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Management of the Malaysian Economy in 1994

Overview

When the 1994 Budget was formulated last year, economic management was aimed at ensuring strong, vibrant and sustainable growth with reduced inflation while, at the same time, fostering a more balanced and equitable society. In 1994, the Malaysian economy witnessed another year of rapid and sustained growth with Gross Domestic Product (GDP) expanding by 8.5%, making it the seventh consecutive year of strong growth. This performance is indeed remarkable by any comparison, particularly after having expanded by an average of 8.8% per annum since 1988. More significantly, this rapid growth was attained within an environment of greater price stability, with the increase in Consumer Price Index (CPI) being contained at 3.8%. In addition, the nation's per capita income further increased to reach RM8,856 with all Malaysians benefitting from income growth.

However, while these policies and strategies are already well in place, the six years of rapid growth has exerted strains on domestic resources, particularly rising aggregate demand and excessive liquidity, tightening labour market, as well as the widening current account deficit in the balance of payments. All these, to some extent, have placed pressures on the general price level in the economy. Indeed, these are problems which are usually associated with an economy undergoing a prolonged period of strong economic growth.

Recognising these problems as concerns that require immediate policy redressal, the Government has implemented a comprehensive anti-inflation policy package to urgently neutralize price pressures on the economy. This policy package comprises fiscal and monetary policies as well as administrative measures formulated since the tabling of the 1994 Budget in October 1993. The

package focused on efforts to remove growth and supply constraints, manage domestic demand and enhance the competitiveness of the economy. It includes measures to expand the productive capacity of the economy, remove infrastructural constraints, develop human resources, reduce excessive liquidity and lower costs of doing business. In addition, the structural problem of the growing deficit in the services account of the balance of payments and the need to strengthen the linkages between the small and medium-scale industries (SMIs) and other industries were also given attention. At the same time, the Government implemented measures to provide the less fortunate segment of the populace with greater opportunities to participate in the development process and to share the fruits of national economic progress.

Sustaining Strong Growth

The rapid growth of the economy in the last six years has resulted in a high degree of resource utilisation in the economy. Capacity utilisation, particularly in the manufacturing sector, remains high while constraints and bottlenecks have emerged in the infrastructure and support services. In addition, with the economy already reaching full employment, the labour market continues to tighten, particularly for skilled and semi-skilled workers.

In the manufacturing sector, continued strong sales orders have increased capacity utilisation of plant and machinery. The Malaysian Industrial Development Authority (MIDA) Industrial Trend Surveys indicated that the capacity utilisation rate of the manufacturing sector remained high at 82% at the end of June 1994. In addition, approved investment in the manufacturing sector declined

substantially in 1992 and 1993. This could constrain the sector's capacity to increase production significantly in 1995/96, since it will take two to three years for set up time, before the approved projects commence operation.

With a view to enhancing the investment climate and increasing the competitiveness and efficiency of the private sector, the Government instituted several measures to encourage reinvestment and new investment aimed at modernising existing production operations, diversifying activities and venturing into new strategic growth frontiers. Towards this end, the Government has raised the rate of reinvestment allowance for large-scale industries from 40% to 50%, while the period for entitlement of this allowance was extended indefinitely effective 1 January 1994. To ensure that Malaysia continues to be an attractive investment centre, the rate of company income tax has been reduced from 34% to 32% effective from the year of assessment 1994. The Government is also committed to reduce this rate further to 30% effective from the year of assessment 1995. For the petroleum sector, to further stimulate its development as a source for growth and Government revenue, the rate of petroleum income tax was also reduced from 45% to 40% effective from the year of assessment 1994, while the export duty on crude oil will be reduced from 25% to 20% effective from 1 January 1995. To further promote investment and develop Malaysia as an attractive investment and financial centre, the Operational Headquarters (OHQ) incentive has been extended to commercial and banking services, whereby companies providing management and support services to their associate companies overseas enjoy the tax incentive at a concessionary rate of 10%.

These fiscal measures, coupled with the Domestic Investment Initiative launched in 1993, as well as the recovery in the industrial countries have induced a significant increase in the applications for investment in the manufacturing sector from both foreign and domestic investors during 1994. The proposed capital investment approved by MIDA rebounded by 174% during the first seven months of 1994. These investment projects would significantly increase the productive capacity of the manufacturing sector from 1997 onwards, after allowing for two to three years lag for set-up time.

