

Economic Management and Outlook

ECONOMIC REPORT

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Overview

The Malaysian economy poised for higher growth...

The Malaysian economy entered 2002 on a stronger footing, after recovering from a downturn experienced in the last two quarters of 2001. Riding on the back of an earlier-than-expected recovery of the United States (US) economy and a stronger outturn in the later half of 2002, the Malaysian economy is expected to register a higher but moderate growth in gross domestic product (GDP).

The year began with optimism as world economy recovered, led by the US on account of better demand for housing, motor vehicles, increased public expenditure on defence and turnaround in demand for electronics. The high expectations of a strong recovery for the year were, however, marred by a series of uncertainties, particularly a weak second quarter performance, reflecting a slower US GDP growth and lower corporate earnings. Billion dollar corporate scandals, involving gross mismanagement and fraudulent accounting practices in the US, coupled with rising Middle East tensions, had also adversely impacted equity prices and depressed investor and consumer confidence. Nonetheless, the continuation of an easy monetary policy and swift government regulatory measures to improve corporate governance and accountability, however, helped arrest further declines in sentiments. Elsewhere, the euro area's moderate expansion and Japan's recovery from recession are envisaged to remain on track, despite increasing risks. With global economic growth intact and supported by a strong domestic sector, Malaysia's economy is expected to further strengthen, particularly during the second half of 2002.

Real GDP is projected to grow at 4%-5% as targetted in Budget 2002, within an environment of low inflation and stronger economic fundamentals, supported by both prudent fiscal and accommodative monetary policies. With more employment created due to better all-round economic performance, unemployment will be contained with the economy continuing to operate under full employment.

Managing the Economy in 2002

Fiscal and Monetary Policy

Supportive fiscal and accommodative monetary policies help strengthen growth momentum...

The earlier-than-expected recovery of the global economy became fragile and vulnerable towards the middle of the year, precipitated by revelations of corporate and accounting malpractices in the US, which slumped the equities market and deteriorated investor confidence. Compounded by lower corporate earnings, the widening current account deficit and depreciating US dollar, global recovery moderated somewhat.

Given the heightened risks, **fiscal policy** remains mildly expansionary in 2002 as a continuing measure to fuel growth momentum and compensates for the probable anticipated slack in exports as well as private sector investment. Hence, to a lesser degree, the public sector continues to play a pivotal role in catalysing growth, notwithstanding the strategic thrust towards fiscal consolidation. The economy continues to be domestic-driven, led by stronger private consumption and domestic demand, supported by the two stimulus packages introduced last year. In addition, tax and non-

tax incentives introduced this year, apart from stimulating consumption, were directed towards enhancing economic and social stability and strengthening competitiveness to sustain growth. The tax measures include, among others, the reduction in personal income tax rates and the reduction or abolishment of import duties on certain products including intermediate goods, aimed at reducing production costs as well as cost of doing business. In addition, in order to encourage the domestic manufacture of machinery and other equipment, the value added criteria for purposes of granting pioneer status and investment tax allowance was reduced from 30% to 20%. To strengthen the contribution of the agricultural sector to growth, reinvestment undertaken by existing companies were given income tax exemption for a period of five years. The 100% allowance on capital expenditure to encourage large-scale food production for export was extended to a wider range of agricultural projects, including vegetable and herb farming, and aquaculture. Reinvestment allowance was also given to encourage investment and promote further development of agro-based downstream industries. In promoting Malaysia as a centre of excellence in education, the Government also provided tax exemptions on educational equipment, including laboratory fittings, language laboratories, workshops and studios.

Reflecting the better economic performance, higher economic activity and improved corporate earnings as well as a more efficient tax collection system, Federal Government revenue is projected to increase further by 5% to RM83,550 million. Consequently, the fiscal position of the Government remains strong, registering continued surpluses in its current account. With development expenditure increasing marginally by 0.3% (2001: 26.1%), fiscal deficit is expected to decline to 4.7% of GDP, a marked improvement from the forecasted 5.1% for 2002 and the 5.5% experienced in 2001.

Continuing its prudent fiscal management policy, Federal Government deficit is financed primarily from non-inflationary domestic sources, with gross domestic borrowings constituting 59.5% of the total. Similarly, domestic debt continues to account for the bulk (77.6%) of total outstanding Federal Government debt that amounted to RM167,835 million. The nation's relatively high level of domestic savings and ample liquidity provided the flexibility to confine dependence on external

borrowings at a low level. With total national debt at a sustainable level of RM183,909 million or 51.7% of GDP, Malaysia remains a medium-indebted nation.

Having undergone deficit budgetting for five consecutive years since the Asian financial crisis in 1997, it is imperative that a consolidation process be resumed. The moderate expansionary stance was to support growth momentum in the wake of a weakening global recovery. The reduced deficit reflects the Government's fiscal prudence and financial discipline as well as the progress towards fiscal consolidation and a balanced budget at the end of the Eighth Malaysia Plan. This is made possible with improved economic performance, higher revenue collection and a more active private sector.

