Public Sector Finance

ECONOMIC REPORT

3

Overview

Public sector finance continues to remain strong with prudent financial management...

Public sector finance remains strong despite the continued expansionary fiscal policy to sustain economic recovery and growth. Given Malaysia's sound macroeconomic fundamentals, the resultant deficit has not created risks to the economy. The deficit, which is into its fifth year, was financed mainly from non-inflationary domestic sources. Government expenditure has remained focussed on bolstering aggregate demand to support recovery and growth in the immediate term as well as to enhance productivity and capacity in the medium to longer term. The Government's prudent policies and practices have provided fiscal flexibility and sustainability in the management of public sector finance.

Fiscal Policy Operations in 2002

Fiscal policy is aimed at sustaining growth in the immediate term and enhancing capacity and productivity in the medium to longer term...

The 2002 Budget, though mildly expansionary to support the growth momentum, was aimed at attaining limited fiscal consolidation with a lower budgetted deficit of 5.1% to GDP (2001: 5.5%). This is in line with the medium term objective to achieve a balanced budget by 2005 as envisaged in the Eighth Malaysia Plan, 2001-2005. The slow growth of the global economy and its attendant risks necessitated the continued support of public expenditure to drive the economy. Hence, during the course of the year, additional allocations for both development and operating expenditures were made in order to sustain the growth momentum. Despite additional allocations made during the year, the continued strong revenue performance is expected to help contain the fiscal deficit to 4.7% of GDP compared with the earlier budget estimate of 5.1% of GDP.

The Budget strategies incorporating fiscal measures through higher allocations for both operating and development expenditures as well as tax measures have played a major role in sustaining Malaysia's economic stability and resilience. These policies have been instrumental in stimulating domestic economic activities and keeping the GDP growth in positive territory in 2001. Similarly, public consumption and investment are estimated to contribute 1.3 percentage point to the 4% - 5% GDP growth expected in 2002.

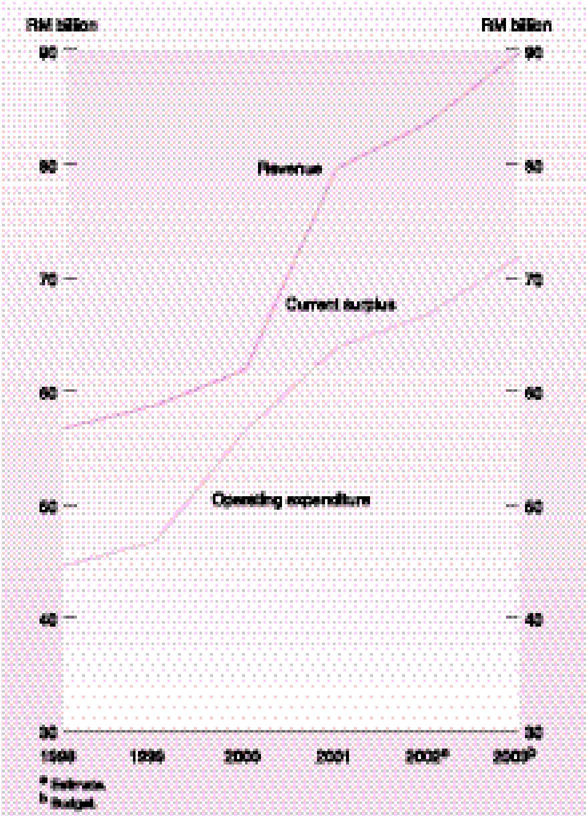
The 2002 fiscal measures were two-pronged, focussing on enhancing consumption in the immediate term as well as building capacities and increasing competitiveness and productivities in the medium to longer term. Towards this end, salary revision for government servants, increased allowances for selected categories of civil servants and armed forces personnel as well as small projects that can be implemented immediately or within a short time were given emphasis to sustain aggregate demand. On expenditure to enhance competitiveness and long-term productivity growth, the focus, as in previous years, is on education and human resource development, capacity building in infrastructure and system improvements that ensure faster delivery of goods and services at lower costs.

Although the expansionary fiscal policy is into its fifth consecutive year since 1998, the deficits have not led to macroeconomic imbalances or instabilities. Fiscal surpluses recorded during the favourable years as well as prudent management and practices have provided fiscal flexibility and sustainability to finance the deficit budget into its fifth year.

Fiscal flexibility was made possible by the continued surplus position in the current account of the Federal Government where revenue collection has continued to outstrip operating expenditure, as shown in Chart 3.1. Currently, revenue stands at 23.5% of GDP, higher than operating expenditure which is 18.8% of GDP. Fiscal flexibility was also supported by the surpluses in the balance of payments that provided the Government with an avenue to raise domestic financing. The bulk of the fiscal deficit continued to be financed by non-inflationary domestic sources such as provident, pension and insurance funds that had not exerted pressures on domestic consumer prices and interest rates. Other measures introduced to increase fiscal flexibility included improved tax collection and administrative processes that reduce or minimise revenue leakages and the current year assessment system that provides better matching of revenue and expenditure.

CHART 3.1

Federal Government Finance - Current Account



With regard to fiscal sustainability, the Federal Government debt to GDP ratio remains low by international standards. Fiscal spending was targetted to raise long-term productivity and, hence, generate higher GDP and revenue streams in the future to meet increased debt obligations. The higher borrowing raised by the Government is expected to increase the Federal Government debt to RM167,835 million or 47.2% of GDP by the end of 2002. Debt service charges, that is interest payment as a percentage of operating expenditure, however, remain low at 14.6% (2001: 15.1%) of operating expenditure or 2.7% of GDP.

By and large, the effectiveness of fiscal policy was also supported by other strategies and policies that continue to build on Malaysia's strong economic fundamentals. In this regard, the stable pegged exchange rate, high savings, low inflation, strong balance of payments surplus, low external debt and high foreign exchange reserves have helped to complement the success of fiscal policy.

Federal Government

Better revenue outturn has helped to contain deficit despite additional expenditures made during the year to sustain the growth momentum...

The initial recovery in the external sector, which showed signs of weakness by mid 2002, prompted the Government to adopt a mild expansionary budget while maintaining a consolidation thrust. For 2002, despite additional development and operating expenditures allocated during the year, the overall financial position is expected to register a deficit of 4.7% to GDP, better than the budgetted 5.1% last October (2001: 5.5% of GDP), as shown in Table 3.1. The continued good revenue outturn has helped to reduce the fiscal deficit.

TABLE 3.1

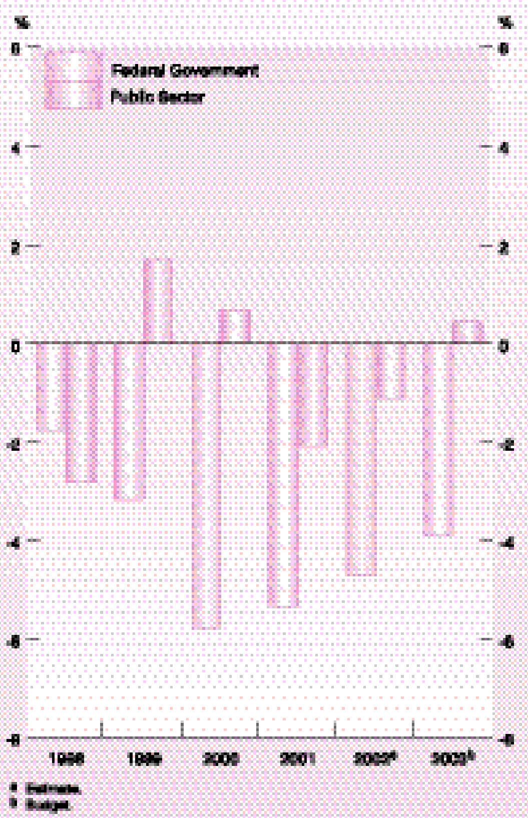
Federal Government Financial Position
2001-2003

	RM million			Change (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003
Revenue	79,567	83,550	89,793	28.6	5.0	7.5
Operating expenditure	63,757	66,706	71,737	12.8	4.6	7.5
Current balance	15,810	16,844	18,056	197.3	6.5	7.2
Gross development expenditure	35,235	35,342[4]	34,963[4]	26.1	0.3	-1.1
Less: Loan recoveries	1,003	1,700	2,000	-65.5	69.5	17.6
Net development expenditure	34,232	33,642	32,963	36.8	-1.7	-2.0
Overall balance	-18,422	-16,798	-14,907	-6.6	-8.8	-11.3
% to GDP	-5.5	-4.7	-3.9			

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.
[4] Exclude contingency fund of RM2,000 million.

