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Resurrecting Goods and Services Tax (GST): The Case for A Comeback

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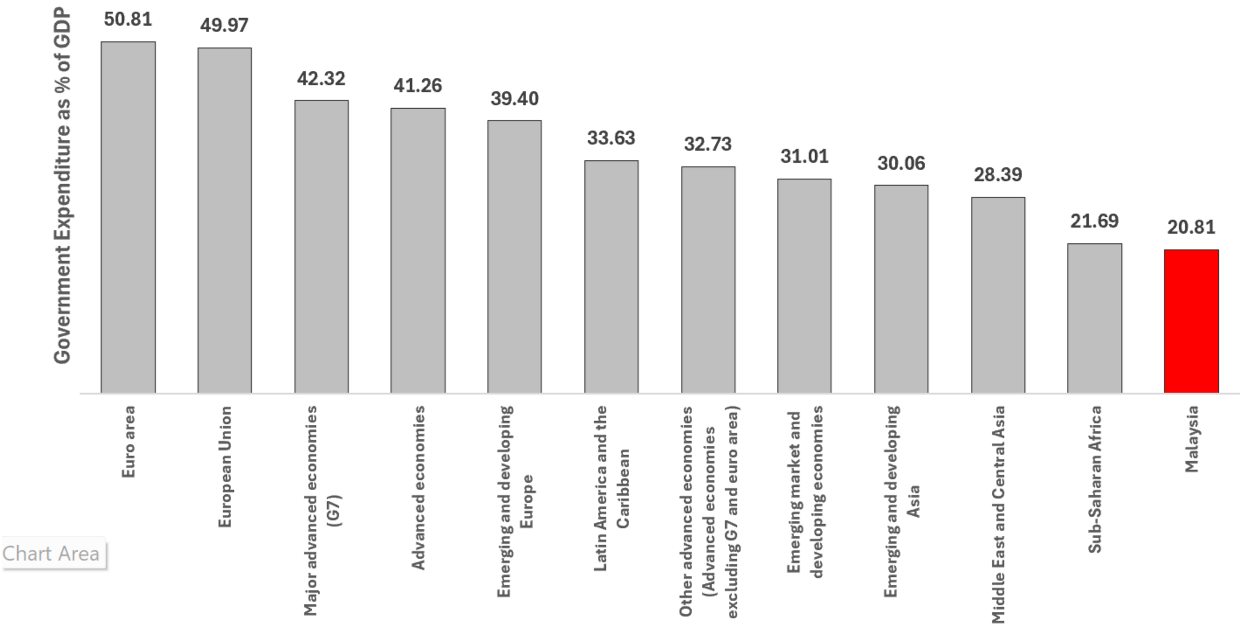
1- INTRODUCTION

With a rapid demographic transformation underway, Malaysia stands at the threshold of a pivotal era marked by heightened public spending to effectively address the profound implications of its aging population. Chief among these challenges is the surging demand for healthcare services, propelled by the intricate and specialized needs of aging individuals. Concurrently, there is an imperative to fortify Malaysia's pension system to uphold the dignity of an expanding segment of the population. Additionally, as the proportion of the workforce relative to the total population diminishes, there emerges an urgent call to invest in education and skills development to mitigate the adverse effects of increased dependency, wherein a greater number of seniors rely on a shrinking pool of workers for support.

Therefore, amplifying public spending is not merely a requisite for safeguarding the well-being of the elderly but also a strategic investment in the nation's future productivity and prosperity. Nonetheless, despite the pressing need for augmented public expenditure, Malaysia's current level of spending remains comparatively low. In 2023, public expenditure stood at RM 397.14 billion, representing only 20.81 percent of GDP for that year, positioning Malaysia among the lowest in terms of public spending relative to its economic development level.

