2 Managing the Malaysian Economy in 2000

Introduction

When the 2000 Budget was tabled in October 1999, the economy had just turned around to register positive growth, after five preceding consecutive quarters of negative growth. The strong turnaround, beginning the second quarter of 1999, reflected largely the comprehensive policies that the Government had in place to engineer the recovery and expedite economic activities as well as financial and corporate restructuring. Macroeconomic management then was aimed at fine tuning monetary and fiscal policies to ensure that they continued to support the economic recovery. To contain the internationalisation of the ringgit and, thereby, speculation as well as to minimise the impact of short-term capital flows on the domestic economy, selective exchange controls were introduced in September 1998, which also provided flexibility in the choice of appropriate monetary and fiscal measures. As economic growth was just picking up momentum, expectations then were that the economy would recover to register real Gross Domestic Product (GDP) growth of 4.3% for 1999 and 5% in 2000. When the 2000 Budget was retabled on 25 February 2000, following the dissolution of Parliament in November 1999, these estimates were revised upwards to 5.4% and 5.8%, respectively, given the improvements registered in the external environment and strengthening of domestic economic activities. Based on growth registered in the first half of 2000, the expansion in real GDP is currently estimated at 7.5%.

At the time when the Budget was first presented, there existed considerable uncertainty about the external environment. Prospects for growth in the major industrial countries, in particular the United States and Japan, remained unclear while the recovery of regional economies was fragile and hinged on the speed with which they could restructure their economies. On the domestic front, indications were that domestic demand, in particular that of the private sector, was not strong enough to support growth and excess capacity continued to prevail in some industries. In such an environment, the broad thrust of policies outlined in Budget 2000 was directed at stimulating domestic aggregate demand, primarily through the fiscal stimulus while maintaining an accommodative monetary policy to support growth. In addition to measures to promote new sources of growth and develop skilled manpower to ensure a conducive environment for growth, various policies aimed at enhancing the competitiveness and resilience of the economy to external risks were also introduced.

The thrust of fiscal policy in the 2000 Budget remained expansionary, aimed at stimulating domestic private demand. The counter-cyclical stance of fiscal policy was into its third year of expansion, in line with the need to provide further growth impetus to the economy to ensure the sustainability of the economic recovery. The expansionary policy was designed to support economic activities that could further strengthen economic recovery, enhance the nation's resilience and competitiveness, expedite the restructuring of the financial and corporate sectors as well as promote environmental and social well-being. Although fiscal policy was expansionary, the Government continued to be committed to fiscal prudence to ensure long-term sustainability. In this regard, the current account remains in surplus with the overall deficit at a sustainable level.

To support the expansionary fiscal stance in providing a conducive growth environment, monetary policy continued to focus on supporting economic recovery. In an environment of subdued inflation and ample liquidity in the banking system, following the continued favourable performance of the balance of payments, interest rates remained low. Given the need to maintain a balance between stimulating economic expansion and ensuring positive real interest rates to sustain the nation's savings level, interest rates for deposits were raised. In line with efforts to increase lending to support the economic recovery, net lending activities of banking institutions expanded, trending upwards since February 2000. In the first eight months of 2000, loan approvals registered significant growth and loan disbursements continued to increase. Lending by banking institutions was supplemented by a significant increase in the issuance of private debt securities (PDS), reflecting a positive trend in overall lending and the success of efforts aimed at developing the corporate bond market as an alternative to traditional bank lending.

The Malaysian economy has strengthened considerably since Budget 2000 and the nation's macroeconomic fundamentals continue to improve as growth becomes more entrenched and broad-based. This was underpinned not only by the favourable performance of the external sector, in particular exports of electronic products, but also by the strengthening of domestic demand conditions. The favourable external environment, stable conditions in the financial markets as well as the supportive stance of both monetary and fiscal policies continued to contribute to improving confidence in the economy. Consequently, the favourable environment and improving confidence levels prompted an encouraging response from the private sector, as evident in the positive trends emerging in regard to domestic aggregate demand. Government policies aimed at enhancing competitiveness, resilience of the economy to external risks, new sources of growth and human resource development have also contributed to ensuring a conducive environment for growth in 2000.

