ISLAMIC FINANCIAL REFORM AND MACROECONOMIC POLICIES: A CASE OF MALAYSIA

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ABSTRACT

Malaysia's overarching economic objective is to achieve developed country status by the year 2020. On the back of sluggish global economic condition and tight fiscal space, the economy will need to grow by a stable and rapid rate over the next few years. Currently, macroeconomic policies in Malaysia follow the conventional model based on the risk-transfer paradigm. Over the next decade, the potential for risk sharing as an alternative to risk transfer is expected to grow rapidly. As pointed out by a number of scholars and researchers, economies can be made more resilient to shocks by adopting financing methods that limit risk transfer (interest rate based debt contracts) and allow greater risk sharing among the market participants on a broad scale. Risk sharing is also the essence of Islamic finance. The question arises as to the design and implementation of macroeconomic policies in a risk sharing system. This concept paper will model the Malaysian economy based on macroeconomic policies that applies the fundamental principle of Islamic finance, i.e., risk sharing. Firstly, a monetary policy that is targeted directly at asset market activities and private sector portfolio adjustments. Secondly, it suggests mobilization of funds for financing fiscal operations based on risk sharing through sale of government low-denomination equity participation papers directly to the public tradable in secondary markets. The latter proposal is supplemented with a reform of the tax structure. The paper will demonstrate its benefits in spurring growth, promoting distributive justice, rendering the economy more stable, strengthening the potency of monetary policy, enhancing fiscal governance and improving financial inclusion.

Keywords: Monetary and fiscal policy, Equity participation shares, Risk sharing.

INTRODUCTION

Macroeconomic policies deal with performance, structure, behavior and decision making of the entire economy. Generally, government objectives for the economy are stability, distribution and growth. In market economies, government does this by taking actions that affect private sector portfolios (in terms of consumption and investment). The two policies to achieve these objectives- used either independently or in combination are Fiscal and Monetary policy. Both policies can be used to close an output gap and intended to influence behavior of macroeconomic variables, i.e. unemployment and inflation.

Fiscal policy means management of government revenues and expenditures. In other words, fiscal policy is how the government manages its budget. It collects revenue via taxation that it then spends on various programs. Changes in fiscal policy affect government deficits and debt.

Conventionally, monetary policy is the process by which the central bank of a country controls the money supply, often targeting a rate of interest for the purpose of promoting economic growth, price stability and full employment. The monetary policy transmission mechanism is the process through which monetary policy decisions impact an economy in general and the price level in particular through monetary policy impulses known as transmission channels. The three common tools of monetary policy are Open Market Operation (OMO), the Overnight Policy Rate (OPR) and Reserve Requirement (RR). These tools are used to induce firm’s and household’s portfolio adjustment.

Both are complementary to each side, but opposed in their operational designs. Since price stability depends on quantum of money supply that can be altered through government expenditure or taxation so in this respect they complement each other. But operationally government is more concerned for making its debt financing cost effective that has little correlation with the central bank operations in managing interest rate structures, so in that respect they are opposed to each other.

One important consequence of the global financial crisis has been a growing uncertainty about the adequacy of policy regimes whose central anchor is the interest rate based debt system. It appears that such regimes have not managed to stimulate stable and strong recoveries; instead they seem to have enhanced the vulnerability of economies to shocks. In most situations budget deficits, arising from deficiencies in revenue to fund increased government spending to stimulate post crisis growth, have been financed through increased borrowing. More often than not the present and prospective rates of growth are lower than the interest rate on the growing debt. In theory a stimulus is supposed to be financed by the subsequent growth; it now appears that in many economies, growth will not be large enough or fast enough to validate the debt levels approaching, or in some cases exceeding, 100% of GDP.

According to the conventional view of public debt, in the short-run output is demand-determined and fiscal deficits (or higher public debts) have a positive effect on disposable income, aggregate demand, and overall output (Elmendorf & Mankiw 1999). The recent global recession and the European sovereign debt crisis have stirred an intense debate about the

effectiveness of fiscal policy and the consequences of rising government debt. Some economists and commentators suggest that this is the right time to apply expansionary fiscal policy (Krugman 2011; DeLong & Summers 2012). Other economists have argued that high levels of public debt have a negative effect on economic growth (Reinhart & Rogoff 2012).

The solution of austerity on fiscal policy, i.e. higher taxes and lower spending suggested by the dominant policy regime takes strong political consensus, which does not appear to be forthcoming in many crisis countries. Increased borrowing via bond issuance or long term government borrowing also does not appear to be a desirable solution as it increases vulnerability, creates a burden on future taxpayers and has adverse distributional implications.

As for monetary policy, the recent financial crisis has revealed the weaknesses of the conventional monetary policy framework. Monetary policy has been found to be a prominent cause of financial instability. Inability of expansionary monetary policy to induce new lending in many economies is considered as evidence of the impairment of conventional monetary policy transmission mechanism. The post-crisis diagnostics have exposed five interrelated failures, i.e.1) failure of theory- vision distorted but blamed: emergence of risk transfer and risk shifting instead of risk sharing; 2) failure of policy- adoption of the distorted vision:

accommodative monetary policy, soft peddling on regulation and failure to address asset market imbalances; 3) failure of regulation- domestic and global; 4) failure of governance- domestic and global; and 5) failure to learn lessons of the past crises: “all crises are debt crises”.

Malaysia is a middle-income country that aspires to be a high-income economy by the year 2020. It is a rapidly growing economy in Asia. Over the past three decades, the Malaysian economy has been experiencing economic growth, but at the same time inundated by a deterioration of overall fiscal balance and consequently a rise in national debt. In order to achieve its high-income aspiration, Malaysia needs to record a steady growth of at least 5% over the next few years. This has proved to be a challenge when the global economy is plagued by the repercussion of the sub-prime crisis and the Eurozone debt crisis.

The debt to GDP ratio remained high; in fact, it rose sharply from 41% in 2008 to 53% in 2009 and remained at approximately the same level by the end of 2013. This figure will be more alarming if the contingent liability of the government is taken into account. The current total external debt of the Government is RM318 million (RM253 million in 2012) which makes up 33% (28% in 2012) of Gross National Income. The external debt service ratio, including the private sector, increased to an average of 10.3% between 2011 and 2013, compared to 7.5% in 2010. This represents a percentage increase of 36% as opposed to 15% in the preceding period. The government's domestic debt has more than doubled (RM247 billion in 2007 to RM523 billion in 2013) in the space of six years, outpacing revenue growth of only 52% during the same period (RM140 billion in 2007 to RM213 billion in 2013).