Figure 1: Public spending as a percent of GDP, Malaysia and country groups, 2023



Source: based on data from IMF (2023) and MoF (2023)

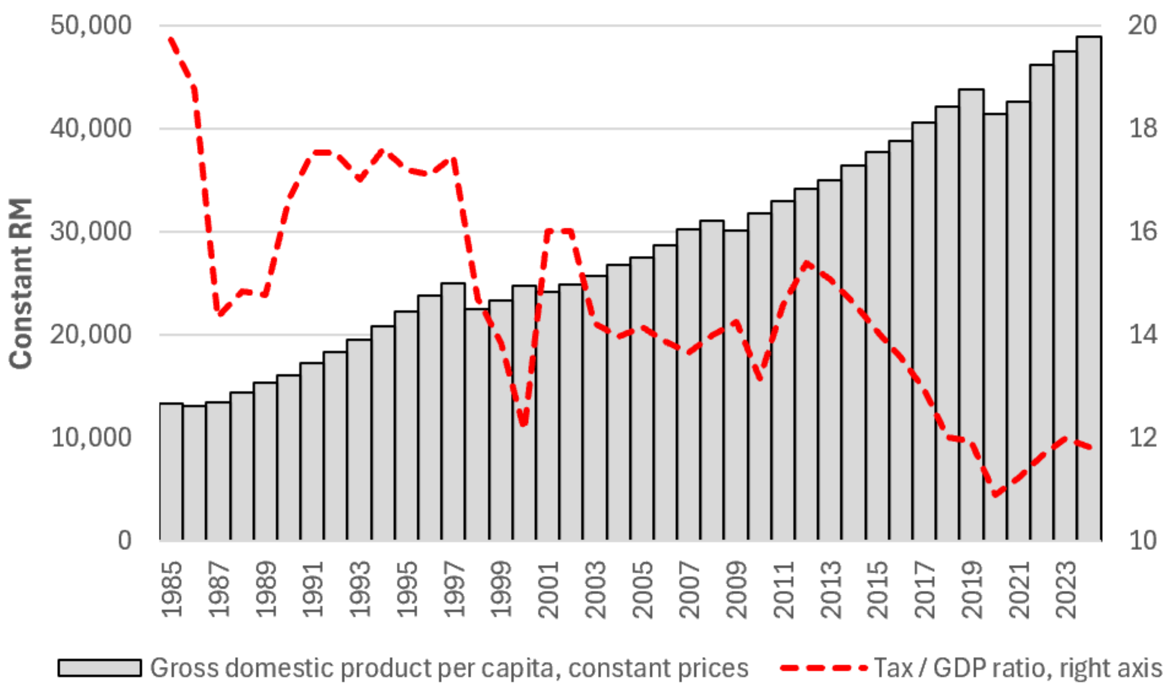
However, Malaysia's ability to efficiently allocate resources toward public expenditure is severely hampered by its limited revenue generation capacity. This constraint not only undermines the government's ability to address societal inequities but also impedes the accumulation of human capital crucial for sustainable development. Without adequate funding, Malaysia risks widening disparities and hindering the upward mobility of its citizens, ultimately jeopardizing the country's long-term economic prospects and social cohesion.

2- A CLOSER LOOK AT TAXATION IN MALAYSIA

Taxation serves as the cornerstone of modern societies, providing governments with essential revenue to fund public services and investments. Beyond its fiscal role, taxation promotes equity by redistributing wealth, mobilizes domestic resources for development, and fosters human capital through investments in education and healthcare.

The potential of a country's taxation system is influenced by various factors, including the level of per capita real income, degree of income inequality, industrial structure of the economy, social and political context, and administrative competence of tax-gathering branches of government. As countries progress along these factors, the tax-GDP ratio tends to increase. Nevertheless, Malaysia has been moving in the opposite direction as tax revenue collection weakened over time, falling to less than 12 percent of GDP in 2023 from 20 percent of GDP four decades ago (Ministry of Economy, 2024) (IMF, 2023).