CHART 3.2

Percentage of Overall Deficit/Surplus to Gross Domestic Product



Revenue

Revenue as a percentage of GDP has recovered to pre-crisis level...

The strong revenue performance is expected to continue in the light of a better GDP growth in 2002, although at a slower rate. After increasing significantly by 28.6% in 2001, the revenue for 2002 is expected to expand by 5%, as shown in Table 3.2. Although the year-to-year increase in percentage term is moderating, the level at RM83,550 million is high given the much bigger revenue base in the previous year. Most categories of tax revenue, in particular direct taxes, are envisaged to register an increase. Non-tax revenue, as a group, is expected to record a decline due to lower petroleum royalties and investment income because of smaller production and lower prices of crude oil. On the whole, the total revenue to GDP ratio is estimated to be maintained at 23.5% (2001: 23.8%). The Federal Government revenue position is, therefore, higher than the average of 19.2% during the crisis years from 1998 to 2000 and is back to the pre-crisis levels of 23.3%.

In line with economic recovery and the current year assessment system, direct tax revenue

TABLE 3.2

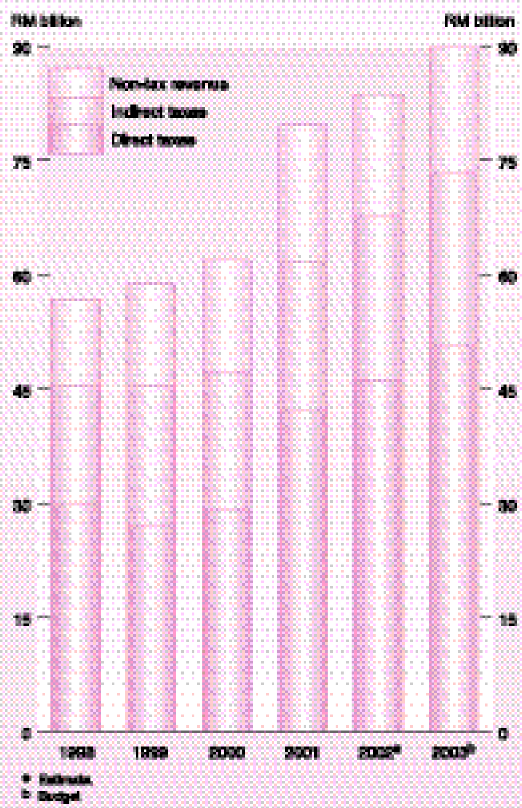
Federal Government Revenue
2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Tax revenue	61,491	67,472	73,144	30.4	9.7	8.4	77.3	80.8	81.4
Direct tax	42,098	46,125	50,587	44.4	9.6	9.7	52.9	55.2	56.3
Indirect tax	19,393	21,347	22,527	7.6	10.1	5.5	24.5	25.5	25.1
Non-tax revenue	18,076	16,078	16,679	23.0	-11.1	3.7	22.7	19.2	18.6
Total revenue	79,567	83,550	89,793	28.6	5.0	7.5	100.0	100.0	100.0
% of GDP	23.8	23.5	23.4						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

CHART 3.3

Major Components of Federal Government Revenue



performance is envisaged to remain buoyant. Unrelenting efforts directed at tax dodgers and those with past arrears continue to contribute to better revenue collection. The Inland Revenue Department's "street survey" operations to identify new companies and individual taxpayers also helped to improve revenue performance. Collection from corporate income tax, which contributed 56.6% to total revenue, is significantly higher by 25.7%, as shown in Table 3.3 due to better performance of the corporate sector. Similarly, collection from individual income tax is slightly higher in line with general increase in income despite the lower income tax rates announced in the 2002 Budget. Petroleum income tax, which is based on the previous year's income, is expected to decline due to lower prices of crude petroleum averaging USD24.92 per barrel in 2001 (tax base year for 2002) compared with USD30.18 per barrel in 2000.

Indirect tax revenue is expected to perform well due to improved sales tax collection arising from hikes in prices of petroleum products and higher sales tax on these products, as shown in Table 3.4. Similarly, the continued strong sales of motor vehicles are expected to lead to higher receipts of excise duties. Collections of excise

TABLE 3.3

Federal Government Direct Tax
2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Income Taxes	40,137	43,932	48,043	48.6	9.5	9.4	95.3	95.2	95.0
Companies	20,771	26,100	28,594	49.4	25.7	9.6	49.3	56.6	56.5
Individuals	9,436	10,416	11,735	34.5	10.4	12.7	22.4	22.6	23.2
Petroleum	9,859	7,334	7,628	64.0	-25.6	4.0	23.4	15.9	15.1
Co-operative	71	82	86	-18.4	15.5	4.9	0.2	0.2	0.2
Others	1,961	2,193	2,544	-8.3	11.8	16.0	4.7	4.8	5.0
Stamp duty	1,649	1,800	2,081	-8.3	9.2	15.6	3.9	3.9	4.1
Others	312	393	463	-8.2	26.0	17.8	0.7	0.9	0.9
Total	42,098	46,125	50,587	44.4	9.6	9.7	100.0	100.0	100.0
% of GDP	12.6	13.0	13.2						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

TABLE 3.4

Federal Government Indirect Tax
2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Export duties	867	821	863	-16.0	-5.3	5.1	4.5	3.8	3.8
Import duties	3,193	3,385	3,513	-11.3	6.0	3.8	16.5	15.9	15.6
Excise duties	4,129	4,272	4,349	8.6	3.5	1.8	21.3	20.0	19.3
Sales tax	7,356	9,016	9,286	23.3	22.6	3.0	37.9	42.2	41.2
Service tax	1,926	2,167	2,450	13.2	12.5	13.1	9.9	10.2	10.9
Others	1,922	1,686	2,066	0.4	-12.3	22.5	9.9	7.9	9.2
Total	19,393	21,347	22,527	7.6	10.1	5.5	100.0	100.0	100.0
% of GDP	5.8	6.0	5.9						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

and import duties are also bolstered by the higher duties on cigarettes and tobacco. Motor vehicles contribute 67.8% to the total excise duty while cigarettes and tobacco products contribute 19.7%. On service tax, a comprehensive review in terms of coverage and thresholds was carried out in the 2002 Budget which came into effect on January 1, 2002. Receipts from service tax are higher due to lower thresholds for each establishment required to pay service tax as well as the wider coverage of taxable services. Receipts from export duties are expected to moderate due to lower oil prices and export volume during the year.

Overall tax revenue is expected to grow by 9.7% and contribute 80.8% to total revenue. In contrast, the growth of non-tax revenue is expected to decline by 11.1%, as shown in Table 3.5 and its share slip to 19.2% (2001: 22.7%) of total revenue. Revenue from licences and permits as a group is also expected to decline, largely on account of reduced collection of petroleum royalties in tandem with lower production and softer petroleum prices. The higher collection from road tax due to continued strong sales and increased number of motor vehicles are, however, expected to mitigate the decline in total collection under licence and permit. Dividend and investment income is lower on account of a smaller dividend payout by Bank Negara Malaysia.

