GSI Global Subsidies Initiative

iisd International Institute for Sustainable Development / Institut international du développement durable

RESEARCH REPORT

Lessons Learned: Malaysia's 2013 Fuel Subsidy Reform

Anna Bridel
Lucky Lontoh

March 2014

Published by the International Institute for Sustainable Development.

About IISD

The International Institute for Sustainable Development (IISD) contributes to sustainable development by advancing policy recommendations on international trade and investment, economic policy, climate change and energy, and management of natural and social capital, as well as the enabling role of communication technologies in these areas. We report on international negotiations and disseminate knowledge gained through collaborative projects, resulting in more rigorous research, capacity building in developing countries, better networks spanning the North and the South, and better global connections among researchers, practitioners, citizens and policy-makers.

IISD's vision is better living for all—sustainably; its mission is to champion innovation, enabling societies to live sustainably. IISD is registered as a charitable organization in Canada and has 501(c)(3) status in the United States. IISD receives core operating support from the Government of Canada, provided through the International Development Research Centre (IDRC), from the Danish Ministry of Foreign Affairs and from the Province of Manitoba. The Institute receives project funding from numerous governments inside and outside Canada, United Nations agencies, foundations and the private sector.

Head Office
161 Portage Avenue East, 6th Floor, Winnipeg, Manitoba, Canada R3B 0Y4
Tel: +1 (204) 958-7700 | Fax: +1 (204) 958-7710 | Website: www.iisd.org

About GSI

GSI is an initiative of the International Institute for Sustainable Development (IISD). GSI is headquartered in Geneva, Switzerland and works with partners located around the world. Its principal funders have included the governments of Denmark, the Netherlands, New Zealand, Norway, Sweden and the United Kingdom. The William and Flora Hewlett Foundation have also contributed to funding GSI research and communications activities.

International Institute for Sustainable Development
Global Subsidies Initiative
International Environment House 2, 9 chemin de Balexert, 1219 Châtelaine, Geneva, Switzerland
Tel: +41 22 917-8373 | Fax: +41 22 917-8054

Lessons Learned: Malaysia's 2013 Fuel Subsidy Reform

March 2014

Prepared by: Anna Bridel and Lucky Lontoh

Acknowledgements

The Global Subsidies Initiative (GSI) of the International Institute for Sustainable Development (IISD) would like to thank the following peer reviewers, who kindly dedicated their time to providing comments on this study:

- Anthony J. Jude, the Asian Development Bank
- Masami Kojima, the World Bank
- Dato' Paul Selvaraj, the Federation of Malaysian Consumers Associations

Peer reviewers' feedback greatly improved the publication. Any mistakes remain the responsibility of the authors.

This work could not have been undertaken without the generous support of Denmark's Ministry of Foreign Affairs (MoFA), the Swedish Ministry of the Environment (MoE) and the Norwegian Agency for Development Cooperation (NORAD). The views expressed in this report do not necessarily reflect the views of these funders and should not be attributed to them.

Table of Contents

List of Figures

1. Introduction

On September 2, 2013, Malaysia's Prime Minister, Datuk Seri Najib Razak announced that the price of diesel and RON95 petrol would increase by 20 sen (US$0.06) overnight, and that cash transfers would be increased to mitigate the impact on the poor. Subsidies for sugar were reduced at the same time.

The partial reform was largely a response to Malaysia's fiscal deficit and rising national debt. It was met with varied reactions from different stakeholders. Proponents argued that it was necessary to reign in the deficit and that Malaysia's subsidy system is skewed in favour of high-income groups. Opponents argued that it would have greatest impact on low-income groups, through inflation, and that subsidy rationalization needs to be accompanied by structural and governance reforms, such as improvements to the public transport system and greater government transparency to plug financial leakages.

This paper provides a brief overview of the reduction in fossil-fuel subsidies. It begins with the context for change, and then explains how prices were altered, what measures were taken to manage impacts and how the government tried to build support for its actions. It concludes with a series of lessons that other countries might draw from these experiences.

2. Context

The rationalization of subsidies forms an important part of both the 10th Malaysia Plan (2010–2015) and the New Economic Model (Economic Planning Unit, 2010), which set out the government's strategy for making Malaysia a high-income nation. In July 2010, a subsidy reform program was initiated by Prime Minister Najib. This set out a schedule of subsidy reductions for fuel, sugar and other products, to span a 3- to 5-year period (Jala, 2010). However, the reforms stalled, and there has been no change in prices for diesel and RON95 petrol since December 2010.

The decision to increase prices in September 2013 was likely taken because there was a window of political opportunity. The partial reform took place four months after Najib extended his coalition's 56-year rule over Malaysia—albeit with its worst-ever performance at the polls, and weeks before internal party polls on October 19—and nearly two months before the release of the 2014 Budget on October 25. In addition, some saw the subsidy reduction as an attempt to boost confidence in the country's fiscal policy and Najib's economic leadership ("Malaysia to cut fuel subsidies," 2013).

The rationale for the government's ongoing commitment to subsidy reform is that subsidies are inefficient at assisting households and businesses, and they can contribute to a range of economic problems, as described below.

Fiscal Deficit and Rising National Debt

In announcing the partial subsidy reform, the Prime Minister stated that the main motivation was to address Malaysia's fiscal deficit and rising national debt (Najib, 2013a).

Malaysia's fiscal deficit of 4.5 per cent of GDP was the second-highest among Asia's 13 emerging markets in 2012, coming only after India (Ramasamy & Koon, 2013). The national target is to reduce this to 3 per cent by 2015. Malaysia's national debt, with a debt-to-GDP ratio of 53.3 per cent, also stands out regionally: it is the second-highest among Asian emerging markets, after Sri Lanka (Ramasamy & Koon, 2013). In August, the global ratings agency Fitch lowered the outlook on Malaysia's credit ratings from stable to negative, citing, among other things, rising debt levels and a lack of budgetary reform (Ramasamy & Koon, 2013).

Since fuel subsidies make up a large item of expenditure, their reform could do much to reduce deficit and debt levels. MYR 24.8 billion (US$7.9 billion) was allocated to fuel subsidies in 2013. The government argued that the subsidy reduction would save at least MYR 1.1 billion (US$349 million) by the end of 2013, and MYR 3.3 billion (US$1 billion) in a full year (Najib, 2013a). Even so, the reform was only partial; costly and significant price support for fuel still exists. The government noted that total fuel subsidy expenditure in 2013 was equal to approximately 5 per cent of total government debt (Najib, 2013a).