Fiscal Policy

Given the need for a continuation of fiscal stimulus to support domestic aggregate demand, the overall deficit of the Federal Government was initially set at 4.5% of GNP. After taking into account supplementary allocations for operating and development expenditure, mainly for education and the salary adjustment for civil servants, the fiscal deficit was revised to 5.9% of GNP. Despite this, the deficit remains within prudential levels. The 2000 Budget also introduced various tax and non-tax fiscal incentives aimed at stimulating domestic spending, strengthening competitiveness and resilience of the economy and enhancing private sector activities in selected sectors. Tax measures introduced were aimed at improving tax buoyancy in the medium term through a rationalisation of the tax structure.

In terms of priority in budgetary allocations, spending was focused on improving the productive capacity of the economy in the longer term. Fiscal measures included selective increases in infrastructure spending, the setting up of funds to support small-and medium-sized enterprises (SMEs), and the provision of higher allocations for the development of the education and other social sectors. While the fiscal stance remained expansionary, the Government continued to emphasise fiscal discipline and prudence to ensure long-term growth sustainability. In this regard, the Government ensured that the current account of the Federal Budgetary position remains in surplus while the financing of the overall budgetary deficit was from non-inflationary domestic sources.

To achieve the maximum desired results, the spending priorities of the Government in Budget 2000 continued to focus on programmes capable of generating high multiplier effects without creating price pressures. Projects that were selected had the potential to increase the productive capacity of the economy, including infrastructure development, education and training as well as health services. In addition, social projects such as low- and medium-cost housing, rural development and agriculture were also given due importance to ensure the continuation of socio-economic balance in the development process.

Total operating expenditure, targeted to increase by 24.6%, was aimed at enhancing public and private sector consumption given the need to support the recovery of domestic aggregate demand, which was then, still lower than that prevailing in the pre-crisis period. This was necessary not only to generate greater consumer confidence and a more positive private sector response to Government measures but also to ensure a broad-based economic recovery, thereby, reducing the reliance on external demand to support the recovery.

Development expenditure was increased in line with the continued fiscal expansion programmes in order to further strengthen the economic recovery. Total development expenditure, including supplementary allocations approved during the year, increased by 11.8% to RM25,286 million in 2000 compared with RM22,615 million in 1999. The bulk of development expenditure was allocated for the economic sectors, with the transport and trade and industry sub-sectors receiving the highest proportion. Expenditure on the social sectors, notably for health and education, was also large reflecting continued Government efforts to improve the social well-being of the people, particularly those belonging to the lower income groups. During the course of the year, expenditure on education was raised by an additional RM3,000 million largely for the implementation of the single session school programme and computer laboratories in schools reflecting Government's strong commitment to human resource development and the transition to a knowledge-based economy (K-economy).

The fiscal stimulus played a pivotal role in resuscitating the economy, both in 1999 and 2000. In 1999, the contribution of the public and private sector to GDP growth was 4 percentage points and negative 2.3 percentage points respectively. The external sector contributed 4.1 percentage points. In 2000, despite the fiscal stimulus, the contribution of the private sector to GDP growth is expected to be more significant, at 9.3 percentage points compared with that of the public sector (2.8 percentage points). Confidence in the sustainability of the recovery, due largely to the contribution of the fiscal stimulus in supporting growth has, therefore, stimulated the encouraging response and contribution of the private sector to growth.

Despite the fiscal stimulus, the overall fiscal deficit remains at a sustainable level. The deficit continues to be largely financed from domestic non-inflationary sources, while care was taken not to crowd out private sector's access to funds. The nation's low debt exposure to external borrowing, subsequently, provided fiscal flexibility, thereby limiting the nation's exposure to foreign exchange and interest risks.

Monetary Policy

The basic thrust of monetary policy in the first nine months of 2000, was to continue to ensure that the environment remained conducive for economic recovery and continued financial and corporate sector restructuring. Monetary policy stance, therefore, remained accommodative, unchanged since the easing which began in the third quarter of 1998 as part of the overall national economic recovery effort to stimulate the growth momentum. A continuation of this stance was appropriate given that inflation remained subdued, the financial sector continued to strengthen while the balance of payments position continued to be favourable. Monetary policy continued to focus on managing the liquidity position to ensure that the persistent ample liquidity did not fuel inflationary pressures. During this period, deposit rates were maintained at levels sufficient to provide a positive real rate of return of depositors.

