

5

Public Sector Financial Performance

1997 Performance

Overview

Fiscal prudence and consolidation continue to be the main thrusts in the management of public sector finance in 1997. Budgetary operations in 1997 focus on achieving a larger surplus by maintaining restraint on consumption spending. Increases in public expenditure are to be contained by tight budgetary controls on expenditure, especially operating expenditure. However, selective increases will be accommodated particularly for programmes that will enhance and improve human resource development, health and the quality of services provided to public. Development expenditure continues to be channelled to expand productive capacity, develop skilled manpower and promote research and development. In line with efforts to reduce the size of the public sector, the government continues to privatise public sector agencies and services.

The commitment to fiscal prudence has subsequently led to a higher consolidated public sector overall surplus as indicated in Table 5.1. Revenue of the general government is expected to increase by 8% while operating expenditure is anticipated to increase by 1.2%. The current surplus is therefore, estimated to be higher at RM24,867 million. At the same time, the Non-Financial Public Enterprises (NFPEs) are expected to record a large operating surplus of RM22,483 million resulting from their strong revenue performance. As such, the public sector is expected to record a large current surplus of RM47,350 million. Public sector development expenditure is expected to increase by 35.3% to RM41,921 million due to higher development expenditure by the NFPEs. This is mainly on account of new investments, particularly by Telekom Malaysia

Table 5.1

Consolidated Public Sector Financial Position (RM Million)

	1996 ¹	1997 ²	1998 ³
Current Account:			
General government:			
Revenue	69,931	75,559	80,975
Operating expenditure	50,068	50,692	49,021
Current account balance	19,863	24,867	31,954
Current surplus of NFPEs ⁴	20,416	22,483	23,496
Public sector current surplus	40,279	47,350	55,450
Development Account:			
Development expenditure	30,978	41,921	44,664
General government	15,859	19,251	21,400
NFPEs	15,119	22,670	23,264
Overall balance	9,301	5,429	10,786
% to GNP	3.9	2.1	3.8

Note: ¹ estimated actual
² revised estimate
³ Budget estimate, excluding 1998 tax measures
⁴ exclude grant from Federal Government

Berhad (TMB), Petroleum Nasional Berhad (PETRONAS), Tenaga Nasional Berhad (TNB) and Malaysian International Shipping Corporation Berhad (MISC). As a result, the public sector overall balance is expected to record a surplus of RM5,429 million or 2.1 % of GNP.

Federal Government

The Federal Government's financial position is expected to remain strong and in surplus for the fifth consecutive year since 1993. This reflects the Federal Government's continued commitment to a policy of fiscal consolidation as part of the macroeconomic strategy to contain demand and price pressures. Federal revenue collection is estimated at RM63,275 million, which is higher than the budget estimate for 1997 of RM61,099 million and an increase of 8.5% over the 1996 outturn. The increase will be from both direct and indirect taxes. Operating expenditure is expected to increase by only 0.5% to RM44,069 million, attributable mainly to the lower increase in emolument. Hence, the current account is expected to record a surplus of RM19,206 million or 7.3% of GNP, compared with RM14,415 million or 6.1% of GNP in 1996. On the other hand, gross development expenditure is expected to increase by a higher rate of 7.9% compared with 4.1% in 1996 due to the faster pace of project implementation under the Seventh Malaysia Plan. After taking into account loan recovery of RM1,650 million, net development expenditure is RM14,140 million. With this, the overall budgetary position of the Federal Government is expected to record a larger surplus of RM5,066 million or 1.9% of GNP as shown in Table 5.2.

Table 5.2

**Federal Government Financial Position
1996-1998
(RM Million)**

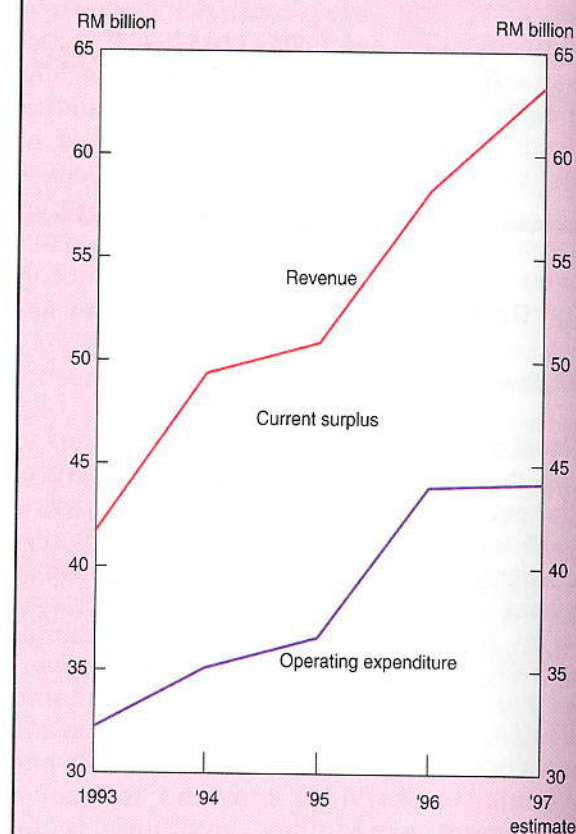
	1996 ¹	1997 ²	1998 ³
Revenue	58,280	63,275	68,058
Operating expenditure	43,865	44,069	42,766
Current balance	14,415	19,206	25,292
Gross development expenditure	14,628	15,790	17,991
Loan recoveries	2,028	1,650	1,650
Net development expenditure	12,600	14,140	16,341
Overall balance	1,815	5,066	8,951

¹ revised estimate

² Budget estimate

Chart 5.1

Federal Government Finance - Current Account



Revenue

The Federal Government's revenue is expected to remain strong amounting to RM63,275 million arising from the continued strong growth of the economy. The growth rate, however, is lower at 8.6% compared with 14.4% in 1996. This is mainly due to reduced collection in petroleum export duties on account of lower export volume and prices as well as a slower growth in collection of import duties due to continued reduction and abolition of import duties on large number of consumer items. **Tax revenue** is expected to increase by 10.5% to RM52,239 million. Direct tax collection is expected to increase by 14.4% compared with 13.9% in 1996 while the increase in indirect tax collection is lower at 5.8% compared with 12.9% in 1996. Tax revenue constitutes 82.6% of the total Federal Government revenue while the remaining RM11,036 million or 17.4% comprises non-tax revenue and non-revenue receipts.

Collection from direct taxes, mainly income taxes and stamp duties, is expected to increase by 14.4% to RM29,567 million, accounting for 46.7% to the total Federal revenue. Of this, revenue from **income tax** is estimated at RM26,432 million, an increase of 16.6% over 1996. Revenue from **corporate tax** is expected to remain strong, increasing by 15.8% to RM16,400 million, though lower than the 21% increase in 1996. Despite further reductions in the individual income tax rates granted in the 1996 Budget, revenue from individual income tax is expected to increase by 4.8% to RM6,466 million, compared with a decline of 0.5% recorded in 1996.

Increased production of crude oil and natural gas as well as the rise in crude oil prices in 1996 contributed to a higher collection of **petroleum income tax**, estimated to increase by 55.8% in 1997 to RM3,432 million. Collection from **other direct taxes** comprising largely of stamp duties, receipts from estate duty and real property gains tax, is expected to increase by 8.7 % to RM3,469 million. However, collection from stamp duties is expected to declined by 3.7% compared with an increase of 23.5% in 1996.