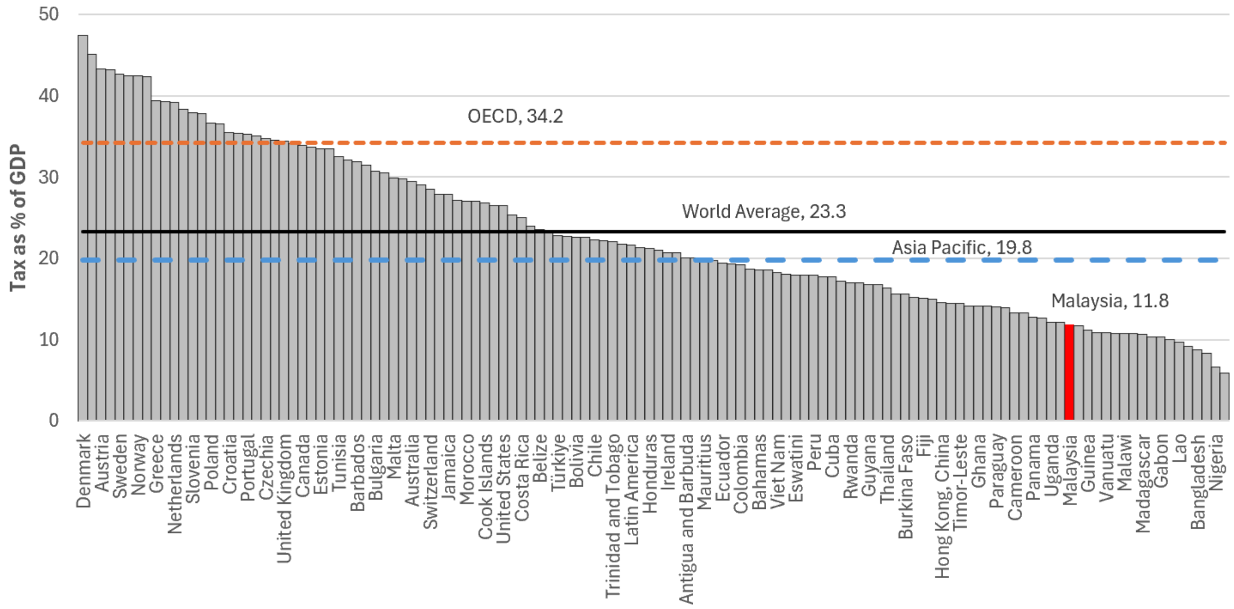
Figure 2: GDP per capita in constant prices (base year 2015) and tax to GDP ratio (right axis), 1985-2025



Source: Based on data from Ministry of Finance (2024). GDP data from IMF (2023)

Unsurprisingly, Malaysia's tax-to-GDP ratio significantly lags behind countries of similar developmental status. In fact, Malaysia's ratio is nearly one-third of the average OECD ratio (34.2 percent) and even falls below the average ratio observed in African countries (15.57 percent) (OECD, 2023).

Figure 3: Tax to GDP ratio, 2021



Source: based on data from OECD (2023)

Malaysia, therefore, possesses significant potential to enhance tax revenue by capitalizing on its economic growth, diverse industries, and strengthened administrative capabilities. A detailed examination of the tax revenue composition offers valuable insights into potential avenues for expanding fiscal capacity through taxation.

Table 1: Taxes in million RM and as a percent of GDP, 2022-2024[1]