The surge in demand for infrastructure and utilities has led to power shortages as well as urban traffic congestion. Recognising that an efficient and adequate infrastructure network is essential to support the rapid development in the economy, the Government continues to give priority to the development, upgrading and maintenance of infrastructural facilities, ensuring an adequate and reliable supply of energy and water as well as improving the quality and efficiency of these facilities and services through improved technologies and the development of human resources. The implementation of large infrastructure and utilities projects has also been accelerated through privatisation efforts to complement the efforts of the Government. Among the major projects currently being implemented are the construction of the Kuala Lumpur International Airport, the Railway's Double Tracking and Electrification Project between Kuala Lumpur-Port Klang and Subang and between Rawang and Seremban as well as the Phase I of the Light Rail Transit in Kuala Lumpur. A new port at Pulau Indah Klang is being developed while expansion and improvements of existing ports have increased cargo handling facilities as well as efficiency. In addition, power supply capacity has also been stepped up to meet expanding demand through the construction of new plants, including those by Independent Power Producers. For Peninsular Malaysia, these efforts will enhance the generation capacity for electricity by 45% to 9,096 megawatt (MW). In addition, the Government has also decided to proceed with the implementation of the Bakun Hydro-electric Project in Sarawak with a potential capacity of 2,400 MW. In terms of telecommunications, Telecom Malaysia Berhad continues its efforts at digitalization through the use of fibre optics. The completion of Menara Kuala Lumpur will further enhance the nation's telecommunications system.

Increasing Linkages between Industries

The manufacturing sector, in particular the export-oriented industries, has provided the lead in the rapid growth of the economy. Recognising that the sector's production continues to be narrowly based, the Government has continued to focus its strategies on industrial widening and deepening to achieve greater value added and linkages. Backward integration especially in the electronics, transport, basic and fabricated metal industries

is encouraged. At the same time, greater linkages through downstream activities are also promoted, especially for the resource-based industries such as wood and rubber products as well as chemicals and petrochemical products.

The development of the SMIs is an important and viable vehicle not only for industrial expansion, but also for the creation of inter-linkages and ancillary support among industries. As such, the linkages between SMIs and the larger industries are being strengthened through developing the SMIs to become reliable manufacturers and suppliers of industrial input, machine parts and components and equipment used by the larger industries and multinational corporations (MNCs). The development of SMIs can also reduce the dependence of industries on imported parts and components in the light of the relatively high import content of Malaysia's exports, as reflected by the current high ratio of imports of intermediate goods to manufactured exports of 0.47:1. In this respect, the establishment of a wafer-fabrication plant, for example, will enable greater backward integration and produce higher value added electronic products away from mere assembly activities. The development of domestic-oriented industries such as vehicle components and accessories, mould and dies and engineering and metal fabrication are also essential in increasing industrial linkages.

In view of the important role of SMIs, continued efforts are being made to further enhance their development. In this context, the Vendor Development Programmes (VDP) are given high priority to encourage linkages between domestic SMIs and Malaysian and foreign anchor companies. Under the VDP arrangement, the anchor companies provide the assurance of market for the vendors (SMIs) while the financial institutions provide the necessary financial facilities based on the market assurance. During the first seven months of 1994, an additional 20 large corporations and MNCs participated in the VDP under the Ministry of International Trade and Industry as anchor companies, bringing the total by the end of July 1994 to 30 anchor companies, with 55 vendors. These vendors are involved in various manufacturing activities such as plastic injection moulding, automotive components, metal stamping and fabrication as well as electro-plating. Under the Ministry of Finance, progress has also been made under the vendor programme to develop

the Bumiputera business community with the Non-Financial Public Enterprises (NFPEs) as anchor companies and Bumiputera SMIs as vendors. Apart from Petroliaam Nasional Berhad, Tenaga Nasional Berhad and Telekom Malaysia Berhad which have already participated as vendor companies under phase one, four more NFPEs will be involved in the second phase, i.e. Heavy Industries Corporation of Malaysia Berhad, Malaysia Airlines Berhad, Keretapi Tanah Melayu Berhad and Syarikat Malaysia Explosives Industries Sendirian Berhad. As at the end of July 1994, 16 Bumiputera vendors have been involved in the programme. The value of the contracts between the vendors and anchor companies was RM177.4 million. In view of the problems of inadequate capital and difficulty of access to financing experienced by some SMIs, the Credit Guarantee Corporation's (CGC) guarantee scheme for small businesses was reorganised and liberalised to facilitate access to financing from CGC.

