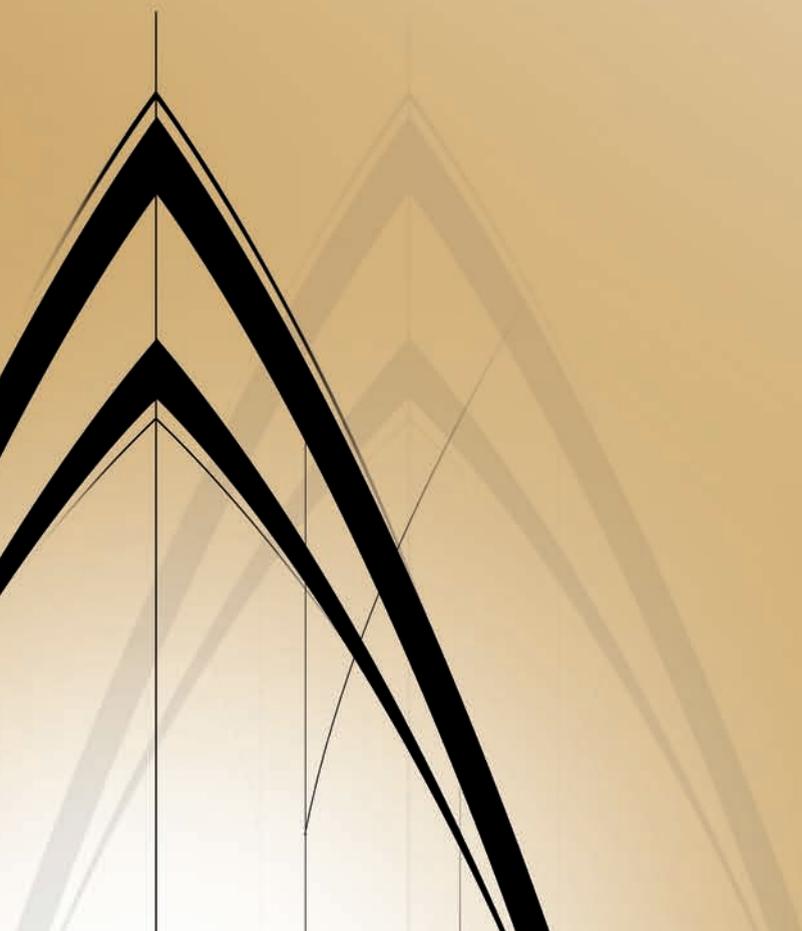


Public Sector Finance

4



Public Sector Finance

Overview

Fiscal policy supports growth...

The thrust of fiscal policy in 2010 is to support growth momentum and reform initiatives to boost the potential output of the domestic economy while maintaining fiscal discipline. Various measures were introduced in Budget 2010 to re-energise private investment, enhance skills development, spur consumer spending as well as generate employment opportunities. The countercyclical measures undertaken by the Government through direct fiscal injection of RM22 billion in 2009 and 2010 brought positive impact to the economy as reflected in the strong growth of 9.5% in the first half of the year.

With recovery on firmer ground, the Government was able to accommodate new and additional commitments during the year. The increased allocation was, among others, to finance reform targets under the six National Key Result Areas (NKRAs), health, education and tourism programmes. It also includes the improved scheme of service for the police and judiciary as well as amendment to the salary scheme of medical and dental lecturers in public institutions of higher learning (IPTAs). Cost-cutting measures were also implemented without affecting the productivity and quality of public service delivery. Subsidies for sugar and fuel were reduced while redeployment of staff and cutbacks in non-critical expenditure instituted. To enhance revenue, new

funding alternatives are being explored with the twin objectives of unlocking the real value of Government assets as well as creating space for greater private sector participation in the economy. Monetisation of assets, privatisation and the disposal of shares in Minister of Finance Incorporated (MOF Inc.) companies are some of the initiatives in the pipeline.

The public sector has a significant role to play in sustaining growth momentum, facilitating private investment as well as transforming the public service delivery. Given these challenges, the public sector is expected to expand 3.8%, contributing 1.0 percentage point to Gross Domestic Product (GDP) growth in 2010 (2009: 5.2%; 1.2 percentage points). The public sector's share to GDP will, therefore, remain high at 24.8% (2009: 25.6%).

Federal Government

Fiscal consolidation on track...

The Federal Government is committed to fiscal consolidation and will continue to observe prudence and value-for-money in its spending. Given the new and increased commitments during the year, total Government expenditure will remain high at RM206.2 billion while revenue collection is estimated to be more favourable at RM162.1 billion. The fiscal deficit is, therefore, expected to decline markedly from 7.0% in 2009 to 5.6% in 2010.

TABLE 4.1

**Federal Government Financial Position
2009 – 2011**

	RM million			Change (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Revenue	158,639	162,131	165,825	-0.7	2.2	2.3
Operating expenditure	157,067	152,158	162,805	2.3	-3.1	7.0
Current balance	1,573	9,972	3,020			
Gross development expenditure	49,515	54,042	49,182	15.6	9.1	-9.0
Less: Loan recovery	519	732	682	-45.9	41.0	-6.8
Net development expenditure	48,996	53,310	48,500	17.0	8.8	-9.0
Overall balance	-47,424	-43,338	-45,481			
% of GDP	-7.0	-5.6	-5.4			

¹ Revised estimate.

² Budget estimate, excluding 2011 tax measures.

Note: Total may not add up due to rounding.

Revenue

Revenue remains firm...

Amid improved growth prospects for the economy, total revenue collection is projected to increase 2.2% to RM162.1 billion or 20.9% of GDP (2009: -0.7%; RM158.6 billion; 23.3%). Tax revenue, accounting for 66.1% of total revenue

is projected to remain steady at RM107.1 billion (2009: 67.1%; RM106.5 billion), supported by a strong turnaround in receipts from company income tax and excise duties. Meanwhile, several measures undertaken by the Government to diversify and enhance the revenue base are anticipated to increase proceeds from non-tax revenue by 5.6% to RM55 billion (2009: 11.2%; RM52.1 billion).

TABLE 4.2

**Federal Government Revenue
2009 – 2011**

	RM million			Change (%)			Share (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Tax revenue	106,504	107,092	115,501	-5.7	0.6	7.9	67.1	66.1	69.7
Direct tax	78,375	76,156	83,983	-4.6	-2.8	10.3	49.4	47.0	50.6
of which:									
Companies	30,199	33,248	36,210	-20.0	10.1	8.9	19.0	20.5	21.8
PITA ³	27,231	18,286	21,786	12.6	-32.9	19.1	17.2	11.3	13.1
Individual	15,590	18,775	19,867	4.2	20.4	5.8	9.8	11.6	12.0
Indirect tax	28,129	30,936	31,518	-8.6	10.0	1.9	17.7	19.1	19.0
of which:									
Excise duties	10,068	11,835	12,026	-5.7	17.6	1.6	6.3	7.3	7.3
Sales tax	8,603	8,241	8,411	2.7	-4.2	2.1	5.4	5.1	5.1
Non-tax revenue	52,135	55,039	50,324	11.2	5.6	-8.6	32.9	33.9	30.3
of which:									
Licences and permits	10,686	10,239	10,012	-3.7	-4.2	-2.2	6.7	6.3	6.0
Investment income	37,394	39,458	33,174	15.9	5.5	-15.9	23.6	24.3	20.0
Total revenue	158,639	162,131	165,825	-0.7	2.2	2.3	100.0	100.0	100.0
% of GDP	23.3	20.9	19.8						

¹ Revised estimate.

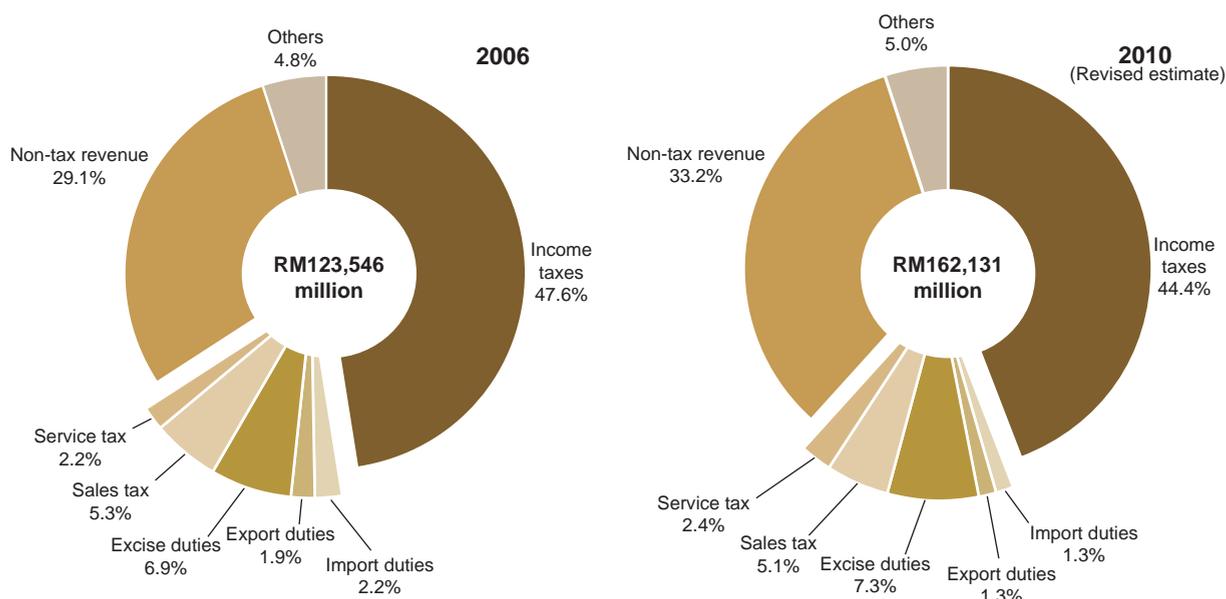
² Budget estimate, excluding 2011 tax measures.