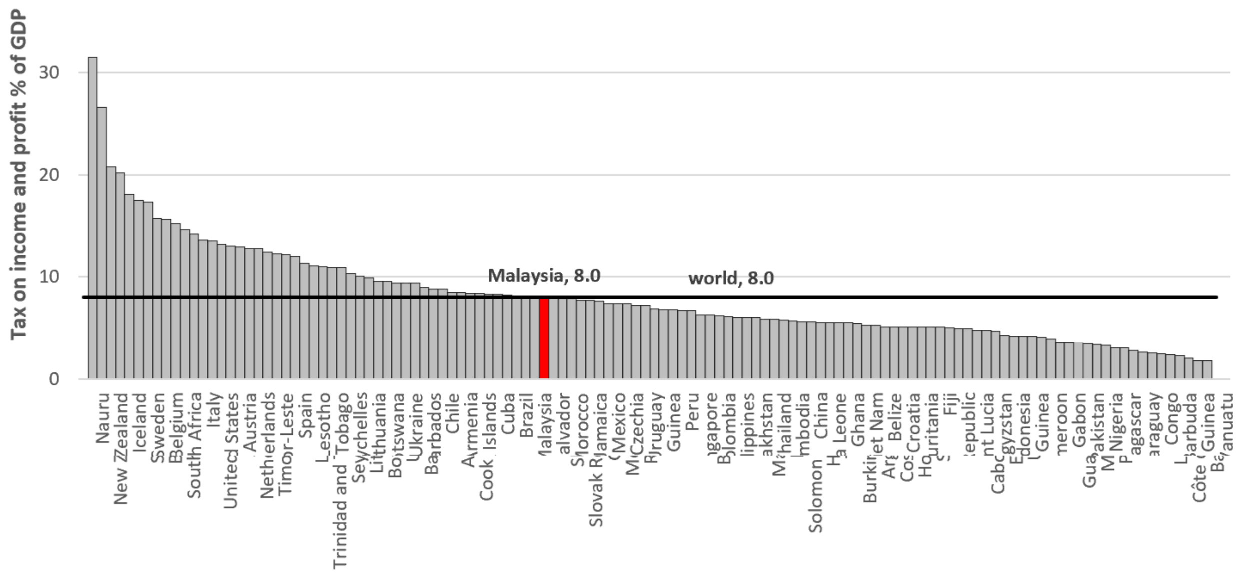
	Million RM			**Percent of GDP**		
	2022	**2023**	**2024**	**2022**	**2023**	**2024**
Total Taxes	**208,765**	**229,020**	**243,620**	**11.65**	**12.00**	**11.83**
Direct tax	**153,476**	**173,020**	**185,000**	**8.57**	**9.06**	**8.98**
Companies Income Tax	82,133	98,435	106,420	4.58	5.16	5.17
Individuals Income Tax	33,776	39,725	42,460	1.89	2.08	2.06
Petroleum Income Tax	23,421	20,520	21,750	1.31	1.07	1.06
Others	10,199	10,360	10,315	0.57	0.54	0.50
Withholding and others	3,947	3,980	4,055	0.22	0.21	0.20
Indirect Tax	**55,289**	**56,000**	**58,620**	**3.09**	**2.93**	**2.85**
Export Duties	2,622	1,800	1,900	0.15	0.09	0.09
Import Duties	3,192	3,038	3,200	0.18	0.16	0.16
Excise Duties	12,556	13,100	13,600	0.70	0.69	0.66
Sales Tax	16,256	17,600	18,300	0.91	0.92	0.89
Service Tax	15,112	16,600	17,500	0.84	0.87	0.85
Others	5,551	3,862	4,120	0.31	0.20	0.20

Source: based on data from Ministry of Finance (2024). GDP data from IMF (2023)

As for the direct taxes, Malaysia's ratio of direct taxes to GDP is in line with the global average, standing at 8.0 percent of GDP (OECD, 2023).

[1] The budget for fiscal year 2022 is actual, year 2023 is estimate, and for fiscal year 2024 is budgeted.