Combating Inflation

Amidst an environment of prolonged and strong growth of the economy, the Government's overriding priority was to ensure that this rapid growth is sustained with low inflation. As inflation has the adverse effect of eroding the real income of consumers, inducing pressures for wage increases which, if not matched by productivity increase, would affect the competitiveness of the economy, the Government further intensified its efforts to combat inflation during the course of 1994. The Government continues to exercise greater fiscal prudence, apart from adopting a tight monetary policy stance and introducing administrative measures. Fiscal and monetary measures were aimed at managing the level of demand, reducing the level of liquidity and increasing savings in the economy, while that of administrative measures at checking the rise in inflationary expectations through enhancing public awareness of the danger of inflation and dissemination of price information to consumers.

Monetary policy in 1994 took a tough anti-inflation stance to effectively manage excess liquidity and avoid the build-up of price pressures and inflationary expectations. As at the end of 1993, money supply expanded at a rapid rate, recording an annual rate of 23.5% for M3, 22.1%

for M2 and 37.5% for M1. This level of liquidity was excessively high compared with the annual growth of nominal GNP of 10.7%. Much of the liquidity was attributed to the large inflows of short-term capital of speculative nature, induced by strong economic fundamentals, the bullish stock market as well as interest rate arbitrage opportunities towards the end of 1993 and in early 1994. Given that the excessive liquidity could generate inflationary expectations, the Government continued to tighten its monetary policy in early 1994 through measures specifically aimed at containing the inflows of short-term funds within a manageable level as well as discouraging speculative trading in the ringgit. These measures included:

- (a) increasing the statutory reserve requirement of the commercial banks, finance companies and merchant banks by 1 percentage point, from 8.5% to 9.5% of their eligible liabilities effective from 3 January 1994. This measure has the effect of absorbing an estimated RM1.5 billion of excess liquidity in the banking system;
- (b) redefining eligible liabilities base of the banking institutions to capture all inflows of funds from abroad, effective 16 January 1994. With this redefinition, the banking institutions would be required to keep an estimated RM1 billion in additional reserves and about RM2 billion in additional liquid assets with the Central Bank;
- (c) subjecting the net external liabilities position of each banking institution, after deducting inflows which are trade-related or genuine investment in Malaysia, to a ceiling specified by the Central Bank, effective 17 January 1994. This measure is to ensure that the inflows of short-term capital are contained at a manageable level at all times;
- (d) prohibiting all residents under the Exchange Control Act 1953 from selling short-term monetary instruments to non-residents effective 24 January 1994. These instruments are Bank Negara bills, Treasury bills, Government securities (including Islamic securities) with remaining maturity of one year or less, Cagamas bonds with remaining maturity of one year or less, bankers acceptances and negotiable instruments of deposits; and

- (e) requiring commercial banks to place with the Central Bank the ringgit funds of foreign institutions held in non-interest bearing vostro accounts effective 2 February 1994. These funds are to be placed in a designated non-interest bearing current account maintained with the Central Bank. With effect from the base period beginning 16 February 1994, these funds were to be included in the eligible liabilities base and be subject to the normal statutory reserve and liquidity requirements. This measure is in addition to the placement of excess funds by the Federal Government and the Employees Provident Fund with the Central Bank.

As a result of the measures taken by the Government, the inflows of short-term funds slowed down significantly, with monthly receipts of foreign portfolio investment declining from RM20.4 billion in January 1994 to RM16.1 billion in April 1994. Net inflows of portfolio investment for the same period declined from a surplus of RM5.8 billion to a deficit of RM957 million. At the same time, the outstanding vostro account balances of foreign banking institutions held with commercial banks contracted from a high of over RM8 billion in January to RM2.6 billion by mid-May 1994, reflecting the success of the imposition of negative interest rate in February 1994 in reducing speculative funds maintained in these accounts. Consequently, the Government decided to discontinue the negative interest rate on the vostro balances held by foreign banking institutions. Thus, effective 16 May 1994 these funds were no longer subject to statutory reserve and liquidity requirements. As this measure would release additional liquidity into the banking system which was still flushed with excess funds, the statutory reserve ratio for commercial banks, merchant banks and finance companies was raised from 9.5% to 10.5% and subsequently to 11.5% on 1 July 1994 to mop up the additional liquidity.

