP nominal and GDP real (at 1970's and 1987's price)

Table 4-1: GDP growth and absolute value

5 year period	GDP nominal		GDP real at 1987's price	
	Average amount per annum (MYR)	Average growth per annum	Average amount per annum (MYR)	Average growth per annum
1970-74*	15,955	17.81%	12,992	15.51%
1975-79	32,486	14.71%	20,780	7.22%
1980-84*	64,182	11.80%	50,644	21.70%
1985-89	87,904	7.53%	64,492	6.18%
1990-94	147,576	10.99%	93,817	7.59%
1995-99	264,593	11.28%	174,875	13.81%
2000-04	383,134	9.79%	223,060	4.60%
2005-09	611,695	7.51%	293,419	11.23%

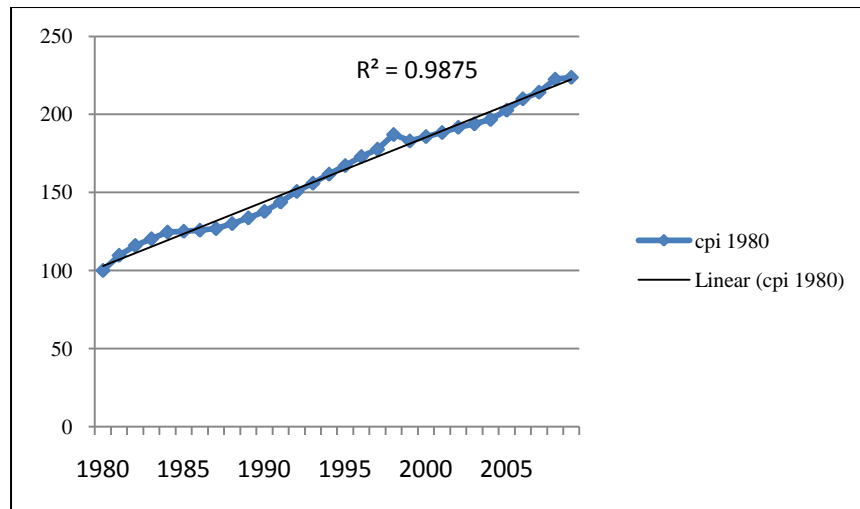
Source: Data gathered from Malaysia Economic Report

*High growth due to recovery from recession and tremendous remedial policy and pragmatic implementation approach

4.1.2 Inflation rate - Consumer Price Index

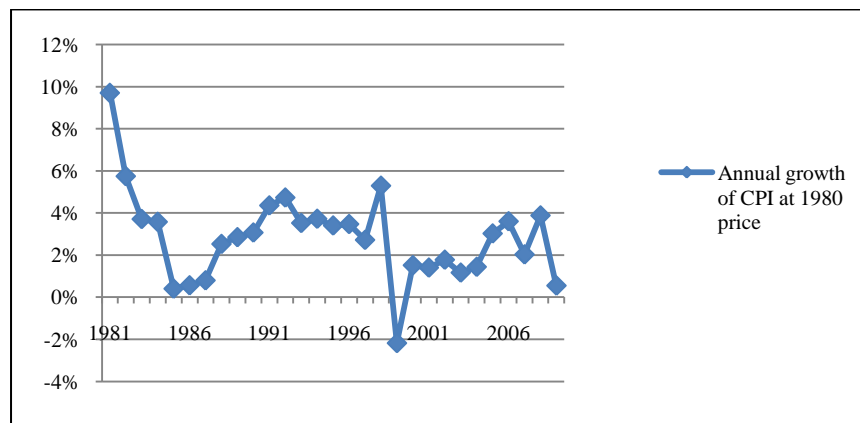
Consumer price index (CPI) as a measure of inflation rate is normally the major GDP deflator. CPI at high level will ultimately cause a rise of cash in circulation and price of goods to increase. Price increase implies a higher living cost. This economic constrain would be higher if the official CPI is measured from prices of “a bias selected basket of goods”. The CPI estimate would then represent a minimal index. If this is true, the actual economic constrain is expected to be higher than what the official CPI reflected.

For over the last four decades the 1980 CPI index rose from 37.80, to 85.79 and to 123.77 in 1990, 2000 and 2009 respectively (Figure 4.4). The CPI increase was in about 2.27 folds in 1990-2000 period and 1.44 folds in 2000-2009 period. As illustrated in Figure 4.5, its normal growth in normal time, is relatively consistent in about 2%, but exceeded 4% in 1981, 1982, 1991, 1992 and 1998 (recession years).



Source: Data gathered from Malaysia Economic Report

Figure 4-4: CPI series



Source: Data gathered from Malaysia Economic Report

Figure 4-5: CPI growth

4.1.3 Electricity consumption

Like other countries, Malaysia as a developing country for industrialization had undergone tremendous economic improvement and dependent on electricity as the physical resource in the production of goods and services (MEWC, 2005). For over 1990-2006 period, the average energy consumption mix showed that electricity consumption was only 18%, compared to petroleum natural gas (56%) and coal (23%) or coke (3%) consumptions.

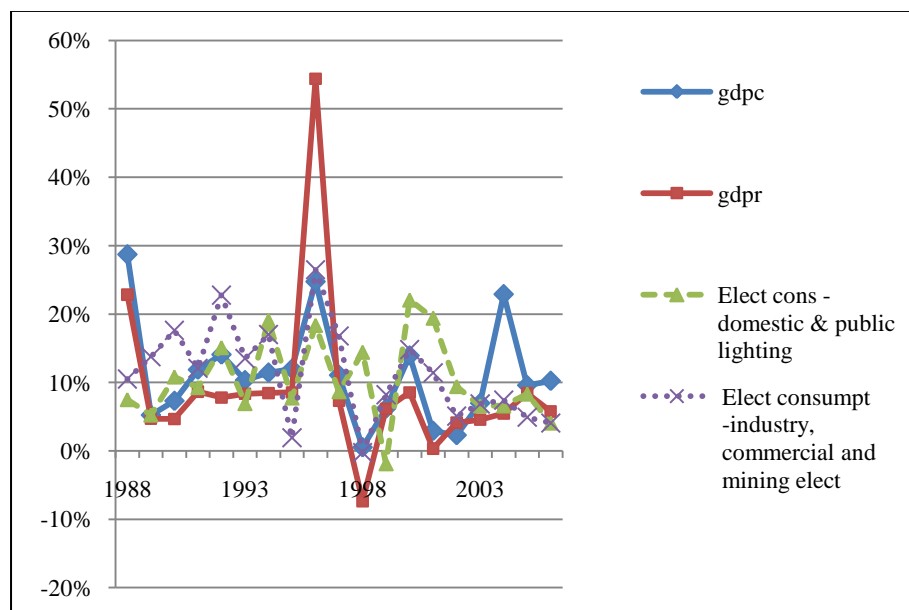
Although electricity consumption is not the major physical resource for production, it grew with GDP and at higher growth during 1990-2004 periods.

Table 4.2 summarises electricity consumption compared to GDP growth and Figure 4.6 illustrates the positive association between economic performance and electricity consumption growth. The upward trend of electricity consumption in UE is evaluated in an OLS regression model as discussed in Chapter 7.

Table 4-2: Electricity consumption by user sectors

5 year period	Demand growth of electricity consumption (GWH)				Average of GDPc
	Domestic and public lighting	Industrial, commercial and mining	Services	Average of total consumption	
1980-84				9.12%	11.80%
1985-89	6.37%			1.53%	7.53%
1990-94	12.23%	12.13%		15.37%	10.99%
1995-99	9.46%	16.59%	10.45%	9.88%	10.89%
2000-04	12.81%	9.11%	10.75%	5.66%	9.79%
2005-09	6.18%	4.505	4.84%	6.41%	9.90%

Source: Data gathered from Malaysia Economic Report



Source: Data gathered from Malaysia Economic Report

Figure 4.6: Growth of electricity consumption relative GDP

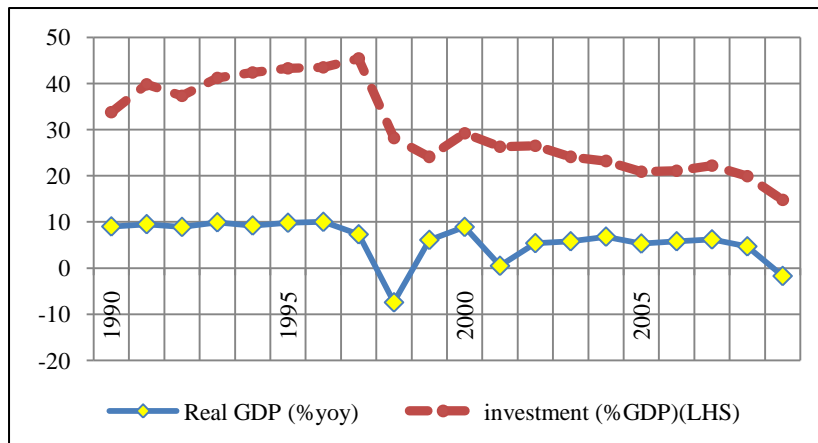
4.1.4 Savings and investment gap

Both savings and investments are important indicators of country's reserves. Savings are cash deposits mainly in the financial institution, while investment is the use of resources intended to increase future production output or income. Malaysia's saving rate is relatively high compared to other countries, ranging from 33% (1979) to 40% (2007). The investment growth instead was from positive in the pre to negative in the post Asian Financial Crisis of 1997-98 crises. Private investment weakened in the post 1997/98 crises from over to under investment. The aggregate investment levels both in product and services relative to GDP declined in the post economic crises, (National Economic Advisory Council's NEM (Part 1), (Quah Boon Huat – Could Malaysia end up bankrupt in 2019 <http://www.mier.org.my/newsarticles/archive/pdf/10/07/2010> The star).

Goh and Lim (2010) explained the positive savings investment gap that led to current account surplus was a result of a reduction in investments rather than a rise on savings. The post crises total investments had reduced to half of the size of the pre crises level. The private investments reduction was from 32.7% in 1995 to 11.8% in 2008 while public investments reduced relatively steady from 13% to 10.5% in the same period, as illustrated in Figures 4.7 and 4.8.

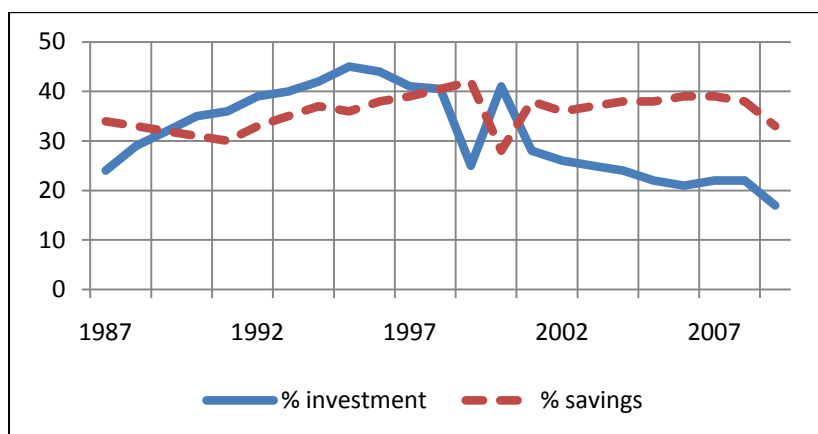
A large saving-investment gap because of low investment but high private consumption investment is partly due to a flourishing UE. Money laundering may have been practiced, but people could have been cautious about using “illegal funds” on “open investment” as it leaves paper trails which participants would want to avoid detection from the authorities.

Activities in the UE are said be less productive as resources utilization are less likely to have access to formal financial markets and difficult for them to increase the scale of production due to fear of detection. Rusenova (2003) remarks a large part of income obtained in the “hidden economy” remains outside the financial system because they are less likely to be invested in projects with the highest expected rate of returns.



Source: Data gathered from Department of Statistics Malaysia, Central Bank of Malaysia, 10th Malaysia plan

Figure 4.7: Growth of GDP and investment



Source: Data gathered from Department of Statistics Malaysia, Central Bank of Malaysia, 10th Malaysia plan

Figure 4-8: Savings and investment gap

4.1.5 Economic crises - 1997-98

The impacts of global recession economy of the 1970s' and 1980s', have recovered over the years. Indeed it rose to its peak just before the Asian financial 1997-98 crises that recorded as the worst downturn. Among the adverse economic structures of the crises are the reduction of Malaysian exports due to the collapsed of external demand of manufactured products, the collapsed of stock market and currency market. The ultimate impact is a reduction in Real GDP growth rate from 7.3% in 1997 to a negative of 7.4% in 1998.

Apart from transformation of these collapsed outputs in the post crises, the number of unemployed labor force, small enterprises, creation of portfolio funds, the price of goods and services and the cost of living increase substantially. There was also a tremendous reduction of household investment in human development, foreign reserves, as well as foreign direct investment. Impacts were then worsened by the 2001 September 11 disasters in the United States, followed by the encroachment into Iraq and SARS.

The pre term crises was also characterized by a robust GDP growth and high investment, but a slower GDP growth amidst reducing share of investment in the post crises, the savings and investment gap was from over to under investment. The savings-investment gap went from negative to positive before and after the crises, resulting to surplus current account (Figures 4.7 and 4.8). Mahani (2009) further support that the post 1997-98 crises economy has recovered and grew, but was not restructured fast enough. The GDP growth was 11.6% in the 1990s' before the crises, negative in the 1997-98 crises, and recovered in 1999 but only to a GDP growth of 8.08% in the 2000s'. The

proportion of unemployed labor force was never restored to the good time of pre crises period as illustrated in Figures 4.9 and 4.10. The federal account showed persistent growing fiscal deficit in the post 1997-98 crises as illustrated in Figures 4.21 and 4.22.