³ Petroleum income tax.

Note: Total may not add up due to rounding.

CHART 4.1

Federal Government Revenue



Revenue from **direct tax** is expected to decline 2.8% to RM76.2 billion (2009: -4.6%; RM78.4 billion), due mainly to a sharp contraction in the collection of petroleum income tax (PITA), which more than offset the strong contribution from other major components of direct tax. Revenue from corporate income tax, which was adversely affected by the economic slowdown in 2009, is expected to rebound 10.1% to RM33.2 billion (2009: -20.0%; RM30.2 billion). Receipts from individual income tax are anticipated to continue expanding at a faster pace of 20.4% to RM18.8 billion (2009: 4.2%; RM15.6 billion). The higher tax collection is on account of a more favourable economic environment, supported by strong expansion in domestic and external demand as well as stable labour market conditions. Similarly, higher business transactions are expected to boost revenue from stamp duties by 21.0% to RM4.1 billion (2009: -4.1%; RM3.3 billion).

Revenue from PITA will decline significantly by 32.9% to RM18.3 billion (2009: 12.6%; RM27.2 billion). The lower receipts from PITA are due, among others, to the change in the tax treatment for upstream petroleum companies as well as

lower production and price of crude oil (Tapis) which averaged USD65.42 per barrel (pb) in 2009. PITA had been assessed on a preceding year basis till 2009. The uncertainties in the price of crude oil due to the current uneven recovery in global demand as well as the strengthening ringgit have compounded the problem.

Effective 1 January 2010, PITA will be self-assessed in the current year based on income received in the same year. The move will standardise Malaysia's tax system as well as ensure better cash flow management that is reflective of current economic conditions. Upstream petroleum companies are allowed to settle PITA on income received in 2009 by instalments over five years. This is expected to ease the burden on the companies involved.

Receipts from withholding tax and cooperative income tax will amount to RM1.3 billion and RM446 million, respectively. The re-introduction of real property gains tax (RPGT) at 5.0% effective 1 January 2010 imposed on gains from disposal of real property within five years from the date of purchase, is also expected to contribute additional revenue to the Government.

The largest contributor to tax revenue is the oil and gas industry, followed by wholesale and retail trade, financial intermediaries, manufacturing sector and real estate. As at end-July 2010, the total number of registered taxpayers was 6,103,219, of which 5.4 million (89.2%) were individual taxpayers, 450,621 (7.4%) companies while the rest included societies and various trust bodies. Of this, taxable returns comprised 1,767,181 individuals and 113,125 companies. Since it was introduced in 2006, the number of taxpayers using e-Filing has steadily increased, with more than 1.9 million taxpayers submitting their tax returns through e-Filing, an increase of 16.5% over 2009. During the same period, the Inland Revenue Board (IRB) continues to enhance tax compliance and revenue collection through productivity gains made in tax administration, enforcement, audit and investigations.

Revenue from **indirect tax** is projected to increase 10.0% to RM30.9 billion, contributing 19.1% to total revenue (2009: -8.6%; RM28.1 billion; 17.7%). Higher commodity prices and export volume, coupled with continued expansion in manufacturing and business activities as well as strong private consumption are expected to boost receipts from indirect tax. Revenue from excise duties on imported and locally manufactured goods, the largest component of indirect tax, is expected to increase 17.6% to RM11.8 billion (2009: -5.7%; RM10.1 billion), supported by strong demand for goods such as motor vehicles, cigarettes and liquor. Similarly, receipts from service tax are projected to register strong growth of 18.6% to RM4 billion. Additional revenue of RM331 million will also be realised from the imposition of service tax of RM50 per year on credit and charge cards as well as RM25 on each supplementary card effective 1 January 2010. The service tax was imposed to inculcate prudent spending habits. There were 9.1 million credit and 227,200 charge cards in circulation as at end-June 2010. Meanwhile, higher crude oil prices will result in lower receipts of sales tax at RM8.2 billion (2009: RM8.6 billion), due to the exemption given under the automatic price mechanism (APM) to stabilise the selling

price of petroleum products. In contrast, revenue from export duties is expected to surge 77.1% to RM2 billion (2009: -58.5%; RM1.2 billion), on account of higher export volume and value of crude oil, the single largest component. Import duties are anticipated to further decline to RM2.1 billion in tandem with Malaysia's progressive commitments on liberalisation of tariffs under regional and bilateral agreements.

Non-tax revenue is anticipated to increase 5.6% to RM55 billion, contributing 33.9% to total revenue in 2010 (2009: 11.2%; RM52.1 billion; 32.9%). Investment income continues to be the major source of non-tax revenue, accounting for RM39.5 billion or 71.7% (2009: RM37.4 billion; 71.7%), followed by licences and permits at RM10.2 billion. Dividend income from *Petroleum Nasional Berhad* (PETRONAS) (RM30 billion), *Bank Negara Malaysia* (RM2 billion) and MOF Inc. companies are expected to remain firm in tandem with strengthening domestic economy and robust external demand. Proceeds from securitisation of Government employees' housing loans will amount to RM4.2 billion (2009: RM4.1 billion). Additional revenue for the year is anticipated from privatisation initiatives (RM350 million), divestment of shares in MOF Inc. companies (RM568 million) as well as monetisation of Government assets (RM500 million). The measures are in line with Government's aim to reduce its involvement in the economy, optimise the value of public assets through sale, lease or joint development as well as increase free float in *Bursa Malaysia*. Privatisation of selected MOF Inc. companies would allow them to operate more efficiently, expand their activities as well as reduce the fiscal burden on Government.

Income from licences, registration fees and permits is estimated to remain at RM10.2 billion or 18.6% to total non-tax revenue (2009: RM10.7 billion; 20.5%). While receipts from petroleum royalties are envisaged to be stable at RM4.9 billion (2009: RM4.8 billion), road tax collection is expected to increase 6.3% to RM2 billion (2009: 3.2%; RM1.9 billion) in line with higher sales of passenger and commercial vehicles.

Other sources of non-tax revenue include proceeds from the production of oil and gas under Malaysia-Thailand Joint Authority (MTJA) as well as fines and penalties amounting to RM1 billion and RM898 million, respectively (2009: RM819 million; RM690 million). Non-revenue receipts, which include refunds of expenditure and receipts from Government agencies as well as revenue from the federal territories, will amount to RM1.2 billion.

Expenditure

Lower operating expenditure...

Federal Government total expenditure is expected to remain high at RM206.2 billion in 2010, on account of higher development expenditure with the fiscal injection of RM5 billion under the second stimulus package. The allocation includes RM3.4 billion to achieve the 2010 targets under the six NKRAs.

Operating expenditure is expected to contract 3.1% to RM152.2 billion (2009: 2.3%; RM157.1 billion), the first decline since 1998. This is on account of prudent measures taken to rein in expenditure as well as the high-base effect in 2009 when Government spending increased significantly following the implementation of two stimulus packages amounting to RM12 billion. Operating expenditure accounts for 73.8% of total expenditure in 2010.

Expenditure on **emoluments**, the largest component accounting for 30.6% of operating expenditure, is projected to expand 9.0% to RM46.6 billion (2009: 27.2%; 4.3%; RM42.8 billion). Factors contributing to the increase include an allocation of RM633 million to accommodate the improved scheme of service for the police as well as amendment to the salary scheme of medical and dental lecturers in IPTAs. The one-off special cash assistance of RM500 to 1.24 million civil servants in September will cost the Government RM640 million.

TABLE 4.3

Federal Government Operating Expenditure by Object 2009 – 2011

	RM million			Change (%)			Share (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Emoluments	42,778	46,626	45,562	4.3	9.0	-2.3	27.2	30.6	28.0
Debt service charges	14,222	15,886	18,517	11.1	11.7	16.6	9.1	10.4	11.4
Grants to state governments	4,895	4,856	5,510	12.1	-0.8	13.5	3.1	3.2	3.4
Pensions and gratuities	10,146	10,810	12,296	1.2	6.5	13.8	6.5	7.1	7.6
Supplies and services	26,372	23,590	28,232	4.7	-10.6	19.7	16.8	15.5	17.3
Subsidies	20,345	24,933	23,704	-42.1	22.5	-4.9	13.0	16.4	14.6
Grants to statutory bodies ³	12,024	11,891	13,165	-4.5	-1.1	10.7	7.7	7.8	8.1
Refunds and write-off	555	1,115	1,083	-22.6	101.0	-2.8	0.4	0.7	0.7
Others	25,731	12,453	14,736	121.0	-51.6	18.3	16.4	8.2	9.1
Total	157,067	152,158	162,805	2.3	-3.1	7.0	100.0	100.0	100.0
% of GDP	23.1	19.6	19.4						

¹ Revised estimate.

² Budget estimate, excluding 2011 tax measures.

³ Includes emoluments.

Note: Total may not add up due to rounding.

Subsidy Rationalisation

Introduction

The subsidy expenditure increased significantly in 2008, largely on account of the sharp increase in oil prices. In 2009 the Government spent RM20.3 billion or 13.0% of operating expenditure on subsidies.

TABLE 1

Subsidies in Malaysia

Year	Operating Expenditure (OE) (RM million)	Subsidies	
		Value (RM million)	Share to OE (%)
2004	91,298	5,796	6.3
2005	97,744	13,387	13.7
2006	107,694	10,112	9.4
2007	123,084	10,481	8.5
2008 ^a	153,499	35,166	22.9
2009	157,067	20,345	13.0
2010 ^b	152,158	24,933	16.4

^a From 2008, subsidies include fuel subsidies, various other subsidies, incentives, assistance for food security programmes, scholarships and education assistance as well as welfare programmes.