Expenditure Policy

Expenditures were directed at increasing consumption in the immediate term and maintaining productivity and competitiveness in the longer term...

Total Federal Government expenditure is projected to expand by 3.1% to RM102,048 million in order to support the ongoing economic recovery. In line with the 2002 Budget strategy, which is to sustain economic growth momentum, enhance private sector's resilience and competitiveness, diversify sources of growth and ensure more equitable distribution of wealth, the Federal Government expenditure was directed at both the immediate objective of enhancing consumption and the longer term objective of increasing productivity and competitiveness to sustain growth. The expenditure is complemented by a wide range of fiscal incentives. In this regard, the reduction of personal income tax rates, the abolishment of tax disincentives for bonus payments as well as the reduction or abolishment of import duties on selected goods

TABLE 3.5

Federal Government Non-Tax Revenue
2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Licences/permits	5,995	5,490	5,708	8.1	-8.4	4.0	33.2	34.1	34.2
Services/fees	621	693	708	7.8	11.6	2.2	3.4	4.3	4.2
Investment income	10,056	8,205	8,450	36.2	-18.4	3.0	55.6	51.0	50.7
Others	1,404	1,690	1,813	18.7	20.4	7.3	7.8	10.5	10.9
Total	18,076	16,078	16,679	23.0	-11.1	3.7	100.0	100.0	100.0
% of GDP	5.4	4.5	4.3						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

have helped to bolster consumption and aggregate demand. On tax measures to increase competitiveness and reduce the cost of doing business, reinvestment allowance and other tax incentives were revised and their coverage extended to encourage investment and promote downstream agro-based industries. Other incentives include tax exemption on royalty payments and expenses on educational equipment by educational institutions and excise duty exemption for the purchase of national cars for rental are aimed at promoting services such as education and tourism.

Apart from the higher expenditure and wider tax incentives, implementation procedures are reviewed and disbursement of funds expedited to ensure that fiscal spending achieves the desired impact on the economy. In this regard, the Ministry of Finance will constantly monitor the progress of project implementation to ensure minimal delay and adherence to schedule. Procedures, rules and guidelines governing development projects and payment to contractors were reviewed and simplified to further accelerate implementation and disbursement of funds. In relation to this, for projects that have not begun three months after being approved or were 30 per cent behind schedule, a special committee will review the status of the delayed projects and if necessary terminate the contracts. For projects so terminated, the committee will appoint new contractors to speed up implementation and contain cost. In addition, implementing agencies are authorised to approve tenders with higher amounts while contractors who have been awarded projects are given advance payments to facilitate early project start-ups. As a result of all these measures, the expenditure shortfall in 2002 is expected to remain small as in 2001, where the shortfall for operating and development expenditures were 1.6% and 3.9%, respectively.

Operating Expenditure

Operating expenditure has the immediate effect in boosting aggregate demand...

To sustain domestic demand through higher public sector consumption, operating expenditure is envisaged to increase further by 4.6% in 2002, as shown in Table 3.6 (2001: 12.8%). Total emolument is projected to expand by 4.5%.

TABLE 3.6

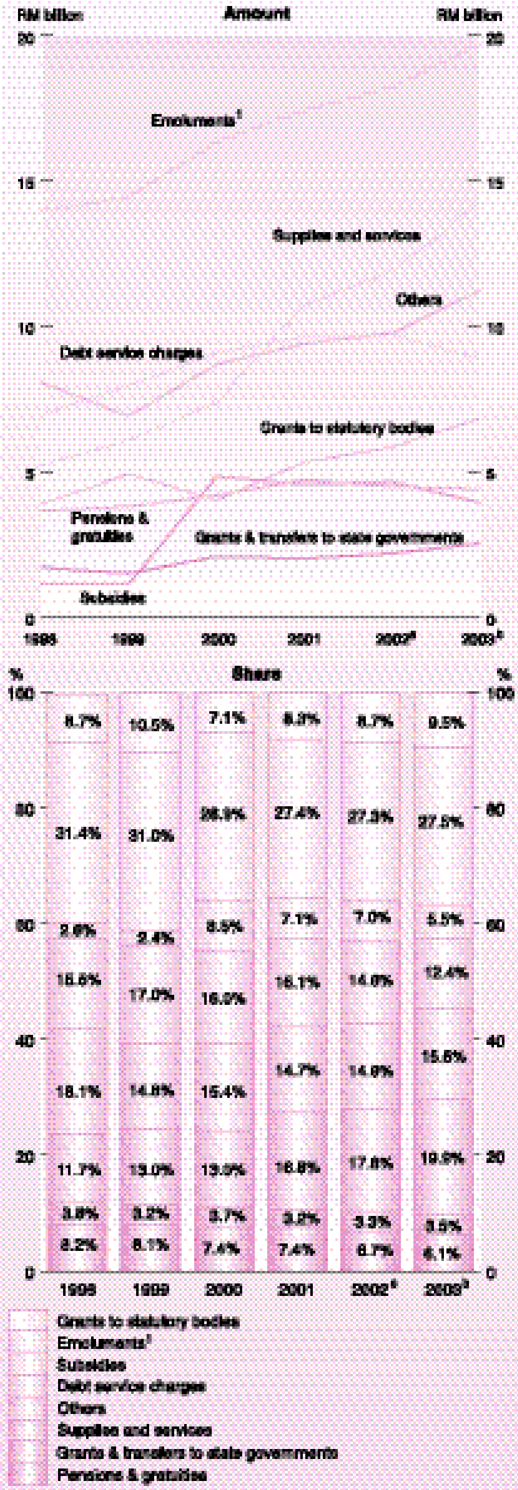
Federal Government Operating Expenditure by Object 2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Emolument	17,443	18,232	19,727	6.6	4.5	8.2	27.4	27.3	27.5
Debt service charges	9,634	9,710	8,868	6.4	0.8	-8.7	15.0	14.6	12.4
Grants to state government	2,012	2,189	2,534	-3.1	8.8	15.8	3.2	3.3	3.5
Pension and gratuities	4,711	4,486	4,408	12.5	-4.8	-1.7	7.4	6.7	6.1
Supplies and services	10,703	11,854	14,253	45.4	10.8	20.2	16.8	17.8	19.9
Subsidies	4,552	4,646	3,936	-5.6	2.1	-15.3	7.1	7.0	5.5
Grants to statutory bodies[4]	5,312	5,833	6,807	41.8	9.8	16.7	8.3	8.7	9.5
Refunds	1,776	2,376	2,731	-25.5	33.8	14.9	2.8	3.6	3.8
Others	7,614	7,380	8,473	15.0	-3.1	14.8	12.0	11.1	11.8
Total	63,757	66,706	71,737	12.8	4.6	7.5	100.0	100.0	100.0
% of GDP	19.1	18.8	18.7						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.
[4] Includes emolument.

