

Public Sector Finance

ECONOMIC REPORT

4

Fiscal Operations in 2004

A two pronged fiscal strategy – supports private sector activities while reining in deficit...

The 2004 Budget was formulated amidst better global economic outlook and strengthened domestic demand. Given the improved scenario and the resurgence of a private sector-led growth, the Government adopted a tighter fiscal stance with the objective of reducing the deficit while simultaneously strengthening the supportive framework to enable the private sector to play a bigger role in generating growth. Fiscal consolidation, while allowing the deficit to decline, will also be pro-growth in approach so as to ensure that the growth momentum nurtured thus far will not be derailed. Hence, the budget strategy is aimed at maintaining and supporting the private sector as the engine of economic growth, as well as to progressively rein in fiscal deficit to a more manageable and sustainable level. The resultant improved financial position is expected to provide a more flexible policy option for the Government, should the need arise.

Fiscal consolidation efforts are two pronged, that is, by introducing revenue enhancing measures and ensuring spending efficiency and effectiveness. Revenue collection and compliance efforts are intensified on specific businesses and professions to minimise tax leakages and evasion. Streamlining of work procedures and the review of tender and other procurement processes are aimed at attaining sound financial management to ensure value for money spent.

Expenditure has been directed mainly to programmes and projects with high multiplier effects and for capacity building, as well as to meet socio-economic goals. The bulk of operating expenditure is for emolument, especially teachers,

doctors and nurses, reflecting the emphasis on human resource development to enhance national competitiveness, as well as for expenditure and transfer payments to benefit the poor and the less fortunate groups. As for development expenditure, the focus is to enhance the longer-term productivity and competitiveness of the economy.

With fiscal consolidation measures in place, the Federal Government's overall deficit is projected to decline further from 5.3% of GDP in 2003 to 4.5% in 2004. The healthy domestic economy and strong current account position of the balance of payments have continued to provide ample liquidity in the banking system with low interest rates. Hence, the bulk of the financing needs of the Government is tapped from domestic sources without crowding out the private sector or exerting undue inflationary pressure on the economy. Although Federal Government debt has increased from RM188,767 million in 2003 to RM219,269 million in 2004, its ratio to GDP remained fairly steady, at around 48% to 50%. Of significance, most of the debt is of medium- and long-term maturity and this reduces the risk of short-term vulnerability.

Federal Government

Federal Government deficit continues downward trend...

The Government continued its fiscal consolidation policy, which began in 2001, after positive and firmer signs of global economic recovery became more evident. The Federal Government is projected to register a deficit of 4.5% of GDP, lower than 5.3% recorded in 2003, as shown in *Table 4.1*. The better fiscal outturn is largely on account of higher tax and non-tax revenue,

TABLE 4.1

Federal Government Financial Position 2003-2005

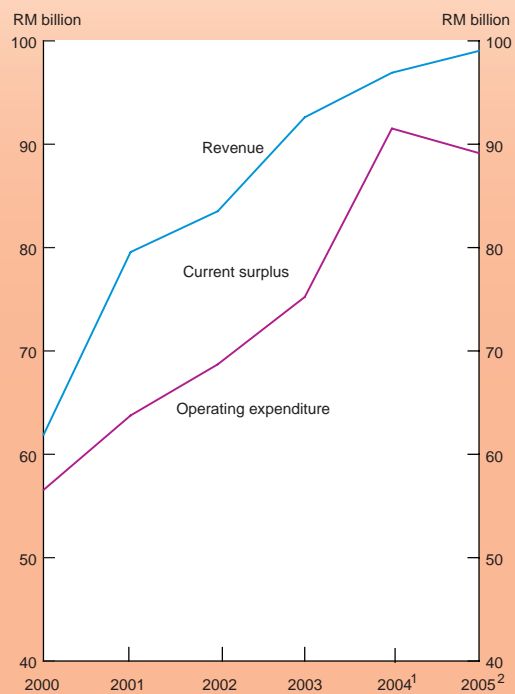
	RM million			Change (%)		
	2003	2004 ¹	2005 ²	2003	2004	2005
Revenue	92,608	96,917	99,030	10.9	4.7	2.2
Operating expenditure	75,224	91,524	89,141	9.5	21.7	-2.6
Current balance	17,384	5,393	9,889	17.3	-69.0	83.4
Gross development expenditure	39,353	31,131	28,304	9.4	-20.9	-9.1
Less: Loan recoveries	1,041	5,824	715	14.6	459.5	-87.7
Net development expenditure	38,312	25,307	27,589	9.2	-33.9	9.0
Overall balance	-20,928	-19,914	-17,700	3.3	4.8	11.1
<i>% of GDP</i>	<i>-5.3</i>	<i>-4.5</i>	<i>-3.8</i>			

¹ Revised estimate.

