

2017 TJC Prelims H2 Economics (9757) – EQ1

1) Malaysia will begin imposing its tourism tax from Aug 1 this year, according to details published on the Royal Malaysian Customs Department's website. Rates start from RM2.50 per room each night at a non-rated accommodation to RM20 per room each night at a five-star accommodation.

Source: Channelnewsasia.com, 2017

- a) Explain how the imposition of the tax might affect consumers' expenditure and producers' revenue for different types of hotels in Malaysia. [10]
- b) Discuss the factors the Malaysian government might have considered before deciding to impose the tourism tax. [15]

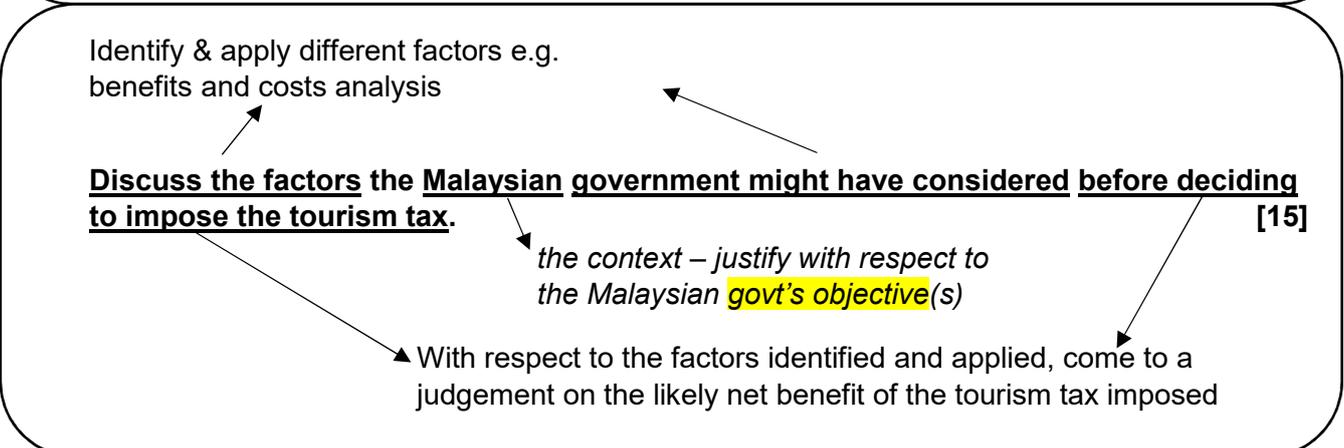
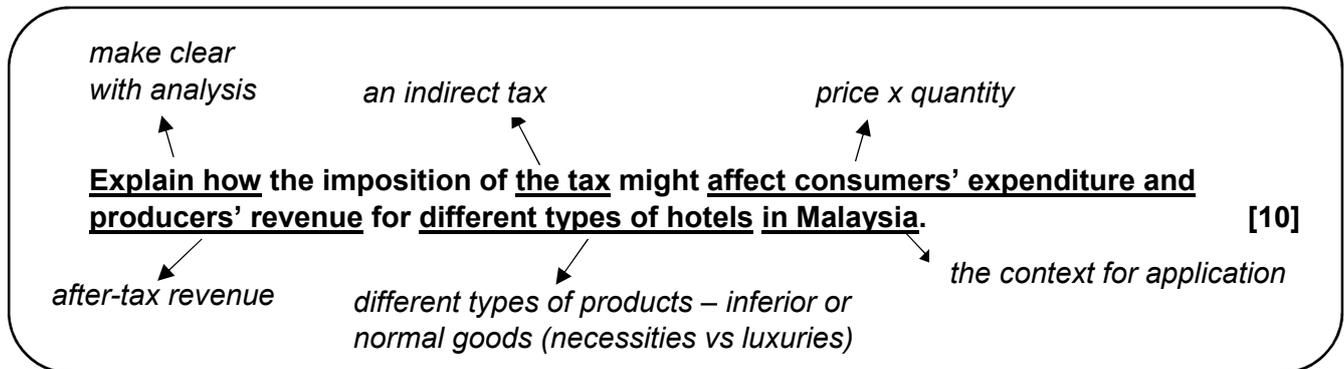
Question Interpretation

(a)