Complementing the fiscal policy, **monetary policy** remains accommodative in order to support economic activities with monetary aggregates continuing to expand along with the improving economy. Given the mild recovery with global interest rates remaining easy, the low interest rate regime continues to prevail in 2002, backed by ample liquidity in the banking system and interest rate differentials that remained in Malaysia's favour. Loans outstanding of the banking system increased by 3.3% at end-July. Loans approved and disbursed were mainly for manufacturing and the purchase of houses and motor vehicles. Broad money supply grew at a stable pace of 0.7% in July, reflecting the increase in economic activity.

The pegged exchange rate regime remains consistent with the fundamentals of the economy and continues to support economic growth. As the US dollar continued to slide, the earlier pressure on the ringgit, experienced especially during the later part of 2001 and early 2002 when the yen depreciated by about 13%, eventually eased and the appreciating trend reversed. The ringgit, in tandem with the depreciated dollar, witnessed declines *vis-a-vis* regional currencies by between 2.8% and 17.2% since end-2001. The depreciated ringgit, however, helped boost exports, which expanded by 6.7% in July.

The banking system remains resilient with a risk-weighted capital ratio (RWCR) of 13.1%, well above the internationally prescribed Basle ratio of 8%, capable of covering non-performing

loans (NPLs), which remained stable at 8% in July 2002. Pengurusan Danaharta Nasional Berhad (Danaharta), the Corporate Debt Restructuring Committee (CDRC) and Danamodal Nasional Berhad (Danamodal) played significant roles in resolving NPLs and corporate debt in the banking system. As at end-June, Danaharta has received RM17,350 million or 58% of the RM29,710 million total expected recovery. From its inception in July 1998 until its disbandment in July 2002, the CDRC has successfully resolved all but four cases. In the case of Danamodal, with the banking consolidation exercise virtually completed, it is envisaged that no further capital assistance will be extended to banking institutions.

Sustaining Economic Growth

Higher growth achieved with stronger macroeconomic fundamentals and enhanced investor confidence...

The immediate and major challenge for 2002 is sustaining growth and strengthening macroeconomic fundamentals, post-September 11. The fragile and vulnerable global recovery necessitated a **mildly expansionary fiscal stance** in order to ensure the growth momentum is sustained. Although, the Government is committed to begin the move towards a balanced budget in the medium term, abrupt reduction of public sector expenditure is deemed premature in the light of the uncertain external outlook.

The projects under the two stimulus packages, amounting to RM7.3 billion in 2001, is expected to filter through into 2002 to contribute positively to growth, as larger infrastructure projects require a longer time frame for completion. Coupled with an accommodative monetary policy *via* a low interest rate regime and a stable pegged ringgit, these measures helped bolster private domestic demand amidst strengthening export growth, particularly of electronics.

The **higher GDP growth** of 4%-5%, driven by the domestic sector for the second year running, is expected to emanate from increasing contribution of the private sector. The services sector continue to be the leading contributor to economic growth adding 3 percentage points to growth, followed by the manufacturing sector

with 1.6 percentage points arising from the turnaround and improvements in global demand for information and communications technology (ICT) products. Spurred by improvements in external demand for electronics exports as well as higher palm oil and rubber prices, private consumption is projected to expand by 5.9% (2001: 2.8%), with private investment recovering by 1.8% (2001: -19.9%).

Economic growth thus far, has been accomplished within an environment of **subdued inflation and full employment**. Consumer price increases remained muted below 2% since 2000. In the first seven months of 2002, the Consumer Price Index (CPI) rose by 1.8% following price increases for telecommunications in March and petroleum products in May. Inflationary pressures were curtailed, due in part to excess capacity still prevalent in the economy as well as the benign global inflation. The Producer Price Index (PPI) that has declined throughout 2001 edged up by 0.6% in March 2002 and further to 1.3% by July, mainly on account of higher prices of crude palm oil. The subdued inflationary outlook provided flexibility in the conduct of fiscal and monetary policies to support the momentum of growth in domestic investment and consumption.

Labour market conditions improved in tandem with the recovery of the global economy. Retrenchment peaked in September 2001 to 5,830 workers, but eased to 1,440 workers in June 2002 as demand for electronic exports picked up and production capacities expanded. In mid-2002, there were 61,100 job vacancies as opposed to 14,300 retrenchments registered by the Manpower Department, reflecting improvements in the job market. The unemployment rate that has crept upwards from 3.1% in 2000 to 3.6% in 2001 is expected to ease marginally to 3.5% in 2002, still within full employment level. As a temporary measure to reduce graduate unemployment while simultaneously imparting them with appropriate skills and capabilities in the fields of ICT as well as enhancing proficiency in the English language, the Government made provisions for the employment-cum-training to more than 30,000 unemployed graduates under the Attachment and Training Scheme (SSL). This measure helped reduce unemployment pressures and mitigate possible unfavourable social repercussions.