4.2 Population characteristics

In the year 2009, Malaysia's population size was about 28 million with an average growth of 1.72%. About 53.63% of the population amounting to 11.566 million people in 2010 is within the age of 15 to 64, the labor force group. Its median age at 25 reflects a country of a young population structure with reasonable labor force supply.

4.2.1 Labor force and direct tax base

The rising proportion of labor force possessing tertiary education that increased from 8.80% (1990) to 22.00% (2008) is a positive indicator of a broader tax base. The 2010 statistic showed that about 2.22 million country's labor force have tertiary education, out of which 75% are employees. Assuming that the labor force with tertiary education are "potential tax payers", then the number of individual tax payers in the direct tax base should be at least 2.22 million.

Indeed, the tax records showed that the number of individual tax payers in both years of 2000 and 2010 were about 2.5 million comprising; 68% - 72% employees and 28% - 32% business group.

As the proportion of labor force approximates the proportion of individual tax payers, the tax base structure is assumed to resemble the labor force structure. This gives some comfort of employing tax base to infer the country's

economy. Other direct tax payers constitute about 350,000 tax filers consisting of companies, co-operatives and other associations.

Over 1980-2009 period, the proportion of GDP contribution by employment sectors in government services fell from 0.12% to 0.067%. The 50% reduction implies that people's income outside government services have displaced the contribution of income salaries from government sectors. The structural income transformation indicates that the trend of individual's income is moving from salary towards business income. Business income is naturally of lower income visibility compared to salaried income.

This is supported by the lower tax form compliance rate of OG compared to SG group (Table 4.2 and 4.3 indicating non compliance by category of tax payers in Appendix of Chapter 4). The number of taxpayers in the individual business group (OG) and companies (C) also grew more than the individual salary group (SG). By income tax forms issued in 2001 compared to 2006, the growths of tax payers were at 22.14%, 71.85% and 38.01% for SG, OG and C respectively. But by non compliance of tax form submission, they differ at 47.15%, 64.69% and 23.86% for SG, OG and C respectively. These non compliances were evaluated and discussed in Chapter 6.

4.2.2 Moderate unemployment rate

It is commonly viewed that unemployment issues associate with economic crises, mismatch between labor force skills and jobs demand, high production cost and conflicts of part time jobs. Its impact is the creation of informal jobs which is a proxy indicator of UE.

There is a larger proportion of unemployed labor force in the post crises than in the pre crises, as summarized in Table 4.3, and Figures 4.9 and 4.1. The

larger proportion of unemployed labor force suggests for more opportunities for informal work as people need to earn for a living. The proportion of unemployed labor force in the post 1997-98 crises (first half of 2000) revert to almost the level of unemployment problem of the 1980 decade.

One reason for the creation of the informal jobs is partly due to the cost of complying with certain work regulations in the official economy. It is often viewed as the stigma of being a “tax”. Examples are the compulsory contributions to social security (SOCSO and EPF [11% by the employee (deducted from pay) and 12% by the employer [deducted as extra expense of the employer]) and the minimal pay for workers employed in the OE.

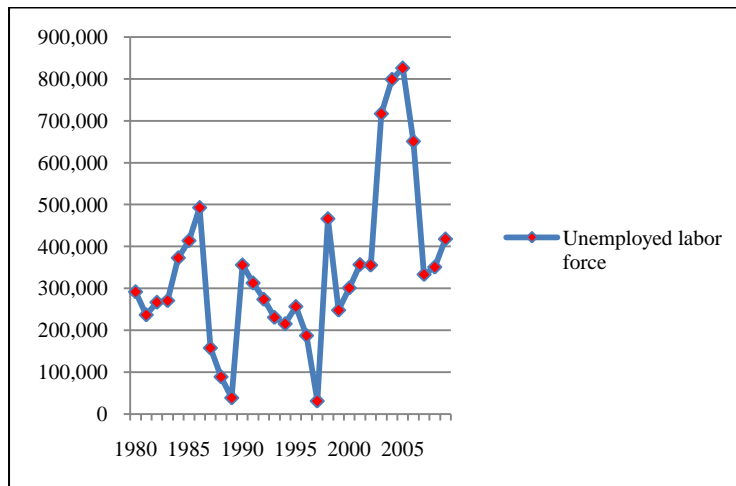
Operational cost and hassles of excessive recruitment procedures and regulations are economic constrains that led to the emergence of informal employers and informal employees. Naturally, employers prefer low operating cost; one way is to employ informal labor whom normally desperate for jobs. They are willing to accept lower wages in order to retain jobs or even conduct commercial crime for survival, to cope with cost of living.

Response from a survey on people’s perception on sufficiency of income showed that about; 20.1 % respondents said that their income covers well and able to save; 37.3% said that their income covers well with no difficulties while; 40.9 % said that their income is insufficient (Asian Barometer Survey conducted in Malaysia year 2007). The survey indicates that only a small proportion of the population has savings and a large proportion needs additional income to live comfortably. This statistic implies that given the opportunity, at least half of the population would take up part time jobs.

Table 4-3: Unemployed labor force (percentage proportion)

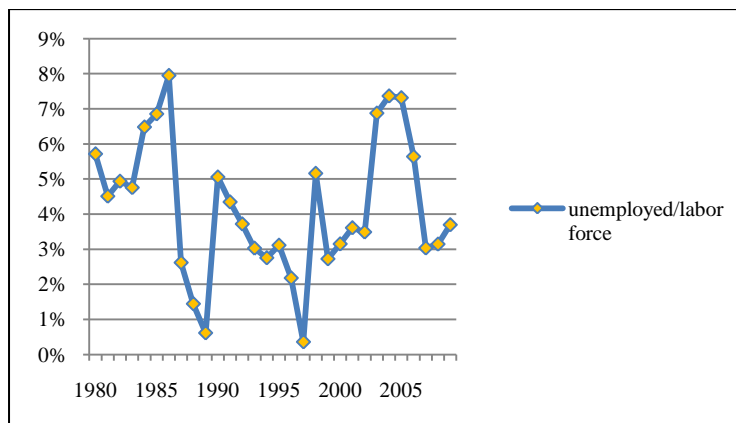
Annual average in 5 year period	Proportion of unemployed labor force -(%)
1980-84	5.28
1985-89	3.89
1990-94	3.78
1995-99	2.70
2000-04	4.91
2005-09	4.56

Source: Data gathered from Malaysia Economic Report



Source: Data gathered from Malaysia Economic Report

Figure 4-9: Number of unemployed labor force



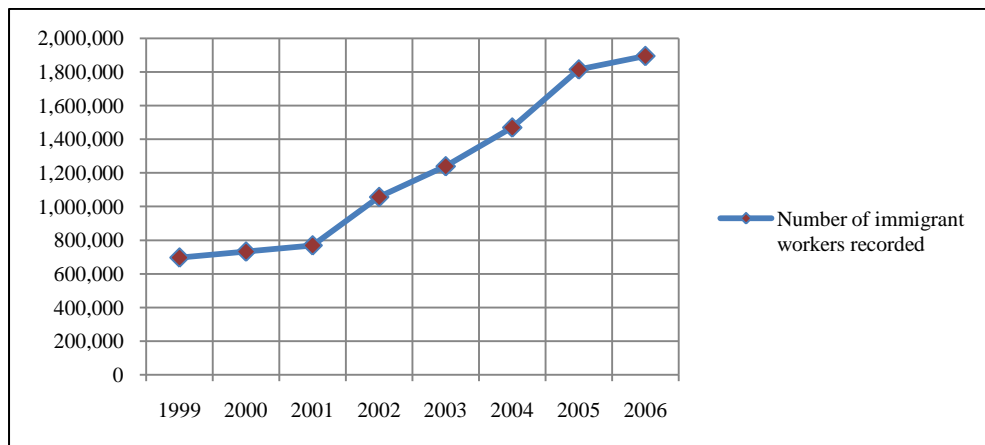
Source: Data gathered from Malaysia Economic Report

Figure 4-10: Proportion of unemployed labor force

In addition to the existing local unemployed labor force, the official immigrants from 1999 to 2008 has increased in 6 folds from a half to 2 million

people in the post 1997-98 crises, as shown in Figure 4.11. This excludes the illegal immigrants, estimated to be an additional of half a million foreigner. The composition of legal immigrant workers, in 2005, by economic sectors showed that about 32.03%, 26.02%, 17.64%, 15.51% and 8.80% were working in the manufacturing, agriculture, domestic servant, construction and services respectively (Berita, 3/5/2010 – <http://mstar.com>).

They initially migrate to this country due to country's demand for cheap labor and scarce jobs in the neighboring countries, but somehow migrants' growth exceeds job demands, placing them unemployed officially. They would naturally turn to working in informal economy, and join the legal activities or illicit activities of UE. This phenomenon is consistent with the issues of UE in the United States, (Zagaris, 1997). He draws attention that illegal immigrants and human trafficking is now rapidly growing and may be the most profitable UE.



Source: Data gathered from Malaysian Economic Report

Figure 4-11: Number of immigrant labor force

Insufficient income, costly formal job, and inadequate formal job, collectively are opportunities of UE participation, the creation of creation of informal workers.

The under reported working labor force or over reported unemployed labor force (who is actually working in the informal job sector but not reported to avoid detection), implies that statistic could be misleading, thus an unreliable indicator of economic performance.

On the positive side, the “employed labor force” in the UE is of benefit to the country in a short run as it reduces incidences of poverty. However, in long it distorts employment policies due to incorrect assumptions. In this context, where UE is large, the unemployment rate may no longer be an indicator of economic cyclicity, instead a misleading indicator.

4.2.3 Impressive GDP per capita income

Country’s GDP per capita derived from GDP nominal and GDP real controlling for population is summarized in Tables 4.4 to 4.6 and illustrated in Figures 4.12 and 4.13. The GDP real is suppressed by some GDP deflators (mainly the CPI). The GDP per capita was from USD 250 in 1957 (independence year) to USD 8,000 in 2010.

Table 4-4: GDP nominal (GDPn) and GDP per capita –growth

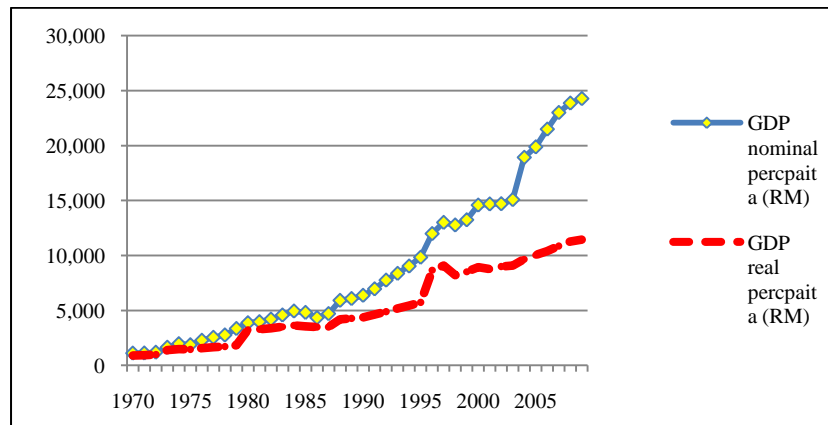
Average of 5 year period	GDPn (%)	GDP per capita (%)
1980-84	7.86	5.07
1985-89	8.97	6.06
1990-94	11.30	9.11
1995-99	11.28	8.51
2000-04	7.89	4.81
2005-09	13.45	10.34

Source: Data gathered from Malaysia Economic Report

Table 4-5: GDP nominal and GDP per capita –growth

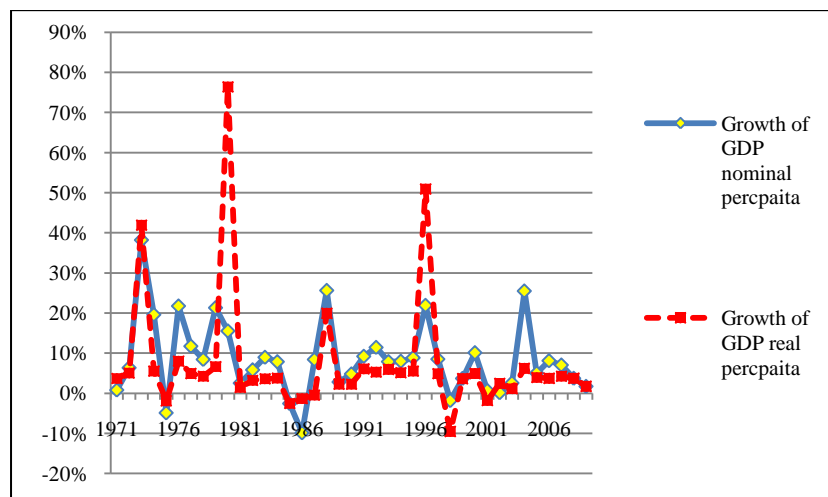
Average of 10 year period	GDPn (%)	GDP per capita (%)
1979-79	16.09	13.7
1980-89	8.42	6.52
1990-99	11.6	8.25
2000 -09	8.08	6.49

Source: Data gathered from Malaysia Economic Report.