² Budget estimate, excluding 2005 tax measures.

CHART 4.1

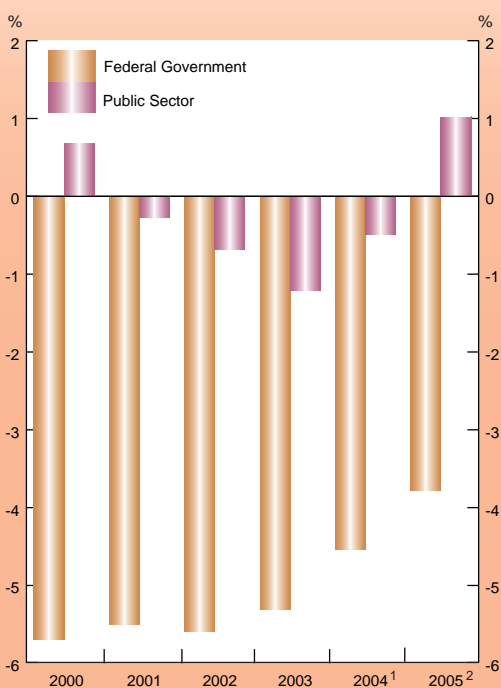
Federal Government Finance - Current Account



¹ Revised estimate.
² Budget.

CHART 4.2

Percentage of Overall Deficit/Surplus to Gross Domestic Product



¹ Revised estimate.
² Budget.

including dividend payment from Petroliam Nasional Berhad (PETRONAS), as well as from the securitisation of Government housing loans and higher loan recovery from the Housing Loan Fund.

Revenue

More efficient revenue collection measures introduced to minimise leakage and tax evasion...

Total revenue projected for the year is RM96,917 million, higher than the RM95,154 million forecast made in September last, as shown in *Table 4.2*. The increase in revenue collection is on account of higher investment income, particularly from dividend receipts and the securitisation of Government housing loans, which is essentially housing loans converted to asset-backed securities. The securitisation of housing loans has not only reduced fiscal deficit but also helped

to establish a new benchmark yield curve for asset-backed securities, especially those issued by the private sector.

Tax revenue is expected to increase by 9% to RM70,759 million from RM64,891 million in 2003 with **direct taxes** contributing 47.9% of total revenue (2003: 46.4%). Individual income tax is projected to increase by 0.7% in tandem with the improved performance of the economy. Similarly, corporate income tax is also higher following stricter tax compliance measures and better business profits. Revenue from petroleum income tax (PITA) is one of the major contributors to direct taxes, accounting for 14.4% of total tax revenue. Based on preceding year's income, PITA is projected to increase significantly by 20.1% in 2004 in line with higher production and crude oil prices in 2003. In terms of contribution to corporate tax by sector in 2003, mining (including PITA) contributed 28.5%, followed by services 17.6%, agriculture and forestry 4% and manufacturing 2.3%.