Efforts aimed at enhancing investor confidence, a prerequisite for capital formation, witnessed the **further restructuring of both the financial and corporate sectors**. The mergers of domestic banks were successfully completed during the year, resulting in a much stronger capital base. The stockbroking companies, which started their consolidation programme since 2000, had their numbers reduced from a total of 66 to 33 companies in 2002. In the insurance sector, merger and acquisition exercises are under way, whereby out of 63 companies in operation, 10 have merged to further enhance their capacity and efficiency.

On the corporate front, encouraging progress has been made in addressing corporate restructuring issues. The CDRC has been successful in promoting corporate restructuring efforts in large Malaysian companies. By end-July, the CDRC has resolved all but four restructuring cases involving a total loan value of RM43,970 million. The four outstanding cases totalling RM2,470 million were transferred to Danaharta. The corporate debt restructuring which was accompanied by asset sales, spin-off of non-core business as well as management changes are expected to make the restructured corporations more resilient. Thus, the much-improved corporate and banking sectors are now in a better position to support economic recovery. In the area of corporate governance, response to the incorporation of the Malaysian Code on Corporate Governance in the revamped Kuala Lumpur Stock Exchange (KLSE) Listing Requirements encompassing disclosure, transparency and protection of minority shareholder interest has been encouraging. There is an increase in general awareness and appreciation of the measures undertaken to enhance standards of corporate governance and shareholder value recognition.

Performance of the **KLSE** has been remarkable in the early part of 2002. The Kuala Lumpur Composite Index (KLCI) soared 207.6% from its lowest ebb of 262.7 points in September 1998 to peak at a 20-month high of 808 points on 23 April 2002, with market capitalisation amounting to RM563 billion. However, by mid-2002, the KLSE succumbed to the slump in world bourses following corporate scandals and opacity of corporate accounts in the US. The KLSE is expected to improve with the return of investor

confidence as world economic outlook becomes more evident and intact, particularly towards the later part of the year.

The success of sound economic and prudent financial management was clearly evident from the **strength of the underlying macroeconomic fundamentals** such as surpluses in the balance of payments, strong reserves, stable exchange rate as well as low inflation and unemployment. This has prompted international rating agencies to revise upward their ratings and upgrade the country's outlook from stable to positive in the early part of 2002 and subsequently to BBB+ stable in the middle of the year. Reflective of the strength and confidence in the country's financial position, bonds issued by the Government as well as the non-financial public enterprises (NFPEs) in international markets, were well received. The sovereign bond of USD750 million priced at 175 basis points above the 10-year US Treasury notes, issued in March 2002 was snapped up by a wider base of investors from the US, Asia and Europe and was oversubscribed almost five times. The first Islamic bond in the world, the USD500 million global five-year Islamic bond issued by the Government in June, was priced at only 95 basis points above the dollar Libor. For the debut, the bond issue was oversubscribed twofold, a clear evidence of investor confidence. Malaysia's international reserves in August 2002 increased to USD34.2 billion, sufficient to cover 5.6 months of retained imports and is 5.1 times short-term external debt. Continued improvement in the real economy, strong financial position, stable political environment and continued investment flows, point towards further upgrade in the country's sovereign ratings in the near term.

Programmes Performance Review

Right policy mix and timely strategies –the hallmark of Malaysia's response...

The weak US economic recovery amidst faltering growth elicited an expansionary budgetary approach from the Government in order to ensure that the momentum of growth is sustained. The first pre-emptive package was undertaken to mitigate the effects of a much slower US economy

in 2001. Towards the later part of the year, in the wake of the September 11 incident that exacerbated the downturn in the global economy, the Government was prompted to respond with a second fiscal stimulus for the year.

Increasing Domestic Activity

Higher domestic economic activity and sustained consumption supported by continuing fiscal stimulus...

The **fiscal stimulus programmes** announced in 2001 involved an array of projects traversing the construction of ports, single session schools, community colleges and housing for the Armed Forces. The programmes also include allocation for food production, upgrading of rural infrastructure and amenities and the promotion of small and medium enterprises (SMEs) provided through special funds as well as provisions for maintenance of public sector facilities. As at end-February 2002, with 61.5% of the total RM7.3 billion package expended, a substantial proportion of fiscal spending remains due in the year on account of the lag in project implementation. In order to ensure smooth and speedy implementation of public sector projects, rules and procedures pertaining to approvals and payments were reviewed and simplified. As an added measure, projects awarded that have not started after three months or are 30% behind schedule will be terminated and awarded to other contractors. The success of the fiscal stimulus has been translated into higher domestic activity and has been pivotal and instrumental in keeping GDP growth in the positive territory for 2001.

In **education**, 240 primary and 163 secondary schools including six matriculation colleges were approved for construction. Three matriculation colleges were completed and fully operational in Johor, Labuan and Perak while 91 primary and 81 secondary schools are expected to be completed in the course of the year, with the remaining under various stages of construction and due for completion in 2003. In the health sector, 241 rural clinics were approved for implementation, and of these, 133 were completed as at July 2002.

