5 Public Sector Financial Performance

1996 Performance

Overview

The conduct of fiscal policy and budgetary operations in 1996 continues to focus on fiscal prudence and consolidation. Coupled with further tightening of monetary policy, the fiscal restraint has contributed towards ensuring a sustainable pace of economic growth with greater price stability and external balance. In particular, the fiscal discipline and prudence in spending has contributed to the strong financial outturn of the Federal Government for the fourth consecutive year since 1993. The strong performance of revenue continued to be sustained, largely on account of higher receipts from income taxes. With the exception of increases in emolument, pension and gratuities arising from salary adjustments, the expansion in other operating expenditure has been minimal, reflecting continued tight budgetary controls by the Federal Government. Similarly, the increase in development expenditure has been kept to a minimum, with greater emphasis given towards reducing infrastructure bottlenecks, enhancing research and development, and human resource development as well as meeting the socio-economic objectives of the nation.

Table 5.1

Consolidated Public Sector Financial Position
(RM million)

	1995[1]	*1996*[2]	*1997*[3]
Current Account:			
General government:			
Revenue	63,352	69,927	73,363
Operating expenditure	42,252	48,400	47,167
Current account balance	21,100	21,527	26,196
Current surplus of NFPEs[4]	14,103	13,508	18,029
Public sector current surplus	35,203	35,035	44,225
Development Account:			
Development expenditure	32,615	36,727	39,500
General government	17,773	17,391	20,310
NFPEs	14,842	19,336	19,035
Overall balance	2,588	(1,692)	4,725
% to GNP	1.2	–0.7	1.8

Note: [1] estimated actual
[2] revised estimate
[3] Budget estimate, excluding 1997 tax changes
[4] excludes grants from Federal Government

While the Federal Government financial position continues to be strong, the consolidated financial position of the public sector in 1996, however, is expected to record an overall deficit of RM1,692 million or 0.7% of Gross National Product (GNP) in 1996 (1995: surplus of RM2,588 million or 1.2%), as shown in Table 5.1. The wider deficit is largely attributable to the lower current surplus of the Non-Financial Public Enterprises (NFPEs). The operating surplus of the NFPEs in 1996 is expected to be lower as a result of slower growth in revenue of 7.2% compared with the increase in operating expenditure of 11.3%. With respect to general government, its current account balance is estimated to record a slightly higher surplus of RM21,527 million (1995: RM21,100 million) on account of a smaller current surplus of the Federal Government, following higher operating expenditure brought about by salary adjustments and the subsequent payment of arrears to civil servants.

Development expenditure of the public sector is expected to be higher by 12.6%, at RM36,727 million. Of this, 52.6% will be incurred by the NFPEs and the balance by the general government. The higher public sector development expenditure in 1996 is on account of increased expenditure by the NFPEs which is expected to increase by 39.3% and to some extent offsets a 2.1% decline in the general government expenditure.

Federal Government

The Federal Government's financial position in 1996 is expected to record a surplus for the fourth consecutive year since 1993, as shown in Table 5.2. Revenue is expected to increase at a higher rate of 10.9% in 1996 compared with 3% in 1995, largely attributable to higher receipts from direct taxes, particularly from corporate income taxes. The operating expenditure in 1996 is envisaged to increase by 14.2%, higher than the 4.3% recorded in 1995 due to the salary adjustments for civil servants. Notwithstanding the higher rate of increase in operating expenditure compared to revenue, the current account of the Federal Government remains strong with a surplus of RM14,716 million. The surplus is higher compared with RM14,381 million in 1995 and Budget estimates of RM14,173 million. Development expenditure is expected to record an increase of 12.2% compared with 24.6% in 1995. Being the first year of the Seventh Malaysian Plan (1996-2000), most of the development expenditures is for continuation projects from the previous Sixth Plan period. As a whole, the overall balance of the Federal Government is expected to record a surplus of RM1,436 million (1995: RM1,861 million).

Chart 5.1
Federal Government Finance - Current Account

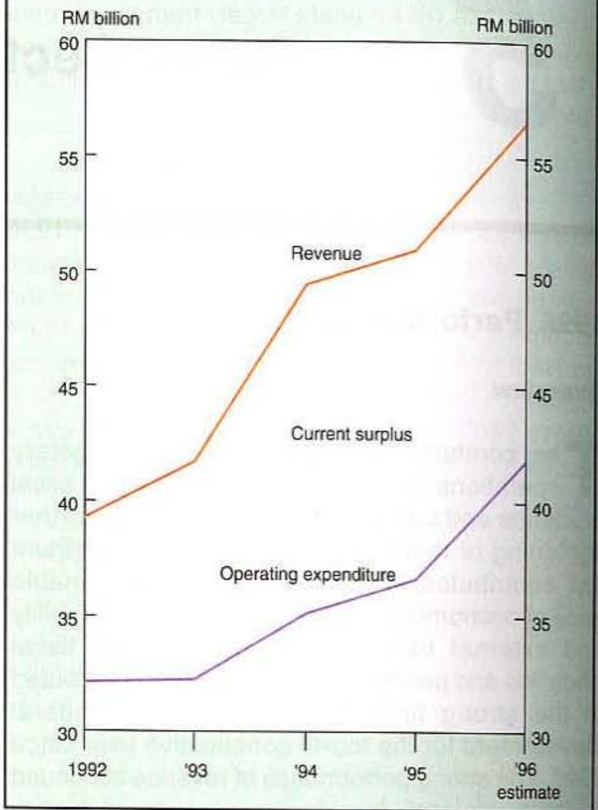


Table 5.2

Federal Government Financial Position 1995-1997
(RM million)

	1995[1]	*1996*[2]	*1997*[3]
Revenue	50,954	56,449	60,778
Operating expenditure	36,573	41,783	41,713
Current balance	14,381	14,716	19,065
Gross development Expenditure	14,051	14,949	16,769
Loan recoveries	1,531	1,669	1,650
Net development expenditure	12,520	13,280	15,119
Overall balance	1,861	1,436	3,946

[1] actual
[2] revised estimate
[3] Budget estimate

Revenue

The sustained economic expansion will continue to have a favourable impact on the Federal Government revenue in 1996. In spite of several tax measures granted in the 1996 Budget, which have resulted in a net loss of potential revenue

[1] The tax measures announced in the 1996 Budget have resulted in a potential revenue gain of RM440 million, especially from levy on goods vehicles and potential revenue loss of RM877 million, especially from individual income tax.

estimated at RM437 million[1], the Federal Government revenue is expected to increase by 10.9% to RM56,449 million in 1996. The bulk of the increase will emanate largely from tax revenue which is expected to increase by 10.3%, from RM41,671 million in 1995 to RM45,943 million in 1996, as shown in Table 5.3.

Revenue collection from direct taxes is envisaged to increase by 9.5% to RM24,853 million in 1996, as shown in Table 5.4. Of this, income tax receipts comprising company, individual and petroleum income taxes, are expected to increase by 10.8% to RM21,734 million. The corporate income tax collection is expected to increase by 13.1% to RM13,240 million in 1996 attributable to strong economic growth in 1995. As the individual income tax rates were further reduced by between 1 to 2 percentage points effective from the year of assessment 1996, resulting in potential revenue loss of RM478 million, revenue collection from individual income tax is expected to decline by 0.9% to RM6,145 million. The marginal decline reflects increased efficiency in the collection machinery and the implementation of the Schedular Tax Deduction Scheme since 1995 as well as higher individual income levels. The reduction in