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

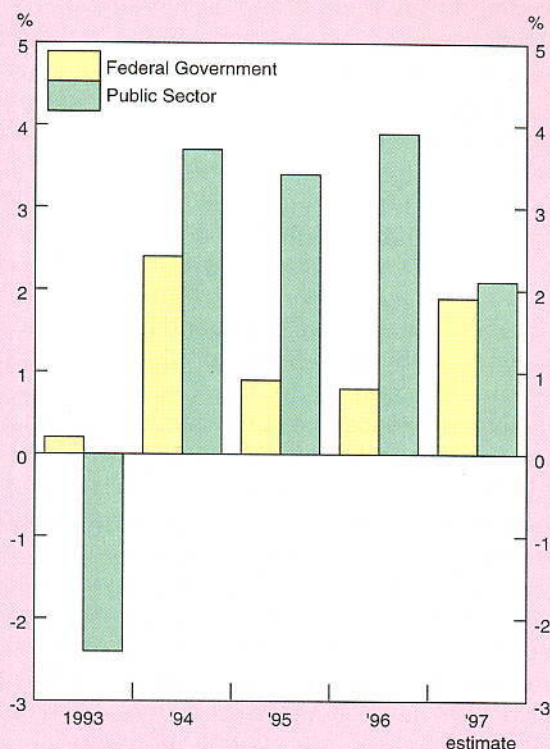


Table 5.3

**Federal Government Revenue
1996-1998**

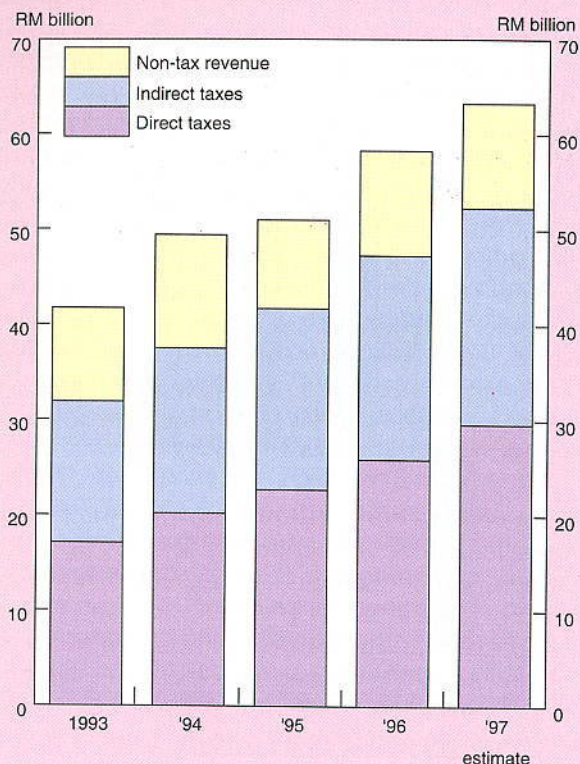
	1996 ¹		1997 ²		1998 ³	
	RM million	% Change	RM million	% Change	RM million	% Change
Total revenue	58,280	14.4	63,275	8.5	68,058	7.6
Total tax revenue	47,272	13.4	52,239	10.5	55,543	6.3
Direct taxes	25,851	13.9	29,567	14.4	31,456	6.4
Indirect taxes	21,421	12.9	22,672	5.8	24,087	6.2
Total non-tax revenue	11,008	18.5	11,036	0.2	12,515	13.4

Note: ¹ actual

² revised estimate

³ Budget estimate, excluding 1998 tax measures

Chart 5.3
Major Components of Federal Government Revenue



The performance of both components of indirect taxes, namely, export and import duties, is expected to decelerate. Revenue from **export duties** on commodities, of which 96.3% is from petroleum, is expected to decline by 4% (1996: increase of 22%) to RM999 million due to lower export volume as well as declining prices of crude petroleum. In spite of the reduction/abolition of import duties on some items, raw materials/components and equipment announced in the 1997 Budget, **import duties** is expected to increase by 2.8% (1996: 9.1%) to RM6,303 million.

Indirect taxes in the domestic economy, namely sales tax and service tax are expected to perform better in 1997. Collection from **sales tax** is expected to amount to RM6,184 million which is 13% higher than that in 1996. Sustained economic growth and strong domestic demand have led to an increase in sales tax revenue in spite of the abolition of sales tax on input for selected products announced in the 1997 Budget. Of this amount, about 31.8% or RM1,967 million is expected to be generated from tax on imported goods, while the other 68.2% or RM4,217 million is to be derived from tax on locally manufactured goods, thus reflecting a continued strong growth of domestic industries. The imposition of a service tax of

Table 5.4

Federal Government Direct Taxes

	1996 ¹		1997 ²		1998 ³	
	RM million	% Change	RM million	% Change	RM million	% Change
Income Taxes	22,661	12.3	26,432	16.6	28,236	6.8
Companies	14,166	21.0	16,400	15.8	17,950	9.5
Individuals	6,172	-0.5	6,466	4.8	6,989	8.1
Petroleum	2,203	0.8	3,432	55.8	3,147	-8.3
Cooperative	130	34.8	134	11.7	150	11.9
Others	3,190	26.8	3,135	-1.7	3,220	2.7
Stamp duty	2,708	23.5	2,607	-3.7	2,670	2.4
Others	482	48.8	528	9.5	550	4.2
TOTAL	25,851	25.9	29,567	14.4	31,456	6.4

Note: ¹ actual

² revised estimate

³ Budget estimate, excluding 1998 tax measures

RM50.00 per card per year on all types of credit cards, and with the continued expansion of tourism related activities and services that are taxable, the revenue from **service tax** is expected to increase by 15.3% to RM1,419 million. Revenue from **excise duties** for 1997 is expected to increase by 4.3% to RM6,039 million compared with a growth of 9.7% in 1996.

Non-tax revenue is expected to contribute about RM10,415 million, accounting for 16.4% of the total revenue in 1997. This is largely due to the dividend payments from PETRONAS and a higher collection of road tax which is expected to increase by 9.4% to RM1,736 million. The strong increase in road tax is in tandem with a strong increase in the number of motor vehicles registered in the country. Revenue from levy on foreign workers is expected to increase to RM1,098 million following the review of the levy rate as well as stricter enforcement by the authorities. The privatisation/divestment of a number of government-owned companies has resulted in less revenue received in the form of dividends. Nevertheless, dividend from PETRONAS is expected to be maintained at RM3,100 million while other interests and returns on investment is expected to total RM270 million.

Operating Expenditure

Operating expenditure of the Federal Government is expected to increase marginally by 0.5% to RM44,069 million compared with an increase of 19.9% in 1996, as shown in Table 5.6. This reflects the continued efforts by the government to contain its spending. Among the major categories in the operating expenditure, only expenditure for supplies and services as well as for pension and gratuities are expected to be higher than the 1996 level. Spending on emoluments and debt service charges, the other two major categories, are expected to be lower. Expenditure on **emoluments**, the largest component of operating expenditure, is expected to decline by 9.1% to RM14,807 million compared with an increase of 24.3% in 1996.

Debt service charges continue to be the second largest component accounting for 14.7% of the operating expenditure and it is expected to decline marginally by 4.9% to RM6,463 million. This is attributable to further reductions in Federal Government debt following a series of prepayments undertaken since 1987. As a result of prudent debt management to reduce its external exposure

Table 5.5
Federal Government Indirect Taxes
1996-1998

	1996 ¹		1997 ²		1998 ³	
	RM million	% Change	RM million	% Change	RM million	% Change
Export duties	1,041	22.0	999	-4.0	978	-2.1
Import duties	6,132	9.1	6,303	2.8	6,540	3.8
Excise duties	5,790	9.7	6,039	4.3	6,400	6.0
Sales tax	5,473	12.4	6,184	13.0	6,669	7.8
Service tax	1,231	21.2	1,419	15.3	1,645	15.9
Others	1,754	31.7	1,728	-1.5	1,855	7.3
TOTAL	21,421	12.9	22,672	5.8	24,087	6.2

Note: ¹ actual

² revised estimate

³ Budget estimate, excluding 1998 tax measures

by greater reliance on domestic market for financing, the servicing of domestic debt now accounts for 90.9% compared with 88.5% in 1996. On the other hand, external debt service charges had declined by 0.8%.

