

Public Sector Finance

Overview

When the 2001 Budget was formulated in October 2000, the economy had registered two years of strong growth since the financial crisis. However, since the beginning of 2001, growth decelerated significantly on account of weakening external demand. The deterioration in external environment and its adverse impact on the domestic economy necessitated the Government to increase the size of its fiscal stimulus in 2001 in order to generate growth.

The fiscal expansion, comprising higher expenditure and greater tax incentives was aimed at providing the stimulus for the expansion of domestic consumption and investment. The lower interest rate regime, stable exchange rate condition, strong balance of payments position and low external debt as well as subdued inflationary environment have enabled the Government to continue pursuing budgetary expansion for the fourth consecutive year without putting pressure on prices and undermining medium- and long-term growth potentials.

TABLE 5.1
**Consolidated Public Sector Financial Position
2000-2002**

	RM million			Change (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002
General government						
Current account						
Revenue	75,480	83,466	87,821	6.3	10.6	5.2
Operating expenditure	64,440	69,523	73,817	19.6	7.9	6.2
Current account balance	11,040	13,943	14,004	-35.6	26.3	0.4
Current surplus of NFPEs ⁴	37,032	41,453	32,998	10.5	11.9	-20.4
Public sector current balance	48,072	55,396	47,002	-5.1	15.2	-15.2
Development expenditure	52,668	61,129	59,327	8.7	16.1	-2.9
General government	27,124	30,350	29,841	29.4	11.9	-1.7
NPFES	25,544	30,779	29,486	-7.1	20.5	-4.2
Overall balance	-4,596	-5,733	-12,325	-309.2	24.7	115.0
% to GDP	-1.3	-1.7	-3.3			

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

⁴ Excludes grants from Federal Government.

While fiscal policy has remained expansionary, the Government is committed to maintaining fiscal prudence and financial discipline in managing its finance in order to ensure continued sustainability of its financial position. In this respect, the Government has not compromised in ensuring that revenue is sufficient to meet operating expenditure. At the same time, the overall budget deficit is maintained at a sustainable level without jeopardising the prospects of long-term growth. In addition, with priority given to financing of the deficit largely from domestic non-inflationary sources, external debt and debt servicing ratio of the Federal Government continue to remain low.

Public Sector

Federal, state and local governments, statutory bodies and Non-Financial Public Enterprises (NFPEs) continue to record a surplus in the current account. This was largely due to improved revenue performance of NFPEs, primarily Petrolam Nasional Berhad (PETRONAS) following sustained high petroleum and liquefied natural gas prices. Given the better revenue performance, the overall deficit of the public

sector is estimated to remain low at 1.7% of GDP despite significant increase in development expenditure of both the Federal Government and NFPEs, as shown in *Table 5.1*.

Federal Government

The current account of the Federal Government is expected to remain in surplus at RM7,879 million, despite the large increase in operating expenditure, mainly on account of better revenue performance. It also reflects the Government's continued commitment to ensuring surpluses in its current account. After taking into consideration development expenditure, the overall financial position of the Federal Government is expected to record a deficit of 6.5% of GDP, higher than 5.8% recorded in 2000, as shown in *Table 5.2*. The increased deficit is largely on account of additional fiscal stimulus in response to the growing difficulties in the external sector. Apart from containing and minimising the adverse spillover effects from the deteriorating global economy, the stimulus package is also aimed at cushioning the poor and the less fortunate from the economic slowdown.

TABLE 5.2

Federal Government Financial Position 2000-2002

	RM million			Change (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002
Revenue	61,864	69,011	73,400	5.4	11.6	6.4
Operating expenditure	56,547	61,132	65,342	21.2	8.1	6.9
Current balance	5,317	7,879	8,058	-55.6	48.2	2.3
Gross development expenditure	27,941	32,058	28,382	23.6	14.7	-11.5
Less: Loan recoveries	2,909	1,800	1,700	152.5	-38.1	-5.6
Net development expenditure	25,032	30,258	26,682 ⁴	16.6	20.9	-11.8
Overall balance	-19,715	-22,379	-18,624	107.8	13.5	-16.8
% to GDP	-5.8	-6.5	-5.0			

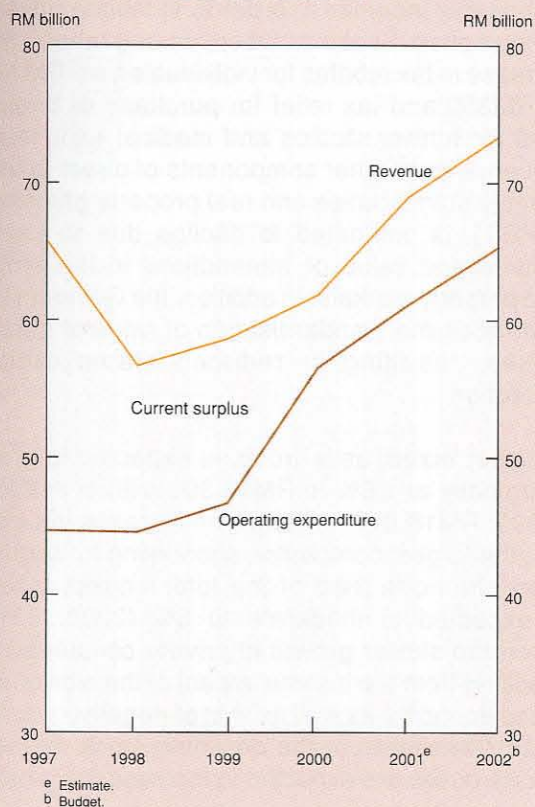
¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

⁴ Excludes contingency fund of RM2,000 million.

CHART 5.1
Federal Government Finance -
Current Account



Revenue

The revenue performance for 2001 is commendable, growing at 11.6%, the highest level since the financial crisis despite slower economic growth and weak external demand, as shown in *Table 5.3*. The improved revenue performance was largely due to improved corporate and petroleum income tax as well as higher dividend receipts from PETRONAS.

Direct taxes, as a group, continues to be the largest contributor to total revenue with corporate and petroleum income taxes expected to record significant increases compared with other direct taxes, as shown in *Table 5.4*. Higher crude petroleum prices, which increased 66.7% from an average of USD18 per barrel in 1999 to USD30 per barrel in 2000 has contributed to significant increase in petroleum income tax. Corporate income tax is also expected to increase due to better performance of companies and smaller impact on current year profits from carried forward losses as most of the losses were offset in year 2000. In addition, a part of corporate tax payable in 2000 was collected in 2001 as instalment payment was allowed during the transition period, following the introduction of the current year assessment system introduced in 2000.