TABLE 4.2

Federal Government Revenue 2003-2005

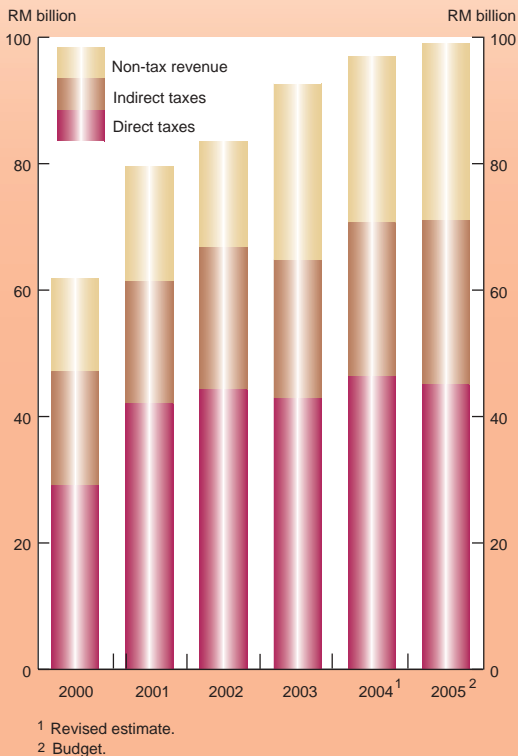
	RM million			Change (%)			Share (%)		
	2003	2004 ¹	2005 ²	2003	2004	2005	2003	2004	2005
Tax revenue	64,891	70,759	71,142	-2.9	9.0	0.5	70.1	73.0	71.8
Direct tax	43,016	46,424	45,100	-3.0	7.9	-2.9	46.4	47.9	45.5
o/w: Companies	23,990	24,511	21,265	-2.6	2.2	-13.2	25.9	25.3	21.5
Individuals	7,984	8,042	8,786	-19.3	0.7	9.3	8.6	8.3	8.9
Indirect tax	21,875	24,335	26,042	-2.8	11.2	7.0	23.6	25.1	26.3
o/w: Excise duty	5,031	6,042	6,331	6.0	20.1	4.8	5.4	6.2	6.4
Sales tax	7,965	7,436	8,133	-13.8	-6.6	9.4	8.6	7.7	8.2
Non-tax revenue	27,717	26,158	27,888	66.4	-5.6	6.6	29.9	27.0	28.2
o/w: Licences/permits	6,634	7,262	7,636	12.8	9.5	5.2	7.2	7.5	7.7
Investment Income	15,201	16,399	17,369	82.0	7.9	5.9	16.4	16.9	17.5
Total revenue	92,608	96,917	99,030	10.9	4.7	2.2	100.0	100.0	100.0
% of GDP	23.5	22.1	21.2						

¹ Revised estimate.

² Budget estimate, excluding 2005 tax measures.
o/w: of which.

CHART 4.3

Major Components of Federal Government Revenue



Indirect taxes, which constitute 25.1% of total revenue, are estimated to increase by 11.2% to RM24,335 million (2003: -2.8%; RM21,875 million), mainly on account of higher excise duties. The upward revision in the structure of excise duties early this year on motor vehicles, which compensated for the lower import tariffs in line with the impending full implementation of ASEAN Free Trade Area (AFTA), contributed to the higher excise duty receipts.

Import duties are envisaged to increase only marginally by 3% to RM4,036 million in 2004 (2003: 6.8%; RM3,919 million), a trend in consonance with gradual international trade liberalisation and AFTA obligations. In addition to the change in the duty structure of motor vehicles, import duties on selected goods, such as computer batteries, wooden and plastic goods, were reduced or abolished. Export duties, on the other hand, are expected to increase substantially by 36.9%, mainly due to higher

collection of export duties on petroleum arising from better crude oil prices.

Collection from **non-tax revenue** is projected to decline by 5.6% to RM26,158 million in 2004 (2003: 66.4%; RM27,717 million). This is mainly due to reduced receipts and proceeds from sales of Government's investments in selected government-linked companies (GLCs). Other non-tax revenue items, such as fees from licences and permits, are envisaged to sustain at previous year's level.

During the year, continuous efforts are being taken to improve tax administration and enforcement capability. Raids and tax audits are carried out to ensure better compliance and deter potential tax evaders. With all these efforts, an additional 834,000 tax files has been opened in the last two years. Anti-smuggling and other tax evasion counter-measures are also implemented to minimise leakages and improve tax buoyancy. In this regard, the implementation of cigarette banderole, in force since August 2004, as well as the installation of scanning machines at entry checkpoints will reduce tax evasion and improve overall revenue collection. In addition, the scanning machines also help to detect imports of prohibited goods and improve security.

Expenditure

Expenditure based on the principle of cost effectiveness, value for money and priority projects...

Budgetary expenditure continues to be directed to sectors that will enhance capacity building to improve productivity and efficiency, as well as to the priority sectors of agriculture, rural development, education and health. To obtain maximum value, projects with high multiplier effects and linkages to the economy are given priority. In line with social obligations, grants given to state and local authorities by the Federal Government also include allocations for rural development and poverty reduction. Total Federal Government expenditure is estimated at RM122,655 million in 2004, up by 7.1% from last year.

