

Fiscal Operations in 2003

Amidst continued global uncertainties, fiscal operations, while expansionary, were premised on striking a balance between sustaining the growth momentum and fiscal consolidation...

In Budget 2003, the Government made clear its explicit intention to consolidate its fiscal position after six consecutive expansionary budgets and on expectations of improved prospects for higher world growth. The statement reflects the commitment of the Government to balance its budget in line with the policy objective of the Eighth Malaysia Plan. The expected better global prospects, which would have enabled fiscal consolidation to take place, however did not materialise. The external environment further deteriorated with the US-led invasion on Iraq and the outbreak of the Severe Acute Respiratory Syndrome (SARS), further weakening global growth. To mitigate the adverse repercussions of these developments on the economy, the Government announced the Package of New Strategies in May 2003, which aims at enhancing competitiveness, sustaining consumption and generating economic activities by mobilising domestic sources of growth to reduce the over-dependence on external sources.

The Package focusses, among others, on stimulating consumption through a 2% reduction in employees' contribution to Employees Provident Fund (EPF) as well as a half-month bonus for civil servants. Some of the sectors that will get a boost from the Package are the housing sector, from tax exemption on loans and real property gain tax exemption for low- and medium-cost housing and waiver on stamp duties; and the small and medium enterprises (SMEs) through additional allocation to the various funds and micro credit schemes set up to enhance their accessibility to financing.

The new Package, in essence, differs from the earlier stimulus packages implemented in March and September 2001 in terms of funding as well as strategy. With the twin objectives to enhance medium- and long-term national competitiveness and address the impact of SARS-affected sectors, the new pro-growth package aims at stimulating private sector growth and investment as well as providing relief to specific sectors and industries affected by SARS. Cognizant of the fiscal deficit position of the Federal Government and the need to cap expenditure, only RM1.7 billion is financed from the Federal Government's budget although the Package is worth RM7.3 billion. Bank Negara Malaysia (BNM) and the Development Financial Institutions (DFIs) are expected to provide the balance of the financing needs of the Package, which are channelled to various micro credit schemes established under the different loan programmes. With additional expenditure, coupled with slower revenue growth arising from a lower revised GDP growth, the overall Federal Government deficit is forecast to marginally decline from 5.6% of GDP in 2002 to 5.4% of GDP in 2003, but higher than the targetted 4.0% in September last year.

Government expenditures were directed toward supporting the 2003 Budget strategies of increasing domestic investment, developing new sources of growth as well as strengthening the effectiveness of public service. In this regard, the thrust of the expenditures was for education and training, with emphasis on imparting skills and knowledge needed to support emerging high value-added industries and Information and Communications Technology (ICT) development for the transformation towards a knowledge-based economy. To increase competitiveness and reduce cost of doing business, expenditure on infrastructure and industrial sector was also

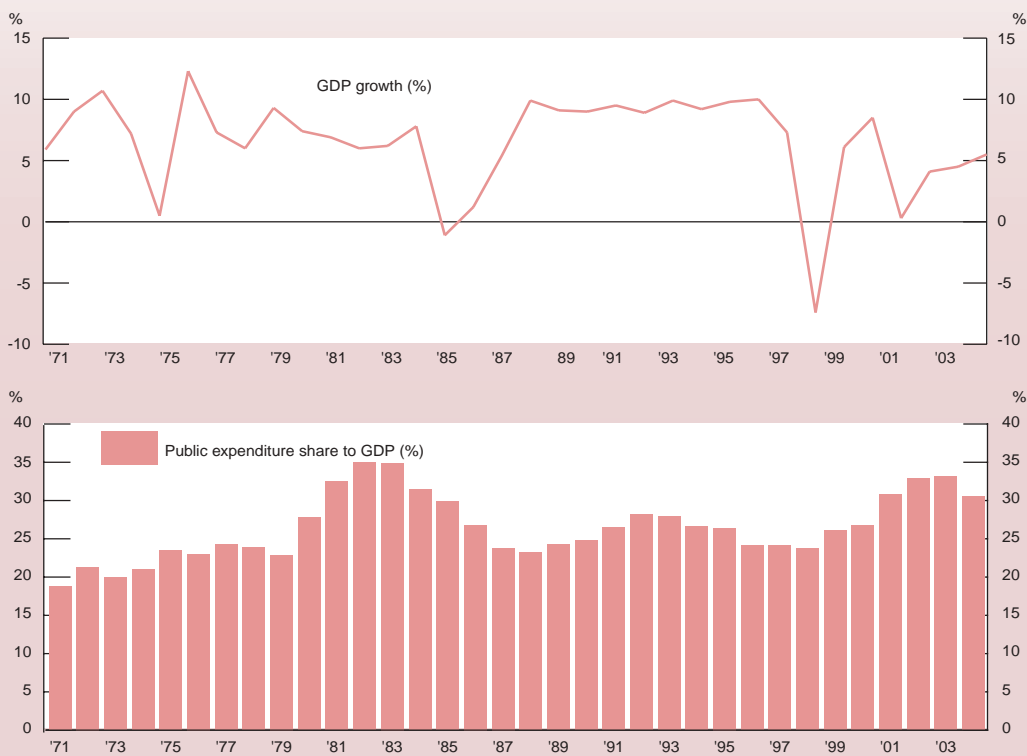
THE ROLE OF FISCAL POLICY SINCE THE ASIAN FINANCIAL CRISIS

Fiscal policy has played a significant role in Malaysia's macroeconomic management. The policy thrusts, have by and large, reflected the socio-economic objectives as contained in the medium- and long-term development plans as well as the prevailing and likely economic environments. In the 1970s, the Government's interventionist policy based on the twin objectives of the New Economic Policy (NEP), led to the establishment of various public enterprises that resulted in public sector expenditure expanding by an average of 13.7% from 1971 to 1982. Following the implementation of the privatisation policy in 1983, where the private sector became the engine of growth, public sector expenditure shrunk to 4.3% from 1983 to 1996. Conversely, private investment grew at an average rate of 14.4% and contributed to 22.1% to GDP during the same period. Real GDP growth rates during the period from 1988 to just before the 1997-1998 financial crisis period were the highest in the nation's history, averaging 9.5% per annum.