TABLE 5.3

Federal Government Revenue 2000-2002

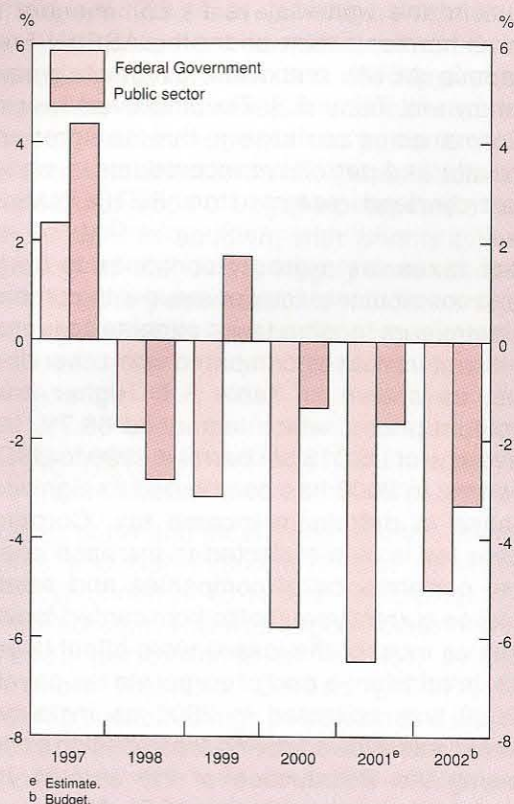
	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Tax revenue	47,173	52,556	56,388	4.0	11.4	7.3	76.3	76.2	76.8
Direct tax	29,156	34,256	36,801	7.0	17.5	7.4	47.1	49.6	50.1
Indirect tax	18,017	18,300	19,587	-0.5	1.6	7.0	29.2	26.5	26.7
Non- tax revenue	14,691	16,455	17,012	10.2	12.0	3.4	23.7	23.8	23.2
Total revenue	61,864	69,011	73,400	5.4	11.6	6.4	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

CHART 5.2
Percentage of Overall Deficit/Surplus to
Gross Domestic Product



The increase in individual income tax is marginal, resulting from the tax concessions and rebates granted in the 2001 Budget, aimed at increasing disposable incomes in order to stimulate private consumption. These included, among others, the increase in tax rebates for individuals from RM110 to RM350 and tax relief for purchase of books, fees for further studies and medical expenses. Revenue from other components of direct taxes, namely stamp duties and real property gains tax (RPGT), is estimated to decline due to lower volume and value of transactions in the stock and property markets. In addition, the Government undertook the standardisation of rates of stamp duties, resulting in reduced stamp duties collection.

Indirect taxes, as a group, is expected to grow marginally at 1.6% to RM18,300 million in 2001 (2000: RM18,017 million). The increase in sales tax, the largest contributor, accounting for slightly more than one third of the total indirect taxes, is expected to moderate to 5% (2000: 33%) given the slower growth in private consumption resulting from the income impact of the slowdown in the economy as well as that of negative wealth effects arising from the declining stock market. Excise duties are expected to increase marginally

TABLE 5.4

**Federal Government Direct Tax
2000-2002**

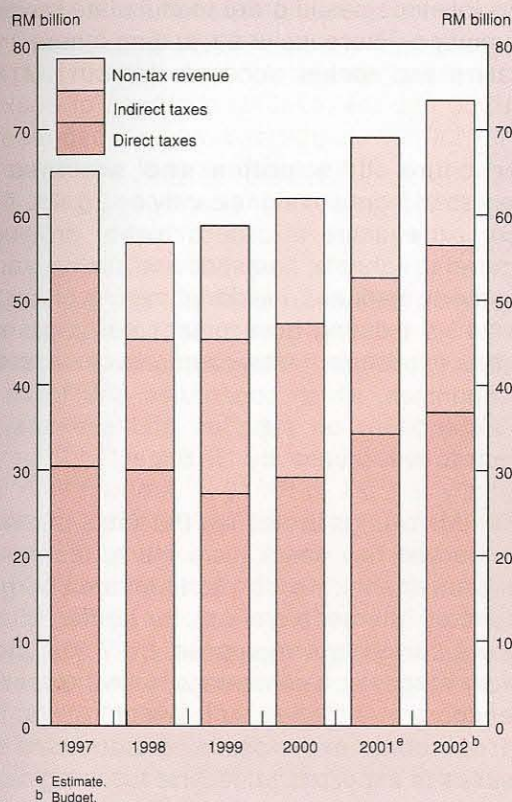
	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Income taxes	27,017	32,444	34,881	7.4	20.1	7.5	92.7	94.7	94.8
Companies	13,905	16,862	18,818	-11.7	21.3	11.6	47.7	49.2	51.1
Individuals	7,015	7,277	8,045	9.3	3.7	10.6	24.1	21.2	21.9
Petroleum	6,010	8,220	7,926	110.4	36.8	-3.6	20.6	24.0	21.5
Co-operative	87	85	92	-38.7	-2.3	8.2	0.3	0.2	0.2
Others	2,139	1,812	1,920	2.4	-15.3	6.0	7.3	5.3	5.2
Stamp duties	1,799	1,500	1,607	14.9	-16.6	7.1	6.2	4.4	4.4
Others	340	312	313	-34.8	-8.2	0.3	1.1	0.9	0.9
Total	29,156	34,256	36,801	7.0	17.5	7.4	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

CHART 5.3
Major Components of Federal Government Revenue



by 3% due to continued good sales performance in motor vehicles. Import duties, which contribute 18.1%, on the other hand, are expected to decline in line with Malaysia's commitment to customs harmonisation under the ASEAN Free Trade Area (AFTA). In addition, to promote greater efficiency and modernisation as well as lowering the cost of doing business in the transport and distribution system, several products such as prime movers and trailers in the haulage industry as well as machinery and equipment for the plantation industry, were given import duties and sales tax exemption. The decline in import duties is, to some extent, offset by increased collection from excise duties and sales tax on account of better collection from motor vehicles segment as well as further increase in sales tax on cigarettes, tobacco and alcoholic beverages in line with policies to promote a healthy life style and to combat social ills. Export duties, which is largely derived from petroleum export (97.8%), is also expected to increase marginally in line with sustained high petroleum prices. Collection of service tax remains at about the previous year's level.

Non-tax revenue, which includes receipts from investment income, licences and permits as well as petroleum royalties and dividends, is expected

TABLE 5.5

**Federal Government Indirect Tax
2000-2002**

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Export duties	1,032	1,052	1,016	54.0	1.9	-3.4	5.7	5.7	5.2
Import duties	3,599	3,318	3,511	-23.8	-7.8	5.8	20.0	18.1	17.9
Excise duties	3,803	3,916	4,110	-19.5	3.0	5.0	21.1	21.4	21.0
Sales tax	5,968	6,269	6,840	33.0	5.0	9.1	33.1	34.3	34.9
Service tax	1,701	1,734	1,956	16.6	1.9	12.8	9.4	9.5	10.0
Others	1,914	2,011	2,154	-6.2	5.1	7.1	10.7	11.0	11.0
Total	18,017	18,300	19,587	-0.5	1.6	7.0	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

to grow strongly by 12%, contributing to about one quarter of total revenue, as shown in Table 5.6. The increase in non-tax revenue is largely due to higher investment income and receipts from licences and permits. The improved corporate performance of government companies, in particular PETRONAS, has contributed to higher investment income as well as increases in petroleum royalties. The increase in revenue from licences and permits is contributed by buoyant sales of motor vehicles, which accounted for more than half of the revenue in this category.

Operating Expenditure

The expenditure for operational and administration purposes is expected to register a lower rate of increase of 8.1%, (2000: 21.2%), as shown in Table 5.7. The slower increase is on account of the reduction in the provision for subsidies (-14.2%) largely for petroleum products and refunds. Excluding these, operating expenditure is expected to increase by 11.9%.

To further improve the welfare of civil servants, allowances for selected categories of essential public services were increased. The increase in allowances is for the police, armed forces, fire service personnel, nurses and doctors, principals

and head masters and retired army personnel in recognition of their contribution to society and the nation. Hence, **emoluments**, the single largest component in operating expenditure, is expected to register an increase of 3.4%. Emoluments for teachers and nurses accounts for 60% of the total.

Expenditure for **supplies and services** is expected to increase significantly by 35.6%. The higher expenditure is due to higher provision allocated to schools, hospitals and clinics, youth skill training institutes, industrial training institutes as well as existing government buildings and facilities. In addition, rental payments of ministries and agencies, which constitutes one tenth of the expenditure on supplies and services, is expected to increase by 37.8%.

Higher borrowings to finance the fiscal stimulus over the last few years have led to increased interest payments. Hence, **debt service charges** comprising interest payments for domestic and external borrowings increased by 7.9%. Debt service charges as a percentage to total operating expenditure is, however, still low at 16% of the total operating expenditure. Expenditure for subsidies is expected to decline following price increase of petroleum products effective October 2000 and the decline of crude petroleum price, which reduced the quantum of subsidy payments.