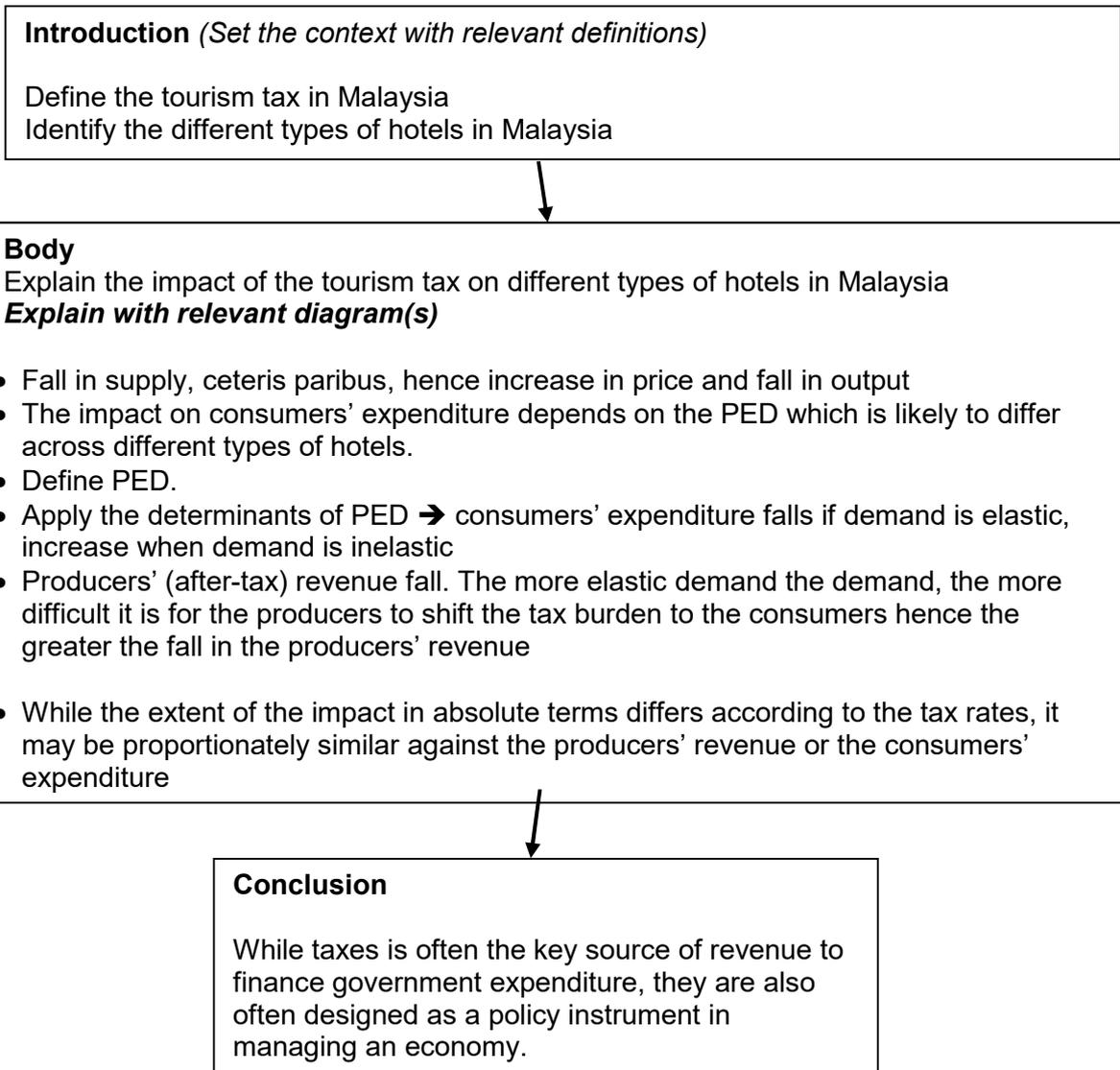
- What is the tourism tax in Malaysia?
- How is the consumers' expenditure / producers' revenue calculated?
- How about the after-tax revenue?
- How do the various effects differ across different types of hotels in Malaysia? What is/are the determining factors of the differences?