When the economy was experiencing robust growth with private sector playing the major role as during the period before the Asian financial crisis, the fiscal stance was tight and the country registered fiscal surpluses from 1993 to 1997. Public expenditure was 25.8% of GDP and was mainly to facilitate private sector initiatives and development. On the other hand, in the years immediately after the Asian financial crisis, which plunged the Malaysian economy into its deepest recession, the Government embarked on an expansionary fiscal policy to provide counter-cyclical measures to compensate for the financially strapped private sector. From an initial austerity drive based on fiscal tightening stance, the Government reversed the decision to implement fiscal stimulus measures to resuscitate the economy. In line with the strategy to spur economic recovery through construction activities, an infrastructure development fund was set up to assist in the financing of large infrastructure

CHART 4.1

GDP Growth and Public Expenditure Share to GDP (%)



projects and public facilities to avoid delays in their implementation. In addition to the emphasis given to stimulate economic activities, the Government also allocated more funds for socio-economic projects to cushion the impact of the crisis on the more vulnerable segments of the society. The expansionary budget policy has been effective and together with strong export demand for electronic and electrical products, the economy bounced back from -7.4% in 1998, to chart a strong GDP growth of 8.5% in 2000. The Malaysian economy again faced difficult challenges when the world economy began slowing down towards the end of 2000. The external environment became even more uncertain with heightened geopolitical tensions following September 11 incident. In order to mitigate the effects of slower world growth and September 11, the Government implemented two fiscal stimulus packages of RM3.0 billion and RM4.3 billion in March and September 2001, respectively. These stimulus packages were mainly allocated for small projects in rural and selected urban areas for which funds could be disbursed quickly. Development projects identified were those with high spillover effects, low import content and short gestation periods, such as upgrading of government buildings and facilities, training of retrenched workers and unemployed graduates and tourism promotion.

Thus, despite the increasingly difficult external environment that followed the Asian crisis, led by slower world growth and finally culminating in the Iraq war and outbreak of SARS this year, Malaysia's economy continued to show resilience and record positive annual growth rates. The ability to steer clear of recession was due in part to the strong macroeconomic fundamentals built over the years and the effective use of fiscal measures to mitigate the adverse impact of the global environment on Malaysia.

The latest Package of New Strategies, implemented in May this year, marks the culmination of fiscal stimulus thus far. The Package, while designed to help mitigate the adverse effects of the Iraq war as well as SARS, has a medium and long-term approach through enhancing the nation's overall competitiveness. Thus, the new Package is broad-based with a longer horizon and emphasises private sector initiatives with focus on SMEs development. As the objective is to stimulate private sector investment and enhance competitiveness, the package focusses on making funds more accessible at reasonable costs to the private sector, particularly the SMEs. The Package is, therefore, less construction oriented and less dependent on direct Government spending with only RM1.7 billion provided through budgetary allocation out of the total RM7.3 billion.

The contribution of public sector expenditure to GDP growth has been significant, particularly in 2001 when Malaysia was able to avoid recession to grow at a marginal 0.3%. The effectiveness of fiscal instruments in sustaining growth indeed reflects the flexibility and adaptability of the Government in macroeconomic management to speedily respond and adopt appropriate fiscal policy thrusts to meet the prevailing needs of the economy. The contribution of the public sector to GDP growth has increased over the 1999-2002 period from 26.1% to 32.9%, reflecting the expanding role of the public sector and consistent with its continuous expansionary budget policy and the series of fiscal stimulus packages. The expanding role of the public sector is considered necessary, given that private investment continues to remain well below pre-crisis levels.

Public sector expenditure has been two pronged, namely to sustain aggregate demand in the immediate term to support domestic economic activities and growth, as well as to expand capacity, improve productivity and enhance the government delivery system. While operating expenditure was maintained at around 17.0% of GDP, development expenditure on the other hand, has shown an increasing trend in recent years, due to the stimulus packages and the continued need to build capacity, infrastructure and human resource development to enhance competitiveness. As a percentage to GDP, it has increased from an average of 5.9% prior to 1997 to 8.0% post 1997.

Fiscal prudence and responsibility have always been the cornerstone of Malaysia's fiscal management. It is pertinent to note that Government borrowings have been made only to finance development projects and not for operating purposes, as the current account registered surpluses averaging 4.3% of GDP from 1997 to 2003. Overall deficit of the Federal Government edged up 5.6% of GDP in 2002, but is expected to decline to 5.4% in 2003, way below 16.7% in 1982, despite the expansionary budgets and a series of fiscal stimulus packages. In 2004, the deficit is envisaged to decline further to 3.3% of GDP. The consolidated public sector as a whole has shown a much stronger financial position with surpluses achieved in 1999 and 2000 despite the Federal Government incurring deficits since 1998. With better performance of NFPEs and reined-in public expenditure, the consolidated public sector is expected to achieve overall surplus again in 2004. The Government remains committed to fiscal consolidation and a balanced budget, as expressly stated in the Eighth Malaysia Plan and the 2003 Budget.

given priority. In the social sector, the bulk of expenditure was for upgrading health care facilities and standards, expanding rural electricity and water supply coverage, enhancing welfare and promoting community and youth development.

The Government continues to exercise vigilance on its external indebtedness and has capitalised on the lower domestic interest rates and ample liquidity in the financial system by sourcing 91.7% of its financing needs from the domestic market. The issuance of Malaysian Government Securities (MGS) is expected to constitute 95.2% of the total domestic borrowing. Four new issues and eight reopening of MGS amounting to RM39,850 million are expected to be completed by the end of the year. The balance of domestic borrowing consists of rollover of Government Investment Issues (GII) and Treasury Bills (TB) upon maturity.

In spite of higher borrowing and Federal Government debt increasing to 47.7% of GDP in 2003, other measures of debt vulnerability are still within prudential limits. Debt service charges as a percentage to revenue and operating expenditure remain low at 9.9% and 12.1%, respectively. Similarly, external debt of the Federal Government is also low at 9.1% of GDP. Given the moderately high savings rate in the economy,

ample liquidity in the financial system, and the sizeable current account surplus of the balance of payments, financing fiscal deficits is not a critical issue for Malaysia. The Government, however, sees the need for and is committed to fiscal consolidation in its move to strengthen its financial position and achieve balanced budget.

Federal Government

Fiscal Policy was targetted at increasing consumption and building capacities to enhance long-term growth prospects...

In 2003, Federal Government receipts were lower than anticipated on account of more subdued GDP growth of 4.5% compared with the original forecast of 6% to 6.5%, following the weak external environment. Thus the lower revenue growth, compounded by spillover expenditure arising from the previous year's expansionary budget as well as the Package of New Strategies, resulted in a marginally lower Federal Government overall deficit of 5.4% of GDP (2002: 5.6%) but higher than the targetted 4% deficit envisaged in the original 2003 Budget, as shown in *Table 4.1*. Despite slower revenue growth and a higher operating expenditure, the current account continues to register substantial surplus.