TABLE 5.6

Federal Government Non-Tax Revenue 2000-2002

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Licences/permits	5,548	5,792	6,061	20.3	4.4	4.6	37.8	35.2	35.6
Services/fees	576	530	567	26.0	-8.0	7.0	3.9	3.2	3.3
Investment income	7,384	8,928	9,093	5.4	20.9	1.8	50.3	54.3	53.5
Others	1,183	1,205	1,291	-5.7	1.9	7.1	8.0	7.3	7.6
Total	14,691	16,455	17,012	10.2	12.0	3.4	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

TABLE 5.7
Federal Government Operating Expenditure by Object
2000-2002

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Emoluments	16,357	16,921	17,581	13.3	3.4	3.9	28.9	27.7	26.9
Debt service charges	9,055	9,768	9,429	14.0	7.9	-3.5	16.0	16.0	14.4
Grants to state governments	2,077	2,161	1,959	37.3	4.0	-9.3	3.7	3.5	3.0
Pensions and gratuities	4,187	4,891	4,556	10.4	16.8	-6.8	7.4	8.0	7.0
Supplies and services	7,360	9,983	11,763	21.2	35.6	17.8	13.0	16.3	18.0
Subsidies	4,824	4,137	4,719	324.6	-14.2	14.1	8.5	6.8	7.2
Grants to statutory bodies ⁴	4,016	5,196	5,749	-18.2	29.4	10.6	7.1	8.5	8.8
Refunds	2,382	1,783	2,352	38.7	-25.1	31.9	4.2	2.9	3.6
Others	6,289	6,292	7,234	21.4	0.0	15.0	11.2	10.3	11.1
Total	56,547	61,132	65,342	21.2	8.1	6.9	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

⁴ Includes emoluments.

TABLE 5.8
Federal Government Development Expenditure by Sector
2000-2002

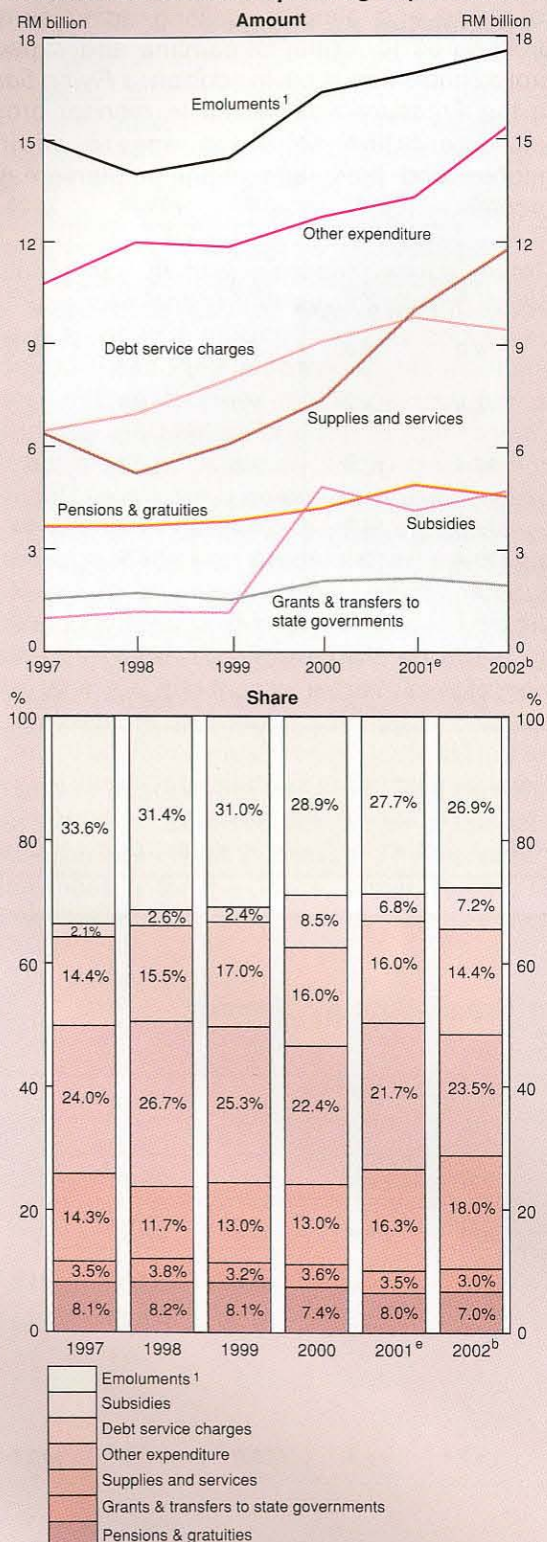
	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Social services	11,076	14,618	10,992	59.7	32.0	-24.8	39.6	45.6	38.7
Economic services	11,639	11,614	11,798	29.8	-0.2	1.6	41.7	36.2	41.6
Security	2,332	2,842	2,980	-25.3	21.9	4.9	8.3	8.9	10.5
General administration	2,894	2,984	2,612	-19.3	3.1	-12.5	10.4	9.3	9.2
Total	27,941	32,058	28,382	23.6	14.7	-11.5	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

CHART 5.4
Federal Government Operating Expenditure



Development Expenditure

In line with fiscal expansion, development expenditure is expected to increase significantly by 14.7%, as shown in *Table 5.8*. While higher development spending is provided to stimulate domestic aggregate demand in the short-term, the thrust of the expenditure is also focussed on human resource development as well as industrial and physical infrastructure to ensure sustainable growth in the long-term.

In the course of the year, given the stronger-than-expected slowdown of the US economy, an additional RM3 billion pre-emptive allocation was introduced in March 2001 to mitigate the negative impact on domestic economic activities. Specifically, the additional fiscal stimulus package was for the construction of single-session schools, community colleges, universities, housing quarters for armed forces as well as oil palm replanting subsidies and special assistance to rubber smallholders. In view of the slow implementation of projects under the pre-emptive package, the Government has further approved RM1 billion for small projects that can be implemented immediately both in the rural and selected urban areas.

The September 11 attack on the US and its adverse impact on the global economy further necessitates the Government to implement another stimulus package of RM4.3 billion in September 2001 to contain and minimise the negative spillover effects from the deteriorating global economy. Apart from adding further stimulus to domestic economic activities, the package was also aimed at cushioning the poor and other less advantaged segments of the society from the impact of the economic slowdown, generating business and income opportunities for small enterprises as well as providing skill training for retrenched workers and unemployed graduates. The package also provides for the doubling of current rates of welfare payments, upgrading and maintenance work on government buildings and facilities, additional computer laboratories in 2,000 schools, monthly allowance for degree and diploma holders to learn IT, mathematics and languages, training of retrenched workers and the promotion of tourism.

To expedite the implementation process of development projects, a number of administrative measures were undertaken. Towards this end, the Treasury has empowered ministries and agencies with bigger financial authority. Tender boards at the ministerial and departmental levels can now approve tenders of up to RM50 million for works and RM30 million for supplies and services. The tender boards are also allowed to approve restricted tenders of up to RM5 million. For quotations, authority has been delegated to ministries to approve up to RM200,000. For statutory authorities, the ceiling for the approval of tender awards for all supplies, services and works has been increased to RM100 million while for restricted tenders, they have been given authority of up to RM10 million.

In order to accelerate project implementation as well as reduce processes, the Government appointed project management consultants (PMCs) to supervise public sector projects. Projects were also awarded on turnkey and design-and-build basis to shorten processing time as well as expedite project completion. Contractors are also required to commence work immediately after the award of tender while payment procedures to main contractors and sub-contractors for work done have been simplified

to expedite the implementation process. Meanwhile, the Ministry of Finance will continue to revise and simplify existing administrative procedures to further streamline and expedite project implementation. In addition, a *Flying Squad* in the Treasury was set up to monitor project implementation so as to ensure minimal hitches and time lags in the implementation process.