Reflecting the monetary stance, the 3-month Bank Negara Malaysia (BNM) intervention rate which was last adjusted in August 1999, remained unchanged at 5.50%. The persistent ample liquidity in the banking system, maturing of deposits with higher costs and greater competition in lending activities, particularly among the commercial banks led the average base lending rates (BLR) to decline to an all time low of 6.75% since mid-May 2000. BLR of finance companies breached the historical low of 8.40% registered at end-1994 to stand at 7.95%. Deposit rates, similarly, declined further in the first seven months of 2000 given the downward pressure exerted by the situation of ample liquidity. The 3-month fixed deposit rates of both commercial banks and finance companies declined to 3.26% and 3.30%, respectively, at end-July 2000 from 3.75% and 3.80%, respectively, at end-July 1999. In August, however, banking institutions raised deposit rates aimed at ensuring that the low interest rate regime did not unduly affect those dependent on interest from savings as their main source of income. Following the increase, the 1-month to 12-month fixed deposit rates now range between 3.44% and 4.10% at end-September 2000 (3.20% and 3.90% at end-July 2000), ensuring a reasonable positive rate of return to sustain the nation's level of savings. The increase in deposit rates did not lead to an increase in lending rates, given that banking institutions were able to absorb the increase, following the strengthened position of banking institutions on account of profitability and stronger demand for loans.

In tandem with the expansion in economic activities, lending activities of the banking system picked up in the first eight months of 2000. Loan approvals registered a significant increase of 24.7% to a monthly average of RM10,848 million in the first eight months of 2000 compared with RM8,697 million per month in 1999. Loan disbursements, likewise, continued to increase, averaging RM28,786 million a month compared with the RM26,526 million monthly average registered in 1999. Total loans outstanding, however, registered an annual growth of 3.6% at end-August 2000, given the continuing high repayments, averaging RM28,170 million in the first eight months (1999: RM27,744 million a month). Deposits with the banking system increased by 2.5% as at end-August. Consequently, reflecting the higher increase in loans relative to deposits, the loan-deposit ratio increased from 83.2% at end-1999 to 84.6% at end-August 2000. Although lending by the banking institutions only increased moderately in the first eight months of 2000, it was supplemented by the 171.4% increase in total PDS outstanding compared with the same period last year. The banking system continued to remain strong. The risk-weighted capital ratio of the banking system improved to 13.1% at end-August (end-August 1999: 12.9%). The net non-performing loans (NPL) ratio (based on 6-month classification) was 6.9% at end-July (end-July 1999: 7.9%) down from a peak of 9.0% at end-November 1998.

With regard to selective exchange control measures instituted in September 1998, the Government continued to simplify the procedures aimed at enhancing implementation efficiency. Effective 27 July 2000, travelers were no longer required to complete Travelers' Declaration Forms subject to specific conditions. To facilitate declaration, simplified declaration forms would be issued for resident travelers while that of non-residents would be incorporated into the Embarkation Card issued by the Immigration Department.

Financial Sector Reform

Given the role and importance of the banking system in the economic recovery process, the Government adopted a comprehensive pre-emptive approach to strengthen resilience of the banking sector aimed at preventing the emergence of a systemic crisis as well as maintaining public confidence. This included the establishment of an asset-management company, *Danaharta,* a special purpose recapitalisation agency, *Danamodal* and the Corporate Debt Restructuring Committee (CDRC) to facilitate corporate debt restructuring. Significant progress has been made in regard to the restructuring process, which is currently ahead of schedule and at lower cost than had been earlier anticipated.

In the course of 2000, significant progress was achieved in financial sector restructuring. As at end-August 2000, loans acquired and managed by *Danaharta*, amounted to RM46,785 million of which RM38,610 million was from the banking system, constituting 43.2% of NPLs of the banking system. *Danaharta* became increasingly focused on loan and asset management activities. Loan workouts, involving 2,450 borrowers, were initiated and three tender exercises on foreclosed properties and foreign loans assets were launched. As at end-August, loans or assets totalling RM21,567 million had been restructured or disposed with an average recovery rate of 75%. *Danamodal* had injected a total of RM7,590 million into 10 banking institutions. With improving economic circumstances, five banking institutions have repaid their loans. As at end-August 2000, the amount of capital injected was reduced to RM4,860 million.