Expenditure on **supplies and services** is expected to increase by 11.2% to RM6,309 million compared with a decline of 4.6% in 1996. The higher outlay is due to higher supplies of materials, service fees, transportation and rentals which together is expected to increase by about 31.7% to RM4,690 million in 1997. Expenditure on **pensions and gratuities** is expected to record a slower growth of 1.9% to RM3,575 million in 1997 after an increase of 27.4% in 1996 as payment for salary adjustments has been completed in 1996. This amount also includes RM820 million for the annual contribution to the Pensions Trust Fund (PTF).

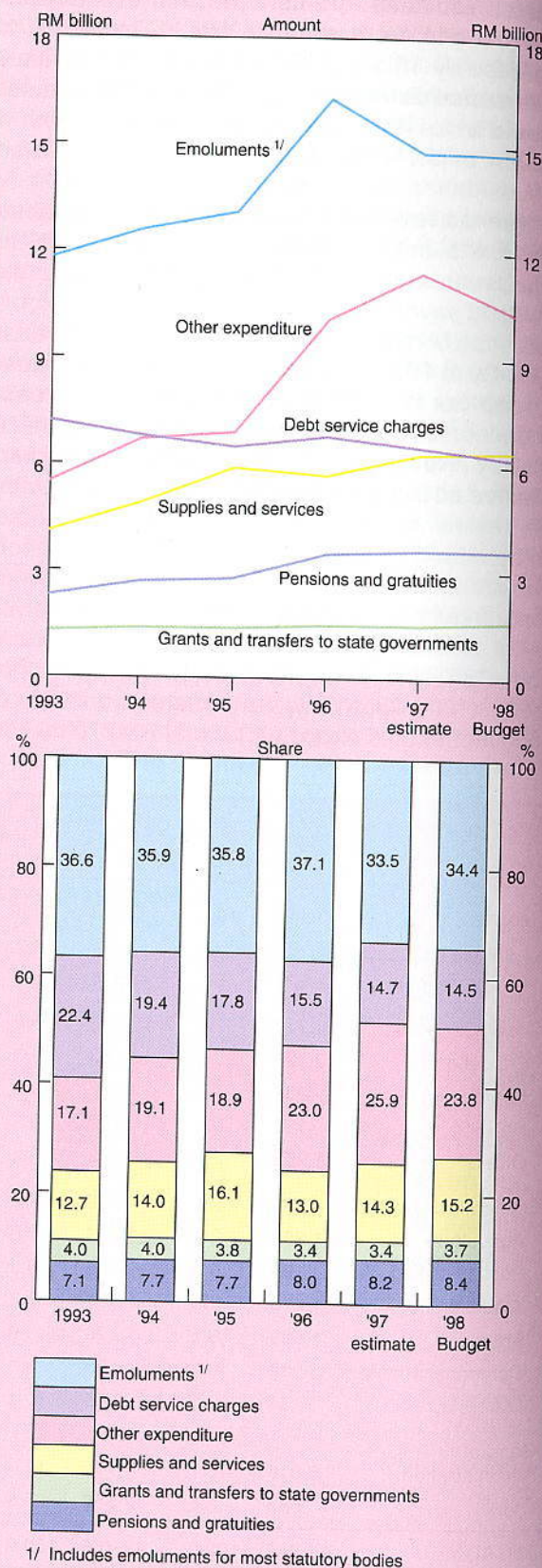
Grants and transfers to state governments are expected to increase by 5.1% to RM1,525 million in 1997, mainly due to higher allocation being provided for road maintenance grants, capitation grants and grant for common user departments. Road maintenance grants remains the largest component under this category of

Table 5.6

**Federal Government Operating Expenditure by Object
(RM million)**

	1997 Revised Estimate	% Share	1998 Budget Allocation	% Share
Emolument	14,807	33.6	14,743	34.5
Debt Service Charges	6,463	14.7	6,164	14.4
Grants to state governments	1,525	3.5	1,616	3.8
Pensions and gratuities	3,575	8.1	3,635	8.5
Supplies and services	6,309	14.3	6,474	15.1
Subsidies	934	2.1	895	2.1
Others	10,456	23.7	9,239	21.6
TOTAL	44,069	100.0	42,766	100.0

**Chart 5.4
Federal Government Operating Expenditure**



expenditure, amounting to RM516 million or 33.8% of the total as more roads are covered by the grants. Capitation grants and grant for common user department amount to RM202 million and RM182 million or 13.2% and 12%, respectively of the total amount of grants. Expenditure for **subsidies** is expected to increase by 9.9% to RM934 million. This is largely for the increase in subsidy for petroleum products and the paddy fertilizer scheme, which are estimated to increase from RM180 million and RM90 million in 1996 to RM228 million and RM133 million, respectively in 1997.

In terms of sectoral classification, total expenditure for most of the sub-categories except for general administration are expected to decline as shown in Table 5.7. The largest expenditure is for the social services sector which is expected

to decline by 0.3% to RM14,779 million. This accounts for 33.5% of the total operating expenditure. About 90.4% of the expenditure under this category is for the education and health sub-sectors. A sum of RM10,124 million or 68.5% is for education while another RM3,239 million or 21.9% is for health. These are largely for the emolument of teachers and medical staff as well as for supplies and services. Expenditure for the **economic services** sector is also expected to decline marginally by 0.3% to RM4,273 million. Within the economic sector, transport is the largest sub-sector accounting for 35.8% of the total, followed by agriculture and rural development 30.3% and trade and industry 29.9%. Expenditure for the security sector, accounting for 14.6% of total operating expenditure, which is mainly to cater for the purchase of supplies and services as well as for emolument is expected to decrease marginally by 3.1% to RM6,419 million. Of this expenditure, 59.2% is for the defense sub-sector while the balance is for internal security. In line with the government's emphasis on improving productivity and efficiency and increasing the use of information technology, expenditure for general administration is expected to increase by 16% to RM6,016 million or 13.7% of total operating expenditure in 1997 compared with 11.8% in 1996.

Table 5.7
Federal Government Operating
Expenditure by Sector
(RM million)

	1997 Revised Estimate	% Share	1998 Budget Allocation	% Share
Security	6,419	14.6	6,253	14.6
Defense	3,798	8.6	3,737	8.7
Internal security	2,621	6.0	2,516	5.9
Social Services	14,779	33.5	15,373	35.9
Education	10,124	22.9	10,383	24.3
Health	3,239	7.4	3,516	8.2
Housing	164	0.4	102	0.2
Others	1,252	2.8	1,372	3.2
Economic Services	4,273	9.7	4,039	9.5
Agriculture	1,296	2.9	1,182	2.8
Public utilities	105	0.2	110	0.2
Trade & industry	1,278	2.9	1,395	3.3
Transport	1,529	3.5	1,279	3.0
Communications	32	0.1	38	0.1
Others	34	0.1	35	0.1
General Administration	6,016	13.7	4,743	11.1
Other	12,583	28.6	12,358	28.9
TOTAL	44,069	100.0	42,766	100.0

Development Expenditure

The emphasis of development expenditure in 1997 continues to be on infrastructure and human resource development in order to increase the productive capacity of the economy. Total development expenditure is expected to increase by 7.9% to RM15,790 million. Significant increases are expected to be recorded in most sub-sectors particularly housing, public utilities, education, health and trade and industry, indicating that bigger amounts of money are being channeled to projects which will expand the economic base and upgrade infrastructure facilities and utilities so as to be able to sustain the nation's growth momentum.