Diversifying Sources of Growth

Services sector to spearhead growth...

Aside from an expansionary budget, the Budget 2002 strategy is to diversify the economy and identify new sources of growth. In this regard, there was commendable achievement in enhancing the role and contribution of the **services sector**. This sector is expected to expand by 5.3% and contribute 57% to GDP in the year. The **tourism industry** is particularly seen to be vibrant and has expanded remarkably well over the years. Tourism had contributed RM24,220 million to foreign exchange earnings in 2001, an increase of 39.7% from the previous year (2000: RM17,340 million). In the aftermath of September 11, tourist arrivals plunged to 596,200 in November, well below the twelve-monthly average of 1.1 million arrivals achieved prior to the incident. However, with intense promotional activities through an allocation of RM200 million provided by the Government, the number of tourist arrivals rebounded to a high of 1.3 million in April 2002 and stabilised at the former monthly average within the first half of the year.

The tourism market has become more diversified with more tourists arriving from the Republic of China and the Middle East. Occupancy rates of hotels increased to 68.2%, with tourists staying longer for 7.1 days on average, resulting in per capita tourist expenditure of RM2,012 (2001: RM1,896). It is expected that air travel and tourism industry will further improve towards the end of the year with an anticipated 13 million tourist arrivals and earnings to register RM26,200 million for the year, making tourism the second largest foreign exchange earner for the nation. To further promote this sector, the Government established a RM400 million fund for the development of tourism infrastructure and refurbishment of tourist facilities.

Great strides were made in establishing Malaysia as a **transport and logistic hub**. In this regard, the relatively new Port of Tanjung Pelepas (PTP), Johor made headlines when it captured a substantial proportion of the regional port handling business by securing long-term contracts with

mainline operators, namely Maersk-Sealand, the world's largest operator, and Evergreen Marine Corporation. Within a span of two-and-a-half-years since its first year of operations, PTP registered a phenomenal growth in container throughput of 48,668 TEUs (20-foot equivalent units) in the first six month of 2000 to 2 million TEUs in 2001. By year-end, it is poised to surpass its target of 2.5 million TEUs.

The Kuala Lumpur International Airport (KLIA), one of the world's state-of-the-art airports, has been identified by the International Air Travel Association (IATA), as one of the potential hubs for air travel in the Asia Pacific region for 2002. In order to maximise these strengths and intensify the utilisation of KLIA, a number of incentives were given to attract both new and existing airlines to land in KLIA as well as increase their frequencies. In addition to the five-year full waiver on landing and parking fees for international airlines as well as for those increasing their frequencies, a RM10 million incentive programme was introduced to provide a matching grant to new international airlines that undertake promotional activities for the airport. Such measures succeeded in attracting two new airlines and increasing frequencies by another six. In June 2002, exemplary of the high quality of service, the Malaysia Airlines (MAS) received the 'Best Cabin Staff 2002' award for the Asian region, following a survey conducted by the UK-based Skytrax Research of London. In the same survey, the Malaysia Airlines Flagship Lounge in the KLIA, the biggest in the world, was voted the world's top three airline lounges.

Enhancing Competitiveness

Progress towards knowledge-based economy with support from venture capitalists and ICT as the enabling technology...

In cognisance of the role of a **knowledge-based economy** in promoting growth and productivity, the Government has implemented the Knowledge-based Economy Master Plan. The Master Plan, launched in September, outlines seven strategic thrusts comprising recommendations to accelerate the shift towards the

knowledge-based economy. The strategic thrusts focus on areas that are salient for the transformation to the new economy, encompassing human resource development, institutional framework, info-structure and infrastructure, science and technology capacity, role of the private sector, a knowledge-based civil service as well as bridging the knowledge and digital divides. In providing the infrastructural support for the development of a knowledge-based economy and ICT industries, the development of the Multimedia Super Corridor (MSC) has covered further grounds. As at July 2002, 745 companies (2001: 621 companies) have been awarded MSC status. Investment in the Corridor has reached RM9.7 billion, an increase of 42% compared with 2001, and has provided employment to 18,550 workers, out of whom 84% or 15,594 are knowledge workers. Thus far, there are 53 world-class companies operating in the MSC.

To promote innovation and creativity along the concept of a K-based economy, a **venture capital** fund of RM500 million was created to provide equity financing for venture companies involved in ICT in the form of zero-interest-bearing loans for durations up to 10 years. The Fund, managed by the Malaysia Venture Capital Management Berhad (MAVCAP) will be utilised *via* two programmes; the first involving RM100 million for an out-sourcing programme, and the balance for a direct investment programme. As at mid-2002, three out of four targetted companies were approved funding under the out-sourcing programme in the fields of software and applications, communication and networking, and photonics. For direct investment programmes, MAVCAP has approved three projects involving RM33.9 million in areas of communications, micro electronic systems and biotechnology. In addition, the Government, in collaboration with the Japan Bank for International Cooperation (JBIC), established a RM1.6 billion ICT Fund. The Fund is managed by Malaysia Debt Ventures Berhad, a company under the Ministry of Finance Incorporated, launched on 30 August 2002. The Fund provides loans to multimedia developers, producers of high-tech products, service providers, traders and those who use ICT in education, healthcare and entertainment.