Source: Data gathered from Malaysia Economic Report

Figure 4.12: GDP nominal per capita and GDP real per capita - gap (at 1970's and 1987's price)



Source: Data gathered from Malaysia Economic Report

Figure 4-13: Growth of GDP per capita

Table 4-6: GDP per capita – growth and in absolute value

5 year period	GDP per capita nominal		GDP per capita real at 1987's price	
	Average amount per annum (MYR)	Average growth per annum	Average amount per annum (MYR)	Average growth per annum
1970-74*	1,407	16.24%	1,147	14.05%
1975-79	2,563	11.67%	1,647	4.38%
1980-84*	4,314	8.15%	3,410	17.68%
1985-89	5,169	4.89%	3,797	3.57%
1990-94	7,696	8.27%	4,901	4.94%
1995-99*	12,167	8.48%	8,042	10.97%
2000-04	15,595	7.80%	9,087	2.58%
2005-09	22,503	5.13%	10,800	3.48%

Source: Data gathered from Malaysia Economic Report.

* Recession period

4.2.4 Skew income distribution

The GDP per capita increased from MYR 750 (1970) to MYR 24,000 (2010) with population poverty improved from about 50% to 3.5%, but prosperity was unreasonably skew.

Skew income distribution as viewed from tax structure indicated that only 16% labor force falls in the captured tax base. This is equivalent to 2.5 million individual tax payers compared to the 15 million labor force in the country. Only about 5% individual and 2% institutional taxpayers in the tax net contributed to about 70% or 80% of direct taxes respectively.

With regards to household income study, evidence of disproportionate income bracket was shown by Ragayah (2008). She divided the gross household income into three categories; top 20%, middle 40% and bottom 40%. For over 1980-2009 period, on average 15%, 35% and 50% of the household belongs to the top, middle and bottom group respectively. In addition to the existing disproportionate income bracket, increases in the means of annual gross household income were faster in the upper than in the lower income level. The

increases were in 3 folds for the lower income bracket and 4 to 5 folds for the upper income bracket.

Income distribution of about 5.8 million households in 2007, indicated that the top 4.9% have an annual income above MYR 120,000, followed by the next 15.8% households earning an annual income between MYR 60,000 and MYR 120,000. The remaining bottom household of 15%, 26.6%, 29% and 8.7% were earning; between MYR 36,000 and MYR 60,000; between MYR 24,000 and MYR 36,000; between MYR 12,000 and MYR 24,000; and an annual income below MYR 12,000, respectively (A report from the Eighth Malaysia Plan and related articles)

The Gini coefficients as inequality index, (as defined in Table 4.1 in the Appendix of Chapter 4), were at 0.41, 0.44, 0.5 and 0.57 for the years 1957/58, 1967/68, 1973/74 and 1976/77 respectively, (Jomo, 1981). Later records showed that the Gini coefficients were at 0.4863, 0.4765, 0.491 and 0.4920 for 1984, 1992, 1997 and 2006 respectively, (The World Development Indicators Database). It appeared that Gini coefficients were never restored to its origin of independence year.

In Asia Pacific region, the records of 1999 population between the richest 20% and the poorest 20% indicated that Malaysia was one of the countries that has the highest income disparity ratio, at 11.7%.

On the other hand, the Human Development Index (HDI) that measures income and economic growth rate, (as defined in Table 4.1 in the Appendix of Chapter 4), showed conflicting incidence. HDI growth was at 1.1% annually, it increased from 0.541 (1980) to 0.744 (2010), placing Malaysia above the regional average.

There have been consensus views on the difficulties on the improvement of unequal income distribution due to differences in human skills, educational attainment, disparities in value of assets and access to capital. Nevertheless, the conflict between high HDI score and an outstanding income inequality, is often said to be due to some distorted data that could be partly due to a flourishing UE.

4.3 Societal characteristics

Citizens' dismay and dissatisfaction over "profligacy" is a sign of an unhealthy socio-economic interaction. It drives people to participate in non-compliant to rules, the activities of UE. A flourishing UE can also be seen in the societal consumption pattern such as private expenditure and consumption of cash as the medium of exchange and consumption of physical resource.

4.3.1 Private consumption

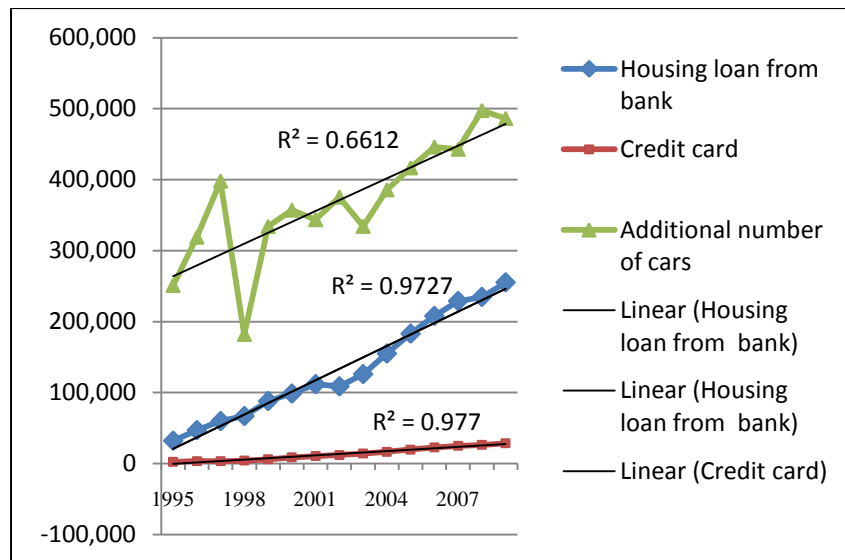
The growth of private consumption rose sharply in the post economic 1997-98 crises. Figures 4.14 and 4.15 illustrate the growth of saloon cars, purchases of landed property/capital by the growth of property loans, credit cards expenditure and telecommunication and internet dial up subscriptions.

"The private sector capital spending was led by the expansion in the production of domestic-oriented industries amid high levels of capacity utilization. The public sector capital investment rose as a result of higher development expenditure mainly in the education and transportation sectors", (Bank Negara report).

These "official remarks" to the 5.3% increase growth of household spending in 2010, is yet to be examined. Higher private consumption growth compared

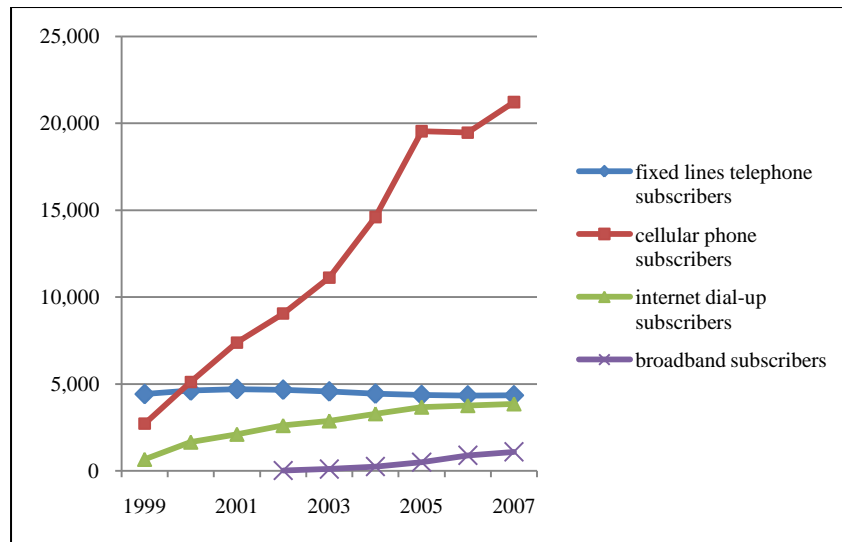
to GDP growth is an indication of expenditure exceeds income. If this is inferred to an individual, then an unexplained large ratio of personal expenditure to reported income (high personal consumption relative to reported income) is an indicator of unmeasured disposable income.

Although illegal funds are often laundered to legitimate markets, before it is streamed for investment, most of the time people do not use UE money to invest as they fear that investment may subject to anti money laundering detection. They instead prefer to hold cash or spend on luxurious consumptions and speculative market. The trend of high growth private consumption is a sign of spendthrift society on ill-gotten money such as a flourishing UE that promote a spendthrift consumerist culture.



Source: Data gathered from Malaysia Economic Report

Figure 4-14: Property loan, new car registration and credit card expenses



Source: Data gathered from Malaysia Economic Report

Figure 4-15: Telecommunication and internet dial subscription

Like any other countries, Malaysia has also experienced an encouraging growing trend on the use of internet. According to national communication agency, Telekom Malaysia (TM) Bhd., the number of internet dial up subscribers has increased from 2.9 million in 2003 to almost 5 million in 2006 and is expected to reach the 10 million mark in the next five years. The number of internet users, increased from 3.7 million in 2000 (about 15.0% of the population) to 16.9 million in 2009 (about 64.6% of the population). The tremendous increase of “speed” telecommunication would inspire the growth of e-business and e-commerce, facilitating business invisibility which are incentives for UE. (<http://www.internetworldstats.com/asia/my.htm>).

4.3.2 Cash consumption

The economic medium of exchange has evolved from barter trade to gold, cash and cheques, today into a society of cashless world with credit card and debit card. The cashless society is global as it is now facilitated by e-commerce, internet banking and e-purse transactions. Malaysia has also practice liberal foreign exchange policy that facilitates banks dollarization of

the domestic currency, the Malaysian Ringgit (represented as MYR and written in local symbol as RM) would speed up. With the various non cash financial instruments and dollarization of MYR, one would expect a lower growth of MYR cash in circulation.

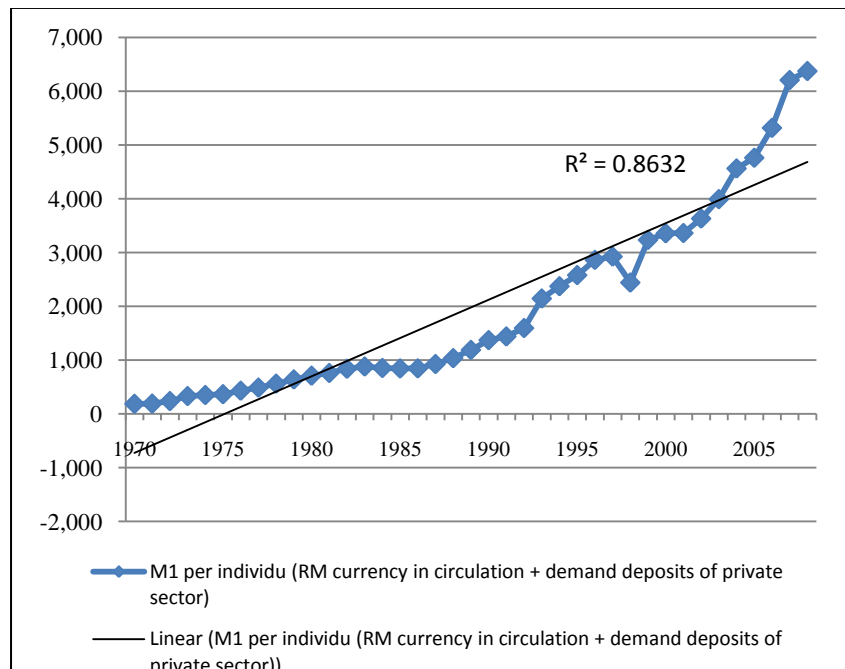
Despite financial transformation towards a cashless society, M1 aggregates and cash in circulation instead grew faster in the post than in pre 1997-98 economic crises (Figures 4.16 to 4.18). The average growth of cash in circulation between 1980 and 2009, examined in 5 year period was at 5.59%, 9.99%, 13.77%, 4.57%, 6.29% and 8.12% respectively. In 2007, cash in circulation amounts to about MYR42,192 million compared to the country's population of about 27 million, suggesting that everyone in the country has about MYR1,552 cash in hand (MYR42,192 million / 27 million). The amount of cash held in hand would be much higher if people earning less than MYR5,000 monthly have just enough to live without cash in hand.

Based on the household income survey in 2007, of about 5.8 million households, only 5% households earn more than MYR10,000 monthly. Assuming that two people are working in each household, then the top 5% households would cover people earning an average of MYR5,000 monthly. It is more likely that people in these 290,000 households (5% x 5.8 million) would be able to have savings of cash in hand. The amount of cash held among the top 5% rank approximates to almost MYR 72,745 (42,192 million divided by (290,000 households x [2 people working])).

In addition to a large amount of cash held among the top 5% income bracket group, the proportion of cash in large denomination (notes of MYR50 and MYR100) increased from a total of 55% in 1997 to almost 90% in 2009, with

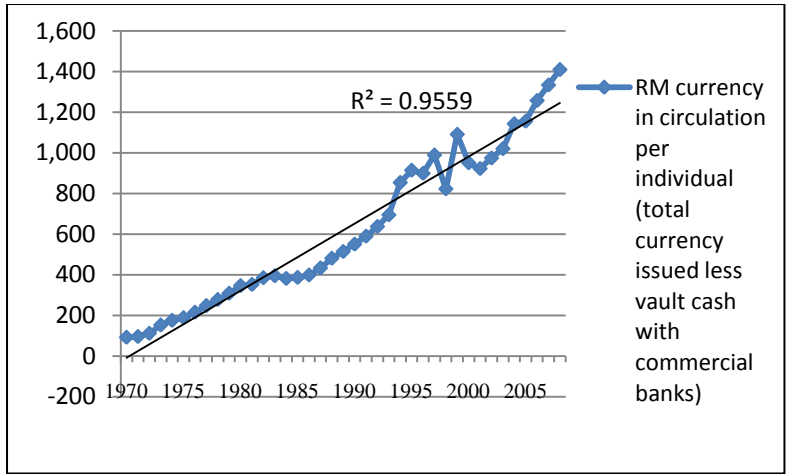
the remaining 10% in smaller denomination (Figures 4.19 and 4.20). The notes of MYR 50 were from less than 40% to more than 50%, while MYR 100 from 20% to 30%.

