
Anti-profiteering Regulations: Effects on Consumer Prices & Business Margins

Hafiz Noor Shams



Summary

The parliament passed the Price Control and Anti-Profiteering Law in 2011 granting the federal government greater power to manage consumer prices in Malaysia. This law was expected to expire on 31st December 2016. However, the government renewed the Price Control and Anti-Profiteering Act in 2017 without a sunset clause.

This paper explores the effectiveness of the Price Control Act through difference-in-differences method applied to Malaysia's consumer price index as well as the potential effects of the anti-profiteering regulations. The research is based on meetings with government officials as well as on statistics from the Companies Commission, Department of Statistics and the Ministry of Domestic Trade, Cooperative and Consumerism.

The paper argues that average inflation in the January-July 2017 period had returned to the rate before the GST was introduced. This may suggest the regulation is no longer relevant, regardless of whether it was useful. The paper also laid out the criticisms of the rules which include rising cost of doing business, forced absorption of rising input cost, anti-competitive nature of the 2015-2016 profit control mechanism, inflexible net profit bench-marking across time and whether the price pressure addressed by the regulation is due to the inherent nature of the taxation system or due to profiteering by businesses.

Conclusively, the paper is unable to determine whether the PCAP was effective in curbing price inflation. Therefore, in the short run, it is recommended that the benchmark formula is made more dynamic while in the long term, it is suggested a sunset set clause be reintroduced into the regulation to wind it up.

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I. A short history of price controls in Malaysia

Price controls on consumer goods have existed in territories now part of Malaysia since at least 1946. That was the year when the Price Control Act was first enforced by the British Malayan colonial government.

Malayan prices during the 1945-1947 post-war period was excessively inflationary.¹ Reconstruction brought increased demand but the supply shortages caused by the war had yet to be alleviated. The British Military Administration of Malaya attempted to suppress wages to fight off severe price inflation. The effort was deeply unpopular. Wage suppression, supply shortages, rising living costs along with political discontents led to widespread unrests across the country. The most prominent general strike was organized on January 29 and 30 1946. Another strike took place on February 15, the fourth anniversary of the fall of Singapore, which led to harsh police crackdowns on protesters.²

British military rule ended with the creation of the civilian-run Malayan Union on April 1 1946. The new colonial civilian government took a more sophisticated approach toward inflationary pressure by enforcing a new Price Control Act in October. The 1946 Act allowed the government to impose maximum prices on any good or service and penalised those who did not adhere to the restriction. Other notable powers included the ability of the authority to control the supply of controlled items indirectly through the issuance of licenses and restriction of exports, as well as the ability to compel sellers to provide consumers with the controlled items.³

Indirect price controls can also come in the form of supply restrictions. Control of Supplies Act of 1961 passed by the parliament of the newly independent Federation of Malaya made explicit the government's ability to do so on all items beyond what was provided by the Price Control Act. The act itself was not a new invention: legal supply control mechanism in some form had been enforced as early as 1939 in the Straits Settlements, the Federated Malay States, and in the states of Johor and Kelantan. The difference is that the supply control instituted in the 1930s was designed to regulate supply of foodstuff rather than all consumer items.⁴

These two laws are not the only mechanisms that exist to control prices in Malaysia. For example, the Control of Padi and Rice 1994 aims to keep prices of rice stable. The Gas Supply Act 1993 does the same for the fuel. There are plenty of other instances of controls. Furthermore, controls over industrial production have existed earlier: the British colonial government in Malaya restricted the supply of rubber in the early 1920s and again in the 1930s to combat overproduction and raise prices. Malaysia itself has attempted to control rubber supply with cooperation from Indonesia and Thailand in more recent years.⁵

¹ John H. Drabble. *An Economic History of Malaysia, c. 1800-1990: The Transition to Modern Economic Growth*. 2000. Page 160.

² Timothy N. Harper. *The End of Empire and the Making of Malaya*. 1999. Page 80-81.

³ Price Control Act 1946.

⁴ Control of Supplies Act 1961.

⁵ Malaysia, Indonesia, Thailand mull cutting rubber output to stabilise prices. *Bernama*. July 17 2017

2. Price Control and Anti-Profiteering Act 2011

The Price Control Act had undergone numerous amendments. The most significant change occurred in 2011 when the government expanded its powers substantially through the Price Control and Anti-Profiteering Act (PCAPA), which supersedes the 1946 law.

The original colonial law gave the government the ability to set price ceiling of all goods as well as services linked to the goods only. The newer 2011 act widens such powers by vesting Putrajaya through the Ministry of Domestic Trade, Cooperatives and Consumerism the authority to establish price floors, fix selling prices and limit net profits made on any goods and services sold, in addition to previous controls provided in the 1946 law.

PCAPA was introduced as part of the federal government's plan to replace the sales and services tax with a more efficient value-added tax called the goods and services tax (GST). The GST itself was supposed to be enforced in 2011 – the same year PCAPA became law – but it was delayed to 2015 out of political concerns. The 2013 election was the first electoral contest for Najib Razak as Prime Minister, who was under pressure to improve his Barisan Nasional coalition's electoral performance relative to the 2008 election. The previous Prime Minister Abdullah Ahmad Badawi was forced to step down after a weak BN victory in the 2008 election at the federal level. In the same election, BN lost the states of Kedah, Penang, Perak and Selangor to the opposition while failing to win in Kelantan. Mr Najib returned to power in the 2013 with a reduced majority.

The GST was initially meant to be introduced at the rate of 4%, a rate projected by the Royal Malaysian Customs to be revenue neutral for the government, relative to its income from old sales and services tax. This was the source of government's confidence in claiming the GST would not put upward pressure on prices in the short term. However, the government set the introductory rate at 6% instead despite expectations set earlier by Putrajaya. The higher rate raised government revenue but it also created strong inflationary pressure on consumer goods, at least in the short run. As this paper shows, inflation was elevated above pre-GST trends for about two years. Despite so, the government continually asserted publicly its belief that the GST would have no or limited inflationary effect on prices. Former deputy finance minister Ahmad Maslan infamously claimed the GST could bring prices down.⁶

⁶ GST Boleh Turunkan Harga Barang – Ahmad Maslan. Astro Awani. April 3 2015.