Dwindling Current Account Surplus

In Malaysia, the current account surplus dropped to MYR 900 million (US$285.9 million) in the second quarter of 2013, the lowest position since 1999 (Porter, 2013a). Abdul Wahid Omar, Minister in the Prime Minister's department in charge of financial affairs, explained that this was caused by four main factors: increased spending on overseas investment and property buying; higher imports for infrastructure projects; lower palm oil and rubber export prices; and the acquisition of new aircraft by Malaysian Airline System Berhad (Porter, 2013). Low-cost fuel also contributes to the dwindling surplus, by stimulating consumer demand for costly fuel imports. Analysts from Macquarie Group Ltd, a global investment banking group, believe there is a real risk that the current account deficit could slip into deficit for the first time since the fourth quarter of 1997 (Porter, 2013).

Ringgit Depreciation

During the four months since the election in May, the ringgit lost 7.4 per cent against the US dollar, hitting a three-year low of 3.2947 per dollar in August (Porter, 2013). This has been driven partly by regional turmoil over reduced US monetary stimulus[1] and Asia's faltering growth outlook, fuelling a sell-off of emerging market stocks and currencies. According to bank Credit Suisse, Malaysia and Thailand are the most vulnerable after India and Indonesia, as a result of their high foreign bond ownership and slowing current account surplus, which makes them unfavourable to the international market (Porter, 2013). Even within Asia, the ringgit is one of the worst performers, in part due to the absence of reform measures to reduce the fiscal deficit ("Inflation to be steady," 2013). Analysts at Barclays Plc have cited weak public finances when advising bond investors to hold underweight positions in Malaysia (Porter 2013).

[1] Chairman Ben Bernanke announced in May that the U.S. Federal Reserve intended to start reducing its bond buying this year (Bloomberg, 2013a).

3. *Pricing*

The three major subsidized fossil transport fuels in Malaysia are diesel, RON95 and RON97.

RON97—a premium fuel used, by more wealthy segments of Malaysian society—is subsidized significantly less than the other two. Its price is also changed more frequently, because, according to the government, it is partially derived from market forces (Ministry of Finance, 2012).

In the September reform, the following price increases were implemented:

- Diesel: from MYR 1.80 (US$0.57) to MYR 2.00 (US$0.63) per litre
- RON95 petrol: from MYR 1.90 (US$0.60) to MYR 2.10 (US$0.66) per litre.
- RON97 petrol: from MYR 2.70 (US$0.84) to MYR 2.85 (US$0.90), although this was dropped in November to MYR 2.75 (US$0.87)

The last time the prices of RON95 and diesel were raised was in 2010, when there were two small increases of 5 sen (US$0.01) in relatively close succession. The increase came in July, when the price of diesel was raised from MYR 1.70 (US$0.53) to MYR 1.75 (US$0.54) per litre; and the price of RON95 from MYR 1.80 (US$ 0.55) to MYR 1.85 (US$ 0.57) per litre. Then, six months later, in December, diesel and RON prices were raised again to MYR 1.80 (US$ 0.56) and MYR 1.90 (US$ 0.59) per litre, respectively.

TABLE 1. SUMMARY TABLE OF DIESEL AND RON95 PRICE CHANGES, JULY 2010 TO NOVEMBER 2013

FUEL	PRICES PER LITRE			
	PRE-JULY 2010	JULY 2010	DEC. 2010	SEPT. 2013
Diesel	MYR 1.70 (US$0.53)	MYR 1.75 (US$0.54)	MYR 1.80 (US$0.56)	MYR 2.00 (US$0.63)
RON95 petrol	MYR 1.80 (US$0.55)	MYR 1.85 (US$0.57)	MYR 1.90 (US$0.60)	MYR 2.10 (US$0.66)

Despite these price increases, fossil transport fuels in Malaysia remain subsidized, as suggested by Figure 1, which shows the pump price for diesel, RON95 and RON97 across several Southeast Asian countries as of September 2013, following Malaysia's latest price rise. Prices in the Philippines, which has a deregulated fuel pricing system, represent market-based prices for diesel and petrol. Malaysian prices for RON95, RON97 and diesel are lower than the Philippine benchmark, and even lower than the prices in Indonesia and Thailand, which also provide significant fuel subsidies. Regionally, Singapore has the highest prices, with both market-based pricing and relatively high fuel taxes (GIZ, 2011).

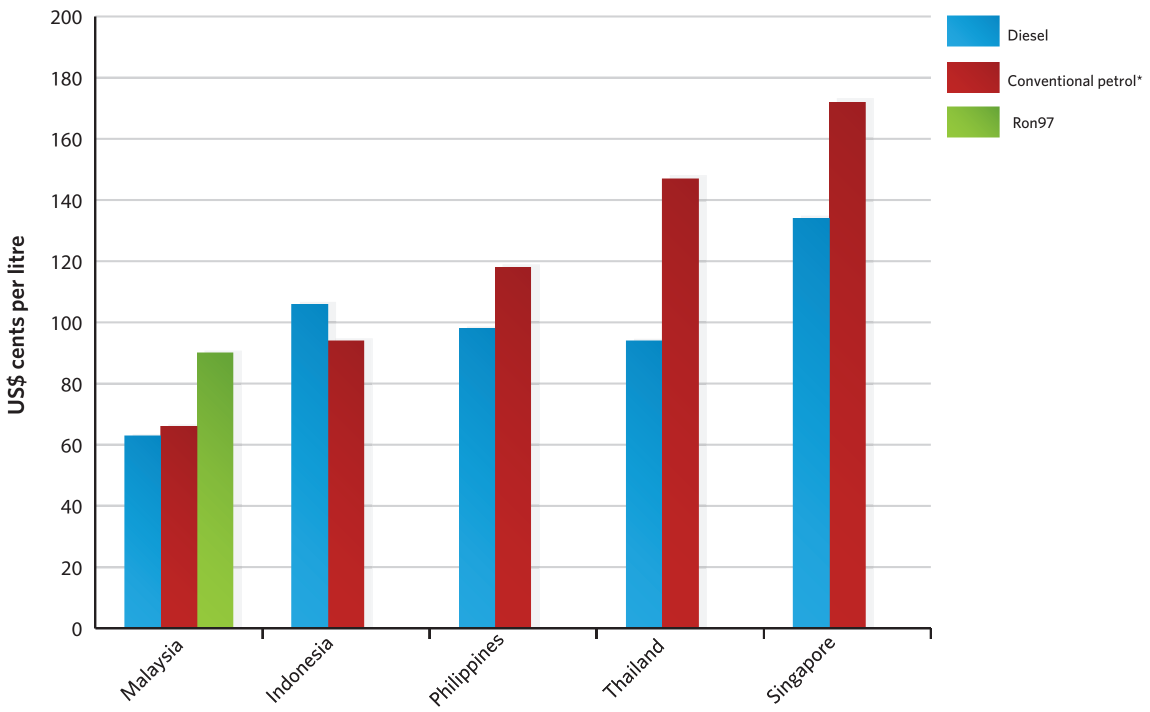

FIGURE 1. SEPTEMBER 2013 PUMP PRICE FOR DIESEL AND GASOLINE IN MALAYSIA, THE PHILIPPINES, THAILAND, SINGAPORE AND INDONESIA (U.S. CENTS)

**For Malaysia, "conventional petrol" refers to RON95 and for the Philippines it refers to RON93.*

Source: Bernama (2013).