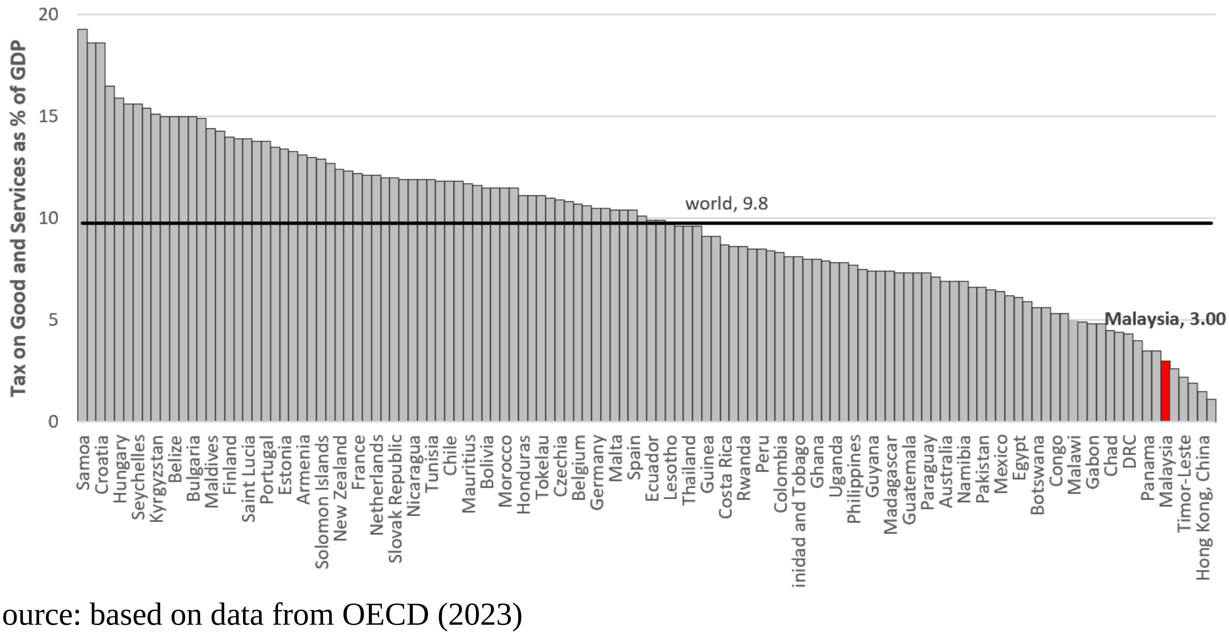
Figure 4: Tax on income and profit as a percent of GDP, 2021



Source: based on data from OECD (2023)

Nevertheless, Malaysia's tax on goods and services ranks among the world's lowest as a percentage of GDP, notably falling well below the global average of 9.8 percent of GDP (OECD, 2023).

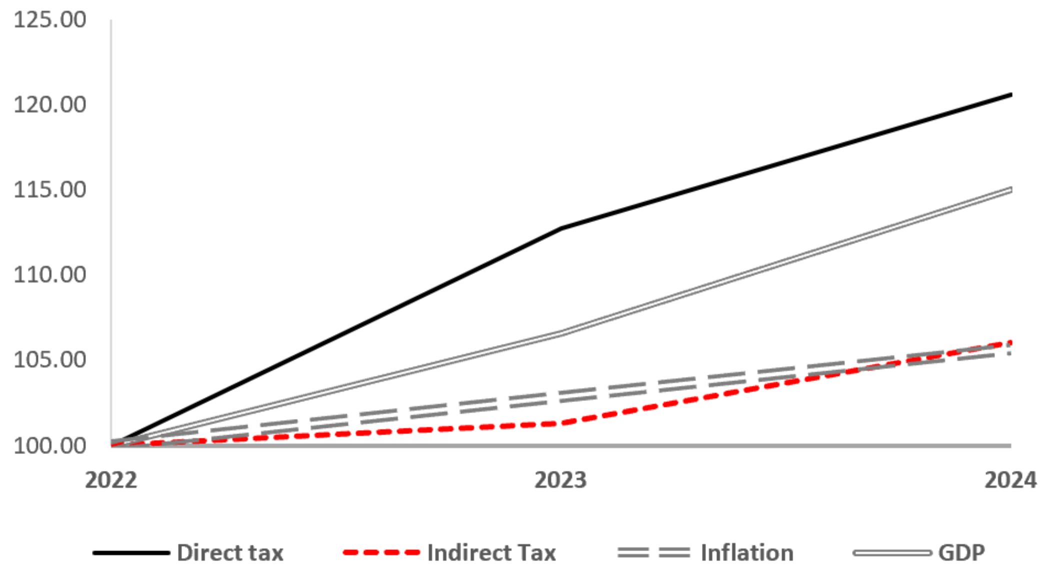
Figure 5: Tax goods and services as a percent of GDP, 2021



Source: based on data from OECD (2023)

Furthermore, it is concerning that the disparity continues to widen over time, as the tax on sales and services grows at a slower pace than GDP growth, diminishing its relative contribution to the economy.