(b)

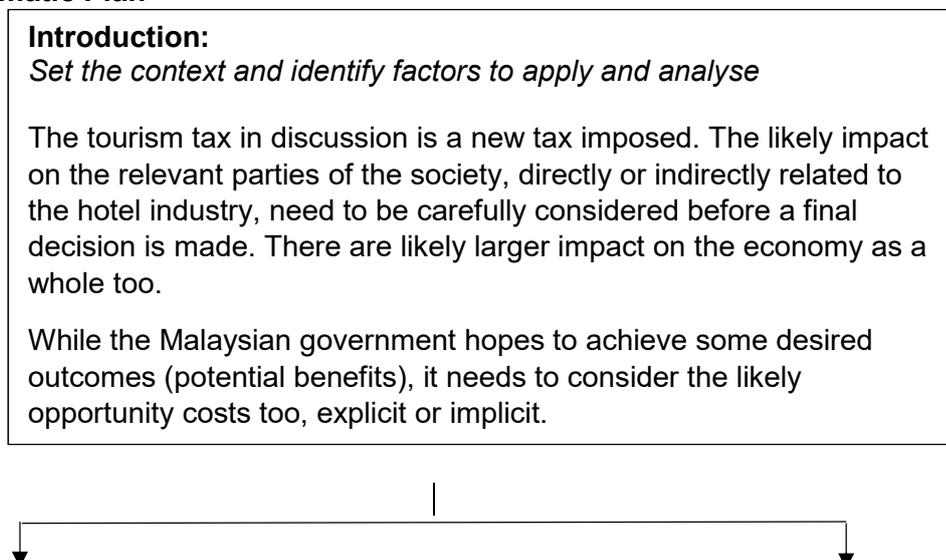
- What is/are the objectives of government?
- What are the likely objectives (benefits) for the Malaysian government?
- What are the likely unintended consequences (costs)?
- Overall, how is it likely that the Malaysian government decides to impose the tourism tax? What likely determinants are there for net benefits of the tax imposed?



(a) Schematic Plan



(b) Schematic Plan



Benefits

- Explain how **the state of the Malaysian economy** determine the government's decision to impose the tourism tax
- The Malaysia economy faces declining growth rate in recent years, government budget deficit and a weakening currency (1MDB debt crisis in 2014)
- The purpose of the tourism tax could be to raise revenue for general government spending, including investment in the tourism industry.
- The boost to tourist arrivals with the weaker currency that makes Malaysia a relatively cheaper destinations provides the platform for the government to impose the tourism tax for the necessary revenue.
- The tourism tax could help to counter the loss in gains from trade as a result of its undervalued currency due to the speculation against its currency.

Costs

- Explain the **unintended consequences** on different interest groups in the economy, and the economy at large using the AD/AS framework
- Fall in profitability of the hotel industry and the auxiliary industries (e.g. restaurants, transport, tourist attraction and leisure activities, recreational, cultural and sporting, tour agent, retail industries)
- Fall in export revenue with falling tourist arrivals, fall in AD and contractionary impact on the economy with rising unemployment and economic slowdown. Falling X leads to a weaker currency too.
- Likely distortionary impact on resource allocation with an under-allocation of resources to the hotel industry. However, this should be minimal as long as the government invests the revenue collected in the tourism sector
- Likely inflationary impact with an indirect tax imposed but likely negligible being not a general tax

Evaluative conclusion

(comment with respect to the factors raised above, some examples shown below - 3 points suffice)

- The governments must bear in mind the likely conflicts in objectives such as the policies can be calibrated more effectively to achieve the intended outcome without causing other problems
- Despite the risk of unemployment, the Malaysia government might go ahead with the tourism tax as the risk is lower with the relatively weak currency
- Given the relative weak Malaysia currency, the concern over the loss of tourist arrivals and the foreign exchange earnings is likely minimal
- To the extent that the impact on the tourism sector is not expected to result in a loss of foreign exchange earnings, the government would impose the tourism tax.
- Overall, the Malaysia government has to be careful not to dampen tourist arrivals with the tourism tax. The plan for investment in tourism infrastructure must follow through.
- In view of the likely supply-side policy on tourism infrastructure development using the tax revenue raised, the overall impact appeared positive in the long run and motivated the government to go ahead with the tourism tax
- Perhaps the most important/relevant decision to be made then is the way and the extent to which the tourism tax is to be imposed.