The subsidies that remained following the partial reform amounted to 80 sen (US$0.25) per litre for diesel (28.6 per cent of the market price) and 63 sen (US$0.25) per litre for RON95 (23 per cent of the market price), as illustrated in Figure 2. Going forward, the exact per-litre value of the subsidy will fluctuate in accordance with international crude prices and exchange rate.

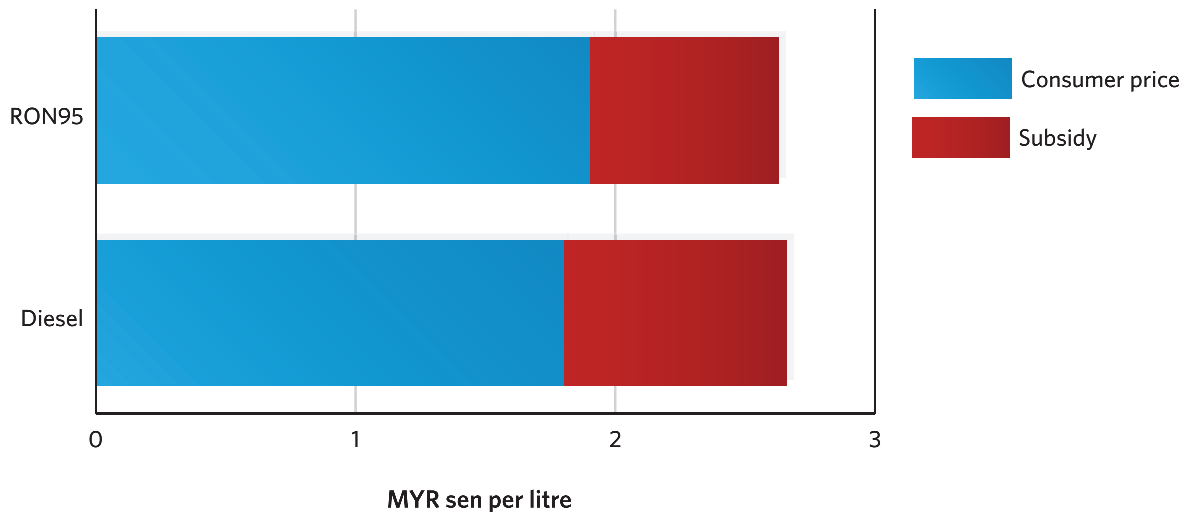

FIGURE 2. PRICE COMPOSITION OF RON95 AND DIESEL IN MALAYSIA AS OF SEPTEMBER 3, 2013

Source: Najib (2013a).

No Change to the Fuel Pricing Mechanism

The prices of diesel and RON95 are set through what the government calls an "automatic pricing mechanism" (APM) (IISD, 2013a). In international policy literature, however, an automatic pricing mechanism is typically one where fluctuations in the international market price of fuel are passed onto the consumer at regular intervals according to a pre-established formula (IISD, 2013b). This is not the case in Malaysia, where the prices of RON95 and diesel have not been changed since December 2010: the APM is simply a formula used to determine how much subsidy is needed to cover the difference between a fixed retail price, and the market price (IISD, 2013a).

Internationally, Malaysia's fuel pricing mechanism would be therefore be categorized as an *ad hoc* pricing mechanism—one where prices are determined by the government, often involving unsystematic price changes over long intervals.

The September reform did not make any changes to the design of this underlying fuel-pricing system. The government has also not released a structured plan by which it intends to phase out the subsidies to RON95 and diesel, although it has expressed its commitment to reforming subsidies in the future.

For RON97, the government states that the pricing mechanism has been subject to a managed float since July 2010 (Ministry of Finance, 2012). However, as shown previously in Figure 1, prices for this premium grade of petrol are still below the benchmark market price represented by the Philippines, despite the fact that its price is higher and altered more frequently than the prices of RON95 or Diesel (see Figure 3). The September reform did not make any chances to the underlying design of the fuel-pricing mechanism for RON97. Indeed, the government asserts that prices for RON97 are consistent with the international market price, so the issue of the subsidisation of this fuel has been absent from the Budget and government press releases (Singh, 2013).