TABLE 4.1

Federal Government Financial Position 2002-2004

	RM million			Change (%)		
	2002	2003 ¹	2004 ²	2002	2003	2004
Revenue	83,515	89,168	95,595	5.0	6.8	7.2
Operating expenditure	68,699	73,237	80,030	7.8	6.6	9.3
Current balance	14,816	15,931	15,565	-6.3	7.5	-2.3
Gross development expenditure	35,977	37,963	29,960 ³	2.1	5.5	-21.1
(-) Loan recoveries	908	1,183	1,000	-9.5	30.3	-15.5
Net development expenditure	35,069	36,780	28,960	2.4	4.9	-21.3
Overall balance	-20,253	-20,849	-13,395	9.9	2.9	-35.8
% of GDP	-5.6	-5.4	-3.3			

¹ Revised estimate.

² Budget estimate, excluding 2004 tax measures.

³ Exclude contingency fund of RM2,000 million.

CHART 4.2

Federal Government Finance-Current Account

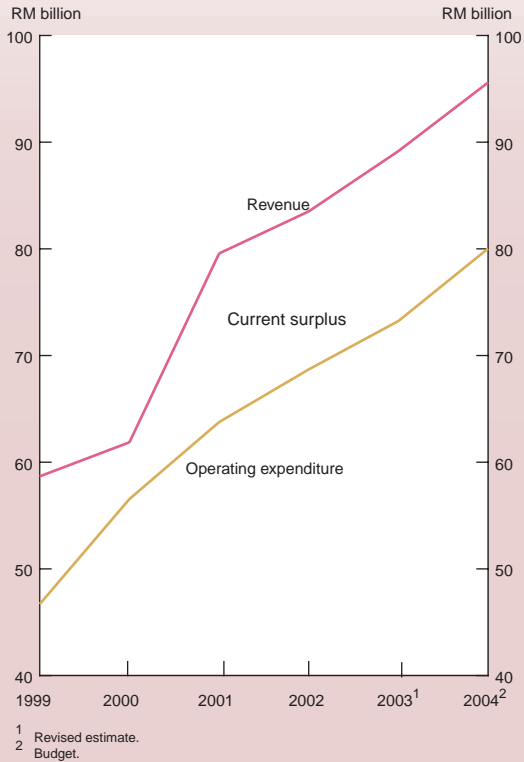
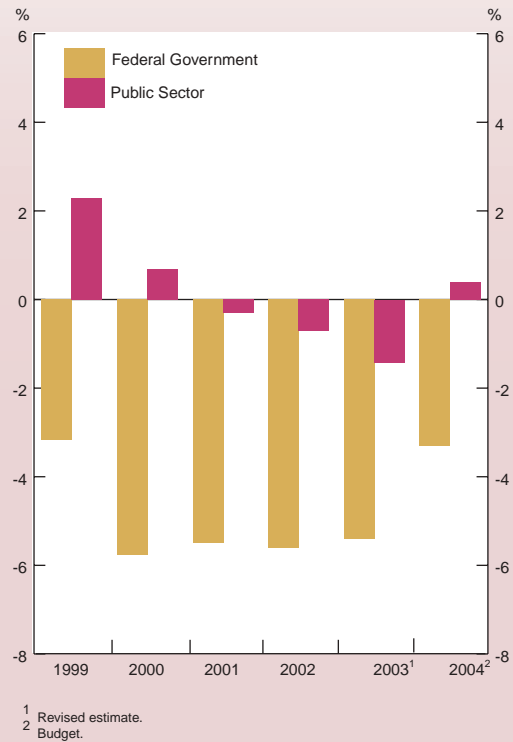


CHART 4.3

Percentage of Overall Deficit/Surplus to Gross Domestic Product



Revenue

Federal Government revenue in 2003 is projected at RM89,168 million, 6.8% higher than 2002, but slightly below the original estimate of RM89,183 million made during the presentation of the 2003 Budget. Revenue collection for most categories increased except for sales tax, which declined by 7.9% due to higher tax exemptions for petroleum products under the Automatic Pricing Mechanism (APM) formula, where the increase in crude oil prices will result in a decline in sales tax collection. Revenue performance is in line with recent trends, with total collection constituting about 23.1% of GDP. If not for the decline in sales tax collection following increase in tax exemptions for petroleum products, total revenue collection is likely to be above the recent trend. In 2003, no increase or new taxes were introduced despite reduction in taxes for several items. The focus was on enforcement, particularly on tax evasion and containment of smuggling

and contraband activities. The Government's relentless efforts in improving tax collection, ensuring compliance and pursuing tax defaulters and evaders have borne significant results. Both corporate and individual income taxes showed slight improvement despite the rebates and reduction of tax rates granted to individual taxpayers over the past couple of years, as shown in *Table 4.2*.

Direct taxes remain the major sources of revenue, representing 52.2% of the total revenue (2002: 53.1%). As for indirect taxes, its share to total revenue is 25.4% in 2003. Import and export duties have continued to register declining trends in line with trade liberalisation and gradual dismantling of trade barriers. Import duties, as a percentage to total indirect tax, declined from 28.1% in 1997 to 17.2% in 2003, while export duties fell marginally from 4.5% to 4.4% during the same period. On the contrary, to compensate for the declining trend of import and export duties,

TABLE 4.2

Federal Government Revenue 2002-2004

	RM million			Change (%)			Share (%)		
	2002	2003 ¹	2004 ²	2002	2003	2004	2002	2003	2004
Tax revenue	66,861	69,171	75,112	8.7	3.5	8.6	80.1	77.6	78.6
Direct tax	44,351	46,481	49,261	5.4	4.8	6.0	53.1	52.2	51.6
o/w ³ : Companies	24,642	24,952	27,571	18.6	1.3	10.5	29.5	28.0	28.8
Individuals	9,889	10,370	10,986	4.8	4.9	5.9	11.8	11.6	11.5
Indirect tax	22,510	22,690	25,851	16.1	0.8	13.9	27.0	25.4	27.0
o/w: Excise duty	4,745	4,933	5,452	14.9	4.0	10.5	5.7	5.5	5.7
Sales tax	9,244	8,514	10,442	25.7	-7.9	22.6	11.1	9.5	10.9
Non-tax revenue	16,654	19,997	20,483	-7.9	20.1	2.4	19.9	22.4	21.4
o/w: Licences/permits	5,882	6,684	6,443	-1.9	13.6	-3.6	7.0	7.5	6.7
Investment Income	8,353	10,798	11,370	-16.9	29.3	5.3	10.0	12.1	11.9
Total revenue	83,515	89,168	95,595	5.0	6.8	7.2	100.0	100.0	100.0
% of GDP	23.2	23.1	23.3						

