CHAPTER VI

CONCLUSION

Joint-Fund Contribution

Malaysia as a political and economic entity was established by the Malaysia Bill[1]. According to Annex J of the agreement, which governed the financial and economic arrangements pertaining to Singapore when she joined Malaysia, Singapore agreed that the Federal government should receive 40% of federal revenue derived from Singapore. She further agreed that the federal government should have overriding powers of taxation as well as in other fiscal and economic fields. As a result of this agreement the federal government obtained the following sums of money while Singapore was still part of Malaysia.

Federal Government's Share (40%) of Receipts of the Joint Fund.

1964	\$119,922,115
1965	\$150,573,728 (Revised Estimates \$87,600,000)

Originally, the 1965 figure was more than \$150 million but since Singapore left Malaysia, on the 9th of August 1965, the revised estimates show a decrease of over \$65 million. It may also be noted here that the Separation Agreement expressly provided that Annex J was to be regarded as no longer binding on both parties.

At the moment there is widespread speculation on the future Malaysia - Singapore relationship. While economically speaking a "customs area"[2] might be of benefit to both Singapore and Malaysia, the very separation of Sinapore is sufficient notice that relationships between the two countries, economic or otherwise, have taken on a political tone.

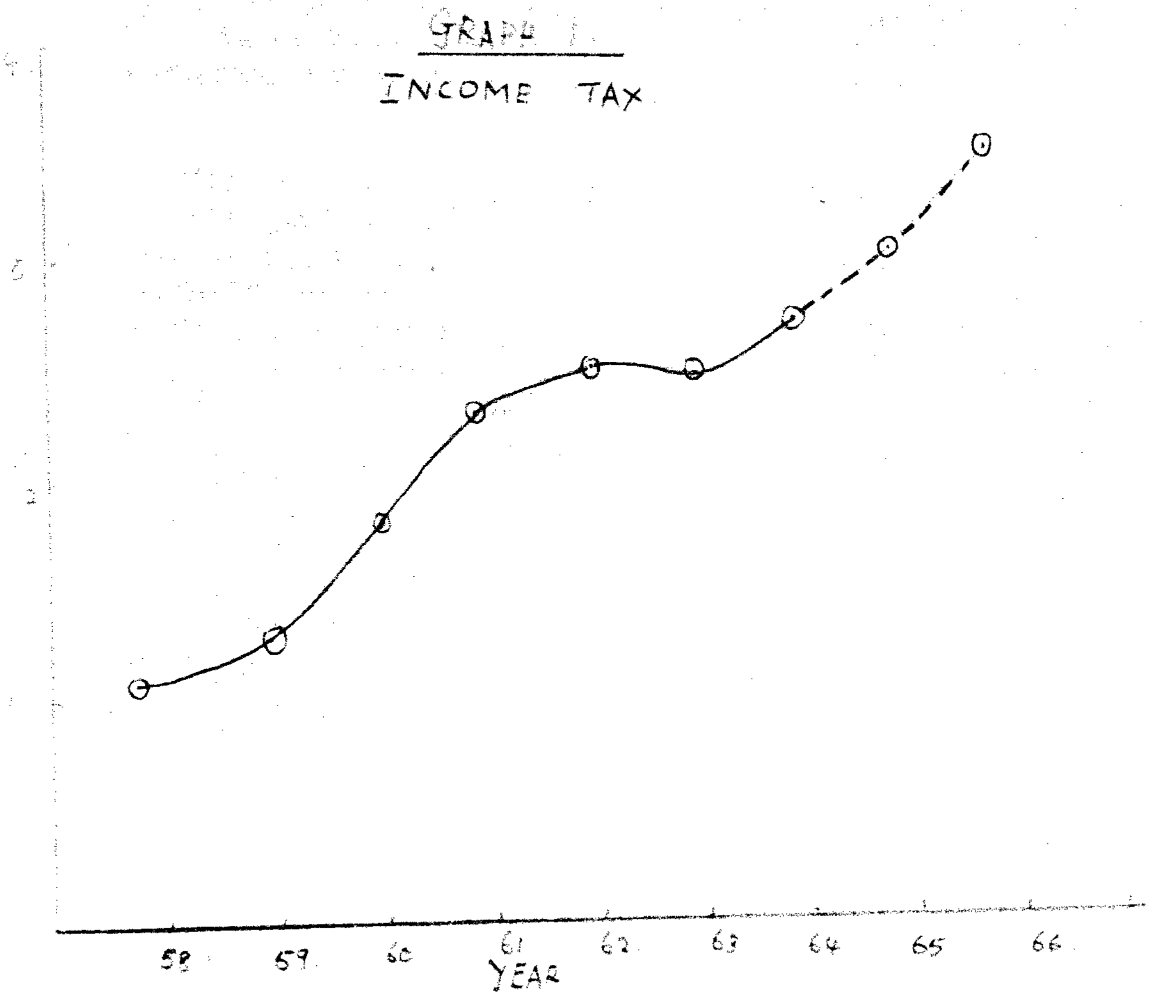
---

[1]Malaysia Agreement concluded between the Federation of Malaya, United Kingdom of Great Britain, and North Ireland, North Borneo, Sarawak and Singapore, 1963. Government Printer.

[2]1966 Supply Bill op. cit. page 26.

Sources of Tax Revenue

Graph 1 shows the rising trend of income tax over the years.



Currently income tax contributes around 25% of total revenue. As such, income tax is not an instrument of mass taxation in Malaysia. Therefore it cannot be used as an anti-inflationary measure as can be done in developed countries. Increases in the significance of income tax contribution is a desirable feature because it provides an element of equity which no other tax can provide in the same degree. But before any improvement can be made in this direction there is a need:

i) to improve the rate structure of income tax in Malaysia;

ii) to readjust the provisions with regard to reliefs and exemptions,

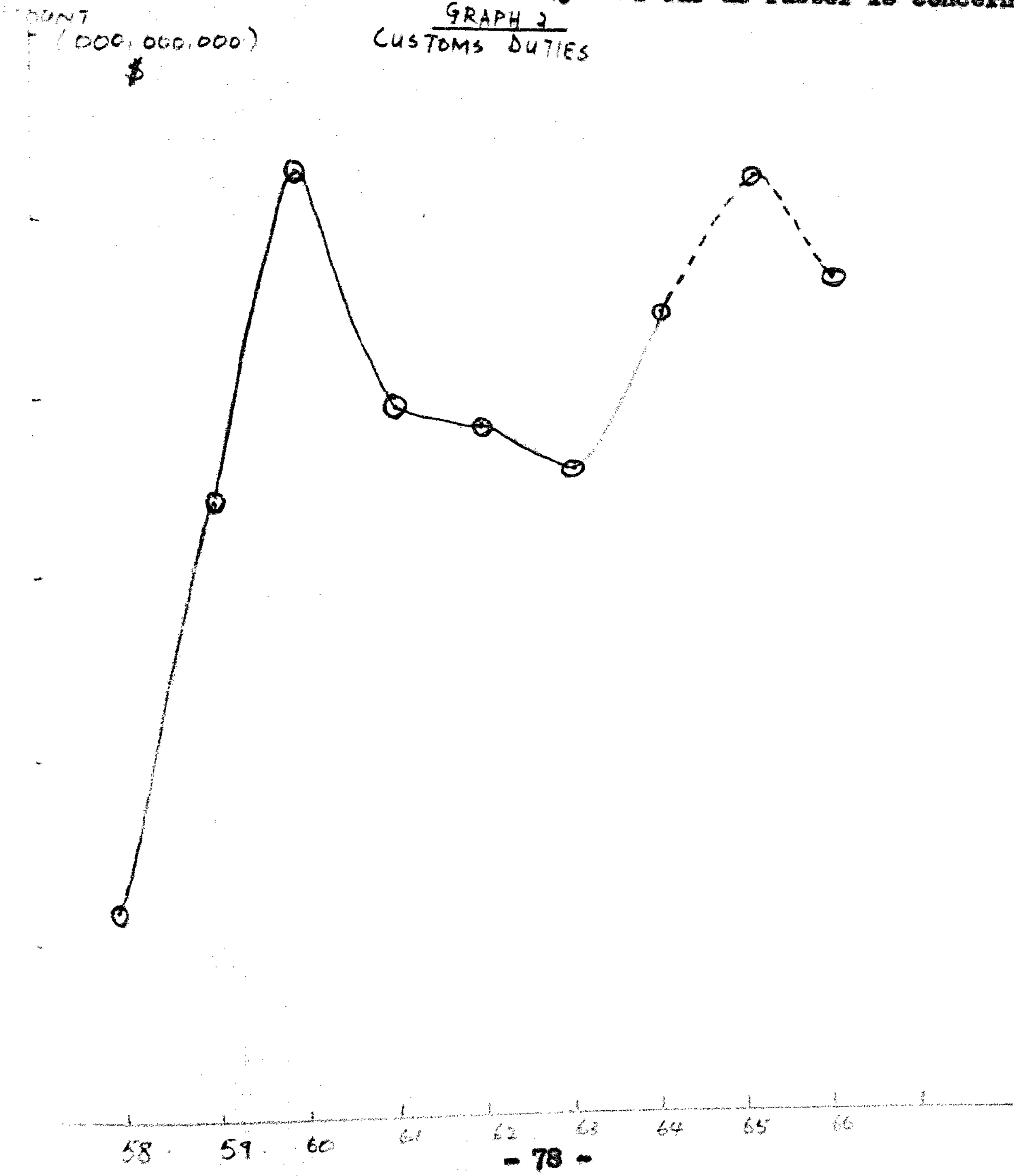
iii) to harmonise the differences in income tax within the different regions of Malaysia