CHART 3.4

Federal Government Operating Expenditure



1 Excludes emoluments for most statutory bodies.
e Estimate.
b Budget.

The ten per cent salary adjustment for civil servants, extension of pension age from 55 to 56 years and increase in overtime allowances for doctors as well as gratuities and grants for armed forces and police personnel have an immediate effect in boosting consumption. On the other hand, gratuity payments are slightly lower due to the extension of pension age from 55 to 56 years, which reduced the need for gratuity provision in 2002. Outlays on supplies and services continued to rise largely on account of increased activities in repair and maintenance as well as higher procurement relating to e-government flagship applications and payment of professional services to improve and upgrade the delivery of public services. Similarly, the special scheme to improve the skills of the unemployed graduates especially in science, mathematics, computer and languages as well as on-the-job training in Government departments and agencies through the graduate attachment scheme under last year’s stimulus programme are expected to increase expenditure on supplies and services by 10.8% (2001: 45.4%). Debt service charges for domestic and external loans increased marginally by 0.8% in 2002. However, as a percentage to total operating expenditure, it continues to remain low at 14.6% and has even improved when compared to the previous year. Expenditure on subsidies for diesel and liquefied petroleum gas (LPG), rice, fertilisers, textbooks as well as the food and nutrition programme for school children is projected to be slightly higher by 2.1%.

Development Expenditure

Development expenditure is aimed at capacity building that enhances efficiency, improves social well-being as well as provides an enabling environment for the private sector to compete...

Development expenditure in 2002 is expected to expand marginally by 0.3% after a sharp increase by 26.1% in 2001, as shown in Table 3.7. The expenditure continues to aim at building capacities and capabilities to provide the enabling environment for the private sector to compete and excel, including measures that would reduce the costs of doing business such as the provision of reliable utilities at reasonable costs, good infrastructure, and effective delivery systems of

TABLE 3.7

Federal Government Development Expenditure by Sector 2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Economic services	12,725	14,925	12,693	9.3	17.3	-15.0	36.1	42.2	36.3
Social services	15,384	14,535	16,127	38.9	-5.5	11.0	43.7	41.1	46.1
Security	3,287	3,080	3,063	41.0	-6.3	-0.5	9.3	8.7	8.8
General administration	3,839	2,802	3,080	32.7	-27.0	9.9	10.9	7.9	8.8
Total	35,235	35,342	34,963	26.1	0.3	-1.1	100.0	100.0	100.0
% of GDP	10.5	9.9	9.1						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

TABLE 3.8

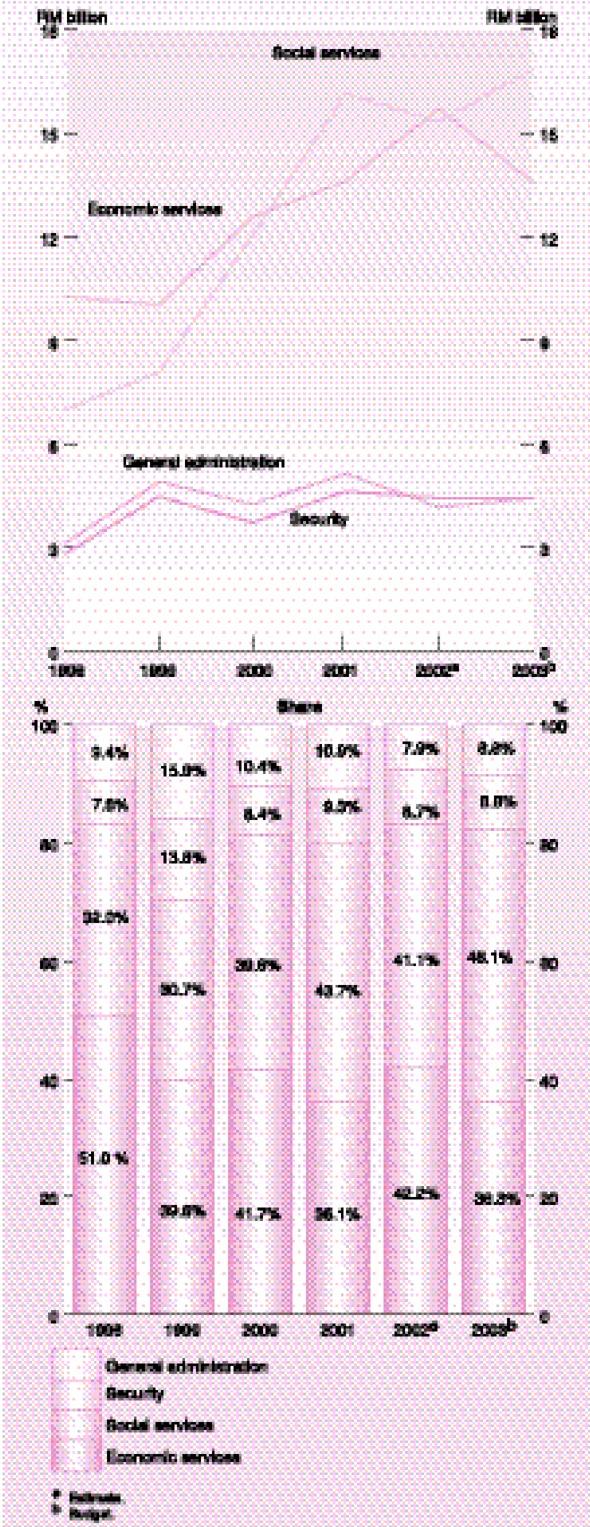
Federal Government Development Expenditure for Social Services 2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Education	10,363	9,275	9,795	46.0	-10.5	5.6	67.4	63.8	60.7
Health	1,570	1,316	1,790	23.4	-16.2	36.0	10.2	9.1	11.1
Housing	1,268	1,882	2,150	6.2	48.4	14.3	8.2	12.9	13.3
Others	2,182	2,063	2,392	44.4	-5.5	16.0	14.2	14.2	14.8
Total	15,384	14,535	16,127	38.9	-5.5	11.0	100.0	100.0	100.0
% of GDP	4.6	4.1	4.2						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

CHART 3.5

Federal Government Development Expenditure by Sector



public services. Part of the development expenditure is also used to finance corporate restructuring exercises presently in progress. After a hike of 38.9% in 2001, the expenditure for social services declined by 5.5% to RM14.535 million in 2002 but is still substantial, accounting for 41.1% of development expenditure, as shown in Table 3.7. The bulk of the allocation will be for human resource development, an essential prerequisite for successful transformation to a knowledge-based economy. In this context, upgrading of facilities for science and computer education as well as construction of new single session schools and community colleges will continue to be given emphasis.

Outlays for housing will remain large, increasing by 48.4%, reflecting the unwavering commitment of the Government to provide decent housing for the poor, as well as for those in the armed forces, police and the teaching profession. Of the total amount allocated under housing, 48.9% is for the public while the remaining 51.1% is for armed forces personnel and other categories of civil servants. Expenditure on health is envisaged to decline after a significant increase in 2001. However, reflecting the Government's objective to improve services in the rural areas, the provision for rural health care is expected to increase in 2002, particularly for the construction and installation of the latest health equipment in rural health clinics. Other expenditure under health services includes upgrading and construction of hospitals. In addition, priority is also given to improve rural accessibility to economic and social services such as electricity, water supply and roads to narrow the rural-urban gap.

In the economic services sector, the Government continues to emphasise on four main areas, namely rural and agriculture development, infrastructure and utilities, industrial development focussing on the development of venture capital, e-commerce and small and medium enterprises (SMEs), as well as services, in particular tourism, as shown in Table 3.9. Expenditure on infrastructure is largely for construction and upgrading of roads and the electric rail double tracking project. Expenditure for water and electricity supplies and other public amenities is expected to increase significantly in line with the Government's continued objective to enhance quality of life, particularly among the rural population.