Chart 5.2
Percentage of Overall Deficit / Surplus to Gross National Product

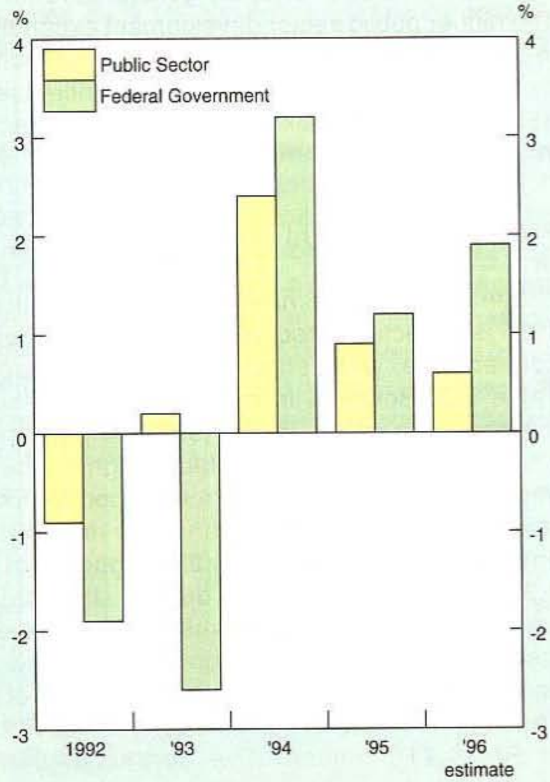


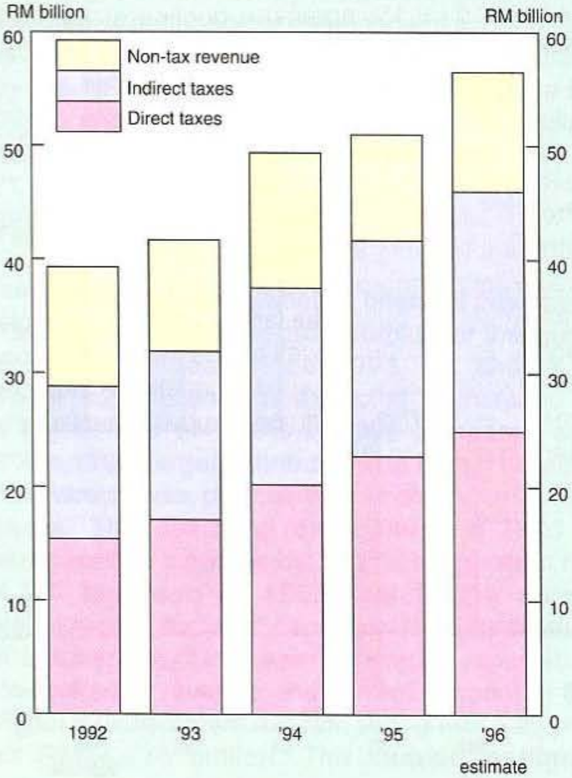
Table 5.3

Federal Government Revenue

	1995[1]		1996[2]		1997[3]	
	(RM million)	(% change)	(RM million)	(% change)	(RM million)	(% change)
Total revenue	50,954	(+3.0)	56,499	(+10.9)	60,778	(+7.6)
Total tax revenue	41,671	(+11.2)	45,943	(+10.3)	49,845	(+8.5)
Direct taxes	22,699		24,853		26,908	
Indirect taxes	18,972		20,090		22,936	
Total non-tax revenue	9,283	(–22.4)	10,556	(+13.7)	10,933	(+3.6)

Note: [1] estimated actual
[2] revised estimate
[3] Budget estimate, excluding 1997 tax changes

Chart 5.3
Major Components of Federal Government Revenue



individual tax rates will alleviate the tax burden of the lower income group with those in the RM2,500 chargeable income bracket and less being exempted from paying income taxes. At the same time, the highest marginal individual tax rate has also been aligned to the corporate tax of 30%.

Collection from petroleum income tax and stamp duty is also anticipated to increase. In spite of the reduction of petroleum income tax rate by five percentage points to 40% effective from the year of assessment 1994, the petroleum tax revenue is envisaged to increase by 7.5% to RM2,350 million in 1996, on account of higher petroleum prices of US$18.34 per barrel in 1995 compared with US$17.08 in 1994. The encouraging performance of the Kuala Lumpur Stock Exchange (KLSE) is expected to contribute significantly to the increase in stamp duty collection from RM2,192 million in 1995 to RM2,574 million in 1996. Collection from other direct taxes, comprising largely receipts from estate duty and real property gains tax, is estimated to register an increase of 32.2% to reach RM545 million.

Table 5.4

Federal Government Direct Taxes

	1995[1]		*1996*[2]		*1997*[3]	
	(RM million)	*(% change)*	*(RM million)*	*(% change)*	*(RM million)*	*(% change)*
Income Taxes	20,095	(+15.9)	21,734	(+8.2)	23,545	(+8.3)
Companies	11,707	(+10.8)	13,240	(+13.1)	14,326	(+8.2)
Individuals	6,203	(+35.9)	6,145	(–0.9)	6,649	(+8.2)
Petroleum	2,185	(–1.2)	2,350	(+7.5)	2,570	(+9.4)
Others	2,604	(–7.7)	3,119	(+19.8)	3,364	(+7.8)
Stamp duty	2,192		2,574		2,780	
Others	412		545		584	
TOTAL	22,699	(+12.6)	24,853	(+9.5)	26,908	(+8.3)

Note : [1] estimated actual
[2] revised estimate
[3] Budget estimate, excluding 1997 tax changes

Receipts from indirect taxes are expected to increase further by 11.2% to RM21,090 million in 1996, as shown in Table 5.5, in spite of the continued abolition or reduction of import duties, excise duties and sales tax on a wide range of goods. In the 1996 Budget, import duties on more than 1,510 items were reduced and/or abolished, including food preparation from fruits, household items and raw materials for manufacturers. These reductions will result in a potential revenue loss of RM312 million. However, revenue from import duties is envisaged to increase by 10.7% compared with 0.1% in 1995 on account of higher imports. Collection from excise duties will be at a lower rate of 8.4% as against an increase of 22.9% in 1995, reflecting a slower rate of expansion in domestic consumption. Collection from sales tax is expected to increase by 8.8% while that of service tax by 15.2%. Revenue from export duties (almost entirely on petroleum) is expected to increase by 9.1% against a decline of 26.3% in 1995, reflecting mainly the higher petroleum prices.

Collection from non-tax revenue and non-revenue receipts is expected to increase by 13.7% after a significant decline of 22.4% in 1995, attributable to higher receipts from road tax which are expected to increase by 9.9%. This increase was brought about by the larger number of vehicles registered in 1996 as well as the increase in road tax rates on motorcars with bigger engine capacity. No proceeds from divestment of government shares are expected in 1996.

Table 5.5

Federal Government Indirect Taxes

	1995[1]		*1996[2]*		*1997[3]*	
	(RM million)	*(% Change)*	*(RM million)*	*(% Change)*	*(RM million)*	*(% Change)*
Export duties	853	(–26.3)	931	(+9.1)	975	(+4.8)
Import duties	5,622	(0.1)	6,223	(+10.7)	6,683	(+7.4)
Excise duties	5,280	(+22.9)	5,721	(+8.4)	6,292	(+10.0)
Sales tax	4,869	(+17.9)	5,299	(+8.8)	5,736	(+8.3)
Service tax	1,016	(+23.2)	1,170	(+15.2)	1,357	(+15.9)
Others	1,332	(2.4)	1,746	(+31.1)	1,893	(+8.4)
TOTAL	18,972	(+9.5)	21,090	(+11.2)	22,936	(+8.8)

Note: [1] estimated actual
[2] revised estimate
[3] Budget estimate, excluding 1997 tax changes

Operating Expenditure

The expansion in operating expenditure of the Federal Government is expected to be higher in 1996 at 14.2% to reach RM41,783 million compared with an increase of 4.3% in 1995, as shown in Table 5.6. This is mainly on account of additional expenditure of RM1,113 million in 1996 on emoluments, pension and gratuities, following the implementation of salary adjustments for the civil service. In terms of expenditure category, emoluments remain the largest expenditure component of operating expenditure, accounting for 32.1%, followed by debt service charges (15.6%) and supplies and services (14.3%).