The major lesson of the recent crisis for Islamic finance is the urgent need for the design, development and implementation of a comprehensive, unified, uniform, global

and dynamic regulatory-prudential-supervisory framework uniquely designed to ensure the stability of the Islamic financial system (Mirakhor & Krichene 2009). The solution lies in introducing risk sharing along with the availability of credit for primarily the purchase of real goods and services that Islamic finance aims at introducing (Chapra 2011b). Taking an alternative to debt financing (risk transfer) from which interest is absent is the first step towards change.

Risk sharing is the essence of Islamic finance. Lessons from the debt crisis and interest based system forces a fundamental reassessment of the way both monetary and fiscal policy is conducted. Current policies based on the risk transfer system have adverse implications to the economy. Tax policies that consistently favor the rich will exacerbate the current income and wealth disparity. An alternative approach that actively seeks to identify emerging imbalances and takes action to reduce them is needed. One such imbalance is the divergence between the financial and real economy. This is where the risk sharing feature of Islamic finance can help bridge the gap.

The purpose of this paper is to present a conceptual model of the Malaysian economy based on macroeconomic policies that applies the fundamental principle of Islamic finance, i.e., risk sharing. Firstly, a monetary policy that is targeted directly at asset market activities and private sector portfolio adjustments. Secondly, it suggests mobilization of funds for financing fiscal operations based on risk sharing through sale of government low-denomination equity participation papers directly to the public tradable in secondary markets. The latter proposal is supplemented with a reform of the tax structure. The paper will demonstrate its

benefits in spurring growth, promoting distributive justice, rendering the economy more stable, strengthening the potency of monetary policy, enhancing fiscal governance and improving financial inclusion.

This paper is structured as follows. It starts with the introduction, briefly touching what fiscal policy and monetary policy are; and its related issues due to the financial crisis. The next section provides the background to the implementation of the conventional macroeconomic policies framework in Malaysia and its shortcomings. It then goes on to review the literature on fiscal policy and Islamic monetary policy with its incentive structure. This is followed by a discussion of the Islamic finance macroeconomic policies covering the Islamic fiscal policy reform and the proposed Islamic monetary policy framework. The final section concludes with brief potential policy implications.

CONVENTIONAL MACRO POLICIES

Fiscal Policy Framework in Malaysia

Examining the trend of income and expenditure over the last two decades, it may be surmised that Malaysia had been exercising pro-cyclical fiscal policy where during the years 2000 to 2008, the increase in revenue was matched by a corresponding increase in expenditure. This fact was also confirmed in a study by (Rafiq & Zeufack 2012). Malaysia's revenue has enjoyed steady growth over the past two decades. However, as year-on-year total expenditure surpassed that of revenue, the federal government debt increased by almost the same rate to make up the shortfall.

The increase in government spending is attributable to the increase in operating expenditure such as emoluments, subsidies, supplies and services. The ratio of public servants to the overall population in Malaysia is almost 5%, which is one of the highest in the region. Development expenditure, which has the potential for creating capital assets and future returns, has fallen over the years (halved from 33% of total expenditure in the early 2000 to 16% in 2013) while subsidy expenses have increased. Instead of increasing efforts to keep its spending under check, the government has embarked on deficit reduction exercise through reduction of government spending on subsidies (subsidy rationalization), which currently account for 17% of total expenditure. This measure has hit the middle-income groups who do not qualify for the targeted subsidy program such as 1Malaysia People's Aid (BR1M) cash handouts.

At the same time, government borrowing has been increasing to make up for the deficiency in government budget. The government obtained financing internally and externally from the issuance various types of Treasury Bills, Government Investment Issues and Malaysian Government Securities. As Malaysia has a dual banking system, this financing can be issued under conventional terms (i.e. interest-based) or based on *Shariah* principles. The majority of borrowing is under the conventional terms.

Malaysia has a Fiscal Policy Committee (FPC) that takes a leading role in monitoring the fiscal position of Malaysia and strengthening public finances. The Ministry of Finance's Fiscal Policy Office, and an inter-agency technical group comprising officers from the Economic Planning Unit (EPU), the Central Bank and Ministry of

Finance, supports the FPC. As of 2013, the FPC reaffirmed the Government's commitment to achieve a fiscal deficit target of about 3.0% of GDP by 2015, and a balanced budget by 2020.

On 2 May, 2009, the Prime Minister announced the government's plan to develop a New Economic Model (NEM) that will speed Malaysia's transition to a high-income country. The NEM emphasises ways to stimulate economic growth by increasing income and improving productivity of workers across all sectors of society. Other reforms include empowerment of the private sector and reduction in fiscal disparity between the wealthiest and poorest of Malaysians. This is in line with the 10th Malaysia Plan (10MP)[i], which is a comprehensive blueprint prepared by the EPU to allocate the national budget from year 2011 to 2015 to all economic sectors. Improving socioeconomic inequalities and level of living quality are two of the five thrusts of the 10MP. These strategic plans normally shape the budgetary requirements of the country, both in terms of taxation and government spending.

Tax is the largest component of Malaysian government's total revenue. There are various types of tax in Malaysia, the main ones being Income Tax, Real Property Gains Tax, Sales and Service Tax and Stamp Duty. Direct taxes have been the more dominant source of revenue for the government. Malaysia has a progressive tax system for individuals and various other taxes and duties are levied with various exemptions and rebates given. The tax legislation can be complex to ordinary taxpayers and only the more tax savvy with the financial means to hire tax consultants are able to gain full benefits of saving tax

through tax planning schemes. Due to the complexities and loopholes in the tax legislation, some may choose not to comply or find creative ways to shirk the tax system. Leakages in the tax system reduce tax revenue. With pressures mounting on the call for fiscal reform, the government has focused on broadening the tax base through the implementation of a new indirect tax, GST. However, GST causes inflationary pressure that will affect the price level of goods and services. On the other hand, raising the rate of direct taxes runs counter to the call for a reduction in income tax rate in order to be competitive with the other low tax countries in the Asia Pacific region, such as Singapore and Hong Kong.

It was the lack of credible prospect for budgetary reform to improve the fiscal condition that led the Fitch Rating Agency to downgrade Malaysia's sovereign rating from "stable" to "negative" in July 2013. Two issues which need to be addressed in order to improve Malaysia's current fiscal scenario is the insufficiency of tax revenue and the high level of debt. Malaysia's tax structure has to be reformed to generate more revenue for the government and alternative source of funds have to replace the current government borrowing.

Monetary Policy Framework in Malaysia

The Central Bank Act 2009 enjoins the Bank Negara Malaysia (BNM) responsibility for implementing the monetary policy to promote monetary stability and financial stability conducive to the sustainable growth of the Malaysian economy. *"In promoting monetary stability, the bank shall pursue a monetary policy which serves the interest of the*

country with the primary objective of maintaining price stability giving due regard to the developments in the economy" (Section 22(1), Act 701).