TABLE 3.9

Federal Government Development Expenditure for Economic Services 2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Agriculture and rural development	1,394	3,040	2,886	17.8	118.1	-5.1	11.0	20.4	22.7
Public utilities	1,092	2,587	1,785	-28.0	136.9	-31.0	8.6	17.3	14.1
Trade and industries	4,830	5,546	2,517	31.7	14.8	-54.6	38.0	37.2	19.8
Transport	5,042	3,631	4,892	3.7	-28.0	34.7	39.6	24.3	38.5
Communications	330	53	193	44.6	-83.9	263.5	2.6	0.4	1.5
Others	37	67	420	-79.4	81.1	526.9	0.3	0.4	3.3
Total	12,725	14,925	12,693	9.3	17.3	-15.0	100.0	100.0	100.0
% of GDP	3.8	4.2	3.3						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

TABLE 3.10

Federal Government Development Expenditure for Trade and Industry Programme 2001-2003

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Economic services/Industry	3,264	3,953	1,315	39.1	21.1	-66.7	67.6	71.3	52.2
Tourism	482	304	314	21.4	-36.9	3.2	10.0	5.5	12.5
Small & medium enterprises	1,069	1,289	888	-	20.6	-31.1	22.1	23.2	35.3
Others	14	-	-	27.3	-	-	0.3	0.0	0.0
Total	4,830	5,546	2,517	31.7	14.8	-54.6	100.0	100.0	100.0
% of GDP	1.4	1.6	0.7						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

TABLE 3.11

Federal Government Development Expenditure for Agriculture and Rural Development Programme 2000-2002

	RM million			Change (%)			Share (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003	2001	2002	2003
Agriculture	888	2,501	2,556	220.6	181.6	2.2	63.7	82.2	88.6
Land development	162	352	132	62.0	117.3	-62.5	11.6	11.6	4.6
Fisheries	113	99	87	3.7	-12.4	-12.1	8.1	3.3	3.0
Livestock	42	53	66	-6.7	27.1	23.6	3.0	1.7	2.3
Forestry	19	35	43	54.8	85.3	21.5	1.4	1.2	1.4
Others	169	-	2	40.8	-	-	12.2	0.0	0.1
Total	1,394	3,040	2,886	17.8	118.1	-5.1	100.0	100.0	100.0
% of GDP	0.4	0.9	0.8						

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

For expenditure under economic services/ industry, as shown in Table 3.10, the bulk of it is for research and development carried out by industrial research agencies such as the Malaysian Institute of Micro-Electronic Systems (MIMOS), Standards and Industrial Research Institute of Malaysia (SIRIM) and Technology Park Malaysia. This reflects the Government's emphasis on enhancing research and development capabilities to support the nation's competitiveness. Realising the role of SMEs in providing the linkages across sectors of the economy, 23.2% of the expenditure for trade and industry is for the development of SMEs.

Increased expenditure on agriculture and rural development, as shown in Table 3.11, reflects the Government's policy to revitalise the agriculture sector as the third engine of growth. Areas with potential and given emphasis include herbal and agro-based products, ornamental fish and horticulture as well as the development of food and halal food industries, with the latter having the potential in view of the vast international markets.

The aftermath of the September 11 incident has created greater awareness of the importance and the need to enhance defence and internal security. Hence, defence expenditure that focusses on enhancing the capability of the armed forces and police to meet increasing sophisticated challenges related to national security calls for constant upgrading of military and surveillance equipment as well as the knowledge and skill level of security personnel manning the equipment. Expenditure for general administration is envisaged to decline due to gradual completion of the development at Putrajaya, while the construction of ICT infrastructure to support e-government applications and computerisation to enhance productivity of the government machinery is expected to be sustained at the previous year's level.

Financing

Improved credit standing reduces cost of borrowing...

Given ample liquidity, the Government continues to fund its financing requirements from domestic

TABLE 3.12

Federal Government Financing
2001-2002

	RM million		Share (%)	
	2001	2002	2001	2002
Net domestic borrowing	*13,381*	6,082	72.6	36.2
Gross borrowing	23,500	18,000	77.0	59.5
Investment Issues	2,000	3,000	8.5	16.7
Government Securities	21,500	15,000	*91.5*	*83.3*
Less: Repayment	10,119	11,918		
Net external borrowing	6,294	9,789	34.2	58.3
Gross borrowing	7,029	12,245	23.0	40.5
Market loans	6,385	9,170	90.8	74.9
Project loans	645	3,075	9.2	25.1
Less: Repayment	735	2,456		
Change in assets[1]	-1,253	927	-6.8	5.5
Total	18,422	16,798	100.0	100.0

[1] (-) indicates an accumulation of assets.

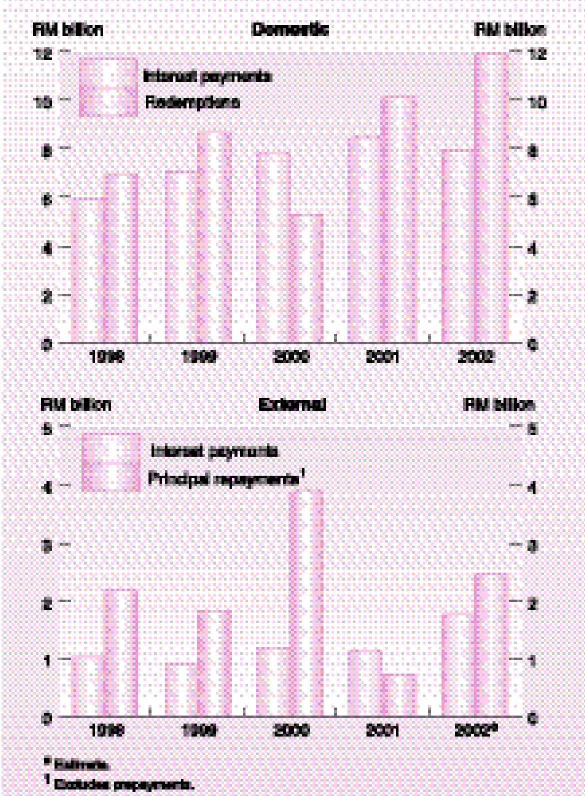
sources. Total Federal Government gross borrowing is estimated at RM30,245 million, of which 59.5% is from domestic sources, as shown in Table 3.12. After taking into consideration repayments, total net borrowing amounts to RM15,871 million. However, the total Federal Government outstanding debt is expected to increase by RM22,111 million to RM167,835 million after taking into consideration estimated foreign currency exchange loss, the assumption of debts incurred by public agencies and privatised entities as well as net borrowing for the Treasury Housing Loan Fund. At this level, the debt burden is sustainable and manageable given the low debt service charges at 14.6% of operating expenditure.

Net domestic borrowing is envisaged to account for RM6,082 million or 36.2% of the financing need in 2002. As in the past, net domestic borrowing is expected to come mainly from issuance of Malaysian Government Securities (MGS) to provident, pension and insurance funds. In addition to being non-inflationary, the regular issuance of MGS will continue to improve liquidity and support the development of the bond market in Malaysia. During the year, the Federal Government is expected to reopen three existing MGS issues totalling RM9,000 million in addition to one fresh issue amounting to RM6,000 million. Other instruments used to raise domestic borrowings are expected to come from Government Investment Issues (GII) and Treasury Bills (TB). On a net basis, no new fund is expected from TB while GII is expected to increase the net borrowing by RM1,000 million.

Net external borrowing is higher at RM9,789 million, accounting for 58.3% of the financing need in 2002. The increase is largely due to loans taken to finance the restructuring of the national airline and the establishment of the Venture Capital Fund for ICT development. Taking advantage of the favourable market conditions of low interest rate and the much-improved credit worthiness of the Government, the bulk of the external loan is derived from market sources where both the conventional global bond and the international Islamic bond were issued. On 5 March 2002, a global bond amounting to USD750 million was issued at 175 basis points above the 10-year US Treasuries compared to a similar loan raised a year earlier at 228 basis points, reflecting increased confidence of foreign investors. In consonance with the Government's objective to develop Islamic banking and to provide impetus for the development of international finance based on Islamic principles, an international Islamic bond issue amounting to USD600 million was raised on 25 June 2002 at 95 basis points above the six-month dollar London Inter Bank Offered Rate (LIBOR). Market loan is expected to contribute 74.9% of the total gross external borrowing, with the remainder constituting the draw-down of existing loans from multilateral and bilateral sources.