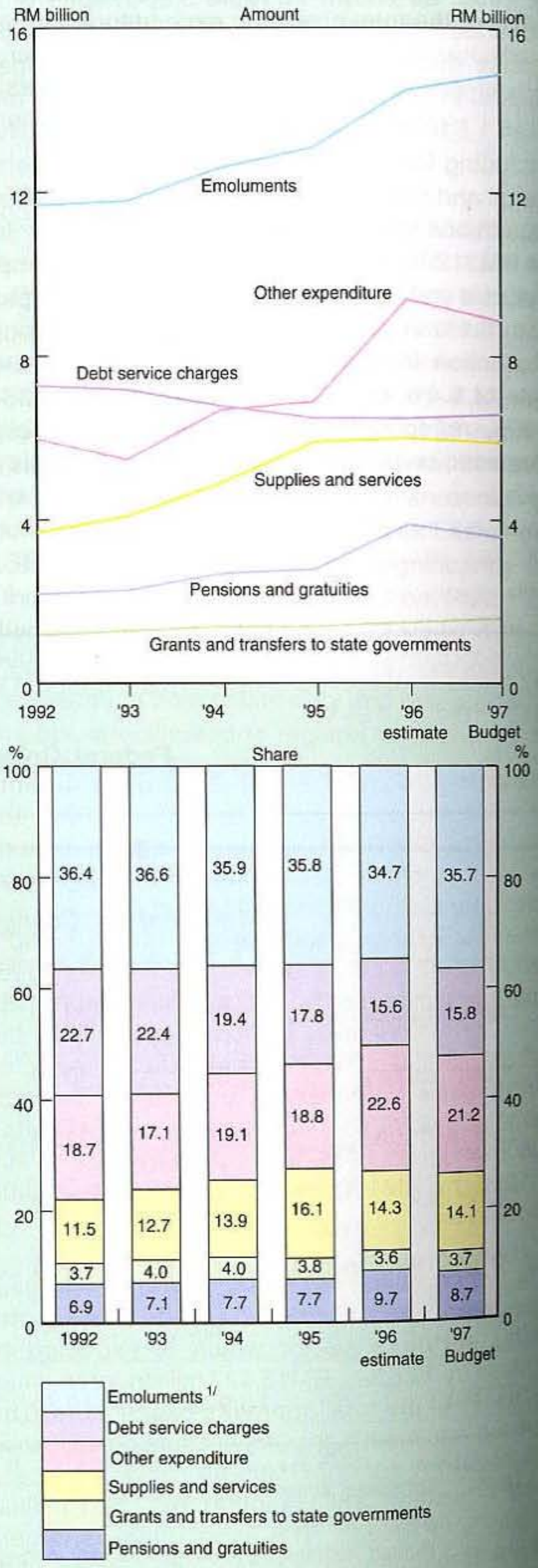
Expenditure on **emoluments** is expected to increase by 10.8% to RM14,512 to meet the salary revisions for civil servants as well as to cater for new recruitments in essential services, especially education and health. In terms of number of posts, a total of 12,115 posts have been abolished by the end of 1995 in line with the efforts at 'right-sizing' the public sector. On the other hand, 6,181 new posts have been created to meet the requirements of education and health as well as other essential services.

Table 5.6

Federal Government Operating Expenditure by Object
(RM million)

	1996 Revised Estimate	*% Share*	*1997 Budget Allocation*	*% Share*
Emolument	14,512	34.7	14,906	35.7
Debt service charges	6,511	15.6	6,595	15.8
Grants to state governments	1,483	3.6	1,556	3.7
Pensions and gratuities	3,864	9.3	3,648	8.8
Supplies and services	5,975	14.3	5,890	14.1
Subsidies	708	1.7	753	1.8
Others	8,730	20.9	8,366	19.4
TOTAL	41,783	100.0	41,713	100.0

Chart 5.4
Federal Government Operating Expenditure



1/ Includes emoluments for most statutory bodies

Debt service charges continues to be the second largest component of the operating expenditure, amounting to RM 6,518 million or 15.6% of the total operating expenditure. Of this, 88.5% is for servicing the domestic debt compared with 86.4% in 1995. The increase in domestic debt servicing has been due to larger redemptions of government papers. On the other hand, external debt service charges declined by 2.3% on account of smaller external debt due to the prepayments of external loans undertaken in previous years.

Expenditure on **supplies and services** is expected to increase by 0.5% to RM5,975 million as against an increase of 21.2% in 1995. The increase was mainly for the special maintenance programme for roads, hospitals, schools and other government buildings. Following the salary adjustment, the expenditure on **pensions and gratuities** increased significantly by 40.3% from RM2,755 million in 1995 to RM3,864 million in 1996. With these adjustments, payments for gratuities has been increased by 50%. In addition, a sum of RM828 million was also given as annual contribution to the Pensions Trust Fund (PTF) established in 1991.

Grants and transfers to state governments are expected to increase by 5.3% to RM1,483 million in 1996. Road maintenance grant remains the largest component under this category of expenditure, amounting to RM486 million or 31.8% of the total grants. Capitation grants and the 50% management costs for the common user departments amount to RM203 million and RM185 million or 13.3% and 12.1%, respectively of the total grants. Expenditure for **subsidies** is expected to increase by 15.6%, largely for petroleum products and textbook loan scheme, which are estimated to increase from RM123 million and RM89 million in 1995 to RM140 million and RM94 million, respectively.

In terms of sectoral classification, the largest expenditure, as shown in Table 5.7, is for the **social services** sector which is expected to increase by 10.6% to RM13,427 million, accounting for 32.1% of the total operating expenditure. The increase is to meet higher expenditure on education and health. A sum of RM9,259 million or 68.9% is for education while another RM2,808 million or 20.9% for health. The expenditure is largely for the emolument of teachers and medical staff as well as for supplies and services. Expenditure for the **security** sector, accounting for 14.8% of total operating expenditure, is expected to increase by 3.3% to RM6,203 million, mainly to cater for the purchase of supplies and services as well as for emolument. Of the total expenditure for the security sector, 58.5% is for the defence sub-sector while the balance is for internal security. Expenditure for **general administration and economic services** sector is expected to constitute 12.5% and 12.7%, respectively, of total operating expenditure in 1996. The expenditure for economic services sector is expected to increase significantly by 84.2% to RM5,826 million. Within the economic sector, agriculture and rural development is the largest sub-sector accounting for 37% of the total, followed by trade and industry accounting for 31.8%.

Table 5.7

Federal Government Operating Expenditure by Sector
(RM million)

	1996 Revised Estimate	*% Share*	*1997 Budget Allocation*	*% Share*
Security	6,203	14.8	6,342	15.2
Defence	3,629	8.7	3,852	9.2
Internal security	2,574	6.2	2,490	6.0
Social Services	13,427	32.1	14,532	34.8
Education	9,259	22.2	10,297	24.7
Health	2,808	6.7	2,893	6.9
Housing	196	0.5	112	0.3
Others	1,164	2.8	1,230	2.9
Economic Services	5,286	12.7	4,048	9.7
Agriculture	1,625	3.9	1,232	3.0
Public utilities	215	0.5	107	0.3
Trade & industry	2,296	5.5	1,256	3.0
Transport	1,073	2.6	1,385	3.3
Communications	32	0.1	33	0.1
Others	47	0.1	35	0.1
General Administration	5,208	12.5	5,098	12.2
Other	11,659	27.9	11,693	28.0
TOTAL	41,783	100.00	41,713	100.00

Development Expenditure

The thrust of development expenditure in 1996 continues to be on the strategic sectors, in particular infrastructure and human resource development as well as improving the income and standard of living of the rural population. The total development expenditure in 1996 is expected to amount to RM14,949 million or 6.4% higher than the 1995 expenditure, as shown in Table 5.8, with significant increases in transport, health, public utilities and the trade and industry sub-sectors.