In promoting **e-business**, that is becoming increasingly important in enhancing business activity in the borderless electronic world, a sum of RM5 million was provided for the development of global supply chain management network called RosettaNet Malaysia for online and real-time procurement, production and logistic management. RosettaNet Malaysia Berhad, launched in January 2002, marked the culmination of the concerted effort towards e-business, particularly for industries dealing in high-tech products. With its inception, SMEs will be able to join the ranks of more than 400 world suppliers and participate in a more organized global marketing of products. As at August, 42 companies have registered as members.

Skilled and **knowledge-workers** are prerequisites for the country to propel itself into the K-based economy as well as enhance competitiveness. In this regard, education and training programmes continued to be given emphasis to address the issue of manpower shortage in ICT and related areas. In promoting computer literacy and improving students' accessibility to ICT, a sum of RM441.8 million was provided for the construction of 2,874 computer laboratories and facilities in both urban and rural areas. By mid-2002, a total of 1,977 projects or 68.8% were completed. In addition, as a brain-gain strategy, incentives were offered to attract highly skilled Malaysians working abroad to return. As of August, 474 applications were received and 171 were approved covering expertise in the fields of accounting and finance, medicine, information technology, industry as well as science and technology.

The Government, thus far, has vigorously pursued measures to enhance **productivity** and reduce the cost of doing business through fiscal and non-fiscal measures in order to ensure the nation remains competitive. The country's productivity growth for the period 1996-2001 was 3.3%, surpassing that of several countries of the Organisation for Economic Co-operation and Development (OECD), namely the US (2.3%), United Kingdom (1.6%), Canada (1.4%), France (1.2%), Japan (1.1%), Germany (1.1%) and Italy (0.8%). On the same token, output per worker improved remarkably by 8.8% in the first six months of 2002, higher than the 3.7% increase in unit labour costs.

Currently, Malaysia remains competitive and enjoys a relatively low to moderate **cost of doing business** *vis-a-vis* several countries in the region, particularly with regard to business premises, telecommunications, utility and transportation. This was indicated by a study on the cost of doing business in selected cities within the Asian region undertaken by the Japan External Trade Organisation (JETRO) in 2001. A comparison among 12 Asian cities also shows that Malaysia has one of the lowest effective tax rates as it does not impose tax on dividend income. In addition, Malaysia offers a wide range of tax incentives and allowances including pioneer status, investment tax allowance, reinvestment allowance as well as special incentive packages for specific activities in manufacturing, agriculture and services sectors. These measures, currently in place, enhance the business and investment climate of the country.

Malaysia's leading edge, however, lies in her highly skilled, educated and trainable labour force with increasing number of knowledge-workers for the high value-add ICT companies. In addition, the annual dialogues between the public and private sectors held to resolve private sector concerns are fine examples of a pro-business and investor-friendly Government in line with the concept of Malaysia Incorporated. This continuous exercise is expected to further facilitate business activities in the country. With technological enhancement within the environment of the upcoming new economy, costs of doing business will be invariably reduced, thereby further increasing the country's competitiveness.

Ensuring Equitable Distribution

Focus is on agriculture and rural development while the unemployed supported by special schemes...

The Government initiated various measures to support the **agriculture sector** both in terms of improving yields and prices of agriculture products. The objective is to provide smallholders with better income while at the same time reduce the country's food import bill that amounted to RM12,300 million in 2001. Oversupply of palm oil in the world market had depressed prices to

TAX ON CORPORATE INCOME

Corporate tax is imposed on income derived from Malaysia. However, income received by resident companies engaged in banking, insurance, air transportation and shipping business are taxed on a world income scope. The basis of taxation is on current year income and the tax is structured on an imputation system, whereby tax paid by the company is given as credit to the shareholders.

Prior to 1986, Malaysia imposed a corporate tax rate of 40%, excess profit tax of 5% and development tax of 5%. For tin and timber industries, excess profit taxes were imposed ranging from 5% to 15% and 10% to 20%, respectively. In 1986, both the tin and timber profit taxes were abolished. In the same year, the additional profit tax was reduced from 5% to 3% and, subsequently, abolished in 1988. The development tax was reduced on a staggered basis commencing in 1990 and subsequently abolished in 1993. Likewise, within a decade, the corporate tax rate was reviewed gradually from 40% in 1988 to 28% in 1998.

Review of Taxes on Corporate Income (%)

Assessment Year	Corporate Tax	Supplementary Tax	
		Excess Profit Tax	Development Tax
1980-1985	40	5.0	5.0
1986	40	3.0	5.0
1987	40	3.0	5.0
1988*	40	–	5.0
1989	35	–	5.0
1990	35	–	4.0
1991	35	–	3.0
1992	35	–	2.0
1993*	34	–	–
1994	32	–	–
1995-1997	30	–	–
1998-2002	28	–	–

* Excess profit tax and development tax were abolished in 1988 and 1993, respectively.