Operating expenditure is projected to increase by 21.7% to RM91,524 million (2003: 9.5%; RM75,224 million), as shown in *Table 4.3*. The bulk of the increase in operating expenditure goes to supplies and services, subsidies and refunds. Outlays on supplies and services is projected to expand significantly by 29.8% to RM18,133 million, mainly for maintenance and repairs, rents as well as payments for professional services, as part of the continuous efforts by the Government to upgrade the quality and efficiency of the public service. Payment for subsidies is significantly higher, by 133.3% to RM6,250 million (2003: -27.1%; RM2,679 million), largely to stabilise the retail prices of petroleum products in the country, following steep increases in world market price of crude oil. There will also be a substantial rise in expenditure on refunds on excess taxes collected prior to 2004. The implementation of the current year assessment system, requiring payment of taxes in advance, has led to over payment of taxes in some instances.

A smaller increase can be expected for emolument and pensions and gratuities.

Emolument, the largest component of operating expenditure, is projected to increase marginally. Slightly more than half of the emolument goes to salaries of teachers, doctors and nurses. The payment for pensions and gratuities is slightly higher, totalling RM6,174 million, representing an increase of 5.2% (2003: RM5,870 million; 14.3%). Debt service charges will be higher, but its share to total operating expenditure, presently the third largest component, is contained at 12.7% (2003: 14%). Of the total debt service charges, 84.7% or RM9,867 million is to service domestic debt.

The Government also revamped and restructured a number of ministries such as the Ministry of Education, the Ministry of Energy, Communication and Multimedia as well as the Ministry of Primary Industries and created new ones such as the Ministry of Federal Territory and the Ministry of Natural Resources and Environment, during the year, to further realign their functions to better reflect their respective roles and responsibilities. The additional budgetary implications arising from the restructuring have been contained within the existing budget through redeploying and optimising existing resources.

TABLE 4.3

Federal Government Operating Expenditure by Object 2003-2005

	RM million			Change (%)			Share (%)		
	2003	2004 ¹	2005 ²	2003	2004	2005	2003	2004	2005
Emolument	21,721	21,814	22,241	7.3	0.4	2.0	28.9	23.8	25.0
Debt service charges	10,546	11,655	13,300	9.1	10.5	14.1	14.0	12.7	14.9
Grants to state governments	2,125	2,960	3,089	-16.1	39.3	4.4	2.8	3.2	3.4
Pension and gratuities	5,870	6,174	6,227	14.3	5.2	0.9	7.8	6.8	7.0
Supplies and services	13,968	18,133	18,790	24.0	29.8	3.6	18.6	19.8	21.1
Subsidies	2,679	6,250	5,341	-27.1	133.3	-14.5	3.6	6.8	6.0
Grants to statutory bodies ³	6,844	7,153	7,770	7.6	4.5	8.6	9.1	7.8	8.7
Refunds	2,657	5,113	322	48.3	92.4	-93.7	3.5	5.6	0.4
Others	8,814	12,272	12,061	9.3	39.2	-1.7	11.7	13.5	13.5
Total	75,224	91,524	89,141	9.5	21.7	-2.6	100.0	100.0	100.0
% of GDP	19.1	20.9	19.1						

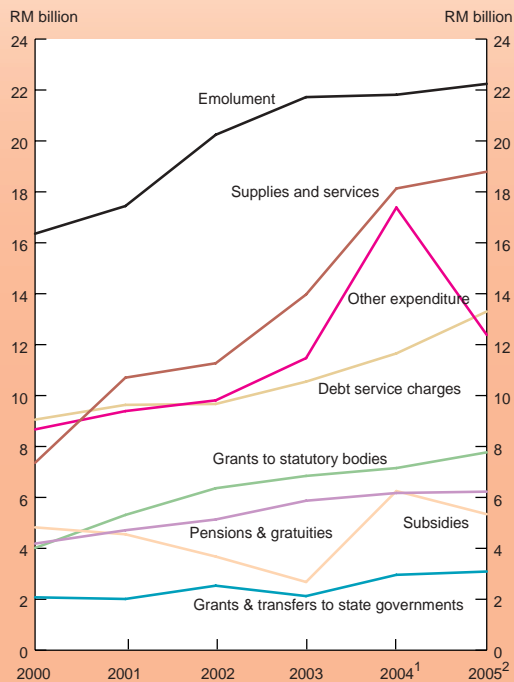
¹ Revised estimate.

² Budget estimate, excluding 2005 tax measures.

³ Includes emolument.