(a)

Suggested Answer	Comments
<p><u>Introduction</u> The tourism tax to be imposed in Malaysia refers to taxes imposed on tourists (or foreigners) staying at paid lodgings in Malaysia (the Malaysians are exempted from it completely). It is an indirect tax and the amount of tax imposed depends on the type of accommodation with a higher amount imposed on higher-rated hotels.</p> <p>A highly rated or a 5-star hotel in Malaysia such as Shangri-La Hotel offers a more comprehensive list of complementary facilities and services in addition to accommodation such as restaurants, room service, laundry, fitness centre, pool, spa, bar, wi-fi. Zero-rated hotels are those providing the bare minimum of basic accommodation service often called budget hotels or even backpacker's hostel.</p>	<p><i>Set the context with relevant definitions</i></p> <p><i>More examples - Grand Millennium, Shangri-La Hotel, Mandarin Oriental, Grand Hyatt, G Hotel Gurney</i></p>
<p><u>Body</u> The impact of the tourism tax on different types of hotels in Malaysia. Explain with relevant diagram(s)</p> <ul style="list-style-type: none">• Taxes are compulsory payments to the government by law• The tourism tax is an indirect tax• An indirect tax imposed leads to a fall in supply as the producers attempt to collect it from the consumers. Ceteris paribus, in general, the price (room rate) increases and the output (occupancy rate) falls• The impact on consumers' expenditure depends on the PED which is likely to differ across different types of hotels.• Define PED – a measure of the degree of responsiveness of quantity demanded to a change in price of the good itself, ceteris paribus.• Five-star hotels are likely to enjoy an inelastic demand for their accommodation services given that they are likely to have wealthy clientele whereby their proportion of income spent of the hotel service is minimal. Their regular customers are likely to include a large pool of business tourists where the service is more of a need and hence demand more inelastic• On the other hand, the non-rated hotel is likely to attract mainly less wealthy budget travellers hence facing a more elastic demand• Apply the determinants of PED → Consumers' expenditure increases if demand is inelastic since the fall in quantity bought is proportionately less than the increase in price paid. The reverse is true when demand is elastic.• While the consumers pay a higher price, the producers receive a lower price after tax. Producers' (after-tax) revenue fall. The more elastic demand the demand, the more difficult	<ul style="list-style-type: none">• <i>General impact of an indirect tax imposed</i>• <i>Largely depending on the price elasticity of demand</i>• <i>Differing price elasticity of demand faced by different types/classes of hotels</i>• <i>Apply PED to analyse the differing impact</i>

<p>it is for the producers to shift the tax burden to the consumers hence the greater the fall in the producers' revenue</p>	
<p><u>Conclusion</u></p> <ul style="list-style-type: none"> • While the Malaysia government collects more tax revenue, both consumers and producers are worse off in general. • All else equal, the greater the tax rates, the greater the impact on the consumers and producers. However, it is likely proportionately similar (against the producers' revenue or the consumers' expenditure). • While taxes is often the key source of revenue to finance government expenditure, they are often designed as a policy instrument in managing an economy too. 	<ul style="list-style-type: none"> • <i>Generally both consumers and producers are worse off.</i> • <i>The impact also depends on the tax rates</i> <p><i>Link to (b)</i></p>

(b)

Suggested Answer	Comments
<p><u>Introduction</u></p> <p>The tourism tax in discussion is a new tax imposed. The likely impact on the relevant parties of the society, directly or indirectly related to the hotel industry, need to be carefully considered before a final decision is made. There are likely larger impact on the economy as a whole too.</p> <p>While the Malaysian government hopes to achieve some desired outcomes (potential benefits), it needs to consider the likely opportunity costs too, explicit or implicit.</p>	<p><i>Set the context and identify factors to apply and analyse how the Malaysian government might have considered them before deciding to impose the tourism tax</i></p>
<p><u>Benefits</u></p> <ul style="list-style-type: none"> • The main purpose of the tourism tax could be to raise revenue for general government spending • Explain how the state of the Malaysian economy determine the government's decision to impose the tourism tax • The Malaysia economy faces declining growth rate in recent years, government budget deficit and a weakening currency (1MDB debt crisis in 2014) • The boost to tourist arrivals with the weaker currency that makes Malaysia a relatively cheaper destinations provides the platform for the government to impose the tourism tax for the necessary revenue. • The tourism tax could help to counter the loss in gains from trade as a result of its undervalued currency due to the speculation against its currency. 	<p><i>Explain how the state of the Malaysian economy determine the government's decision to impose the tourism tax</i></p>