CHART 3.6

Federal Government Loans - Principal Repayments, Redemptions and Charges



Debt

Prudent financial management contains the nation's debt level...

During the year, net domestic and external borrowings are projected to increase the Federal Government debt by 15.2% to RM167,835 million or 47.1% of GDP, as shown in Table 3.13. While domestic debt grew moderately at 7.3%, external debt is expected to increase by 54.5% to RM37,578 million, largely on account of external loans taken for the development of ICT infrastructure, the establishment of Venture Capital Fund and the restructuring of the national airline and other corporate restructuring exercises. The external debt, as a percentage of total Federal Government debt, is projected to increase from 16.7% to 22.4%, indicating a greater use of external sources of financing in 2002.

The nation's external debt comprising Federal Government, Non Financial Public Enterprises (NFPEs), and the private sector long- and short-term external debts remain low despite the higher Federal Government external debt. This is largely on account of the net repayment of NFPEs and private sector debt, which have helped to contain the increase in national debt.

The bulk of the nation's external debt is medium- and long-term with short-term debt constituting only 14.6% of the total, as shown in Table 3.14. International reserves to short-term debt ratio, a measure of reserve adequacy to meet sudden need to repay short-term debt, is 4.8 times as at end of July 2002, reflecting prudent debt management and practice. The external debt service ratio, a measure of principal repayment and interest charges against the country's exports, is expected to remain low at 5.8%. Similarly, the ratio of external debt to GDP at 51.7% is manageable and would place Malaysia as a medium-indebted country.

CHART 3.7

Composition of Federal Government Borrowing in 2002

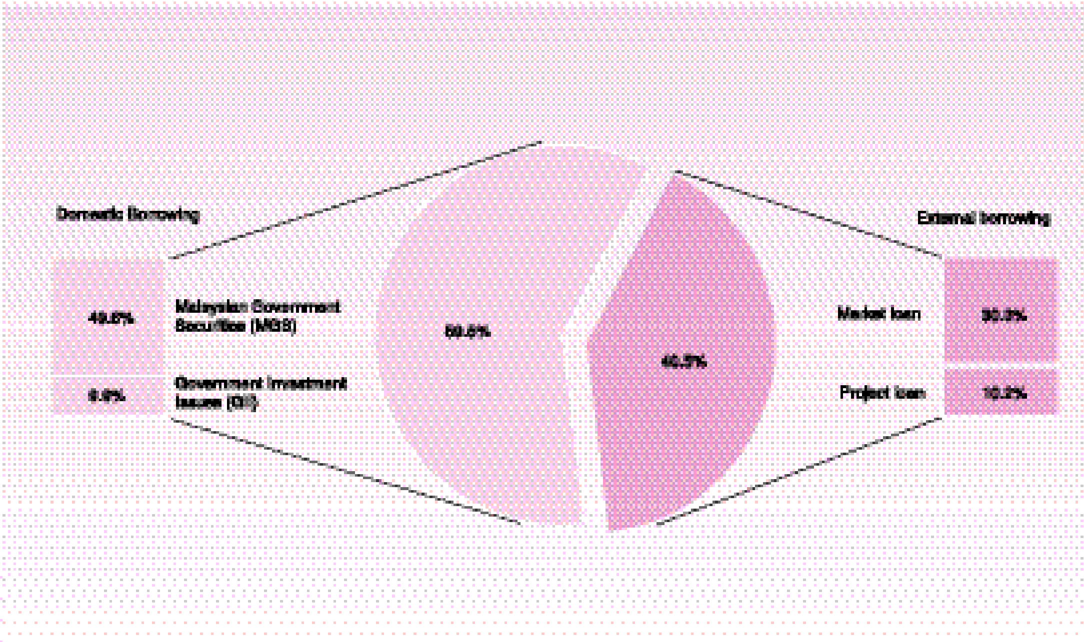


TABLE 3.13

Federal Government Debt
2001-2002

	RM million		Share (%)		GDP (%)	
	2001[1]	2002[2]	2001	2002	2001	2002
Domestic debt	121,396	130,257	83.3	77.6	36.3	36.6
Treasury Bills	4,320	4,320	3.6	3.3	1.3	1.2
Investment Issues	4,000	5,000	3.3	3.8	1.2	1.4
Government Security	103,450	109,550	85.2	84.1	30.9	30.8
Other domestic loans[3]	9,626	11,387	7.9	8.7	2.9	3.2
External debt	24,328	37,578	16.7	22.4	7.3	10.6
Market loans	17,683	27,223	72.7	72.4	5.3	7.7
Project loans	6,646	10,355	27.3	27.6	2.0	2.9
Total	145,724	167,835	100.0	100.0	43.6	47.2

[1] Estimated actual.
[2] Revised estimate.
[3] Mainly syndicated loans from foreign banks incorporated in Malaysia and loans taken for Treasury Housing Loan Fund.