^b Estimate.

Source: Ministry of Finance, Malaysia.

Impact of Subsidies

Total subsidy outlay is increasing and is unsustainable, as it is closely linked to world commodity prices, particularly oil. A recent study by the International Monetary Fund (IMF) shows that some subsidies are not well-targeted and largely benefit the higher income groups. Subsidised goods and services lead to over-consumption. Furthermore, industries are not driven to upgrade and improve productivity when input costs are subsidised. The unintended consequences of subsidies have led to suboptimal resource allocation, impact market efficiency and competitiveness as well as impede long-term economic growth potential. Therefore, when subsidies are not targeted to the right groups, significant public funds are diverted from programmes that will benefit the *rakyat*. Table 2 below indicates the estimated expenditure for major types of subsidies in 2010.

TABLE 2

Allocation for Major Types of Subsidies (RM million)

Components	2010
Liquefied petroleum gas (LPG), diesel and petrol	10,000
Assistance for education	7,101
Other welfare assistance	2,327
Interest rate differential subsidy and electricity	1,514
Paddy, rice, sugar and flour	2,031
Cooking Oil Price Stabilisation Scheme	828
Incentives	629
Others	503
Total	24,933

Source: Ministry of Finance, Malaysia

Restructuring subsidies

Recognising the negative impact, the Government has taken steps to rationalise subsidies. Allowing market mechanisms to determine prices and output will lead to better allocation of resources, reduce wastage and increase efficiency. The process will be measured and gradual to have a minimal impact on consumers and businesses as well as contain inflationary pressures. Efforts to rein in subsidy expenditure started in 2009 when fuel prices were adjusted upward and sugar price increased by 20 sen in January 2010¹. A more comprehensive subsidy rationalisation programme was announced on 15 July 2010. For a start, the following measures were implemented:

- o Subsidy for RON95 and diesel was reduced by 5 sen per litre;
- o RON97 is no longer subsidised and its price is determined by the automatic pricing mechanism;
- o Liquefied petroleum gas (LPG) subsidy was reduced by 10 sen per kilogramme; and
- o The price of sugar was adjusted upward by 25 sen per kilogramme.

The savings from this subsidy rationalisation for 2010 will be used to further improve education, health and community development. Fuel and sugar were initially targeted, as fuel subsidy being the largest component at 40.1% in 2010, will have the greatest impact on Government finances, while higher price of sugar will curb consumption leading to healthier lifestyles. In addition, reports on fuel and sugar subsidies indicate that:

- o About 71.0% of the petrol subsidy benefited middle and high-income groups as well as foreigners;
- o Close to 70.0% of the LPG subsidy are enjoyed by businesses;
- o Malaysia has the highest per capita fuel usage in the region;
- o Businesses and industries were consuming twice as much subsidised sugar as households;
- o Over consumption of sugar has led to higher incidence of obesity and diabetes; and
- o There was significant leakage of subsidised sugar and fuel through smuggling.

Conclusion

Subsidies remain a useful policy tool and will be used prudently for a well defined purpose and period. The Government remains committed towards subsidy rationalisation but will continue to subsidise education, health and critical services such as rural air and train services. The poor and disadvantaged groups will continue to receive assistance through strengthening of the social safety net. The impact of subsidies will be monitored closely to ensure that it does not lead to adverse market distortions and misallocation of resources.

¹Price of RON95 and RON97 was increased by 5 sen and 25 sen to RM1.80 and RM2.05 per litre, respectively in September 2009.

Subsidies, the second largest component of operating expenditure at 16.4%, are expected to increase 22.5% to RM24.9 billion (2009: 13.0%; -42.1%; RM20.3 billion), despite the rationalisation of fuel and sugar subsidies. The category comprises various subsidies, incentives and social assistance programmes. Among them are subsidies for fuel, sugar, cooking oil, incentives to increase food production as well as educational assistance and social welfare programmes. Provision is also made for the *Orang Asli*. In 2010, the cost of subsidies is expected to reach RM14.9 billion (59.7%), social assistance programmes RM9.4 billion (37.8%) and incentives RM629 million (2.5%).

Expenditure on fuel subsidies, the largest item in the category, is anticipated to surge 61.6% to RM10 billion (2009: -64.7%; RM6.2 billion), on account of rising crude oil prices. The price of West Texas Intermediate (WTI) averaged USD77.58 pb for the first nine months of the year (2009: USD61.99 pb). As part of a phased approach to optimise resource allocation as well as reduce market distortions, smuggling activities and the fiscal burden on the Government, subsidy on fuel was reduced effective 16 July 2010. The retail price of RON95 and RON97 as well as diesel for all subsidised sectors was increased 5 sen to RM1.85, RM2.10 and RM1.75 per litre, respectively while liquefied petroleum gas (LPG), by 10 sen to RM1.85 per kilogramme. To ensure minimal leakages, foreign registered vehicles are barred from buying RON95 from 1 August 2010. Similarly, the sale of diesel is also capped at 20 litres per vehicle from any station within a radius of 50 kilometres from the point of entry into the country. There are, however, no restrictions on the sale of RON97, the premium grade petrol, to foreign registered vehicles. The subsidy on sugar was also reduced through a 25 sen increase in its price to RM1.90 per kilogramme on account of rising cost of the commodity as well as public health concerns.

Initiatives to achieve food self-sufficiency, improve productivity in the food sector as well as stabilise the prices of essential food items will continue to be given priority. In 2010, a sum of RM1.8 billion

will be spent on subsidies (RM1.1 billion) and incentives (RM629 million) to help farmers, fishermen and livestock entrepreneurs implement programmes to increase food production.

Social assistance programmes are allocated RM9.4 billion in 2010. Of this, RM7.3 billion is for scholarships at all levels of education and educational assistance programmes. These include nutrition programmes and tuition vouchers in schools and kindergartens as well as contribution to *Kumpulan Wang Amanah Pelajar Miskin* (RM400 million). Scholarships and financial assistance amounting to RM4.7 billion will also be extended to students, trainees at skills training centres and for professional career development.

The second component of social assistance programmes includes various forms of financial assistance (RM2.1 billion) provided to improve the quality of life of the poor, senior citizens, disabled and other vulnerable groups. The sum includes RM751 million provided under the NKRA for low income households. The allocation is for implementing measures to eradicate hardcore poverty as well as reduce the incidence of poverty from 3.6% in 2007 to 2.8% in 2010. Initiatives include distributing welfare assistance on the first day of each month, providing support to increase home ownership either through sale or rental as well as income generating activities to provide sustainable income and enhance productivity of the poor. Meanwhile, to improve the standard of living of *Orang Asli*, a sum of RM36 million is provided for agriculture inputs, scholarships, educational, welfare and nutrition programmes.

Accounting for 15.5% of operating expenditure, **supplies and services** are envisaged to contract 10.6% to RM23.6 billion (2009: 16.8%; 4.7%; RM26.4 billion) in consonance with ongoing administrative measures to reduce wastage. Major components of expenditure are professional and other services, repair and maintenance, supplies and rentals. Other items include payments for communication and utilities, travel as well as food and beverage.

Debt service charges are a mandated item and remain manageable at RM15.9 billion or 10.4% of operating expenditure (2009: RM14.2 billion; 9.1%). **Grants to statutory bodies**, which are mainly for emoluments as well as supplies and services, are anticipated to remain stable at RM11.9 billion (2009: RM12 billion). The 21 IPTAs and three teaching hospitals, *Majlis Amanah Rakyat* (MARA) and IRB account for the bulk of expenditure at RM9.2 billion or 77.2% of the total. Meanwhile, a sum of RM10.8 billion is set aside for **pensions and gratuities**. It includes the special cash assistance of RM500 paid to 590,000 Government pensioners in September (RM295 million). **Grants and transfers to state governments** will amount to RM4.9 billion while allocation for **asset acquisition** will see a marked contraction of 62.6% to RM966 million (2009: RM4.9 billion; -9.0%; RM2.6 billion) in tandem with measures to rein in discretionary expenditure.

Development expenditure is projected to increase 9.1% to RM54 billion in 2010 (2009: 15.6%; RM49.5 billion), the highest allocation to date. The increase in expenditure is due to direct fiscal injection of RM5 billion under the second stimulus package as well as new commitments under four NKRA's covering rural basic infrastructure, urban public transport, low-income households and crime. Project implementation will also be expedited as 2010 is the final year of the Ninth Malaysian Plan (9MP). In terms of sectoral allocation, economic services remain the largest recipient (50.2%), followed by social services (39.2%), security (7.2%) and general administration (3.3%).

The **economic services** sector is allocated RM27.1 billion, of which RM7.9 billion is for the transport sub-sector. This is to finance the construction, maintenance and upgrading of roads and bridges, railways, airports, ports and jetties as well as rural infrastructure. Major ongoing road works in the sub-sector include the construction of Trans-Eastern Kedah Hinterland Highway, Alor Setar – Tasik Pedu – Gurun Ring Road, East Coast Highway (LPT) Phase II from Jabur to Kuala Terengganu, as well as upgrading

Alor Setar – Kuala Nerang – Durian Burong Road. Railroad projects under construction are the electrified double-tracking projects between Ipoh – Padang Besar and Seremban – Gemas. Airports currently being upgraded include Kota Kinabalu (Phase II) and Kuching. Meanwhile, construction, maintenance and upgrading of rural and village roads (RM1.2 billion) will be accelerated nationwide to provide better infrastructure and spur economic development in rural areas. The sum includes RM381 million for the NKRA on improving rural basic infrastructure. Sarawak, Sabah, Perak, Negeri Sembilan and Kelantan account for 68.8% of the allocation in 2010.

