

# "Readjust subsidy allocation but tread with caution"

By **S Birruntha** - August 18, 2023 @ 8:04am



The 2024 Budget should advance adjustments in subsidy allocation with a specific focus on rationalising electricity and diesel subsidies, economists suggest. NSTP/ASWADI ALIAS.

KUALA LUMPUR: The 2024 Budget should advance adjustments in subsidy allocation with a specific focus on rationalising electricity and diesel subsidies, economists suggest, but tread with caution.

Economists warned against undertaking excessive austerity measures as Malaysians are still reeling from the rising cost of living.

Malaysian Institute of Economic Research economist Dr Shankaran Nambiar said some adjustments will likely be required for the upcoming national budget in relation to subsidy rationalisation.

"It is likely unavoidable that we will need to fully commit to this rationalisation process," he said, adding that the best way to start would be to introduce targeted subsidies.

"Electricity has been subsidised for a long time and it would be a good choice. The commercial users could be brought closer to market price, while those in the B40 could be exempted from tariff increases," he told the New Straits Times.

Nambiar said the other option would be to relax the subsidy for all, with cash handouts or other compensating payments being made for those in targeted income groups.

It would be unwise to undertake excessively restrictive austerity measures, as the rakyat are already under pressure from the rising cost of living, he cautioned.

He noted that although the rate of inflation is coming down, the price levels of food and cost of eating away from home are high.

"Under these circumstances, subsidy reductions will have to be made judiciously. There is no reason why those in higher income brackets have to benefit from subsidies in the same way that the less well-off are – petrol subsidies are a case in point.

"But we must find the right mechanisms to do this," Nambiar added.

Bank Muamalat Malaysia Bhd chief economist and social finance head Dr Mohd Afzanizam Abdul Rashid concurred that the government should advance subsidy rationalisation.

However, he said the current issue is that the existing subsidies are not targeted specifically for fuel, and the high-income earners are the ones who are benefiting the most.

"It also leads to other problem such as smuggling and leakages when foreigners using our petrol. More importantly, it will distort the price discovery mechanism as prices are being kept artificially low.

"This will result in misallocation of resources, leading to inefficiencies," he said.

Afzanizam expects more cash transfer programmes from the government in the budget to help eligible recipients to face the rising cost of living.

Malaysia University of Science and Technology economist Dr Geoffrey Williams said subsidy rationalisation should continue to be a priority.

He noted that a lot of progress has been made on utilities prices, but the biggest area is still in petrol and diesel.

"Subsidies on food production and price controls should also be cut now. There have been some subsidies sneaking in through the Rahmah programmes. These are small bit significant in distorting markets," he said.

Williams said cutting subsidies on products and price controls should be replaced by assistance in raising incomes through reverse tax credits and cash transfers.

He emphasised that these methods directly benefit the recipients while eliminating middlemen.

Cutting subsidies, he said, also saves money, while shifting to income support instead of subsidies is cheaper, more efficient and more direct to those in need.

"The government can afford this spending and can also make savings to accommodate the reallocation of funds," he added.

Centre for Market Education chief executive officer Dr Carmelo Ferlito believes that the government should initiate a process of subsidy rationalisation, starting with electricity and diesel subsidies in the budget.

However, he advocated for a gradual approach as the optimal strategy to embark upon.

Ferlito also maintained that if subsidies are eliminated but substituted with alternative forms of assistance, then most of the removal benefits will vanish.

"Subsidies distort demand and production structure, impacting the price system and they hide real inflation. They should not be replaced by other distortionary tools," he said.

On that note, Ferlito said reducing government expenditures is favourable, and the government should foster economic growth through institutional reforms and by assuming a less involved role in the economy.

"That is the best way to create wealth and thus help the poor," he said.