The part most relevant to the GST in PCAPA is the anti-profiteering aspect. Actual regulation operationalising the anti-profiteering law was only put in place in 2014 and enforced in January 2015, ahead of April 1 GST implementation. Officially, the anti-profiteering rules are called the Mechanism to Determine Unreasonably High Profit (Net Profit Margin) Regulations.

On December 26 2014, the government gazetted the regulation, which set the formula to determine profiteering, specified the classes of goods coming under control and announced the period for which the regulation would come into force. The regulation stated that no net profit could be increased legally from January 2 2015 until June 30 2016 above a certain benchmark. On June 24 2016, a week before the regulation was supposed to expire, the government extended the control duration to December 31 2016. When December came, the government extended the regulation again – albeit with some liberalisation – but this time indefinitely despite promising the measures would be temporary.

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2.1. Mechanism to Determine Unreasonably High Profit Regulations

The first two years had net profit control harshly applied on all consumer goods sold. The authorities defined net profit as the difference between sale price and cost at a certain point in time. There were multiple cases to cover various scenarios but they all could be boiled down to differences between the two variables.

To illustrate the point, if the final sale price for a particular good was RM10 and the cost was RM9 during the benchmarked period, then the net profit would be RM1. To comply with the rule, the seller's net profit must never exceed RM1. If the seller made a net profit higher than the RM1 ceiling, the selling party would be deemed as making unreasonably high profits, i.e. profiteering. If found guilty, the violator would risk a hefty fine or imprisonment.⁷

The 2015-2016 net profit ceiling was based on absolute net profit earned on January 1 2015, or the first day the good was introduced to the market after the regulation was enforced. The ceiling differed from business to business, depending on the absolute net profit they made on the day their operations were benchmarked by the authority. This made it perfectly legal for a hotel to make RM10 net profit on a glass of teh tarik and a mamak restaurant RM1 on the same offering, as long as their net profit did not exceed their tailored benchmark.

The 2017 regulation, which is now in force, refined and liberalised the rules. Instead of setting the ceiling based on absolute net profit, the maximum net profit is now expressed in percentage terms.⁸ For instance, if a seller's net profit was 5% (calculated either through mark-up or margin approach), then its net profit cannot exceed 5%. This is a liberalisation because the seller's net profit in percentage terms could remain constant in the face of rising costs, whereas previously under the 2015-2016 rule, net profit in percentage terms could shrink under a specific but regular case of cost increase. The specific case is discussed in Subsection 4.3. At the same time, the range of goods covered were narrowed down to food and household items.

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⁷ For body corporate, first time offense could face a fine up to RM500,000 and subsequent offense RM1,000,000. For a person, the first offense could bring a maximum RM100,000 fine or three years jail, while subsequent violation brings a penalty of no more than RM250,000 or an imprisonment no more than five years.

⁸ For clarity, beginning 2017, Net Profit = (Selling price – Cost)/Cost or (Selling price – Cost)/Selling Price. The former is called mark-up percentage and the later margin percentage in the regulation.

2.2. Enforcement of anti-profiteering regulation

The Ministry of Domestic Affairs, Cooperative and Consumerism took actions against violators. There were 195 prosecutions related to the PCAP as a whole in 2015. The number rose to 230 in 2016. One of the biggest retailers fined under the Act, specifically under the net profit control regulation was Aeon Co Bhd when the company was penalised RM110,000 for increasing their net profit on muffins in Malacca in 2015. Another retailer EconSave Cash & Carry Sdn Bhd was fined for RM40,000 under the anti-profiteering regulation in the same month for widening its absolute net profit on raw coconut milk beyond what was permitted. Bloomberg reported the ministry carried out 188,410 inspections at various business premises which led to 642 investigations just in April 2015.⁹ Total investigations rose to 1,902 cases by May 2015.¹⁰ On top of that, there are about 6,000 officers enforcing the regulation all around the country.

These news and statistics, along with the effectiveness of the net profit control as concluded through the analysis of prices may suggest enforcement was carried out religiously. Nevertheless, the ministry informed us they gave offending businesses the opportunity to comply with its directives before prosecuting the violators. The ministry would only prosecute after businesses failed to comply after follow-up inspection.

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⁹ Payaswini Upadhyay. GST: How Australia and Malaysia Disciplined Profiteering Conduct. Bloomberg, July 7 2017

¹⁰ Bruce Hamilton, Bonny Teo. Taking a Look at the Anti-Profiteering Regulations. The Edge Weekly, July 11 2015

3. Effectiveness of the Anti-Profiteering Regulation

Since the primary purpose of net profit control under PCAPA is to combat the general price increase due to profiteering in the economy, there is a need to discuss the behaviour of inflation from April 2013 to July 2017 in order to ascertain the effectiveness of the regulation. This inquiry could be answered partially through difference-in-differences method. July 2017 is the latest price data available from the Department of Statistics at the time of writing.

There are three comparisons needed to be made to assess whether:

1. the GST was inflationary (Case 1)
2. the regulation was effective (Case 2)
3. the GST, if it was inflationary, created a persistent or temporary inflation (Case 3)

Case 1 compares price behaviour – as measured by the consumer price index (CPI) – before and after the implementation of the GST along with net profit control. If GST was inflationary, then inflation rates should be higher in the latter of the two periods. To test the hypothesis, the period of April 2013–December 2014 is compared with the April 2015–December 2016 interval. The January–March 2015 period is discounted from the analysis because the regulation was in force while the GST has not, which complicates attempt at comparison.