CHART 3.8

Federal Government Debt

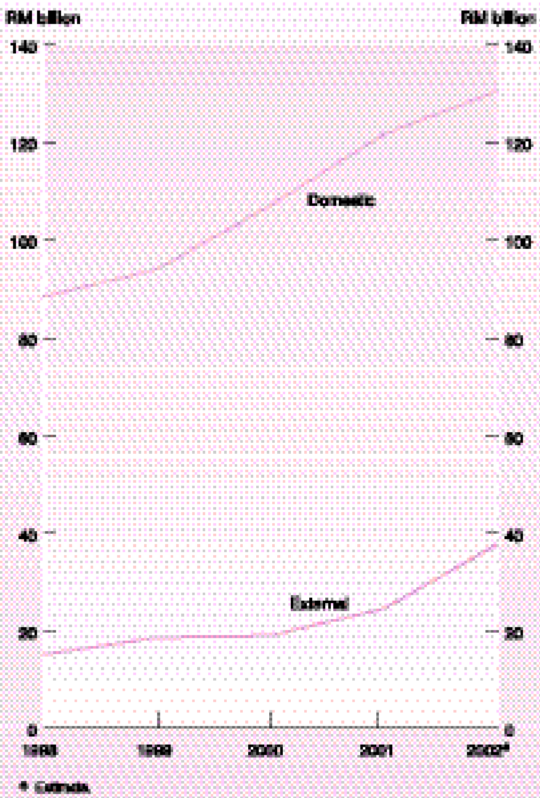


CHART 3.9

Federal Government External Debt by Sources

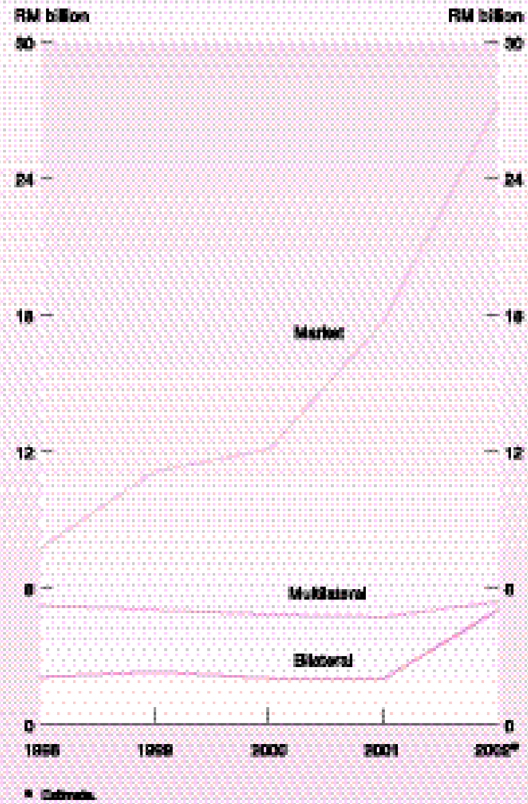


TABLE 3.14

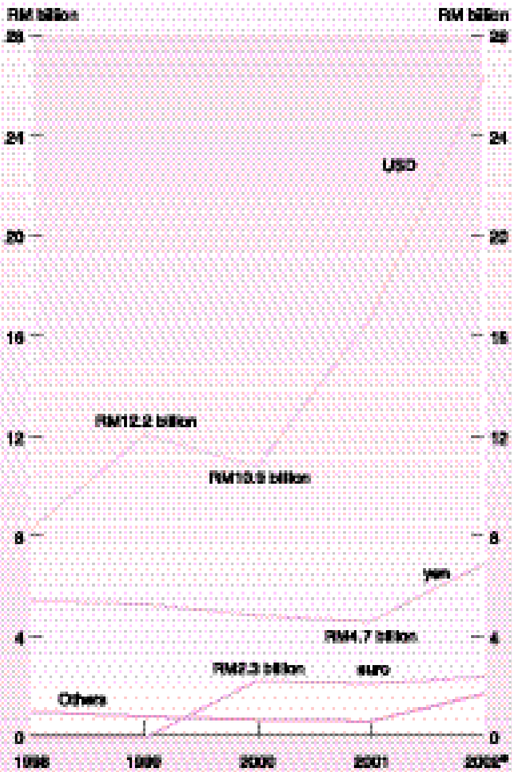
National Debt
2001-2002

	RM million		Share (%)		GDP (%)	
	2001[1]	2002[2]	2001	2002	2001	2002
Medium and long term debt	149,193	156,973	86.2	85.4	44.6	44.2
Public sector	91,743	101,889	53.0	55.4	27.4	28.7
Federal Government	24,328	37,578	14.0	20.4	7.3	10.6
NFPEs	67,415	64,311	38.9	35.0	20.1	18.1
Guanranteed	10,606	9,535	6.1	5.2	3.2	2.7
Non-Guanranteed	56,809	54,776	32.8	29.8	17.0	15.4
Private sector	57,450	55,084	33.2	30.0	17.2	15.5
Short term debt	23,974	26,936	13.8	14.6	7.2	7.6
Total	173,167	183,909	100.0	100.0	51.8	51.7

[1] Estimated actual.
[2] Revised estimate.

CHART 3.10

Federal Government External Debt by Currency



* Estimate.

CHART 3.11

External Debt Service Ratio

* Estimate.

State Governments

State governments continue to register an overall deficit, financed largely from Federal Government grants...

The consolidated financial position of the 13 state governments is expected to register a lower overall deficit amounting to RM1,460 million in 2002 or 0.4% of GDP (2001: -RM1,697 million or 0.5% of GDP), as shown in Table 3.15. As in the past, the deficit is largely financed by grants from the Federal Government amounting to RM2,635 million.

State revenue which consists of two major components, namely revenue from own sources and non-revenue receipts, is expected to increase by 19.6% to RM9,940 million in 2002. States' own sources of revenue are 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. As for tax revenue sources, the higher collection is largely from land and land-related taxes and entertainment tax. Non-revenue receipts, comprising mainly Federal Government grants and reimbursements to state governments, are sustained at previous year's level to ensure adequate financing of infrastructure and amenities provided by the states.

Total operating expenditure of state governments is estimated to increase by 6.4% to RM5,644 million (2001: RM5,305 million).

Supplies and services remains the largest component of operating expenditure, constituting 32.2%. Following a salary adjustment for state civil servants, expenditure on emolument increased by 7.5%, constituting 33% of the operating expenditure. Development expenditure, on the other hand, increased significantly by 22.4%. The increase in expenditure was largely due to expansion and upgrading of public amenities, water supply projects, infrastructure, housing, and agriculture and rural development.

General Government

The deficit of the general government is largely due to the deficit incurred by state governments and statutory bodies, the financing of which is largely through Federal Government transfers...

The consolidated position of the general government which consists of accounts of the Federal Government, state governments, local governments and statutory bodies after netting out inter-government transfers such as grants and net lending shows a deficit of RM16,760 million or 4.7% of GDP (2001: RM16,746 million or 5.0% of GDP), as shown in Table 3.16. The deficit of the general government is largely due to the deficits incurred by the statutory bodies and state governments and is mainly financed through transfers by the Federal Government.

TABLE 3.15

Consolidated State Governments Financial Position
2001-2002

	RM million		Change (%)	
	2001[1]	2002[2]	2001	2002
Current account				
Revenue	8,312	9,940	-19.4	19.6
Operating expenditure	5,305	5,644	1.0	6.4
Current account balance	3,007	4,296	-40.6	42.9
Development account				
Gross development expenditure	4,870	5,953	-8.9	22.2
Development fund	4,133	4,953	-12.8	19.8
Water supply fund	737	1,000	21.6	35.7
Loan recoveries	166	197	-37.6	18.7
Net development expenditures	4,704	5,756	-7.4	22.4
Overall balance	-1,697	-1,460		
% of GDP	-0.5	-0.4		

[1] Estimated actual.
[2] Revised estimate.

Non-Financial Public Enterprises (NFPEs)

Despite challenging business environment, NFPEs continue to record a significant increase in overall surplus...

The NFPEs, as a group, continues to perform well in 2002 despite the challenging external environment, with the overall surplus expected to record a significant increase by 44.6% to RM13,616 million (2001: RM9,414 million), as shown in Table 3.17. The NFPEs continue to play a significant role in the economy, particularly in natural resource development and the provision of public utilities.

The consolidated revenue of the NFPEs is envisaged to increase by 5.5% to RM110,902 million due to continued strong demand for telecommunication and utility services, while the performance of the oil and gas-related sector, as indicated through the revenue of PETRONAS, has remained commendable when compared with the previous year.

The commissioning of several development projects that commenced operations in 2002 led to an 8.8% increase in current expenditure. In addition, the continuous quest for better service delivery through organisational restructuring and operation reviews also contributed to the increase in operating expenditure.

Development expenditure, on the other hand, declined by 14.1% due largely to the completion of some major overseas development projects

TABLE 3.16

Consolidated General Government Financial Position
2001-2003

	RM million			Change (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003
Current account						
Revenue	91,633	99,848	105,751	20.6	9.0	5.9
Operating expenditure	72,299	76,409	82,134	12.2	5.7	7.5
Current account balance	19,334	23,439	23,617	67.3	21.2	0.8
Development expenditure	36,080	40,199	39,600	16.9	11.4	-1.5
Overall balance	-16,746	-16,760	-15,983	-13.3	0.1	-4.6
% to GDP	-5.0	-4.7	-4.2			

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.