Figure 6: Different taxes, inflation, and GDP growth rates (base year is 100 in 2022)



Source: calculation is based on data from Ministry of Finance (2024) and IMF (2023)

The attempts to address this issue has been limited in impact. The most recent effort has been in budget 2024, where the government announced the introduction of new measures to broaden the tax base, enhance compliance, and streamline administration to effectively mobilize domestic resources. Key initiatives include (Ministry of Finance, 2023):

- Increasing the excise on sugary drinks from RM0.40/liter to RM0.50/liter.
- Raising the Service Tax by an additional 2 points, now standing at 8 percent, excluding food, beverages, and telecommunication services.
- Introducing a 5 percent excise on chewing tobacco, alongside an additional RM27/kg.
- Implementing a 10 percent capital gains tax solely on the disposal of unlisted shares of local companies.
- Expressing further intentions to impose new taxes on luxury goods and companies with global income, although specific implementation dates were not provided.

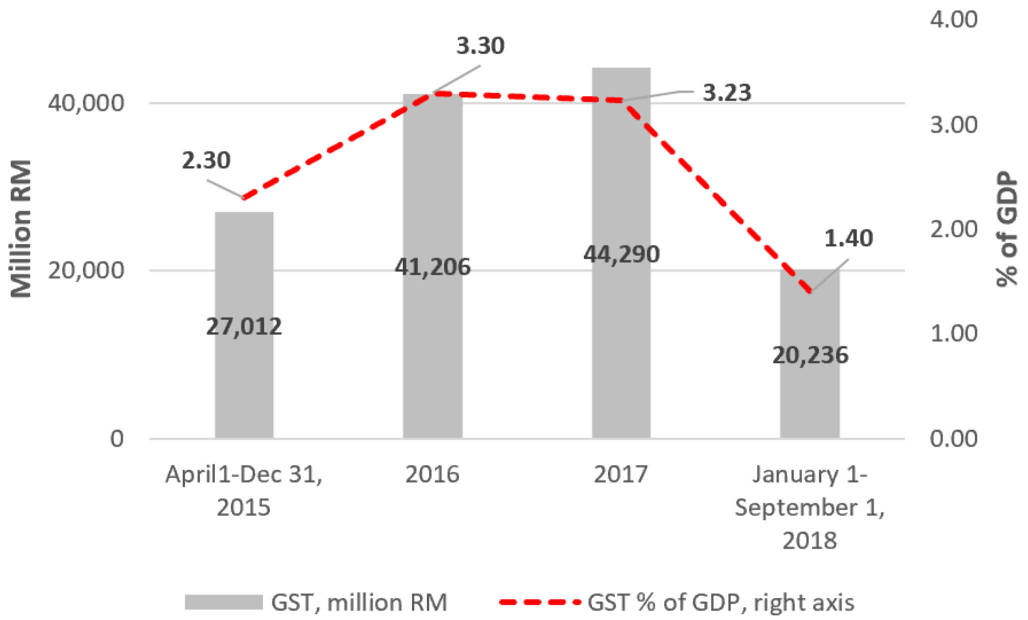
While the collective impact of these measures was not reflected in the 2024 budget, their potential to generate tax revenue is assessed to be very limited, contributing only around 0.3 percentage points of GDP (IMF, March 2024)

3- TIME TO REINSTATE GST

An observation on Table 1 is the conspicuous absence of Value Added Tax (VAT) among the array of tax options utilized in Malaysia. This largely accounts for the nation's weakened tax generation capacity, particularly evident in the realm of goods and services, as illustrated in Figure 5.

However, this has not always been the case in Malaysia. The introduction of the Goods and Services Tax (GST), akin to VAT, spanned from April 1, 2015 to September 1, 2018. During this period, it generated substantial tax revenue amounting to 3.23-3.30 percent of GDP for the years in which GST was fully implemented (Ministry of Economy, 2024).This constituted nearly one-fifth of Malaysia's total revenue during the same years.