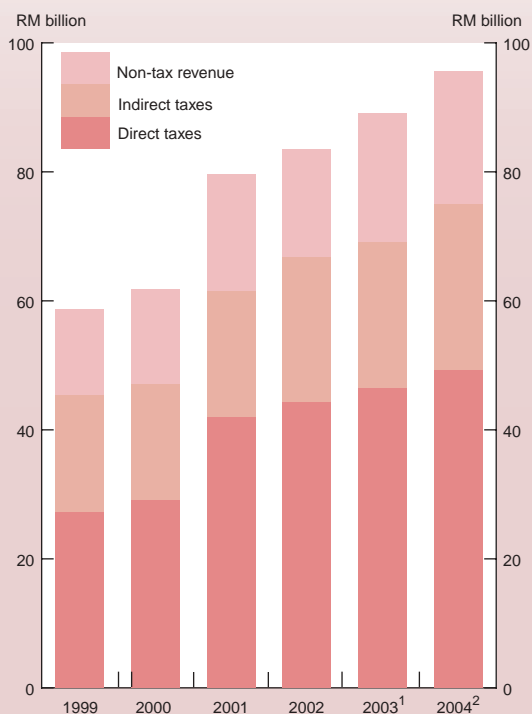
¹ Revised estimate.

² Budget estimate, excluding 2004 tax measures.

³ o/w: of which.

CHART 4.4

Major Components of Federal Government Revenue



¹ Revised estimate.

² Budget.

there is a greater reliance on sales and service taxes, the scope and threshold of which have been extended to encompass greater coverage. Thus, sales tax as a percentage to total indirect tax increased from 26.6% in 1997 to 37.5% in 2003. Similarly, service tax too has grown significantly from 6.4% to 10.4% during the same period. Non-tax revenue as a percentage of GDP and total revenue has increased only marginally, mainly contributed by investment income, licences and permits and royalties.

Expenditure

Total Federal Government expenditure is higher by 6.2% in 2003 with both operating and development expenditures contributing to sustain the growth momentum on account of the expansionary fiscal stance and the additional fiscal stimulus package implemented since May 2003. As a percentage of GDP, both operating and development expenditures now stand at 19.0% and 9.8%, respectively (2002: 19.0%, 10.0%).

Operating expenditure, which accounts for 65.9% of total Federal Government expenditure, is expected to increase by 6.6% to RM73,237

TABLE 4.3

Federal Government Operating Expenditure by Object 2002-2004

	RM million			Change (%)			Share (%)		
	2002	2003 ¹	2004 ²	2002	2003	2004	2002	2003	2004
Emolument	20,242	19,727	20,934	16.0	-2.5	6.1	29.4	26.9	26.2
Debt service charges	9,669	8,868	9,929	0.4	-8.3	12.0	14.1	12.1	12.4
Grants to state government	2,534	2,534	2,724	25.9	0.0	7.5	3.7	3.5	3.4
Pension and gratuities	5,134	4,408	4,624	9.0	-14.1	4.9	7.5	6.0	5.8
Supplies and services	11,269	14,781	17,216	5.3	31.2	16.5	16.3	20.2	21.5
Subsidies	3,677	3,925	3,413	-19.2	6.7	-13.0	5.4	5.4	4.3
Grants to statutory bodies ³	6,361	6,854	7,640	19.7	7.8	11.5	9.3	9.4	9.5
Refunds	1,792	2,731	2,185	0.9	52.4	-20.0	2.6	3.7	2.7
Others	8,021	9,409	11,365	5.3	17.3	20.8	11.7	12.8	14.2
Total	68,699	73,237	80,030	7.8	6.6	9.3	100.0	100.0	100.0
% of GDP	19.0	19.0	19.5						

¹ Revised estimate.

² Budget estimate, excluding 2004 tax measures.

³ Includes emolument.