A sum of RM712 million is allocated for the NKRA on urban public transport which aims to expedite greater use of public transport, particularly light rail transit to ease traffic congestion in the city. Projects slated for the year include improving facilities in KTMB commuter stations, upgrading the automated fare collection system and integrated transport information system (ITIS), improving the bus system, building bus lanes as well as park-and-ride facilities. Closed circuit televisions (CCTVs) and global positioning satellites (GPS) will also be purchased to beef up surveillance and improve public safety. The setting up of the Land Public Transport Commission (LPTC) in June 2010 as a single regulatory body for all land public transport bodes well for the holistic development of an integrated public transport system. LPTC, which will absorb the functions of more than 13 government departments and agencies, is tasked to develop and implement a seamless master plan for greater usage of public transport nationwide, beginning with Klang Valley. The Government aims to increase public transport modal share in Greater KL (Klang Valley) to 30.0% by 2015 from 12.0% in 2009.

Under the trade and industry sub-sector, funds (RM4.7 billion) continue to be provided for major projects such as upgrading infrastructure facilities in industrial areas, funding strategic investments, enhancing skills and entrepreneur development as well as promoting vendor development programmes for the automotive sector. Development of local

TABLE 4.4

Federal Government Development Expenditure by Sector 2009 – 2011

	RM million			Change (%)			Share (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Economic services	26,428	27,123	28,315	23.8	2.6	4.4	53.4	50.2	57.6
of which:									
Agriculture and rural development	5,508	3,136	836	31.6	-43.1	-73.3	11.1	5.8	1.7
Trade and industry	5,592	4,711	9,621	22.1	-15.8	104.2	11.3	8.7	19.6
Transport	8,531	7,904	9,644	-7.4	-7.3	22.0	17.2	14.6	19.6
Social services	17,381	21,197	15,539	26.7	22.0	-26.7	35.1	39.2	31.6
of which:									
Education and training	10,840	11,702	10,363	37.4	8.0	-11.4	21.9	21.7	21.1
Health	2,575	3,594	2,212	55.9	39.6	-38.5	5.2	6.7	4.5
Housing	1,420	1,181	903	-20.2	-16.9	-23.6	2.9	2.2	1.8
Security	3,956	3,914	4,373	-31.5	-1.1	11.7	8.0	7.2	8.9
General administration	1,749	1,809	955	-12.5	3.4	-47.2	3.5	3.3	1.9
Total	49,515	54,042	49,182	15.6	9.1	-9.0	100.0	100.0	100.0
% of GDP	7.3	7.0	5.9						

¹ Revised estimate.

² Budget estimate.

Note: Total may not add up due to rounding.

entrepreneurs, in particular small and medium enterprises (SMEs) will be given priority as they are the backbone of the economy, accounting for 99.2% of all business establishments. Access to financing as well as technical and advisory services on product development, marketing, skills and technology enhancement will be facilitated. Towards this, 79 SME funds and grants administered by various agencies were rationalised to 33 funds and coordinated by SME Corporation Malaysia (SME Corp). In addition, a sum of RM506 million was provided to SME Corp for soft loans, capacity enhancement as well as branding and promotion. Funds will also be channelled to state economic development corporations and *Tabung Ekonomi Kumpulan Usaha Niaga* (TEKUN) for the implementation of various development programmes.

Corridor development will be expedited with an allocation of RM3.4 billion for comprehensive infrastructure development as well as special projects in the five regional growth corridors. The corridor projects will provide ample opportunities

for new investments, create jobs, encourage transfer of skills and technology as well as nurture the development of local industries and entrepreneurial skills.

Tourism-related facilities and amenities will be upgraded. Funds will be provided for the concerted development and promotion of existing and new tourism products such as eco-tourism, agro-tourism and edu-tourism as well as health tourism. Intensive promotional activities are being undertaken to encourage wider participation in the Malaysia My Second Home (MM2H) and homestay programmes as well as in international events such as the Sepang Grand Prix Fest, Rain Forest EcoChallenge and *Pesta Air Nasional*. Innovative products to boost tourist arrivals include promoting the diverse culture and culinary delights of Malaysia as well as artworks by talented local artists as reflected in the 1Malaysia Contemporary Art Tourism 2010 (MCAT) held in Kuala Lumpur in July 2010. In addition, a three-month "Fabulous Food 1Malaysia" campaign to be held towards the

end of the year, will showcase the best of local foods. Tourist receipts in 2010 are estimated at RM59.2 billion from 24 million tourists.

The agriculture and rural development sub-sector accounts for 5.8% or RM3.1 billion of total development expenditure (2009: 11.1%; RM5.5 billion). Efforts will be intensified to modernise and commercialise the sub-sector through the adoption of modern farming methods and agricultural best practices, higher value-added activities, upgrading infrastructure, innovative marketing approaches as well as research and development (R&D). Projects undertaken include upgrading the drainage and irrigation infrastructure for improved *padi* cultivation, implementing the *Paya Peda* dam project in Terengganu to facilitate *padi* cultivation in Besut and developing food farming industry such as the cultivation of fruits, vegetables, seaweed and herbs. The aquaculture industry is being modernised with special focus on the production of fish fry and ornamental fish, while an entrepreneurship training scheme will be implemented to encourage more youths to become aquaculture breeders. Agriculture extension services and skills training programmes will be enhanced to better serve the farming community as well as attract and train youths and graduates to be successful agro-entrepreneurs. Allocation is also provided to uplift the livelihood of the rural poor in Sabah and Sarawak, land and regional development, improve basic infrastructure facilities in farms, upgrade drainage and irrigation as well as undertake flood mitigation projects.

The public utilities, energy and communications sub-sectors are expected to expend RM4.7 billion or 8.7% of total development expenditure (2009: RM3.5 billion; 7.1%). To bridge the rural-urban divide, emphasis will be on the provision of public amenities such as potable water and uninterrupted electricity supply, telecommunication facilities as well as sewerage services in rural areas. A sum of RM200 million is also provided for rural electrification under the NKRA for improving rural basic infrastructure, especially in Sabah and Sarawak. Access to public amenities will also be expanded and upgraded in urban areas.

Other projects undertaken include expediting the implementation of high-speed broadband in urban areas, upgrading the services of the Emergency Call Centre (999) as well as improving the quality of meteorological services.

The **social services** sector is given RM21.2 billion (2009: RM17.4 billion). Of this, the largest share or RM11.7 billion is for education and training, the key component in the transformation of the nation into a high-income, knowledge-intensive and innovation-led economy. Life long learning is also actively promoted to enhance employability. Allocation is provided for upgrading infrastructure and facilities, R&D, improving the quality of training programmes as well as upgrading and maintenance of equipment in universities, polytechnics, skills training centres, teacher training and community colleges. Major ongoing projects include the upgrading and expansion of *Universiti Teknologi MARA* (UiTM), *Universiti Teknologi Malaysia* (UTM), *Universiti Sains Malaysia* (USM), *Universiti Malaysia Sabah* (UMS) and *Universiti Malaysia Sarawak* (UNIMAS). Projects and programmes related to meeting industry requirements for a skilled workforce in all disciplines will be expedited. Polytechnics under construction, upgraded or expanded include those in Mersing, Nilai, Muadzam Shah and Mukah (Sarawak). Ongoing projects also include Advanced Technology Training Centres (ADTEC) in Taiping, Bintulu, Jerantut and Kemaman as well as industrial training institutes in Marang, Miri, Kepala Batas and Nibong Tebal. To expand access to quality and affordable education, the school system will be strengthened with substantial allocation given to pre-school (RM11 million), primary (RM1.5 billion) and secondary education (RM1.8 billion).

Allocation for the health sub-sector is the second largest at RM3.6 billion or 6.7% of total development expenditure. Provision is for building, upgrading and maintenance of hospitals and health clinics, purchase of medical and health equipment as well as improving hospital information and technology system and training of medical staff. Major ongoing projects include the construction, upgrading or expansion of hospitals in Kota

Bharu, Tampoi, Kluang, Cheras, Tampin, Rompin, Batu Pahat, the Sabah Medical Centre as well as Allied Health Science Colleges in Ulu Kinta and Johor Bahru. To provide basic healthcare to the urban poor, 51 Malaysia clinics have been established with an allocation of RM10 million in places such as Sibul, Tawau, Bukit Mertajam, Teluk Intan, Kulim and Marang. Access to rural health care services will be further strengthened through the improvement of health and dental facilities nationwide.

The housing sub-sector is allocated a sum of RM1.2 billion to build affordable homes for the low-income group and quarters for civil servants, including uniformed personnel. The implementation of *Program Perumahan Rakyat* (PPR) and PPR *Bersepadu* will be accelerated while abandoned housing projects rehabilitated. *Jabatan Perumahan Negara* (JPN) is expected to complete the construction of 2,618 units of PPR *Disewa* and PPR *Dimiliki* by end-2010. Meanwhile, 4,990 units in 20 abandoned housing projects are being rehabilitated. In addition, *Syarikat Perumahan Negara Berhad* (SPNB) is also rehabilitating 4,951 units in 16 abandoned housing projects under the first stimulus package. Consistent with the Government's policy of increasing home ownership among the *rakyat*, about 44,000 units of low-cost houses have been offered for sale by *Dewan Bandaraya Kuala Lumpur* (DBKL) and JPN.