<p><u>Costs</u></p> <ul style="list-style-type: none"> • Explain the unintended consequences on different interest groups in the economy, and the economy at large using the AD/AS framework • Fall in profitability of the hotel industry and the auxiliary industries (e.g. restaurants, transport, tourist attraction and leisure activities, recreational, cultural and sporting, tour agent, retail industries) • Fall in export revenue with falling tourist arrivals, fall in AD and contractionary impact on the economy with rising unemployment and economic slowdown. Falling X leads to a weaker currency too. • Likely distortionary impact on resource allocation with an under-allocation of resources to the hotel industry. However, this should be minimal as long as the government invests the revenue collected in the tourism sector • Likely inflationary impact with an indirect tax imposed but likely negligible being not a general tax 	<p><i>Explain the unintended consequences on firms, households and their welfare, and the economy at large</i></p>
<p><u>Evaluative conclusion</u></p> <ul style="list-style-type: none"> ○ The governments must bear in mind the likely conflicts in objectives such as the policies can be calibrated more effectively to achieve the intended outcome without causing other problems ○ Despite the risk of unemployment, the Malaysia government might go ahead with the tourism tax as the risk is lower with the relatively weak currency ○ Given the relative weak Malaysia currency, the concern over the loss of tourist arrivals and the foreign exchange earnings is likely minimal ○ To the extent that the impact on the tourism sector is not expected to result in a loss of foreign exchange earnings, the government would impose the tourism tax. ○ Overall, the Malaysia government has to be careful not to dampen tourist arrivals with the tourism tax. The plan for investment in tourism infrastructure must follow through. ○ In view of the likely supply-side policy on tourism infrastructure development using the tax revenue raised, the overall impact appeared positive in the long run and motivated the government to go ahead with the tourism tax ○ Perhaps the most important/relevant decision to be made then is the way and the extent to which the tourism tax is to be imposed. 	<p><i>Comment with respect to the factors raised above, some examples shown below - 3 points suffice</i></p>

(a) LORMS

	Knowledge, Application / Understanding and Analysis	
L3	<p>Answers that clearly explain how the possible impact of the Malaysia tourism tax on the consumers' expenditure and producers' revenue of the different types of hotels in the country, through applying the concept of price of elasticity demand and its relevant determinants, 'non-rated accommodation vs five-star accommodation'.</p> <p>Answers in this range are characterised by strong and well-structured paragraphs with relevant and complete diagrams.</p>	8 – 10 (9)
L2	<p>Insufficient rigour: Answers that insufficiently analyse how the Malaysia tourism tax might affect the consumers' expenditure and producers' revenue of the different types of hotels in the country, or contain some minor errors in the analysis.</p> <p>Lack of scope: Answers that do not analyse the impact on the producers' after-tax revenue capped at 5m.</p>	5 – 7 (6)
L1	<p>Answers may have some knowledge of the relevant concepts but with significant conceptual errors or a superficial description of how the Malaysia tourism tax might affect the consumers' expenditure and producers' revenue of the different types of hotels in the country.</p>	1 – 4 (3)

(b) LORMS

	Knowledge, Application / Understanding and Analysis	
L3	<p>Thorough analysis of assess the costs and benefits of the tourism tax, with application to the given context and with relevant examples.</p> <p>Answers in this level are characterised by well-structured paragraphs AND a logical flow of arguments.</p>	8 – 10 (9)
L2	<p>Answers that gives a descriptive explanation of the various costs and benefits of the tourism tax</p> <p><u>OR</u> Answers may be lop-sided in nature</p> <p><u>OR</u> Answers may demonstrate rigour and scope in analysis, BUT without adequate application to the Malaysia context</p> <p><u>OR</u> Answers that appear largely rehearsed in a generic manner.</p>	5 – 7 (6)
L1	<p>Answers may have some knowledge of the relevant costs and benefits of the tourism tax but with significant conceptual errors or are very descriptive.</p> <p><u>OR</u> Answers that are largely descriptive and have limited application of economic concepts.</p> <p><u>OR</u> Answers that contain serious and pervasive misconceptions.</p>	1 – 4 (3)
	Evaluation/Synthesis	

E3	<p>Conclusion / judgement based on a good synthesis or an evaluative appraisal that built around the factors considered by the Malaysian government in its decision on the tourism tax.</p> <p>Provides an insightful, and convincing evaluative comments supported by economic or contextual analysis, demonstrating good awareness of the Malaysia context.</p>	4 – 5
E2	<p>For evaluative statements made not analysed in line with the factors considered by the Malaysian government in its decision on the tourism tax or not supported by economic or contextual analysis with respect to the Malaysia context.</p>	2 - 3
E1	<p>For an unsupported or unexplained evaluative statement.</p>	1