CHART 4.5

Federal Government Operating Expenditure

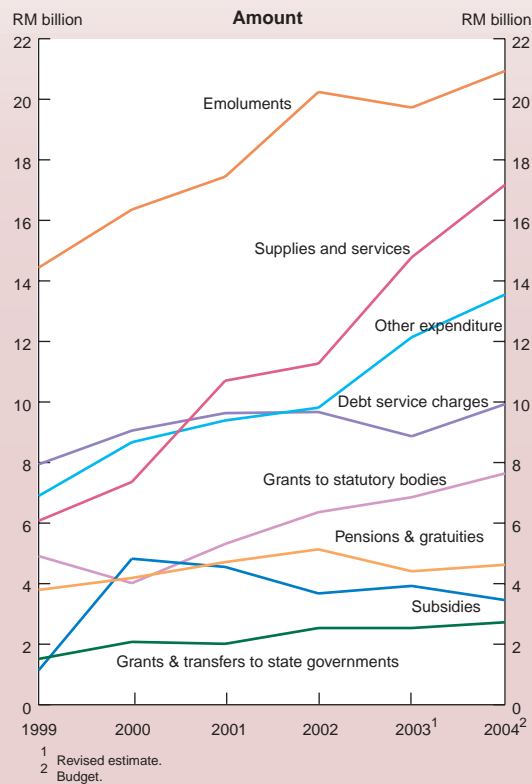


CHART 4.6

Federal Government Development Expenditure by Sector

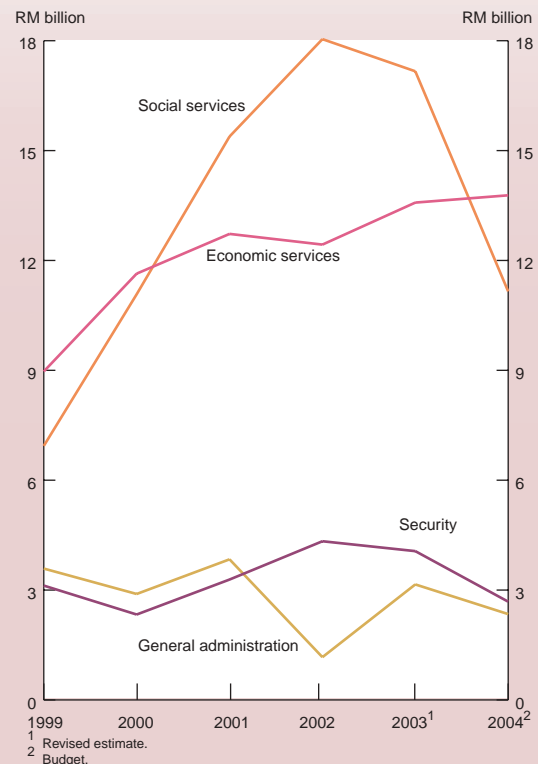


TABLE 4.4

**Federal Government Development Expenditure by Sector
2002-2004**

	RM million			Change (%)			Share (%)		
	2002	2003 ¹	2004 ²	2002	2003	2004	2002	2003	2004
Economic services	12,434	13,581	13,779	-2.3	9.2	1.5	34.6	35.8	46.0
o/w ³ :Agriculture and rural development	1,364	2,956	3,421	-2.2	116.7	15.7	3.8	7.8	11.4
Trade and industries	3,474	3,135	1,890	-28.1	-9.8	-39.7	9.7	8.3	6.3
Transport	5,401	5,091	6,377	7.1	-5.7	25.3	15.0	13.4	21.3
Social services	18,043	17,165	11,154	17.3	-4.9	-35.0	50.2	45.2	37.2
o/w: Education	12,436	10,495	4,615	20.0	-15.6	-56.0	34.6	27.6	15.4
Health	1,503	1,990	2,643	-4.3	32.4	32.8	4.2	5.2	8.8
Housing	1,808	2,150	1,366	42.6	18.9	-36.5	5.0	5.7	4.6
Security	4,333	4,063	2,683	31.8	-6.2	-34.0	12.0	10.7	9.0
General administration	1,167	3,154	2,344	-69.6	170.3	-25.7	3.2	8.3	7.8
Total	35,977	37,963	29,960	2.1	5.5	-21.1	100.0	100.0	100.0
% of GDP	10.0	9.8	7.3						

¹ Revised estimate.

² Budget estimate, excluding 2004 tax measures.

³ o/w: of which.

million in 2003, as shown in *Table 4.3*. The largest share or 32.9% of the operating expenditure is for emolument and payments of pension and gratuities for civil servants. Other increases include outlays for supplies and services, which is higher by 31.2% as part of the measures to improve the public sector delivery system. Debt service charges was lower at RM8,868 million for 2003 despite additional loans taken and the refinancing of loans due to lower interest rates. Higher grants to agencies and other levels of government, scholarships, textbooks loan scheme, food assistance programme, subsidy payments for petroleum products such as diesel and liquefied petroleum gas (LPG) and agriculture, in particular for fertilizers and *padi* farmers, have also pushed up transfer payments.

The thrust of the **development expenditure** was geared toward supporting the 2003 Budget strategies of increasing domestic investment, developing new sources of growth as well as strengthening the effectiveness of public service.

Therefore, a total of RM10,495 million or 27.6% was for education and training to ensure adequate supply of skilled and K-workers to support the development of ICT and high value-added industries.

Public and low cost housing has always been a priority of the Government in line with the policy to provide shelter for all. The increased expenditure on public and low cost housing is, therefore, expected to benefit the lower income group as well as public sector personnel in the armed forces, police, customs and the teaching profession. Syarikat Perumahan Nasional Berhad (SPNB) is expected to construct a total of 25,815 units of low cost houses during the year with 16,015 units presently in the final stage of completion. The Government also increased expenditure for the health sub-sector to cater for ongoing construction of new and upgrading of existing hospitals and as well as improving health care standards. An additional RM200 million was allocated under the Package of New Strategies for local authorities to improve the

cleanliness of public places and promote healthier life styles and living conditions to contain the spread of contagious diseases in the light of the SARS outbreak.

Development expenditure for economic services is expected to increase significantly by 9.2% in 2003, after a slight decline by 2.3% in 2002, as shown in *Table 4.4*. In the transport sub-sector, emphasis was given to improving and upgrading the country's infrastructure, particularly to increase the efficiency of the nation's air, sea and land transportation. This is expected to lower the cost of doing business and hence enhances the nation's competitiveness. Most of the projects are for the construction of roads and bridges, maintenance and upgrading of rail tracks, dredging and deepening of port channels and upgrading of airport runways. With the emphasis on the development of SMEs as a catalyst for higher value-added growth in manufacturing, expenditure under the trade and industry sub-sector was largely focussed on the development of SMEs and industrial research. A sum of RM500 million was channelled to DFIs as equity to supplement their efforts to finance small businesses in agriculture and non-agriculture sectors through micro-credit schemes under the Package of New Strategies. Expenditure on agriculture and rural development remains high, with flood mitigation projects, rural roads, water supply and electrification given priority. Transfers to agriculture and land development related agencies are sizable, constituting 20.0% of the expenditure under this sub-sector. Expenditure under general administration is expected to increase significantly due to, among others, the purchase of ICT equipment, upgrading works of Malaysian missions overseas and renovations and upgrading of court buildings.

Financing

The Government continued to undertake prudent measures in its management of public sector finance to reduce its exposure to foreign debt and risks by sourcing its financing needs mainly from the domestic market. Furthermore, the Government was able to reduce its debt service charges by refinancing its loans at lower interest rates.

Net borrowing from domestic sources, amounting to RM23,250 million, represents all the financing needs of the Federal Government, as shown in *Table 4.5*. Consequently, the Government was

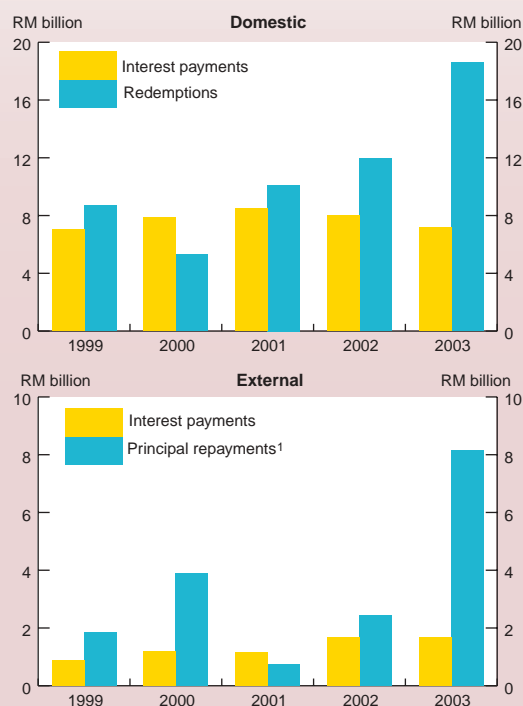
TABLE 4.5

Federal Government Financing 2002-2003

	RM million		Share (%)	
	2002	2003	2002	2003
Net domestic borrowing	6,076	23,250	30.0	111.5
Gross borrowing	18,000	41,850	63.2	91.7
Investment issues	3,000	2,000	16.7	4.8
Government securities	15,000	39,850	83.3	95.2
(-) Repayment	11,924	18,600		
Net external borrowing	8,020	-4,391	39.6	-21.1
Gross borrowing	10,466	3,771	36.8	8.3
Market loans	9,091	1,439	86.9	38.2
Project loans	1,375	2,332	13.1	61.8
(-) Repayment	2,446	8,162		
Change in assets	6,157	1,990	30.4	9.6
Total	20,253	20,849	100.0	100.0