Apart from the health, education and housing sub-sectors, allocation is also provided to improve facilities and services at the local level (RM2.8 billion), community and rural development (RM1.3 billion), culture, youth and sports (RM369 million) as well as welfare services (RM26 million). Expenditure is mainly for solid waste management (RM705 million), fire-fighting services (RM567 million), welfare services for the elderly and other vulnerable groups, upgrading and building parks and recreational facilities as well as rehabilitating rivers and flood mitigation projects. Provision is also made to refurbish and build new homes for vulnerable groups in rural areas, especially in Sabah and Sarawak under

the NKRA for improving rural basic infrastructure (RM401 million). To uplift the socio-economic standard of the rural poor, allocation is also provided for community and rural development with emphasis on village rehabilitation schemes and programmes that promote education, skills training and generate economic activities. Income-generating programmes to improve the lives of rural hardcore poor will be continued through *Skim Program Lonjakan Mega* (RM141 million) in Sabah (Pulau Banggi), Sarawak (Batang Sadung and Batang Lupar) and Pahang (Tanjung Gahai and Chemomoi). Projects under *1Azam Niaga* and *1Azam Khidmat* (RM320 million) also promote small businesses, entrepreneurship and skills development among the poor. The Government will continue to assist the *Orang Asli* community integrate into mainstream development. A sum of RM42 million will be extended to construct settlements, provide agriculture inputs to farmers and fishermen as well as provide business equipment to entrepreneurs.

Expenditure for the **security** sector is estimated at RM3.9 billion or 7.2% of total development expenditure (2009: RM4 billion; 8.0%). Of this, RM2.7 billion is for the defence sub-sector, while RM1.2 billion for internal security. The allocation will be utilised to purchase and upgrade equipment, improve surveillance and enforcement as well as enhance the capacity and capability of uniformed personnel through training and skills upgrading.

General administration will be allocated RM1.8 billion (2009: RM1.7 billion) in line with initiatives to improve productivity and quality of public sector delivery system. Priority is given to enhancing computerisation systems in government departments as well as for the development of new and wider usage of e-Government applications. Provision is also made for land acquisition, buildings and fittings as well as renovation, refurbishment and maintenance of Government facilities such as quarters, judicial courts and training institutes. A sum of RM20 million is also extended to enhance technical service delivery related to survey and mapping services.

Financing

Borrowing mainly from domestic sources...

The Federal Government gross borrowings are projected to decline on account of lower loan repayments, redemptions and deficit financing requirements. The high savings rate, low inflation and healthy current account surplus provide ample liquidity in the financial system for the Government to continue sourcing its borrowings locally without crowding out the private sector. With revenue more than sufficient to meet operating expenditure, borrowings are primarily to finance development expenditure.

Total gross borrowings for the year are expected to amount to RM65 billion. Of this, RM60.5 billion

comprises domestic borrowing while RM4.5 billion is from external sources. Of the total, a sum of RM24.8 billion will be utilised to repay existing debt while the balance of RM40.2 billion is to finance the deficit.

In 2010, RM37.1 billion will be raised through the issuance of Malaysian Government Securities (MGS). Of the total issuance of MGS, three new issues amounting to RM9 billion will be raised through open tender. The remaining, RM28.1 billion will be raised through the reopening of eight existing MGS, including one through private placement amounting to RM2 billion. During the first eight months of the year, coupon rates for MGS with 5 and 10-year maturities ranged between 3.84% - 4.38% per annum. MGS continues to be the largest source of funding, accounting for 61.3% of total gross domestic borrowings.

The Government is also expected to issue six new Government Investment Issues (GIIs) up to RM21 billion for the year, including one through private placement amounting to RM3 billion. Following the overwhelming response to the *Syariah*-based savings bond of RM5 billion issued under the second stimulus package in 2009, the 1Malaysia retail *sukuk* was issued in June 2010 with a take-up rate amounting to RM2.4 billion, allocated to 74,781 investors. The *sukuk*, which provides an attractive savings instrument for the *rakyat* in a low interest rate environment, carries a maturity period of 3 years with a 5.0% annual rate of return paid quarterly. The retail *sukuk* can be bought and sold before the maturity date at selected agent banks.

As at end-June 2010, the Employees Provident Fund (EPF) (36.5%), banking institutions (20.7%), foreign holders (18.2%) and insurance companies (6.4%) remained the largest holders of MGS and GIIs. Foreign holdings of MGS and GIIs have been steadily increasing over the years, from a mere 4.5% in 2005 to 18.2% as at end-June 2010, signalling investor confidence in the Malaysian economy. The regular issuance of Government securities provides a benchmark yield curve for the development of a deep and liquid domestic capital market.

TABLE 4.5

Federal Government Financing 2009 – 2010

	RM million		Share (%)	
	2009	2010 ¹	2009	2010 ¹
Gross borrowings	93,951	64,986	100.0	100.0
Domestic	93,500	60,499	99.5	93.1
Investment issues	33,500	23,399	35.7	36.0
Government securities	60,000	37,100	63.9	57.1
External	451	4,487	0.5	6.9
Market loans	-	4,047	-	6.2
Project loans	451	440	0.5	0.7
Repayments	43,358	24,794	100.0	100.0
Domestic	36,621	23,975	84.5	96.7
External	6,737	820	15.5	3.3
Net Borrowings	50,593	40,191		
Domestic	56,879	36,524		
External	-6,286	3,667		
Change in assets²	-3,169	3,147		
Total	47,424	43,338		

¹ Estimate.

² (+) indicates a drawdown of assets.

Note: Total may not add up due to rounding.

Gross international borrowings increased for the first time since 2006 to RM4.5 billion when the Government raised a 5-year global *sukuk* in May 2010 amounting to USD1.25 billion or RM4 billion at 3.928%. The issuance of the sovereign *sukuk* was, among others, to promote Malaysia as a global Islamic financial hub and to establish a new US dollar benchmark as price guidance for corporate international fund raising. During the year, a total of RM440 million is expected to be drawn down from bilateral (RM367 million) and multilateral (RM72 million) sources to finance ongoing projects and programmes related to higher education and training as well as water supply and sewerage services.

Debt

Federal Government debt increases...

The Government will implement sound macroeconomic policies and observe prudent debt management strategies to ensure debt level remains sustainable. Federal Government debt is projected to be lower at 52.7% of GDP in 2010 (2009: 53.3%) while national debt continued to

trend downwards to 28.6% of GDP as at end-June 2010 (end-2009: 34.3%).

Total Federal Government debt is expected to increase to RM408.2 billion (2009: RM362.4 billion), mainly on account of borrowings to meet funding requirements. Although the debt level has increased in recent years, debt servicing capacity remains affordable while debt service charges are within prudential limits. Total debt service charges as a proportion of revenue remain manageable at 9.8% (2009: 9.0%). Likewise, Federal Government external debt, which is mainly denominated in US dollars and yen, is expected to increase 26.6% to RM17.5 billion or 2.3% of GDP (2009: -32.1%; RM13.8 billion; 2.0%) following the issuance of the global *sukuk*.

National debt, comprising the external debts of the Federal Government, Non-Financial Public Enterprises (NFPEs) and the private sector declined to RM221.7 billion as at end-June 2010 (end-2009: RM233.1 billion), due to net repayments of both medium- and long-term as well as short-term debt. In addition, gains were also reaped from the stronger ringgit during the period.

TABLE 4.6

Federal Government Debt 2009 – 2010

	RM million		Share (%)		GDP (%)	
	2009	2010 ¹	2009	2010 ¹	2009	2010 ¹
Domestic debt	348,600	390,724	96.2	95.7	51.3	50.4
Treasury Bills	4,320	4,320	1.2	1.1	0.6	0.6
Investment Issues ²	70,910	88,711	19.6	21.7	10.4	11.4
Government Securities	242,270	260,993	66.9	63.9	35.6	33.7
Housing Loan Fund	31,100	36,700	8.6	9.0	4.6	4.7
External debt	13,786	17,454	3.8	4.3	2.0	2.3
Market loans	6,049	10,096	1.7	2.5	0.9	1.3
Project loans	7,738	7,357	2.1	1.8	1.1	0.9
Total	362,386	408,178	100.0	100.0	53.3	52.7

¹ Estimate.

² Includes *Syariah*-based savings bond of RM5 billion issued in 2009 and 1Malaysia retail *sukuk* issued in 2010.

Note: Total may not add up due to rounding.

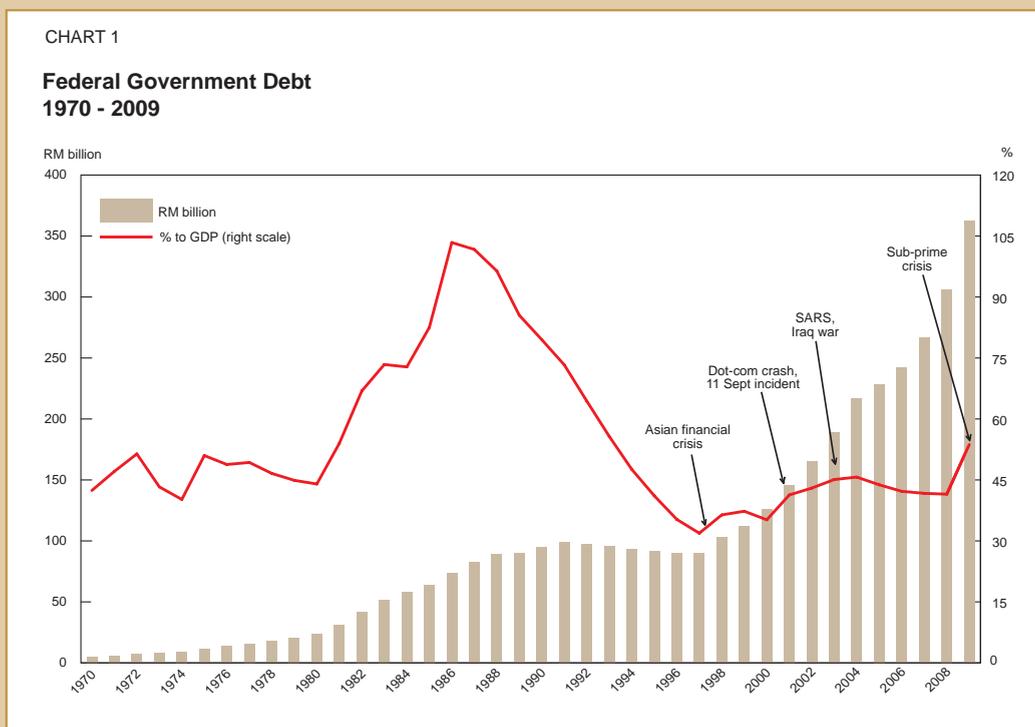
Managing Federal Government Debt

Background

Prudent debt management is an essential characteristic of Malaysia's fiscal policy. This involves ensuring that the Federal Government's financing needs and payment obligations are met at the lowest possible cost over the medium to long term, consistent with a prudent degree of risk. Sound debt management will allow the Government to maintain debt at a sustainable level, thus contributing to growth and stability. Over the last 40 years, the Government's debt service charge to Gross Domestic Product (GDP) has been averaging 3.5%. This has provided sufficient flexibility in the implementation of fiscal policy over economic cycles.