Reflecting the importance of human resource development and its role in the new economy as well as efforts to promote better quality of life, expenditure on **social services** is projected to surpass economic services as the largest component of total development spending, constituting 45.6%, as shown in *Table 5.8*. The expenditure on **education** is expected to increase by 35.7% to RM9,630 million in line with the objective to inculcate a knowledge-based economy and to narrow the digital divide. Major projects include the construction and upgrading of schools, polytechnics and computer laboratories. Larger allocations are also given for scholarships for higher education as well as for the National Higher Education Fund to provide loans for students in institutions of higher learning. The expenditure on **housing**, amounting to RM1,922 million, is for low-cost public housing

TABLE 5.9
**Federal Government Development Expenditure
for Social Services
2000-2002**

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Education	7,099	9,630	5,905	83.7	35.7	-38.7	64.1	65.9	53.7
Health	1,272	1,098	1,273	52.2	-13.7	15.9	11.5	7.5	11.6
Housing	1,194	1,922	1,820	10.5	61.0	-5.3	10.8	13.1	16.6
Others	1,511	1,968	1,994	30.8	30.2	1.3	13.6	13.5	18.1
Total	11,076	14,618	10,992	59.7	32.0	-24.8	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

TABLE 5.10

**Federal Government Development Expenditure for
Economic Services
2000-2002**

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Agriculture and rural development	1,183	2,314	2,942	8.7	95.6	27.1	10.2	19.9	24.9
Public utilities	1,517	878	2,503	-18.0	-42.1	185.1	13.0	7.6	21.2
Trade and industry	3,667	4,380	2,414	31.1	19.4	-44.9	31.5	37.7	20.5
Transport	4,863	3,986	3,514	68.1	-18.0	-11.8	41.8	34.3	29.8
Communications	228	12	52	-20.9	-94.7	333.3	2.0	0.1	0.4
Others	181	44	373	250.9	-75.7	747.7	1.5	0.4	3.2
Total	11,639	11,614	11,798	29.8	-0.2	1.6	100.0	100.0	100.0

¹ Estimated actual.² Revised estimate.³ Budget estimate, excluding 2002 tax measures.

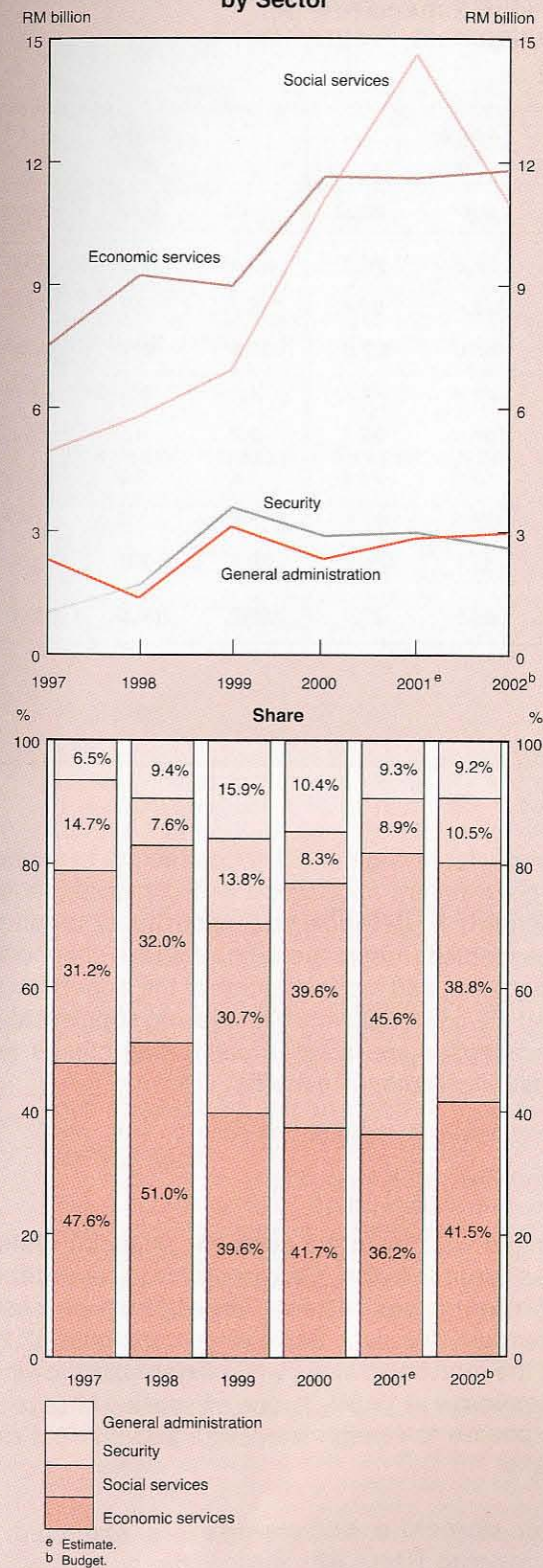
TABLE 5.11

**Federal Government Development Expenditure
for Trade and Industry Programme
2000-2002**

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Industrial development	37	1	1	53.9	-97.3	0.0	1.0	0.0	0.0
Economic services	2,346	1,445	1,389	14.6	-38.4	-3.9	64.0	33.0	57.5
Tourism	397	882	294	31.9	122.2	-66.7	10.8	20.1	12.2
Industrial research	876	1,985	730	128.1	126.6	-63.2	23.9	45.3	30.3
Others	11	67	- ⁴	-72.8	509.1	-100.0	0.3	1.6	0.0
Total	3,667	4,380	2,414	31.1	19.4	-44.9	100.0	100.0	100.0

¹ Estimated actual.² Revised estimate.³ Budget estimate, excluding 2002 tax measures.⁴ Reclassified under other sub-headings.

CHART 5.5
Federal Government Development Expenditure
by Sector



projects for the poor as well as living quarters for the armed forces, police personnel and teachers in rural areas. To ensure better health care and accessibility, the expenditure on **health services**, which amounts to RM1,098 million, is mainly for ongoing projects to upgrade hospitals and clinics in both rural areas and urban centres.

Expenditure for the **economic sector**, amounting to RM11,614 million, is for industrial, transportation and agriculture and rural development, as shown in *Table 5.10*. Under the **trade and industry** sub-sector, the bulk is for the development of small- and medium-scale industries, construction and development of industrial sites, franchise and vendor development, consultancy and market development as well as for programmes that can further enhance and develop the Bumiputra Commercial and Business Community. A venture capital fund amounting to RM500 million has been channelled to the newly established Malaysia Venture Capital Management Berhad (MAVCAP) to provide venture capital financing for high-tech companies in line with the strategy to develop innopreneurs and technopreneurs. In addition, RM350 million as part of RM1 billion allocation has been channelled to the shipping fund managed by Bank Industri dan Teknologi Malaysia Berhad as part of the continued efforts to enhance Malaysia's shipping capacity. The tourism sector is also given priority in recognition of its potential as one of a major source of foreign exchange earnings with an estimated 11 million tourist arrivals in 2001. Higher expenditure has been provided for tourism promotion as well as the development of tourist facilities, including affordable lodging facilities.

The Government has acquired 29.1% of the equity in Malaysia Airlines (MAS) due to its strategic and national importance. The national airline is Malaysia's vital link to the rest of the world both for passengers and high value-added cargoes. It is also an important employer for many Malaysians and a strategic provider of transportation and communications within the country.