Assuming that law abiding citizens will not ordinarily increase their “day to day need for cash”, the dispute over large amount of cash held in hand in large denomination, is a collective consequence of high inflation rate (low purchasing power), large currency held abroad by migrant workers* (a study of the US currency) and a flourishing UE (cash is the preferred medium of exchange). *For instance in 2008, about MYR 12.2 billion were recorded as brought out of Malaysia by almost 2 million foreign workers in Malaysia. (http://ms.wikipedia.org/wiki/ops_pekerja_asing, 11/01/2011).



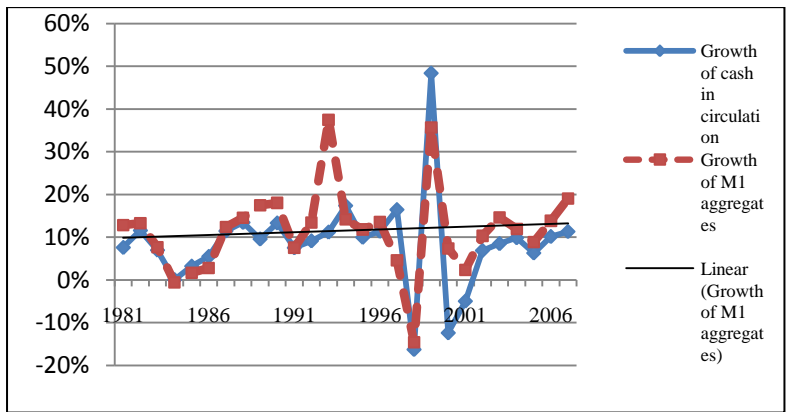
Source: Data gathered from Malaysia Economic Report

Figure 4.16: M1 aggregate held per person



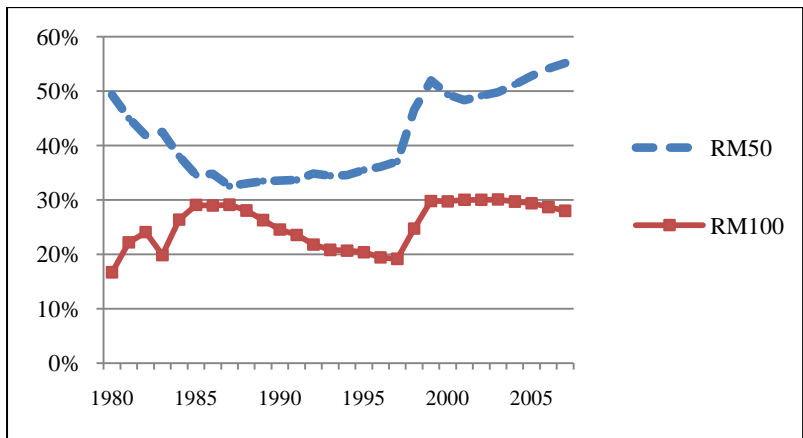
Source: Data gathered from Malaysia Economic Report

Figure 4.17: Cash in circulation held per person



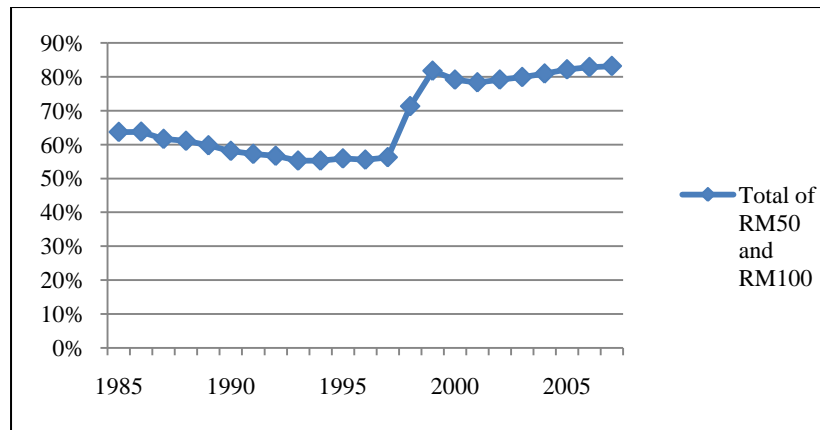
Source: Data gathered from Malaysia Economic Report

Figure 4.18: Growth of cash in circulation and M1 aggregates



Source: Data gathered from Malaysia Economic Report

Figure 4.19: Proportion of large denomination notes of MYR 50 and MYR 100



Source: Data gathered from Malaysia Economic Report

Figure 4.20: Proportion of total large denomination

4.3.3. Unequal consumptions and opportunities

Various policies measures and massive development of infrastructure have been geared towards the achievement of the country's Vision 2020 and high income per capita economy. If the vision comes true, is the achievement fair?

Anecdotal evidence of reports on poorly managed policy and argument of unequal opportunities among the entrepreneurs in making substantial profit need to be examined. For instance, privatization with excessive interference by the state had led to favorable conditions for "log rolling" and "rent seeking" activities and the institutionalization of UE for selective group, the cronyism and nepotism propaganda.

The activities of unnecessary lobbying, proposals, consultations often result in adoption of laws and public projects whose cost exceed their "benefits", could have been possibly contribute to a declining income transaction visibility. The heavy government investment for unrealized private investments such as privatization, huge government link company such as PERWAJA, PROTON, MSC, IPP, have been reported to recourse the public sector when resolving corporate financial crises.

The public's disillusioned by mega projects with huge "subsidized or bailouts program" and other undesirable trends and political malfeasance could provoke threats of retaliation from the public and would embrace dissatisfaction against government because privatization are said to vehicle activities at the expense of tax money. As tax payers are required to bear the cost of a financial meltdown, it creates citizen's dissatisfaction over government, a reflection of a default "contract between government and the citizens". The feeling of dissatisfaction provides strong motivation for activities to be further streamed into the underground activities such as tax non compliance.

4.4 Federal account

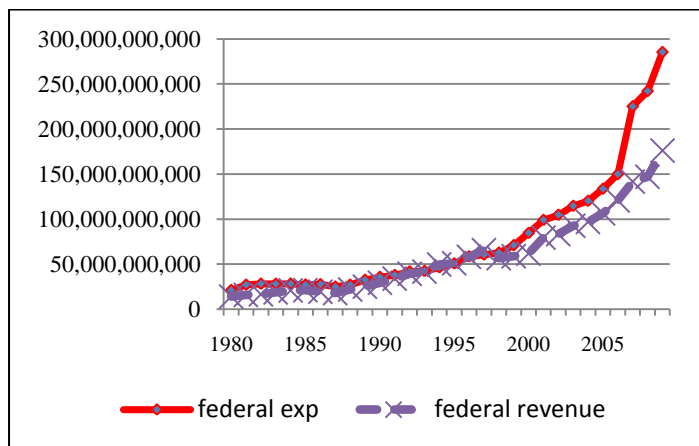
The trend of Federal revenue and federal expenditure are important performance indicators of the Federal Government. The important tools of federal administration are the fiscal policy concerning taxes and federal expenditure to provide various facilities to the citizen.

4.4.1 Federal expenditure

The size of federal expenditure in relative to GDP and population is often used as indicators of the size of government; high value reflects strong government intervention. Over the period 1980-2009, examined in 5 year period, the federal expenditure increased in 1.33, 1.19, 1.30, 1.40, 1.42 and 2.14 folds respectively, (Figure 4.22). In relative to GDP, it is below 30% in the normal years but increase to more than 30% in 1975-79, 1980-84 and 2005-09, (Table 4.8). Federal expenditure increased substantially in 1983-84, 1988, 1990-94, 1997, 2001, 2003, 2006 and 2007. The federal revenue to GDP ratio examined

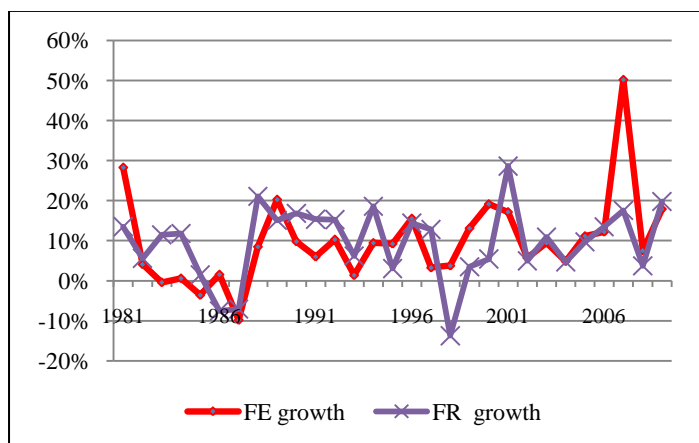
in 5 year period over 1980-2009 was 26.74%, 24.40%, 26.22%, 22.18%, 22.52% and 22.28% respectively (Table 4.9). Both widening gap between federal revenue and federal expenditure (Figure 4.21) and the declining ratio of the federal revenue to GDP, are negative indicators of federal account.

By type of expenditure, the development expenditure on economy decreases while on social increases. The operational expenditure showed that debt service decreases but “other expenditure”, subsidies, pensions and gratuities, increased, as examined over 5 years moving average (Figure 4.25 and 4.26).



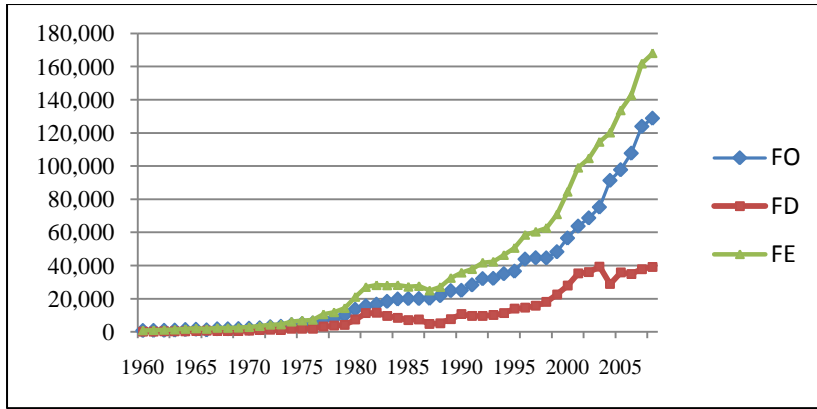
Source: Data gathered from Malaysia Economic Report

Figure 4-21: Federal revenue and Federal expenditure - gap



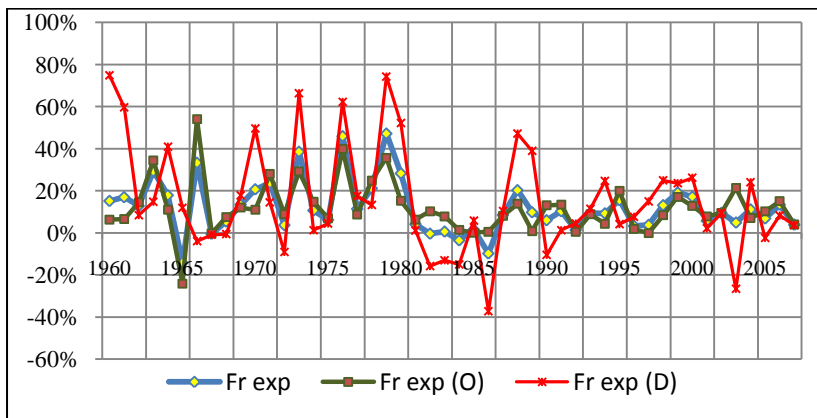
Source: Data gathered from Malaysia Economic Report

Figure 4-22: Growth of federal expenditure



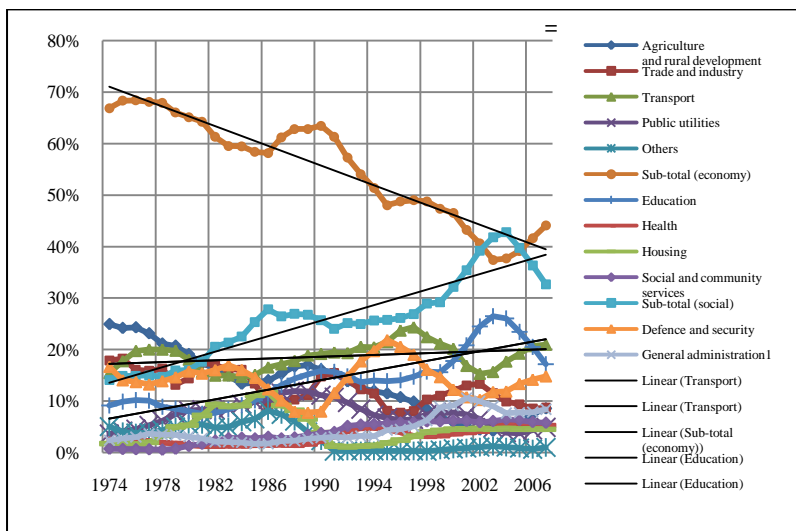
Source: Data gathered from Malaysia Economic Report