Case 2 assesses the effectiveness of the regulation. This is tested by comparing price behaviour during the period of GST with net profit control (April 2015–December 2016) with a period of GST with relaxed control (January–July 2017). If the regulation had a mitigating effect on price inflation, then the relaxed control should be associated with a period of higher inflation rates.

Case 3 inquires whether GST-linked inflationary was persistent and how long if it was. If the GST-linked inflation is persistent, then the average inflation rates between the April 2015–December 2016 and the January–July 2017 periods should be about the same.

The CPI used in all cases has been modified to strip out the effects of fuel prices fluctuation unrelated to the GST. This allows the study of the effect of GST and the regulation on prices while cutting out significant noise linked to fuel prices.

Core CPI would be a better series to use but unfortunately, Malaysia only began publishing its core CPI in January 2017; the series is available publicly up to January 2016 the earliest, which does not cover all the periods needed to test the three cases.

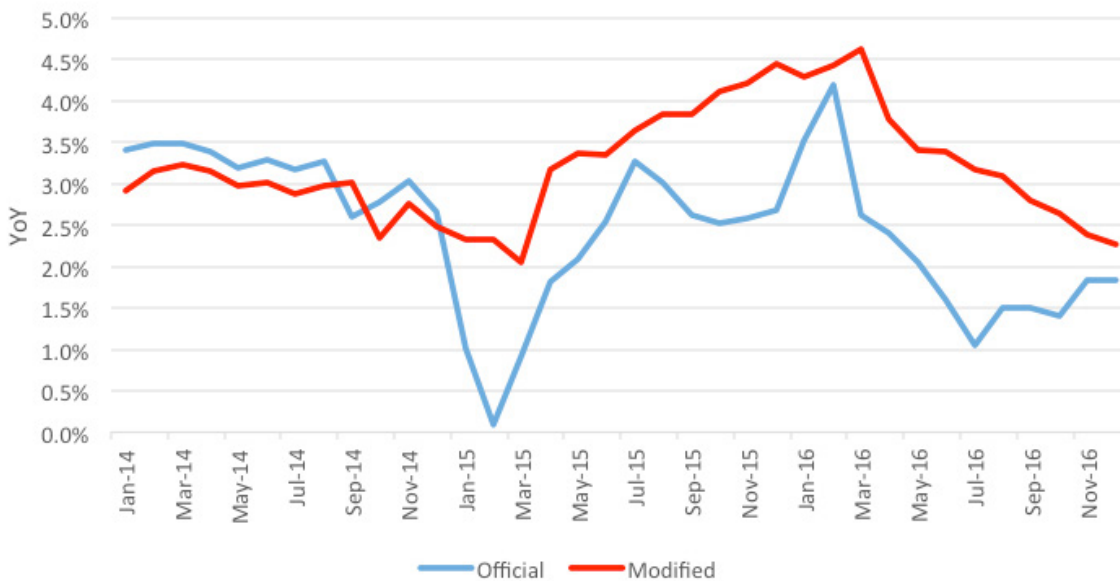
3.1. Case I: Was the GST inflationary?

The official CPI inflation in April 2015 rose to 1.8% year-on-year (YoY), a 0.9 percentage point acceleration from the previous month. April 2015 was the month when the GST came into effect. On monthly basis, April inflation was 0.9% versus 0.0% in March. On the surface, this suggests GST affected prices upward in the very short term. Inflation eventually hit 4.2% YoY in February 2016 before slacking off partly due to base effect, a mathematical artefact that pollutes the reliability of year-on-year calculation.

Inflation rates would have been higher if it were not for a slump in crude oil prices, which affected retail fuel prices substantially. To understand how much higher, transport prices must be removed from the overall CPI. Transport is the component most sensitive to fuel price fluctuation out of 12 major CPI subindices. This method does not remove fuel price fluctuation fully (fuel prices also affected other components like food and housing) but it provides a very good guideline on how the CPI would react without fuel price fluctuation.

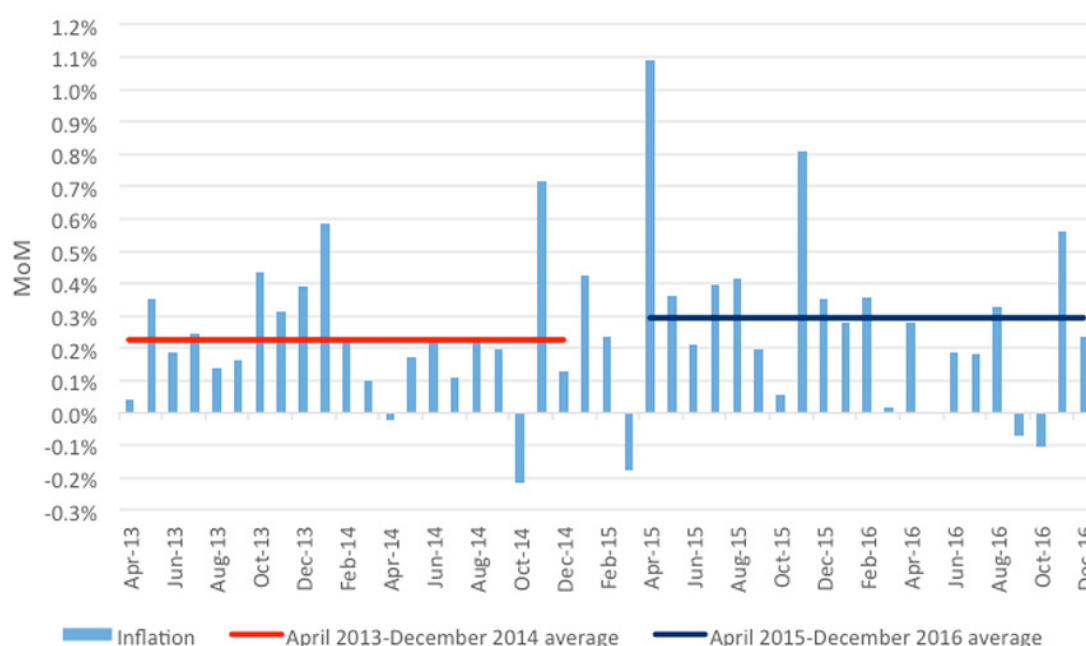
Based on the modified CPI, the estimated inflation rate in April 2015 would have been 3.2% YoY, 1.4 percentage points higher than the rate calculated from the official CPI. On top of that, the April 2015 modified inflation rate was 1.1 percentage point higher than the previous month on YoY basis. Note that the April jump under the modified CPI is higher than that recorded by the official index from YoY perspective. The modified inflation rates remained higher than the official rates right up to January 2017 (See Chart 1).