CHART 4.4

Federal Government Operating Expenditure



1 Revised estimate.
2 Budget.

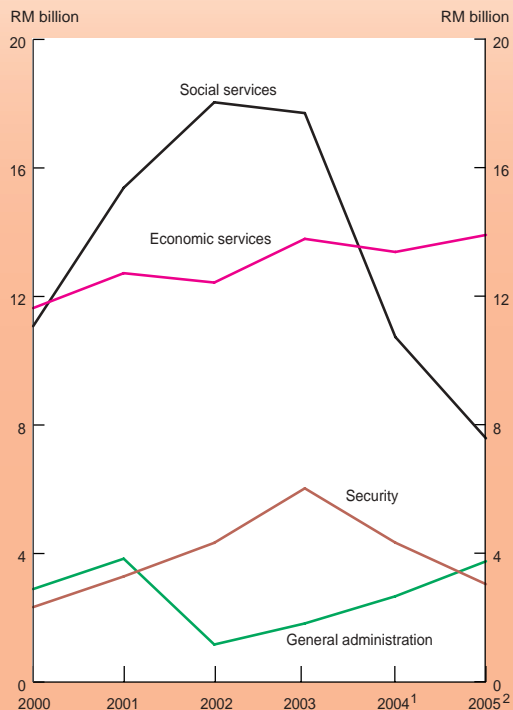
Development expenditure is expected to decline by 20.9% to RM31,131 million in 2004, as shown in *Table 4.4*, in line with the Government's objective to reduce deficit as well as following the accelerated implementation and completion of projects in the first three years of the Eighth Malaysia Plan (8MP) as part of the counter-cyclical measures to avert an economic melt down. This is in spite of the additional RM10 billion added to the 8MP, making the new ceiling of RM170 billion to ensure continuity of social projects and rural development programmes. The smaller expenditure, however, is still sufficiently large to sustain the growth momentum presently underway. The bulk of the development expenditure is for smaller scale projects, particularly agriculture and rural projects, improving water supply and expanding the rural road network to enhance the quality of life of the rural sector.

Total expenditure for the **economic sector** is estimated at RM13,385 million, representing 43%

of total development expenditure in 2004 (2003: RM13,793 million; 35%). The transportation sub-sector accounts for the largest share of 22.5% amounting to RM7,014 million, mainly for the construction and upgrading of roads, bridges, ports and airports such as the East Cost Karak Highway, Kelang Lama Road, Bario and Long Akhar Airfields and Bintulu Airport. Expenditure on agriculture and rural development is expected to increase substantially by 64.9% to RM2,671 million, reflecting the Government's refocus to further modernise the agriculture sector into a commercially viable sector, particularly in food production and downstream activities, as well as improve the standard of living in rural areas. Likewise, expenditure for public utilities will also increase substantially by 90.7% to RM1,754 million (2003: -49.1%; RM920 million), in line with efforts to bridge the rural-urban divide by improving rural accessibility to public amenities such as electricity and water supply, and telecommunications. For the trade and industry

CHART 4.5

Federal Government Development Expenditure by Sector



1 Revised estimate.
2 Budget.

sub-sector, 40.8% of expenditure is expended for small- and medium-enterprises (SMEs) and tourism development projects. Priority is given to the credit guarantee scheme and relocation scheme for SMEs, and for the promotion of eco-tourism as well as upgrading of tourism infrastructure facilities.

A total of RM10,738 million is expended for **social services**, the second largest component in development expenditure. Expenditure for the education sub-sector will be lower in 2004, following the completion of most projects for education under the 8MP, such as single session schools, computer laboratories, polytechnics as well as universities. On the other hand, operating expenditure is higher, mainly to cater for the increase in teachers' salaries, reflecting the Government's emphasis on quality education, such as improving the teacher-student ratio. To provide better quality healthcare and improve accessibility to health and medical services, a sum of RM2,646 million is for health services in rural areas, upgrading of hospitals and clinics

and also the construction of new hospitals in Serdang, Sungai Buloh and Temerloh. Part of the expenditure is also for the purchase of healthcare equipment and machines to improve the quality of healthcare in the country. A sum of RM1,320 million is for housing in 2004, of which RM669 million is for the armed forces and police personnel, particularly in the Klang Valley, Kuching, Kinarut, Pontian and Batu Uban, while the balance is to be expended for public low- and medium-cost housing implemented under the *Perumahan Rakyat* and *Perumahan Rakyat Bersepadu* programmes. Syarikat Perumahan Negara Berhad (SPNB), a government-linked company, is also involved in the construction of low cost houses using their own funds. During the year, SPNB is expected to construct 18,194 units, of which 11,842 units are presently in the final stages of completion. Expenditure for **general administration**, totalling RM2,670 million, is mainly geared towards the upgrading of information and communication technology (ICT) equipment as well as acquisition of fixtures and fittings for new Government buildings.