In June 2000, the Government launched the Enterprise Programme, a special programme aimed at expediting the resolution of NPL problems of SMEs. This programme complements the various mechanisms that are in place to assist SMEs affected during the crisis to accelerate debt restructuring. The programme provides additional financing that will facilitate borrowers with credit facilities in a number of banking institutions to restructure their loans. It wil also enhance the viability of SMEs in the long term.

Financial sector reform continued to be undertaken as part of the move to develop a core group of resilient and dynamic domestic banking institutions capable of competing in a dynamic environment of technological change as well as increasingly diverse and sophisticated consumer demands. The merger programme for domestically controlled banking institutions represents a key element in overall financial sector reform. To encourage banking institutions to merge, several incentives, comprising exemption from stamp duty and real property gains tax as well as tax allowance on 50% of the accumulated losses of banking institutions to be acquired, were provided. Under the merger programme, 53 banking institutions currently in operation, will be merged into 10 major groups, with all but one comprising a commercial bank, a merchant bank and a finance company. As at end-August 2000, all merger partners had successfully concluded merger negotiations and signed Sales and Purchase Agreements, thereby, qualifying them to enjoy the merger incentives accorded by the Government. To ensure that the consolidation effort will not be delayed, a target date of end-December 2000 has been set for all domestic banking institutions to complete the consolidation exercise.

BNM has also embarked on the formulation of a long-term Financial Sector Master Plan. The main thrust of the Financial Sector Master Plan, is to develop a core of strong and forward-looking domestic banking institutions and to chart strategic directions for the industry in the next decade. BNM is also undertaking initiatives on a number of fronts to improve supervision and regulation. The overall regulatory framework, in the context of the Financial Sector Master Plan, is expected to address issues, among others, of the need to inculcate sound and effective risk management, further developing the risk-based capital adequacy framework, develop a system for prompt corrective actions as well as putting in place measures to limit the Government's financial guarantee for deposits.

Capital Market Developments

In ensuring that the capital market is well-placed to cope with the challenges associated with globalisation and liberalisation, a number of new initiatives are being pursued to complement existing measures. In April 2000, the Government announced the policy framework for consolidation of the 62 stockbroking companies as a follow-up to earlier initiatives to encourage mergers. The objective of the consolidation is to form a group of well-capitalised Universal Brokers that will not only provide efficient and cost-effective services for investors but are strong enough to withstand the risks associated with the stockbroking industry and competitive pressures arising from globalisation and liberalisation. The consolidation of the industry is to be market driven and flexibility is provided for stockbroking companies to find their own partners. Stockbroking companies, not wishing to be accorded the benefits accruing to Universal Brokers will remain as Niche Brokers.

Tax incentives were also provided in Budget 2000 to provide the impetus for the consolidation of the stockbroking industry. These incentives include tax credit to be utilised within two years for 50% of the accumulated losses carried forward and stamp duty and real property gains tax exemption for all stockbroking companies which have executed firm agreements for mergers of at least four stockbroking companies by end-2000. Those not merging before the deadline but before end-2001 will still qualify for the tax incentives. The rewards will, however, be lower as the utilisation period for the tax credit will be limited to one year as opposed to two years. As an additional incentive, effective 12 June 2000, Universal Brokers are allowed to operate an additional branch at any location subject to the approval of the Securities Commission (SC).

To create a more competitive capital market that will benefit investors, SC also announced in April 2000, the liberalisation of transaction costs that will be implemented in two stages. The first stage, which takes effect from September 2000, will see commission rates for all trades above RM100,000 become fully negotiable while commissions for trades below RM100,000 will be subject to a cap of 0.75%. In Stage 2, beginning 1 July 2001, commission rates will be fully negotiable for all trades subject to a cap of 0.7%. Other fees and levies, including clearing fees and SC levy will also be reduced concurrently.

In efforts to consolidate the fragmented insurance industry into large and well-capitalised insurers capable of meeting the challenges of globalisation as well as increasing domestic demand for insurance services, higher capital and solvency margin requirements have been introduced as well as the provision of an incentive package. As at September 2000, five mergers involving 10 insurance companies have been completed, with 15 more companies at various stages of merging.