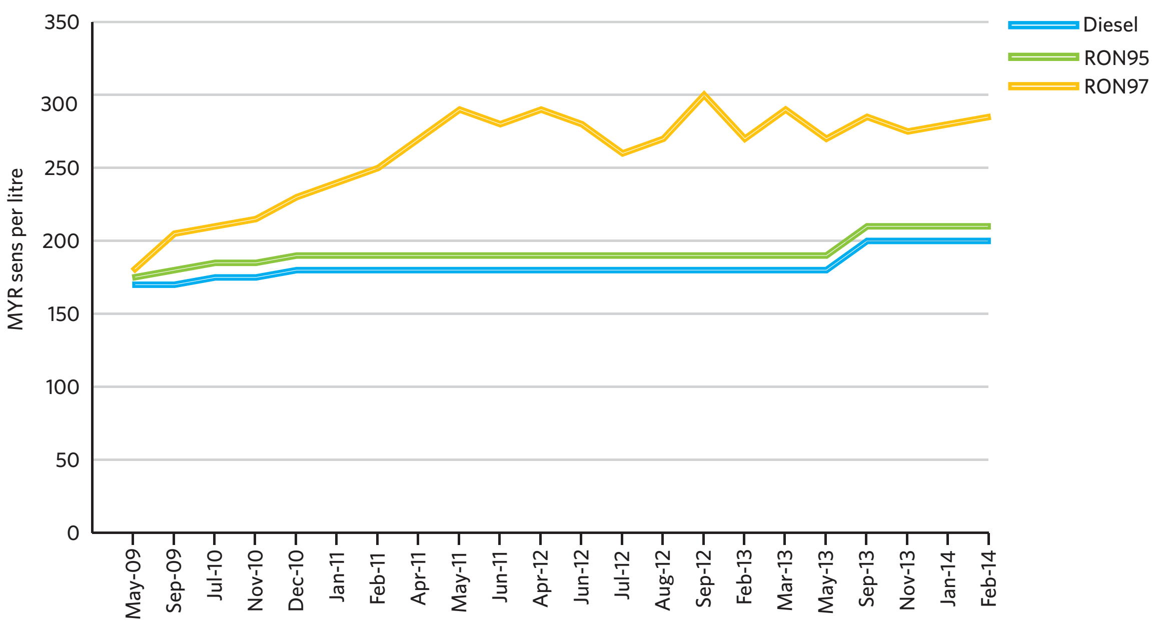

FIGURE 3. CHANGING PRICES OF DIESEL AND PETROL (RON95 AND RON97) (SEN/LITRE)

Source: Galvintan (n.d.).

Other Changes

The Ministry of Finance also announced in September that it intends to curb the overall subsidy that has been used to control the prices of other fuels,[2] sugar and cooking oil, down from US$13.09 billion in 2012 to US$11.6 billion in 2013 (Ramasamy, & Koon, 2013). In the budget speech on October 25, Najib announced that the 34 sen (US$0.11) sugar subsidy would be abolished because of the high incidence of diabetes among Malaysians under the age of 30 (Najib, 2013b).

On December 2, 2013, it was announced that electricity tariffs would increase by 14.89-16.9 per cent, starting from 2014. The last increase was in June 2011, when the tariff was raised by 7.12 per cent. The tariff increase will affect users who consume at least 300 kWh per month, predominantly businesses and larger households (Kong, 2013). The cost of electricity will be raised to 38.5 sen/kWh (US$0.12/kWh) in peninsular Malaysia, which is still below the international market price of 42 sen/kWh (US$0.13/kWh) (Zachariah, 2013). Even with the new tariffs, the government will be spending MYR 2.4 billion per year to subsidize electricity (Kong, 2013).

Nevertheless, there has been no reform of subsidies to independent power producers (IPPs),[3] although the secretary general of the Energy, Green Technology and Water Ministry said that the government wants to cut subsidies to power producers next year as part of its long-term subsidy rationalization plan. Subsidies for the power sector are estimated at MYR 8–12 billion per year (Zachariah, 2013).

The Prime Minister also said that the government would reschedule some state building projects, although he has not yet decided exactly which ones will be delayed. It seems, from earlier statements, that projects with a high import content and low multiplier impact on the real economy will be the most likely targets for postponement (Najib, 2013b). Priority projects such as the rail network, Mass Rapid Transit (MRT) lines 1, 2 and 3 in Kuala Lumpur are expected to go ahead (Najib, 2013b).

In the 2014 Budget, released in mid-October, Najib announced the replacement of the sales and service taxes with a single goods and service tax (GST), which will be fixed at 6 per cent and is slated to take effect on April 1, 2015. Various items will be exempted, including basic food items, piped water, the first 200 units of electricity per month for domestic users, transportation, education, health services and the sale, purchase and rental of residential properties. The government plans to publish guide prices for goods and services to ensure that prices are not escalated unfairly.

[2] In addition to RON95 and diesel, the government also subsidizes LPG.

[3] Since the 1990s, IPPs have been able to sign rigid power purchase agreements (PPAs) with government linked companies (GLCs), many of which give considerable benefits to the IPPs. For instance, it allows IPPs to pass on the cost of burning more expensive distillates when there are gas shortages to Tenaga Nasional Berhad (TNB) (which oversees Peninsular Malaysia), and which is then compensated by the government (Ismail, 2012). Deep analysis of the power sector is made difficult by the non-disclosure of payments made to the various IPPS and the opacity of PPAs. While some studies suggest that IPPs are generating a profit from subsidized gas, the government denies that IPPs profit from gas subsidies (Teh, 2011).

4. *Impacts and Compensation Measures*

Impacts

Economic growth: Credit Suisse revised Malaysia's macroeconomic forecasts in response to the government's decision to raise prices of diesel and RON95. The firm cut its 2013 GDP growth forecast from 5 per cent to 4.4 per cent and its 2014 estimate from 5.2 per cent to 5 per cent, reflecting an expected decline in private consumption and likely delays to some infrastructure projects affecting investment (Credit Suisse, 2013).

Inflation: Higher inflation was also predicted as a consequence of reform. *Credit Suisse* projected that inflation would remain manageable, since the price increase took effect when inflation pressure was low. It increased its average year-on-year inflation forecast from 1.9 per cent to 2.1 per cent for 2013, and from 2.1 per cent to 2.8 per cent for 2014 (Credit Suisse, 2013). The *Wall Street Journal* predicted higher medium-term inflationary impacts, stating that inflation could reach 3.5 or 4 per cent in 2014, on the basis that it may take some time for the costlier fuel to push up prices, causing some delay before the full impact takes place. As such, the *Journal* predicted that that the central bank will most likely raise rates by a half or quarter percentage point in the second half of 2014 (Gangopadhyay, 2013a). Data released by the Malaysian Department of Statistics reports an inflation rate of 2.8 per cent for October, up from 1.9 per cent for August. This effect was largely due to higher transport costs, which rose to 4.9 per cent from 4.6 per cent in September (Trading Economics, 2013). The CPI from September to October increased from 107.9 to 108.3 index points (Trading Economics, 2013).

Fiscal deficit: *Credit Suisse* cut its fiscal deficit forecast from 4.5 per cent to 4 per cent of GDP for 2013, indicating that this should improve going forward (Credit Suisse, 2013). By comparison, in the 2014 Budget, Najib projected that the deficit would decline from 4 per cent to 3.5 per cent of GDP from 2013 to 2014 (Najib, 2013b). The government estimated that the reduction in fuel subsidies would save US$349 million (0.1 per cent of GDP) in 2013, and US$1 billion in a full year (Najib, 2013b). The Prime Minister also stated the government's commitment to a balanced budget by 2020, and affirmed that federal debt would not rise above 55 per cent GDP (Najib, 2013b). Two new departments, Outcome Based Budgeting (OBB) and the Fiscal Policy Committee (FPC, established in June) are also intended to strengthen the government's financial position (Najib, 2013b).