Figure: 4-23 – Federal expenditure by development and operational expenses - in absolute value of MYR)



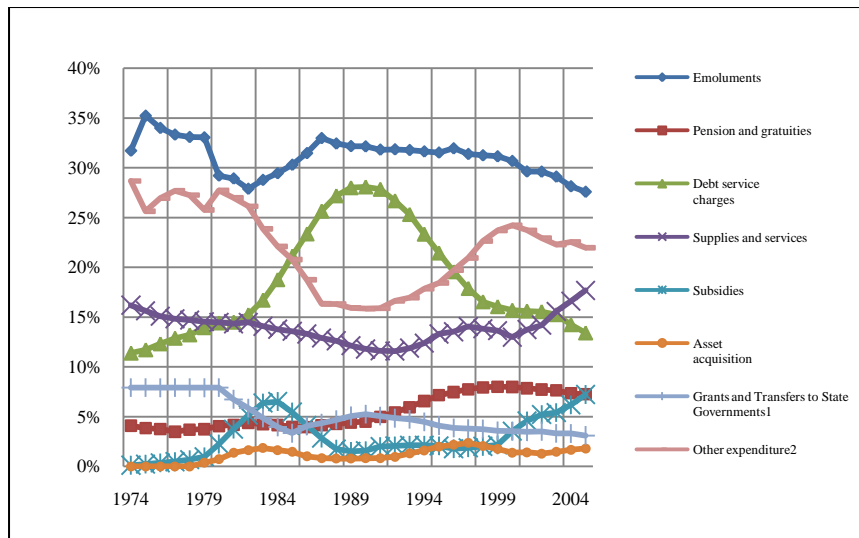
Source: Data gathered from Malaysia Economic Report

Figure: 4-24: Growth of federal expenditure by development and operational expenses



Source: Data gathered from Malaysia Economic Report

Figure 4.25: Development expenditure by public sectors



Source: Data gathered from Malaysia Economic Report

Figure 4.26: Operating expenditure by public sectors

4.4.2 Federal deficit

The widening gap between federal expenditure and federal revenue (Figure 4.21) in the 2000 decade implies that the Asian Financial 1997-1998 economic crises resulted to a long run federal deficit.

Federal deficit is characterized by the growth of the federal expenditure that increased from 2.11% in 1998 to 16.06 % in 2009 (Figure 4.22) and by a declining federal expenditure to GDP ratio (Figure 4.27). Federal budget was from surplus to a rising deficit; lowest in the first half of the 1990 decade and highest in the second half of the 2000 decade. Federal deficit improved from MYR80,023 million (1980 decade) to MYR22,834 million (1990 decade) but worsening again to MYR452,397 million (2000 decade). Its growth increased more than 50% during recession period or when the GDP growth was low or negative, as seen in 1981 (57.06%), 1999 (104.62%) and 2007 (184.79%).

The federal account took a while to restore its surplus position as in the pre-crises, but fundamentals were not strong enough to indicate traces of

improvement. It is time to wind down the cause of the longstanding federal deficit.

Table 4-7: Federal deficit – growth and in absolute value

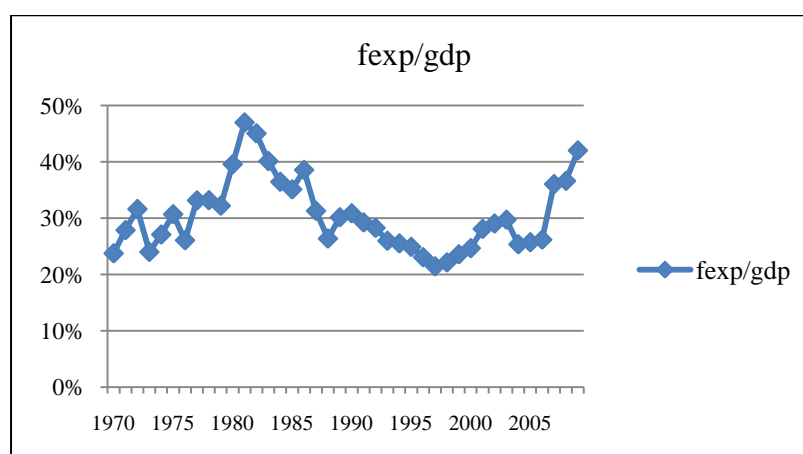
5-year period	Federal deficit (MYR million)	5 year moving average (%)
1980-84	46,699	4.98
1985-89	33,324	3.36
1990-94	10,059	-147.83
1995-99	12,775	-592.09
2000-04	108,424	17.87
2005-09	343,973	47.66
Total	555,524	

Source: Data gathered from Malaysia Economic Report

Table 4.8: Size of federal expenditure and federal deficit – relative to GDP

5 - year period	Federal expenditure to GDP (%)	Federal deficit to GDP (%)
1970 - 74	26.84	6.92
1975 - 79	31.04	7.52
1980 - 84	41.60	14.86
1985 - 89	32.28	7.87
1990 - 94	27.96	1.74
1995 - 99	23.02	0.84
2000 - 04	27.36	5.72
2005 - 09	33.29	10.82

Source: Data gathered from Malaysia Economic Report



Source: Data gathered from Malaysia Economic Report

Figure 4-27: Federal expenditure to GDP ratio

4.5 Tax burden

Over the period from the origin of tax legislation, tax revenue (direct and indirect taxes) has been the main constituent (above 70%) of the federal revenue. The major components of direct taxes are income tax, petroleum tax, stamp duties and real property gains tax. While the major components of indirect taxes are the export duties, import duties, excise duties, sales tax, service tax. Although tax revenue increases in 2 digit folds, the overall tax GDP ratio was inelastic and exhibited a downward trend, (Tables 4.9 and 4.10).

There was a shift of tax revenue mix in relative to GDP and federal revenue; direct tax ratio increased while indirect tax ratio decreased, (Figure 4.28). Giles and Tedds (2002) proposed that evolution towards indirect taxes such as the GST and more corporate taxes, and away from personal income taxes, could partly reduce opportunities for UE activities. For Malaysia, association between tax mix and tax burden is yet to be examined.

Table 4-9: Taxes - relative to federal revenue and GDP

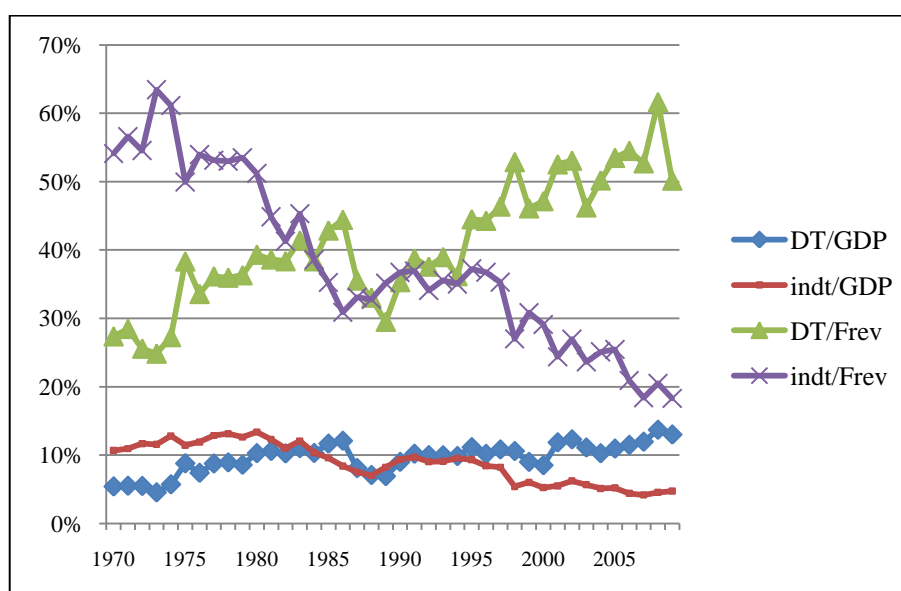
5 year period	% of the federal revenue to GDP	% of total taxes to federal revenue
1970-74	24.92	70.71
1975-79	23.52	75.75
1980-84	26.74	75.12
1985-89	24.41	71.04
1990-94	26.22	62.75
1995-99	22.18	76.85
2000-04	21.65	68.89
2005-09	22.47	67.86

Source: Data gathered from Malaysia Economic Report

Table 4-10: Tax mix - direct and indirect taxes

Average tax ratio (%)	1970	1980	1990	2000	2009
Direct tax					
Direct tax/Fed revenue	27.38	39.32	35.31	47.15	50.16
Direct tax/ GDP	5.41	10.27	9.00	8.51	13.00
Indirect tax					
Indirect tax/ Fed revenue	54.64	51.21	36.73	29.12	18.3
indirect tax/ GDP	10.47	13.38	9.36	5.26	4.75

Source: Data gathered from Malaysia Economic Report



Source: Data gathered from Malaysia Economic Report

Figure 4-28: Change in tax mix relative to GDP and federal revenue.

4.5.1 Direct tax

Over the years both direct tax law and tax system have transformed to a lower tax burden. During the 1970s and 1980s tax reform moved towards broadening the tax base and increase tax revenue to feed the federal consumption.

But tax reform in the 1990s and 2000s was made from a different approach.

Tax strategy instead was geared to promote economic growth for an ultimate

increase of tax revenue. Indeed, tax grew in tandem with GDP nominal and amidst the economic cycle, in fluctuations of “delayed” effect (Figure 4.29).

Lower burden direct tax reform includes abolishment of several direct taxes (tin profit tax, timber profit tax, excess profit tax, estate duty tax and development tax). Taxable income has been narrowed from a world scope to Malaysian derived income. Both the flat tax rates for corporate income tax and scaled progressive tax rates and individual income tax have been reduced to almost a half. The tax system has also been improved to facilitate voluntary income reporting and tax payment, beginning in the 1990.

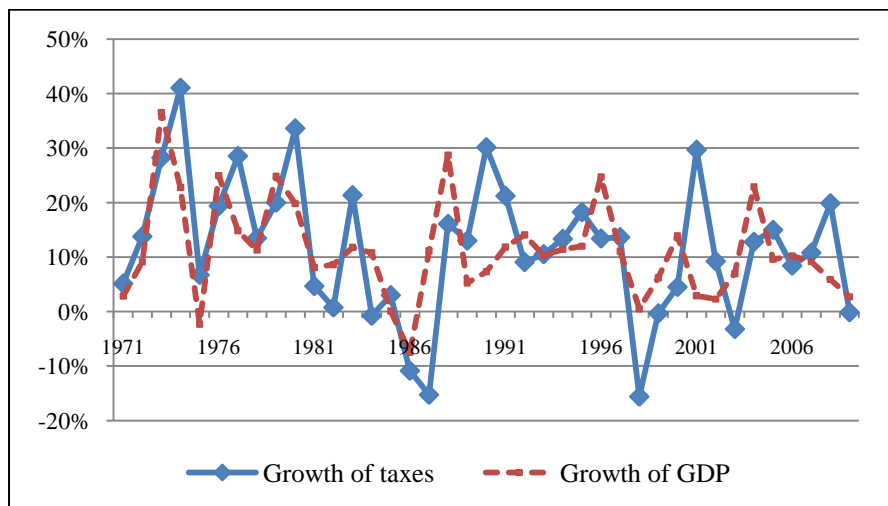
The latest major reform was from formal to self assessment and moving towards voluntary reporting programs with more audit enforcement to curb non compliance. The majority of tax payers of direct taxes are individuals and institutional (majority companies). The individual tax payers are now exempted from tax on chargeable income below a threshold of MYR2,500. For those whose taxable incomes above MYR2,500 are now given wider scope and higher amount of personal tax deductions and rebates. This lower burden tax reform implies that opportunities of UE have been reduced to a certain extent and less individuals fall in the tax bracket.

The institutional tax payers are now granted lucrative tax incentives in specific industries to stimulate aggregate demand and promote economic growth, with a view to making it more efficient and competitive.

Institutional tax payers are the major contributors of direct taxes (Figure 4.30). In the second half of 2000s’ (2005-2010), companies contributed about 47% income tax and 28% petroleum tax while individuals contributed 18% income tax. The remaining 7% taxes were from real property gains tax and stamp duty

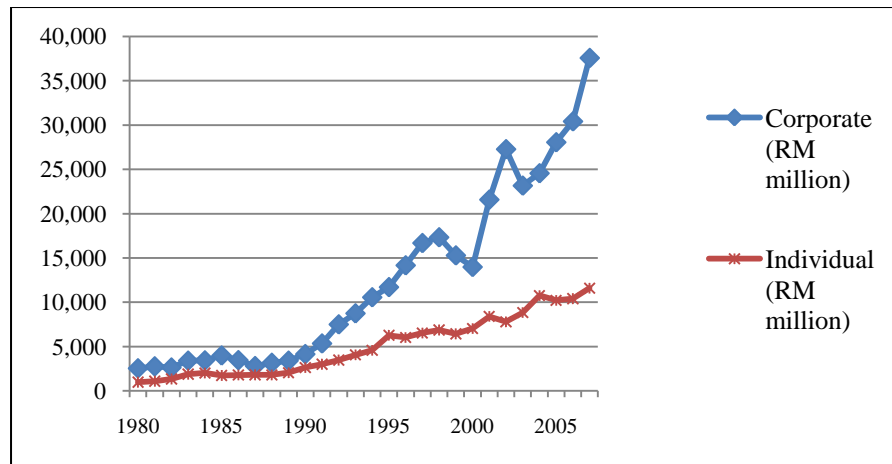
tax, etc. “More corporate taxes compared to individual taxes” (institutional tax is 3 to 4 times more than individual tax) is consistent with the findings of Burgess and Stern (1993) where “corporate taxes are more important than individual taxes in developing countries”.