About 33% of the total development expenditure will be utilised for infrastructure projects as shown in Table 5.8. The transport sub-sector will spend about RM4,162 million. A big portion of this or RM3,000 million is for roads and bridges and another RM899 million is for rail transportation. Under the road projects, a sum of RM2,438 million is for the construction of roads and bridges in

Table 5.8

Federal Government Development Expenditure for Economic Services
(RM million)

	1997		1998	
	Revised Estimate	% Share	Budget Allocation	% Share
Agriculture and rural development	1,237	16.1	1,262	14.3
Public Utilities	942	12.3	1,189	13.5
Trade and industry	1,306	17.0	1,532	17.3
Transport	4,162	54.2	4,800	54.4
Communications	5	0.1	16	0.2
Others	28	0.3	29	0.3
TOTAL	7,680	100.0	8,828	100.0

urban areas while RM482 million is for rural roads. In addition, road construction will be further accelerated through privatisation. These will include the Elevated Highway, the KL-Karak Highway, the Damansara-Puchong-Putrajaya and the Cheras-Kajang Road. In other sub-sectors, facilities at airports will be upgraded, particularly in Pulau Tioman, Langkawi and Tawau to cater for the expected increase in passenger traffic. Programmes for public utilities comprising the provision of water and electricity supply are expected to utilise another RM942 million, of which 81.7% is to be spent for water supply while another 18.3% is for electricity, particularly for rural electrification programmes.

In the agriculture sector, reflecting the Government's continued efforts to upgrade the standard of living of people in the rural areas, a sum of RM1,237 million is to be spent for agriculture and rural development, as shown in Table 5.9. The focus continues to be towards improving productivity and promoting modern agricultural practices. Programmes under land development, integrated agriculture development and drainage and irrigation will account for 60.1% of the expenditure on agriculture and rural development. Other programmes will include rubber replanting, livestock industries, fisheries and forestry.

Chart 5.5
Federal Government Development Expenditure by Sector

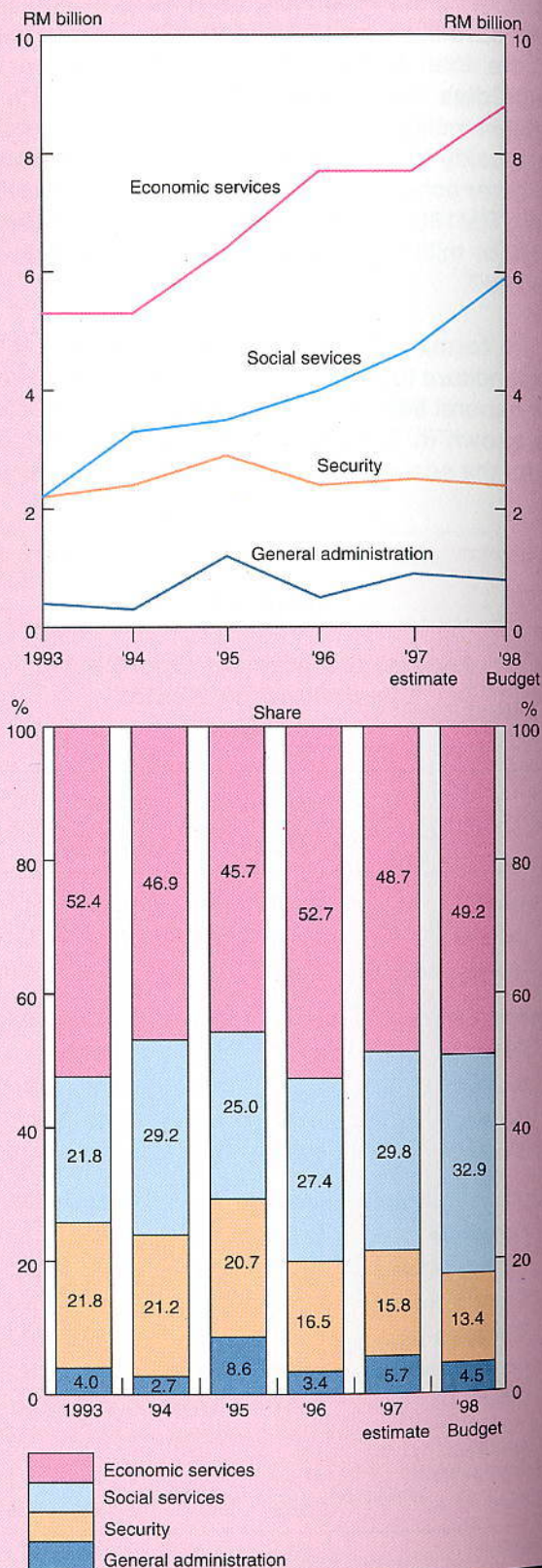


Table 5.9

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

	1997		1998	
	<i>Revised Estimate</i>	<i>% Share</i>	<i>Budget Allocation</i>	<i>% Share</i>
Agriculture	346	27	355	28.1
Land Development	153	12.4	70	5.6
Drainage and irrigation	245	19.8	346	27.4
Rubber replanting	179	14.5	119	9.4
Fisheries	105	8.5	115	9.1
Livestock	38	3.1	48	3.8
Forestry	33	2.7	44	3.5
Others	138	11.1	165	13.1
TOTAL	1,237	100.0	1,262	100.0

Trade and industry programmes will amount to RM1,306 million or 17 % of the allocation for the economic services sector as shown in Table 5.10. Of this total, about RM576 million or 44.1% is for industrial development, mainly in the form of loans and grants to government agencies and the NFPEs. In addition, the government will continue to place emphasis on technology infrastructure and research and development to support the development of the country's industrial technology capabilities. For this purpose, RM166 million will be spent for industrial research, particularly to develop and commercially exploit untapped research findings in the public sector research agencies and universities.

Development expenditure for the social services sector is expected to increase by 18.1%, with education accounting for the largest proportion, followed by health services, as shown in Table 5.11. Expenditure on education is expected to increase by 2.9% to RM2,235 million compared with an increase of 2.4% in 1996, reflecting the Government's commitment to increase the number of skilled and quality workforce to meet the manpower requirements of the country. The bulk of the expenditure is meant to increase the capacity

of existing institutions such as polytechnics, technical schools and institutions of higher learnings. Health sector development is expected to take up about RM521 million to further improve the health care and quality of life of the population. Health service will continue to be expanded, especially in rural areas, to increase the accessibility of the lower income group to better health facilities.

The provision of housing continues to be emphasised. In 1997, a sum of RM828 million is expected to be spent for the housing sub-sector, an increase of 65.2% over 1996. Expenditure for housing programmes for the armed forces and police personnel will amount to RM479 million, while expenditure on quarters for teachers in rural areas will amount to RM90 million. Another RM63 million is for low cost housing projects. Other programmes under the social services sector, such as for information and broadcasting, culture, youth and sport programmes and other social services, are expected to account for 23.8% of the total expenditure for the social services sector.

Expenditure for the security sector is expected to increase by 2.5% to RM2,498 million. Of this, RM2,098 million or 84% is expected to be spent by the defense sub-sector for the modernisation of the armed forces while the remaining RM401 million is for internal security, particularly for the Royal Malaysian Police to purchase equipment and construct police stations and training centres.

Table 5.10

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

	1997		1998	
	<i>Revised Estimate</i>	<i>% Share</i>	<i>Budget Allocation</i>	<i>% Share</i>
Industrial development	576	44.1	578	37.7
Tourism	490	37.5	144	9.4
Industrial research	166	12.7	740	48.3
Others	74	5.7	70	4.6
TOTAL	1,306	100.0	1,532	100.0

Table 5.11

**Federal Government Development
Expenditure for Social Services**
(RM million)

	1997		1998	
	<i>Revised Estimate</i>	<i>% share</i>	<i>Budget Allocation</i>	<i>% share</i>
Education	2,235	47.5	3,044	51.7
Health	521	11.1	743	12.6
Housing	828	17.6	750	12.7
Others	1,120	23.8	1,353	23.0
TOTAL	4,704	100.0	5,890	100.0

Expenditure for general administration is expected to increase from RM 513 million in 1996 to RM907 million in 1997. Of this, RM877 million is for the development of departmental services, construction of office buildings and the purchase of equipments while the remainder is for foreign affairs.