Chart 1
Official headline CPI-inflation versus modified CPI-inflation



Of greater interest is general inflationary pressure across time, not merely a one-time jump in prices. This could be seen better by analysing the modified CPI on a monthly basis. The 21-month modified CPI-inflation (April 2015–December 2016) averaged 0.29% month-on-month (MoM), 0.07 percentage points higher than the preceding 21-month period of April 2013–December 2014 (See Chart 2).¹¹ In other words, the modified inflation rates would have been 0.07 percentage point lower without the GST. The MoM difference might seem small but it could possibly translate into 0.84 percentage point difference between the two scenarios (GST versus no GST) in a year's time.

Chart 2
Average inflation in April 2013–December 2015 versus in April 2015–December 2016



From these comparisons, it could be concluded that GST had inflationary effect on prices, possibly hastening monthly consumer price growth by at least 0.07 percentage point faster than what it would without the tax in place.

A hypothesis testing could be done on the two periods. The null hypothesis that price pressures the two periods are the same could be rejected at 80% confidence level.

¹¹ April 2015 had MoM inflation abnormally high. If it is removed from the average, the average inflation for the April 2015–December 2016 period would be 0.25%, which is still 0.3 percentage point higher than the April 2013–December 2014 average.

3.2. Case 2: Was the regulation effective?

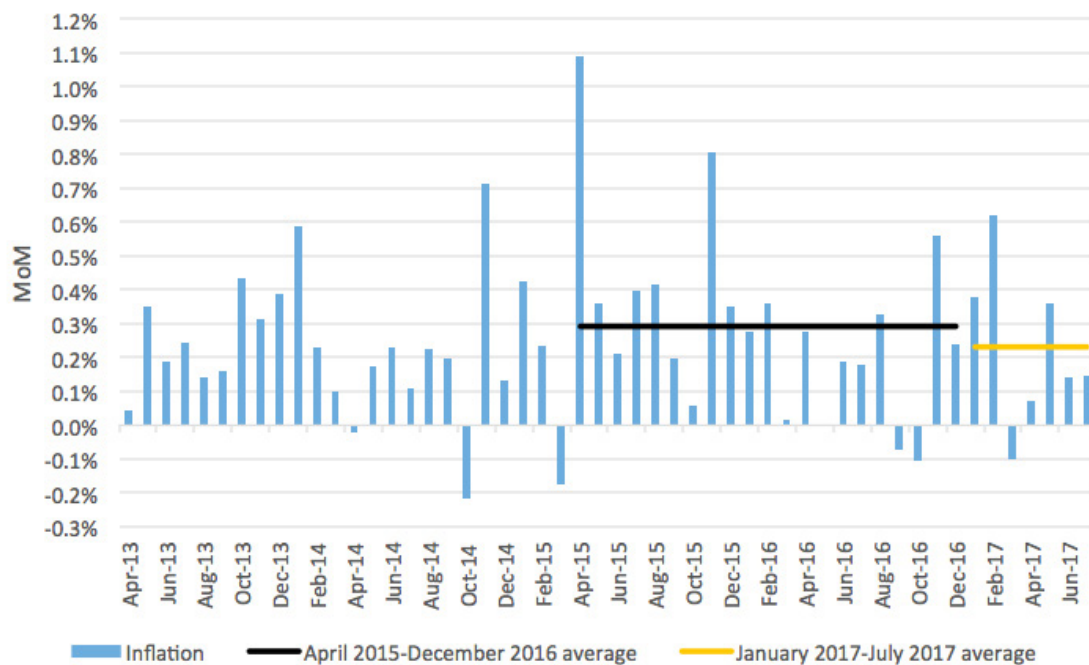
The net profit regulation may have a mitigating effect on GST-inflation. It is very possible without the net profit control and if the control was effective, the difference could have been higher than 0.07 percentage point. This subsection attempts to assess whether the regulation was effective.

The net profit control was liberalised in January 2017 through the loosening of profiteering definition and the narrowing of scope of goods covered. If the margin control was effective, then inflation rates during the relaxed period should be higher than during the period of tight control.

This question – whether the regulation was effective – is tougher to answer than the first inquiry. Comparative efforts have to deal with limited data available as well as the unreliability of the YoY measurement spoiled by base effect caused by the GST. The value-added tax pushed prices up for so long that YoY comparison is made be irrelevant. In fact, the GST made inflation from YoY perspective temporarily largely useless in understanding the presence of slack in the overall economy from the typical macroeconomic models. Nevertheless, the average modified inflation for the period of January–December 2016 was 3.4% YoY, 0.9 percentage higher than the 2.5% YoY average for the January–July 2017 period, which does not conform to the hypothesis. July 2017 is the latest available data at the time of writing.

Month-on-month measurement could be used to circumvent the base effect problem present in the YoY approach. Yet, the MoM approach rejects the hypothesis as well: the modified inflation rates for the January–July 2017 averaged 0.23% MoM, 0.06 percentage point lower than April 2015–December 2016 average (See Chart 3).

Chart 3
Average inflation in April 2015-December 2016 versus in January-July 2017



Therefore, the test result is unable to determine whether the regulation was effective in curbing inflationary pressure on consumer prices. Further tests may be required to determine the validity of hypothesis by controlling other factors that may be relevant.