TABLE 4.4

Federal Government Development Expenditure by Sector 2003-2005

	RM million			Change (%)			Share (%)		
	2003	2004 ¹	2005 ²	2003	2004	2005	2003	2004	2005
Economic services	13,793	13,385	13,914	10.9	-3.0	4.0	35.0	43.0	49.2
o/w: Agriculture and rural development	1,620	2,671	2,425	18.8	64.9	-9.2	4.1	8.6	8.6
Trade and industry	3,456	1,629	1,790	-0.5	-52.9	9.9	8.8	5.2	6.3
Transport	7,354	7,014	7,452	36.2	-4.6	6.2	18.7	22.5	26.3
Social services	17,707	10,738	7,587	-1.9	-39.4	-29.3	45.0	34.5	26.8
o/w: Education	10,193	4,494	2,817	-18.0	-55.9	-37.3	25.9	14.4	10.0
Health	2,681	2,646	1,089	78.4	-1.3	-58.8	6.8	8.5	3.8
Housing	1,928	1,320	1,729	6.6	-31.5	31.0	4.9	4.2	6.1
Security	6,029	4,338	3,046	39.1	-28.0	-29.8	15.3	13.9	10.8
General administration	1,824	2,670	3,757	56.2	46.4	40.7	4.7	8.6	13.2
Total	39,353	31,131	28,304	9.4	-20.9	-9.1	100.0	100.0	100.0
% of GDP	10.0	7.1	6.1						

¹ Revised estimate.

² Budget estimate.

o/w: of which.

Financing

All new financing from domestic sources...

Total gross borrowings of the Federal Government in 2004 is estimated at RM47,155 million compared with RM44,994 million in 2003. The funds raised are for financing the deficit as well as for redemptions of existing debts. Taking advantage of the ample liquidity in the banking system, the bulk of the funding, amounting to RM45,850 million, will be from domestic sources through the issuance of Malaysian Government Securities (MGS) and Government Investment Issues (GII), as shown in *Table 4.5*. Of this total, RM16,100 million are new issues while the balance is reopening of existing securities. As in the past, with revenue more than sufficient to cover the operating expenditure, borrowing is only for financing development expenditure.

During the year, the Government is expected to issue five new MGS and reopen nine existing

TABLE 4.5

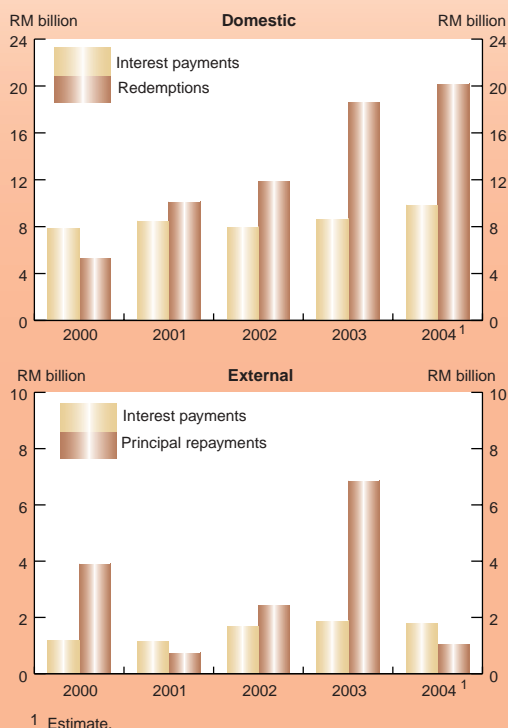
Federal Government Financing 2003-2004

	RM million		Share (%)	
	2003	2004 ¹	2003	2004
Gross borrowings	44,994	47,155	100.0	100.0
Domestic	41,850	45,850	93.0	97.2
Investment issues	2,000	4,100	4.4	8.7
Government securities	39,850	41,750	88.6	88.5
External	3,144	1,305	7.0	2.8
Market loans	1,437	-	3.2	-
Project loans	1,707	1,305	3.8	2.8
Repayment	25,453	21,234	100.0	100.0
Domestic	18,600	20,200	73.1	95.1
External	6,853	1,034	26.9	4.9
Net Borrowings	19,541	25,921		
Domestic	23,250	25,650		
External	-3,709	271		
Change in assets	1,387	-6,007		
Total	20,928	19,914		

¹ Estimate.