Monetary policy framework in Malaysia has evolved with changing economic and financial environments over time, from monetary targeting in 1973-1996 to interest rate targeting with floating exchange rate in July 2005-present. Price stability is defined as low and stable inflation and continued to remain paramount as monetary policy framework evolved. Operating target i.e. Average Overnight Interbank Rate (AOIR) with OPR as target is tightly controlled by the BNM and represents the first step in the transmission of monetary impulses.

At the present the financial sector does not adequately and effectively transmit monetary policy of the Central Bank to the private sector. There is dissonance between the primary objectives of monetary policy (to induce portfolio adjustment in the private sector; firms and households) while the objective of the financial sector is to maximize profit. This dissonance weakens the policy transmission mechanism and does not guarantee that monetary policy action will be transmitted to the private sector undistorted.

The current monetary policy transmission mechanism through the financial sector can blunt or render ineffective monetary policy actions. Lending behavior of the banking system in the US and elsewhere post-crisis is a demonstration of such event. Even with zero or negative real interest rate, the banks have not been willing to lend. However, this behavior is justified, it does provide strong evidence that the financial sector can impair, distort monetary policy signals as it serves as the only means of

transmission of these signals. Of course stronger monetary policy instruments, such as RR, can be used, but these are blunt instruments, send strong signal that may distort the intention of policy makers and central banks are generally reluctant to use them unless necessary as it can be counterproductive at times. Besides overnight rate, the most frequently used instruments-aside from "Jaw-boning"-is OMO that implements monetary policies through sales and purchases of government securities.

Interest-based debt instruments exacerbate income distribution bias towards higher incomes because these instruments are sold wholesale, in large denominations and bought mostly by banks and financial institutions whose shareholders are the more economically-able segment of the population (higher income people) or foreign investors. In the latter case, resources leak out of the society and middle and lower income groups are taxed to serve these instruments. Additionally, foreign debt exposes the economy to external shocks (i.e. sudden stops) as in 1997/ 98 crisis.

Under conventional system rules, monetary policy is usually burdened heavily with too many variables (inflation, exchange rate etc.) besides the real economic variables. It not only has to keep an eye on the evaluation of variable in the real economy by monitoring and, if necessary taking policy actions to affect them, it also has to be alert to the borrowing needs of the government, exchange and interest rate movements, the credit standing of the country in the international markets, fiscal policy changes and a host of other sensitivity. A small policy miss-step in monetary policy can cause large real changes in the economy.

LITERATURE REVIEW

There are several previous literatures that have presented the conceptual framework on the working of an Islamic macroeconomic policy such as (Mirakhor 2012; Mirakhor 2011; Al-Hasani & Mirakhor 2003; Mirakhor & Zaidi 1991; Tahir 2013). The distinctive feature of the Islamic economy is one, which operates on the basis of risk sharing and interest-free financial system. The organization of the Islamic economy is such that the socio-economic justice in the society is achieved (Chapra 2011a). Whilst previous literatures provide the general conceptual framework, this study will provide the application of the Islamic macroeconomic policy framework in the specific case of Malaysia.

Fiscal Policy

One of the main functions of fiscal policy is resource allocation through tax revenue generated to sectors of the economy in order to generate maximum growth. The roles of the public sector in an Islamic economy and fiscal policy in Islam have been addressed in many previous literatures (Kahf 1983; Faridi 1983; Gulaid 1995). Specific application of the Islamic fiscal policy framework for a particular country has been studied by (Iqbal 1995) for Pakistan and (Toutounchian 1995) for Iran. The former provides fiscal reform proposal in the form of schemes based on the principle of earmarking the revenue to specific needs, while the latter provides the use of Islamic mode of contract in order to finance public expenditures. Similarly, (Hassan &

Siddiqui 1994) looked at the use of equity financed budget deficit in an interest-free Islamic economy.

In recent literature on Islamic economics, there has been some discussions about the role of public expenditure in an Islamic state and whether a modern government has the right to impose additional taxes i.e. taxes other than the traditional Islamic levies and if so under what conditions (Kahf 1997; Kahf 1983). While there is widespread support for the right of a Muslim government to impose additional taxes, Islamic scholars are much stricter with regard to seeking clear and proper justification for any additional taxes and the utilization of public revenue. Malaysia is a multi-ethnic and multi-religious society. The fiscal reform proposed in this study thus, concentrated only on the taxation system and government financing policy that could achieve the socio-economic objective of the Islamic economy.

The central issue in the design of an optimal tax system is the desirable characteristics of the tax system itself. An optimal tax system is usually viewed as one that balances the various desirable attributes of taxation: taxes must be raised (revenue-yield) in a way that treats individuals fairly (equity), that minimizes interference in economic decisions (efficiency), and that does not impose undue costs on taxpayers or tax administrators (simplicity) (Alm 1996). A rather similar view was put forward by (Smith 1776) who listed four maxims with regard to taxes in general:

1. Equality: that people's tax payments should be in proportion to their respective abilities;
2. Certainty: that tax liabilities should be clear, certain and plain to the contributor rather than arbitrary;

3. Convenience of payment: that taxes should be collected at a time and in a manner that is convenient for the taxpayer; and
4. Economy in collection: that taxes should not be expensive to collect, and should not discourage business.

Progressive and Flat Tax

Many other countries implement a progressive tax due to the nature of income inequality that usually happens in a capitalist system. Results of studies on the effectiveness of the progressive tax system in reducing inequality and improving growth have been mixed. Studies by (Arnold 2008) and (Duncan & Peter 2008) have shown that there is a negative relationship between progressivity of tax and inequality albeit very minimal. Studies by (Duncan & Peter 2008) and (Duncan & Peter 2012), using a panel of countries, also showed that under certain conditions, tax progressivity may increase actual inequality, especially in countries with weak law and order and a large informal non-taxable sector. However, a study by (Diamond & Saez 2011) concluded that the top bracket earners should be subject to rising and high marginal tax rates and (Angyridis 2013) showed that increasing tax progressivity has a profound effect in reducing inequality and a mild negative effect on growth. As noted by (Duncan & Peter 2008), the positive effects of reducing tax progressivity (i.e. moving to a flatter tax regime) is less apparent in developed countries which has a high tax compliance rate to start with. Therefore, it seems to suggest that progressive tax rates may work better in an economy where there is high tax enforcement and low informal economy.