3.3. Case 3: Was the GST-linked inflation persistent?

Case I shows the GST caused a general rise in prices. But for how long?

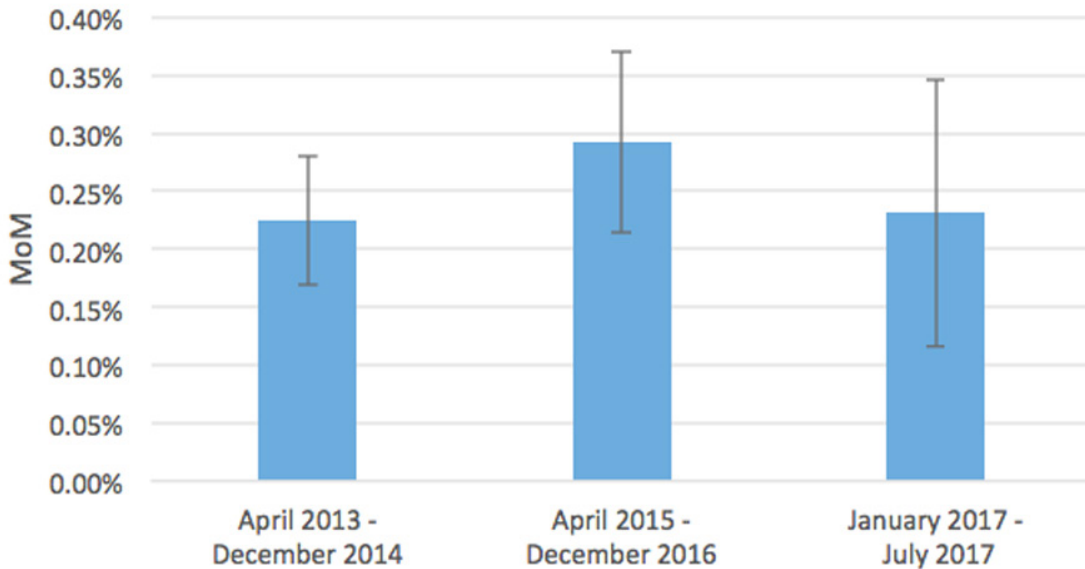
Analysis suggests the GST-inflation is not persistent. The modified inflation rates averaged 0.23% MoM in the January–July 2017 period, which is almost the same average as in the April 2013–December 2014 period before the GST came into force. This suggests after about two years the GST was introduced, inflation rates have almost returned to its previous average.

A hypothesis testing could also be done on these two periods, just like in Case I. The null hypothesis that price pressures the two periods are the same could not be rejected at 80% confidence level.

3.4. Summary of results

The result summary is presented in Chart 4 along with its confidence intervals at 80% level:

Chart 4



The mainstream theoretical understanding is that value-added tax (VAT; a more descriptive name for goods and services tax) does not affect price growth, either up or down.¹² To put it differently, the imposition of VAT would only lead a one-time rise in price level without affecting the slope at which prices grow. Section 3 of this paper shows the Malaysian experience is slightly different: inflation rates were elevated temporarily for two years after the tax was imposed before returning to its pre-VAT level. There were both a one-time rise in price level and a change in slope.

A short note is necessary here. While the modified CPI substantially removed fuel price fluctuation, the method and calculation do not remove other factors that might affect prices but unrelated to either the GST or the margin controls. Indeed, an alternative way to answer these questions is through regression analysis with structural breaks.

This method also does not separate inflation caused by the GST specifically and by profiteering, which may affect the results if it is somehow considered. Further study may be necessary to refine the analysis.

¹² Charlotte E. Ruebling, *A Value Added Tax and Factors Affecting its Economic Impact*. Federal Reserve Bank of St. Louis. September 1973. Page 15.

4. Criticisms of the regulation

Regardless of the effectiveness of the regulation, there are possible side-effects from its implementation. Among these are the rising cost of doing business, anti-competitive nature of the regulation, and the effect of regulation on consumer welfare in terms of choices.

Additionally, it is unclear if the inflationary pressure – controlling for fuel price fluctuation – present during the period is inherently due to the value-added system itself, or is due to profiteering. Theoretically, the regulation is meant to address profiteering concerns, instead of addressing general upward price pressure due to the newly introduced tax system. But in practice, the difference might not matter to the government, leaving the regulation working beyond its intended scope.

There are six subsections below. The first four have been largely be tackled by the 2017 liberalisation; nothing can be done about the negative effects highlighted in the subsections anymore. The latter two are ongoing criticisms.

4.1. Rising cost of doing business/compliance cost

The net profit control regulation introduced additional cost to businesses. The costs revolve around compliance and the absorption of rising input costs. These factors may have played a role in the spike in business closure in 2015.

The regulation requires any seller to provide detailed documentation relating to the calculations of its costs and selling price whenever the authority suspects a violation happening. Complaints are not rare: in December 2016 951 complaints were filed under anti-profiteering regulations. While not all complaints led to investigations, the large number of cases heightened the risk of businesses being investigated, and thus incurring compliance cost. In 2015 and 2016, the authority investigated 9,760 cases.¹³

The risk is especially high given that many small business owners even to this day are still unaware of the applicability of the net profit regulation to their establishment. The ministry said they have addressed this issue being lenient: if a business owner is caught violating the regulation, he or she is given the chance to rectify the pricing. Action would only be taken if the business owner failed to do so after subsequent inspection.¹⁴

The determination of profiteering through the formula designed requires the compilation of paperwork beyond normally required for accounting purposes. While this may seem trivial for companies with the money to invest in excellent corporate governance, not all businesses run on strict processes. Smaller businesses especially do not have the same resources as large corporations dedicated to red tapes. Compliance and even fines can have undetectable effect on the profitability of large companies, but it could be disastrous to the continuity of small businesses. The law fails to scale its monetary punishment to match the economic status of an entity, leaving smaller or the not so well-off entities effectively being penalised more than larger better-off bodies.