Financing

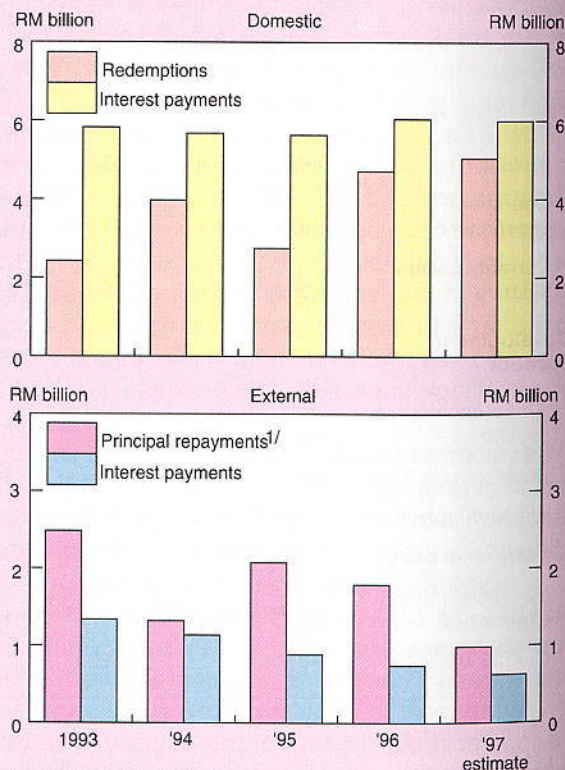
In 1997, operations of the Federal Government is expected to be financed fully from its revenue collection. The strong revenue growth coupled with fiscal prudence is expected to result in another surplus estimated to be at RM5.1 billion (1996: RM1.8 billion) in the Federal Government account. With this favourable financial position, there is no borrowing requirement expected for the Federal Government in 1997.

However, in undertaking to meet its monetary function especially the demand for government papers and to control excess liquidity in the financial system, the Federal Government is expected to raise a total of RM5,100 million in 1997 through the issues of Malaysian Government Securities (MGS). Of this amount, a total of RM5,048 million is for the redemption of existing instruments during the year, comprising RM3,648 million of MGS and RM1,400 million of Government Investment Issues (GIIs). No new issues of Treasury Bills (TBs) and GIIs are expected to be raised during

the year. Total net domestic borrowing of the Federal Government in 1997 is estimated at RM52 million compared with RM1,291 million in 1996.

The Government will continue to minimise its exposure to foreign exchange and interest rate risk by taking a cautious approach considering the present position of the ringgit against other currencies. Nevertheless, the favourable financial position would facilitate the Government to prepay some of its higher cost external loans. The Government has prepaid RM742 million of project loans and RM178 million of market loans in 1997. In terms of gross borrowing, apart from market loans, the Federal Government external borrowing comes mainly from the disbursement of existing project loans amounting to RM470 million. As a result, net external borrowings of the Federal Government is expected to record a smaller outflow of RM1,466 million compared with RM2,177 million in 1996.

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



State Governments

The financial position of state governments in 1997 is expected to weaken as its overall balance continues to worsen from a deficit of RM911 million in 1996 to a larger estimated deficit of RM1,526 million in 1997. **Revenue collection** is expected to increase by 1.3% after registering an increase of 8.6% in 1996. Operating expenditure is also expected to increase by 0.7% thus, leading to a current account surplus of RM3,422 million compared with RM3,352 million in 1996. However, development expenditure is expected to increase by 16.1% compared with 22.7% in 1996, contributing to the larger overall deficit of the consolidated state governments fiscal position.

Total revenue of the state governments is expected to decline in comparison with 1996 as contributions from their own source is expected

to be lower. State governments' **own source** revenue is expected to increase by 0.6% to RM6,948 million in 1997 or 81.4% of total receipts of state governments, compared with an increase of 9.7% in 1996. Own source is made up mainly of land and forestry based revenue. For the states of Sabah, Sarawak and Terengganu which are endowed with petroleum, petroleum royalty is also a major contributor to the state revenue. Higher revenue collections are expected in four states, namely Selangor, Johor, Sabah and Sarawak while the other states would record lower revenue figures. This is due to the weaker revenue collections of tax and non-tax revenue. Tax revenue, comprising direct tax and indirect tax accounts for 20.2% of the total state receipt and is expected to increase by 2.3% to RM1,725 million (1996: RM1,687 million). Non-tax revenue, comprising mainly of licence, royalty, service fees, land premium and return on investment accounted for 65.6% of the total state receipt. This revenue is expected to increase by 3.5% to RM5,594 million in 1997 (1996: RM5,406 million).

The other sources of revenue for State Governments are **grants and reimbursements** from the Federal Government. The contribution of Federal Government grants and reimbursements to the state governments' revenue could be small for some states but as large as 60% for others. As a group, total grants received from the Federal Government is expected to increase by 5.1% to RM1,525 million in 1997 compared with RM1,451 million in 1996. The increase is mainly due to the increase in road maintenance grant. Main components of the grants given to state governments are road maintenance grant (RM516 million), capitation grant (RM202 million) and revenue growth grant (RM147 million). Reimbursement from the Federal Government is expected to be lower in 1997, amounting to RM60 million compared with RM69 million in 1996.

Petroleum and forestry-based revenue remains as the largest resource-based revenue for state governments, accounting for about 37.7% of the states' own revenue source (1996: 34.3%). For some states, the contribution is much higher of up to 79% for 1997. Petroleum royalties are expected to decline by 10.3% to RM608 million in 1997 (1996: RM678 million), due to the anticipated lower price for crude oil in 1997. Terengganu is expected to receive RM416 million in petroleum royalty, accounting for about 76.3%

Table 5.12
Consolidated State Governments'
Financial Position
(RM million)

	1996 ¹	% Change	1997 ²	% Change
Current account				
Revenue	8,425	8.6	8,533	1.3
Operating expenditure	5,073	21.7	5,111	0.7
Current account balance	3,352	-6.6	3,422	2.1
Development account				
Gross development expenditure	4,594	14.8	5,266	14.6
Development fund	4,042	19.1	4,663	15.4
Water supply fund	552	-9.2	603	9.2
Loan recoveries	331	-37.4	318	-3.9
Net development expenditure	4,263	22.7	4,948	16.1
Overall balance	-911		-1,526	

¹ Estimated actual.

² Estimate.

of the state's own revenue. Petroleum royalties are lower for Sabah and Sarawak amounting to RM60 million (Sabah) and RM132 million (Sarawak), contributing to 3.9% and 5.9%, respectively to the state's own revenue. Forestry-based revenue is expected to increase from RM1,529 million in 1996 to RM1,859 million in 1997. Thus its contribution to the total state's own revenue increased to 26.8% (1996: 22.1%). For Sabah and Sarawak where forestry-based revenue is significant, revenue from forestry for Sabah is expected to increase by 50.1% to RM770 million (1996: RM513 million), while forestry revenue for Sarawak is expected to increase to RM970 million due to the higher production of sawn log, resulting from site preparation work for the Bakun Hydroelectric project.

Total expenditure of the state governments is expected to record an increase of 7.7% in 1997.