Current account: Analysts maintained their current account forecast for Malaysia at 3 per cent, although it is predicted that the government's announcement on fuel prices and likely improvements in the global trade cycle will help the current account going forward.

Credit rating: Standard & Poor's Ratings Services said the proposed 2014 budget has had no impact on the sovereign ratings and outlook on Malaysia, although Fitch Ratings said the budget signaled reform ("SE Asia stocks rise in light volumes," 2013). For Moody's Investors, Malaysia's move to raise prices was regarded as a positive step, but not yet sufficient, stating that "the lack of additional reforms would place the government's fiscal targets increasingly out of reach" (Gangopadhyay, 2013b).

Households: No specific projections or data related to the September reform's impacts on households were identified by this review. However, it is highly likely that such impacts in Malaysia accord with general experience with the reform of fossil-fuel subsidies related to gasoline and diesel (IISD, 2013b). The price rise is likely to have had the most significant direct impact on the effective incomes of middle- to high-income groups, who can afford to use transport vehicles, diesel SUVs and motorbikes, which predominantly run on diesel and RON95. Indirect impacts are more dispersed, pushing up prices across a range of goods and services, as indicated by the inflationary effects of reform.

Increased fuel prices, particularly diesel prices, are likely to increase the price of public transport services; the price of goods involving transport, including basic commodities such as fish, meat and vegetables; and the price of goods requiring diesel as an intermediate input, again including agricultural and fishing vehicles. These kinds of indirect impacts affect all households, with low-income households typically being the least able to adapt to the higher cost of living (IISD, 2013b).

Such expectations were confirmed by a June 2013 study conducted by the Universiti Malaya Centre for Poverty and Development Studies, which explored the impacts of reforming subsidies related to energy, food production and transfers to households and enterprises, using a CGE model, and assuming that none of the funds would be reallocated to help the poor. The study projected that the removal of subsidies would have a significant impact on households through transportation and food costs, and could significantly widen income gaps between the rich and the poor, with poverty in rural areas most affected, though it did not attempt to separate out the specific impacts related to fuel subsidies alone (Solaymani, Kari & Zakaria, 2013). The authors argued that such impacts necessitated the use of government intervention to protect the most affected groups, using the savings from subsidy reforms (Malaysiakini, 2014).

Compensation Measures

In September the Prime Minister said that an expansion of cash transfers and other social welfare measures would mitigate the impact of the fuel price increase on low-income groups. In the mid-October Budget, Najib said that half of the savings from restructuring subsidies would be distributed in the form of direct cash assistance to low-income groups, with the other half being used to finance development projects.

Najib announced in the Budget speech a total allocation of MYR 4.6 billion (US$1.5 billion) next year to implement an extended 1Malaysia People's Aid (BR1M) program, which he expects will benefit 7.9 million recipients (Najib, 2013b). The US$1.5 billion spending on BR1M next year is significantly more than the US$1 billion that the government expects to save in a full year from raising the price of diesel and RON95. The full compensation fund is likely to be funded also by the reductions in sugar subsidies and increases in the electricity tariff, since it is also intended to help cushion the socioeconomic effects of these changes.

BR1M was started in 2012 to provide cash aid of MYR 500 (US$159) to households with incomes of MYR 3,000 (US$953) and below. The second phase was expanded to include singles aged 21 and above with an income of under MYR 2,000 (US$635) per month, receiving MYR 250 (US$79) each (Najib, 2013b). BR1M allocations outlined in the 2014 Budget include:

- Cash allocations to households with monthly incomes below MYR 3,000 (US$953) increase from MYR 500 (US$159) to MYR 600 (US$191). This group will also receive an additional RM 50 (US$16) to provide protection of up to MYR 30,000 (US$9,534) in the event of death or permanent disability.
- Cash allocations for individuals aged 21 and over and with a monthly income not exceeding MYR 2,000 (US$635) will be increased from MYR 250 (US$79) to MYR 300 (US$95).
- For the first time, cash allocations of MYR 450 (US$143) will be extended to households with a monthly income of between MYR 3,000-4,000 (US$953–1,271) to alleviate the rising cost of living borne by the lower middle-income group. This group will also receive an additional MYR 50 (US$16), raising their total assistance to MYR 500 (US$159).

- Pensioners will receive financial assistance of MYR 250 (US$79) to help them meet the rising cost of living.
- A half-month bonus for 2013, with a minimum payment of MYR 500 (US$159) will be paid to civil servants in early January 2014.

In addition, the Prime Minister announced the establishment of a comprehensive database system, integrating the databases of eKasih,[4] previous recipients of welfare assistance and BR1M recipients. This is to prevent the misallocation of assistance, and ensure that cash handouts are not duplicated. The initiative is to be led by the Prime Minister's Department (JPM).

It is not clear from the Budget speech how frequently the cash allocations for low income groups will be disbursed, how they will be financed, or how long they will continue.

Other measures outlined in the 2014 Budget include the promotion of low- and medium-cost housing. The government will provide 80,000 housing units with an allocation of 1 billion ringgit under an affordable housing scheme. The sale prices of the houses will be 20 per cent below market price. Prime Minister Najib also outlined various measures to mitigate the effect of the GST, including reducing personal income tax rates by 1 to 3 per cent percentage points for all taxpayers, and giving MYR 2,000 (US$634) to taxpayers with a monthly income of up to MYR 8,000 (US$2,534) received in 2013. In addition, training grants of MYR 100 million (US$31.7 million) will be provided to businesses that send their employees for GST training in 2013 and 2014, and financial assistance amounting to 150 million ringgit will be provided to small and medium enterprises for the purchase of accounting software in 2014 and 2015.

[4] EKasih is a government-run poverty-reduction and monitoring program in which families that meet the criteria of poverty status, or earn below MYR 2,300 per month, can register for financial assistance. The EKasih system was created in 2007 and uses data based on the Census of Poor Households (Birm).

5. *Building Support*

Communication Efforts

Fuel subsidy reform was not included in the governing Barisan Nasional's political manifesto during the general election in May 2013. The decision to reduce subsidies in September can be traced to the establishment of the Fiscal Policy Committee (FPC) on June 18, 2013. The FPC's mandate was to solve the budget deficit problem. Then, towards the end of August it was announced that the FPC was meeting to consider options for budgetary reform, including subsidy rationalization. On September 2, the FPC released a press statement detailing the price increases for diesel and RON95 effective from 12.01 a.m. on September 3.