iv) and possibly apply progressive rates to company taxation.

The most notable feature of customs duties is a decline in its importance over the years. Graph 2 depicts the fluctuating nature of customs revenue. Nevertheless, customs duties still form the most important source of revenue as far as the federal government is concerned. The share of export duties as well as the contribution of import duties to total revenue has tended to decline. More important than this decline are the extreme fluctuations and their adverse implications on the economy.

The purpose of advalorem customs duties appears to be to skim off excessive profits and thereby avoid inflationary pressure. But the anti-inflationary effect depends not so much on the ad valorem rates that are applicable but more so on the use made of the additional funds obtained from such duties. In the case of Malaysia, it is apparently very unsafe to rely on customs duties very heavily. Export duties revenue seem to fluctuate considerably. As far as rubber is concerned

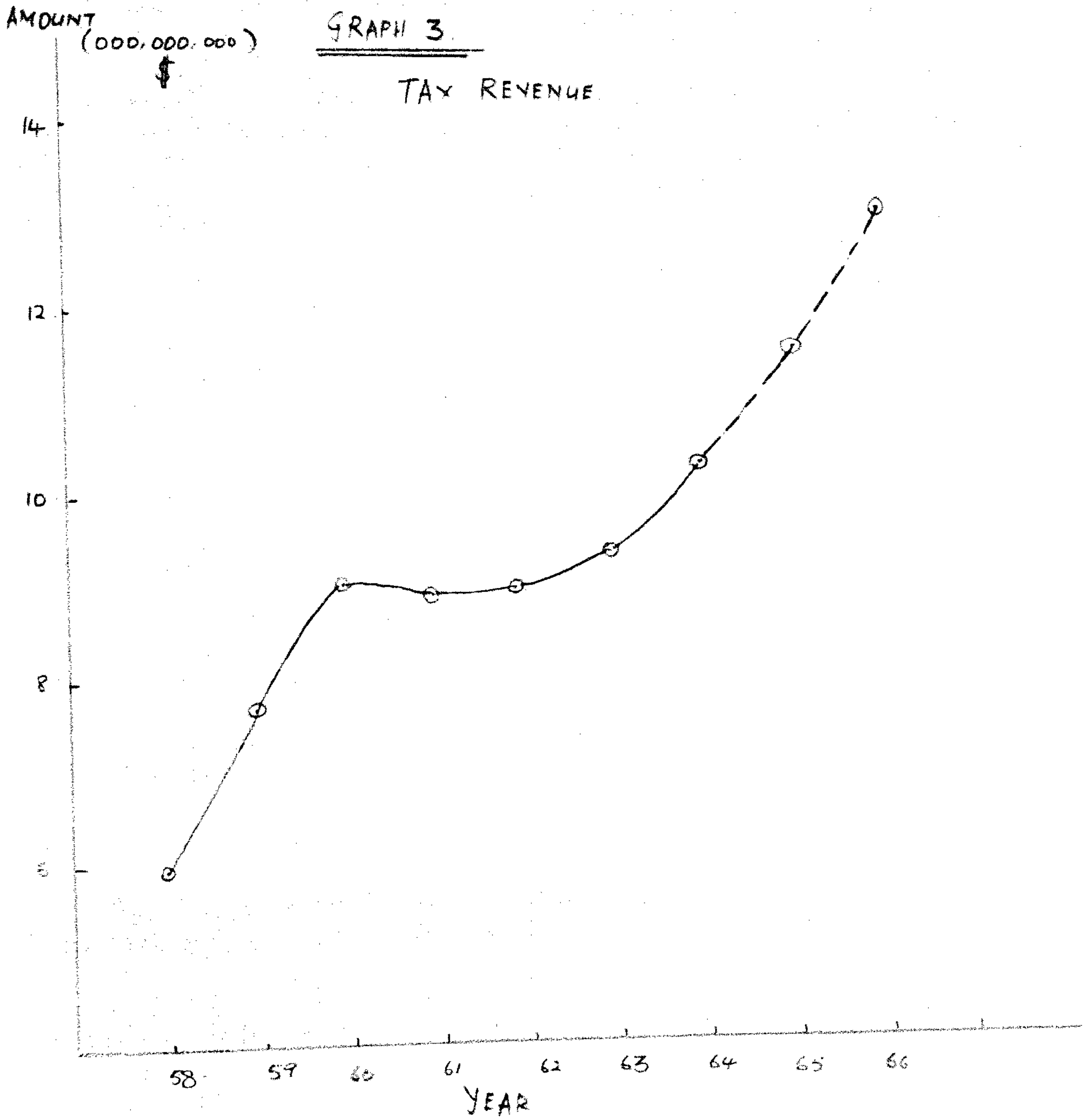
GRAPH 2
CUSTOMS DUTIES



there has been a general tendency for prices to decrease and there remains a possibility of further declines as a consequence of major technical advances in synthetic rubber. At best, revenue from tin might show a slight increase but revenue from this source will probably stagnate before a rapid decline. Export duties, as we have seen, have been decreasing both in absolute and relative terms. Licences also show a tendency to increase in absolute amount but no so in its share in total revenue. Both excises and licences are free of excessive fluctuations and in that sense are more predictable and reliable as a source of revenue.

Tax Revenue

Graph 3 indicates the growth of tax revenue in recent years. Except in 1961, every year has shown an increase over the previous year's level. The biggest jumps have occured in 1960 and 1964. The 1965 level is also expected to be much higher than the 1964 figure.



The 1960 increase was largely caused by increased revenue from customs and inland revenue. The 1964 tax revenue increase was the effect of large increases in inland revenue and in excise revenue. The revenue increase from customs duties was not extremely important in that year. The anticipated increase in the 1965 tax revenue is expected to be caused by a reasonable increase in inland revenue and customs duties and as a result of the new taxes introduced that year.