The present “scaled progressive tax rate” has been fairly agreed as a feasible and desirable tax system, compared to the flat tax rate system. However, as it taxes people with higher income to pay a larger share than those with lower income, it has been criticized as being unfair to people in the higher income bracket. The positive association between income level and larger proportion of income to tax is often said to develop vertical inequity and appear an incentive to evade tax. Private benefit is realized larger in tax evasion at higher tax rates than lower tax rates.



Source: Data gathered from Malaysia Economic Report

Figure 4-29: Growth of GDP and direct taxes



Source: Data gathered from Inland Revenue Board of Malaysia

Figure 4-30: Institutional (corporate) and individual direct tax

4.5.2 Indirect tax

The historical tax rates are summarized in Table 4.5 in Appendix of Chapter 4. The government uses indirect tax as a tool in designing policy measure. Often higher tax rate is imposed to suppress supply and demand or support other policies. For instance, government imposed additional taxes on import tariff or excise duties at fairly high tax rates on certain prohibited activities and the consumption of certain goods. Transformation of indirect tax law to higher tax burden to discourage consumption of certain goods or services, and support other health and societal policies, are meant to suppress its demand and supply in the official economy. But businesses and consumers treat taxes as additional cost to business operation and cost of living.

According to Hubbard & O'Brien (2006), states with high tax system and extensive government regulations to inhibit certain consumptions or services but low enforcement tend to develop a flourishing UE. The effects of increasing tax rates on certain goods in Malaysia are yet to be examined.

4.6 Components of underground economy

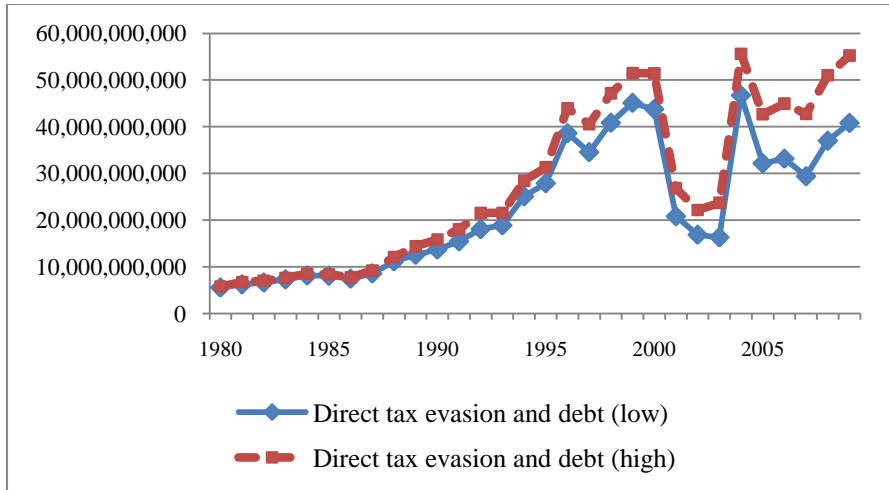
The economic components of UE focused here are the irregular economy and illegal economy, as defined in paragraph 3.1 of Chapter Three. The irregular economy comprise of income of non compliance with tax law. The illegal economy measured here are mainly the income of commercial illicit activities.

4.6.1 Irregular economy

The income of non compliance with tax law consists of activities of non compliance with direct tax law (tax loss arise forms the direct tax gap) and activities of non compliance with indirect tax law (tax loss arise forms the indirect tax gap).

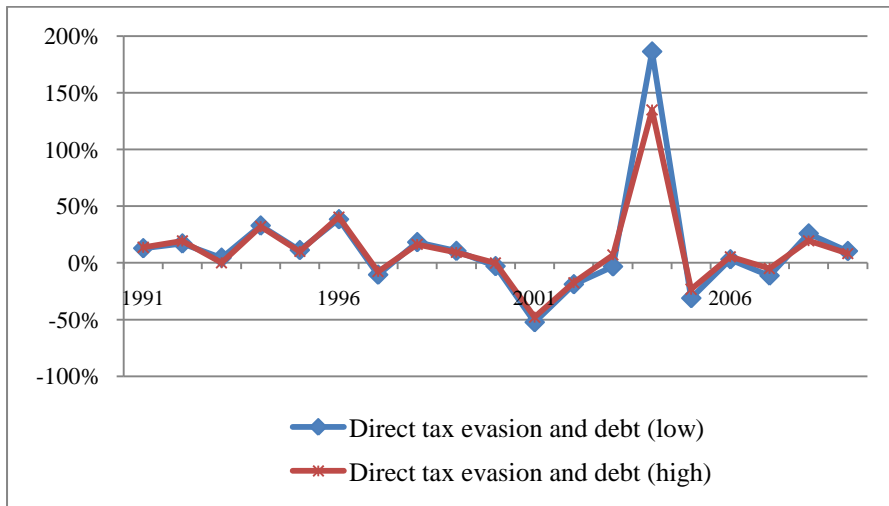
4.6.1.1 Direct tax non compliance (Direct tax gap)

The components of direct tax gap are tax evasion and unpaid tax. Direct tax gap was at MYR 10 billion in the second half of 1980s. It rose to more than MYR 50 billion in 1998, 2004 and 2008. The size range estimates as discussed in Chapter 6 exhibit a wider gap in the post 1997-98 crises compared to the pre period, (Figures 4.31 and 4.32). The trend of a wider gap between the lower and upper estimated series is an indication of an either an enforcement deterioration or a faster UE growth or both, yet to be examined.



Source: Data gathered from Inland Revenue Board of Malaysia

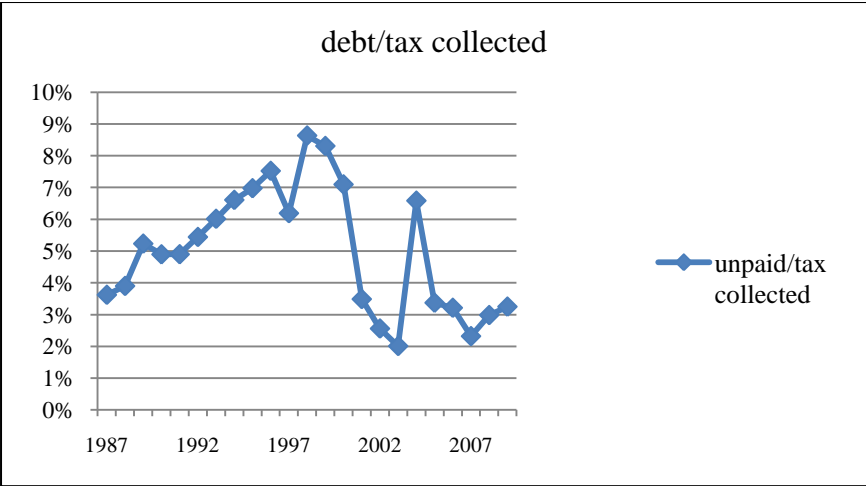
Figure 4-31: Irregular economy (direct tax non compliance) - in absolute value



Source: Data gathered from Inland Revenue Board of Malaysia

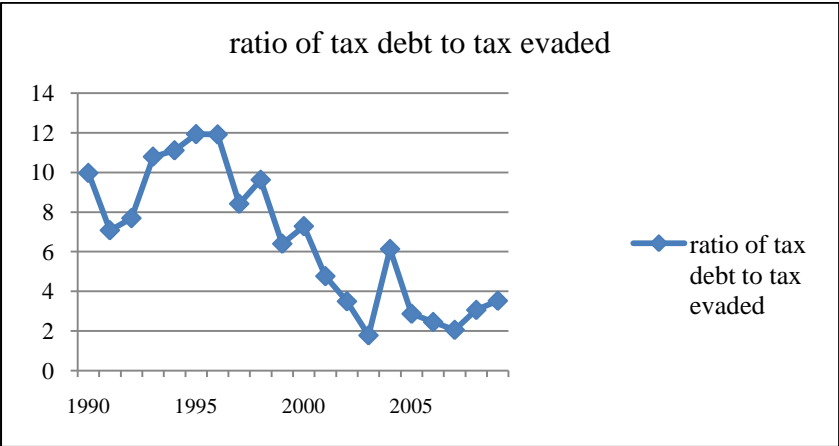
Figure 4-32: Irregular economy (direct tax non compliance) - growth per annum

Over the period of 1987-2009, direct tax gap mix between tax evasion and unpaid tax changes. The percentage ratio of unpaid tax to both tax collection and tax evasion exhibited a downward trend, with a reduction of about 10% to 3% respectively (Figures 4.33 and 4.34). The declining proportion of unpaid tax implies either an improvement of tax collection system or more people are not reporting their income to tax authority. The trend of direct tax gap mix is yet to be examined and discussed in Chapter 5 and Chapter 6.



Source: Data gathered from Inland Revenue Board of Malaysia

Figure 4-33: Percentage ratio of unpaid tax to tax collection



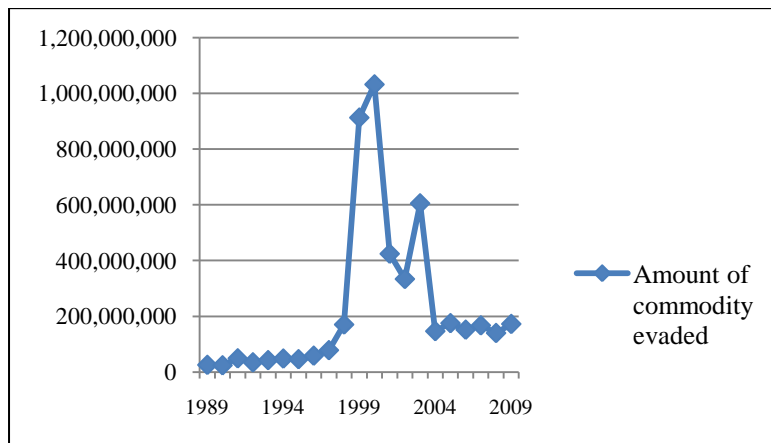
Source: Data gathered from Inland Revenue Board of Malaysia

Figure 4-34: Ratio of unpaid tax to tax evasion

4.6.1.2 Indirect tax non compliance (Indirect tax gap)

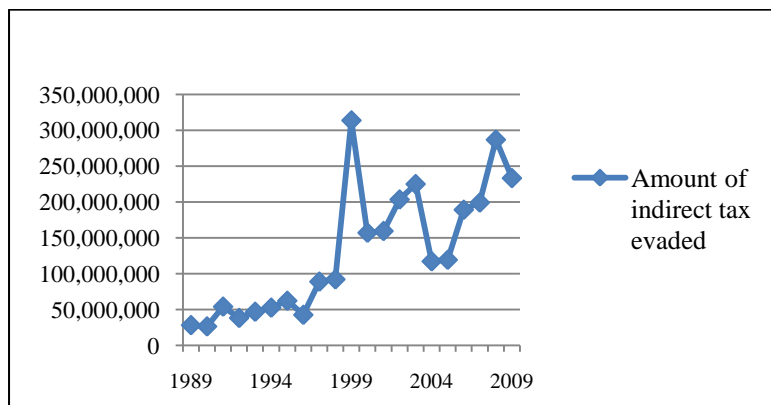
The component of indirect tax gap is mainly tax evasion, with a smaller proportion of unpaid tax. The main activities of indirect tax evasion are smuggling, forgery on import permit, false good declaration such as; low prices, incorrect exemption, age of vehicle, lower quantity of import goods. Smuggling activities are non compliance with rules and law on importation and exportation that are not routed through customs port. Trade mispricing include goods that are not subject to declaration and payment of excise duties

and sales taxes; under invoicing to reduce the import duty; miss declaration of quantity and product description of imports and locally manufactured products to reduce duty and taxes on commodities; smuggling of drugs between countries. The smuggled goods worth, indirect tax evaded and tax debt, all peaked in 1997-99, during the crises period. However the percentage proportions of commodities value and tax evaded are disproportionate as the various goods smuggled were subject to different tax rates ranging from 10% to more than 300% (Figures 4.35 and 4.36 and Table 4.5 of the Appendix of Chapter Four).



