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The need for fiscal reforms supersedes oil price windfall – Economists

KUALA LUMPUR: The sharp increase in the Brent crude oil price to more than US$100 per barrel compared to the estimated oil price of US$66 per barrel when Budget 2022 was tabled will be a net positive for the government, but fiscal reforms are more pertinent as oil prices may not remain at current rates indefinitely, experts said.

It is estimated that the government might need to fork out RM28 billion for 2022 subsidies if the oil price remains above US$100 per barrel compared with RM11 billion for 2021.

"So there are two points to consider: first, (oil) prices may not remain high indefinitely, and second, the increase in revenue is estimated to be around RM16.95 billion, and the RM11 billion subsidy allocated last year meets the estimated RM28 billion this year, so it is covered," Malaysia University of Science and Technology economics professor Dr Geoffrey Williams told Bernama.

Although he believes that the oil price windfall will be sufficient to fund price controls, fiscal reforms of food and fuel subsidies alike embarked by the government would be required to ensure that the subsidies benefit the targeted groups.

Finance Minister Datuk Seri Tengku Zafrul Abdul Aziz said the government will review the fuel and cooking oil subsidy mechanism, so that it will be more targeted towards aiding and subsidising the vulnerable groups and those who really need help.

"The implementation of targeted subsidies is expected to optimise the government's financial resources and the savings achieved can be redistributed for more effective programmes to contribute to the well-being of the people," he told the Dewan Rakyat recently.

Tengku Zafrul said the current subsidy scheme entails subsidised prices enjoyed by all, regardless of rich or poor. Furthermore, he said the high-income group is enjoying more subsidies based on a greater level of consumption compared to the low-income group.

According to research from Asean+3 Macroeconomic Research Office (AMRO), a US$1 increase in oil prices adds RM646 million to Malaysia's gross domestic product (GDP), RM339 million to government revenue and 0.03 per cent to the Consumer Price Index (CPI).

Thus, with a US$50 increase, it adds RM32.3 billion to GDP, RM16.95 billion to government revenue and 1.5 per cent to the CPI.

"As for inflation, since headline CPI is falling and CPI without oil is below 2.0 per cent, as well as core inflation below 1.0 per cent, the impact on inflation will be modest overall, and if the oil price rises taper off, that is they are short-lived, then the inflation effect is temporary," Williams said, emphasising that the situation is all uncertain because of the ongoing conflict between Russia and Ukraine.

He asserted that the current situation has added a lot of uncertainty to forecasts for Malaysia growth because official forecasts depend a lot on external global demand which will be affected on the downside by this terrible conflict.

"This is why for growth we are currently cautious around 3.5 per cent this year," he added.

On inflation, he said higher oil prices raise Malaysia's GDP and government revenue but this is used for subsidies, which will keep petrol station prices low for RON95 but diesel will rise and so transport costs will rise and may be passed on to consumers in the CPI.

"Overall, with headline inflation falling to 2.3 per cent in January and inflation without oil, as well as core inflation both being very low, we maintain our view that inflation in Malaysia will be modest and there is no need for higher interest rates.

"But the uncertainty due to Ukraine is very high so we need to monitor closely," he added.

Likewise, Bank Islam Malaysia Bhd chief economist Dr Afzanizam Abdul Rashid said the timing is not right to remove fuel subsidies at the moment and that doing so would significantly increase the rate of inflation and may cause other prices to rise as well.

Asked if the government's coffers could absorb the impact of increased fuel subsidies, he said the government is still benefiting from the rise in fuel prices through the expected higher collection in petroleum income tax, export duty, petroleum royalty, and dividend income from Petronas, which is estimated to be about RM44 billion in the most recent 2022 Fiscal Outlook and Federal Government Revenue Estimates.

"According to the most recent information from the MoF (Ministry of Finance), fuel and cooking oil subsidies total around RM8 billion and assuming that the figure has tripled, the subsidies could amount to around RM24 billion, which is still a net positive for the government.

"Given the current circumstances, removing fuel subsidies now would do more harm than good. However, when it comes to subsidy removal, there is no such thing as a perfect time and it's a very delicate balancing act," he added.

He emphasised that the main issue is that fuel subsidies are not targeted, thus, there are wastes because the high-income group benefits more from fuel subsidies.

"As a result, fiscal reforms would be required, but the tricky part has always been timing. The government should begin by creating an awareness campaign about the need to rationalise fuel subsidies.

"This is to ensure that the rakyat will fully support the initiative from the start. Second, there must be a clear and effective mechanism in place to target subsidies. Ideally, the market should decide on fuel subsidies, and fuel subsidies should be redirected to direct or cash transfer programmes," he said.

He reiterated that fiscal reform could be a significant challenge when irresponsible businesses seek to profit from the situation, thus, issues relating to the enforcement of existing laws pertaining to prices, as well as any policies that have been prescribed, should be well thought out and clearly communicated to stakeholders, with a reasonable timeline for implementation.

Meanwhile, CLSA Ltd senior economist Anthony Nafte believes that rising energy prices will exacerbate the slowdowns in developed economies, putting pressure on Asian export growth this year.

"Malaysia has yet to adjust domestic fuel prices," he said, adding that, "The country is taking a bigger hit on subsidies and will apply more pressure on the fiscal side, which then risks the fiscal position in terms of infrastructure spending to support growth going forward."

Surging oil prices, which currently stood at US$115 per barrel, amid the geopolitical tensions between Russia and Ukraine have stoked fears of global inflation.

The Department of Statistics Malaysia said the CPI increased 2.3 per cent to 124.9 in January 2022 from 122.1 in 2021, surpassing the country's average inflation for the period of 2011 to January 2022 (1.9 per cent). – Bernama

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