In going forward, the Government initiated in 1999, subsequent to the announcement in Budget 2000, the development of a strategic long-term plan for the Malaysian capital market. The Capital Market Master Plan will provide a comprehensive and cohesive plan for charting the strategic positioning and future direction of the capital market over the longer term.

Development of the Corporate Bond Market

Another step which was taken during the recent financial crisis to further strengthen the stability of the financial system was to reduce the over reliance on the banking system to finance economic activities. As a measure to diversify the sources of financing away from the banking sector, thereby, mitigating systemic risks, measures were accelerated to further develop the corporate bond market and to enhance its role as a financier of domestic economic activities. Aside from establishing the National Bond Market Committee, the Government made SC the single regulatory authority over the corporate bond market in Budget 2000.

Efforts to further develop the corporate bond market have achieved considerable progress. Primary issues relating to the rationalisation of the regulatory framework governing corporate bonds and the corporate bond issuance process have been addressed. This is in line with the need to increase the supply of corporate bonds in the market.

In rationalising the regulatory framework, the basic issue of overlapping regulatory requirements from multiple regulatory authorities was addressed given that the lengthy and fragmented approval process discouraged issuers from taking advantage of market conditions to issue bonds. To address these weaknesses, amendments were made to the Securities Commission Act (SCA), 1993, Banking and Financial Institutions Act, 1989 and Companies Act, 1965 which came into effect on July 2000. These amendments effectively centralised the approval process over prospectus and debenture requirements with SC, introduced a disclosure-based scheme of regulation, imposed higher statutory responsibilities on trustees for debenture issues and set a minimum content level for all trust deeds as well as removed the requirement to seek BNM’s approval for debt issuance.

SC also introduced several guidelines and regulations to ensure that the new regulatory framework was facilitative, transparent, cost efficient and effective. Guidelines for the issuance of PDS were introduced, effective 1 July 2000, to provide a facilitative and efficient approval process for all debt proposals. As a measure to widen the issuer base and broaden the spectrum of instruments, an Asset-backed Securitisation Consultative Committee was established and a set of guidelines are expected to be introduced in the last quarter of 2000. To complement the new legislative framework, SC also issued guidelines on minimum content requirements for trust deeds and prospectus as a result of amendments to SCA, 1993 and the Companies Act, 1965. Effective July 2000, regulations to shelf registration were introduced to allow for multiple bond issues within a period of two years on a single application to SC.

The Malaysian Government Securities (MGS) has been identified as the benchmark necessary for the development of a benchmark yield for the bond market. The Government, therefore introduced a benchmark programme involving regular issuance of large benchmark tranches, instituting a pre-announced auction calendar, buying back off-the-run issues and removing curbs on corporate repo transactions. In March 2000, the Government Securities Auction Calender for 2000 was announced, aimed at enhancing transparency and facilitating the formulation of investment strategies by investors.

Further, in regard to exchange control requirements, the general permission of the Controller of Foreign Exchange will be granted to resident and non-resident controlled companies seeking to issue corporate bonds, subject to the condition that the proceeds are not utilised to invest abroad or refinance offshore borrowing as well as meeting other conditions on the issuance of PDS. This decision came into effect in August 2000. Given the significant and far reaching steps taken to develop the corporate bond market, interest in financing activities through the corporate bond market has been on the rise as evident from recent trends to finance activities through the bond market.

Corporate Sector Reform

The improving economic circumstances, in particular strong external demand, improving asset prices, low interest rates and on-going debt restructuring, contributed to improving corporate performance and profitability since the crisis. Debt restructuring has been undertaken through the sale of NPLs to *Danaharta*, voluntary out-of-court restructuring under CDRC and restructuring or liquidation through the courts. As at end-August

2000, CDRC successfully completed 38 cases involving RM25,693 million. Of these, 29 cases involving RM23,879 million or 38.7% of the total distressed debts were restructured while nine cases with debts of RM1,814 million were transferred to *Danaharta.* Other debts amounting to RM16,343 million are being reviewed while 17 cases totaling RM3,903 million were rejected. Operational restructuring has also occurred consequent to the asset rehabilitation process under *Danaharta*, elimination of non-core activities under CDRC and debt restructuring under Section 176 of the Companies Act, 1965.