CHART 4.6

Federal Government Loans - Principal Repayments, Redemptions and Charges

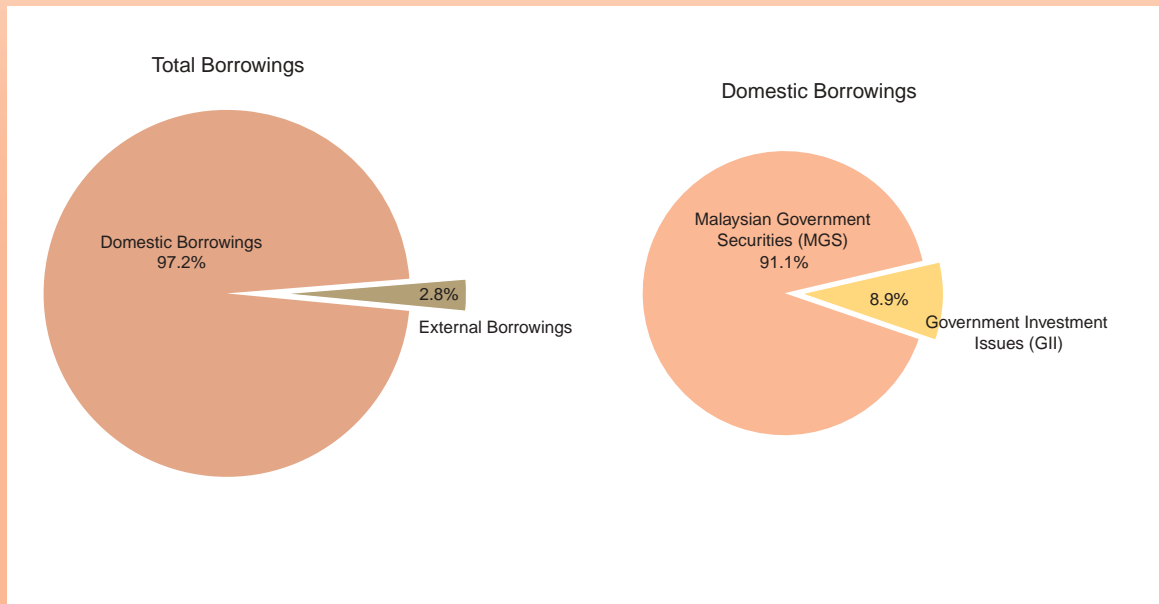


ones. The amount raised from new issues, amounting to RM12,000 million, is by open tender and private placement. Reopening of existing MGS is expected to raise RM29,750 million. In 2004, MGS with maturities of five and 10 years are issued at coupon rates ranging between 4.3% and 6.8% per annum, while for those with a maturity of 15 years, the rate is 5.7%. The rates on MGS issued in 2003 with similar maturity range from 3.7% to 7.6%. Of the total MGS outstanding as at June 2004, 29.8% has a maturity of less than three years, 28.4% more than three and less than five years, and the balance 41.8%, more than five years. The profile indicates that the maturity is evenly spread and, hence, the risk of debt bunching is reduced.

In line with the objective to reduce external debt and minimise exposure to external risks, no new external borrowing will be raised this year other

CHART 4.7

Composition of Federal Government Borrowings in 2004



than the disbursement of existing project loans. A total of RM1,305 million is expected to be drawn down from bilateral and multilateral sources to finance projects for education and training, upgrading and rehabilitation of water supply, construction of railways, poverty eradication as well as ICT venture capital. The Federal Government's external debt is expected to reduce to RM35,499 million or 8.1% of GDP at the end of 2004 (2003: RM37,284 million; 9.5% of GDP) with the repayment of RM1,034 million of external loans.

Debt

National debt lower...no new external borrowings by Federal Government...

The Federal Government overall debt position is expected to improve with debt as a percentage

to GDP declining to 50% at end of 2004, lower than the average of 53.6% recorded for the period 1988-2003. Correspondingly, the nation's external debt ratio to GDP is also expected to decline to 44.3% (at end 2003: 47.3%).

Total Federal Government debt is projected to increase to RM219,269 million, with domestic debt constituting 83.8% of the total, as shown in *Table 4.6*. Although the debt level has increased in recent years, the debt servicing capacity of the Federal Government remains strong. Debt service charges as a percentage of operating expenditure and revenue is estimated to remain low at 12.7% and 12%, respectively (2003: 14% and 11.4%). With the bulk of the loans at fixed interest rates, the exposure to risks due to future interest rate hikes is minimal.