With the convergence of domestic and international interest rates, coupled with the ringgit having appreciated by 7.2% from RM2.76: US\$1 as at the end of January 1994 to RM2.56 as at the end of July 1994, the opportunities for interest arbitrage as well as possible gains through speculation that ringgit would appreciate significantly diminished by the third quarter of 1994. This is reflected in the steady net outflows of funds for portfolio investment since February

through July 1994. This, coupled with the inflation rate trending down from 5% in February 1994 to 3.3% in August 1994, provided the basis for the relaxation of specific measures imposed earlier. Consequently, the restriction on residents from selling short-term monetary instruments to non-residents was lifted in August 1994. The restriction on swap transactions with non-residents was also lifted. However, as the liquidity in the economy was still high, the Central Bank issued RM1 billion worth of Bank Negara bills in two tranches, RM500 million worth of three-month bills and another RM500 million worth of six-month bills in August 1994 to further mop up the liquidity.

Apart from adopting a tight monetary policy, the Government continues to exercise greater fiscal prudence and restraint to complement the restrictive monetary stance with a view to further reducing excess demand and removing price pressures in the economy. This includes restraining operating expenditure, prioritising development expenditure to selectively focus on projects that contribute to the alleviation of infrastructural and supply constraints as well as liberalising imports through the reduction of import duties. The reduction or abolition of import duties on more than 600 items in the 1993 Budget has had a positive impact on reducing inflation and, at the same time, enabled consumers to purchase goods at lower prices. In the 1994 Budget, import duties on more than 500 items, including intermediate goods, such as building materials, construction equipment, medical equipment and motor vehicle spare parts, as well as infant and baby food were reduced or abolished.

While the tight monetary and fiscal restraint policies have successfully dampened much of the demand pressures in the economy, the tight labour market and supply constraints have also contributed to fueling inflationary expectations. In addition, inflation is being partly attributable to infrastructure and distribution bottlenecks as well as market imperfections, such as lack of price information, unhealthy business practices as well as lack of consciousness among consumers of the danger of inflation and among distributors and traders of the need for fair pricing. Consequently, administrative measures were taken to complement fiscal and monetary measures to combat inflation. Past experience has also indicated

the existence of price rigidities in the distribution system and that distributors and traders were reluctant to reduce immediately prices of those goods for which import duties have been reduced or abolished. To ensure that the prices of goods were reduced in accordance with the reduction of import duties, as announced in the 1994 Budget, greater enforcement was undertaken by the Enforcement Division of the Ministry of Domestic Trade and Consumer Affairs. To improve price information, Price Information Centres were established in all state capitals, where prices of about 90 consumer items were collected and disseminated weekly through the mass media and 25 items on a daily basis.

To reduce the build-up of inflationary expectations and enhance public awareness of the danger of inflation, an Anti-Inflation Campaign was launched by the Prime Minister on 19 May 1994. Consumer associations were allocated RM2.2 million to undertake programmes on consumer awareness and other anti-inflationary activities, while the Ministry of Domestic Trade and Consumer Affairs published monthly bulletins and brochures on consumer issues and inflation. Stores that have practised fair pricing were identified and given recognition as 'Fair Price Shops'.

Notwithstanding these, however, the Government's involvement in price determination will be kept to a minimum to ensure consumers are given reasonable protection against excessive profiteering while, at the same time, providing reasonable returns to the producers, distributors and retailers. Towards this end, the Consumer Protection and Competition Laws are being drafted, to make the rules governing fair market practices even more transparent and to reduce the need for Government intervention in pricing.

This comprehensive package of policies to combat inflation by the Government has yielded positive results in moderating increases in the price levels. The rate of increase in the CPI which peaked at 5% in February 1994 has eased steadily to reach a low of 3.3% in August 1994. Thus, inflation for the whole of 1994 is not expected to exceed 3.8%. The increase would have been at a lower rate of 2.9% if not for the substantial increase in food prices which rose by 5.6% due largely to supply shortages.

