13 June 2016

GST Rate Cut is Not Unusual as UK, Ireland Have Shown in the Past

- *General consumption tax has seen downward revisions in several occasions in the past. VAT / GST implemented in other countries before Malaysia have seen occasions where the rates were revised lower. For example, in United Kingdom, the rate was revised down by 2.5% to 15% from 17.5% in 2008 while Ireland reduced the rate on several times in 1985 to 1991 and 2001.*
- *GST rate cut could be temporary in nature. Previously, we presented two hypothetical scenarios of GST rate by 1% to 2% under different projection of oil prices in 2017. Malaysian government could announce a limited time period of the reduced rate prior to the implementation, similar to the exercise made by the government of United Kingdom in 2008.*
- *Evidence from the UK suggests a cut in the VAT acts as a fiscal stimulus. In December 2008, the UK had cut the VAT rate by 2.5% for 13 months in effort to stimulate spending.*
- *GST rate cut scenarios presented in previous report highlights the possible maneuver the government could do but not necessarily suggest the government to undertake it.*

General consumption tax has seen downward revisions in several occasions in the past. VAT / GST implemented in other countries before Malaysia have seen occasions where the rates were revised lower. For example, in United Kingdom, the rate was revised down by 2.5% to 15% from 17.5% in 2008 while Ireland reduced the rate several times in the periods of between 1985 to 1991 and 2001. On the other hand, after setting the rate high in 1984 at 35%, the Irish government had gradually reduced the rate by 14% to only 21% by 1991.

GST rate cut could be temporary in nature. Previously, we presented two hypothetical scenarios of GST rate by 1% to 2% under different projection of oil prices in 2017. Malaysian government could announce a limited time period of the reduced rate prior to the implementation, similar to the exercise made by the government of United Kingdom in 2008. The pre-announced and temporary rate cut has shown to increase domestic consumption and GDP based on the past experience in UK. On a side note, the government did contemplate on lower GST rate i.e 4% prior to the actual implementation but instead opt for 6%. It was done so to obtain higher revenue which would enable to government to really push through its fiscal consolidation plan.

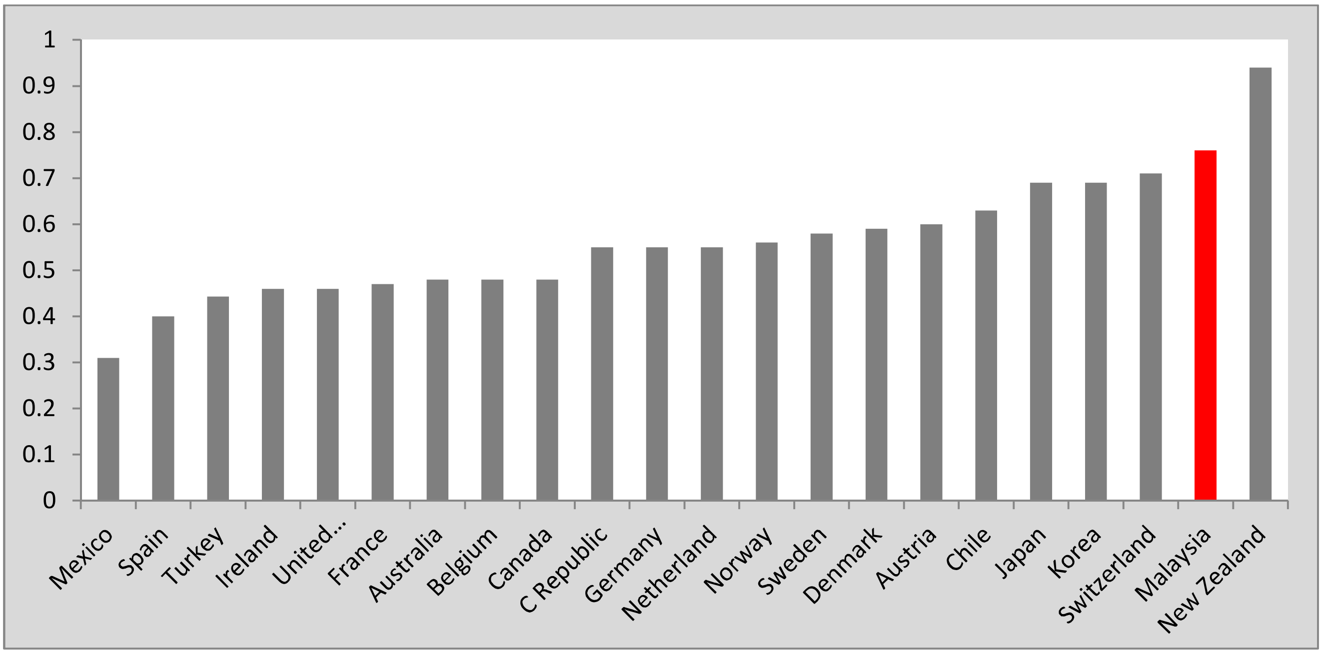
Evidence from the UK suggests a cut in the VAT acts as a fiscal stimulus. In December 2008, the UK had cut the VAT rate by 2.5% for 13 months in effort to stimulate spending. According to a paper (Thomas, 2014), the move managed to boost retail sales by 1.0% and 0.4% increase in total expenditure. Businesses initially pass the VAT rate cut via lower prices which in return boost spending from consumers. Despite prices eventually returned several months later to the level prior the rate cut, the magnitude of consumption front loading was enough to reflect higher spending throughout the period. We note that the UK government did increase the duty on alcoholic beverages by 8 percent as a way to offset the loss in tax revenue.