Equality is achieved in a progressive tax system by distributing income through imposing high tax burden on the rich for welfare expenditure on the poor. However, it has also been argued that equality is achieved when everyone is taxed at the same rate. This is a characteristic argument for the flat tax system. Under a flat tax system, there is no distinction between the income classes; therefore, it is said to be a fairer tax system. It incentivizes work effort as whatever the income level; the tax rate remains the same. The flat tax system is simple and hence more cost efficient to comply and administer. However, (Duncan & Peter 2008) showed that generally, there is a tradeoff between efficiency and equality. (Voinea & Mihaescu 2009) indeed found that there is an increase in inequality determined by the flat tax in Romania and (Duncan & Peter 2008) concluded that as taxes become more efficient, via lower progressivity (or flatter tax rate), income inequality tends to increase. However, they argued that the increased inequality under the flat tax system is not necessarily the case for all countries.

The most referred to literature on the flat tax system is the flat tax proposed by Robert Hall and Alvin Rabushka in 1983 – later revised in 1995 – which taxes businesses and individuals at the same single rate. Businesses are taxed on total sales less labor costs, cost of capital goods, and purchase of raw materials, while individuals are taxed on the difference between their total labor compensation and a personal allowance. There is no tax on savings, no double taxation on dividends, and interest income is taxed as part of business income, making it a tax on consumption. The tax is simple such that a tax return can be made on a postcard. The

presence of a personal allowance for taxpayers indicates that the flat tax system by (Hall & Rabushka 2007) is a modified flat tax. Another variation is a true flat tax proposed by (Browning & Browning 1985). Their true flat tax is a low and single rate tax on total income without any preferential treatment given to specific sources or uses of income. A true flat tax is thought to harm low and middle-income earners, which is a politically unacceptable consequence. However, their study showed that a flat tax rate will harm lower income households to a much smaller degree than is generally believed or estimated, and may even benefit them over the long run. Based on their findings, transfer program are a better way to ensure adequate income for the truly impoverished. If there are any costs involved from the implementation of a true flat tax, the efficiency gains are sizeable enough to offset a large part of these costs. The strong perception that a flat tax would substantially shift the tax burden from the highest income groups to low and middle-income taxpayers – many of whom currently pay little or no income tax – accounts for the reason why current flat tax proposals are actually modified flat tax proposals.

Studies have shown that the implementation of a simpler tax structure such as the flat tax system has the ability to generate more revenue. This was demonstrated in a study by (Ivanova et al. 2005) and (Gorodnichenko et al. 2008) on the 2001 flat tax reform in Russia. However, the effects of the flat tax system in reducing tax evasion or labor informality has been mixed. (Mara & Narazani 2011) concluded that the flat tax has not contributed in the reduction in labor informality in Albania while (Gorodnichenko et al. 2008) found a large and significant

change in tax evasion arising from increased voluntary tax compliance in Russia. There is also a strong evidence of positive relationship between lower tax rate and lower tax evasion.

Latvia, Lithuania and Estonia are countries that have first introduced flat tax in the 1990s. Hong Kong adopted the flat tax idea in 1947 and recently revived it in the 1980s. The success of the flat tax regime has prompted other countries such as Russia and other transitional countries such as Slovakia, Romania, Georgia and Albania to follow suit. Flat tax has become increasingly popular in Eastern Europe but other countries such as Western Europe, the U.S., United Kingdom and Australia with well-established middle classes have only given the flat tax reform a deliberation. For example, (Labeaga et al. 2008) did a study on the current tax reform in Spain and found potential benefit of adopting a basic income flat tax scheme as a distributional mechanism that can both reduce inequality and increase social welfare. (Aaberge et al. 2000) studied the labor supply responses and welfare effects of a flat tax reform in Italy, Norway and Sweden and found that flat tax benefits Norway.

From the above discussion, both progressive and flat tax system have their pros and cons. While a progressive tax system seems to triumph in terms of its ability to redistribute income, the flat tax system improves tax compliance and labor incentives through its simplicity. As Malaysia is currently under a progressive tax system and the impediments of the current tax system have been discussed above, there may be some benefits to be gained from the simple flat tax system. As (Palil & Mustapha 2011) found that one of the determinants of tax non-compliance in

Malaysia is the level of tax knowledge, the tax system should be simpler and easy to understand. Little has been studied about the progressivity of tax rates and extent of tax evasion in Malaysia apart from a mention of it in a paper by (Chen 2012).

It is widely acknowledged that Malaysia needs to widen its tax base. The current move taken by the government in introducing GST has raised many concerns about purchasing power among the population as confirmed in a study by (Palil & Ibrahim 2011). Their study also suggested that there would be a significant change in consumption behavior; people will be more prudent and selective in their purchasing behavior, which would potentially distort aggregate demand. Proponents of GST argue that the generation of information on transaction chains in such tax system is useful for enhancing the probability of detection of informal activities as well as closing the information gaps and preventing cheating, especially when a well-designed income tax and GST are operating in tandem. However, because of the "tax interaction effects" between income tax and GST, the well-meaning presence of special provisions and exemptions in most GST and income tax system put in place to protect the interests of the poor or special interest groups, increases the incentive to cheat (Ahmad et al. 2012). A well-designed income tax and GST tax system is arguably an efficient tax system for maximizing revenue collection, but in developing middle-income societies such as Malaysia, it is almost impossible not to introduce compensatory measures such as exemptions in a GST system. The absence of these compensatory measures has implications not only for the cost of living of the population but also politically unpopular. As

such, it is arguable that a GST system may not be feasible in terms of achieving equity and fairness in taxation in a middle-income country such as Malaysia.

Wealth Tax

Several literatures have studied capital taxes or taxes on wealth; (Atkinson 1971; Hansson 2002; Mcdonnell 2013), to name a few. (Boadway et al. 2010) have questioned the rationale for a wealth tax on the grounds that it constitutes double or triple taxation i.e. taxation under income tax when it is created and then taxation subsequently in its own right. However, double taxation is not peculiar to wealth taxes as householders also pay their consumption taxes out of their post-tax income. (Mcdonnell 2013) put forward six arguments in favor of wealth taxes. The potential revenue yield is one obvious benefit to the government. The redistribution of wealth is often considered the fundamental objective of a wealth tax and it is these social justice concerns, which make up the second set of arguments in favor of wealth taxes. Wealth taxes reduce inequality in the distribution of wealth by constraining the accumulation of wealth by the wealthy. Underlying these social justice concerns are the concepts of vertical equity and ability to pay. Horizontal equity is another benefit. The idea is that persons or groups with the same taxable capacity, or ability to pay, should be treated equally and should pay the same amount of tax. Administrative efficiency and the fight against tax evasion form the basis of the fourth and fifth set of arguments often used to justify annual wealth taxes. Data from wealth tax can be crosschecked against other tax returns to help detect and discourage evasion of other types

of taxes. Lastly, net wealth taxes may encourage more productive use of assets by imposing charges on wealth irrespective of income.