Already there are anecdotes indicating that small businesses had to shut down due to burdensome documentation required to make the GST (and the net profit control) work, which among others required the purchase of a more sophisticated accounting software in place if businesses are to comply with the law.¹⁵ While these complaints were explicitly about the implementation of the GST, part of the costs were also linked to the enforcement of the net profit control regulation. Disentangling the two is difficult. In any case, with businesses already facing a difficult economic environment in 2015 and 2016, the additional compliance costs made the situation worse and may matter on the margin.

Measuring the compliance costs and assigning the costs appropriate to either the GST implementation or the PCAPA enforcement could be the subject of future papers, which would involve the collection and analysis of massive financial data from diverse group of small businesses.

¹³ Statistik Utama KPDKK. Ministry of Domestic Trade, Cooperatives and Consumerism.

¹⁴ Author's meeting with the ministry.

¹⁵ Chloe Wang. Most local firms welcome Malaysia's GST, but small businesses are hardest hit. Channel NewsAsia. April 1 2015

4.2. Forced absorption of rising input cost

The 2015-2016 regulation forced businesses to absorb some input cost increase instead of passing it through to their customers in some instances. As described in the section outlining the general mechanism employed during the first two years the regulation in place, businesses could not make net profit more than what they did during their benchmark period. That net profit was defined as the absolute difference between selling price and cost. If cost rose within the restriction period, net profit in percentage terms, could shrink even if net profit in absolute term remained constant. This is discussed further in Subsection 4.3.

The Ministry in late 2016 replaced that formula with one that expressed the limit in percentage terms, thus eliminating the criticism. Nevertheless, the strict definition used had caused severe difficulties for businesses that may have contributed to a spike in business closure in 2015. The damage has already been done. made the situation worse and may matter on the margin.

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4.3. Anti-competitive nature of the 2015-2016 profit control mechanism

Not only were all businesses forced to absorb rising costs, the 2015-2016 regulation also unfairly discriminated against low-cost businesses.

All items sold by businesses theoretically have their own unique maximum net profit benchmark, or baseline as ministry officials call it. The regulation creates almost a perfect discrimination.¹⁶ The formula was designed to consider segmentation that is part of the market dynamics.

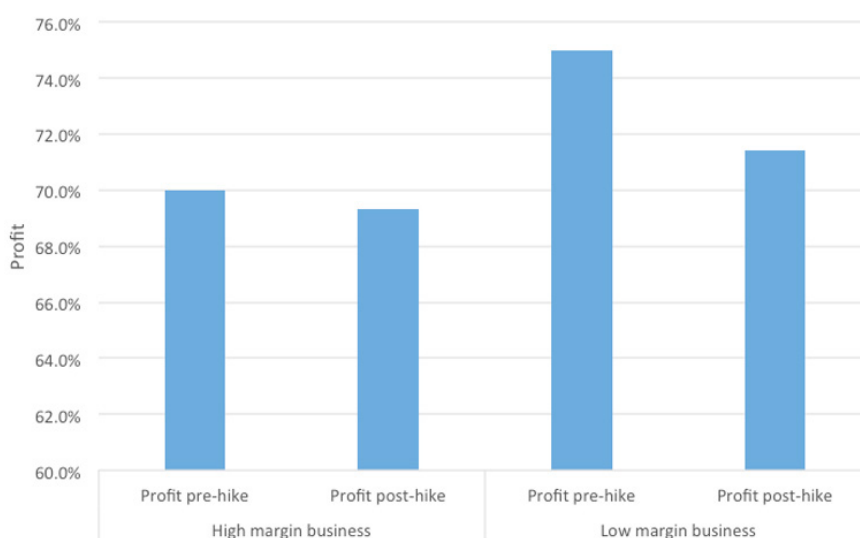
Different businesses do target different consumer segments. Higher-income consumers offer businesses catering to that market greater margin (due to, for example, better service, presentation or branding) than businesses serving lower-income groups. For instance, Jaya Grocer is a supermarket targeting well-to-do consumers offering more expansive brands than those available Tesco or Mydin Hypermarket.

But the problem with the regulation was that it calcified the segmentation by eliminating the possibility of business cutting through the segments. And while doing so, it forced some segments to absorb greater cost than others. Consider a black coffee sold in an upmarket café in Bangsar for RM10 and the same coffee sold at a mamak restaurant for RM2. The upmarket café can be expected to earn a net profit of RM7 while the mamak restaurant RM1.50. This means coffee cost of the café is RM3 while for the restaurant, RM0.50. The café made 70% profit and the restaurant 75%. This could entirely be a market phenomenon for price-takers.

The following illustrates how the law discriminated beyond what the market would. In case of RM0.10 cost increase, the café could sell its coffee for RM10.10 while the restaurant RM2.10 to preserve their respective absolute net profit as allowed under the 2015-2016 regulation. Observe that while absolute net profit would remain the same, the net profit in percentage terms fell. After the hike, the café made 69.3% profit while the restaurant 71.4% (See Chart 5).