Table 1: UK, Ireland Have Done it in the Past

Country	Rate Cut	Remarks
United Kingdom	**1976** 2.0% (10% to 8.0%) **2008** 2.5% (17.5% to 15.0%)	In 2008, the rate was reduced for 13 months. Offset via higher alcoholic beverages duty
Ireland	**1985 – 1991** 14.0% (35.0% to 21.0%) **2001** 2% (23.0% to 21.0%)	Gradual reduction in 1985 – 1991
France	**2000** 1.0% (20.6% to 19.6%)	

Source: MIDFR

Chart 1: Malaysia Was Ranked Top 3 in Consumption Tax Revenue Ratio (TRR)



Note: Calculation formula: TRR = VAT revenue / (Consumption x Standard VAT rate). Consumption: Final Consumption Expenditure OECD applies 2011 data in its publication to normalise reporting.

Source: OECD Publishing (2013), MIDFR

Malaysia has high GST revenue ratio which underlines efficiency in tax collection. For the first 3 quarters of implementation, custom reported GST net revenue collection of RM27.0 billion. This lead to a high TRR ratio of 0.76 which ranked Malaysia third compared to countries in the OECD 2013 report, underlining the great efficiency of the GST revenue collection system despite being newly implemented. Unlike Mexico or Spain which struggles with collection of tax revenue, Malaysia is efficient on this score thus we opine this could contribute to the reason for a plausible GST rate cut in 2017 for the country.

GST rate cut scenarios presented in previous report highlights the possible maneuver that the government could do. We would reiterate that the hypothetical GST rate cut presented earlier suggests there is room for such maneuver but we do not necessarily advise such move to be undertaken. Further study has to be made to assess the possible income and consumer behaviors should the government choose to opt for a rate revision. Other form of downward revision in taxes such income tax and business related taxes are more applicable and effective in boosting domestic sector as currently practiced by the government in the past.

MIDF RESEARCH is part of MIDF Amanah Investment Bank Berhad (23878 - X).

(Bank Pelaburan)

(A Participating Organisation of Bursa Malaysia Securities Berhad)

DISCLOSURES AND DISCLAIMER

This report has been prepared by MIDF AMANAH INVESTMENT BANK BERHAD (23878-X). It is for distribution only under such circumstances as may be permitted by applicable law.

Readers should be fully aware that this report is for information purposes only. The opinions contained in this report are based on information obtained or derived from sources that we believe are reliable. MIDF AMANAH INVESTMENT BANK BERHAD makes no representation or warranty, expressed or implied, as to the accuracy, completeness or reliability of the information contained therein and it should not be relied upon as such.

This report is not, and should not be construed as, an offer to buy or sell any securities or other financial instruments. The analysis contained herein is based on numerous assumptions. Different assumptions could result in materially different results. All opinions and estimates are subject to change without notice. The research analysts will initiate, update and cease coverage solely at the discretion of MIDF AMANAH INVESTMENT BANK BERHAD.

The directors, employees and representatives of MIDF AMANAH INVESTMENT BANK BERHAD may have interest in any of the securities mentioned and may benefit from the information herein. Members of the MIDF Group and their affiliates may provide services to any company and affiliates of such companies whose securities are mentioned herein This document may not be reproduced, distributed or published in any form or for any purpose.