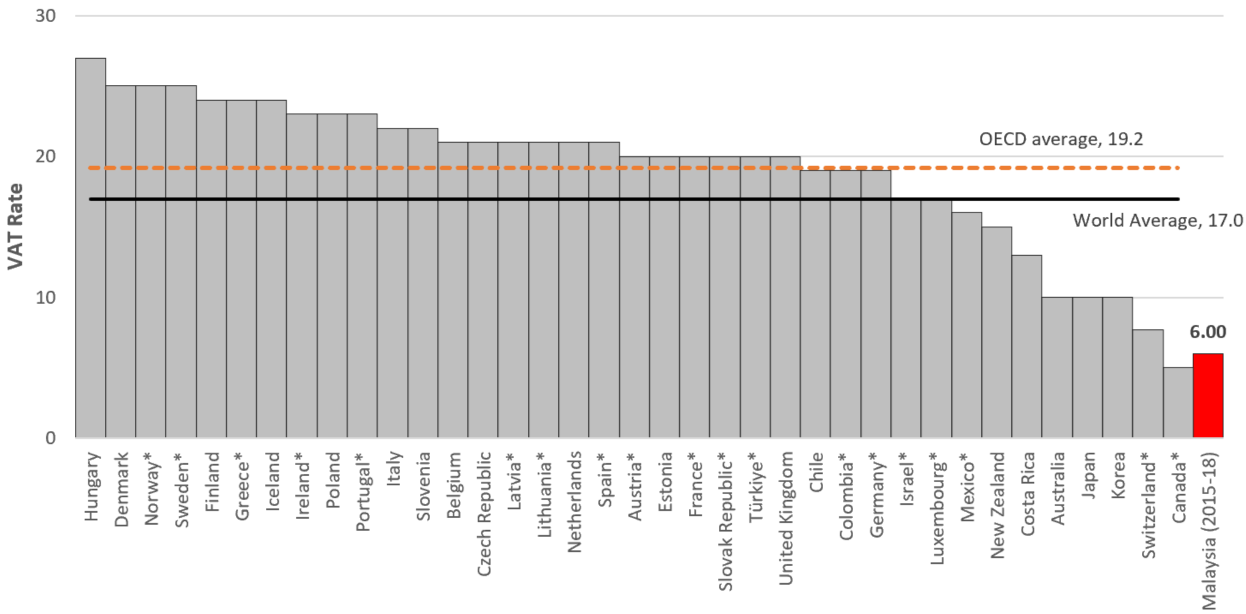
Figure 7: GST tax collection in million RM and as a percent of GDP (right axis), 2015-2018



Source: based on data from Ministry of Economy (2024). GDP data from IMF (2023)

VAT stands as a potent revenue tool employed across all OECD countries, except for the USA, contributing an average of 20 percent to total revenues in these nations (OECD, 2023). It is worth highlighting that Malaysia introduced GST at a notably lower rate of 6 percent, contrasting with the average VAT rates observed in other OECD countries, which stood at 19.3 percent in 2023 (OECD, 2023).

Figure 8: VAT tax rates in OECD countries, Malaysia (2015-2018), and the world’s average, 2023



Source: based on data from OECD (2023) and Ministry of Economy (2024)

Therefore, reintroducing the VAT in Malaysia has an enormous upside potential to generate revenue stream that can be channelled for inclusive growth path. If Malaysia introduces VAT gradually and to reach the world average rate of 17 percent, the amount generated has the potential to ultimately reach more than 9 percent of GDP, totalling RM188.4 billion in 2024.

Table 2: Potential VAT tax revenue at different rates in billion RM and as a percent of GDP, 2024[2]

2024		
VAT rate, %	**tax/GDP, %**	**Billion RM**
6	3.23	66.49
10	5.38	110.81
17 (world average)	9.14	188.38

4- MAKING IT WORK…. LEARNING FROM THE PAST

The decision to eliminate the GST in 2018, a pledge made during the 2018 election, stemmed primarily from its regressive nature as a consumption tax, disproportionately affecting the income of the less affluent compared to the wealthy. Reintroducing it without addressing equity concerns poses significant political challenges.