Source: Data gathered from Royal Malaysian Customs

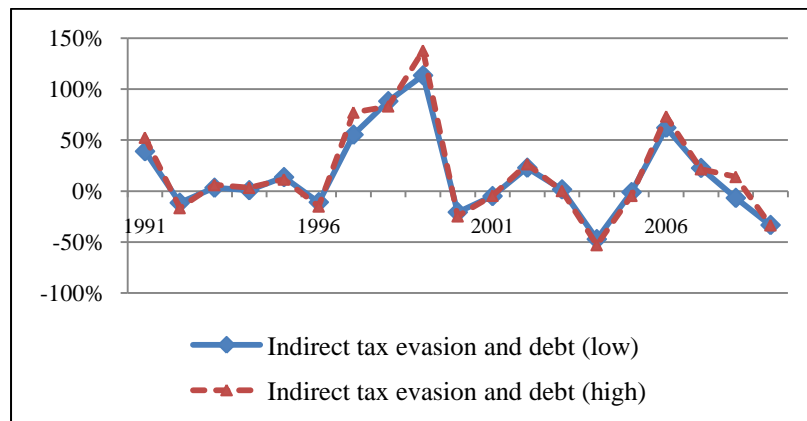
Figure 4-35: Value of total goods smuggled (MYR)



Source: Data gathered from Royal Malaysian Customs

Figure 4-36: Evasion of indirect tax on smuggled goods

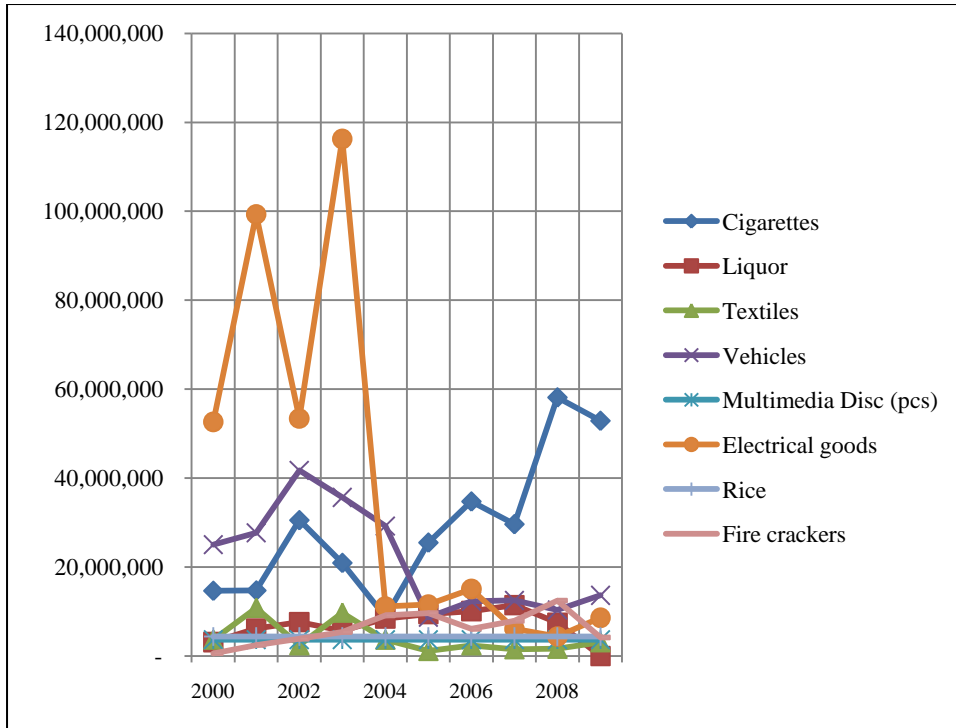
The intermittent up and down slope of indirect tax gap over the years could have been due to retaliation between enforcement and smugglers to overcome each other, depending on non compliant rate, detection rate and enforcement success rate (Figure 4.37).



Source: Data gathered from Royal Malaysian Customs

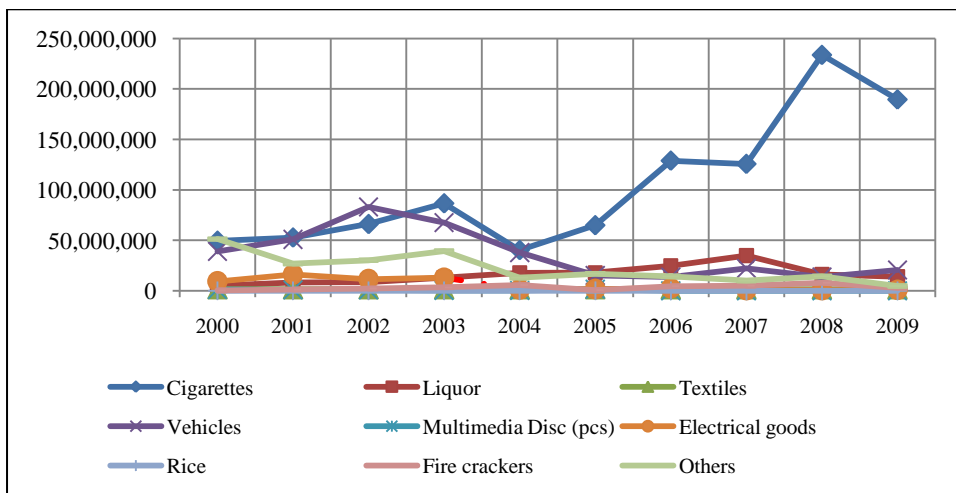
Figure 4-37: Growth of indirect tax non compliance

In terms of commodity value, as in Figure 4.38, electrical goods and vehicles used to be the popular smuggled goods in the 2000-04 period but no longer in 2005-09 period. In contrast smuggled goods such as cigarettes and liquor beverages continuously exhibited an upward trend from MYR 14 million (2000) to MYR54 million (2009). Indirect tax loss from cigarettes and liquor beverages, as well as motor vehicles showed more distinguishable increasing plots compared to discs, electrical and textile goods, Figure 4.39. The common characteristics of cigarettes, liquor beverages and motor vehicles are goods with high tax rates as summarized in Table 4.11. It appeared that increasing the price of goods to discourage consumptions is a failure strategy as suppliers and consumers opt out of the official economy to meet their necessities.



Source: Data gathered from Royal Malaysian Customs

Figure 4.38: Value of various smuggled goods (MYR)



Source: Data gathered from Royal Malaysian Customs

Figure 4.39: Indirect tax evasion across various smuggled goods (MYR)

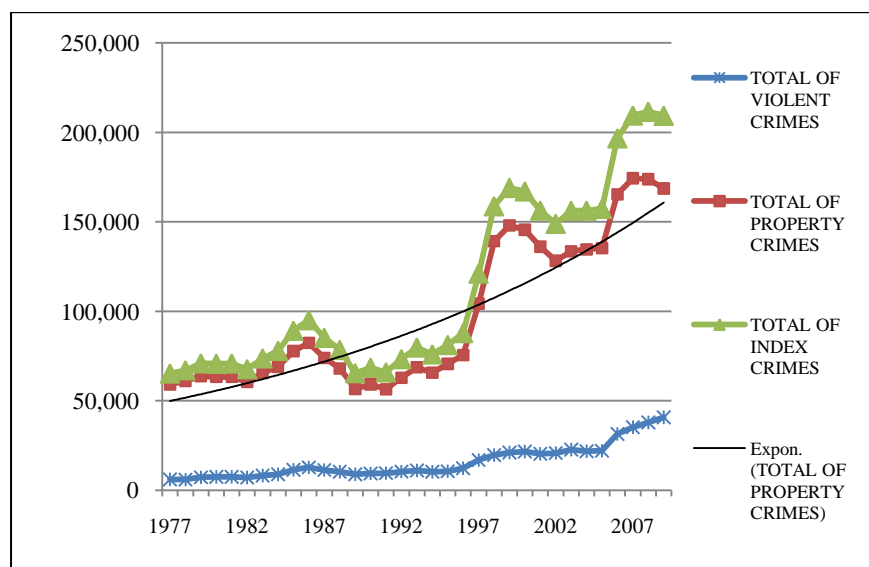
4.6.2 Illegal economy

The components of illegal economy comprise of commercial illicit activities mainly relating to income of drug trafficking, frauds and briberies.

“Recent news reports claimed that Malaysia had lost MYR150 billion in illicit cash outflows in 2009, the fourth highest amongst developing countries, has raised alarm bells, (Malaysian Business, March 2012). Figure 4.43 illustrates the composition of illegal economy comprising activities of bribery, drug trafficking, and other commercial crime. The number of commercial crime exhibited an upward trend as in Figure 4.40 but the illegal income captured were inconsistent, fluctuates (Figure 4.4) and reached its peak in 1997-98 crises (Figure 4.42).

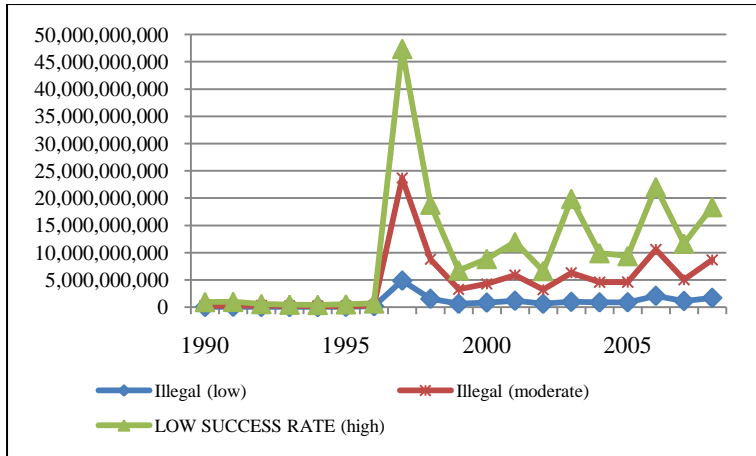
The disproportionate association between number of cases and amount of illegal income is likely due to degree of detection ability, enforcement success rates or cases of inconsistent value.

The income of illegal activities is naturally not reported to tax authority to avoid detection and face criminal laws. If this is true, the income arise could be used to estimate the unreported taxable income of people in the existing tax base and income of people who outside the tax net.



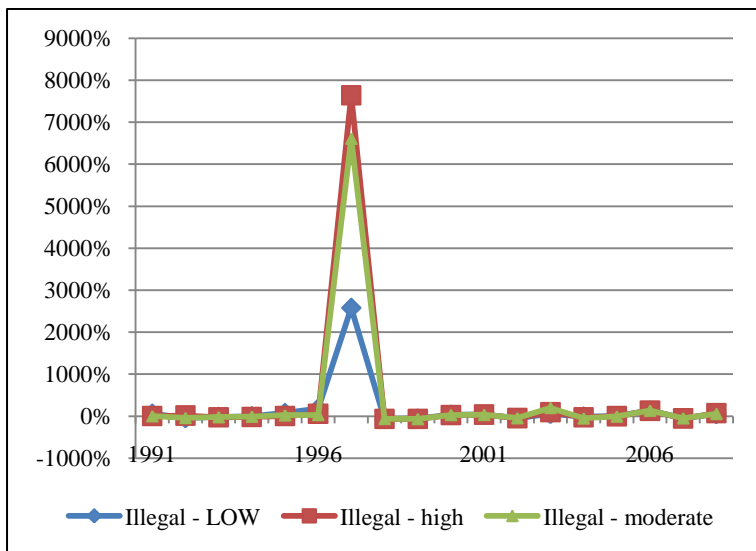
Source: Data gathered from Royal Malaysian Police

Figure 4-40: Number of criminal cases



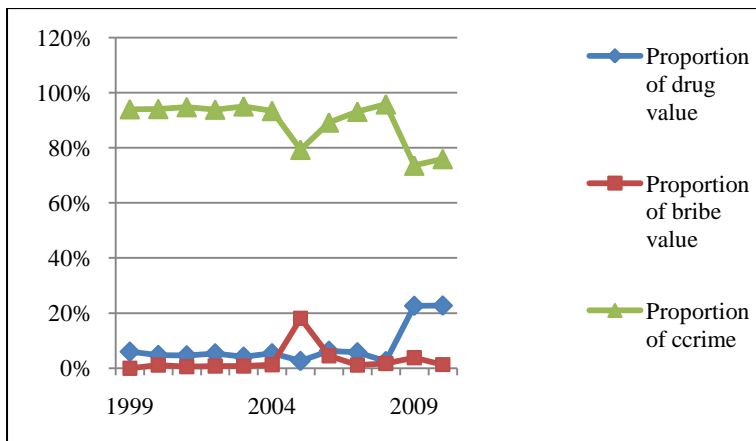
Source: Data gathered from Royal Malaysian Police

Figure 4-41: Income (MYR) of illicit activities (illegal economy)



Source: Data gathered from Royal Malaysian Police

Figure 4-42: Growth of illegal economy



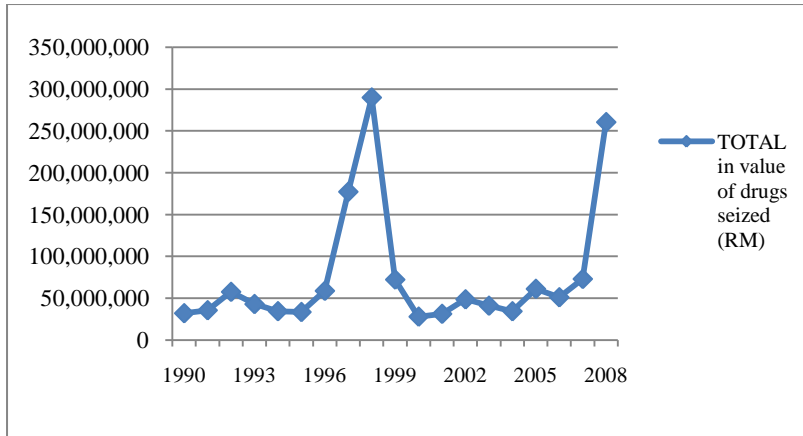
Source: Data gathered from Royal Malaysian Police

Figure 4-43: Activities of illegal economy

4.6.2.1 Drug trafficking

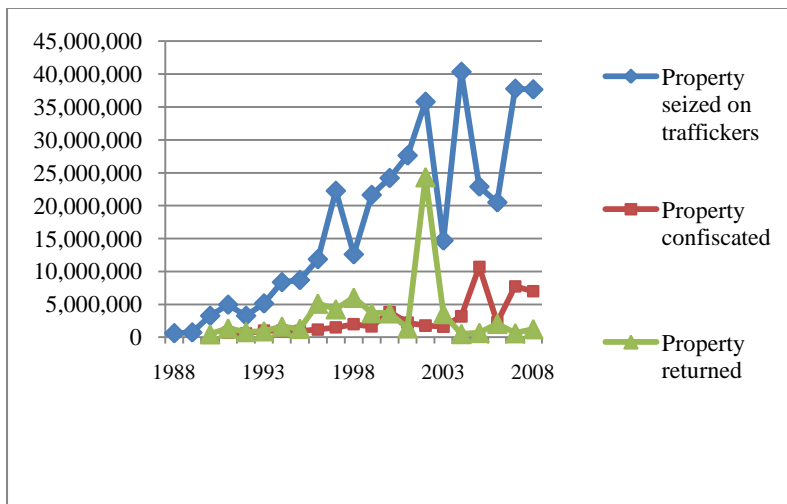
Drug traffickers have been reported as organized powerful syndicates that respect no borders and laws. Anecdotal evidence indicated that the big shanks generally managed to escape using “drug money” to lobby authorities. Ever since the 1980 records the number of drug trade or drug traffickers and the quantity of drugs seized by police and customs forces have been on the rise. Value of drug seized is estimated by the product of quantity of drug seized from drug traffickers and its market price (obtained from police force). Despite increasing number of drug trafficking, quantity and value of drugs seized fluctuates. Disproportionate links between number of cases captured and amount seized could be due to enforcement success rates or/and inconsistent cases, (Figure 4.44).