Overcoming Labour and Skill Shortages

During the year, the labour market continued to tighten further. With the unemployment rate expected to reach an unprecedented low of 2.9% in 1994, the country has virtually attained full employment. As a result of rapid economic growth, the demand for workers has outpaced the number of new entrants in the job market. Labour shortages, of both skilled and unskilled labour, have become more prevalent, especially in the more industrialised states of the country. The intense competition among employers for labour by offering better wages and benefits has led to a higher incidence of job hopping and staff pinching. This, in turn, has resulted in greater pressures on wages. Monthly surveys by the Department of Statistics indicate that wages of all levels of employees in the manufacturing sector rose by 6.7% during the first seven months of 1994, while productivity increase was 2.2% resulting in a 4.4% increase in unit labour cost. Although wages comprised only about 7% of the total sales value of manufactured goods, the increase in unit labour cost could affect the competitiveness of Malaysian products in the international and domestic markets.

To ease the general shortage of labour, the Government continues to allow the recruitment of skilled and professional workers from abroad. In the case of unskilled and semi-skilled workers, the bringing in of foreign labour has been frozen to ensure that those already in the country are being absorbed, although exceptions are given on a case by case basis.

The manufacturing sector has been encouraged to locate their operations or projects which are labour intensive to less industrialised parts of the country, particularly the eastern corridor states of Peninsular Malaysia, as well as in Sabah and Sarawak, where labour surpluses still exist. Such relocations would not only enable them to tap cheaper labour but also bring about a more balanced growth between regions within the country. Towards this end, industrial projects eligible for pioneer status and which are located in these areas are given exemption of 85% of their statutory income effective from the 1994 Budget day. As for companies eligible for investment tax allowance, the rate of allowance is increased to 80% and the amount of allowance to be exempted for each assessment year will

be increased to 85% of the statutory income for that assessment year. Malaysian companies, particularly those with labour-intensive production processes and which can no longer compete with similar industries in countries with surplus labour, are also encouraged to invest abroad. In this context, the Government has lowered the tax on remitted incomes derived from investment abroad to not more than 10% of such remittances, instead of exempting 50% of these remittances from tax.

As the manufacturing sector cannot continue to rely on cheap foreign labour to remain cost competitive, it needs to undertake a strategic shift towards labour-saving and higher technology production processes, with a view to increasing labour productivity and reducing unit labour costs. To facilitate this shift, the 1994 Budget has increased the rate of reinvestment allowance and extended it for an indefinite period to encourage the manufacturing sector to continuously modernise their plants and equipment as well as to automate or robotise their production processes.

The availability of trained and skilled manpower as well as the technological competence of the nation are crucial in facilitating the continuous shift towards higher technology production processes and enhancing national capability in areas of innovation and research and development (R&D). In this context, the manufacturing sector must intensify their human resource development efforts, given that financial assistance for training of their employees can be procured from the Human Resource Development Fund (HRDF). To attract employers to make use of the facilities under the HRDF, the Human Resource Development Council (HRDC) has, in 1994, made some changes to the conditions of procuring assistance from the Fund. These changes include the increase in the rate of financial assistance up to 80% of allowable costs of training, allowing retraining and skills upgrading programmes at the diploma level to be eligible for financial support, expediting payments of claims and the introduction of the Training Agreement With Training Providers (PERLA) scheme, where employers need to pay only a small upfront fee for training and the provider of training will claim the balance from the HRDC. The PERLA scheme is to facilitate and encourage employers, particularly smaller employers, to increase the momentum of retraining and upgrading of skills of their workforce with minimum financial burden.

To generate more skilled and R&D workforce for the economy, the 1994 Budget provided an allocation of RM114.3 million to finance skill training programmes under the Ministries of Human Resources, Youth and Sports, Public Enterprise and MARA as well as the Industrial Management Training Programme to train the personnel of R&D agencies, such as Standards and Industrial Research Institute of Malaysia, Malaysian Agricultural Research and Development Institute, Palm Oil Research Institute of Malaysia and Malaysian Institute of Micro-Electronic System. Complementing this, is the additional allocation of RM116.4 million to Intensification of the Research in Priority Areas programme to intensify R&D and RM86.3 million for the development of the Technology Park covering 314 hectares in Bukit Jalil, Federal Territory, which will provide facilities for R&D.