TABLE 3.17

Consolidated NFPEs Financial Position[1]
2001-2002

	RM million		Change (%)	
	2001[3]	2002[4]	2001	2002
Revenue	105,075	110,902	-9.0	5.5
Current expenditure	65,918	71,750	-8.1	8.8
Retained income	39,157	39,152	-10.4	0.0
% of GDP	11.7	11.0		
Development expenditure[2]	29,743	25,536	27.3	-14.1
Overall balance	9,414	13,616	-53.7	44.6
% of GDP	2.8	3.8		

[1] Refer to 36 NFPEs.
[2] Include grant from the Federal Government.
[3] Actual.
[4] Estimate.

in 2001. Although development expenditure is lower, the focus was on modernisation, upgrading and investments abroad to seek new avenues for growth and earnings. In this regard, although some of the development projects have been completed, many others are still ongoing from previous years such as the construction of Liquefied Natural Gas (LNG) ships for the Malaysia International Shipping Corporation (MISC) and production-sharing contracts for the development of LNG. Other PETRONAS development projects include the phased development of the permanent campus of Universiti Technologi PETRONAS in Tronoh, Perak. As for Tenaga Nasional Berhad (TNB), a large portion of the capital expenditure is for expansion and upgrading of transmission and power generation. Major projects include the Jenariang Power Station, Port Dickson Power Station Rehabilitation Phase 1 and sub-stations in Jalan Pantai and Sentul Raya. In the case of Telekom Malaysia Berhad (TMB), the focus of its development expenditure is to further upgrade and rationalise the telecommunication sector. The capital expenditure of Putrajaya Holdings Sdn. Bhd. remains large because of the ongoing projects to develop the new federal administrative capital at Putrajaya.

Consolidated Public Sector

The lower overall deficit of the consolidated public sector is mainly due to lower development expenditure by the NFPEs...

The financial position of the consolidated public sector, which consists of the accounts of the general government and the NFPEs after netting out transfers and net lending, continues to record a surplus in the current account despite lower current surplus of NFPEs. The increase in the consolidated revenue coupled with lower development expenditure of NFPEs is expected to lead to lower overall deficit in the consolidated public sector account at RM3,737 million or 1.1% of GDP in 2002 (2001: -RM7,143 million or 2.1% of GDP), as shown in Table 3.18.

Fiscal Outlook For 2003

Fiscal policy emphasises on consolidation while focussing on education and rural development...

A more robust growth prospect anticipated for 2003 will allow the Government to reduce its direct interventionist role in the economy undertaken since the financial crisis in 1997. This will enable the Government to further

TABLE 3.18

Consolidated Public Sector Financial Position
2001-2003

	RM million			Change (%)		
	2001[1]	2002[2]	2003[3]	2001	2002	2003
Revenue[4]	91,633	99,848	105,751	20.6	9.0	5.9
Operating expenditure	72,299	76,409	82,134	12.2	5.7	7.5
NFPEs current surplus	38,958	38,880	40,514	-5.5	-0.2	4.2
Public sector current balance	58,292	62,319	64,131	10.5	6.9	2.9
Development expenditure	65,435	66,056	62,694	29.7	0.9	-5.1
General Government[5]	35,692	40,520	39,880	31.8	13.5	-1.6
NFPEs	29,743	25,536	22,814	27.3	-14.1	-10.7
Overall balance	-7,143	-3,737	1,437			
% to GDP	-2.1	-1.1	0.4			

[1] Estimated actual.
[2] Revised estimate.
[3] Budget estimate, excluding 2003 tax measures.
[4] Excludes transfers and net lending within general government.
[5] Development expenditure differs from development expenditure in Table 3.16 due to transfers and net lending.

consolidate its fiscal position in order to provide for greater policy flexibility in times of crisis. Hence, the budgetted deficit is expected to decline to 3.9% of GDP (2002: 4.7% of GDP), as shown in Table 3.1.

The thrust of Budget 2003 will reflect the supporting role of the Government to enhance the private sector as the driver of growth by promoting private sector dynamism and competitiveness as well as diversifying sources of growth in niche areas of the services sector and agriculture. The Government's role in this regard is to build and reinforce the enabling environment for the private sector to compete and excel both domestically and internationally. Hence expenditure on human resource development and training, research and development as well as further development of SMEs, agriculture and services will be given emphasis.

Operating allocation will be higher by 7.5% to RM71,737 million largely to meet higher emolument, supplies and services and transfers. Approximately 46.5% of the emoluments are salary for teachers, nurses and doctors which in essence is part of the human resource development endeavour of the country. Outlays on supplies and services continue to increase largely on account of the increase in rental for the completed and occupied buildings in Putrajaya as well as to furnish newly completed projects that will commence operation in 2003 such as 283 schools, 20 hostels, 20 community colleges, skill training institutes mainly under MARA, eight new hospitals, police stations, immigration depots and fire stations. This is in line with the objective to develop skilled labour force, promote public health standards and improve delivery of public services. In addition, grants for statutory bodies, particularly public higher education institutions also contribute significantly to higher operating expenditure. This includes grants provided to two new university colleges, namely Kolej Universiti Kejuruteraan Utara Malaysia (KUKUM) and Kolej Universiti Kejuruteraan Teknologi Malaysia (KUKTEM). Further, a sizable proportion of the operating expenditure, amounting to RM3,936 million, will be for subsidy payments for petroleum products, rice and fertilisers, food and school textbooks.

Development allocation will be slightly lower by 1.1% to RM34,963 million in line with fiscal consolidation. As in the past, continued emphasis will be placed on social and economic services sectors with special focus on education and rural development. About 46.1% of the development allocation will be channelled to the social services and 36.3% for economic services.

Under the social services sector, education and training are given top priority, reflecting the Government's emphasis on human resource development to enhance the quality of the labour force. Major development projects for education and training are for the construction of schools, especially primary and secondary schools, matriculation institutions, polytechnics, community colleges and teachers' quarters. In addition, school computerisation projects, infrastructure and facilities for public higher education institutions are also included in the package.

Priority is also accorded to health services in line with the Government's continued efforts to improve the quality of medical services and public health as well as promoting health tourism. Major development projects include the construction of 25 new hospitals, modification and upgrading of existing hospitals and 383 health clinics in rural areas. Some of the hospitals under construction are located in Serdang, Sungai Buluh, Sungai Petani and Lahad Datu. In addition, the Total Hospital Information System (THIS) will continue to be implemented in a number of hospitals to enhance health information management.

In addition to allocations provided under social services, there are also allocations under economic services that are targetted toward social objectives which benefit the rural populace such as rural electrification, water supply, rural roads and other infrastructure. Some of the major infrastructure projects that are likely to benefit the rural population are the construction of the East Coast Highway, Simpang Pulai-Lojing-Gua Musang-Kuala Berang road, Tanjung Kidurong-Suai-Kuala Niah-Kuala Sibuti -Bakam road and Semporna-Kunak road.

An allocation of RM2,150 million is provided for housing. This includes a sum of RM1,426 million to finance the construction of living quarters for armed forces and police personnel as well as other civil servants. In addition, RM993 million is allocated for various low cost public housing projects, reflecting the Government's aim of achieving "zero squatters" in the Federal Territory and major cities in Malaysia. A sum of RM83.6 million is also provided for loans to the state governments to continue financing the construction of 79,800 houses under the Low Cost Public Housing Projects in rural and urban areas.

Development allocation for the economic services sector will continue to emphasise on industrial, infrastructure and agriculture and rural development. On industrial development, the focus is to finance SME development under the purview of the Ministry of Entrepreneur Development, Ministry of International Trade and Industry and Ministry of Rural Development.

Another major sub-sector under economic services is transportation in which the construction and upgrading of trunk roads and electric double tracking of railway are among the major projects. Major trunk roads to be upgraded and repaired are Kapar-Sabak Bernam, Klang-Banting, Muar-Melaka-Alor Gajah-Simpang Ampat and Kuala Kangsar-Grik. The total allocation for construction, upgrading and repairing of roads, highways and bridges in 2003 amounts to RM2,969 million. As for the Rawang-Ipoh electric double tracking project, an allocation of RM1,041 million is provided for.

Continued efforts to promote tourism is also given due attention under the economic services sector. In 2003, the focus is multi-pronged, ranging from the "Malaysia Truly Asia" campaign to promoting Malaysia as a venue for international conferences and events as well as ecological, health and education tourism.