Under the **transport sub-sector**, about 70% of the expenditure goes to the construction and upgrading of roads and bridges and the remainder is for ports, airports and railways. The higher

TABLE 5.12

**Federal Government Development Expenditure
for Agriculture And Rural Development Programme
2000-2002**

	RM million			Change (%)			Share (%)		
	2000 ¹	2001 ²	2002 ³	2000	2001	2002	2000	2001	2002
Agriculture	277	458	900	14.9	65.3	96.5	23.4	19.8	30.6
Land development	100	210	341	1.9	110.0	62.4	8.5	9.1	11.6
Drainage and irrigation	472	988	1,260	35.1	109.3	27.5	39.9	42.7	42.8
Rubber replanting	18	152	260	-89.5	744.4	71.1	1.5	6.6	8.8
Fishing	109	220	95	53.3	101.8	-56.8	9.2	9.5	3.2
Livestock	45	69	52	29.2	53.3	-24.6	3.8	3.0	1.8
Forestry	42	29	34	39.5	-31.0	17.2	3.6	1.3	1.2
Others	120	188	-	34.5	56.7	-100.0	10.1	8.0	0.0
Total	1,183	2,314	2,942	8.7	95.6	27.1	100.0	100.0	100.0

¹ Estimated actual.

² Revised estimate.

³ Budget estimate, excluding 2002 tax measures.

expenditures are aimed at providing a more efficient and integrated national transportation network in order to facilitate the movements of goods and people within the country as well as internationally.

Expenditure for **agriculture and rural development** is expected to increase significantly, reflecting the Government's policy to revitalise the agriculture sector as the third engine of growth, as shown in *Table 5.12*. An important area given emphasis is the promotion of food production to reduce the nation's food import bill in the medium- and long-term. In this regard, the Government has implemented several projects for commercial farming for the production of food. As for rural development, the Government has provided additional allocations for projects that can be implemented speedily. In this regard, projects relating to rural roads, electrification and water supply are given priority.

Expenditure for **general administration** is expected to increase by 3.1%. The increase is

largely for laying the ICT infrastructure to support e-government application and computerisation. Meanwhile, **defence and security** expenditure is expected to increase in line with the continuous upgrading and modernisation of the armed forces and the police, given the increasing sophistication and challenges faced in combating crimes and ensuring national security.

Sources of Financing

Ample liquidity in the domestic financial system has enabled the Government to source its borrowing requirements largely from domestic sources. Domestic borrowings constitute 82.2% of the total borrowings while external borrowings remain low at 17.8%, hence minimising Malaysia's exposure to foreign exchange and interest rate risks.

Net domestic borrowings are expected to amount to RM15,421 million, the bulk of which

THE FORWARD-LOOKING BUDGETARY PROCESS

Introduction

The preparation of the national Budget is an integral part of financial and fiscal management. Thus far, the national Budget has been prepared and approved on an annual basis. The process begins with the Treasury issuing the call circular, usually in January, to all ministries or agencies requesting for the submission of budget proposals for the following year. Apart from highlighting the short-term economic scenario of the nation, the Treasury call circular spells out broad budget strategies and macroeconomic targets to be achieved.

After submission of budget proposals, the Treasury begins the budget examination process with each ministry or agency by reviewing the progress of existing programmes and projects as well as ensuring that new programmes and projects comply with the broad strategies and criteria set in the call circular. After elaborate consultations and reviews, which take into account, among others, the financial position of the Government such as revenue and debt profile, the national consolidated Budget is finalised and submitted to the Parliament for consideration and approval in late October.

The New Process – Preparing and Examining The Budget Once Every Two Years

Beginning 2002, with the effect of Circular No. 2/2001, the budget preparation and examination process will be carried out once every two years instead of annually. The change in the budgetary procedure, however, is purely administrative and does not involve amendments to the Federal Constitution or the Financial Procedure Act, 1957. In this regard, the national Budget will continue to be submitted to the Parliament for consideration and approval annually. Although the Treasury will still have to prepare the allocation annually for submission to the Parliament, the detail examinations and reviews of ministries' proposals will be carried out once every two years.

Rationale

The administrative change in budget examinations and reviews to once in every two years as against annually helps to increase the quality and efficiency of budget allocations. The new process injects a medium-term policy focus to an otherwise short-term budgetary process. It provides the flexibility to take into account both the shorter-term annual fiscal policies and the medium-term objectives and policies within the context of the five-year development plans and outline perspective plans. With Government spending determined two years ahead, the new process facilitates the assessment of the fiscal position of the Government and, hence, improves cash flow planning and management. In particular, Government borrowing programmes and requirements can be more accurately determined in advance to minimise either over or under borrowing.

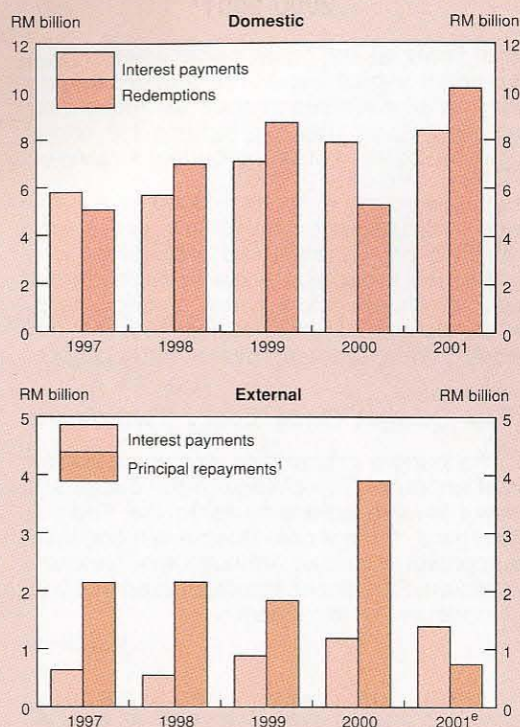
Through the two-year budgeting process, resources such as manpower, time and money at both the Treasury and the 50 ministries and agencies for budget examination purposes, will be reduced. The resources released can be redirected and applied for tasks such as ensuring faster project implementation, identifying and rectifying implementation weaknesses as well as suggesting proposals and feedback for improvement. In setting the budget two years ahead, ministries and agencies are able to plan and implement programmes and projects with greater certainty, discipline and transparency.

The success of the forward-looking budgetary process lies in budget allocations premised on a clear understanding of national policy thrusts and strategies. In addition, the new process allows for expeditious budgetary reallocations to be effected to take into account unanticipated changes in local and international environments. Therefore, even though the allocations have been determined two years ahead, there is enough flexibility to meet unforeseen developments.

Conclusion

The national Budget as an effective planning tool in financial management has been long recognised. The recent change in budgetary process is to further enhance that role. The forward-looking budgetary process is the result of the continuous efforts of the Government towards streamlining administrative procedures, reducing red tape and delegating powers. The new process frees resources, improves efficiency in spending, enhances programme and project effectiveness and strengthens mechanisms for control, monitoring and accountability.

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



is through the issuance of Malaysian Government Securities (MGS) that is absorbed largely by the provident and pension as well as insurance funds. In addition to meeting the financing needs of the Government, the regular issuance of MGS also set the benchmark yield curve to further support the development of the domestic bond market. The Employees Provident Fund (EPF) remains the major subscriber, accounting for 73% (as at end of August) of MGS issued, with the remaining MGS held by banking institutions, public enterprises, non-bank financial institutions and foreign investors. During the year, four MGS issues amounting to RM21,500 million will be issued. After taking into consideration repayments amounting to RM7,100 million, the net MGS issued is expected to amount to RM14,400 million.