Reducing the Services Deficit

A major issue facing the economy has been the persistent deficit in the services account of the balance of payments. The deficit has widened from RM9.7 billion (8.8% of GNP) in 1990 to RM15.0 billion in 1993 (9.7% of GNP). In 1994, this deficit is expected to increase to RM17.7 billion (10.3% of GNP), with 51% of the deficit being attributed to net outflows of investment income, 35% to freight and insurance and 18% to other services such as contract and professional services. The need to address the services deficit has become more urgent, as the merchandise account of the balance of payments is expected to record a smaller surplus this year, as a result of a higher rate of increase in merchandise imports than exports. Consequently, the deficit in the current account of the balance of payments is expected to widen to RM11.7 billion, compared with RM6.3 billion in 1993. While the sharp increase in merchandise imports is not of immediate concern as the increase was mainly due to strong growth in the import of capital and intermediate goods which are for productive purposes, the persistent deficit in the services account has to be more vigorously addressed. Consequently, the Cabinet Committee on Trade In Services, chaired by the Prime Minister, and the Senior Officials Committee on Trade In Services have formulated various strategies and measures to reduce the deficit in services. These include:

- (a) encouraging Malaysian companies to invest abroad to earn investment income and

repatriate the income to Malaysia. Consequently, the rate of tax exemption on income remitted from overseas investment has been increased from 50% to 70%. Companies will, therefore, effectively pay tax at a rate of not more than 10% on income remitted. Companies, including those in the oil and gas industry which export services, will enjoy the exemption for an indefinite period effective from the year of assessment 1994;

- (b) moderating the outflow of investment income by encouraging companies to reinvest their profits in Malaysia. This is done by increasing the reinvestment allowance to 50% and extending the allowance for an indefinite period;
- (c) building the nation's capability in exporting on a cost, insurance and freight (c.i.f.) basis and importing free on board (f.o.b.). In this context, efforts are being made to transform the domestic freight forwarding industry into a multi-modal transport industry, which includes the possibility of introducing legislation to ensure that the quality of services provided is of an acceptable standard. Port Kelang will be promoted as a load and transshipment centre as well as entrepot port. Accordingly, as one of the measures aimed at promoting Port Kelang, the cabotage policy has been amended to enable foreign ships to ferry goods between Penang Port and Port Kelang. Prior to the amendment, foreign ships were not permitted to participate in the Malaysian cabotage trade. In addition, the Electronic Data Interchange (EDI) has been introduced in Port Kelang in 1994 to simplify and speed up import-export procedures to facilitate faster movement of cargoes. Administrative, procedural and legislative constraints are also being removed while bunkering services at Port Kelang are to be improved to attract more foreign ships to call at Port Kelang;
- (d) increasing the retention of reinsurance premiums within Malaysia by allowing financially sound foreign reinsurance companies to operate in Malaysia. Two such companies have been registered while another has been given approval to operate in Malaysia. These companies can contribute towards increasing domestic retention

capacity as well as underwriting of inward reinsurance business. In addition, the Government has also launched the Scheme for Insurance of Large and Specialised Risks in January 1994. The Scheme will also assist in optimising the domestic retention capacity of insurance industry, while increasing the technical capabilities of Malaysian insurers in underwriting such risks. During the first half of 1994, the Scheme had insured 43 large risks, with a total insured value of RM21 billion and a total premium of RM118 million. The percentage of premiums retained domestically was 26.1% or RM30.7 million;