Significant progress continued to be achieved in implementing the recommendations of the Finance Committee on Corporate Governance. In regard to law reform, the first phase of changes to the law has been completed and the most recent law reform package came into force in July 2000 after amendments to SCA, 1993 and the Companies Act, 1965 to harmonise the regime for the regulation of prospectus and trust deeds. The new law clearly delineates the responsibilities of SC and the Registrar of Companies. The second phase of amendments, expected to be completed by end-2000, will include, among others, codification of key duties of directors and provisions to curb controlling shareholders' rights to vote in related-party transactions. Aside from updating rules and regulations to ensure international best practices, amendments were also made to KLSE's listing requirements, including stricter reporting requirements and policy on suspension of trading which are expected to be implemented before end-2000. The final version of the Malaysian Code of Corporate Governance has also been released and companies, with financial year ending end-June 2001 onwards, will have to report on the extent to which they have complied with the Code. In addition, KLSE introduced a new rule to require mandatory accreditation of directors and for directors to attend training programmes as a prerequisite to listing.

The Knowledge-based Economy

In line with developments in the global environment, Malaysia recognises the need to transform the economy to a knowledge-based economy to take advantage of the opportunities created by new information and communications technology (ICT). The K-economy presents a strategy to generate and exploit knowledge to create new value in the economy, thereby contributing to increasing total factor productivity (TFP) and raising the long-term growth potential of the economy. Delay or failure to make this transition may leave Malaysia, an essentially small and open economy, behind as other more agile and technology-oriented economies move ahead. As it stands, the Malaysian economy lags behind in computer infrastructure, research and development as well as technology and in technical and K-skills.

Recognising the need to overcome the present challenges in making the shift, the Government in presenting Budget 2000 announced the need for the paradigm shift and initiated the development of the National K-economy Master Plan. Following this announcement, a Steering Committee on K-economy was established, chaired by the Ministry of Finance with representation from key private and public economic agencies and institutions. This Steering Committee was tasked with the development of the National K-economy Master Plan.

The National K-economy Master Plan, currently being developed, will be holistic in approach and will outline the choice of key strategies to transform Malaysia into a highly competitive and resilient economy. In addition to strategies to ensure the increasing application of knowledge in the production process in all sectors of the existing production-based economy, it will also outline strategies to ensure accelerated development of viable knowledge-empowering and enabling industries and profitable as well as high value - added knowledge-intensive industries. In drafting the National K-economy Master Plan, the contribution of all segments of society is being tapped to ensure ownership of the Plan to reflect a national consensus on the objectives and choice of strategies. To elicit the views of different segments of society, a National K-economy Youth Congress was held in April 2000 and currently, seminars are being conducted at the state level to garner relevant views. Such seminars have, to date, been held in Sarawak, Negeri Sembilan, Terengganu, Perlis, Kedah, Sabah and Kelantan. An International K-economy Symposium was also held in May 2000 to share the experiences of countries like Finland, Ireland, Korea, New Zealand and Singapore, in their move to K-economy status. The K-economy Master Plan is targeted to be completed by end-2000. A National Strategic Plan, a series of Plans of Action in Key Strategic Areas as well as Sectoral Studies in key sectors, are also being concurrently developed.

Financing New Activities and Small and Medium Scale Enterprises

Financing the development of new high technology and knowledge-based activities and ideas-based start-up SMEs will require different and more creative modes of funding. Traditional bank lending, based on collateral may not be forthcoming, for activities based on promising ideas or intangible collateral. To close the financing gap in order to accelerate the transformation to a K-economy, the Government provided assistance to venture capital companies (VCCs) to enable them to play a bigger role in supporting economic growth. In the Budget 2000, a fund totaling RM500 million was provided, of which RM200 million was channeled to *Bank Industri dan Teknologi Malaysia Berhad*. BNM and two commercial banks, namely *Maybank Berhad* and *Bumiputra-Commerce Bank Bhd*., provided a fund of RM300 million to finance VCCs. This is in addition to the capital being provided to 30 existing VCCs. *Perbadanan Usahawan Nasional*, Mayban Ventures Sdn. Bhd., Pica (M) Corporation Bhd. and PFM Capital Holdings Sdn. Bhd. are among the major providers of venture capital in the market.