Net external borrowings, expected to amount to RM4,797 million, are largely from new market loans raised during the year as well as

disbursements of existing loans. Since 1999, there has been no new loans from the multilateral sources of World Bank and Asian Development Bank. The new market loan of RM3,800 million (USD1 billion) was raised through the global bond issued in July 2001 at a coupon rate of 7.5%. The bond raised was three times over-subscribed and was priced at 228 basis points above the 10-year US Treasuries, reflecting foreign investors' confidence in the country's strong fundamentals, including its low external debt position. Disbursements of existing loans were from the World Bank (RM359 million), Islamic Development Bank (RM65 million) and Asian Development Bank (RM113 million) and the balance is from the bilateral sources of which the Japan Bank for International Cooperation (JBIC) provided RM390 million. During the year, gross external borrowings amount to RM5,539 million, of which RM4,612 million are market loans and the balance RM927 million, project loans. Repayments amount to RM742 million, of which RM562 million are repayments for project loans and the balance RM180 million, market loans.

TABLE 5.13

**Consolidated State Governments
Financial Position
2000-2001**

	RM million		Change (%)	
	2000 ¹	2001 ²	2000	2001
Current account				
Revenue	9,792	10,460	19.6	6.8
Operating expenditure	5,249	5,878	8.0	12.0
Current account balance	4,543	4,582	36.8	0.9
Development account				
Gross development expenditure	5,392	6,258	21.4	16.1
Development fund	4,742	5,168	25.8	9.0
Water supply fund	650	1,090	-3.7	67.7
Loan recoveries	266	197	-56.8	-25.9
Net development expenditure	5,126	6,061	33.9	18.2
Overall balance	-583	-1,479	15.4	153.7

¹ Estimated actual.

² Revised estimate.

State Governments

The consolidated financial position of the 13 state governments is expected to record a surplus in the current account balance. However, their overall balance is expected to continue to be in deficit. The larger overall deficit in 2001, which is expected to increase by 153.7% to RM1,479 million from the level in 2000, is on account of higher development expenditure, as shown in *Table 5.13*. The deficit is largely financed by loans from the Federal Government and the drawdown of state accumulated assets.

States' **own sources of revenue** account for 86% of the total revenue, derived mainly from non-tax sources such as royalties from petroleum, gas and forestry, sales of goods and services, dividends and interests on investment as well as fees from licences and permits. Tax revenue sources which constitute only 13.5%, are mainly land-related and entertainment taxes. Federal Government **grants and reimbursements** to state governments contribute 14% of the state revenue.

Total **operating expenditure** of state governments is estimated to increase by 12% to RM5,878 million (2000: RM5,249 million) with emoluments and supplies and services constituting the largest components. With regard to **development expenditure**, in addition to expansion and upgrading of infrastructure, housing and public amenities, about 23.2% is for water supply projects aimed at improving rural accessibility to potable water.

Non-Financial Public Enterprises

Non-Financial Public Enterprises (NFPEs) continue to play an important role in the economy through their commercial activities, natural resource development and the provision of public utilities. The performance of NFPEs, as a group, continues to remain strong despite the slowdown in the external and domestic sectors. The strong position of NFPEs is attributable to the sustained demand for petroleum products, electricity and telecommunications services associated with the three major companies, namely PETRONAS, Tenaga Nasional Berhad (TNB) and Telekom Malaysia Berhad (TMB).

TABLE 5.14
**Consolidated NFPEs Financial Position
2000-2001¹**

	RM million		Change (%)	
	2000 ³	2001 ⁴	2000	2001
Revenue	102,308	116,833	2.5	14.2
Current expenditure	62,786	70,893	3.2	12.9
Retained income	39,522	45,940	1.4	16.2
% to GDP	11.6	13.3		
Development expenditure ²	25,544	30,779	6.8	20.5
Overall balance	13,978	15,161	-7.1	8.5
% to GDP	4.1	4.4		

¹ Refer to 37 NFPEs.

² Includes grant from the Federal Government.

³ Actual.

⁴ Estimate.

Reflecting the better performance, the consolidated revenue of NFPEs is expected to grow significantly by 14.2% compared with 2.5% in the previous year, as shown in *Table 5.14*. Although both current and development expenditures will increase substantially by 12.9% and 20.5%, respectively, the overall balance of NFPEs is projected to register a higher surplus on account of better revenue performance. This surplus represents a marked improvement over the previous year, increasing by 8.5% compared with a decline of 7.1% in 2000.

The improved performance of the 37 NFPEs is on account of the higher earnings of PETRONAS, which is expected to contribute to almost two third of total revenue. PETRONAS records the best performance among the NFPEs registering a 21% increase in earnings, accruing largely from sustained high prices of petroleum products, including liquefied natural gas (LNG) as well as favourable returns from strategic investments in 25 countries worldwide. Exports and returns from international business constitute about 80% of PETRONAS' earnings. Revenue of TNB is expected to increase marginally to RM14,379 million mainly due to higher electricity supply to

households of 10.8% as well as to the commercial (6.9%) and industrial sectors (3.5%). The remarkable growth in the cellular telephone business, which is expected to double during the year, contributes to the significant increase in revenue of TMB by 12% to RM10,158 million.

The increase in operating expenditure of 12.9% to RM70,893 million (2000:RM62,786 million) is largely attributed to increased labour costs as a result of salary adjustments as well as operationalisation of newly completed projects. Development expenditure, on the other hand, is expected to experience a larger increase of 20.5% to RM30,779 million (2000:RM25,544 million), with about 80% originating from PETRONAS, TNB and TMB for their modernisation and expansion programmes.

During the year, PETRONAS continues its investments in both upstream and downstream activities. Major projects undertaken include gas-processing plants, central facilities projects as well as expansion of the LNG tanker fleet by Malaysia International Shipping Corporation (MISC) to accommodate the expansion in capacity of the Bintulu LNG Plant. Within the country, a production-sharing contract (PSC) was signed with Royal Dutch Shell in Sabah while international PSCs were entered into in Sudan, Algeria and Pakistan, extending the total number of exploration and production ventures to 22 in 14 countries. As for downstream activities, six new plants in two Integrated Petrochemical Complexes were completed during the year. These were the acetic acid joint-venture plant with British Petroleum, acrylic acid plant with Badische Anilin- and Soda-Fabrik AG (BASF), the vinyl chloride monomer, the polyvinyl chloride and the ammonia-syngas plants and the aromatic plant producing paraxylene and benzene.

Capital expenditure of TNB is mainly for the expansion and upgrading of transmission and distribution networks to cater for future growth in demand. Major projects completed and expected to be operational by end-2001 were the Sultan Abdul Aziz Power Station (Phase 3), the 500 KV Transmission System Phase 1 and 1A and the Universiti Tenaga Nasional (Phase 3) projects. TNB also signed power

purchase agreements (PPA) with two independent power producers (IPPs) which will add 1,360 MW to its existing capacity. By year-end, the power generation of TNB is expected to increase by 5% to 66,817 Gwh (2000: 63,635 Gwh).

TMB has also embarked on new projects to upgrade and expand existing network systems by introducing more efficient and state-of-the-art technologies to meet current business needs, such as the Wireless Local Loop, Asymmetric Digital Subscriber Line, Multimedia Interactive and High Speed Internet Access. The expansion of broadband circuits and other multimedia facilities will enhance its services, particularly to the Multimedia Super Corridor (MSC) area. TMB is expected to invest a sum of RM551 million in the supply of telecommunications services to rural areas using Code Division Multiple Access, a hybrid network that combines the wireless, mobile and internet technologies. The inception of the first phase in Sarawak in September 2001 will initially benefit 15,000 people and eventually 150,000 users annually in the rural and remote areas nationwide. Although TMB anticipates a significant growth of more than 100% from its cellular telephone business, the fixed-line telephone business is expected to remain the major revenue earner, contributing about 70% of total revenue.