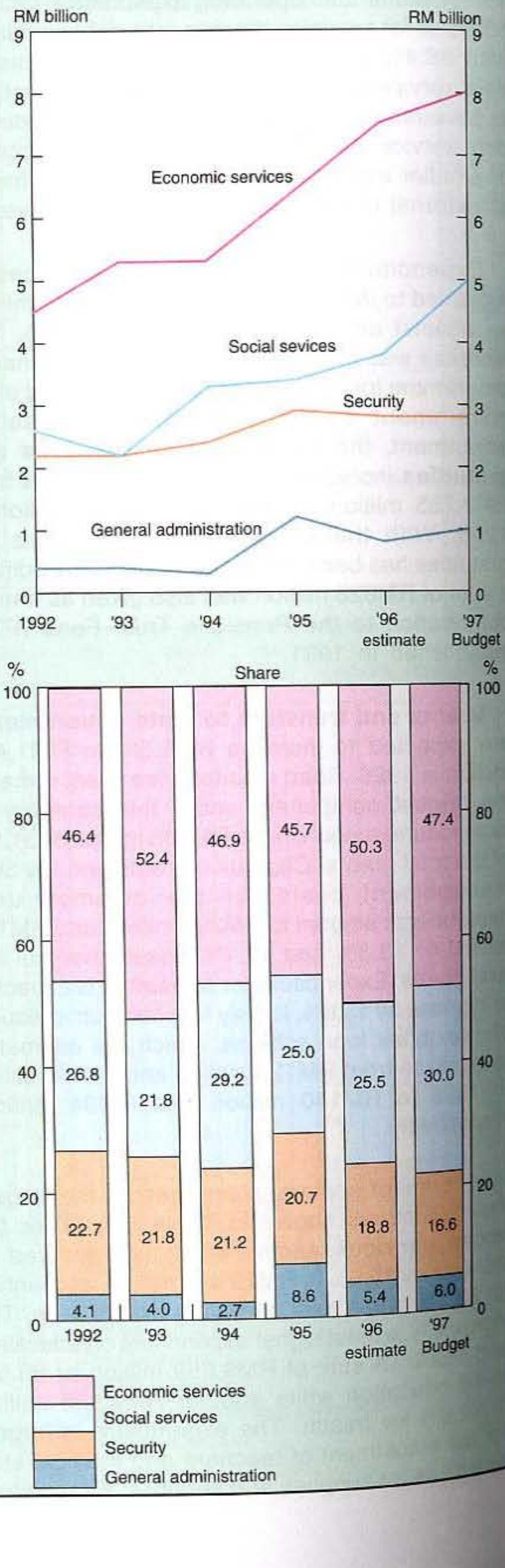
Expenditure for infrastructure projects is expected to remain large at RM4,712 million or 31.5% of the total development expenditure, of which 26.7% is for the transport sub-sector. Transportation projects include the construction of Middle Ring Road II, the road from Simpang Pulai to Kuala Berang as well as road projects in Sabah and Sarawak. The first phase of the Light Rail Transit from Jalan Ampang to Jalan Sultan Ismail is almost completed. The second phase linking Sentul-Bukit Jalil which started in August 1995, is expected to be completed by 1998 while the construction of System II PUTRA, linking Gombak and Petaling Jaya, has already started in 1996. The Federal Government's financial involvement in these projects amounted to RM1,260 million, mainly in the form of soft loans. At the same time, facilities at airports are being upgraded,

Table 5.8

Federal Government Development Expenditure for Economic Services
(RM million)

	1996 Revised Estimate	1996 % Share	1997 Budget Allocation	1997 % Share
Agriculture and rural development	1,300	17.4	1,350	17.0
Public utilities	714	9.6	1,092	13.7
Trade and Industry	1,425	19.1	1,403	17.7
Transport	3,998	53.5	4,063	51.1
Communications	2	0.0	8	0.1
Others	28	0.4	32	0.4
TOTAL	7,467	100.00	7,948	100.00

Chart 5.5
Federal Government Development Expenditure by Sector



particularly in Pulau Tioman Langkawi, Tawau, Sibu and Bintulu to cater for the expected increase in passenger traffic, arising from efforts to promote Malaysia as a major tourism destination.

Programmes for public utilities, comprising water and electricity supply, are expected to utilise another RM793 million, of which 63.2% is to be spent for water supply while another 36.8% for electricity, particularly for rural electrification programmes.

Reflecting the Government's continued efforts to upgrade the standard of living in rural areas, a sum of RM1,300 million is to be spent for agriculture and rural development, as shown in Table 5.9. Beginning from 1996, the Government has provided a special allocation of RM200 million annually for the maintenance of rural roads, including roads in areas under FELDA, FELCRA, RISDA and regional development authorities. Programmes under land development, integrated agriculture development and drainage and irrigation account for 61.1% of the expenditure on agriculture and rural development. These programmes include rubber replanting, livestock industries, fisheries and forestry.

Table 5.9

Federal Government Development Expenditure for Agriculture and Rural Development Programme
(RM million)

	1996		*1997*	
	Revised Estimate	*% Share*	*Budget Allocation*	*% Share*
Agriculture	369	28.4	380	28.1
Land development	176	13.5	168	12.4
Drainage and irrigation	257	19.8	267	19.8
Rubber replanting	304	23.4	196	14.5
Fisheries	79	6.1	115	8.5
Livestock	26	2.0	42	3.1
Forestry	8	1.2	37	2.7
Others	81	6.2	145	10.7
TOTAL	1,300	100.00	1,350	100.00

Table 5.10

Federal Government Development Expenditure for Trade and Industry Programme
(RM million)

	1996		*1997*	
	Revised Estimate	*% Share*	*Budget Allocation*	*% Share*
Industrial development	653	45.8	616	43.9
Tourism	208	14.6	178	12.7
Industrial research	422	29.6	528	37.6
Others	142	10.0	81	5.8
TOTAL	1,425	100.0	1,403	100.0

A sum of RM1,425 million is expected to be utilised for industrial development, industrial research as well as tourism, as shown in Table 5.10. Industrial development programmes account for the largest share, accounting for 45.8% or RM653 million. To further improve research and development (R&D) so as to strengthen the technological base of the economy, about RM422 million is expected to be spent for industrial research. This will be mainly undertaken by agencies such as Forest Research Institute of Malaysia (FRIM), Nuclear Energy Unit, Malaysian Institute of Microelectronic System (MIMOS) and Standard and Industrial Research Institute of Malaysia (SIRIM). SIRIM was corporatised in September, 1996 to enable the entity to concentrate on industrial research. Recognising the role of the tourism industry as a source of foreign exchange earnings, a sum of RM208 million is to be spent for projects under tourism, primarily to increase facilities and develop tourism products.

Development expenditure for **social services** sector is expected to increase by 7.8%, with education accounting for the largest share, followed by health services, as shown in Table 5.11. The increased expenditure on education reflects the Government's commitment to promote human resource development to meet skilled and semi-skilled manpower requirements in the country.

Table 5.11

Federal Government Development Expenditure for Social Services
(RM million)

	1996		1997	
	Revised Estimate	*% Share*	*Budget Allocation*	*% Share*
Education	1,900	50.2	2,354	46.7
Health	505	13.3	579	11.5
Housing	435	11.5	929	18.4
Others	948	25.0	1,174	23.4
TOTAL	3,788	100.0	5,036	100.0

The bulk of the expenditure will be for the construction of school buildings, upgrading educational facilities and the development of institutions of higher learnings. About RM250 million would be utilised for the development of the University Kebangsaan Malaysia and the International Islamic University. To further improve the health care services and quality of life, especially in rural areas, a sum of RM108 million is allocated for public health services in the rural areas. This includes the construction of 47 new health offices and health centres and 37 new rural clinics and midwife clinics. The expenditure for health facilities, such as hospital equipment, is expected to amount to RM202 million.

Expenditure for housing is expected to increase by 8.1% to RM435 million, of which RM71 million is for low cost housing projects. In addition, an allocation has also been provided through two special funds, namely the Fund to Accelerate the Construction of Low-Cost Houses (FACLCH) and the Low-Cost Housing Revolving Development Fund (LCHRDF), to speed up the construction of low cost houses with a view to easing the housing problem faced by the lower income group. Expenditure for housing programmes for the armed forces and police personnel amounts to RM230 million, while expenditure on quarters for teachers in rural areas and customs officers amount to RM70 million and RM50 million, respectively. Other programmes under the social services sector, such as information and broadcasting, cultural, youth and sport programmes and other social services, are expected to account for 25% of the total expenditure for the social services sector.