About 80% of HIV/Aids were diagnosed as due to drug abuse and the majority of drug addicts are within the primary work force age. The consequence of this drug menace is that in addition to a deprived essential labor force, the government has to incur “unnecessary” expenses to remedy health hazard and combat drug trafficking. Despite of rigid drug law enforcement, drugs menace appears endless, drug is continuously smuggled into the country to be processed and re packaged for local users and smuggled out of the country. The “lucrative gains” from drug trafficking were demonstrated as black wealth by police reports (Figure 4.45).



Source: Data gathered from Royal Malaysian Police

Figure 4-44: Value of drugs seized (MYR)



Source: Data gathered from Royal Malaysian Police

Figure 4-45: Value of assets seized - black wealth (MYR)

4.6.2.2 Other illicit or commercial criminal activities

Commercial crimes (ccrime) as illustrated in Figure 4.43, constitute at least 80% of the illegal income. They include; fraud; criminal breach of trust; swindles and cheating; handling of fake credit cards; illegal cash withdrawals from ATMs; forgery; syndicate involving counterfeiting and distributing; gambling; illegal betting; illegal lotteries; shark loans; piracy; and non compliance of Film Censorship Act 1952 (Figure 4.43). About 90% of these commercial crimes constitute activities of fraud and breach of

trust/swindles/cheating, with the remaining 10% comprise of shark loans, forgery, credit-card fraud, cyber, computer and internet fraud.

People with attitude of lust after wealth often end with debts because they tend to gamble. Where banks loans are subject to requirement of collateral and documentation, private money lenders, namely the loan sharks are alternative.

“Ah Long”, the loan-shark operator are underground money lender. They lend money at excessive interest charges that led borrowers to unreasonably high debt. They use acts of intimidation and strong-arm tactics as harassment of loan shark for payment. The number of unlicensed moneylenders is on the rise, for instance about 520 and 870 cases were reported to Malaysian Chinese Association Public Service in 2007 and 2009 respectively. Although this money lender syndicate provides informal jobs and assists the desperate, the criminal harassments and unreported private interest are serious societal economic impacts.

Original copies of soft-wares, VCDs and the related products are often “overprice” because they subject to regulatory costs such as royalty, licensing fees, taxes, etc. But demand in an IT world for these items is on the rise. Alternative to the original copies is to opt for cheaper versions which are the “pirate copies” as they are replicated without regulatory costs. Income of unregulated activities (replication of pirate soft ware and illegal VCDs) is part of UE and will affect film industries as well as the creative communities and those working in the movie distribution line such as cinema and video stores. Besides affecting the economy of the related industries the damage on social costs can be debilitating. Piracy often goes hand in hand with sale of pornographic videos. The sex industry has been reported to associate with

more criminal acts such as cheating and human trafficking. The gap between income of the “pimps” (profit master mind) and “sex workers” (desperate) is often large, an indication of unfair “wealth” and income disparity.

4.6.2.3 Bribery

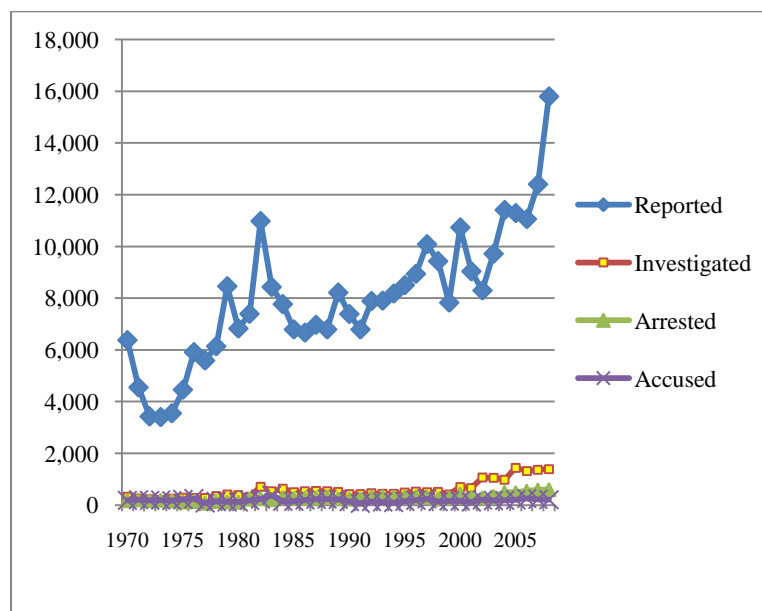
Reports of rampant corruption and illegal practices in Malaysia are alarming, (Morgan Stanley; Transparency International Malaysia (TIM) and; National Transparency Perception Survey (NTPS)). TIM survey relating to public awareness of weaknesses in transparency and integrity, indicated that enforcement agencies tend to focus on petty corruption rather than centering on grand scale corruption. According to NTPS, about 59% of the corporate respondents on corruption by participants group indicate that police forces are the most corrupt institution, followed by political parties and customs. The general perception of corruption in Malaysia is that corruption is somewhat isolated within the elite political and business circles. Several sources also noted the inefficiency of governmental efforts against corruption.

In terms of enforcement, the number of bribery cases reported to Anti Corruption Security, as the agency to enforce law corruptions, increased in about 2.48 folds over a period of 1970-2009. The increased could be either due public are more concern about immoral conducts therefore more reports made or more people are becoming more immoral.

However, the number of reported cases taken for investigation was much lower. About half of the reported cases were classified as “general complaints of unsatisfactory feelings against the authority”, hence not related to bribery activities. Categorizing such activities is very subjective as corruption is a multi faceted crime where it is defined differently according to conditions.

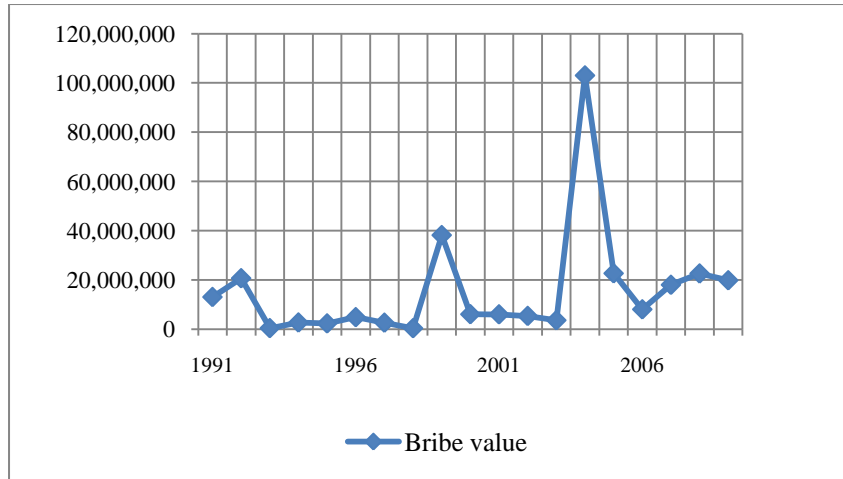
Similar to drug offences, the number of bribery cases and amount of bribery captured is disproportionate, implying various type of cases that involve a wide range of amount taken and the enforcement success rate, as shown in Figure 4.46 – 4.47.

In addition to low enforcement success rate, it also exhibited a declining trend (Figure 6.1), indication of deterioration of enforcement efficiency. Investigation reports also indicated that cases lack of information regarding evidence of guilt to proceed with prosecution charges, resources constraints(officers and courts) and debates on corruption are sometimes have been depoliticized and focus of investigations sometimes shifted to substantive issues or interference of other parties. Literature stated that corruption could be either a cause or consequence of UE. In the case where corruption is a cause of UE, it is important to examine the effect of corruption on UE.



Source: Data gathered from Malaysian Anti Corruption Commission

Figure 4-46: Bribery cases - number of reports, investigated, arrested and accused cases



Source: Data gathered from Malaysian Anti Corruption Commission

Figure 4-47: Amount of bribery captured (MYR)

4.7 Law at curbing and enforcement to deter underground economy

Legal, judicial system and enforcement strengths are important strategies to combat activities in the UE. Law with regards to curbing irregular economy include the provisions of Income Tax Act, 1967 for direct tax; the provisions of Custom's Act 1967, Sales Tax Act 1972 and Excise Act 1976 for indirect tax.

Indirect tax law deals with regulation on import and export of services and custom's main enforcement is to combat activities of smuggling and under invoicing of goods. Direct tax law is about regulation on the reporting of income earned to income tax. To enforce direct tax law enforcement, the Inland Revenue Board (IRB) has to deploy extensive resources such as third party information reports, feasible economic studies and equipped task force.

IRB conducts three main enforcement programs as follows:

- i. Tax audit enforcement to raise tax on unreported income due to act of "minor" evasion attempt.
- ii. Investigation task force to raise tax on unreported income due to

deliberate act of cheating (fraud).

- iii. Debt task force to collect unpaid tax raised on reported income, right up to civil proceedings.

Law with regards to curbing illegal economy includes Prevention Act of Corruption Act 1988, Copyright Act 1987 and Malaysia's Optical Disc Act 2000. To stem the root of drug trafficking and drug abuse in Malaysia, various drug-related offences have been made punishable by law. This includes the provisions under the Dangerous Drugs Act (DDA) 1952 which carries mandatory death sentence and the Dangerous Drugs (Special Preventive Measures) Act 1985, for drug abuse. In fact the war against drug menace extends to exchange information/intelligence from domestic to across borders enforcement. Certain provisions in the drug code of criminal procedure empower the police to seize suspect property and also authorise the court to attach and forfeit the property derived from illicit drug trafficking.

Summary

Malaysian economy has undergone substantial changes since its independence in 1957; the economic structure has transformed from a resource based to market-based and to an emerging multi-sector economy. The impressive development is likely due to collective results of comprehensive efforts on remedial policies, pragmatic implementation steps and tax strategy towards lowering direct tax burden to promote economic growth.

Despite impressive economic indicators for instance the continuous increase of annual household income and per capita income, Malaysia has shown some

anecdotal incidences and visibility of proxy indicators of UE. Indeed the size and growth of UE estimate was at its peak during the period of 1997-98 economic crises, and there have been some structural economic differences between pre and post rises period. They include; lower GDP growth (from 9.3% to 3.9%); rising purchasing price (larger demand to supply); increase electricity consumption (physical resource for economic activities); widening savings-investment gap (from 16.5% to -0.5% of investment growth implying income is not properly steamed or utilised); faster growth of immigrant workers and moderate unemployment rate coupled with rising commercial crime and smuggled goods (creation of informal jobs for jobless as survival line); widening of skew income distribution (the equity index barely improved implying a distortion of “opportunity” leading to income disparity); high growth of private expenses (signifying a spendthrift culture); rising cash in circulation in large denomination despite of alternative financial means (common medium of exchange in underground transactions); citizens’ dismay and dissatisfactions over “profligacy” (reflecting refusal of sharing income earned to taxes); a shift of federal surplus to rising federal deficit exceeding 10 year period (federal expenditure grew faster than federal revenue denoting fiscal imbalance); lower tax/GDP ratio (from 18% to 15% - tax is inelastic to GDP); rising indirect tax burden (incentives of smuggling), and substantial change in tax mix revenue from indirect to direct tax (signifying more opportunity to evade).

The UE value in total and in its components (irregular economy [direct and indirect tax non compliant] and illegal economy [criminal activities]) as well as tax gap [tax evasion (under report and non filing) and tax debt],

continuously increase, grew with GDP. However, its growth was in the opposite direction of GDP (and GDP per capita), during recession and booming time. The country's economic performance is impressive but the impacts of a flourishing UE and inequality may cause a faltering image to the country; the gross violation may outrage public opinion and affect tax morale or voluntary compliance; the rising federal expenditure could deplete decade worth of country's effort towards high income economy; and the impacts of UE could not tarnish the rising GDP per capita. The anecdotal evidence and exploratory analyses put forward compel visibility of indicators of a flourishing UE, and spurs calls for a further examination on the extent of size, trend, characteristics and variable correlations.