Even though many popular contentions seems to posit that wealth tax causes capital flight, its effect may not be as alarming as the perception would suggest (Hansson 2002). A carefully implemented wealth tax on selected classes of assets has the incentive structure that allocates idle assets to productive use by switching from low-yielding investments to high-yielding ones, in order to offset the additional taxes. Taxes are currently levied on wealth in countries such as India, the Netherlands and Norway. The global financial crisis has caused some countries such as Iceland, Spain, France and Cyprus to re-introduce annual wealth taxes on individuals, some on a temporary basis to alleviate budget constraints.

The bestseller book on wealth gap by Thomas Piketty, *Capital in the Twenty-First Century,* has recently captured global interest. (Piketty 2014) analyses a unique collection of data from twenty countries ranging as far back as the eighteenth century to uncover the main driver of inequality. He demonstrated that in rich countries at the frontier of technology and skills, the growth of incomes is between 1% and 2% a year while the rate of return on capital averages about 4% to 5% a year. So those who draw their income from capital returns will outstrip wage earners and "inherited wealth grows faster than output and income". He contended that the only way that this can be remedied is with intervention from governments; otherwise, wealth will concentrate at levels incompatible with democracy, let alone social justice. Capitalism, he concluded, automatically

creates levels of inequality that are unsustainable. Therefore, (Piketty 2014) proposes a high tax on the top earners and a global wealth tax.

The implementation of wealth tax has not been without objections. (Ebb 2004) cited that the fall in fashion of the wealth tax in Europe is due to its contribution on capital drain, high management costs and distortions in resource allocation due to double taxation. (Shakow & Shuldiner 1999) and (Evans 2013) noted two administrative weaknesses to wealth tax; one is the need to value assets and liabilities to determine net worth and the other is the need to distinguish between the return on capital and return from labor. Wealth can be hidden in tax havens. Hence, inequities begin to arise between honest and dishonest taxpayers. Another problem with wealth tax is liquidity in paying wealth tax when assets are normally held in an illiquid form.

Implementation of any new tax will normally be met with criticism. However, on the basis that the tax net has to be widened and to balance the inequality created by the flat tax system suggested by empirical studies, the tax reform proposed will include a flat tax on wealth. Measures have to be put in place to prevent wealth from leaving the country. In the interest of equity, it is justifiable to tax wealth in addition to income.

Monetary Policy

Monetary policy by central bank is associated with monetary management, specifically volume of liquidity in the economy in relation to: (i) the supply of money, (ii) availability of money, and (iii) cost of money or rate of interest to attain a set of objectives oriented towards the

growth and stability of the economy. The official goals usually include relatively stable prices and low unemployment. Islamic economists have not challenged this conventional wisdom.

(Chapra 1983) presented an early framework of how monetary policy should be designed to play in an Islamic economy and to show how it can be made to play its role effectively if interest is abolished and two important instruments of monetary policy i.e. discount rate and open market operations in interest bearing government securities, are not available. He listed three important goals, i.e. 1) Economic well-being with full employment and optimum rate of economic growth; 2) Socio-economic justice and equitable distribution of income and wealth; and 3) Stability in the value of money to enable the medium of exchange to be a reliable unit of account, a just standard of deferred payments and a stable store of value. He argued that in order to achieve the above three (3) objectives in full compliance with Islamic values, the entire economic system would have to be reformed fundamentally.

(Khan & Mirakhor 1989) developed a short run macroeconomic model of an Islamic economy in which all credit consists of Mudarabah transactions and monetary policy has the same effects whether the authorities choose to influence money supply or the flow of Mudarabah financing by changing the profit and loss sharing ratio. They concluded that there is no fundamental change in the way monetary policy affects and Islamic economy compared to a traditional economy.

(Mirakhor & Zaidi 1991) developed a more comprehensive Islamic macroeconomic model of monetary policy to analyze the link between financial and real sectors in an open economy with a flexible exchange rate regime. Monetary policy can affects the rates of return on financial and real assets and thereby affects real investment demand, output and the balance of payments.

(Mirakhor 1993) analyzed an economy in which there is no interest bearing assets, only equity shares. He presented an open-economy model to analyze the effects of trade in goods and assets on the macroeconomic equilibrium of the economy. He pointed out that the absence of interest bearing assets does not hamper macroeconomic analysis or the workings of the economic system.

(Choudhry & Mirakhor 1997) discussed the indirect instruments of monetary control in a market oriented Islamic financial system. They proposed equity based government securities with rate of return based on budgetary surplus. Such securities can be utilized as instruments of monetary control, enhance the role of price signal and improve market incentives.

(Haque & Mirakhor 1999) proposed an equity instrument to be sold by governments with its rate of return indexed to the domestic rate of return in Islamic countries and to the return in international Islamic equity markets, each with specified weights. They detailed practical issues of market development for the instrument of government finance and monetary management.

Empirical evidence shows that monetary policy has been a factor in financial stability. According to (Askari et al. 2010), the monetary policy of central banks affects the real

economy as well as the financial sector; stimulate demand for goods and services and increase employment through a credit boom and injection of excessive liquidity. They stated that in the absence of a highly stable and predictable monetary framework, financial institutions will face recurrent financial instability with increased frequency.

Incentive Structure for Monetary Policy

Equity Premium

The term equity premium is simplified from the equity risk premium. The equity risk premium is considered as a key financial variable, which is an essential ingredient in investor's financial decisions. It has important bearings on, for example, the required rate of return on stocks or investment projects, asset allocation and capital budgeting. In essence, equity premium means the return that an investor expects over and above the risk-free rate of return in exchange for investing in common stock (risky security) instead of treasury bonds (risk free security). This excess return compensates investors for taking on the relatively higher risk of the equity market. The size of the risk premium will vary as the risk in a particular stock, or in the stock market as a whole, change. High risk investments are compensated with a higher premium.

(Mehra & Prescott 1985) invented the phrase equity premium puzzle. It is based on the observation that in order to reconcile the much higher return on equity stock compared to government bonds in the United States, individuals must have implausibly high risk aversion according to standard economic models. Similar situations prevail in many other industrialized countries.

(Kocherlakota 1996), (Mehra & Prescott 2003) presented a detailed analysis of the explanations for the puzzle in financial markets dealing with (1) a contention that the equity premium does not exist and the puzzle is a statistical illusion; (2) modifications to the assumed preferences of investors; and (3) imperfections in the model of risk aversion. They concluded that the puzzle is real and remains unexplained. Subsequent reviews of the literature have similarly found no agreed resolution. (Grant & Quiggin 2006) distinguished several classes of explanation of the puzzle. The most basic explanation is that there is no puzzle to explain and that there is no equity premium.