The Federal Government debt-to-GDP ratio, which averaged 47.0% in the seventies, exceeded 100.0% in 1986 and 1987. The sharp increase was mainly due to the cumulative effect of increased public expenditure to implement development projects, expansionary fiscal policy to mitigate the impact of economic slowdown and revenue contraction following lower commodity prices. Subsequently from 1987, with rapid economic recovery as well as prudent fiscal policy and sound debt management, the debt-to-GDP ratio was progressively reduced to its lowest level at 31.9% in 1997. During this period, strategies to strengthen the Federal Government financial position, which included rightsizing of the public sector and privatisation of Government agencies, boosted revenues and contained the expenditure increase. This led to Malaysia recording fiscal surpluses between 1993 and 1997.

With the onset of the 1997/1998 Asian financial crisis and following a series of destabilising events such as the September 11 incident and dot-com crash in 2001 as well as the Iraq war and outbreak of the severe acute respiratory syndrome (SARS) in 2003, the Government once again embarked on expansionary fiscal policies to mitigate the impact of economic slowdown and the slack in private



investment. Despite these events, efforts to consolidate the fiscal deficit remained on track, with deficit decreasing from 5.5% in 2000 to 3.2% in 2007 and the debt-to-GDP ratio averaging 42.2% during the same period. However, following the global financial crisis and economic slowdown in 2008/2009, the Government had to introduce two stimulus packages amounting to RM67 billion (9.9% of GDP) to cushion the impact on the domestic economy. As a result, the fiscal deficit widened to 7.0% of GDP with debt-to-GDP ratio increasing to 53.3% in 2009.

Fiscal Rules and Guidelines

In managing debt, the Federal Government is guided by several rules and guidelines, particularly with respect to borrowings. Article 111 of the Federal Constitution allows state governments to borrow only from the Federal Government due to the need to control credit creation, which is key to controlling inflation and promoting employment. Regulations under various Acts impose limit on borrowings by the Federal Government. Through a gazetted order under the External Loans Act 1963, foreign debt is capped at RM35 billion to limit exposure to exchange rate risks. Similarly, the combined outstanding borrowing domestically for development expenditure, through the Loan (Local) Act 1959 and the Government Funding Act 1983, is capped at 55% of GDP, while the Treasury Bill (Local Act) 1946 limits the current maximum amount of Treasury Bills that can be issued and outstanding at any one time to RM10 billion. These ensure debt management practice takes into account the long-term funding requirements, balanced debt maturity profile, foreign currency exposure and the needs of investors for government debt papers. The limits imposed by the various Acts provide broad parameters to the level and composition of debt.

In addition to the above legislative limits on borrowings, there are several administrative guidelines to further strengthen financial discipline. This includes ensuring that operating expenditure is well within revenue estimates to maintain an operating surplus. The surplus is thus utilised for development expenditure and any shortfall is made up through borrowings. This guideline ensures that operating expenditure is financed through revenue, while borrowings are only used for development expenditure. Furthermore, to strengthen fiscal discipline, debt service charges as a charged expenditure, take priority over other expenditures. This guarantees interest payments to debt holders and binds the Government to its debt obligations.

Federal Government Debt: Current Position

As at end-2009, 96.2% of Federal Government debt was denominated in ringgit, with the balance in foreign currency, mainly USD and yen. With ample liquidity in the financial system, the Government is able to borrow domestically at a reasonable cost as reflected in the Malaysian Government Securities (MGS) yield curve, which has been relatively flat in the past five years. In addition, a significant amount of Government debt of approximately 36% is held by public sector entities such as the Employees Provident Fund (EPF), Social Security Organisation (SOCSO), *Bank Negara Malaysia* (BNM) and *Bank Simpanan Nasional* (BSN), which provide a stable source of financing and reduce roll-over risk.

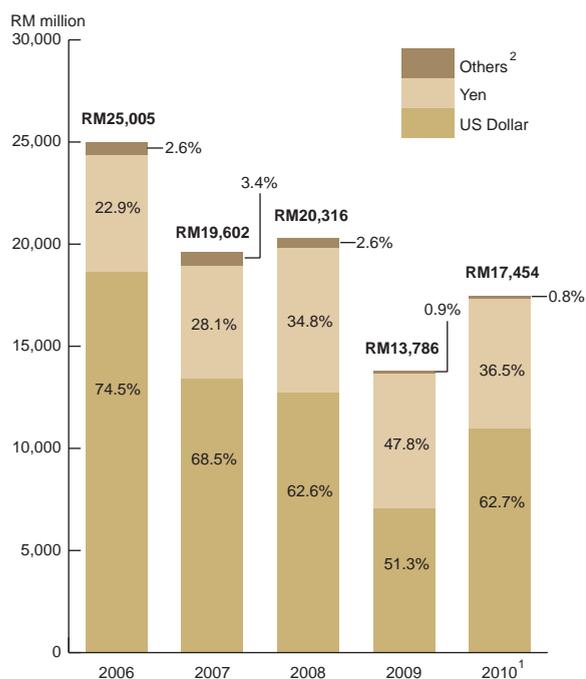
The ability of the Government to service its debt obligations is further strengthened as the debt service charge-to-revenue ratio is trending downward from 14.6% in 2000 to 8.0% in 2008, though the ratio increased slightly to 9.0% in 2009 due to revenue contraction during the recent economic crisis. Investor confidence in Malaysia's credit strength and prudent fiscal management was reflected by the oversubscription of the 5-year sovereign *sukuk* launched on 27 May 2010. This was a major achievement against the backdrop of a volatile and challenging global market environment.

Conclusion

The Federal Government has formulated strategies and measures to create sufficient fiscal space to counter future shocks as well as further intensify efforts to consolidate its financial position as outlined in the Tenth Malaysia Plan. These include enhancing revenue, efficiency and effectiveness in spending as well as improving the business climate through the national transformation programmes. This underscores the Government's commitment to prudent and sustainable debt position to ensure fiscal flexibility and robust economic growth.

CHART 4.2

Federal Government External Debt by Currency



¹ Revised estimate.

² Includes pound sterling and euro.

Note: Figures in bar chart denote % share.

Medium- and long-term debt, comprising 67.5% of national debt, contracted 3.7% to RM149.6 billion (end-2009: RM155.4 billion), due to net repayment by the NFPEs and private sector. The external debt of NFPEs declined to RM68.3 billion (end-2009: RM71.6 billion), reflecting mainly net repayments by companies, particularly in the finance, insurance and transport sub-sectors. Similarly, net repayments recorded by companies mainly in the electronics, utilities and agriculture sub-sectors saw a decline in private sector debt to RM64.2 billion (end-2009: RM70 billion). In contrast, Federal Government external debt increased 24.0% to RM17.1 billion due to the issuance of the global *sukuk*. The NFPEs, private sector and the Federal Government accounted for 45.6%, 42.9% and 11.4%, respectively of the medium- and long-term debt which is mainly denominated in US dollars and yen.

Likewise, short-term external debt declined 7.2% to RM72.1 billion (end-2009: -2.4%; RM77.8 billion), mainly due to moderation in inter-bank borrowings, net repayment of loans by the non-bank private sector as well as exchange rate gains. The banking sector (RM64.6 billion)

TABLE 4.7

National Debt
2009 – 2010

	RM million		Share (%)		GDP (%)	
	2009	2010 ¹	2009	2010 ¹	2009	2010 ¹
Medium-and long-term debt	155,376	149,593	66.6	67.5	22.9	19.3
Public sector	85,386	85,370	36.6	38.5	12.6	11.0
Federal Government	13,786	17,092	5.9	7.7	2.0	2.2
NFPEs	71,600	68,278	30.7	30.8	10.5	8.8
Guaranteed	13,261	12,446	5.7	5.6	2.0	1.6
Non-guaranteed	58,339	55,832	25.0	25.2	8.6	7.2
Private sector	69,990	64,222	30.0	29.0	10.3	8.3
Short-term debt	77,760	72,148	33.4	32.5	11.4	9.3
Total	233,136	221,741	100.0	100.0	34.3	28.6

¹ As at end-June 2010.