CHART 4.7

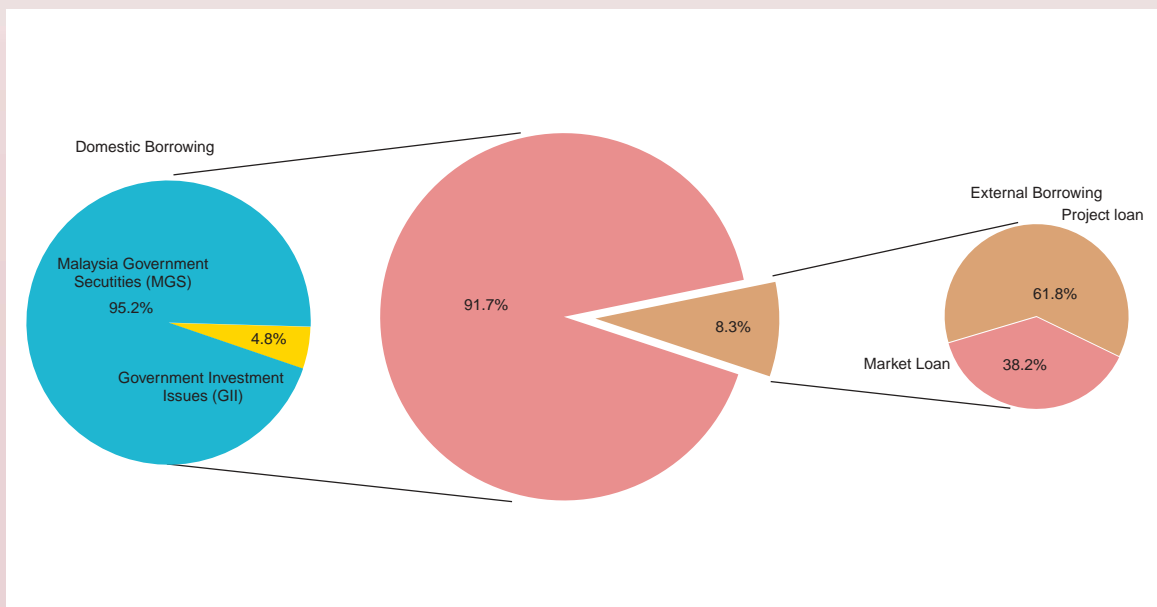
Federal Government Loans - Principal Repayments, Redemptions and Charges



¹ Excludes prepayments.

CHART 4.8

Composition of Federal Government Borrowing in 2003



able to contain its level of foreign debt and minimise exposure to foreign exchange risk.

With market interest rates remaining low, the Government is able to refinance and raise new loans at lower rates, thereby reducing debt service charges. In addition to meeting the financing requirements of the Government, the regular issue of Government papers also provided the benchmark yield to facilitate the development of the domestic bond market.

In the first half of 2003, the Government issued three new and reopened five MGS amounting to RM25,100 million. For the rest of the year, it is expected that one new and three reopening of MGS amounting to RM14,750 million will be issued. In addition, the existing GII and TB amounting to RM2,000 million and RM7,120 million, respectively will be rolled over upon maturity. While provident, pension and insurance funds hold about 71.4% of MGS, GII and TB are mainly held by banks and insurance companies as at 30 June, 2003.

During the year, the Government is expected to raise RM1,439 million from the international financial market through syndicated loans to maintain its foreign market presence as well as to provide a benchmark yield curve. The continued good response to Malaysian papers reflects continued investors' confidence underpinned by Malaysia's strong economic fundamentals, investor friendly policies, sound economic management and political stability. Drawdown of project loans from bilateral and multilateral sources amounted to RM2,332 million, constituting 61.8% of the total external loans. These loans were taken during the 2000-2002 period to finance specific projects such as the National Sewerage Treatment project, the electric double tracking project as well as funds to provide the financing of venture capital for ICT projects. In 2003, Federal Government's external debt is expected to decline marginally to RM34,962 million or 9.1% of GDP (2002: RM36,283 million, 10.1% GDP).

Debt

Total Federal Government debt increased by 11.4% to RM183,817 million or 47.7% of GDP, with domestic debt comprising the bulk or 81.0% of the total, as shown in *Table 4.6*. Although debt level has increased in recent years, the external debt has declined by RM1,321 million in 2003. The debt servicing capacity of the Federal Government has also remained strong with most debt vulnerability indicators within prudent limits. Interest charges as a percentage to operating expenditure and revenue remained low at 12.1% and 9.9%, respectively. In addition, sound debt management has reduced the bunching of repayments and ensured a well-spaced debt maturity profile. Consequently, 35.2% of Federal Government's debt has a maturity of less than three years, 22.9% between three and five years and the balance 41.9% more than five years as at 30 June, 2003. The bulk of the loans have fixed interest rates, thereby reducing interest risks in the event of upward movements of interest rates in future.

The external debt of the nation, which comprises all long and short-term external debt of the Federal Government, Non-Financial Public Enterprises (NFPEs), and the private sector is expected to