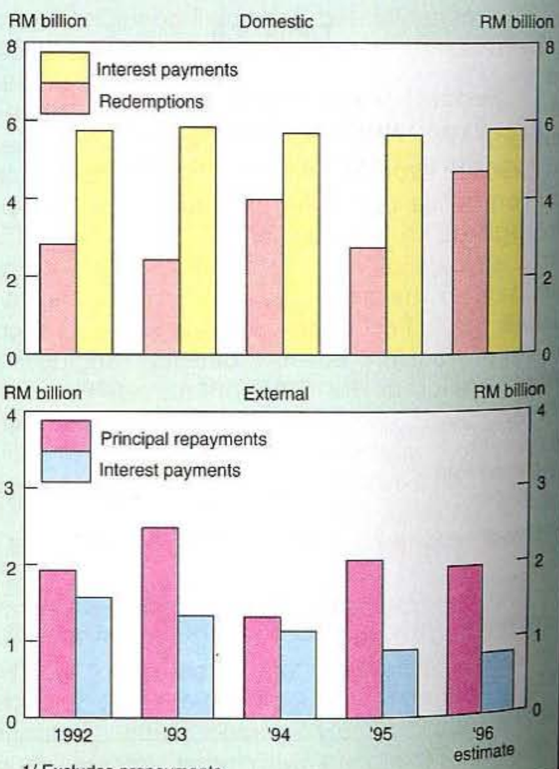
Expenditure for **security** sector is expected to decline by 1.6% to RM2,840 million. Of this, RM2,796 million or 88.6% is expected to be spent by the defence sub-sector for modernisation of the armed forces, including upgrading of its equipment . The remaining RM324 million is for internal security, particularly for the Royal Malaysian Police, including the purchase of equipments and the construction of police stations and training centres.

Expenditure for **general administration** is expected to decline from RM1,210 million in 1995 to RM854 million in 1996. Of this, RM360 million is for the development of the new Administrative Centre at Putrajaya, RM478 million for the construction of other office buildings and the purchase of equipments while another RM8 million is for foreign affairs.

Financing

The continued strong financial position of the Federal Government in 1996 has enabled it to fully finance its operating and development

Chart 5.6
Federal Government Loans - Principal Repayments, Redemptions and Charges



1/ Excludes prepayments

expenditure, without the need to borrow. Notwithstanding this, however, the Federal Government will raise a total of RM16,310 million in 1996 from the domestic market through the issues of Malaysian Government Securities (MGS) and Treasury Bills (TBs) solely with the objective of meeting the demand for papers and in particular to provide a benchmarking for the local bond market. Of this amount, a total of RM15,019 million is for the redemption of existing instruments during the year, comprising RM10,310 million of TBs, RM3,809 million of MGS and RM900 million of Government Investment Issues (GIIs). The remainder RM 1,291 million will be to repay external loans.

Gross external borrowing of the Federal Government in 1996 is expected to come from the disbursement of existing project loans and new market loans amounting to RM600 million and RM152 million, respectively.The Government is expected to continue its prepayment and refinancing programme in 1996. As a result, net external borrowing of the Federal Government is expected to record a higher outflow of RM1,957 million compared with RM1,635 million in 1995.

State Governments

The consolidated financial position of state governments in 1996 is expected to register decline in the current account, mainly due to decline in revenue collection against an increase in operating expenditure. Total receipts of state governments in 1996 are expected to decline by 0.9% to RM9,276 million, while operating expenditure is expected to register an increase of 3%, thus contributing to a surplus of RM3,952 million in the current account of the state governments, as shown in Table 5.12. Two states, however, are expected to record current account deficits, ranging from RM10 million to RM15 million, namely Perlis and Terengganu. The states' total net development expenditure will decline by 3.8% to RM3,887 million in 1996. As a whole, the overall financial position of the states is expected to record a surplus of RM396 million in 1996 (1995: RM575 million).

Revenue from **state governments' own source** is expected to decline 2.6% to RM7,667 million in 1996, compared with an increase of 11.8% in 1995. Higher revenue collections are expected in five states, namely Sarawak, Sabah, Selangor, Johor and Terengganu while other states will record lower revenues.

Non-tax revenue which accounts for 49.8% of total state revenue, is expected to increase by 1.2% to RM4,620 million in 1996 (1995: RM4,567 million). The **revenue from petroleum and forestry** continues to be significant, accounting for 30.4% of the states' own revenue sources. **Petroleum royalties** received by the state governments of Terengganu, Sarawak and Sabah are expected to increase by 19.3% from RM602 million in 1995 to RM614 million in 1996 due to higher prices for petroleum. For Terengganu, petroleum royalties are expected to amount to RM409 million, accounting for 90.7% of the state's own revenue. For Sarawak and Sabah, petroleum royalties amount to RM150 million and RM55 million respectively, accounting for 6% and 3.8% of the respective state's own revenue. **Forestry-based revenue** is expected to account for 22.3% of the total states' own revenue in 1996 (1995: 19.5%) with the collection expected to increase by 12.1% to RM1,717 million, compared with RM1,532 million

Table 5.12

Consolidated State Governments' Financial Position

(RM million)

	1995[1]	*% Change*	*1996*[2]	*% Change*
Current account				
Revenue	9,362	9.5	9,276	–0.9
Operating expenditure	5,168	–0.8	5,323	3
Current account balance	4,194	25.4	3,952	–5.8
Development account				
Gross development expenditure	4,041	6.2	3,887	–3.8
Development fund	3,362	8.1	3,532	5.1
Water supply fund	679	–2.3	355	–47.7
Loan recoveries	422		331	
Net development expenditure	3,619		3,556	
Overall deficit	575		396	

[1] Estimated actual.
[2] Estimate.

in 1995. For Sabah, revenue from forestry is expected to increase by 27.2% to RM697 million, compared with RM548 million in 1995.

Grants from the Federal Government, mainly for road maintenance, is expected to decline by 13.1% to RM1,306 million compared with RM1,503 million in 1995, contributing 17% of the states' total revenue. On the other hand, reimbursement from the Federal Government to the states is expected to remain the same at RM81 million.

The **operating expenditure** of the state governments is expected to increase by 3% to reach RM5,323 million in 1996 (1995: RM5,168 million). Emolument is the single largest component and is expected to increase by 1.8% in 1996 (1995: 6.6%). It accounted for RM1,299 million or 20.4% of the total operating expenditure. Expenditure on supply and services is expected to increase by 25.3% to total RM1,891 million.

Development expenditure of the state governments is expected to be lower in 1996 by 3.8% to amount to RM3,887 million, particularly for infrastructure, agriculture, transportation and commerce and industry. The state governments will also allocate higher expenditure for housing in line with the Government housing development programme to provide adequate, affordable, and quality housing, particularly for the low income group. During the Seventh Malaysia Plan period (1996-2000), a total of 29,000 public low-cost houses is projected to be built by the state governments. Subsequently, the expenditure on low cost housing is estimated to increase by 32.9% to RM423 million in 1996 compared with RM344 million in 1995. The states with the larger allocations for this programme are Pahang, Kedah and Johor, which are expected to allocate a total of RM74.4 million, RM25 million and RM21.8 million, respectively.

Non-Financial Public Enterprises

The **overall performance** of 31 NFPEs (those monitored for macroeconomic purposes) is expected to remain strong with revenue a mounting to RM50,046 million in 1996, as shown in Table 5.13. However, the rate of increase in revenue is lower at 7.3% compared with 9.5% increase in 1995. The NPPEs which recorded significant increases in revenue performance include Petronas, Syarikat Telekom Malaysia

Table 5.13

Consolidated NFPEs Financial Position[1] 1995–1996
(RM million)

	1995	*% Change*	*1996*	*% Change*
Revenue[2]	46,620	9.5	50,046	7.3
Current expenditure	32,517	22.2	36,538	12.4
Retained income	14,103		13,508	
Development expenditure	14,842	–8.6	19,336	30.9
Overall balance	–740		–5,828	

[1] Refers to 32 NFPEs in 1995 and 31 in 1996
[2] Includes grants from Federal Government

Berhad (STMB) and Tenaga Nasional Berhad (TNB). In addition, several of the smaller NFPEs also showed improved performance due largely to the successful restructuring and merging exercises of government companies undertaken since 1993 and the diversification of their activities.