Operating expenditure is expected to increase slightly by 0.7% to RM5,111 million (1996: RM5,073 million). Emoluments, the single largest component in the current expenditure of all the states, is expected to decline by 4.8% in 1997 (1996: 32.7%). It will account for 30.3% of the total operating expenditure of the state governments. Expenditure on supply and services is expected to increase by 17.9% to RM1,703 million. **Development expenditure** of the state governments is expected to continue to increase in 1997 by 16.1% to RM4,948 million. In order to provide adequate, affordable, and quality homes, the state governments continue to allocate their expenditure for housing particularly for the lower income group. In 1997, the expenditure on housing is estimated at RM378 million (1996: RM364 million). Expenditure on water supply increase by 9.2% to RM603 million mainly for improvement of water supply services to support industrial growth and individual consumers.

Non-Financial Public Enterprises

In 1997, the consolidated financial performance of the **28 Non-Financial Public Enterprises (NFPEs)** is expected to record another year of strong growth with a current surplus estimated at RM22,856 million or 8.7% of GNP (1996: RM20,789 million) (see Table 5.13). Total consolidated revenue is expected to increase by

5.8% to RM65,543 million (1996: RM61,923 million) or 23.1% of GNP. Major contributors to the total revenue of NFPEs are PETRONAS, TNB and TMB contributing 67.5% to the total revenue of NFPEs in 1997 (1996: 69.6%).

Total **current expenditure** increased by 3.8% to RM42,687 million or 16.3% of GNP (1996: RM41,134 million). This increase is due to higher expenditure for business expansion, larger production cost as well as higher debt servicing expenses resulting from the large borrowing by NFPEs, especially from external sources, to finance their capital investment including foreign investment. Debt servicing of NFPEs is expected to be higher in 1997 due to larger amount borrowed as well as the impact of the ringgit depreciation against major currencies. Debt servicing is estimated to be about RM2.8 billion or 6.6% of the total operating expenditure of NFPEs.

The **capital expenditure** of NFPEs is expected to increase further in 1997 by 49.9% to RM22,670 million or 8.6% of GNP, largely on account of capacity expansion and modernisation programmes of several NFPEs, mainly those involved in infrastructure and utilities as well as in the oil and gas and manufacturing sector. Larger NFPEs such as PETRONAS, TNB, TMB and MISC account for the largest capital expenditure spending, amounting to RM20,410 million or 47.8% of total NFPEs capital expenditure in 1997 (1996: 31.2% or RM12,828 million). TNB is expected to further invest in power generation, transmission and distribution projects locally as well as power generation projects in Bosnia and Pakistan. TMB is also expected to make additional investments to enhance the local network as well as investment in switching, transmission and telecommunication infrastructure for the MSC projects. With these large capital investments, the consolidated overall account of the NFPEs is expected to record a smaller surplus of RM185 million in 1997 compared with a surplus of RM5,670 million in 1996.

The large capital investment by the NFPEs was financed mainly through external borrowings together with domestic borrowings and internally generated fund. In 1997, the total net external borrowing of NFPEs is expected to increase by 144% to RM7,045 million (1996: RM2,844 million),

Table 5.13

Consolidated NFPEs Financial Position¹
1996 - 1997
 (RM million)

	1996	% Change	1997	% Change
Revenue ²	61,923	17.5	65,543	5.8
Current expenditure	41,134	15.8	42,687	3.8
Retained income	20,789		22,856	
Development expenditure	15,119	8.6	22,670	49.9
Overall balance	5,670		185	

¹ Refers to 32 in 1995, 31 in 1996 and 28 in 1997 (PERNAS Edar, PERNAS International Hotel and PERNAS Trading has been excluded from the list following their corporatisation exercise)

² Includes grant from Federal Government.

largely raised through bond issues and offshore loans by the major NFPEs (TNB, PETRONAS and TMB). With this, the total external debt of NFPEs outstanding is expected to increase by 14.9% to RM33,600 million (1996: RM29,237 million). The Government will continue to closely monitor the investment activities and borrowings of NFPEs to ensure that they are consistent with the Government's policy of fiscal prudence.

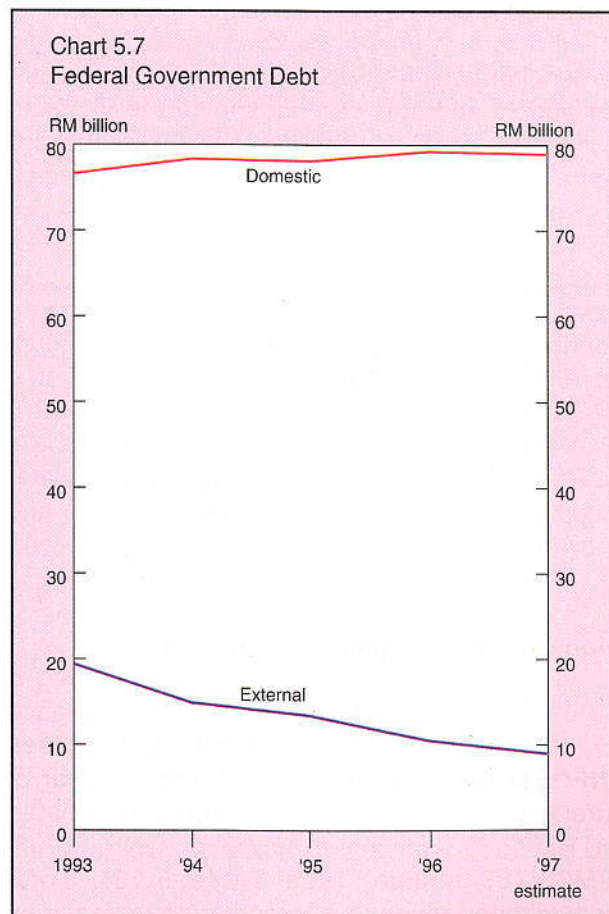
On privatisation, the Government continues to privatise and corporatise entities and projects as a means to improve efficiency and reduce the Government's financial burden. In 1997, Pemas International Hotel and Properties (PIHP) bought over all subsidiaries of PERNAS Holding through a Management Buy-Out (MBO) exercise. Another Government entity privatised in 1997 was the Sabah Electricity Board (SEB). It was sold to a consortium led by TNB. Major projects privatised during the year include the Express Rail Link (ERL) from the Kuala Lumpur International Airport (KLIA) in Sepang to the KL Sentral Station in Kuala Lumpur which costs RM1.79 billion and the Kajang - Seremban Highway (KASEH) costing to RM1.35 billion. In addition, the University of Malaya, the Federal Land Consolidation and Rehabilitation Authority (FELCRA) and the Maritime Academy have been corporatised in 1997.

National Debt

Continued recourse to external financing by NFPEs and the private sector has led to a further increase in the **national debt** by 11% to RM79,781 million (1996: RM71,907 million). However, its percentage to GNP increased slightly from 30.2% in 1996 to an estimated 30.4% in 1997.

The **public sector** external debt which is made up of the Federal Government and NFPEs external debt is expected to increase by 7.0% to RM42,481 million (1996: RM 39,707 million). The Federal Government's outstanding external debt which accounts for only 20.9% of the public sector external debt as compared to 26.4% in 1996, is expected to decline by 15.2% to RM8,881 million (1996: RM10,470 million). This is mainly due to the prepayment programme undertaken by the Federal Government. In relation to the national debt, the Federal Government's external debt accounts for only 11.1% of the total in 1997 against 14.6% in 1996. On the other hand, the continuing increase

Chart 5.7
 Federal Government Debt



in NFPEs external borrowing, averaging 16% for the period 1992-1997, has led to a further increase in the external debt of the NFPEs by 14.9% to RM33,600 million (1996: RM29,237 million). The increase in the public sector external debt is therefore, contributed solely by the higher external debt of the NFPEs. It accounts for 53.2% of the national debt.

Private sector external debt grew by 14.8% in 1996 to 15.8% in 1997, slightly higher than the growth rate of the NFPEs external debt in 1997 of 14.9%. In absolute terms, this is the largest increase among all the components of the national debt. Within a period of six years, the private sector external debt accounts for close to half of the national debt compared to only 15.4% in 1991.