In the press statement the Prime Minister highlighted some of the problems associated with subsidies and the gains from reform, including:

- Stressing that strengthening Malaysia's fiscal position was vital to sustaining the resilience of the economy and enhancing public and investor confidence.
- Pointing out that the subsidy system benefits everyone, including higher-income groups and foreigners, and arguing that a more targeted system is needed to cater to vulnerable groups.
- Explaining that the government is subsidizing 83 sen (US$0.26) for every litre of RON95 and MYR 1 (US$0.32) for every litre of diesel, bringing the total fuel subsidy allocation for 2013 to MYR 24.8 billion (US$7.9 billion). Najib said that the reduction of the subsidy would still involve the government subsidizing these two fuels, but by a lesser amount.
- Explaining that there would be compensation and mitigation measures for low-income groups, such as increasing BR1M in the 2014 Budget, and in the longer term, introducing a comprehensive social safety net.
- Highlighting some of the other measures being taken by the government to improve the country's fiscal position, such as delaying public sector projects and focusing on tourism in the longer term.
- Stressing that the subsidy rationalization would be carried out in many stages, not suddenly, and that the FPC's announcement of the price rises for diesel and petrol was just the first step.

In addition to these announcements, the Malaysian government has in place ongoing communications efforts to promote transparency about subsidies, primarily through declarations of the cost of fuel subsidies on posters at petrol stations, and on the monthly electric bill. Figure 4 shows a poster at a petrol station. It gives the market price of petrol and diesel (*harga sebenar*) and compares them with the controlled price (*harga kawalan*), and then draws attention to the subsidy cost to the government (*subsidi oleh kerajaan*).

FIGURE 4. GOVERNMENT DECLARATION OF PETROL AND DIESEL SUBSIDIES AT A PETROL STATION

Source: PaulTan.org

Reaction to the Fuel Price Increases

The fuel price hike has been met with diverse opinions. Opponents argue that it puts more pressure on households and families, while supporters say the rise is reasonable given Malaysia's large fuel subsidies compared to other countries. Many civil society groups and commentators have also called on the government to address financial leakages and abuses, and express skepticism about whether public services will actually improve as promised.

The price rise was immediately met with sporadic protests across the country by trade unions, workers and members of the public. The president of the Federation of Malaysian Consumers Associations (FOMCA) said that the government needed to improve nationwide public transport before hiking prices, and the Muslim Consumers Association (PPIM) said that although the increase was inevitable, the government needed to plug leakages in the system before placing the burden on consumers (Bedi, 2013).

Non-Government Organizations (NGOs)

The ASLI Centre for Public Policy Studies (CPPS), a Malaysian NGO, argued that raising taxes to reduce the deficit was likely to lead to prolonged economic contraction. The CPPS stressed that spending-based adjustment must be supported by structural reforms, such as greater liberalization of economic sectors and good public service delivery, to promote the growth of private investment (CPPS, 2013). Tan Sri Ramon Navaratnam, chairman of the CPPS and former president of Transparency International Malaysia, highlighted several structural and governance reforms in Malaysia's economic management, including: (i) raising the transparency of non-financial public sector indebtedness, (ii) developing less-protective Bumiputera policies, and (iii) "introducing drastic measures to cut corruption and wastage of public funds" (Navaratnam, 2013).

Media

Newspapers that have historically been supportive of the government, such as the *New Straits Times*, stressed the negative impacts of the blanket fuel subsidies and how the rationalization of prices will make it possible to tailor subsidies to the poor ("Subsidies to be tailored to the poor", 2013). Online forums featured more outspoken opposition to the price rise. The online newspaper *Malaysiakini* has given a voice to opponents to the reform, and the *Malaysian Insider* argues that Malaysia's "strident opposition" could delay the government's move to cut subsidies (Malaysiakini, 2013; "Political pressure will dictate," 2013). *Free Malaysia Today*, nevertheless stressed the unsustainability of the current subsidy mechanism, concluding that the price hike was justified (Vinod, 2013). Paultan.org, a popular Malaysian automotive news site pointed out that fuel subsidy reductions would curb petrol smuggling (Paul Tan, 2013).

Political parties

The three main opposition parties—the Democratic Action Party (DAP), the People's Justice Party (PKR) and the Pan-Malaysian Islamic Party (PAS)—have all focused on the negative consequences of the fuel price hike. The leading opposition party, PKR, said that cutting fuel subsidies was a "shortcut" that would not solve Malaysia's debt problem, and that a more holistic plan was required to tackle Malaysia's ailing finances. The party also questioned why subsidies given to private companies such as independent power producers, estimated at MYR 13 billion (US$4 billion) have not been cut. Only subsidies that affect the Malaysian people have been targeted (Zahiid, 2013).

Comments from the opposition have also highlighted the bigger conversation happening in Malaysian politics about trust and government transparency, and its relation to the issue of subsidy reform. Several opposition Members of Parliament raised the issue of good governance directly, saying that before attempting to reduce subsidies, government corruption needed to be tackled. DAP M.P. Sim Tong Him said, "much of our revenue went off due to corruption and maintaining white elephant projects . . . many people do not believe that the government is doing enough to eliminate corruption" (Vinod, 2013). In a recent survey of 681 business executives and employees, Ernst & Young found that 39 per cent of respondents said that bribery or corrupt practices happen widely in Malaysia, nearly double the Asia-Pacific average of 21 per cent (Ernst & Young, 2013). Moreover, 29 per cent said that bribery or corrupt practices had increased due to tough economic times and increased competition (Ernst & Young, 2013).

The DAP said that the withdrawal of subsidies and implementation of GST would severely affect low-income households (Subramaniam, 2013). The PAS focused on inflation, arguing that a failure to mitigate inflation would lead to a permanent increase in the price of goods. The party said that the BR1M cash handouts would not be sufficient to counter the price rise (Khong, 2013).

6. Lessons Learned and Looking Forward

Malaysia's attempt to raise the price of fossil fuels in September 2013 was—by the most basic of measures—successful. Prices were indeed increased and have, to date, stayed that way. It remains to be seen whether or not the government will succeed in turning this partial reform into a more fundamental one that delivers on sustainable development, ensuring a neutral or even progressive impact for low-income households. But a number of lessons stand out as a result of Malaysia's experiences.

Pricing

An ad hoc change in prices is not a long-term solution. Malaysia has moved from one fixed price to another. The new price is higher, but still below market levels. This means that it still provides inefficient subsidies and, if international oil product prices rise or if the exchange rate falls, expenditures may return to unsustainable levels. A long-term solution would move to a pricing system that sets prices automatically according to the market, and disassociates price-setting from political decision making. A short-term transition pathway would be to move to an automatic pricing mechanism that, although still providing subsidies, would allow prices to fluctuate in response to international price changes.