- (e) encouraging exports of other services which would increase receipts of foreign exchange from royalties, contract and professional services. Effective from the year of assessment 1994, the incentives for the establishment of OHQ were extended to commercial and investment banking services which entail the enjoyment of tax incentive at a concessionary rate of 10%. In addition, legislation with regard to the establishment of a Construction Industry Development Board has been passed by Parliament. The Board, among other things, will help to promote the export of services related to construction industry;
- (f) increasing foreign exchange earnings through tourism. In this context, the tax exemption on income generated by tour operators who bring in at least 500 foreign tourists has been extended up to the year 2000 and it covers tourists arriving by land, sea and air. In addition, import duty on motorised homes has also been reduced in view of the potential in holiday travel using motorised homes. In addition, the Ministry of Culture, Arts and Tourism has undertaken a number of programmes to further develop and promote tourism. These include promotional activities overseas, holding of exhibitions, food and cultural fairs in conjunction with Visit Malaysia Year 1994 as well as the promotion of eco-tourism and agro-tourism; and
- (g) reducing the net outflow of foreign exchange through education by encouraging parents to send their children to local institutions of higher learning rather than overseas. The relief on children pursuing higher education locally was, therefore, increased

to four times the normal relief for income tax purposes. Simultaneously, the child relief for children pursuing higher education abroad was reduced from four times to two times the rate of relief given to a child. The longer term strategy to reduce the outflow and increase the inflow of foreign exchange through education is to make Malaysia a centre of excellence in education, in order to attract students from other countries as well as local students to pursue their higher education locally. Towards this end, the Government will amend the Universities and University Colleges Act 1971 as well as enact a new Act, the Private Higher Education Institution Act. This would allow foreign universities to set up branch campuses in Malaysia. In addition, the Government will also establish a National Accreditation Authority to act as the regulatory body of private educational institutions. These measures are part of the comprehensive package of reforms to make Malaysia a centre of excellence in education.

The measures taken during 1994 to strengthen the services account of the balance of payments reflect part of the nation's long-term strategy to strengthen the nation's capability in substituting services imports and in exporting services. The need to build this capability is imperative as Malaysia progressively liberalises its trade in services, in accordance with its commitment to the General Agreement on Trade in Services under the Uruguay Round. Such capability should prepare Malaysia for increased global competition in the services trade and prevent the nation's services deficit from becoming unsustainable in the future.

Maintaining Fiscal Prudence

Fiscal policy in 1994 continues to focus on greater prudence and discipline in budgetary operations towards the further consolidation of the public sector and the strengthening of its financial position. These measures complemented the tight monetary policy adopted by the Central Bank to contain excessive demand pressures and moderate price increases. On the expenditure front, the operating expenditure of the Federal Government has been kept under tight expenditure restraint. The restraint has been mainly through

efforts at "right sizing" of the public sector, with the workforce of the public sector generally being reduced, except for essential services such as health and education, as well as through privatisation of Government agencies. In terms of development expenditure, the Government, nevertheless, continued to undertake selective investment on priority and productive projects, particularly infrastructural and human resource development to alleviate infrastructural and manpower constraints as well as promote science and technology to deepen and widen the base for the development of high value-added industries. On the revenue front, the Government continues its efforts to restructure its tax system with a view to creating a conducive environment for stronger private sector growth, introducing tax relief to reduce the burden of the lower income group as well as reducing taxes on essential goods to further dampen prices.

Although the 1994 fiscal policy entails corporate tax cuts, reductions and removals of import duties and the provision of additional incentives, the Federal Government revenue remains strong, registering a growth of 9.6%. Overall, in spite of increases in operating expenditure of 4.8% and that of development of 23.5%, the Federal Government achieved another year of balanced budget with a surplus of RM637 million. The achievement of the balanced budget reflects the continued Government's commitment to further consolidation of its finances to contain excessive demand pressures in the economy, moderate price increases and steer the economy towards sustainable growth.

To further rightsize the public sector and reduce its presence in the economy as well as to enable the private sector to play a greater role, the Government continues to accelerate efforts at privatising Government agencies and projects. The National Padi Authority was corporatised which resulted in the reduction of 4,000 staff from the Government's payroll. In addition, projects that were approved for privatisation in 1994 include the Bakun Hydro-electric Project in Sarawak, one independent power producer, the North-South Link Highway, Penang Port as well as the National Sports Complex. Consequently, the privatisation programme continues to be an integral part of fiscal policy to further reduce the financing requirements of the Government and bring about increased participation of the private sector in meeting the development needs of the nation.

An integral part of the 1994 fiscal policy is to contribute towards the maintenance of sound external debt management of the country. Given that there is excess liquidity in the economy and strong Government finances, the Government continues to prepay external loans, particularly those entailing higher costs of financing. During the first eight months of 1994, RM1.6 billion of external loans has been prepaid. Consequently, the external debt of the Federal Government is expected to decline from RM19.4 billion in 1993 to RM17.2 billion in 1994. Further prepayments may be undertaken during the remaining months of 1994.