Recent research has shown the global character of the equity premium puzzle and has attributed a significant part of it to institutional factors (Erbaş & Mirakhor 2010). They argued that transparency reduces adverse incentive and ambiguity effects.

Risk Sharing

One of the core principles of Islamic economics is the notion of risk sharing. It is based on Verse 275 of Surah Al-Baqarah of the Quran.

Risk sharing is a risk management method in which the cost of the consequences of a risk is distributed among several participants in an enterprise, such as in syndication. In a partnership, risk sharing is a business arrangement in which consequential costs and benefits are distributed amongst all participating partners. In doing so, partners rely on the commercial success of the business to receive their share of financial benefit from the enterprise while reducing

the risk of loss involved if the enterprise loses money. (Fischer 2010) found that equity-like financing, in which partners share both the benefits and risks of more profitable projects, typically overcomes the inefficiencies of partners' free riding and overcompensation of peer monitoring, leading to sharp reductions in risk-taking and profitability. The results showed that equity increased risk-taking's expected returns relative to other financial contracts.

The moral dimension to risk sharing is its ability to strengthen social solidarity by enhancing cooperation among all economic agents and expanded financial inclusion (Askari et al. 2012). A system that pool resources be it financial, entrepreneurial or technical will result in greater output and larger profits (Mirakhor 2010). Additionally, (Askari et al. 2012) provided an elaborate justification for risk sharing as a viable alternative foundation for the financial system and how the risk sharing principle is closely tied to the real sector of the economy.

According to (Kharas & Gill 2007), in order for a middle income country like Malaysia to advance out of the middle income status, the benefits of the growing economy must be widely shared, and social opportunity for the vast majority of the citizens must be improved. Sharing allows risk to be spread and thus lowered for individual participants (Mirakhor 2012). Risks are shared according to the capability of the bearer.

The number of empirical studies on risk sharing has grown rapidly in recent years. As cited from (Kim et al. 2004), initially the formal literature tested the null hypothesis of full risk sharing at various aggregation levels, such as individuals in villages (Townsend 1994), households (Mace 1991)

(Cochrane 1991) (Altug & Miller 1990), and countries (Canova & Ravn 1996) (Lewis 1996). Whilst, informal tests of full risk sharing using cross country income and consumption correlations are pioneered by (Backus, Kehoe & Kydland 1992).

Estimating the consumption risk sharing of a country is essential for at least two reasons: 1) the degree of risk sharing provides a yardstick on which a country can mitigate the influences of idiosyncratic shocks on the economy, which can be achieved through either further capital market integration or international lending or borrowing; 2) the presence of risk sharing is viewed as a substitute to synchronized business cycles for the formation of the common area.

(Shiller 2003) has cited empirical evidence that suggests risk sharing within countries and across borders is today an insignificant fraction of its potential. He recognized the full potential benefits of risk sharing for mankind. He pointed that the reduction of risks on a greater scale would provide substantial impetus to human and economic progress, i.e. that massive risk sharing can carry with it benefits far beyond that of reducing poverty and diminishing income inequality. He suggested macro market instruments of risk sharing.

(Kim et al. 2004) measured the magnitude of risk sharing of 10 countries in Asia by using cross country consumption correlations and formal regression analysis. Risk sharing is found to be far from complete and quite low for most of the countries. The study illustrated that risk sharing not only insulates an economy from shocks, but could have prevented the 1997 crisis from happening.

(Mercereau 2006) estimated how much Australia and other countries in Asia pacific region would gain from greater financial integration. The results suggest that these welfare gains are large in favor of progressive capital account liberalization, across the region. He concluded that international risk sharing may boost GDP growth because investors are more willing to invest in high risk-high return projects.

(Qiao 2010) estimated an empirical non-stationary panel regression model that tests long run risk sharing. Based on this study, he asserts a positive relationship between various measures of financial integration and cross country risk sharing. However, this positive relationship is less in the recent financial integration period indicating that the increase of risk sharing is not proportional to the increase in capital flows.

Promoting maximum risk sharing is the ultimate objective of Islamic finance. Continued transfers of risk with interest rate-based debt instruments do not serve the collective welfare. Risk sharing may well provide an efficient replacement (Mirakhor 2012). Muslim scholars consider profit loss sharing and equity participation as the first best instruments of risk sharing (Iqbal & Mirakhor 2011), (Mirakhor 2010), (Mirakhor & Zaidi 2007).

ISLAMIC FINANCE AND MACROECONOMIC POLICIES

The opportunities of Islamic finance in providing global alternative to conventional finance involves alternative means of monetary, fiscal, budgetary policy implementation

through which a high performance, stable economy can be built which would be resilient to external shock.

Basic tenets of Islamic finance are clearly set out in the second part of the verse 2: 275; ("…But Allah has permitted exchange and has forbidden usury…"). Based on this verse, an analysis of the Islamic financial system (IFS) and its interaction with the real economy is based on the principles of risk sharing and prohibition of *riba*. Prohibition of *riba* meant elimination of all fixed-fee debt contracts and that IFS would have to be primarily equity based. On the contrary, in conventional finance, interest is *riba* and for the purpose of risk transfer or risk shifting. Accordingly, it impedes and become a noise to the monetary policy.

Objectively Islamic finance is no different from conventional in running fiscal and monetary policies but since its financial transactions are to be carried out under some restrictions so in that respect they have to be amended and redesigned in accordance with these tenets.

The ideal Islamic finance points to a full-spectrum menu of instruments serving a financial sector imbedded in an Islamic economy in which the institutional rules of behavior including rules of market behavior, complied to *Shariah* is fully operational. The essential function of that spectrum would be spreading and allocating risk among market participants comprising firms, households, governments and international economy.

Hence, the major and immediate challenges to system wide implementation are to develop risk sharing financial instruments and benchmark; liquid secondary and money market; and instruments for effective monetary and fiscal policy.

An Islamic perspective would propose a two pronged solution reform of the tax system and a radical change in the way governments finance their spending. The result of these reforms would lead to a change in the design and implementation of fiscal and monetary policies. Certainly the current monetary policy framework, which relies on interest rate mechanism, is not compatible, relevant and effective in Islamic financial landscape. Structural adjustments in monetary management are needed to provide a level playing field for Islamic finance. An alternative to reliance on interest rate based instruments is to devise policy tools that rely on the risk sharing features of equity finance.