At present, the Malaysian corporate tax rate is comparatively lower than that of other nations in ASEAN, Asia and most of the developed countries with the exception of Hong Kong, Singapore, Taiwan, Ireland and the Republic of Germany. Furthermore, since Malaysia does not impose tax on dividend income, the corporate tax rate of 28% compares favourably with other nations. In addition, Malaysia has a very comprehensive tax incentives scheme such as Pioneer Status, Investment Tax Allowance, Reinvestment Allowance and special incentive package for targetted activities in the manufacturing, agriculture and services sectors. Taking into consideration these incentives, the effective tax rate is lower, for example 8% for the manufacturing sector.

Comparison of Corporate Tax *
(%)

Country	Corporate Tax	Tax on Dividend	Effective Tax	VAT Rate
Hong Kong	16.0	–	16.0	–
Ireland	20.0	–	20.0	4.3, 12.5, 20.0
Singapore	24.5	–	22.0	3.0-5.0
Taiwan	25.0	30.0	47.5	20.0
Germany	25.0	–	25.0	7.0, 6.0
Malaysia**	28.0	–	28.0	–
Korea	28.0	–	28.0	10.0
Thailand	30.0	10.0	37.0	7.0
United Kingdom	30.0	–	30.0	5.0, 17.5
China	33.0	–	33.0	13.0, 17.0
United States	40.0	30.0	58.0	–
Japan	42.0	30.0	59.4	5.0

* As at 2001.

** Malaysia does not impose VAT. However, a single stage sales tax is imposed on locally manufactured and imported product with sales tax rate ranging from 5%-25%. Service tax is also imposed on certain services at the rate of 5%.

Comparison of Tax Rates in Asian Cities *
(%)

Cities	Corporate Tax	Personal Tax (Highest Rate)	VAT (Standard Rate)
Kuala Lumpur	28.0	28.0	Sales tax: 5-25% Service tax: 5%
Bangkok	30.0	37.0	7.0
Beijing	33.0	45.0	17.0
Ho Chi Minh City	Hotel, finance, insurance service: 25% Preferential tax: 10–20% Manufacturing: 10–20%	50.0	10.0
Hong Kong	Individual business: 15% Corporation profit: 16%	17.0	0
Jakarta	10.0–30.0	35.0	10.0
Manila	32.0	32.0	10.0
New Delhi	35.7	30.6	16.0
Seoul	<100 m. won: 16% >100 m. won: 28%	40.0	10.0
Shanghai	33.0	45.0	17.0
Singapore	24.5	26.0	3.0
Taipei	>NT\$50,000 to NT\$100,000: 15% >NT\$100,000: 25%	40.0	5.0

* As at 2001.

its lowest at RM642 per tonne in 2001. To help boost prices, the Government introduced a replanting programme involving 200,000 hectares of oil palm holdings with trees more than 25 years old. Such a measure has helped curtail the glut and assisted in stabilising prices to average RM1,267 per tonne for January-August 2002.

Under the 2002 Budget, a record RM5,340 million was allocated for the implementation of **projects in rural areas** aimed at increasing the income and well-being of the rural community. Such projects include agricultural extension services and fertiliser subsidies, free textbooks, the construction of rural roads, electricity and water supply, rural health clinics and schools. Through these programmes, the *Orang Asli* community continues to enjoy better amenities, apart from specific programmes undertaken such as attitudinal change and mindset development programme and enhancement of pre-school education to reduce the number of school dropouts.

The Government undertook positive steps to address the issue of **unemployment among graduates**, which in July 2002 numbered about 44,000. With an allocation of RM226 million, the Government launched the six-month SSL programme in October 2001 and provided financial assistance of RM500 per month to participants. This programme involves temporary attachments of unemployed graduates to Government departments and agencies, and the private sector. As of July, a total of 27,260 graduates were placed under the Scheme with more than 60% attached to administrative and managerial jobs, while a substantial proportion was placed under training schemes in the fields of ICT and the English language. The programme has been successful in raising the confidence level and marketability of graduates.

The **social development** objective of equitable distribution of economic wealth remains a priority. Commendable progress has been achieved in addressing poverty eradication and improving the quality of life. Poverty levels have declined to below 6% (1995: 8.7%) while the Quality of Life Index has improved to 108.43 points (1980: 86.22 points). Per capita income in nominal terms

has risen from RM12,956 in 2001 to RM13,450 in 2002, while purchasing power parity (PPP) has increased 2.7% from USD8,632 to USD8,918 in the same period. Income disparity, as measured by the Gini coefficient for the period 1995-1999 has improved from 0.456 to 0.443, while the disparity between urban and rural incomes has narrowed from 1:1.95 to 1:1.81. Nevertheless, the policy towards narrowing further the rural and urban gap, in terms of economic and social amenities and income, will continue to be pursued relentlessly.