The changing structure of the external liabilities is best reflected by the fact that almost 89% of the national debt is accrued to the external debt of the NFPEs (42.1%) and the private sector (46.8%). In contrast, in 1991 these two subsectors accounted for only 42% of the national debt. On the other hand, the external debt of the Federal Government has been declining since 1986.

The external debt is denominated in various currencies notably US dollars, Yen and some major European currencies. With the significant

depreciation in the ringgit, the exchange rate lost due to this on the national debt is estimated to be 1.9% of GNP.

With the increase in national debt, the **debt servicing** is also expected to be higher at RM16,153 million in 1997 (1996: RM15,974 million). Of this, RM4,098 million or 25.4% is for interest charges, RM11,135 million or 68.9% for repayment and RM920 million or 5.7% is for prepayment. Interest charges are expected to be higher in 1997 due to the large borrowings and the impact of depreciation of ringgit against major currencies. Increases in repayment are due to larger number of loans that mature in 1997. The **national debt service ratio** is expected to increase to about 6.0% compared with 5.7% in 1996.

Federal Government Debt

Federal Government debt is expected to decline by 2.1% to RM87,770 million (33.5% of GNP) in 1997 from RM89,681 million (37.7% of GNP) in 1996. This can be attributed mainly to the strong Federal Government's financial position that has enabled it to fully finance its operation and at the same time, be able to retire early some of its higher cost loans.

Table 5.14

National Debt

	1996			1997		
	RM Million	% Change	Share	RM Million	% Change	Share
Public sector	39,707	-2.5	55.2	42,481	7.0	53.2
Federal Government	10,470	-21.5	14.6	8,881	-15.2	11.1
NFPEs	29,237	6.7	40.7	33,600	14.9	42.1
Guaranteed	6,976	-21.3	9.7	7,049	7.7	8.8
Non-guaranteed	22,261	20.1	31.0	26,551	17.0	33.3
Private sector	32,200	14.8	44.8	37,300	15.8	46.8
TOTAL	71,907	4.5	100	79,781	11.0	100

External debt of the Federal Government is expected to decline by 15.2% to RM8,881 million or 3.4% of GNP (1996: RM10,470 million or 4.4% of GNP), mainly due to the prepayment programme undertaken by the Federal Government amounting to RM920 million. As most new borrowings are disbursement of existing projects loan and existing market loans are being prepaid, the market loans represents a larger proportion (50.8%) of the total Federal Government external debt. The remaining 49.2% are project loans. In contrast, when the Government first initiated the prepayment programme in 1987, 17.8% were projects loans and 68.6% market loans. As for currency profile of the loans, US dollar denominated debt is still the biggest proportion of the Federal Government external debt, accounting for 57.5% of total the Federal Government external debt (1996: 47.8%), amounting to a ringgit equivalent of RM5,103 million. The Yen denominated debt, however, is expected to decline by 31.9% (1996: 38.1%), amounting to a ringgit equivalent of RM2,834 million. The depreciation of ringgit against the US dollar would have some adverse impact and it

is estimated that at the current outstanding amount a 10% ringgit depreciation would increase the Federal Government external debt by about RM550 million.

Total domestic debt is expected to decline by 0.4% to RM78,889 million or 30.1% of GNP, accounting for 90% of the total Federal Government debt. MGS and TBs remain the major components of domestic debt accounting for RM68,362 million (or 86.7% of total domestic debt) and RM4,320 million (or 5.5% of total domestic debt), respectively. Other holdings of domestic debt are GILs and loans for the Treasury Housing Loans Fund, amounting to 7.9% of the total domestic debt outstanding.

The Federal Government is expected to spend RM12.7 billion on **debt servicing (interest payment and repayment)**, a decline 4.8% over the 1996 position. Of this total, 87.3% or RM11 billion is expected to be utilised for servicing domestic debt while the remaining is for the external debt. The Federal Government's **debt service ratio** remains low at 0.6% in 1997(1996:1.1%).

Chart 5.8
Federal Government External Debt by Source

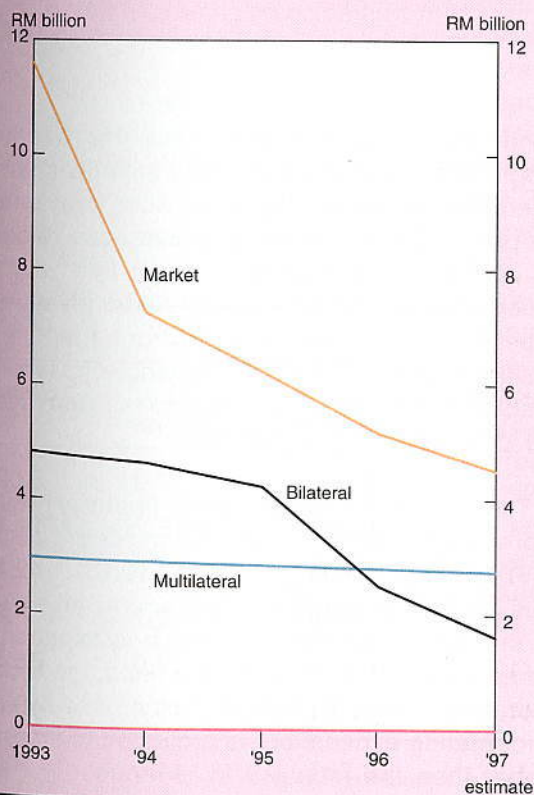


Chart 5.9
Federal Government External Debt by Currency

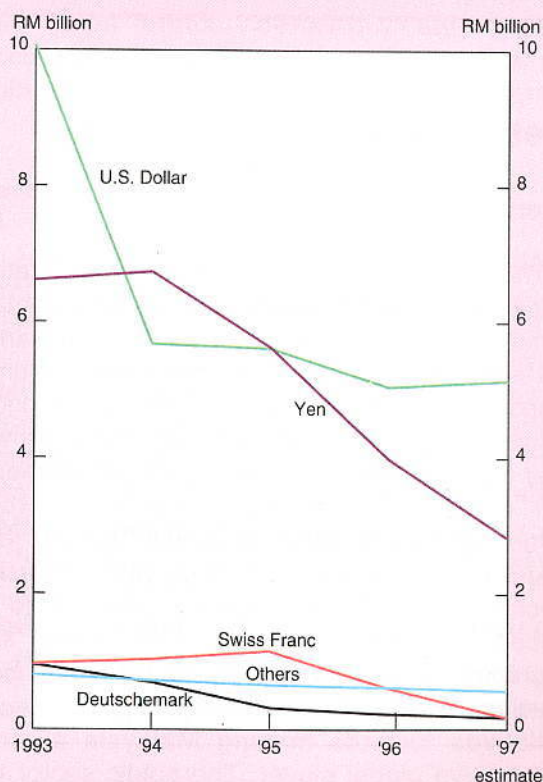


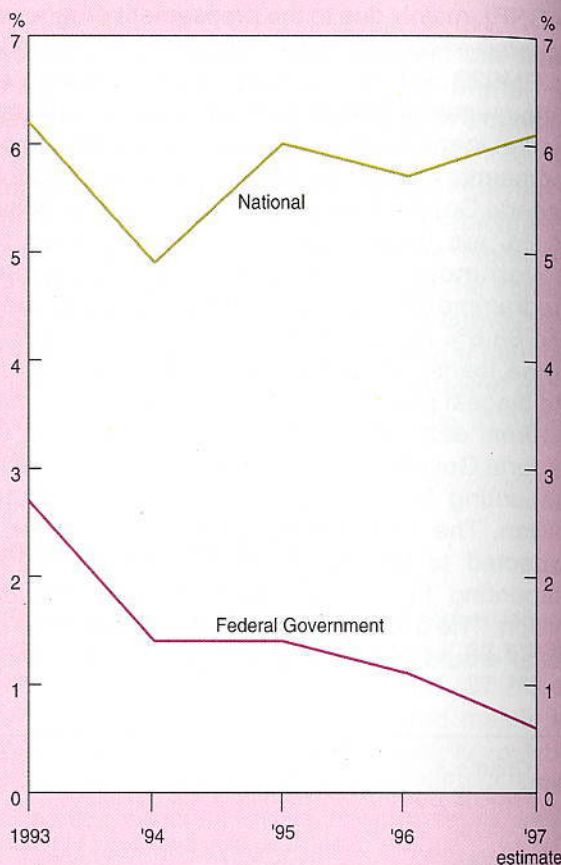
Table 5.15

Federal Government Debt (RM million)