Goals traditionally assigned to fiscal and monetary policies by Islamic Economists:

Fiscal Policy (Consensus view at the 1981Islamabad Seminar)

1. Ideological orientation with equal attention to material and spiritual welfare
2. Fulfillment of basic needs of all the people
3. Providing the necessary infrastructure to promote economic growth
4. Promoting an egalitarian economic and social order

Monetary Policy (Umar Chapra, the 1981Islamabad Seminar)

Economic well-being with full employment and optimum rate of economic growth,

1. Socioeconomic justice and equitable distribution of income and wealth, and
2. Stability in the value of money

Islamic Fiscal Policy Reform

One of the most important roles of the government is the design and implementation of incentive structures that encourage coordination and cooperation in the market to achieve a desired economic goal. These incentive structures are incorporated in government policies that should create a just and equitable outcome for all.

The alternative fiscal measures being proposed are:

1. Tax structure that features a simple and fairer tax that is based on the ability to pay.

- A flat rate tax on income that avoids potential manipulations, easy to administer and fair. The low-income group which has not been liable to tax or has been levied a low rate of tax previously can be compensated by the imposition of a minimum threshold before tax is payable or via direct monetary benefits. This minimum level of income is similar to the concept of *nisab* in Islamic alms, *zakat* and one, which could enable a person to live a decent life under the current standard of living condition.
- A wealth tax that targets the wealth of wealthy. It is broad based such that the rate can be kept low. It is a form of redistribution of wealth from the rich to the poor.

The aim of the reform in the tax structure is to increase tax revenue through greater tax compliance and at the same time the imposition of tax is based on the financial capacity of the taxpayer.

2. Public financing which is free of interest. What constitutes a major difference is the financing of the budget deficits (shortfalls of revenues to finance current and

development spending); Government could replace borrowing with mobilizing of resources domestically (currently saving rate estimated at 35% of GDP more than the total PSBR of the government) through risk sharing instruments. Risk sharing instruments to finance a portfolio of development expenditure will replace the issuance of interest-based Treasury Bills and Government Securities. The shares are issued in low enough denomination such that the general public will have access to them. The rates of return of the shares are tied to the growth of the portfolio of development projects.

The risk-sharing instrument could take at least two forms:

a) Designing and issuing risk sharing instruments on a portfolio of all development projects. One such instrument can be called Development Project Certificates of Risk Sharing (DPCRS) for example.

- Determination of pay off rates: it should be recalled that the purpose of Islamic finance is to forge a close relationship between the real sector and finance. The rate of pay off or dividend to these certificates will be based on the "benchmark" adjusted downward by the risk premium of the government.
- Resources to pay dividends will come from the annual pool of interest payment expenditure on domestic and international borrowing.
- These certificates would be sold on the secondary market.
- Households, firms, banking institutions and non-bank financial institutions in the financial sector as well as the central bank can purchase (and sell) these instruments.
- The maturity structure of these instruments could be the same as the debt instruments presently used by the

government to raise borrowed funds or could be designed differently than the present debt instruments.

- Note that initially the rate structure will be based on the risk-premium adjusted "benchmark" rate. Thereafter, the market price of these certificates, once traded on the secondary market will be an additional input into the determination of the rate of return to these certificates.

b) Government could also design and issue:

A GDP-based Risk Sharing Participation Certificate (GDPPC) to finance other parts of its budgetary requirements.

- Rate of return (dividends rate) on these certificates will be based on GDP growth rates adjusted by government's risk premium, keeping in view the "benchmark" rate, also adjusted by Government's risk premium depending on its current policy stance; the government could choose a dividend rate which would be higher than the two. The justification is that government spending (e.g. social spending for defence and public services) have much higher Social Rates of Return (SRR) than spending by the Private Sector. The same procedure can be used on dividend payments rate and justified by the same high social rate of return arguments.

Here, the trading of the risk-sharing instruments can be done in the equity market similar to other stocks.

Proposed Islamic Monetary Policy

Monetary policy in Islamic framework should only be in conformity with the ethos of Islam. Under Islamic system, monetary policy can only be implemented through those monetary instruments, which are consistent with Islamic teaching. The first step towards change, is an absent of

interest as an alternative to debt financing wherein replacing debt with equity as the basis for issuing new money by central bank. In Islamic finance, central bank follows a stable monetary policy that creates no distortions in the economy, and causes no risk for the economy or for banking sector. Its main function is to ensure an optimal supply of money that preserves the value of the currency as well as financial assets.

The new proposed monetary policy model is based predominantly on risk and profit sharing mechanism. It is hypothesized that the risk sharing method as an alternative to risk transfer or risk shifting method enhances macroeconomic stability; imparts greater strength to monetary policy; accelerates economic growths; and improves income distributions.

Two outcomes would be expected from this proposal:

1) Shariah based Monetary Policy Framework

• To enhance monetary policy signaling and transmission.

– Using "Real Rate of Return" (R*) as policy anchor;
– Influencing directly household's decision in allocating financial asset;
– Changing price setting behavior of banking institutions. Banks has no longer monopoly power in setting retail deposit rates. Deposit rates are also influence by R*. Basically R* remove the noise and barrier to the monetary policy.

2) Equity based instruments

• To promote for Islamic finance product to be priced independently from conventional system. With different maturity structure, it gives central bank a great flexibility.

- Equity Papers to complement households' deposit;
- Central Bank issuing Equity Papers to conduct OMO;
- Government issuing Equity Papers to raise financing.

Objectives

The monetary policy objectives are the same as in the conventional system, i.e. inducing portfolio adjustment in the Private Sector. Except that monetary policy can pack greater amount of power here because it can affect changes in the real sector both directly and indirectly. The instruments it will use for OMO will be composed of Gross Domestic Product (GDP) based risk sharing certificate, Development Projects Certificates of risk sharing, Central Bank Participation Certificate = portfolio of blue chip equity shares constituting 15-20% of central bank reserves (for fine tuning monetary policy). All of these with their respective maturity structure give the central bank a great deal of flexibility in choosing when, where and how it wants monetary policy and which instrument to be used. To put together its asset portfolio, the central bank will have to decide on its composition.