National Debt

The nation's short- medium- and long-term external debt continues to remain low. The bulk of national debt or 88.8% are medium- and long-term with debt maturity profile ranging from one to more than 10 years. With national debt at 46.9% of GDP, Malaysia is classified as a medium indebted country. At this level and with well-scheduled debt profile, the national debt remains sustainable, manageable and within prudent limits.

Medium- and long-term debt of both the public and private sectors is expected to increase by 2%, reflecting largely the growth in public sector debt. Public sector debt, is estimated to increase 11.8% to RM87,735 million due to increase in medium- and long-term debt of the Federal Government and NFPEs, as shown in

TABLE 5.15

**National Debt
2000-2001**

	RM million		Change (%)		Share (%)	
	2000 ¹	2001 ²	2000	2001	2000	2001
Medium- and long-term debt	141,188	143,959	3.3	2.0	88.9	88.8
Public sector	78,471	87,735	1.9	11.8	49.4	54.1
Federal Government	18,820	23,617	2.5	25.5	11.8	14.6
NFPEs	59,651	64,118	1.7	7.5	37.6	39.6
Guaranteed	11,182	11,964	0.6	7.0	7.0	7.4
Non-guaranteed	48,469	52,154	2.0	7.6	30.5	32.2
Private sector	62,717	56,224	5.2	-10.4	39.5	34.7
Short-term debt	17,633	18,118	-27.3	2.8	11.1	11.2
Total	158,821	162,077	-1.3	2.1	100.0	100.0

¹ Estimated actual.

² Revised estimate.

Table 5.15. On the other hand, private sector debt is expected to decrease by 10.4% to RM56,224 million, following the implementation of corporate debt restructuring programmes.

Short-term debt, which consists of borrowings by the banking sector and private corporations, is expected to increase marginally by 2.8% to RM18,118 million. This is due to an increase in short-term borrowings mainly to finance operating activities. Short-term debt as a percentage of international reserves remains low at 16% as at end of September 2001 (2000: 15.5%), reflecting prudent fiscal and sound financial management.

External debt servicing is projected to increase by 3.7% to RM22,340 million in 2001 (2000: RM21,536 million), of which principal repayments are estimated at RM15,140 million and interest charges at RM7,200 million. Due to higher debt servicing, the **debt service ratio**, which represents the ratio of principal

repayments and interest payments to exports of goods and services, is estimated to increase marginally to 5.8% (2000: 5.1%).

Federal Government Debt

Total Federal Government debt, which comprises domestic and external debt of the Federal Government, is estimated to increase by 16.1% to RM145,842 million in 2001, or 42.2% of GDP (2000: RM125,625 million or 36.9% of GDP), as shown in *Table 5.16*. Of this total, domestic debt is expected to increase by 14.4% mainly due to larger issues of MGS, which accounted for 84.6% of the total Federal Government domestic debt. The remaining 15.4% or RM18,775 million consists of Treasury Bills (TBs), Government Investment Issues (GIIs) and Treasury Housing Loan Fund as well as syndicated loans by locally incorporated foreign banks.

TABLE 5.16
Federal Government Debt
2000-2001

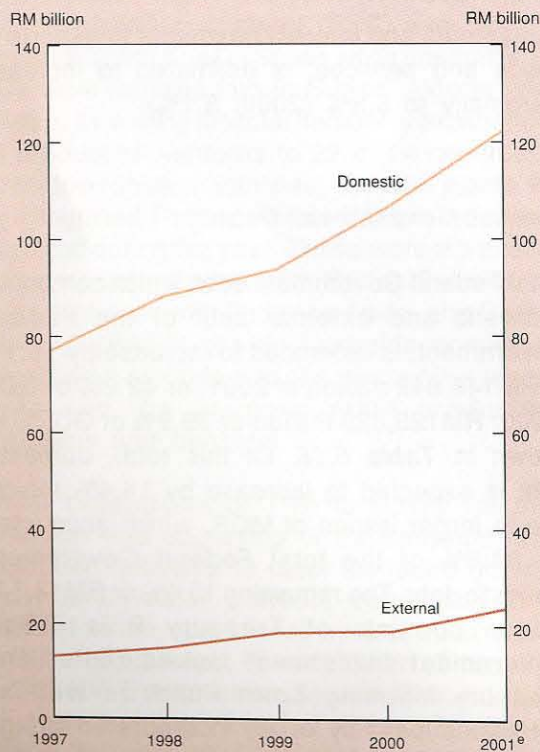
	RM million		Change (%)		Share (%)	
	2000 ¹	2001 ²	2000	2001	2000	2001
Domestic debt	106,805	122,225	13.9	14.4	85.0	83.8
Treasury Bills	4,320	4,320	-	-	4.0	3.5
Investment Issues	4,000	4,000	-	-	3.7	3.3
Government Securities	89,050	103,450	13.7	16.2	83.4	84.6
Other domestic loans ³	9,435	10,455	3.7	10.8	8.8	8.6
External debt	18,820	23,617	2.5	25.5	15.0	16.2
Market loans	12,040	16,472	8.7	36.8	64.0	69.7
Project loans	6,780	7,145	-7.0	5.4	36.0	30.3
Total	125,625	145,842	12.0	16.1	100.0	100.0

¹ Estimated actual.

² Revised estimate.

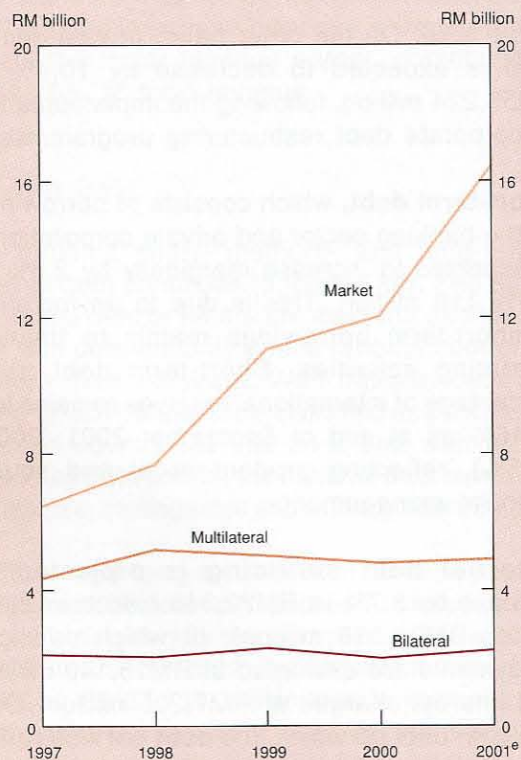
³ Mainly syndicated loans from foreign banks incorporated in Malaysia and loans undertaken by the Treasury Housing Loan Fund.

CHART 5.7
Federal Government Debt



^e Estimate.

CHART 5.8
Federal Government External Debt by Source



^e Estimate.