A Brief Comparison[3]

In the case of the United Kingdom, inland revenue contributed 54.78% of total revenue for the financial year 1964/1965; and estimated 56.00% in 1965/1966. For the same periods customs and excise are expected to produce 42.69% and 41.13% of total revenue. The difference with Malaysia is that while we rely heavily on customs revenues the United Kingdom economy is more dependent on inland revenue. In other words, the United Kingdom government derives most of its revenue from direct taxation, while in Malaysia most federal revenue comes from indirect taxation. In the case of Malaysia then, there is heavy emphasis on commodity taxes and taxation of exports and imports. There is a heavy dependence on price movements for any increases in revenue. Malaysia, unlike the United Kingdom, exhibits excessive fluctuations in revenue and consequently our economy is vulnerable to world market conditions lying outside our control. Furthermore, in an advanced country like the United Kingdom, tax policy tends to accept the level of expenditure as its revenue goal; the sequence runs from expenditure to taxes. But in Malaysia, like in other under-developed countries, the level of expenditure seems to depend much more heavily on the ability of the tax system to place the required revenues at the disposal of the government; the sequence then runs from taxation to expenditure. When we compare the Malaysian structure to that of the United Kingdom, one other distinguishing feature is the low contribution of non-tax revenue to total revenue in the case of the United Kingdom. The equivalent figure for Malaysia is around 20%.

Some Recent Developments

1. As from 12th June, 1967, the Malaysian dollar will be on parity with gold. However, the present rate of exchanges with sterling at 2s. 4d. is to be maintained.

2. Malaysia and Singapore will issue their own currency when the Currency Board ceases to function on June 12th 1967.[4]

---

[3] Figures for the United Kingdom calculated from data obtained in Public Finance in Britain. Central Office of Information. 1965.

[4] Straits Times, Friday, August 19th 1966. Page 1. Column 1.

3. On the 19th of August, 1966, the Malaysian government scrapped Commonwealth preferential rates of import duty on a wide range of articles ranging from textiles to musical instruments to motor-cars. Also removed were the preferential rates attached to the registration rates on motor vehicles. Instead as from 19.8.1966, registration rates of motor vehicles are to be based on the open market value of the vehicle.

Harmonisation

The International Bank for Reconstruction and Development felt that "there are some important contrasts in economic structure," but "these need not prove an important or inseparable obstacle to a fruitful political and economic union".[5] Common tax rates appear to be very necessary towards economic integration. Harmonisation implies the complete elimination of tariff and other trade barriers to the circulation of local goods throughout Malaysia and the imposition of the same import duty on like products originating in countries outside Malaysia. Such harmonisation will lead to greater opportunities for local producers. But obviously, harmonisation and greater economic co-ordination are by themselves not sufficient, although they make a substantial contribution towards solving our economic problems.

The harmonisation of duties and tariffs should be preceded by a detailed study in which economic co-ordination should be given as much consideration as revenue preoccupations. Currently little has been done by the Tariff Advisory Board[6] and the process of harmonisation needs to be speeded up.

Conclusion

The financing problem is probably going to assume major proportions. As current expenditure increases and as current revenue might at best indicate only a slow growth at the present tax rates, the contribution to investment from the current surplus will be substantially lower. There is a need for a constant review of our tax system as a whole and to make alterations whenever it is required. The problems and drawbacks of our tax system are not the fault or responsibility of the government alone. The public in general has a role to play in improving our tax system. Worth mentioning are the conditions as recommended by the United Nations Technical Assistance Administration,[7] for an efficient tax system to develop.

---

[5] Report of the Economic Aspects of Malaysia by a Mission of the International Bank for Reconstruction and Development. July 1963. Government Printer. Page 8.

[6] For some recent changes see Bank Negara - Annual Report and Statement of Accounts 1965, page 21.

[7] Taxes and Fiscal Policy in Under-Developed Countries, op.cit. Page 20-21.

i) existence of a predominantly money economy,

ii) a high standard of literacy among taxpayers,

iii) maintenance of proper accounting records, honestly and reliably maintained,

iv) a large degree of compliance on the part of tax payers and the readiness to accept the ability-to-pay principle.

In general terms, a change of our tax system and tax structure seems inevitable. Any future change has to be viewed in the context of certain objectives of a tax policy. Our tax structure should make available for economic development the maximum flow of human and material resources. It should also be able to maintain resonable economic stability in the face of long-run inflationary pressure and short-term international price movements. Our tax structure, should finally be able to reduce any inequalities of wealth, income and consumption standards.