This paper argues for **a phased reintroduction of the GST coupled with a structured system of periodic tax refunds**. Given the anonymity of transactions under a VAT system, designing a tax refund mechanism in the form of cash transfer to families with children, senior citizens,

[2] This is assuming the same level of tax administrative efficiency that was achieved in 2015-2018 when GST was implemented.

persons with disability, expecting mothers, can mitigate welfare losses resulting from inflationary pressures and diminished budgets during vulnerable life stages. Below system of tax refund can be introduced at the same time VAT is imposed.

Table 3: A proposed system of tax refund to accompany VAT

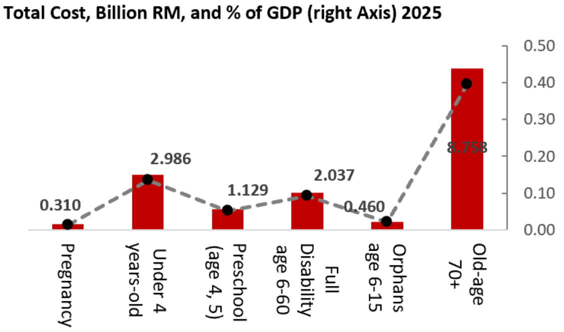
Benefit	**Monthly Amount**	**Eligibility/conditionality/description**
Pregnancy Benefit	RM 150	Pregnant women. Cash or can be provided in the form of nutrition supplements
Children Benefit	RM 150	Children under 5.
Preschool Benefit	RM 150	Children aged 5 and 6. Conditional preschool enrolment.
Orphans Benefit	RM 200	Orphans 6-15 years-old
Disability Benefit	RM 300	Persons with disability age 6-60
Old-age Pension	RM 500	All persons above 70

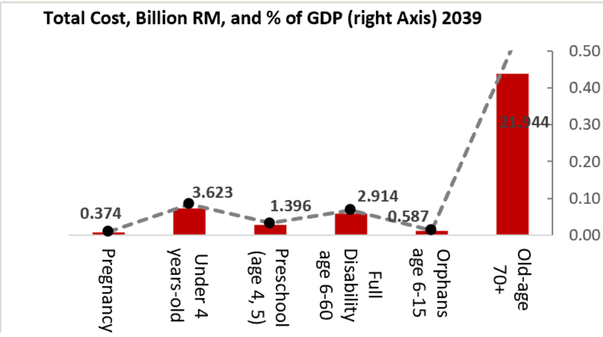
In terms of cost of the system of tax refunds, Table 4 shows **affordability of such system.** Over the projection period, benefits are assumed to maintain RM real value (indexed for inflation). However, as the economy is expected to continue to grow in real terms, the benefit level will decline relative to per capita GDP or income over the projection period.

Table 4: Projected overall cost in in (RM billion) and as share of GDP, 2025-2039[3]

[3] Calculation is based on a costing model under a set of assumptions and using data inputs from UN (2022) and IMF (2023). A more technical report on the model can be provided upon request.

	2025	2029	2033	2039
Total Expenditure, Billion RM	**15.679**	**19.349**	**23.452**	**30.838**
Pregnancy	0.31	0.33	0.35	0.37
Under 4 years-old	2.99	3.22	3.39	3.62
Preschool (age 4, 5)	1.13	1.23	1.30	1.40
Full Disability age 6-60	2.04	2.29	2.54	2.91
Orphans age 6-15	0.46	0.50	0.54	0.59
Old-age 70+	8.76	11.78	15.34	21.94
Total Expenditure,% of GDP	**0.709**	**0.690**	**0.695**	**0.717**
Pregnancy	0.01	0.01	0.01	0.01
Under 4 years-old	0.13	0.11	0.10	0.08
Preschool (age 4, 5)	0.05	0.04	0.04	0.03
Full Disability age 6-60	0.09	0.08	0.08	0.07
Orphans age 6-15	0.02	0.02	0.02	0.01
Old-age 70+	0.40	0.42	0.45	0.51





It is important to link this cost with the revenues expected from imposing VAT (see Table 2). Ultimately, the combined impact of VAT and the above system tax refunds can serve as a progressive social policy tool, while at the same time, generate sizable revenues to increase social investment in the future productivity and prosperity of Malaysia.

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