CHART 5.9

Federal Government Debt by Currency

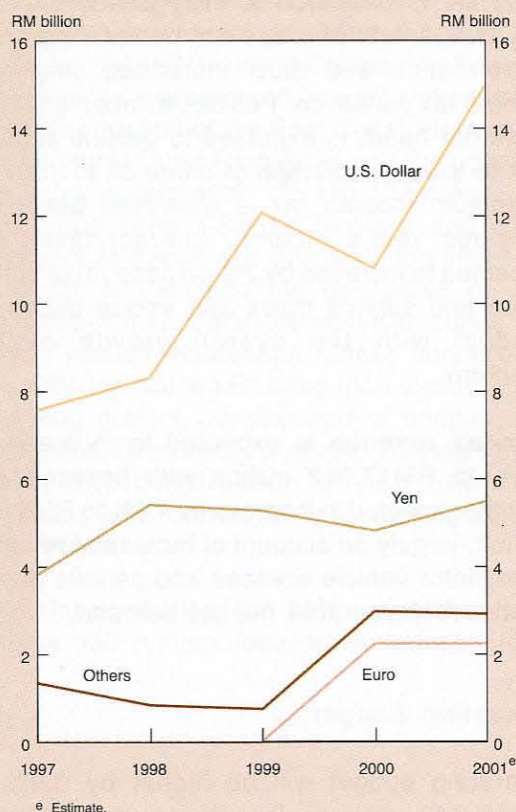
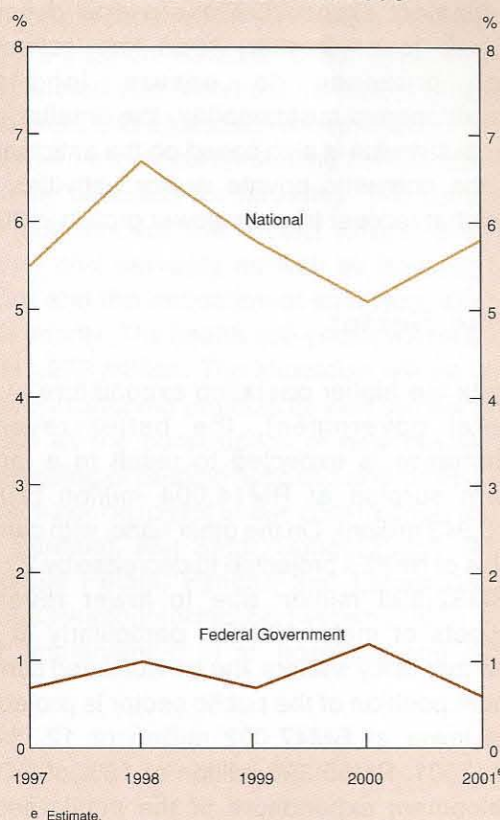


CHART 5.10

External Debt Service Ratio



External debt is estimated to increase by 25.5% to RM23,617 million or 6.8% of GDP (2000: RM18,820 million or 5.5% of GDP). Market loans remain the largest component of external debt, accounting for 69.7% (RM16,472 million) while the remaining 30.3% or RM7,145 million is project loans. Taking advantage of the favourable market conditions as well as the nation's low external debt profile, the Government tapped the international capital markets in July 2001 to raise the bond issue of USD1 billion. Apart from meeting financing requirements, external borrowings have helped to maintain Malaysia's market presence, besides establishing a benchmark for corporate sector borrowings.

In terms of currency composition, 63.8% or RM15,070 million of total external debt is denominated in US dollar. This is followed by yen, which accounts for 23.5% while the balance is in other currencies such as euro, swiss francs and pound sterling.

Concomitant to higher borrowings in recent years to finance the fiscal deficit, Federal Government **debt servicing** (interest payments and principal repayments) is estimated to increase by 13.1% to RM20,641 million (2000: RM18,243 million). Principal repayments are projected to amount to RM10,873 million, of which 93.2% is for repayment of domestic loans, reflecting the major source of financing from the domestic market. Interest payments amounts to RM9,768 million, of which 85.7% is for domestic loans.

Outlook For 2002

The external environment remains vulnerable, particularly given the uncertainty pertaining to the extent and duration of the slowdown in the global economy. As such, growth in 2002 will have to continue to emanate from domestic sources. In this regard, the Government budgetary

operation will remain expansionary. However, with better revenue performance and lower development expenditure, the overall deficit is expected to be smaller. Apart from reflecting fiscal prudence to ensure long-term macroeconomic sustainability, the smaller size of fiscal stimulus is also based on the anticipation that the domestic private sector activities will somewhat recover from its slower growth in 2001.

Public Sector

Despite the higher operating expenditure of the general government, the better revenue performance is expected to result in a larger current surplus at RM14,004 million (2001: RM13,943 million). On the other hand, with current surplus of NFPEs projected to decrease by 20.4% to RM32,998 million due to lower revenue prospects of major NFPEs, particularly in the export and utility sectors, the consolidated current account position of the public sector is projected to be lower at RM47,002 million or 12.7% of GDP (2001: RM55,396 million or 16% of GDP). Development expenditure of the public sector is expected to decline by 2.9% to RM59,327 million (2001: RM61,129 million). Despite lower development expenditure, the overall financial position of the public sector is expected to record a larger deficit at RM12,325 million or 3.3% of GDP due to smaller current surplus.

Federal Government

Taking into consideration the need to stimulate the economy, while at the same time maintaining long-term fiscal sustainability and macroeconomic stability, the size of the stimulus and hence the overall deficit is expected to be lower in 2002. The overall Federal Government deficit is expected at RM18,624 million or 5% of GDP. The Federal Government budget allocation will continue to emphasise on programmes and projects that will have immediate multiplier effects on domestic activities as well as strengthen long-term growth potentials of the economy.

Revenue

Revenue is projected to increase by 6.4% to RM73,400 million, due to better corporate performance and thus, increased corporate income tax collection. Petroleum income tax, on the other hand, is expected to decline slightly, due to lower production of crude oil in 2001 as petroleum income tax is assessed based on previous year's income. Indirect taxes are expected to increase by 7% on account of higher sales and service taxes and excise duties, in tandem with the overall growth of the economy.

Non-tax revenue is expected to increase by 3.4% to RM17,012 million with licenses and permits expected to increase by 4.6% to RM6,061 million, largely on account of increased revenue from motor vehicle licences and permits due to continued favourable market demand.

Operating Budget

Operating budget will be higher by 6.9% to RM65,342 million, largely to meet higher emoluments, debt service charges and supplies and services. The increase in allocation for **emoluments** is due to annual salary increments while the allocation for **supplies and services** is expected to increase in line with the completion of development projects as well as increased allocation for repairs and maintenance. An additional allocation is also provided for the maintenance of small rural roads and drains throughout the country. In addition, a sizeable proportion of the operating expenditure, amounting to RM4,719 million will be for subsidy payments for rice and fertilisers, petroleum products, food and school text books.

Development Budget

Development allocation for the **economic sector** will continue to emphasise on industrial, infrastructure and agriculture and rural development. On industrial development, the focus

will remain on small- and medium-scale enterprises (SMEs), development of e-commerce, research and development as well as further promotion and development of the Bumiputra Commercial and Business Community. The major infrastructure projects to be undertaken include the construction of the East Coast Highway and Butterworth Outer Ring Road and the upgrading of trunk roads such as Muar-Melaka, Jalan Balakong, Kapar-Sabak Bernam and Klang-Banting. In Sabah and Sarawak, the major road projects will include the upgrading of Jalan Kuching-Serian, Jalan Nengoh-Kanibungan and Jalan Merotai-Kalabakan. Other infrastructure projects include the Rawang-Ipoh electric double tracking project, construction of bridges, flood mitigation, channel deepening at Tanjung Pelepas Port, and construction of new airports at Limbang and Bintulu as well as upgrading of Miri Airport.

Development allocation for the **social services** sector will remain focused on education and

training, housing, health and welfare services. An allocation amounting to RM1,561 million will be for the construction of primary and secondary single-session schools. Other projects include vocational and technical institutes, quarters for teachers and allocation for higher education loan fund. An allocation amounting to RM1,820 million will be allocated for **housing**. The construction of quarters for the armed forces, police and other civil servants as well as housing for the poor and the relocation of squatters will remain the priority. The **health** sub-sector will be allocated RM1,273 million. The allocation will be used for several ongoing projects as well as new projects such as the construction of new hospitals and upgrading of existing hospitals and clinics. Among the major hospitals under construction are those in Serdang, Alor Setar, Sungai Buloh, Ampang, Sungai Petani, Pandan and Lahad Datu. The Total Health Information System (THIS) will also be implemented in all hospitals and clinics.