Nurturing a Caring Society

The creation of a just and caring society requires that the benefits from economic progress be shared by all segments of the population. Economic progress must continue to be balanced with the social aspects of development. The Government, therefore, continues to focus on efforts at assisting the less fortunate sections of the society to enable them to participate actively and benefit from the rapid development process. Towards this end, concerted efforts have been undertaken to ensure that the poor and the less fortunate are availed with opportunities and resources to enable them to effectively participate in the mainstream of the nation's development.

A major programme implemented in 1994 is the low-cost housing programme, particularly for the urban poor. The housing problem faced by the low and medium-income groups has become more acute in major urban areas, largely as a result of out-migration of rural population to urban areas. Due to the inadequacy of affordable housing, this has led to the proliferation of squatter areas in the towns, where health standards are low and basic amenities inadequate. Therefore, in an effort to raise the standard of living and quality of life of the low-income groups in urban areas, the Government has set up a Low-Cost Housing Fund totalling RM1,100 million during 1994. The Low-Cost Housing Fund consists of two tranches. The first tranche of RM500 million, which is provided by the Central Bank through financial institutions, is for the purpose of providing concessionary bridging finance to eligible developers at 2% interest rate to accelerate the construction of low-cost houses. This scheme is being coordinated by the

Syarikat Perumahan Pegawai-Pegawai Kerajaan (SPPK). The second tranche of RM600 million is for the financing of the construction of flats in major towns with acute squatter problems to be rented to poor households for a period up to five years. Under this tranche, the Government contributed RM300 million, while banks, financial institutions and corporations contributed RM300 million. The large contributions provided by the private sector augur well for the nation as these reflect the high level of corporate social responsibility displayed by the private sector.

The progress in terms of the implementation of low-cost houses under this Fund has been impressive. Under the first tranche, a sum of RM267.1 million or 53.4% of the total has been approved as at the end of September, 1994 by SPPK for financing the construction of 14,592 units of low-cost houses under 35 projects. Under the second tranche, 23 projects costing RM510 million or 85% of the total and involving the construction of 9,673 units of flats have been approved, apart from RM30 million for the development of traditional and new villages. In addition to the Low-Cost Housing Fund, the Government has also set up a revolving fund of RM500 million in August 1994. The purpose of this revolving fund is to increase the stock of affordable housing within five years and to promote house ownership among low-income earners in urban areas of the Federal Territory, Selangor, Johor and Penang.

In the rural areas, while the incidence of poverty has been reduced significantly, the Government continues to intensify its efforts at eradicating poverty, particularly the hardcore poor. For this purpose, allocations were provided to finance the Development Programme for the Hardcore Poor, which focused on increasing productivity and their income as well as improving their standard of living. Besides these, the Government continues

to expand and improve social and infrastructural amenities in rural areas, particularly electricity and water supply as well as the provision of roads, aimed at improving the well-being of the poor. In addition, to supplement the income of the hardcore poor and enable them to participate in investment opportunities, the Amanah Saham Bumiputera-Program Pembangunan Rakyat Termiskin (ASB-PPRT) program was further extended to a greater number of the hardcore poor while the unit trust funds of the state Governments have also benefitted them.

For the low-income group in general, as a measure to further assist them, the 1994 Budget had reduced their tax burden through the increase in the rate of rebate enjoyed by an individual whose chargeable income is RM10,000 and below. With this increase, a taxpayer who is earning RM1,270 per month and enjoying a personal relief and relief for his wife and five children will not be paying any income tax.

Conclusion

The pursuance and implementation of a pragmatic and comprehensive package of macro-economic policies during the course of 1994 have enabled the Malaysian economy to continue to sustain its rapid growth into its seventh year, and within an environment of modest price increases. The rapid economic growth has also succeeded in opening up greater opportunities for all Malaysians to benefit from the development process and enjoy a higher income and standard of living. Of greater importance, this growth has also fostered strong economic fundamentals on which the nation can continue to embark on undertaking adjustments and effect shifts towards the building of greater resilience and dynamism that can withstand and keep pace with the changing economic environment in the domestic and international scene.