Outlook for 2003

Onward to stronger growth...

With the mild recovery intact in 2002 and expected to gather momentum in 2003, the world economy is projected to register output growth of 3.7% with trade expanding at 6.6%. The US is forecast to chart a stronger GDP growth of 2.6%, while the euro area is expected to further improve by 2.9%. Japan, which has shown further signs of bottoming out, has entered into a recovery mode and is projected to grow by 1.1% in 2003.

The Malaysian economy, with the stronger macroeconomic fundamentals already in place and complemented by more resilient corporate and financial sectors, is now poised to benefit from the much-improved global economic environment projected for 2003. Output expansion is anticipated in all sectors of the economy, with GDP envisaged to chalk 6%-6.5%, arising from a broader based economy with growth emanating from a more pronounced role of a revitalised and dynamic private sector. The manufacturing sector is expected to continue its expansion to record 8.5% increase in output and contribute 2.6 percentage points to GDP growth while the services sector, with a projected increase of 5.9%, remains the major contributor to growth with 3.3 percentage points. The construction sector is forecast to expand 4.5% while the agriculture and mining sectors are envisaged to improve by 3.4% and 2.5%, respectively.

Economic growth will be domestic-led and private sector-driven, particularly in new niche areas of services including tourism, transport, education,

health and also agriculture. This is aimed at reducing over-dependence on manufacturing as well as the external sector. With Federal Government expenditure increasing at a moderate pace of 4.6%, the public sector financial position will be strengthened with a move towards consolidation and a balanced budget at the end of the Eighth Malaysia Plan. Federal Government fiscal deficit is targetted to narrow to 3.9% of GDP from 4.7% in 2002.

To support the development of a domestic-led economy, activities of SMEs will be further nurtured. The public sector will continue to provide the enabling environment conducive for business and investment activities to flourish. In this regard, the Government is committed towards minimising and subsequently, eliminating bureaucratic

delays to further improve service delivery as well as ensure prompt and timely execution and completion of projects and programmes. With added measures directed towards further stimulating economic activity in 2003, both private sector investment and consumption are envisaged to rebound by 16.5% and 9.9%, respectively.

Emphasis will also be given towards further enhancing the quality of education at both the primary and secondary levels as part of the human resource development programme with a view to improving the quality of labour force. Rural development programmes will continue to be given priority with added focus on the poor and the disabled in accordance with the move to further uplift the quality of life of the *rakyat*.

DIVERSIFYING SOURCES OF GROWTH: THE DEVELOPMENT OF BIO-VALLEY MALAYSIA

Introduction

Malaysia's transformation from an agriculture-based economy to an export-oriented electronics and electrical manufacturing nation is well known. This transformation was made possible through pragmatic and aggressive industrialisation policies and programmes to diversify the economy. The deliberate move to transform the country from a nation dependent on exports of rubber and tin to a more broad-based economic structure, where manufacturing and services contribute 87.8% to gross domestic product (GDP), has enabled Malaysia to achieve high GDP growth of close to 7% during the past three decades.

New Sources of Growth

Rapid developments in technology, particularly information and communications technology (ICT), brought in the third wave of growth which centres on the resourceful use of knowledge to create new value, wealth and economic growth. Determined to avoid being marginalised and to ride the new wave of growth, the early foundations towards creating the enabling environment was put in place for the knowledge-based economy. The infrastructure for ensuring the growth of research and creativity was laid with the establishment of the Multimedia Super Corridor (MSC) in 1996.

Recognising that the growth of the future economy lies in technological advancement, the thrust of both the Seventh and Eighth Malaysia Plans is to shift away from an input-driven growth strategy to one that is knowledge and technology-driven. Technology, skills and innovation, deemed catalysts for future growth and key enablers for the transformation to the knowledge-based economy, will help the nation realise the full potential of output growth and further accelerate structural transformation and value-add of the economic sectors. Biotechnology is identified as a core technology to propel domestic innovation and capability to produce novel products for commercial purposes in areas of medicine, energy, farming and food production as well as environmental management.

Biotechnology

Biotechnology involves techniques using living organisms to make or modify products and to enhance plants and animals or to develop micro-organisms for specific use. The vast diversity of the country's flora and fauna provides researchers ample raw materials and scope for biotechnology research.

The Government has provided strong support and encouraged the development of biotechnology through funding for research and development (R&D), human resource development and infrastructure. Presently, biotechnology research is mainly undertaken by public sector institutions such as the Malaysian Agricultural Research and Development Institute (MARDI), Malaysian Palm Oil Board (MPOB), Malaysian Rubber Board (MRB), Institute of Medical Research (IMR) and Forest Research Institute of Malaysia (FRIM). Most Malaysian public universities in the country have a biotechnology research unit. Private sector involvement in biotechnology is largely in areas of plant tissue culture, such as in the production of orchids. There are also manufacturers using biotechnology to produce high quality clarified fruit juices and syrups. Plants such as *tongkat ali* and *pegaga* are used to produce herbal health products. Currently, there are about 50 Malaysian companies using biotechnology processes, mostly in areas of food production, herbal products and pharmaceuticals.