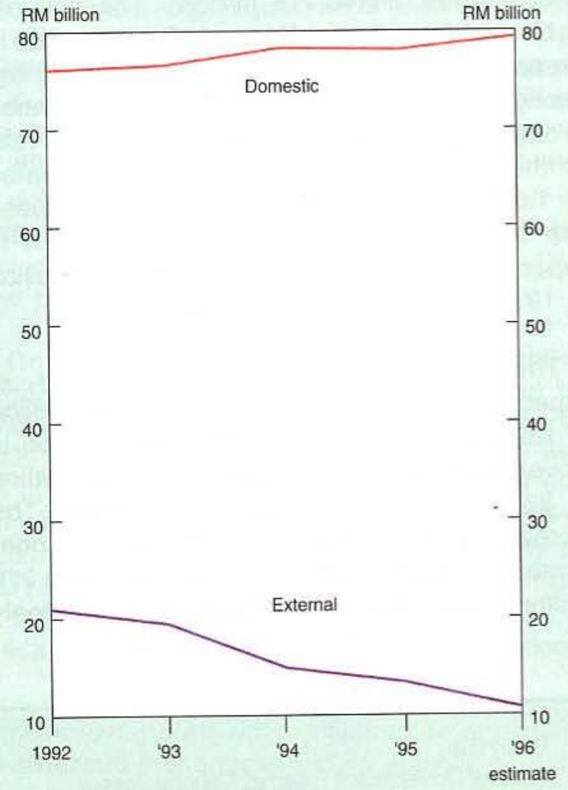
The **current expenditure** of the NFPEs is expected to increase to RM36,538 million in 1996, an increase of 12.4% compared with 22.2% increase in 1995. The lower rate of increase in revenue compared to that of operating expenditure will see a decline in the **operating surplus** to RM13,508 million in 1996 compared with RM14,103 million in 1995. The surplus is expected to be contributed by the larger NFPEs, mainly PETRONAS, TNB and STMB.

The **development expenditure** of the 31 NFPEs is estimated to increase in 1996 by 30.3% (1995: –8.6%) to RM19,336 million due to the expansion and modernisation programmes of several NFPEs, mainly on infrastructure projects as well as in the oil and gas and manufacturing sectors. PETRONAS, TNB and STMB accounted for the largest development expenditure, amounting to RM15,386 million or 79.6% of total NFPEs development expenditure in 1996 (1995: 81.2% or RM12,054 million). A major part of the expenditure of PETRONAS will be directed to down stream activities in oil and gas sector.

Overall, the smaller operating surplus coupled with the higher development expenditure will result in the **consolidated account** of the NFPEs to record a larger deficit of RM5,828 million in 1996 compared with a deficit of RM740 million in 1995.

In terms of divestment of government interest in NFPEs, Khazanah Nasional Berhad, the new holding company of the Federal government, has divested 83% of its holding in HICOM to Mega Consolidated Sdn.Bhd. thereby, reducing its holding to only 6.55%. With the holding of Ministry of Finance Incorporated, the other holding company of the Government, in HICOM remaining at 8.14%, the Government's interest in HICOM has been reduced to 14.69% compared with 46.69% earlier. In September 1996, the Urban Development Authority (UDA) was corporatised. With the corporatisation of UDA, it is expected that its management and financial performance will be further improved.

Chart 5.7
Federal Government Debt



National Debt

The outstanding national debt is estimated to increase at a lower rate of 5.4% to reach RM72,260 million at the end of 1996, after increasing by 14.9% in 1995, as shown in Table 5.14. As a percentage to GNP, the national debt will be lower at 31.7% compared with 34% in 1995.

Table 5.14

National Debt

	1995			1996		
	RM Million	*% Change*	*% Share*	*RM Million*	*% Change*	*% share*
Public sector	40,116	7.4	58.5	39,870	–0.6	55.2
Federal Government	13,331	–10.0	19.4	10,675	–19.9	14.8
NFPEs	26,785	18.9	39.1	29,195	9.0	40.4
Guaranteed	8,867	–1.0	12.9	6,976	21.3	9.7
Non-guaranteed	17,918	31.9	26.1	22,219	24.0	30.7
Private sector	28,451	27.5	41.5	32,390	13.8	44.8
TOTAL	68,569	14.9	100.0	72,260	5.4	100.0

The public sector external debt, comprising the external debt of the Federal Government and NFPEs, is expected to decline by 0.6% to RM39,870 million (1995: RM40,116 million). The external debt position of the Federal Government is expected to improve further, due largely to the strong fiscal position as well as the appreciation of ringgit against major currencies during the year (at the end of June 1996, the ringgit appreciated by 1.84% against US$, 8.42% against Japanese yen and 7.71% against deutschemark). It is expected to decline by 19.8% to RM10,675 million in 1996 (1995: RM13,331 million).

The external debt of NFPEs, however, is expected to increase by 9.0% to RM29,195 million in 1996, of which 23.9% or RM6,976 million is Government guaranteed (1995: RM8,867 million or 33.1% of total NFPEs external debt). The increase is mainly due to the increase of non-guaranteed debt of 24% which reached RM22,219 million (1995: RM17,918 million). This is largely to finance further investment in infrastructure projects and capacity expansion needed to further address infrastructural constraints in the economy.

The private sector external debt is also expected to increase by 13.8% to RM32,390 million in 1996 (1995: RM28,451 million), largely to take advantage of the relatively lower cost of borrowing abroad. Thus, the share of private sector external debt to national debt is expected to increase to 44.8% in 1996 (1995: 41.5%)

The national **debt servicing** is expected to increase from RM15,311 million in 1995 to RM16,060 million in 1996, of which 50.5% is for servicing the external debt of public sector. The debt servicing is still high as greater number of loans are expected to come to maturity in 1996, for both the public and private sectors, as well as prepayment by the public sector. However, the **national debt service ratio** is expected to decline to 5.9% compared with 6.2% in 1995.

Chart 5.8
Federal Government External Debt by Source

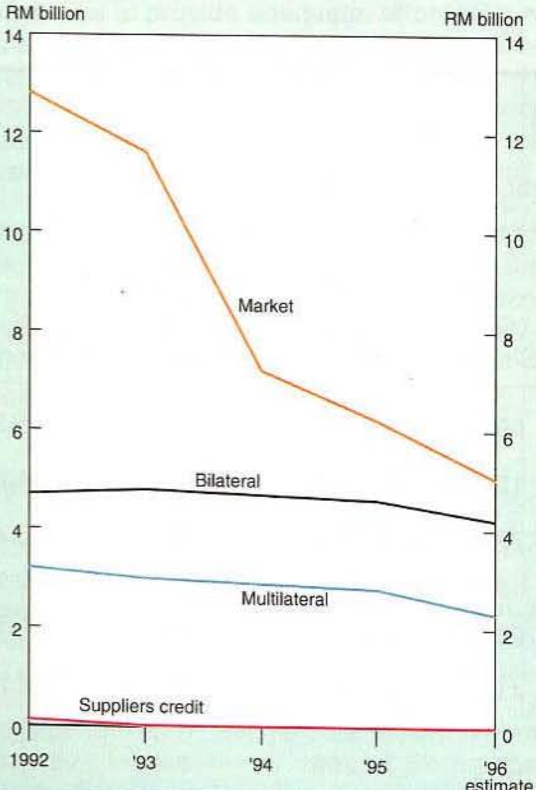
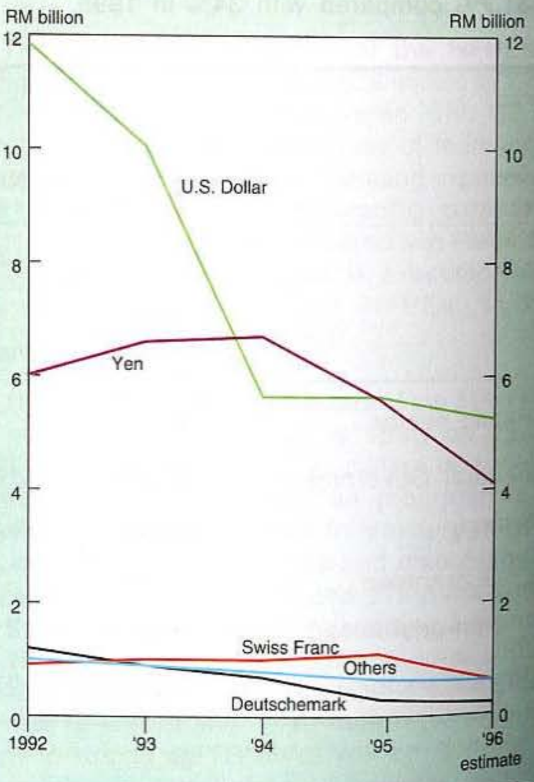


Chart 5.9
Federal Government External Debt by Currency



Federal Government Debt

The total outstanding debt of the **Federal Government**, comprising external and domestic debt, is expected to decline by 1.5% to RM90,004 million, as shown in Table 5.15. MGS and TBs are the major contributors to domestic debt, amounting to RM71,230 million (or 89.8% of total domestic debt). Other holdings of domestic debt comprising GIIs and loans of the Treasury Housing Loan Fund, account for 10.2% of the total domestic debt outstanding.