Managing Impacts

Policies to mitigate negative impacts ought to be prepared before reform takes place. In announcing the reform, Prime Minister Najib explained that cash transfers would be used to help support low-income households, but details of this were only made available in the 2014 Budget, nearly eight weeks later. This offered little benefit to those trying to cope with higher prices in the short-term. Similarly, the proposal to develop a comprehensive welfare database could have more effectively supported the reforms if it had been announced and completed before prices were increased.

Building support

Transparency about subsidies is vital to build support for reform. The Malaysian government has engaged in ongoing activities to raise awareness about subsidy costs, including publicizing information on posters at petrol stations and on monthly electric bills. These efforts could be replicated in other countries faced with subsidy reform.

But clarity and consistency about subsidy reform plans is important too. In announcing the latest price increase, Najib stated that reform would now be carried out in "many stages," but these were not detailed. It is hard for citizens and businesses to plan for the unknown, and equally difficult to simply trust that governments will mitigate unfair impacts. Citizens need to know that the government is serious about reforming subsidies, and to have clear expectations about how this will affect them.

Governments need to communicate why reform is a structural change for the better. Many commentators in Malaysia did not see why a cash transfer would be any better than subsidies: they are almost as costly as each other, it was argued, so how are they any different? The answer to this question—that subsidy reform is about the transition to a more targeted, efficient and effective welfare system—was not well reflected in public debate. Moreover, as reactions in the media have shown, consumers often blame the government for price increases that are a product of international markets. Linking subsidy reform to other structural reforms may boost public support and help focus on the bigger picture. In Malaysia, for example, commentators suggested linking reform to the development of an integrated public transport network to provide an affordable alternative to passenger car transport, as well as the reform of the civil service and bureaucracy, such as making pay and tendering more transparent.

References

Alin, J. (2013, September 23). Current subsidy mechanism not practical. Retrieved from http://www.freemalaysiatoday.com/category/opinion/2013/09/23/current-subsidy-mechanism-not-practical/

Bedi, R. (2013, September 2). *Fuel price hike: 20 sen increase will burden the people, say groups*. Retrieved from http://www.thestar.com.my/News/Nation/2013/09/02/fuel-hike-will-burden-people.aspx/

Bernama. (2013, September 3). Fuel price still cheapest vis-à-vis neighboring countries. T*he Sun Daily*. Retrieved from: http://www.thesundaily.my/news/820756

Centre for Public Policy Studies. (2013, October 23). Fiscal consolidation: Cutting waste as a key to accelerating growth. Retrieved from http://www.cpps.org.my/upload/Fiscal%20Consolidation_Perspective_Lau.pdf

Credit Suisse. (2013, September 4). Malaysian economics. *Asian Daily*. Retrieved from http://www.btinvest.com.sg/system/assets/19124/Credit%20Suisse%20Economics%20Research%20-%20%20Malaysia%20Economics,%204%20Sept%2013.pdf

Department of Statistics, Malaysia. (2013, September 4). Malaysia Inflation Rate, reported in *Trading Economics*. Retrieved from http://www.tradingeconomics.com/malaysia/inflation-cpi

Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ). (2011). *International fuel prices 010/2011.* Retrieved from http://www.giz.de/Themen/en/dokumente/giz-en-IFP2010.pdf

Economic Planning Unit, Prime Minister's Department. (2010). *Tenth Malaysia Plan 2010-2015*. Putrajaya, Malaysia.

Ernst & Young. (2013). Building a more ethical business environment: Asia-Pacific fraud survey report, Series 2013. Retrieved from http://www.ey.com/Publication/vwLUAssets/2013_Asia-Pacific_Fraud_Survey/$FILE/EY-Asia-Pacific-Fraud-Survey.pdf

Galvintan. (n.d.). Malaysian fuel price history. Retrieved from http://blog.galvintan.com/malaysian-fuel-price-history/

Gangopadhyay, A. (2013a, September 4). Malaysia's move on subsidies fans rate hike expectations. *Wall Street Journal*. Retrieved from http://blogs.wsj.com/economics/2013/09/04/malaysias-move-on-subsidies-fans-rate-hike-expectations/

Gangopadhyay, A. (2013b, September 4). Moody's says more subsidy cuts, fiscal reforms, needed for Malaysia. *Wall Street Journal.* Retrieved from http://online.wsj.com/article/BT-CO-20130904-701363.html

Governments must demonstrate commitment to good governance, open politics, says Najib. (2013, December 2). *Malay Mail Online*. Retrieved from http://www.themalaymailonline.com/malaysia/article/governments-must-demonstrate-commitment-to-effective-rule-open-politics-say

Inflation to be steady in August, up in September. (2013, September 17). *The Star*. Retrieved from http://www.thestar.com.my/Business/Business-News/2013/09/17/Inflation-to-be-steady-in-August-up-in-September.aspx

International Institute for Sustainable Development (IISD). (2013a). *A citizen's guide to energy subsidies in Malaysia*. Geneva: IISD. Retrieved from http://www.iisd.org/gsi/resources/citizens-guide-energy-subsidies-malaysia

International Institute for Sustainable Development (IISD). (2013b). *A guidebook to fossil-fuel subsidy reform for policy-makers in Southeast Asia*. Geneva: IISD. Retrieved from http://www.iisd.org/gsi/fossil-fuel-subsidies/guidebook

Ismail, Z.I. (2012). Key reforms: Some of MyPOWER's initiatives have started to show some results. *Business Times.* Retrieved from http://www.btimes.com.my/Current_News/BTIMES/articles/POWVIEW/Article/print_html

Jala, I (2010). *Subsidy Rationalization Lab: Opening Presentation*, PEMANDU. Retrieved from http://www.slideshare.net/Adamloh/subsidy-rationalization-lab-by-day

Khong, A. (2013, September 3). PAS warns Putrajaya of inflation spike from fuel price hike. *The Malay Mail Online*. Retrieved from http://www.themalaymailonline.com/print/malaysia/pas-warns-putrajaya-of-inflation-spike-from-fuel-price-hike

Kok, T. (2013, December 3). What happened to review on gas subsidies to independent power producers? *The Malaysian Insider*. Retrieved from http://www.themalaysianinsider.com/sideviews/article/what-happened-to-review-on-gas-subsidies-to-independent-power-producers-ter