CHART 4.9

Federal Government External Debt by Currencies

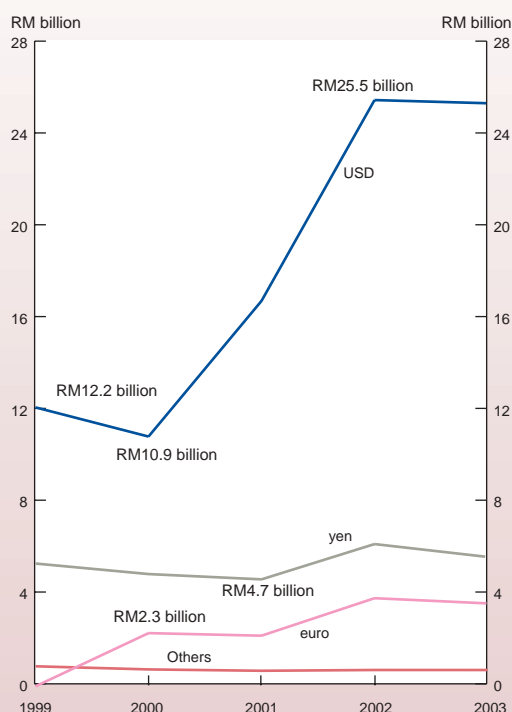


TABLE 4.6

Federal Government Debt 2002-2003

	RM million		Share (%)		GDP (%)	
	2002	2003	2002	2003	2002	2003
Domestic debt	128,680	148,855	78.0	81.0	35.6	38.6
Treasury bills	4,320	4,320	3.4	2.9	1.2	1.1
Investment issues	5,000	7,000	3.9	4.7	1.4	1.8
Government security	109,550	130,800	85.1	87.9	30.3	33.9
Other domestic loans ¹	9,810	6,735	7.6	4.5	2.7	1.8
External debt	36,283	34,962	22.0	19.0	10.1	9.1
Market loans	28,674	25,766	79.0	73.7	8.0	6.7
Project loans	7,609	9,196	21.0	26.3	2.1	2.4
Total	164,963	183,817	100.0	100.0	45.7	47.7

¹ Mainly syndicated loans from foreign banks incorporated in Malaysia and loans taken for Treasury Housing Loan Fund.

TABLE 4.7

**National Debt
2002-2003**

	RM million		Share (%)		GDP (%)	
	2002	2003	2002	2003	2002	2003
Medium and long term debt	153,560	151,234	82.7	81.3	42.6	39.2
Public sector	100,613	97,338	54.2	52.3	27.9	25.2
Federal Government	36,283	34,962	19.6	18.8	10.1	9.1
NFPEs	64,330	62,376	34.7	33.5	17.8	16.2
Guaranteed	10,180	12,410	5.5	6.7	2.8	3.2
Non-Guaranteed	54,150	49,966	29.2	26.8	15.0	13.0
Private sector	52,947	53,896	28.5	29.0	14.7	14.0
Short term debt	32,014	34,794	17.3	18.7	8.9	9.0
Total	185,574	186,028	100.0	100.0	51.5	48.2

increase marginally by 0.2% to RM186,028 million or 48.3% of GDP with Federal Government and NFPEs paring down their debt, as shown in *Table 4.7*. Thus, although private short-term and long-term debt has increased, the lower NFPEs and Federal Government debt has helped to contain the total national debt level. The bulk of the nation's external debt is medium and long term, with short-term debt constituting only 18.7% of the total. The international reserves to short-term debt ratio, a measure of reserve adequacy to meet short-term external debt obligation, is more than sufficient to cover four times of short term debt as at 30 June, 2003. The external debt service ratio, a measure of principal repayment and interest charges against the country's export earnings, is expected to remain low at 7.7%. These indicators reflect the strong health of the Government financial position.

State Governments

Despite higher expenditures for both operating and development, the consolidated financial position of the state governments remains healthy

due to substantial increase in state revenue. The overall deficit at RM381 million was RM140 million lower than 2002, as shown in *Table 4.8*. The deficit, as in previous years, is financed mainly from loans provided by the Federal Government and from drawdown of accumulated financial assets of state governments.

Similar to the Federal Government, operating expenditure is higher on account of increased emolument payments following the implementation of the Malaysia Remuneration System for public sector employees. In addition, acquisition of assets and transfers to local authorities also increased significantly due to efforts to further improve services at the state and local government levels. The bulk of the 33.6% increase in development expenditure was for drainage and irrigation, rural and agriculture development as well as the provision and upgrading of water supply, housing and other public amenities.

During the year, total revenue collected is estimated at RM11,001 million of which 84.5% was from states' own sources while the balance

TABLE 4.8

Consolidated State Government Financial Position 2002-2003

	RM million		Change (%)	
	2002	2003 ¹	2002	2003
Current account				
Revenue	8,341	11,001	0.3	31.9
Operating expenditure	5,090	6,073	-4.1	19.3
Current account balance	3,251	4,928	8.1	51.6
Development account				
Gross development expenditure	4,161	5,559	-14.6	33.6
Development fund	3,685	5,029	-10.8	36.5
Water supply fund	476	530	-35.4	11.3
Loan recoveries	389	250	134.3	-35.7
Net development expenditures	3,772	5,309	-19.8	40.7
Overall balance	-521	-381	-69.3	-26.9
% of GDP	-0.1	-0.1		

¹ Revised estimate.

comes from federal grants. The main sources of state revenue are royalties from mining and forestry, land premium and land related taxes, investment income and fees from permits and licences and receipts from provision of services.

General Government

The financial position of the general government which consolidates the accounts of the Federal Government, state governments, local authorities and statutory bodies after netting out inter-government transfer and net lending, shows an overall deficit of RM17,023 million or 4.4% of GDP, lower than the Federal Government deficit of RM 20,849 million or 5.4% of GDP. The surplus positions enjoyed by the statutory bodies and local authorities helped to reduce the deficit, thus improving the overall financial position of the general government, as shown in *Table 4.9*.

TABLE 4.9

Consolidated General Government Financial Position 2002-2004

	RM million			Change (%)		
	2002	2003 ¹	2004 ²	2002	2003	2004
Current account						
Revenue	96,763	105,599	114,556	5.6	9.1	8.5
Operating expenditure	76,314	81,732	88,335	5.6	7.1	8.1
Current account balance	20,449	23,867	26,221	5.8	16.7	9.9
Development expenditure	36,975	40,890	37,931	2.5	10.6	-7.2
Overall balance	-16,526	-17,023	-11,710	-1.3	3.0	-31.2
% of GDP	-4.6	-4.4	-2.8			

¹ Revised estimate.

² Budget estimate, excluding 2004 tax measures.

Non-Financial Public Enterprises (NFPEs)

The overall financial position of NFPEs is expected to continue to register surplus despite challenging business environment. Revenue is projected to be higher at RM134,998 million on account of higher telecommunication and electricity sales while revenue from oil and gas was lower due to more subdued prices of crude oil last year, as shown in *Table 4.10*.

The increase in operating expenditure by 8.7% is largely attributed to higher fuel and manpower costs resulting from the increase in price of fuel and yearly increments for staffs. The higher operating expenditure is also due to the constant upgrading in technology and the employment of highly skilled manpower to manage these technologies to improve services.