In 1996, the National Biotechnology Directorate (BIOTEK) was established under the Ministry of Science, Technology and Environment (MOSTE) to promote and coordinate R&D activities in biotechnology as well as to develop private-public sector collaboration in the national biotechnology

programme and to assist in the commercialisation of research. BIOTEK currently manages seven categories of biotechnology R&D activities, namely molecular, plant, animal, medical, environmental and industrial, biopharmacy and food. Biotechnology Cooperative Centers (BCCs), managed by BIOTEK and in collaboration with leading research institutions and universities undertake R&D activities in each category. International partnership between the BCCs and the Massachusetts Institute Of Technology (MIT) was initiated in 1999 to facilitate the interaction, development and training of scientists in critical areas like genomics, bioinformatics and bioprocessing through the exchange of Malaysian and MIT research personnel. The programme aims to nurture a group of professionals capable of spearheading the development of the biotechnology industry in Malaysia.

Development of Bio-Valley Malaysia

Development of biotechnology in Malaysia will be further enhanced with the Bio-Valley Malaysia initiative proposed in the Eighth Malaysia Plan. The Bio-Valley, to be located within the MSC will be the nucleus of the biotechnology industry. The Bio-Valley adopts a cluster approach that has been successfully applied to develop biotechnology industries around the world, particularly in the United States and Canada. The cluster will comprise biotechnology research institutions, universities and specialised companies. This is to foster inter-relationships and the convergence of intellectual expertise and entrepreneurship as well as the sharing of resources, which will enable the industry to establish a centre of excellence. The advantage of collaboration and co-location will allow each company within the cluster to compete globally, an achievement that cannot be accomplished in isolation. Furthermore, the concentration of companies within the Bio-Valley will enhance and hasten the commercialisation of the technologies and products produced by the research institutes, which in turn will stimulate growth of new companies. Synergistic efforts arising from industry players will encourage active interaction and spur innovation and technology transfer.

The development of Bio-Valley Malaysia within the MSC takes into account the synergy between biotechnology and ICT. As biotechnology is a knowledge-intensive field, support of appropriate information technology is crucial for its development. The initiative will be collectively known as the Biotechnology and Information Technology Super Corridor.

Three new research institutions, the National Institute for Agro-Biotechnology, National Institute for Pharmaceutical and Neutraceutical Biotechnology and National Institute for Genomics and Molecular Biology, will form the core of Bio-Valley Malaysia. Each institute will undertake research in respective fields of biotechnology, vital for the overall development of the industry. The institutions will be staffed with experts and equipped with state-of-the-art equipment and infrastructure to conduct world class R&D. In addition, these institutions will have strong links with Malaysian universities, act as incubators for innovative research, train scientists and support nascent biotechnology companies. The establishment of Bio-Valley Malaysia will stimulate interests from international centers of excellence for biotechnology to collaborate with the national institutes in term of research and knowledge.

The strategic areas of research were chosen based on factors such as availability of research resources, ability to optimise national capacity, capitalising on successful R&D experience and private sector investment. Research in agricultural biotechnology is expected to bring forth tools that will revitalise the agriculture sector by increasing food production, making the sector more competitive with transgenic crop varieties with high yields and quality, generate rapid growth in livestock farming through advanced reproductive technology and recombinant vaccines for deadly diseases such as Nipah virus. Pharmaceutical and neutraceutical biotechnology research can lead to discovery of functional food and drugs, which will promote better health care. Genomics and molecular biology research is important for the generation of new knowledge and innovation.

The Bio-Valley will be managed by the Bio-Valley Development Corporation, under the National Bio-Valley Development Board. The Corporation will also address issues relating to biosafety and public awareness of biotechnology. Another body, the Biotechnology Development Directorate will assist in the commercialisation of research products such as patent drafting, technology transfer and licensing, managing inter-industry relationships and attracting foreign and domestic investment.

Status of Implementation

MOSTE has identified 1,200 acres of land within the MSC for the Bio-Valley project. Consultants for the project have also been identified and a master plan for the development is being drawn. Negotiations with the Selangor State Government are under way to obtain approval for land use. The project is expected to be completed within the time frame of the Eighth Malaysia Plan.

Conclusion

Although various parties in Malaysia currently conduct biotechnology research, the commercialisation of research results remains low with hardly any new patents that generate economic value for research. Innovation is lagging as inventors are working in isolation and effective entrepreneurial strategies are lacking. In this regard, the Bio-Valley Malaysia initiative has been designed to address these issues and stimulate the development of biotechnology intellectual property as well as foster formation of new companies in the biotechnology sector. The consolidated efforts of researchers and industry players in the Bio-Valley is expected to spawn new sources of growth as well as enhance existing economic sectors.