Kong, L. (2013, 5 December). Higher electricity tariffs in Malaysia a shock. *The Straits Times*. Retrieved from: http://news.asiaone.com/news/malaysia/higher-electricity-tariffs-malaysia-shock

Koon, C.P. (2013, September 16). Malaysians brace for austerity as Najib cools spending. *Bloomberg News*. Retrieved from http://www.bloomberg.com/news/2013-09-16/malaysians-brace-for-shift-to-austerity-as-najib-cools-spending.html

Malaysia to cut fuel subsidies to bolster economy, but help poor. (2013, September 2). Reuters. Retrieved from: http://uk.reuters.com/article/2013/09/02/malaysia-economy-measures-idUKK7N0GM00320130902

Malaysia Ringgit hits 3-week high after fuel subsidies cut. (2013, September 3). *The Star*. Retrieved from http://www.thestar.com.my/Business/Business-News/2013/09/03/Malaysia-Ringgit-Hits-3Week-High-After-Fuel-Subsidies-Cut.aspx

Malaysiakini. (2013, September 4). Najibnomics – just BR1M the great unwashed. Retrieved from http://www.malaysiakini.com/news/240173

Malaysiakini. (2014, March 5). Fuel subsidy cuts may rewind inequality to 1970. Retrieved from http://www.malaysiakini.com/news/256080

Ministry of Finance. (2012). "Chapter 4: Public Sector Finance", *Economic Report 2012*. Retrieved from: http://www.treasury.gov.my/pdf/economy/er/1112/chap4.pdf

Najib Tun Haji Abdul Razak. (2013a, September 2). Fiscal Policy Committee (FPC) press statement. *Prime Minister's Office*. Retrieved from https://www.pmo.gov.my/?menu=news&news_id=11939&news_cat=4&page=1729&sort_year=&sort_month=

Najib Tun Haji Abdul Razak. (2013b, 25 October). The 2014 budget speech introducing the supply bill: Strengthening economic resilience, accelerating transformation and fulfilling promises. Retrieved from http://www.pmo.gov.my/?menu=speech&page=1676&news_id=680&speech_cat=2

Navaratnam, R. (2013, 22 November). Sustain our reformative process. *The Star.* Retrieved from http://www.thestar.com.my/Opinion/Letters/2013/11/22/Sustain-our-reformative-process.aspx

Ng, E. (2013, 2 September). DAP slams fuel price hike, scorns promise of BR1M help for poor. *The Malaysian Insider.* Retrieved from http://www.themalaysianinsider.com/malaysia/article/dap-slams-fuel-price-hike-scorns-promise-of-br1m-help-for-poor

Paul Tan. (2013, September 16). *PDAM*: Further fuel subsidy reductions may stop petrol smuggling, use savings to abolish road tax. Retrieved from http://paultan.org/2013/09/26/pdam-fuel-subsidy-petrol-smuggling/

Political pressure will dictate Malaysia subsidy cuts, GST roll out to slash fiscal deficit. (2013, October 15). *The Malaysian Insider*. Retrieved from http://www.themalaysianinsider.com/malaysia/article/political-pressure-will-dictate-malaysia-subsidy-cuts-gst-roll-out-to-slash

Porter, B. (2013, August 21). Wahid Says Ringgit too weak as growth improves: Southeast Asia. *Bloomberg News.* Retrieved from http://www.bloomberg.com/news/2013-08-20/wahid-says-ringgit-too-weak-as-growth-improves-southeast-asia.html

Ramasamy, M., & Koon, C.P. (2013, September 2). Malaysia raises fuel prices as Najib seeks to trim budget gap. Retrieved from http://www.bloomberg.com/news/2013-09-02/malaysia-raises-fuel-prices-as-najib-seeks-to-trim-budget-gap.html

SE Asia stocks rise in light volumes; Malaysia up on 2014 budget. (2013, October 28). *Reuters*. Retrieved from http://uk.reuters.com/article/2013/10/28/markets-southeastasia-stocks-idUKL3N0II0HD20131028

Singh, R. (2013, September 4). RON97 increased to RM2.85 per litre, no surprise says expert. *The Malaysian Insider.* Retrieved from http://www.themalaysianinsider.com/malaysia/article/ron97-increased-to-rm2.85-per-litre-no-surprise-says-expert

Solaymani, S., Kari, F. & Zakaria, R.H. (2013, November 25). Evaluating the role of subsidy reform in addressing poverty levels in Malaysia: A CGE poverty framework. *Journal of Development Studies*. doi: 10.1080/00220388.2013.841888

Subramaniam, P. (2013). DAP: Subsidy slashed and GSP will impact homemakers most. Retrieved from http://www.fz.com/content/dap-subsidy-slashes-and-gst-will-impact-homemakers-most

Subsidies to be tailored to the poor. (2013, October 31). *New Straits Times*. Retrieved from http://www.nst.com.my/nation/general/subsidies-to-be-tailored-to-the-poor-1.388884?cache=%3Fpage%3D0%2F7.197525%3Fkey%3DMalaysia%3Fpage%3D0%2F7.293665%3Fkey%3DKuala+Lumpur%2F7.425366%2F7.425366%2F7.425366

Teh, C. (2011). *Without subsidies, gas IPP power would be very expensive*. Research for Social Advancement.

Trading Economics. (2013). *Malaysia inflation rate*. Retrieved from http://www.tradingeconomics.com/malaysia/inflation-cpi

Vinod, J. (2013, September 23). Address corruption before removing subsidies. *Free Malaysia Today*. Retrieved from http://www.freemalaysiatoday.com/category/nation/2013/10/23/address-corruption-before-removing-subsidies/

Zachariah, E. (2013, December 2). Electricity tariff up 15% next year, minister announces. *The Malaysian Insider.* Retrieved from http://www.themalaysianinsider.com/malaysia/article/electricity-tariff-up-15-next-year-minister-announces

Zahiid, S.J. (2013, September 3). Rafizi: Fuel price hikes just easy shortcut, not solution. *The Malay Mail Online.* Retrieved from http://www.themalaymailonline.com/malaysia/article/rafizi-fuel-price-hikes-just-easy-shortcut-not-solution

Further details and contact information

For further information contact Kerryn Lang at: klang@iisd.org or +41-22-917-8920.

International Institute for Sustainable Development
Global Subsidies Initiative
International Environment House 2, 9 chemin de Balexert, 1219 Châtelaine, Geneva, Switzerland
Tel: +41 22 917-8373 | Fax: +41 22 917-8054