With respect to external debt, net repayment by the Federal Government is expected to increase by 19.7% to RM1,957 million (1995: RM1,635 million). Hence, the outstanding external debt is expected to decline to RM10,675 million at the end of 1996 (1995: RM13,331 million), after taking into account net foreign exchange revaluation.

Table 5.15

Federal Government Debt
(RM million)

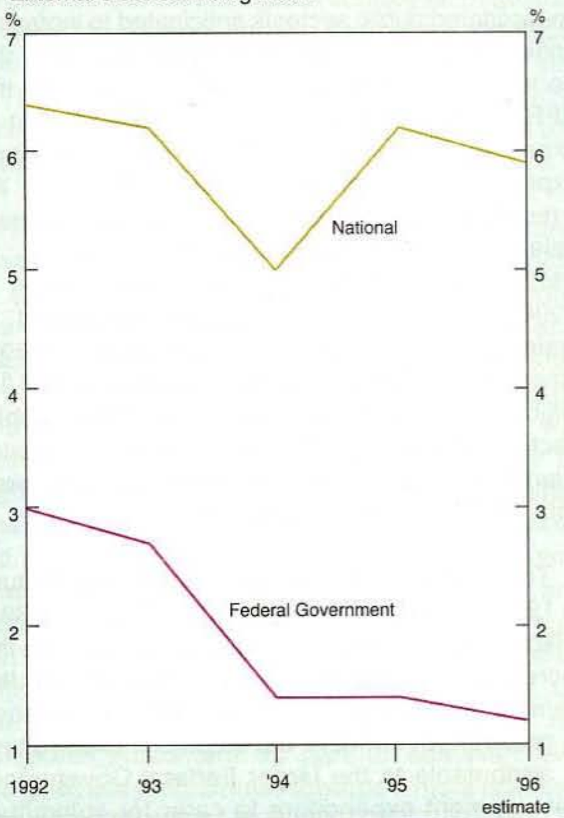
Debt Profile	*1995*	*% Share*	*1996*	*% Share*
Domestic debt	78,038	100.0	79,329	100.0
Treasury bills	4,320	5.5	4,320	5.4
Investment certificates	5,050	6.5	3,900	4.9
Government securities	64,719	82.9	66,910	84.3
2 - 3 years	—			
4 - 5 years	2,100			
6 - 10 years	12,336			
11 - 15 years	13,735			
16 - 21 years	36,548			
Other loans[1]	3,949	5.1	4,199	5.3
External debt	13,331	100.0	10,675	100.0
Market loans	6,231	46.7	5,042	47.2
Project loans	7,100	53.3	5,643	52.8
Suppliers' credit	—		—	
TOTAL	91,369		90,004	

[1] Mainly loans undertaken by the Treasury Housing Loans Fund.

In terms of currency profile of the Federal Government external debt, the US dollar denominated debt remains the largest proportion, amounting to a ringgit equivalent of RM5,199 million or 48.3% of total external debt. However, it is significantly lower compared with RM5,570 million or 41.8% in 1995. The yen denominated external debt is also expected to decline by from 42.2% in 1995 to 38% in 1996. In ringgit equivalent,it is expected to decline from RM5,627 million in 1995 to RM4,088 million in 1996. Other holdings include Swiss franc (5.8%), deutschemark (2.4%) and pound sterling (2.6%).

On debt servicing, the Federal Government is expected to undertake payments amounting to RM24,076 million in 1996, (RM21,644 million in 1995). Of this, RM20,814 million or 86.5% will be utilised for servicing domestic debt and the remaining for external debt. Repayments for external debt is expected to decline slightly to RM1,963 million compared with RM2,063 million in 1995. However, after taking into consideration prepayment to be undertaken this year, the Federal

Chart 5.10
External Debt Servicing Ratio



Government external debt servicing is expected to increase from RM2,949 million in 1995 to RM3,262 million in 1996. Nevertheless, given the strong expansion in export earnings, the debt service ratio of the Federal Government in 1996 remains low at 1.2% compared with 1.4% in 1995.

1997 Outlook

Overview

Fiscal prudence and consolidation will continue to underscore Government's policy in the management of public sector finance. Complemented by tight monetary policy, fiscal policy and budgetary operations in 1997 will strive for larger budget surplus, largely through continued restraint on consumption spending with a view to containing excessive demand pressures and ensuring a sustainable growth path for the economy.

In line with this thrust, the consolidated public sector overall balance is projected to improve in 1997. The current account balance of the consolidated public sector is anticipated to increase, arising from larger current surpluses of both the Federal and state governments as well as the NFPEs. Revenue of the general government is expected to increase by 4.9%, while operating expenditure is expected to decline by 2.5%. As a result, the general government's current account balance is estimated to increase by 21.7% to RM26.2 billion compared with RM21.5 billion in 1996. Similarly, the NFPEs are projected to maintain stronger operating surpluses in 1997, amounting to RM18 billion compared with RM13.5 billion in 1996. Hence, the consolidated public sector current account is anticipated to register a larger surplus of RM44.2 billion in 1997 compared with RM35 billion in 1996.

Total public sector net development expenditure in 1997 is projected to increase by 7.6% to RM39.5 billion. The increase is mainly attributable to the increase in development expenditure of both the general government and the NFPEs. The increase in general government development expenditure is attributable to the larger Federal Government development expenditure to cater for committed continuation projects of the Sixth Malaysian Plan as well as new projects under the Seventh Malaysia Plan. In view of the larger current account surplus, the consolidated public sector overall balance is projected to record a surplus of RM4.7 billion or 1.8% of GNP compared with a deficit of RM1.7 billion or 0.7% in 1996.

Federal Government

The Federal government financial position is projected to strengthen further in 1997. Federal revenue is projected to grow by 7.6% to RM60,778 million, largely due to higher receipts from both direct and indirect taxes. Operating expenditure, on the other hand, will decline marginally by 0.2% to RM41,713 million. The stronger revenue performance coupled with a moderate increase in operating expenditure will yield a substantially larger current account surplus of RM19,065 million in 1997. After taking into account loans recovery amounting to RM1,650 million, net development expenditure in 1997 is estimated at RM15,119 million. Consequently, the overall balance of the Federal Government is projected to show a larger surplus of RM3,946 million or 1.5% of GNP.

The thrust of the development expenditure in 1997 will be towards enhancing productivity and efficiency. This is to be achieved through expansion in infrastructure, upgrading the quality of workforce through human resource development as well as enhancing research and development efforts and increasing investment in science and technology. The development of rural areas will continue to be emphasised with a view to further improving the level of income and standard of living of the rural population. Emphasis will be given on replanting, land consolidation and rehabilitation and agricultural support services such as R&D activities, training, extension services and marketing activities. The social agenda will be given greater focus aimed at addressing increasing social problem, particularly among the young. Religious and moral education will be intensified to instill good social behaviour and promote healthy lifestyles. Similarly, moral and ethical values will be further emphasized as an important component in the formulation of social development programme.

