

Contents

Preface — V

1 Introduction — 1

- 1.1 The Status Quo — 1
- 1.2 Sustainable Solutions — 5
- 1.3 Impact of Policy Reform — 6

2 Fiscal Policy and Sustainability — 9

- 2.1 Introduction — 9
- 2.2 Theoretical Foundation of Fiscal Policy — 9
 - 2.2.1 The Common Pool Problem — 11
 - 2.2.2 Sustainability of Public Finance — 12
- 2.3 A Brief Overview of Malaysia's Fiscal Performance — 12
 - 2.3.1 Government Debt and Deficit — 13
 - 2.3.2 Government Expenditure — 15
 - 2.3.3 Government Revenue — 17
- 2.4 Fiscal Policy Instruments — 18
 - 2.4.1 Taxation — 19
 - 2.4.2 Government Spending — 19
 - 2.4.3 Government Borrowing — 20
- 2.5 Issues with Malaysian Fiscal Policy Tools — 20
 - 2.5.1 Income Tax — 21
 - 2.5.2 Real Property Gains Tax — 29
 - 2.5.3 Sales and Service Tax — 30
 - 2.5.4 Stamp Duty — 31
 - 2.5.5 Public Sector Borrowing — 31
- 2.6 Conclusion — 33

3 Studies on Fiscal Sustainability — 35

- 3.1 Introduction — 35
- 3.2 Fiscal Sustainability — 35
 - 3.2.1 Operational Definition — 35
 - 3.2.2 Theoretical Framework — 37
 - 3.2.3 Merits and Criticism — 39
- 3.3 Tax Structure — 40
 - 3.3.1 The Case for a Flat Rate Income Tax System — 42
 - 3.3.2 A Case for Wealth Tax — 46
- 3.4 Public Sector Borrowing — 49
 - 3.4.1 Debt and Growth — 50
 - 3.4.2 Interest-Based Borrowing — 51

3.4.3	Risk Sharing System — 52
3.5	Conclusion — 53
4	Data Description and Modelling — 55
4.1	Introduction — 55
4.2	Research Design and Appropriateness — 55
4.3	Model Specifications — 56
4.3.1	Fiscal Sustainability Indicator — 57
4.3.2	Fiscal Sustainability Test — 61
4.3.3	Univariate Unit Root Tests — 62
4.3.4	Multivariate Cointegration Analysis — 63
4.3.5	Dynamic Ordinary Least Squares Estimation — 66
4.3.6	Testing for Causality — 66
4.4	Simulation of Variable of Interest — 68
4.4.1	Simulation of Tax Revenue — 69
4.4.2	Simulation of Government Expenditure Based on the Risk Sharing Financing Model — 71
4.5	Sources of Data and Variables Used — 72
4.5.1	Specification of Income — 73
4.5.2	Specification of Wealth — 75
4.6	Conclusion — 76
5	Empirical Analysis — 78
5.1	Introduction — 78
5.2	Results of Data Simulation — 79
5.2.1	New Tax Revenue — 79
5.2.2	New Government Expenditure — 82
5.3	Index of Fiscal Sustainability — 83
5.4	Sustainability Test — 85
5.4.1	Univariate Unit Root Tests — 85
5.4.2	Cointegration Relationship — 87
5.5	Estimation of Long-Run Equilibria — 90
5.5.1	DOLS without Structural Break — 90
5.5.2	DOLS with Structural Break — 92
5.6	Causality Analysis — 95
5.7	Analysis of Results — 96
5.8	Conclusion — 98
6	Policy Recommendation — 99
6.1	Introduction — 99
6.2	Role of the Government and Policy Design — 100
6.3	Leveraging on The Strength of Islamic Finance Principles — 101

6.4	A Simple Tax Structure —	102
6.5	Risk Sharing Financing —	104
6.6	EPS —	105
6.7	Benefits of Policy Recommendations —	106
6.7.1	Positive Distributional Impact —	107
6.7.2	Good Governance —	107
6.7.3	Economic Resilience —	108
6.8	Conclusion —	109

References —	111
--------------	-----

List of Figures —	119
-------------------	-----

List of Tables —	121
------------------	-----

Appendix A Implementation of GST in Malaysia —	123
--	-----

Appendix B Sources of Data —	127
------------------------------	-----

Appendix C Derivation of Fiscal Sustainability Index —	129
--	-----

Appendix D Islamic Worldview of the Economy —	133
---	-----

About the Author —	135
--------------------	-----

Index —	137
---------	-----