Chart 5

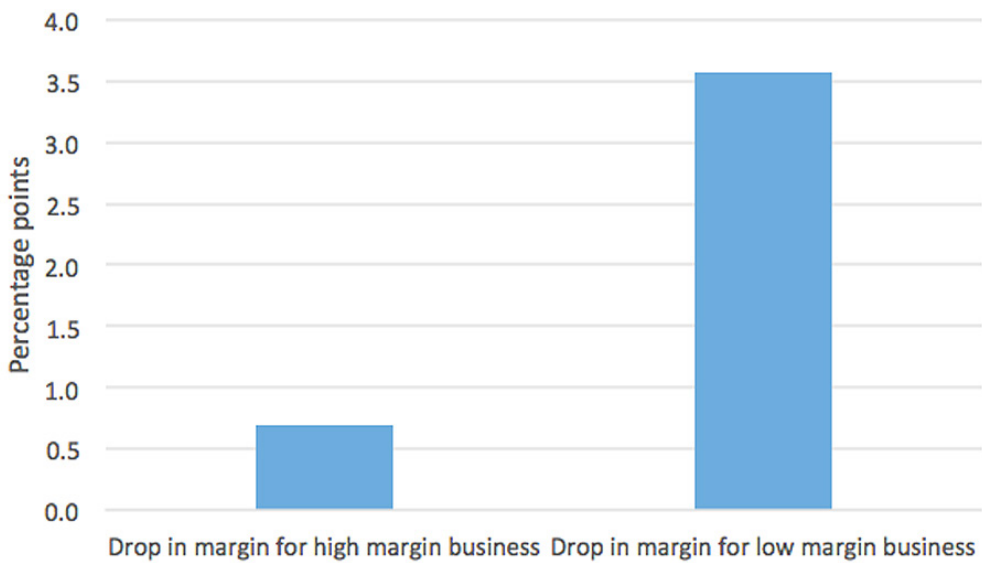
Illustration discriminated cost hike absorption under the 2015-2016 rules, under a 10 sen increase



¹⁶ This is similar to the concept first degree price discrimination. Except of prices, the regulation discriminates all businesses selling consumer goods based on the company own existing net profit.

The disparity is an example of discriminated input cost absorption. The margin of the café dropped less than the restaurant's: the café's net profit fell 0.7 percentage point but the restaurant's dropped 3.6 percentage points (See Chart 6). In simpler terms, the owner of the restaurant would have to put in more effort than the owner of the café to get his or her status quo margin by selling the same product.

Chart 6
Illustration discriminated cost hike absorption under the 2015-2016 rules, under a 10 sen increase: percentage points



Furthermore, the rising compliance costs as mentioned in the earlier section raises the barrier to entry. It sets the playing field unfairly for smaller businesses, as bigger corporations are likelier to be able to withstand the rising cost of doing business. Together with closure of smaller business and higher entrance barrier, this may entrench the market power of large players, much to the detriment of consumers who would lose a range of buying sources.

4.4. Business establishment and closure

The forced cost absorption could have convinced some businesses to close. Statistics from the Companies Commission show that the number of terminated businesses rose significantly in 2015 when 33,326 businesses closed, a figure significantly above the 2011-2015 average of 21,073 (See Chart 7). In the 2016, the figure fell to 26,872 businesses. The same source shows the growth of total companies in Malaysia slowed down in 2015 and 2016 (See Chart 8).

Chart 7
Total terminated businesses

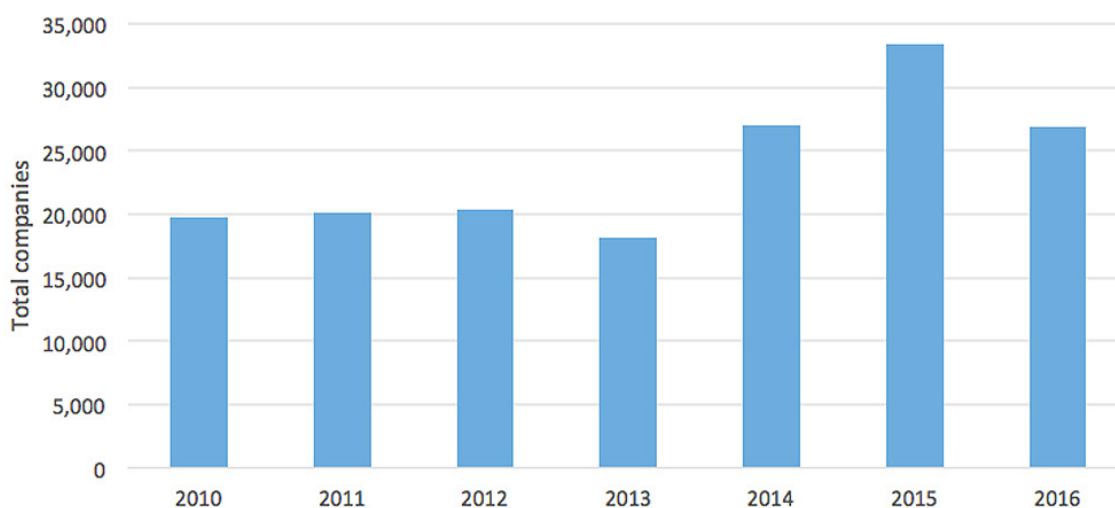
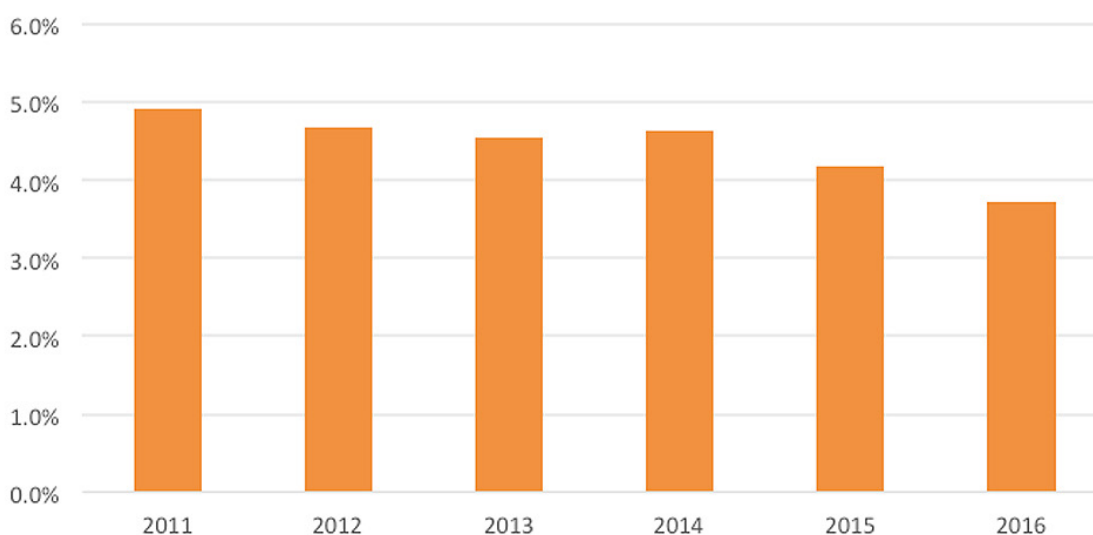


