

How other countries are subsidising their way out of inflation

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AT first, governments around the world had sought to fight off the effects of the Covid-19 pandemic by throwing a lifeline to those mostly affected such as the lower-income groups. But then came a bigger challenge – rising inflation, putting an already stressed populace in a difficult position to afford necessities. So more money is being spent on subsidies.

From Singapore to Thailand, the United Kingdom to the United States, there is some form of help being given to the public to help them face rising inflation. But at what expense?

Soh Lian Seng, head of tax at KPMG in Malaysia, however, points out that in some markets the subsidies are actually decreasing as governments become aware of not busting their budget deficits too much.

“Although subsidies had reached high levels during the pandemic and governments continue to focus on areas most impacted, generally, Asean and India are seeing a decline in subsidies as the world moves towards the endemic phase in the new normal,” he tells *StarBizWeek*.

In particular, he notes that Covid-19 healthcare and social assistance in Indonesia and Singapore as well as food, fertiliser and petroleum in India are being progressively scaled back and estimated to further decline in the foreseeable future.

On the other hand, the national budget for subsidy in Thailand is forecast to remain relatively unchanged since the pandemic, where the subsidy budget is expected to account for the largest proportion.

AmBank Group chief economist Anthony Dass says that government spending on subsidies globally in 2020 saw a sharp jump to 47.3% of total expenditure, from 43.7% in the previous year.

“For instance, the US government expenditure on subsidies and other transfers rose 55.5% year-on-year to US\$4.9 trillion (RM21.7



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trillion), while in the UK it climbed about one-third in 2020,” Dass shares.

The assistance programme given out by governments to cushion the adverse impact of Covid-19, among others included wage subsidies, financial aid for reskill-upscaling, utilities credit and cash transfers.

More recently, food security woes have been making world headlines and subsidies have been leaning towards catering for and expanding programmes on domestic farming.

“The move can be seen in the European Union with aid raised to maintain domestic production by reaching out to their hardest-hit farmers, as well as the Czech Republic that introduced a bill that requires at least 85% of food to be domestically produced by 2027,” says KPMG’s Soh.

Elsewhere, the United States would see its Coronavirus Food Assistance Programme distribute up to US\$16bil (RM70.85bil) worth of relief to local farmers, while the Middle East is considering upgrading farming infrastructure to redirect resources to local food

production. Closer to home, Singapore is looking into vertical farming as a national investment in domestic food production, Soh says, noting that the Singapore government’s social expenditure now accounts for nearly half of its annual budget. Subsidies in the island city-state are centred on areas of healthcare, education and support schemes for seniors and lower-wage workers.

In Malaysia, fuel subsidies make up the bulk of the subsidy bill and may make up RM30bil out of the projected RM77.7bil expenditure on subsidies for 2022. This is to cushion the impact from crude oil prices that hovered above US\$100 (RM443) per barrel.

In Indonesia, subsidies also largely cover electricity, diesel and liquefied petroleum gas. On the contrary, Soh says that Thailand’s subsidy budget has been making strides in developing its less fuel-reliant electric vehicle industry.

Interestingly, some feel the rampant inflationary pressures observed worldwide now are, to some extent, caused by the pandemic-related lockdowns.

“Politicians then tried to put a patch on the hole with expansive fiscal and monetary policies, which included low interest rates and subsidies. But, how can more money cure inflation? It is a contradiction,” opines Centre for Market Education (CME) chief executive officer Carmelo Ferlito.

He says this only creates “the illusion of having more money in hand, while the real purchasing power will keep on deteriorating because subsidies add inflation to inflation”.

According to Ferlito, the way to restore the purchasing power of the people is to bring in deflation. But this means further increase in interest rates, cutting government spending and restoring savings, which in turn bring about a contraction in the economy.

Scaling back subsidies

As governments seek a balance between fiscal discipline and inflation, subsidies are being scaled back.

Indonesia, which was able to finance its



A snapshot of other governments' subsidies



INDONESIA

> Expenditure on subsidies rose 7.8% to US\$80.3bil

(RM355.41bil) in 2020.

> For 2022, doubling allocation for energy and compensation to 520 trillion rupiah (RM160.66bil).



THAILAND

> Expenditure on subsidies rose 9% to US\$34.9bil

(RM154.47bil) in 2020.

> Imposed price caps on essential goods.
> Channelling profit from oil refiners to fund energy subsidies.



SINGAPORE

> Expenditure on subsidies rose 56.1% to US\$18.9bil

(RM83.65bil) in 2021.

> US\$1.5bil (RM6.64bil) for low-income and vulnerable groups.



SOUTH KOREA

> Subsidies and other transfers increased 10.4% to US\$310.9bil

(RM1.4 trillion) in 2020.

> Unveiled a 14 trillion won (RM52.01bil) supplementary budget for the self-employed and small businesses for 2022.



JAPAN

> Subsidies and other transfers rose 2.7% to US\$471bil (RM2.1

trillion) in 2020.

> 2.7 trillion yen (US\$21bil or RM92.95bil) extra budget for 2022 to tackle rising fuel and food prices.



INDIA

> Unveiled a US\$26bil (RM115.08bil) aid package in May;

includes higher subsidies, lower fuel taxes and lower import levies.

Indonesia, which was able to finance its subsidies by tapping into export revenue from coal and palm oil, is slowly reducing subsidies to reduce the budget deficit to the legal limit of 3% of gross domestic product (GDP). A new law on an increase in value-added taxes and tax amnesty is also expected to see additional revenue of about 1% of GDP in the coming year, says Soh.

Singapore, meanwhile, has announced an increase in the goods and services tax (GST) to 9%, plus a slew of taxes on high-income earners, investment properties and luxury cars. According to Soh, the move brings about taxes based on expenditure and wealth, while subsidies to bolster GST expenses for the next few years would be allocated to lower-income households through cash, rebates and vouchers.

"That way, the less-abled households receiving targeted assistance will not be negatively impacted by the new taxes," he adds.

The World Bank in its Indonesia Economic Prospects for June 2022, for example, notes that government subsidies in the country had benefited mostly the middle-to-high-income families and less in helping the poor.

Towards this end, Indonesia has been advised to instead provide targeted social assistance to those in need, which would also allow for fiscal savings.

While subsidies are social safety nets for the poor, it may create or encourage complacency in firms and stymie innovation – thereby indirectly affecting a country's growth potential.

"Such allocations of the national budget may prove a costly trade-off of public money," says Soh.

However, attempts to scale back on subsidies are often met with resistance.

Citing the case of fuel subsidies being phased out in Ecuador in late 2019, Soh notes that its government had to eventually restore them after they were met with violent protests. Such instances of unrest could also be seen in India, Yemen, Jordan and Indonesia.