Operations

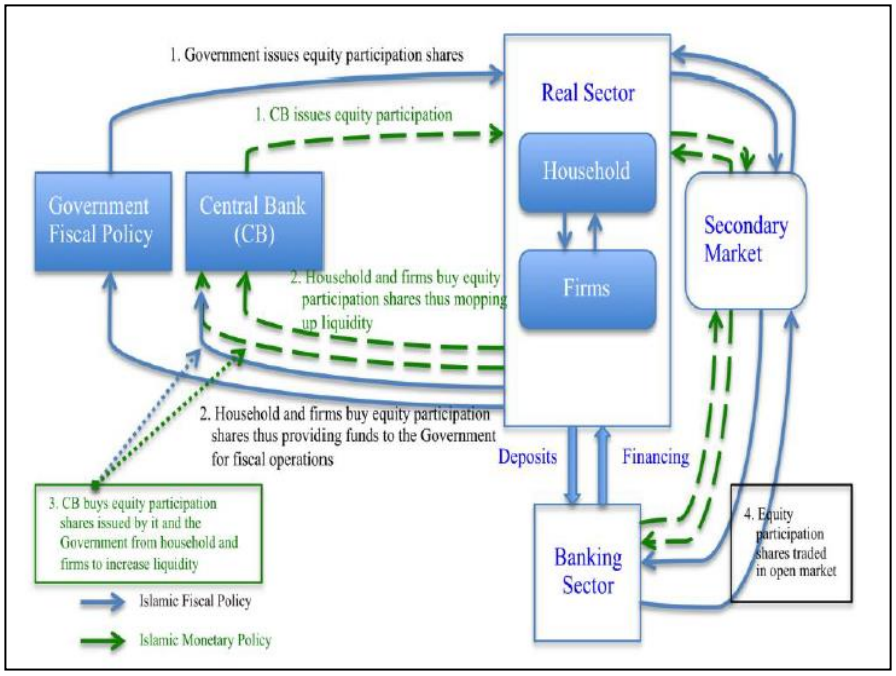
The central bank can use its securities portfolio to implement monetary policy decisions once it decides which macroeconomic variable(s) it wishes to influence. The control variable now will be the rate of return to real economic asset (signal generated by the benchmark calculations in real time). The central bank can also target cost of funds for the financial sector as an indirect way of enhancing its direct influence on the rates via OMO using

government securities in its asset portfolio. As for the composition of holdings of government's securities, the amount purchased by the central bank must be of size to allow effective intervention. The size of the present holding of government debt-based securities could give us a clue on the size of holding of new government risk sharing securities.

The central bank could also issue its own instrument with its rate tied to benchmark-GDP growth rates. The funds for payment of dividends would have to be provided from the central bank profits or from the budget. This instrument could be of shorter maturity then the one issued by the government. Ultimately the rate will be mostly market determined based on the signaling impulses emitted by the real sector reflected in the secondary market pricing of these instruments as well as in the benchmark rate. Different maturities could provide a clear and well-behaved yield curve. Determination of pay off rates will be based on the "Profit sharing rate of return" adjusted downward by risk premium of the government (benchmark). These instruments would be sold on the secondary market. Household, firms, banking institutions and non-bank financial institutions as well as the central bank can purchase (and sell) these instruments. Rate structure will be based on the government's risk-premium adjusted "benchmark" rate.

Alternative Monetary and Fiscal Policies

The following chart illustrates the working of alternative monetary and fiscal policies:



For monetary operation, the central bank issues equity participation shares to contract the money supply (as shown by the green arrows). The purchase of these shares by the households and firms reduces liquidity in the market. For fiscal management (as shown by the blue arrows), the government will be issuing equity participation shares, which households and firms will be purchasing by using their excess funds or savings. The government then uses the proceeds to finance its development budget. Households and firms manage their liquidity by trading these papers in the secondary market. The papers issued by the government also serve as an instrument for monetary operation whereby

the central bank can purchase these papers to inject liquidity into the market.

Advantages of Islamic finance based macro policies

Financing of government via risk sharing would have a positive distributional impact, improve governance as citizens will become more involved in directly financing government projects, provide greater fiscal space and flexibility to policy, reduce the burden on the future generations, enhance social solidarity and provide effective tools for monetary policy.

Under the new regime, monetary policy can directly affect the private sector's portfolio adjustments through the sale and purchase of low denominated, risk sharing instruments that are traded in the secondary markets.

There will be a strong incentive for the citizens to invest their savings in government, risk sharing securities rather than depositing them in banks with no or very low rates of interest. The participants can reduce the risk of income volatility and allow consumption smoothing, which increases the welfare of society. Based on these premises, the overall combined effect of the proposed fiscal policy is expected to generate a higher GDP for the country. By generating increased tax revenue and tapping private sector savings, the government will not only avail itself of a source of funding for its expenditure, but also provide a more equitable opportunity for the public to have access to the wealth of the nation.

Financing through equity instruments has some advantages that include:

- Improve budget stability.

- Enhance resilience of monetary policy and fiscal policies to shocks.
- Less vulnerability to external shocks: contagion and sudden stop.
- The introduction of the new instruments gives monetary policy the flexibility of targeting asset prices, in addition to CPI target, if and when necessary.
- The new instruments will change the base of money creation from debt-credit to equity.
- Reduced burden on monetary policy.
- The new instruments will go a long way in resolving the present policy inconsistency between government's commitment to promote Islamic finance, on the one hand, and borrowing and lending on interest to run its own finance and to carry out fiscal and monetary policies, on the other.
- Allow tapping into the equity premium.
- Serve directly to fill-in the high end of the spectrum of the menu of Islamic instruments in terms of higher return, longer term, risk sharing instruments. The private sector will then have the incentive to fill-in the gap between the two ends by developing risk sharing instruments for the medium term.
- Traded at retail and in the secondary market the instruments will serve households and firms as hedging devices against idiosyncratic risks such as liquidity and productivity risks. This should induce a reduction in saving rate and make more funds available for additional investment generating additional employment, output and income and economic growth.
- Create a more vibrant capital market.

- Less worry about international market credit rating which can change rapidly exposing the country to the risks of international market.
- New instruments can improve international risk sharing as foreign investor will be purchasing the new instruments.
- New instruments should also improve governance as they expand and deepen the financial involvement of citizens in their government's budgetary process.
- Greater efficiency in use of resources by government as it has to compete for funds with the private sector. Any signal of inefficiency will now be reflected in the market price of government securities.
- Will create a new asset class for the *takaful* industry.

CONCLUSIONS

In conclusions, monetary policy has to move away from interest based targeting and bypass intermediation of the rent-seeking moneylenders. At the same time, fiscal consolidation may need to look beyond the usual fiscal measures of increasing taxes and widening the tax base (regardless of ability to pay) and increasing borrowing on interest (regardless of the distributional implications). The proposed framework has the following elements:

a) A monetary policy that is altered through asset market activities and direct private sector portfolio adjustments.

b) A tax structure that can improve the tax revenue.

c) Public sector financing that mobilizes non-debt-creating sources to finance development expenditure.

The use of risk sharing instruments as tools of monetary and fiscal policy has the potential of promoting socio-economic development and human well-being by the justice and equity features of sharing of risks. At the same time, sharing of risks increases trust, transparency, cooperation, and coordination among the people and between the people and the Government, an important ingredient in preserving stability and strengthening social solidarity in a pluralistic country such as Malaysia.

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[i] The First Malaysia Plan started in 1966. The Malaysian Plan is a five-year economic development plan aimed at improving the economy and quality of life of the people in Malaysia.