Debt profile	1996	% Share	1997	% Share
Domestic debt	79,211	100.0	78,889	100.0
Treasury bills	4,320	5.5	4,320	5.5
Investment certificates	4,150	5.2	2,750	3.5
Government securities	66,910	84.5	68,362	86.7
2 - 3 years	1,000		1,000	
4 - 5 years	4,600		4,600	
6 - 10 years	13,086		11,486	
11 - 15 years	13,750		13,450	
16 - '21 years	34,474		37,826	
Other loans ¹	3,831	4.8	3,457	4.4
External debt	10,470	100.0	8,881	100.0
Market loans	5,159	49.3	4,511	50.8
Project loans	5,311	50.7	4,370	49.2
TOTAL	89,681		87,770	

¹ Mainly loans undertaken by the Treasury Housing Loans Fund.

Chart 5.10
External Debt Servicing Ratio



1998 Outlook

Overview

The policy of fiscal prudence and consolidation as part of the macro economic strategy to contain demand and price pressures will be maintained in 1998. Continued fiscal discipline and prudence in spending will provide the economy with a stronger foundation to attain sustained economic growth over the long term. Selective public investments will continue to be necessary to improve infrastructure and other essential facilities and assist in accelerating productivity and increasing efficiency. Special emphasis will continue to be placed on programmes that will enhance skill upgrading, capital deepening and technological development, in order to support the private sector initiatives towards making Malaysia a more competitive global player. The public sector will

continue to implement current improvement programmes and introduce new initiatives aimed at enhancing the quality of services provided to the public. While emphasising budgetary restraint on operating expenditure to be in line with the policy of fiscal prudence, public sector investment expenditure will take into account the overall position of public finance, the balance of payments position and the capacity of agencies to implement the development programmes.

The consolidated public sector financial position is projected to record another large current surplus of RM55,450 million in 1998 or 19.5% of GNP. This can be attributed to a higher current surplus by the general government which is expected to increase by 28.5%. On the other hand, the NEPEs operating surplus is projected to increase by 4.5% as operating expenditure is projected to increase higher than the increase in revenue.

Total public sector development expenditure in 1998 is projected to increase by 6.5% to RM44,664 million. Of this, RM21,400 million or 48% will be spent by the general government while another 52% by the NFPEs. The increase in the general government development expenditure is attributable to the larger estimates for the Federal Government development expenditure allocated for new projects. However, the large increase in the Federal government development expenditure will be partly offset by a lower increase in capital outlay of the NFPEs. Hence, higher the overall financial position of the public sector will show a higher surplus of RM10,786 million or 3.8% of GNP in 1998.

Federal Government

Prudent budgetary operations in line with the need to further strengthen macroeconomic fundamentals together with good revenue performance projected in 1998 will contribute to a strong outturn in the Federal Government's finance for 1998. The Federal Government's financial position is projected to record a larger overall budget surplus of RM8,951 million or 3.2% of GNP compared with RM5,066 million expected in 1997. Federal revenue is projected to grow by 7.6% to RM68,058 million, mainly due to expected higher receipts from both direct and indirect taxes as well as non-tax revenue. Due to the need to tighten fiscal aggregates, operating expenditure¹ is expected to decline by 3% to RM42,766 million, compared with an increase of 0.5% in 1997. The Government will allow for selective increases in the development budget so as to sustain the momentum of economic growth. This strong revenue performance coupled with the small increase in operating expenditure will yield a substantially larger current account surplus of RM25,292 million or 8.9% of GNP in 1998. Gross development expenditure is expected to increase by 13.9% to RM17,991 million in 1998. After taking into account loan recovery from the state governments and public agencies, projected at RM1,650 million, net development expenditure in 1998 is projected to increase by 15.6% to RM16,341 million.

Priority for development expenditure in 1998 will continue to be on infrastructure and human resource development with the objective of enhancing productivity, efficiency and competitiveness of the economy. To achieve this, a well developed and integrated infrastructure and utilities network is essential. To further improve the effectiveness and efficiency of government services, the government is emphasizing greater use of computer and information technology. Besides the general computerisation programme, the government is also a key player in the Multimedia Super Corridor (MSC) in which one of the flagship applications is the Electronic Government. For this purpose, five pilot applications have been earmarked. These include Electronic Delivery of Driver and Vehicle Registration Licensing and Summons Services, Electronic Procurement, Prime Minister's Office-Generic Office Environment, Human Resource Management Information System and Project Monitoring System. The quality of the workforce will continue to be upgraded through human resource development programmes while research and development efforts will continue to be enhanced. In addition, the government will continue to give emphasis on development of the rural areas. Efforts to promote the development of a caring society that has good ethical behaviour and greater accountability together with positive social and spiritual values will continue to be implemented.

Revenue

As the Malaysian economy is projected to remain strong, the Federal Government's revenue for 1998, excluding the implications of the 1998 tax changes, is projected to increase by 7.6% to RM68,058 million compared with an increase of 8.6% in 1997. The stronger growth is essentially from tax and non-tax revenue. On a broader front, total tax revenue collection is projected at RM55,543 million or 81.6% of total revenue. Out of this amount, collection from direct taxes is estimated at RM31,456 million or 46.2% of the total tax revenue while indirect taxes is projected at RM24,087 million.

¹ excluding transfer to development fund, contribution to sinking fund and loan repayments.

industries. In this regard, greater emphasis will be given to technology development and acquisition, commercialisation of R&D and upgrading industrial infrastructure. Of the total, about RM578 million or 37.7% will be spent on industrial development, while a sum of RM740 million has been allocated for industrial research.

An allocation of RM5,890 million will be provided for the social services sector. Of this amount, a total of RM2,485 million will be spent for construction and upgrading of primary and secondary schools, polytechnics, teachers training colleges, industrial training institutes and campuses for institutions of higher learning. In addition, a sum of RM192 million will be spent for construction of new industrial training institutes and upgrading the existing institutes. This reflects the continued commitment by the Government to promote human resource development so as to meet the skilled manpower needs of the country. The allocation for health services will increase by 42.6% to RM743 million. This larger allocation is mainly for the construction of new hospitals, upgrading health centres and rural clinics and for the improvement of health facilities in Government hospitals. The allocation for housing will amount to RM750 million. About RM320 million of this will be spent on housing

projects for the armed forces, the royal police and the government quarters for its staff serving KLIA. Another RM148 million will be for the construction of low cost housing while RM90 million will be for teachers quarters. A sum of RM522 million will be spent for culture, youth and sport programmes, of which RM285 million is for the 1998 Commonwealth Games. About RM801 million will be allocated for other social services and welfare projects.

Allocation for the security sector is estimated to be to RM2,433 million, decline of 2.6%. About 83% of the allocation will be used for defence purposes to upgrade and modernise equipment. The balance will be for internal security, particularly for projects undertaken by the Royal Police Department such as construction of new police stations.

The allocation for **general administration** accounts for RM840 million or 4.7% of the total development allocation in 1998. A sum of RM150 million will be used for electronic government while RM198 million for information technology. The remainder is for buildings maintenance and for foreign affairs.