Note: Total may not add up due to rounding.

remains the major holder of short-term debt while the balance was held by the non-banking private sector (RM7.4 billion) and NFPEs (RM101 million). As at end-June 2010, external debt service ratio was low at 7.6%, reflecting the sustainability of export earnings to service debt obligations while international reserves at RM309.8 billion (USD94.8 billion) were more than sufficient to cover 4.4 times the short-term debt.

State Governments

Stronger current account surplus...

Emerging from the economic slowdown, state governments are expected to incur higher commitments to spur economic development while continuing to strengthen their fiscal position. The consolidated financial position of state governments is projected to register a stronger current account surplus amounting to RM8.1 billion (2009: RM7.2 billion), despite higher operating expenditure. However, the overall financial position of state governments is expected to record a smaller surplus of RM244 million (2009: RM563 million), on account of a strong increase in development expenditure.

Total revenue of states comprises both direct and indirect taxes, non-tax revenue as well as non-revenue receipts from the Federal Government. In tandem with improved growth prospects, total revenue is expected to surge 18.8% to RM18.1 billion. Of this, RM16 billion or 88.6% will be generated from state sources (2009: RM11.8 billion; 77.8%) while the balance, mainly grants and reimbursements from the Federal Government. Royalties from petroleum and forestry, land-based taxes, dividends and interest on investments as well as land premiums are the major contributors to state revenue, accounting for 46.7% (2009: 51.7%) of the total. Other sources of revenue include fees from licences and permits, rentals, receipts from the provision of goods and services as well as fines and penalties. Grants and reimbursements from the Federal Government

TABLE 4.8

Consolidated State Governments Financial Position 2009 – 2010

	RM million		Change (%)	
	2009	2010 ¹	2009	2010 ¹
Current Account				
Revenue	15,233	18,101	-11.2	18.8
Operating expenditure	8,046	9,959	-1.9	23.8
Current account balance	7,187	8,143		
Development account				
Gross development expenditure	6,915	7,995	-5.1	15.6
Development fund	6,551	7,625	-3.7	16.4
Water supply fund	363	370	-24.4	1.8
Less: Loan recovery	290	96	-6.8	-67.0
Net development expenditure	6,625	7,899	-5.0	19.2
Overall balance	563	244		
% of GDP	0.1	0.03		

¹ Revised estimate.

Note: Total may not add up due to rounding.

are expected to amount to RM2.1 billion (2009: RM3.4 billion), mainly for financing infrastructure projects, social as well as public facilities and amenities.

Total expenditure is expected to increase 20.0% to RM18 billion (2009: -3.4%; RM15 billion), on account of higher operating and development expenditure. Operating expenditure, comprising 55.5% of total expenditure, is expected to increase 23.8% to RM10 billion (2009: 53.8%; -1.9%; RM8 billion). The significant increase is attributed to higher emoluments, supplies and services as well as purchase of assets constituting 63.6% of total operating expenditure. Similarly, development expenditure is also anticipated to increase 15.6% to RM8 billion (2009: -5.1%; RM6.9 billion) to finance agriculture and rural development, housing, public amenities, drainage and irrigation, water supply projects as well as upgrade physical infrastructure to support business and industrial activities in states.

TABLE 4.9

Consolidated General Government Financial Position 2009 – 2011

	RM million			Change (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Current account						
Revenue	185,354	185,509	191,233	-2.3	0.1	3.1
Operating expenditure	170,758	168,521	179,539	2.7	-1.3	6.5
Current account balance	14,596	16,988	11,694			
Development expenditure	54,855	57,380	54,822	8.0	4.6	-4.5
Overall balance	-40,259	-40,392	-43,128			
% of GDP	-5.9	-5.2	-5.1			

¹ Revised estimate.

² Budget estimate, excluding 2011 tax measures.

Note: Total may not add up due to rounding.

General Government

Smaller deficit...

The fiscal position of the general government, comprising the consolidated accounts of the Federal Government, state governments, local authorities and statutory bodies is expected to register a lower deficit of 5.2% of GDP in 2010 (2009: -5.9%). This is on account of estimated firm revenues and expenditure commitments amid improved growth prospects. In 2010, the Federal Government allocated RM11.9 billion and RM4.9 billion to statutory bodies and state governments in the form of grants and transfers through its operating expenditure.

Non-Financial Public Enterprises

Higher expenditure...

The consolidated revenue of NFPEs is anticipated to rebound 7.1% to RM348.8 billion in 2010 (2009: -11.9%; RM325.8 billion) in tandem with the strong recovery in the domestic economy and improving external environment. Higher commodity prices, sales of electricity and vehicles, increased

TABLE 4.10

Consolidated NFPEs Financial Position¹ 2009 – 2010

	RM million		Change (%)	
	2009	2010 ²	2009	2010 ²
Revenue	325,761	348,845	-11.9	7.1
Current expenditure	275,006	306,467	-11.3	11.4
Current surplus	50,755	42,377		
Development expenditure	56,791	61,992	-23.1	9.2
Overall balance	-6,036	-19,615		
% of GDP	-0.9	-2.5		

¹ Refers to 30 major NFPEs.

² Revised estimate.

Note: Total may not add up due to rounding.

returns from overseas operations and investments, improved passenger and trade-related activities as well as continued expansion in telecommunications are expected to boost revenue growth. Major contributors to the revenue include PETRONAS, *Tenaga Nasional Berhad* (TNB), Axiata Group Berhad (Axiata), Malaysian Airlines System Berhad (MAS), *Telekom Malaysia Berhad* (TM) and Proton Holdings Berhad (Proton).

Robust economic activities in 2010 are envisaged to impact operating costs of NFPEs. The consolidated current expenditure is anticipated to grow 11.4% to RM306.5 billion (2009: -11.3%; RM275 billion) on account of rising commodity prices and other raw materials, staff training, marketing, repair and maintenance costs as well as continuous improvements in product and service delivery. Despite ongoing measures to constantly improve cost and operational efficiencies, the current expenditure of NFPEs is expected to outpace revenue growth, resulting in lower current surplus of RM42.4 billion, a decline of 16.5% (2009: RM50.8 billion; -14.9%). PETRONAS, TNB, Axiata, TM and UEM Group Berhad are expected to be the major contributors to the current surplus.

In consonance with improved business and consumer confidence, as well as to enhance long-term growth potential, the overall development expenditure of NFPEs is also anticipated to accelerate 9.2% to RM62 billion (2009: -23.1%; RM56.8 billion). This is mainly for upgrading and refurbishment of existing facilities, capacity expansion as well as product and services enhancement. Domestic investments

will account for the bulk of capital expenditure at RM46.7 billion (2009: RM41.5 billion) and are directed towards oil and gas, plantations, electricity, public transport, housing and telecommunications. NFPEs continue to invest overseas to diversify and strengthen business activities, expand market share, reap economies of scale as well as boost shareholder value. Investments abroad are mainly in oil and gas, telecommunications, plantations, construction and real estate.

Given the marked increase in current and development expenditure, the consolidated financial position of NFPEs is projected to register a higher deficit of RM19.6 billion (2009: -RM6 billion), despite strong revenue growth. NFPEs are important as they contribute to capital formation, job creation and skills development. They also undertake strategic investments in areas which may be less commercially viable but imperative for the development of niche areas in the economy. However, to spur greater private sector involvement, the Government will gradually divest its interest in non-core and non-competitive assets in NFPEs, as outlined in Budget 2010.

TABLE 4.11

Consolidated Public Sector Financial Position 2009 – 2011

	RM million			Change (%)		
	2009	2010 ¹	2011 ²	2009	2010 ¹	2011 ²
Revenue	133,957	132,777	138,605	4.4	-0.9	4.4
Operating expenditure	170,250	168,032	176,803	3.2	-1.3	5.2
NFPEs current surplus	101,217	94,245	93,190	-15.2	-6.9	-1.1
Public sector current balance	64,924	58,990	54,992			
Development expenditure	111,282	119,079	118,518	-10.5	7.0	-0.5
General government	54,490	57,087	54,769	7.9	4.8	-4.1
NFPEs	56,791	61,992	63,748	-23.1	9.2	2.8
Overall balance	-46,358	-60,089	-63,526			
% of GDP	-6.8	-7.8	-7.6			

¹ Revised estimate.

² Budget estimate, excluding 2011 tax measures.

Note: Total may not add up due to rounding.

Consolidated Public Sector

Higher deficit...

The financial position of the consolidated public sector comprises the accounts of the general government and the NFPEs after netting out transfers and net lending. In 2010, the consolidated public sector financial account is expected to register a lower current account surplus of RM59 billion (2009: RM65 billion), mainly due to a decline of 6.9% in the current surplus of NFPEs. Coupled with a significant increase in development expenditure, the consolidated public sector finance is expected to record a higher overall deficit of RM60.1 billion or 7.8% of GDP (2009: -RM46.4 billion; -6.8%).

Prospects for 2011

Fiscal policy supports economic transformation...

While the economic outlook for advanced economies in 2011 is mired in uncertainties, emerging economies are expected to post healthy growth. The Malaysian economy is expected to expand 5.0% - 6.0%, supported by robust domestic investment and consumption activity as well as rising intra-regional trade. Higher private sector activity is envisaged on account of broad-based growth across all sectors, spurred by the aggressive and timely implementation of initiatives under the Tenth Malaysia Plan (10MP), Government Transformation Programme (GTP) and Economic Transformation Programme (ETP).