Chart 8
Growth in total registered companies in Malaysia



There may be multiple factors contributing to the closure and it is difficult to ascertain these factors precisely. Nevertheless, the net profit control did make it more difficult for businesses to run at a time when economic growth was slow. Malaysia's second quarter 2016 GDP growth hit its slowest pace at 4.0% YoY since the country had its most recent recession in 2009. Quarterly private consumption expanded 6.0% YoY on average in 2015-2016, when it averaged a full percentage point higher in 2014.

The business closures might have contributed to job losses. While I have not estimated the effects of the business closures on unemployment rate, the implementation of the GST and the net profit control coincided with the rise in the seasonally-adjusted unemployment rate from 2.9% in December 2014 to 3.5% by December 2016.

Businesses largely disagreed with the implementation of the margin control. The Federation of Malaysian Manufacturers¹⁷ and the Associated Chinese Chambers of Commerce and Industry of Malaysia¹⁸ are among business associations critical of the regulation, claiming it raised the cost of doing business.

¹⁷ FMM opposes proposal to replace existing Price Control and Anti-Profiteering Act. New Straits Times. July 18 2016

¹⁸ No to anti-profiteering law. The Star. July 16 2016

4.5. Inflexible net profit benchmarking across time

The 2017 regulation addresses the criticism against the use of absolute net profit as the benchmark in determining profiteering. However, it does not address the fact that the benchmark is still inflexible. Business conditions can change daily but the regulation commits businesses to a benchmark that might be right for a certain day but not for others. The formula does not account for seasonality well. Moreover, the way the formula has been designed ignores the effect of high demand on prices completely.

The inflexibility takes away the ability of business to adapt to market situation. If the benchmarking day was a particularly difficult day, the business would be stuck to a rule determined on that day, condemning the business to low profitability for the whole year.

The benchmark determination can be improved and be made fairer to businesses by making it flexible across time. One mechanism to do so may involve frequent updating of the net profit benchmark throughout the year, either month or quarterly instead of yearly. One other way is to have the net profit of a particular day be benchmarked against the same day a year before (or before the year the regulation was instituted) to address seasonality concerns and demand fluctuation in the market.

4.6. Between VAT inflation and anti-profiteering

Finally, there is a lingering question of whether the price pressure addressed by the regulation is due to the inherent nature of the taxation system or due to profiteering by businesses. The inflation measured in Section 3 investigating the effectiveness of the regulation does not differentiate such sources.

Assuming the net profit regulation was effective – effectiveness which this paper is unable to determine – and if indeed inflationary pressure is inherent to the VAT system, then the profit control regulation may not have addressed anti-profiteering as much as it is suppressing the inflationary nature of the taxation structure itself, which is not the theoretical function of the regulation. As a result, the law may have gone beyond its mandate to fight anti-profiteering and instead, becoming a tool to manage inflation regardless of its sources.

This raises the concern that the regulation could be abused in the sense that it can become an additional tool for the government to manage general inflation. I think the adoption of a more dynamic net profit benchmarking could help prevent abuse as it would tie the regulation to market conditions instead of dates chosen by the government.

5. The 2017 extension of the regulation

In 2017, the anti-profiteering regulation was liberalised but extended indefinitely. There are two aspects to the relaxation. One, its rule in determining profiteering was switched from one based on absolute net profit to net profit in percentages, which in effect no longer forced business to absorb rising cost. Two, the items covered under the regulation are now limited to two classes of goods: food and household items.

The absence of a sunset clause in the regulation suggests it is no longer about the GST. Instead, it has become a general tool to manage inflation rather than simply fight off GST-linked profiteering in the market. Apart from the tweaking the formula to be more dynamic as mentioned abuse, the quickest way to end the risk of abuse is to wind this up.

Is the extension reasonable? Judging purely from the results in Section 3, which shows average inflation this year so far has returned to the same rate as it was before the GST was implemented, the answer is no. Furthermore, if the regulation was effective, it might be relevant in the roughly two years following the introduction of the GST.

Australia offers an example of an anti-profiteering regulation with a sunset clause. Like Malaysia, Australia coupled the introduction of its GST with anti-profiteering measures. The Australian GST came into force in July 2000 while the anti-profiteering measures were carried out beginning July 1999 until June 2002. The expiry of the anti-profiteering regulation did not change headline inflation much: it averaged 0.6% quarter-on-quarter in the July 2002-June 2003 period, slightly lower than 0.7% quarter-on-quarter average in the July 2001-June 2002 period.¹⁹

“
The absence of a sunset clause in the regulation suggests it is no longer about the GST. Instead, it has become a general tool to manage inflation rather than simply fight off GST-linked profiteering in the market.
”

¹⁹ Australia does not make its monthly CPI available publicly. The full quarterly statistics is available at the Australian Bureau of Statistics' website.

6. Conclusion and recommendation

Average inflation in the January-July 2017 period has returned to the rate before the GST was introduced. This may suggest the regulation is no longer relevant, regardless the efficacy of the Act in controlling inflation. Apart from that, there are concerns that the regulation is stepping beyond its mandate by becoming a tool for the government to manage general inflation instead of fighting anti-profiteering practices.

In the short run, it is recommended that the benchmark formula be made more dynamic while in the long run, a sunset set clause be reintroduced into the regulation.

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