Capital expenditure for NFPEs as a group is expected to increase by 9.5% to RM35,365 million due largely to increased expenditure by Petroliaam Nasional Berhad (PETRONAS) and Tenaga Nasional Berhad (TNB). Outlays for capital

expenditure, as in the past, are largely focussed on capacity expansion both locally and abroad. In particular, capital spending incurred by PETRONAS was largely for the construction of the MLNG3 plant, exploration and production under the Production Sharing Contracts, continued development of Universiti Teknologi PETRONAS, and building of liquefied natural gas (LNG) vessels. Similarly, Telekom Malaysia Berhad (TMB) and TNB continued their planned investment programmes to enhance their revenue generating capacity. Among the major projects undertaken by TMB during the year are the submarine cable systems connecting South-east Asia, Middle East and Western Europe and the Corporate Information Superhighway project to facilitate and support multimedia applications, network computing and communications for major and small businesses. As for TNB, a large portion of the capital expenditure is for upgrading of transmission and power generation. Major projects include the Pulau Bunting 220MW Open Cycles Gas Turbines, Kenyir II Hydro project and Cameron Highlands/Batang Padang Life Extension project. As for Putrajaya Holdings Sendirian Berhad, the increased spending was mainly for the on-going construction of government buildings, quarters for civil servants and commercial centres as well as infrastructure works such as roads, bridges and parks.

TABLE 4.10

Consolidated NFPEs Financial Position¹ 2002-2003

	RM million		Change (%)	
	2002	2003 ²	2002	2003
Revenue	126,562	134,998	20.4	6.7
Current expenditure	80,951	88,007	23.8	8.7
Retained income	45,611	46,991	14.9	3.0
% of GDP	12.6	12.2		
Development expenditure	32,297	35,365	34.4	9.5
Overall balance	13,314	11,626	-14.9	-12.7
% of GDP	3.7	3.0		

¹ Refers to 36 NFPEs.

² Revised estimate.

Consolidated Public Sector

The financial position of the public sector portrays the consolidated position of the general government with the NFPEs after netting out all transfers and net lending between the two entities. Due to the surplus of NFPEs, the overall deficit of the consolidated public sector at RM5,687 million or 1.5% of GDP is lower than the general government or Federal Government deficit, as shown in *Table 4.11*. Thus, the financial position of the public sector portrays a more favourable position than the Federal Government or general government, with the deficit standing at 1.5% of GDP compared with 5.4% for Federal Government and 4.4% for general government.

TABLE 4.11

Consolidated Public Sector Financial Position 2002-2004

	RM million			Change (%)		
	2002	2003 ¹	2004 ²	2002	2003	2004
Revenue ³	96,763	105,599	114,556	5.6	9.1	8.5
Operating expenditure	75,450	81,732	88,335	4.4	8.3	8.1
NFPEs current surplus	45,324	46,643	47,499	14.8	2.9	1.8
Public sector current balance	66,637	70,510	73,720	13.3	5.8	4.6
Development expenditure	69,125	76,197	72,071	15.7	10.2	-5.4
General government ⁴	36,828	40,832	38,017	3.2	10.9	-6.9
NFPEs	32,297	35,365	34,054	34.4	9.5	-3.7
Overall balance	-2,488	-5,687	1,649	174.6	128.6	-129.0
% of GDP	-0.7	-1.5	0.4			

¹ Revised estimate.

² Budget estimate, excluding 2004 tax measures.

³ Excludes transfer.

⁴ Development expenditure differs from development expenditure in Table 4.9 due to transfers and net lending.

Outlook for 2004

The public sector financial position is expected to be stronger and reflect a much improved overall balance in tandem with the better economic prospects for 2004. Private sector activity is envisaged to pick up further to generate higher GDP growth, enabling the public sector to focus its role in providing a conducive environment for private sector initiatives to thrive. With the resumption of the private sector as the engine of growth, the Government is able to begin the process of fiscal consolidation to achieve a balanced budget in the near term.

The thrust of the fiscal policy is to cap expenditure and at the same time, increase revenue. Total Federal Government expenditure will be reined in at RM109,990 million, declining by 1.1%, with development expenditure showing a sharper decline of 21.1% to RM29,960 million. The basic

policy thrust of expenditure will be for locked-in items and contractually committed and approved projects. Agencies with own sources of funds, especially those with high uncommitted reserves, will not be given allocation. Improved corporate tax collections and better performances from NFPEs and state-owned companies are expected to provide additional revenue.

For operating expenditure, the bulk or 67.2% of the RM80,030 million operating allocation is for locked-in expenditure, such as pensions and gratuities, debt service charges and emolument. The allocation for supplies and services, such as maintenance and repair services, rental payments, telecommunications and utilities as well as professional fees, another major expenditure item under operating expenditure, will increase by 16.5% to ensure proper maintenance of public assets in order to improve the quality of public services. Grants and fixed

charges including contributions to statutory bodies, state governments and subsidies for petroleum products, *padi* and scholarships constitute the balance.

Based on the mid-term review and revised ceiling of the Eighth Malaysia Plan, **development allocation** in 2004 is RM29,960 million, significantly lower than the projected expenditure of RM37,963 million in 2003. Given the much lower allocation, priority will be given to ongoing and contractually committed and approved projects with NFPEs assuming a greater role in public sector capital formation. Among the primary objectives of development allocation are to direct resources to enhance the nation's competitiveness and to support private sector investment and initiatives. Hence, priority will be given to projects with strong linkages and high multipliers in the economy. This includes projects and programmes to facilitate privatisation and other public-private sector co-operation as well as to enhance the delivery system, especially in the rural areas with a view to developing agriculture into a high economic value generating sector. As in the past and to reflect the Government's social agenda, a substantial sum is allocated for the promotion of a caring society through increased allocation to non governmental organisations (NGOs), ministries and agencies

involved in welfare services, such as Acquired Immune Deficiency Syndrome (AIDS) and drugs prevention programmes, women and children development, health care services as well as activities to assist the handicapped and the disabled.

With respect to revenue, it is expected to grow at 7.2% to RM95,595 million on account of better economic performance, sustained commodity prices and higher equity prices. Growth in revenue is expected to emanate from higher corporate, sales and service taxes due to improved corporate profits and consumption of goods and services.

The more favourable revenue collection coupled with controlled expenditure is envisaged to result in a more pronounced downward trend of the Government's deficit position. Federal Government deficit is, therefore, forecast to record a reduction by RM7,454 million to RM13,395 million or 3.3% of GDP, while public sector deficit is expected to show a slight surplus of 0.4% of GDP. The healthy trends are clear indications of the Government's unwavering commitment to implement fiscal restraints to support long term sustainable economic growth and national competitiveness. With fiscal prudence as the core principle, the Government is confident of achieving a balanced budget in the near term.