Revenue

Federal Government revenue is projected to increase by 7.6% to RM60,778 million compared with an increase of 10.9% in 1996. Most of the increase is expected to emanate from tax and non-tax revenue. Tax revenue which comprises direct and indirect taxes, is anticipated to increase by 8.5%. More than 88% of the direct taxes is accounted for by income tax, namely corporate, individual and petroleum income taxes. Both corporate and individual income taxes are expected to increase by 8.2%. Contribution from petroleum related revenue is expected to remain at 1996 level of 14%.

Receipts from indirect taxes are expected to increase by 8.8% to RM22,936 million, with higher collection anticipated from import duties, excise duties, sales tax and service tax. Collection from import duties is projected to register an increase of 7.4% to RM6,683 million, in line with projected increases in gross imports. Revenue from excise duty is anticipated to increase by 10% to RM6,292 million due to buoyant manufacturing activites while collection from sales tax is also expected to increase in line with the growth in private spending. The contribution of indirect taxes to total tax revenue is expected to remain at the 1996 level of about 38%.

Collection from non-tax revenue and non-revenue receipts is expected to increase by about 3.6%. Collection from road tax is estimated to increase further by 8% as sales of motor vehicles in 1997 are expected to remain strong. However, collection from petroleum royalties gas is expected to increase from RM710 million in 1996 to RM1,540 million, largely on account of the anticipated higher demand for gas.

Operating Allocation

The operating allocation of the Federal Government in 1997 is budgeted at RM41,713 million or 0.2% lower than the 1996 expenditure. The allocation for **emoluments** will stablise at RM14,906 million and remain the largest component of operating expenditure, accounting for 35.7% in 1997. The increase is mainly to cater for annual salary increments and filling up of vacancies and the creation of new posts in essential services, especially in education (9,411 new posts for teachers) and health (1,250 new posts for medical officers and 4,675 for paramedics). On the other hand, the allocation for **debt service charges** is estimated to increase by 1.3% to RM6,595 million, or 15.8% of operating allocation, due mainly to higher interest payment.

The allocation for **supplies and services** will be lower in 1997 at RM5,890 million compared with RM5,975 million in 1996. The allocation is mainly for maintenance and repair works, rental, communications and utilities, and supplies of materials to upgrade the Government administrative machinery and services. The allocation for these components as a group amounts to RM3,936 million or 66.8% of the total allocation for supplies and services. Commitments on **pensions and gratuities** will also decline in 1997 as adjustment and arrears arising from revised salary scheme were already settled in 1996. The annual contribution to the Pension Trust Fund amounts to RM820 million. **Grants and transfers to state governments** are expected to increase by 4.9% to RM1,556 million, mainly due to higher allocation for road grant, capitation grant and grants for common user departments. Allocation for **subsidies** will increase by 6.4% to RM753 million, largely to meet the increase in subsidy on petroleum products and text books. Petroleum products subsidy will increase from RM140 million in 1996 to RM162 million in 1997 while text books subsidy will increase from RM94 million in 1996 to RM104 million in 1997.

The allocation for **other** operating expenditure, which constitutes 20% of the operating allocation, is expected to decline by 4.2%. This includes grants to statutory bodies, scholarships and educational aid, asset acquisition, operating grants to primary and secondary schools and also refunds and write-offs. Grants to statutory bodies will increase by 37.2% to RM1,369 million due to higher allocation for institutions of higher learning. The allocation for scholarships and educational aid amounts to RM629 million while operating grants to primary and secondary schools are expected to amount to RM682 million. A sum of RM1,183 million will be allocated for purchase of office equipment and renovation of buildings. Of the amount, RM265 million will be spent on computer procument as part of administrative improvement programmes towards a more effective and efficient public service.

In terms of sectoral classification, the **social services** sector will remain the largest recipient with an allocation of RM14,532 million or 34.8% of the total operating allocation, largely for education and health which together are expected to account for 90.7% of the total allocation for the social services sector. The allocation for **security** is expected to amount to RM6,432 million or 15.2% of the total allocation for operating expenditure. **General administration**, which constitutes 12.2% of the total allocation for operating expenditure, will remain the third largest sector while the **economic services** sector is estimated to amount RM4,048 million or 9.7% of the operating allocation.

Development Allocation

The allocation for development expenditure in 1997 will amount to RM16,769 million or an increase of 12.2%. The allocation for the **economic services** sector amounts to RM7,948 million and will continue to remain the largest sector, accounting for 47.4% of the total development allocation. The development of infrastructure and utilities will be further intensified in order to sustain the growth momentum of the economy. About 65% of the total allocation for this sector will be utilised for infrastructure projects. The allocation for transport sub-sector amounts to RM4,063 million, of which RM2,934 million will be for roads and bridges and RM889 million for rail transportation. A sum of RM2,438 million of the allocation for road and bridges will be spent on urban areas, RM88.5 million for the construction of roads and flyovers in Kuala Lumpur and the remaining RM482 million for rural roads. Major continuation road projects in 1997 will include the Middle Ring Road II, Johor Causeway Project, the road from Simpang Pulai to Kuala Berang, Kuala Kangsar-Grik Road and major road projects in Sabah and Sarawak. In addition, road construction will be further accelerated through fast-track approaches, particularly through privatisation. These projects include KL-Karak Highway, North South Central Link, Shah Alam Expressway and upgrading Cheras-Kajang Road and Damansara-Puchong-Putrajaya Highway. A sum of RM155.7 million will be allocated for the upgrading of Pulau Tioman airport, Langkawi airport , construction of new airport in Tawau as well as upgrading facilities in other airports. Emphasis will also be given to further improve infrastructure in rural areas. A sum of RM130 million will be allocated for rural road maintenance while RM130 million and RM118 million will be allocated for rural electricity and water supply, respectively.

Agriculture and rural development remains a priority programme in the economic services sector and is allocated a sum of RM1,350 million or 17% of the allocation for the economic services sector, particularly for agricultural and land development, drainage and irrigation and rubber replanting programmes. In agriculture, the focus will be directed towards improving productivity and competitiveness of the sector as well as modernising and commercialising the smallholders sub sector.

Trade and industry programmes will be allocated about RM1,403 million or 17.7% of the allocation for the economic services sector. Of the total, about RM616 million or 43.9% will be spent on industrial development, particularly in the form of loans and grants to government agencies. Priority will continue to be accorded to the promotion of research and technological innovation, as an essential part of the Government's development strategy . For this purpose, about RM528 million has been allocated in 1997. The Government will continue to provide various infrastucture facilities and promote Malaysia as an attractive tourist destination. Hence, about RM178 million will be spent for tourism programmes by the Ministry of Culture, Arts and Tourism.

The allocation for the **social services** sector will account for the second largest, contributing 30% of the total development allocation. The allocation for education, the largest component in the social services sector, is expected to increase by 23.9% to RM2,354 million. A sum of RM490 million will be used for the construction and upgrading of 766 school buildings. Another RM484 million has been allocated for the construction and upgrading of polytechnics, technical and vocational schools while RM767 million for institutions of higher learning. The increase in allocation reflects the continued Government's commitment to promote human resource development to meet the manpower requirements in the country. The allocation for health services will also be higher, increasing by 14.7% to RM579 million. This larger allocation is mainly for the improvement and expansion of health facilities in Government hospitals. The allocation for housing will increase by 113.3% to RM929 million. About RM479 million will be spent on housing projects for armed forces, royal police, squarters resettlement in Kuala Lumpur and government quarters at KLIA while RM90 million and RM63 million for the construction of teacher's quarters in rural areas and low cost housing, respectively. Another RM1,174 million or 23.3% of the allocation for the social services sector will be for information and broadcasting, culture, youth and sport programmes as well as other social services.

The allocation for the **security** sector is estimated to amount to RM2,776 million or a decline of 2.3% compared with a decline of 1.6% in 1996. Most of the allocation will be for progress payment on procument of equipment. Another RM445 million or 16% of the total allocation for the security sector will be for internal security, particularly for projects undertaken by the Royal Police Department, such as drug rehabilitation center and border security fence.

The allocation of **general administration** accounts for RM1,009 million or 6% of the total development allocation in 1997. Most of the allocation is for projects under departmental services and the Ministry of Foreign Affairs. About RM997 million or 97% of the allocation is for departmental services, while the remainder is for foreign affairs.