The conduct of fiscal policy is, however, anticipated to be more challenging. Cognisant that economic transformation is vital to generate higher growth, the fiscal burden on the Government is expected to be heavy, given the higher expenditure to finance the transformation initiatives. Thus, the challenge is to strike a fine balance between providing fiscal support to effect long-term structural changes in the economy, while ensuring sustainability of public finances. Budget 2011 will be geared towards

expeditious implementation of programmes and projects outlined in the 10MP, NKRA and National Key Economic Areas (NKEAs). Fiscal resources will be targeted towards revitalising private investment, intensifying human capital development, ensuring the well-being of the *rakyat* as well as strengthening public sector delivery. Towards this, substantial provision will be made to realise initiatives under the six NKRA (RM9.5 billion), 12 NKEAs (RM6 billion) as well as for completion of projects under the 9MP (RM22 billion) and to cater for new projects under the 10MP (RM12.4 billion). In addition, an initial sum of RM1 billion will be allocated for the Facilitation Fund to implement projects of strategic value and high multiplier impact under the public-private initiative. Allocation will also be provided for corridor and regional development as well as research, development and commercialisation (R&D&C) activities and initiatives to enhance the potential of SMEs.

Towards ensuring fiscal sustainability and macroeconomic stability, the Government remains committed to medium-term fiscal consolidation, despite higher demand on its finances. Supported by prospects of stronger revenue performance, the Federal Government is expected to register a lower deficit of 5.4% of GDP in 2011, despite a 2.8% increase in overall expenditure to RM212 billion.

Operating expenditure is projected to increase 7.0% to RM162.8 billion in line with new commitments under the 10MP and transformation initiatives of the Government. A total of RM1.2 billion and RM525 million will be provided for 'shovel-ready' projects under the NKRA and NKEAs, respectively. Allocation for charged and locked-in items such as **emoluments** (RM45.6 billion), **debt service charges** (RM18.5 billion), **pensions and gratuities** (RM12.3 billion) as well as **grants and transfers to state governments and statutory bodies** (RM18.7 billion) will account for 58.4% of total operating expenditure. **Supplies and services** as well as **asset acquisition** will also be provided a higher sum of RM28.2 billion and RM1.4 billion, respectively to ensure proper maintenance of public assets and improve the quality of public services. In contrast, total

payments for **subsidies** comprising various subsidies (RM14.7 billion), incentives (RM401 million) and social assistance (RM8.6 billion) programmes are expected to remain stable at RM23.7 billion or 14.6% of operating expenditure.

Planning principles espoused in the 10MP will be incorporated in Budget 2011. Development programmes and projects will be implemented on a two-year rolling basis while evaluation, conducted annually, instead of a mid-term review. This allows for greater flexibility to respond speedily to changes in the economic environment as well as undertake new priorities commensurate with Government's financial position.

Funding for initiatives will be linked to outcomes for effectiveness, accountability and transparency. Emphasis will be given for soft infrastructure such as skills training, entrepreneurship development, R&D and venture capital funding to promote greater use of intellectual capital, skills innovation and technology. To ensure cost optimisation and achieve greater savings, value management analysis and life-cycle cost evaluation will be the norm for projects exceeding RM50 million. Centralised procurement will be expanded to include items such as ICT and selected services to achieve savings across Government. Core monitoring entities such as Implementing Coordination Unit (ICU), Performance Management and Delivery Unit (PEMANDU) and Project Management Unit (PMU) will be made more accountable for the timely implementation of programmes and projects. These measures will contribute towards reducing wastage and delays in project implementation while improving the fiscal position of the Government.

Development expenditure will be allocated RM49.2 billion, a decline of 9.0% over 2010 with the lapse of the second stimulus package. Nevertheless, priority will be accorded for the immediate roll-out of NKRA (RM8.3 billion) and NKEA (RM5.5 billion) initiatives which cut across all economic sectors. The NKRA on rural basic

infrastructure (RM6.4 billion) and urban public transport (RM1.4 billion) will account for 94.0% of total NKRA allocation in 2011. As for the NKEAs, major growth areas identified include Greater KL (Klang Valley) (RM2.2 billion), electrical and electronics (RM857 million), agriculture (RM821 million), palm oil (RM447 million), tourism (RM425 million) and education (RM234 million).

The **economic services** sector will be allocated the largest sum at RM28.3 billion in consonance with efforts to achieve developed nation status. Focus will be on infrastructure development and improving public transport as they contribute to productive capacity and efficiency in the economy. Towards this, a sum of RM9.6 billion is allocated for the transport sub-sector, including RM1.4 billion for the NKRA on improving access and connectivity in urban public transport. Major projects carried through into the 10MP include the Ipoh – Padang Besar and Seremban – Gemas double-tracking projects, capacity expansion for KTMB *Komuter* services as well as road works between Sapulut and Kalabakan in Sabah.

Energy, utilities and communications will be provided a sum of RM6.6 billion, mainly for rural water supply and electrification projects as well as sewerage services nationwide. Projects and programmes to be implemented include those identified in the NKRA for improving rural basic infrastructure. Provision is also made for drainage and flood mitigation projects in urban areas. To improve business efficiency and productivity, a sum of RM750 million will be allocated for the implementation of high-speed broadband in urban and priority economic growth areas, including industrial areas.

The trade and industry sub-sector is allocated RM9.6 billion. Substantial provision is made to build capacity and capability as well as promote innovation and entrepreneurship in industry (RM1.5 billion). In this regard, the newly corporatised Malaysian Investment Development Authority (MIDA) will be more aggressive

in promoting quality private investment in manufacturing and services as well as encouraging more homegrown entrepreneurs to invest locally. Similarly, efforts to develop the potential of SMEs as an engine of growth and innovation will be intensified (RM83 million). Tourism will be given a boost with allocation of RM162 million to develop new, iconic and niche products, upgrade tourism sites as well as for more targeted marketing and promotions. About 25 million tourists are expected in 2011, bringing in RM65.7 billion in foreign exchange earnings.

Corridor development (RM506 million) will be realigned with each of the five growth corridors focusing on sectors with comparative advantage to maximise outcomes as well as facilitate implementation and monitoring. While Iskandar Malaysia concentrates on five economic clusters, including education, healthcare and creative industry, Sarawak Corridor of Renewable Energy (SCORE) will draw investments in power generation and energy intensive industries. All corridor projects are expected to have substantial economic spillover effects to foster secondary growth areas. Modernising the agriculture sector (RM553 million) as well as accelerating rural land and regional development (RM155 million) remain a key priority. Focus will be on improving efficiency and productivity in the sector through the adoption of modern farm technology and accredited practices, commercialising R&D output as well as encouraging high value-added activities to make it a lucrative and attractive sector. Support services will be expanded to ensure adequate agriculture infrastructure, facilities and logistics support as well as quality output (RM10 million). Provision for R&D activities which cut across all sectors will amount to RM357 million including for health, housing, ICT, biotechnology and consumerism.

Critical areas such as education and training, health, welfare services and housing are given priority in Budget 2011. Hence, a sum of RM15.5 billion or 31.6% of total development expenditure is allocated under the **social services**

sector. As Malaysia aspires to be a developed and high-income economy, a highly skilled workforce is essential for higher value-added growth. To ensure that the education system produces a dynamic, creative and innovative workforce with the right set of knowledge, skills and attitude, education and training is provided the largest sum at RM10.4 billion or 21.1% of total development expenditure. Of this, RM1.3 billion is for primary education, RM2.4 billion for secondary education, RM2.3 billion for higher education and RM1.2 billion for industrial, skills and management training programmes. In addition, pre-school education (RM200 million), especially in rural areas, will be expanded and strengthened to nurture a solid foundation in education.

Affordable and quality healthcare in urban and rural areas will be further enhanced. An allocation of RM2.2 billion will be provided to build and upgrade hospitals and clinics as well as purchase of medical equipment. The Government will continue to provide affordable public housing for the *rakyat* (RM903 million). The sum includes provision for the construction of PPR *Dimiliki*, *Disewa* and *Bersepadu* as well as quarters for civil servants and proper maintenance of public housing projects. Service delivery as well as provision of infrastructure and facilities in rural areas will be further enhanced (RM527 million). Programmes include a broad range of welfare services and income-generating activities for the poor and vulnerable groups. An allocation of RM1.2 billion will be provided to improve facilities and delivery of services at the local level. **General administration** will be allocated RM955 million to undertake continuous improvements in public service delivery, promote higher IT usage in the civil service as well as for repair and maintenance of Government facilities. A culture of maintenance will be inculcated to prolong the economic life of government assets.

Federal Government **revenue** is projected to increase 2.3% to RM165.8 billion, supported

by higher tax revenue (RM115.5 billion) arising from stronger expansion in domestic economic activity and a sustained growth of the external sector. All components of tax revenue, comprising direct and indirect taxes are anticipated to register positive growth, boosted by higher commodity prices, steady corporate earnings, favourable labour market conditions and rising disposable incomes. Receipts from PITA are also expected to increase on account of higher crude oil prices and strong regional demand from countries, such as India, Thailand, Australia and China. Non-tax revenue, comprising mainly investment income, licences, registration fees and permits are expected to be marginally lower at RM50.3 billion. Proceeds from the utilisation of Government assets such as land are, however, projected to be more favourable at RM2.4 billion. Revenue from Federal Territories is also anticipated to increase in tandem with higher economic activity. The Government will continue to undertake improvements in tax administration to increase

revenue collection and streamline fiscal incentives to accelerate development in key economic areas. Concurrent measures will also be undertaken to achieve savings. Public expenditure will be subject to greater scrutiny while procurement standards, policies and practices enhanced.

The Government remains committed to pursuing a sound fiscal policy, while supportive of the multi-pronged strategy to transform Malaysia into a developed and high-income economy. The structural reforms, which are critical to raise productivity and competitiveness of the economy, will enhance growth over the longer term and have a significant impact on revenue prospects. Economic transformation will be driven by the private sector, empowered by the Government through various strategic initiatives and policy measures. With quality growth becoming entrenched, the pace of fiscal consolidation will be accelerated and the financial position of the Government strengthened.