In addition to the funds provided, various incentives were also given to VCCs in Budget 2000. These incentives were provided for loans to ICT companies as well as for commercialisation of agricultural research by local research institutions such as Malaysian Agriculture Research & Development Institute (MARDI). VCCs were given full tax exemption on all sources of income received during their life span or for a period of 10 years, whichever is earlier. VCCs must, however, invest 70% of its funds in promoted activities and used for purposes of seed capital, start-up capital and first-stage financing.

Modern and competitive SMEs can play an expanded role in contributing more significantly to domestic demand and the export market. In Budget 2000, the Government allocated RM200 million and RM100 million for 1999 and 2000, respectively, under the Credit Guarantee Corporation (CGC) to facilitate the access of loan facilities for small businessmen . The RM200 million Fund for Small and Medium Industries 2, set up to promote SMEs with linkages to export oriented industries and managed by CGC came into effect on 15 April 2000. In addition, RM76.7 million was provided for easy credit facilities for SME entrepreneurs, construction of infrastructure facilities, development of technology and assistance in the promotion of Malaysian products overseas. At the same time, the Government also set up the Entrepreneurs Rehabilitation Fund II with a sum of RM300 million in Budget 2000.

To assist small- and medium-scale *Bumiputera* enterprises, the Government established the *Tabung Projek Usahawan Bumiputera* in February 2000. The allocated fund of RM300 million by BNM is for small- and medium-scale *Bumiputera* entrepreneurs and wholly-owned *Bumiputera* companies which were awarded viable contracts or projects by the Government and its agencies and utilised solely for working capital.

Capacity Building to Meet the Challenges of Liberalisation and Globalisation

The liberalisation and globalisation process will present challenges to the achievement of the nation's development goals. In preparing to face the challenges ahead, the National Committee on Building National Capacity was established. This Committee, which will function for at least two years, will serve as a policy-making body to the Government in considering current, medium and long-term issues. To assist the National Steering Committee, a National Consultative Group has been set up, comprising Government and non-Government representatives, aimed at providing policy inputs on issues for the consideration of the National Steering Committee.

Various World Trade Organisation (WTO) issues are currently being studied, including those on agriculture and services, WTO Trade-related Investment Measures and Trade-related aspects of Intellectual Property Rights agreements. To date, several seminars and workshops have been held to take stock of existing issues on liberalisation and globalisation and identify relevant strategies to manage the challenges as well as utilise the opportunities of the globalisation process.

Conclusion

Policies implemented by the Government in the last two years and in Budget 2000 have contributed to a sustained and broad-based economic recovery.

While the recovery was export-led at the beginning of the economic turnaround, growth has, since, become more broad-based with domestic demand underpinning growth in various sectors of the economy, following policies to promote industries with strong intersectoral linkages. Domestic demand has responded to expansionary monetary and fiscal policies and tax breaks to complement the performance of the external sector. Better economic prospects and strong recovery in incomes also lent support to the marked strengthening of private sector demand, particularly consumption expenditure. Investor confidence continued to strengthen and contributed to building the foundations for long-term economic growth. Similarly, progress in financial sector rehabilitation and consolidation, corporate sector restructuring and on-going accelerated efforts to broaden and deepen the capital market have been very encouraging.

Given these trends, Malaysia's GDP is expected to remain strong as new sources of growth, particularly in the services sector and new ICT and knowledge-based activities, begin to pick up amidst subdued inflationary pressures. The merchandise surplus is anticipated to remain satisfactory, as exports continue to expand with the expected sustained external demand for the rest of the year. Higher import growth is also expected to be registered. This, together with a widening services deficit, is expected to lead to some deterioration in the external payments current account position, as a percentage of GNP in 2000. Despite these developments, a comfortable surplus is still projected for the current account of the balance of payments this year. Recent trends also indicate some pick-up in foreign direct investment which, if maintained, will further strengthen prospects for stronger economic growth. At the same time, as the stimulus for future growth is more forthcoming from the private sector, the Federal Government is expected to reduce its expansionary stance, thereby, further strengthening the foundations of macroeconomic stability.