The external debt of the nation, comprising all short, medium- and long-term external debts

TABLE 4.6

Federal Government Debt 2003-2004

	RM million		Share (%)		GDP (%)	
	2003	2004 ¹	2003	2004	2003	2004
Domestic debt	151,483	183,770	80.2	83.8	38.4	41.9
Treasury Bills	4,320	4,320	2.3	2.0	1.1	1.0
Investment Issues	7,000	9,100	3.7	4.1	1.7	2.1
Government Securities	130,800	154,350	69.3	70.4	33.2	35.2
Housing Loan Fund	9,363	16,000	4.9	7.3	2.4	3.6
External debt	37,284	35,499	19.8	16.2	9.5	8.1
Market loans	28,189	25,695	15.0	11.7	7.2	5.9
Project loans	9,095	9,804	4.8	4.5	2.3	2.2
Total	188,767	219,269	100.0	100.0	47.9	50.0

¹ Estimate.

TABLE 4.7

National Debt 2003-2004

	RM million		Share (%)		GDP (%)	
	2003	2004 ¹	2003	2004	2003	2004
Medium-and long-term debt	152,808	152,599	82.0	78.6	38.8	34.8
Public sector	96,826	97,692	52.0	50.3	24.6	22.3
Federal Government	37,284	35,499	20.0	18.3	9.5	8.1
NFPEs	59,542	62,193	32.0	32.0	15.1	14.2
Guaranteed	10,970	17,681	5.9	9.1	2.8	4.0
Non-Guaranteed	48,572	44,512	26.1	22.9	12.3	10.1
Private sector	55,982	54,907	30.0	28.3	14.2	12.5
Short-term debt	33,536	41,659	18.0	21.4	8.5	9.5
Total	186,344	194,258	100.0	100.0	47.3	44.3

¹ Estimate.

CHART 4.8

Federal Government External Debt by Currencies

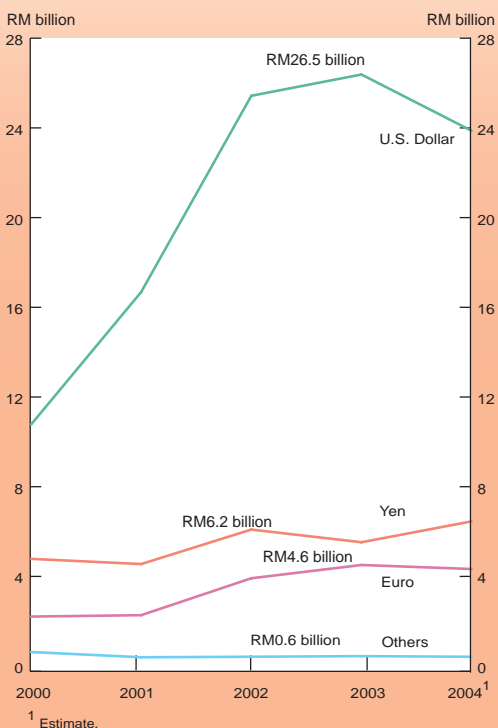


TABLE 4.8

Consolidated State Government Financial Position 2003-2004

	RM million		Change (%)	
	2003	2004 ¹	2003	2004
Current Account				
Revenue	8,541	9,727	2.4	13.9
Operating expenditure	5,307	6,724	4.3	26.7
Current account balance	3,234	3,003	-0.5	-7.1
Development account				
Gross development expenditure	4,362	4,826	4.8	10.6
Development fund	3,969	4,420	7.7	11.4
Water supply fund	393	406	-17.4	3.3
Loan recoveries	545	116	40.1	-78.7
Net development expenditure	3,817	4,710	1.2	23.4
Overall balance	-583	-1,707	-11.9	-192.8
% of GDP	-0.1	-0.4		

¹ Revised estimate.

of the Federal Government, Non-Financial Public Enterprises (NFPEs) and the private sector is envisaged to decline slightly to RM194,258 million or 44.3% of GDP, with the Federal Government continuing to reduce its dependence on external borrowing, as shown in *Table 4.7*. A large proportion of the nation's external debt is of medium- and long-term maturities, with short-term debt comprising only 21.4% of the total. The ratio of international reserves to short-term debt, a measure of reserve adequacy to meet short-term external debt obligation, is more than sufficient to cover five times of short-term debt as at 14 August 2004. The external debt service ratio, a measure of principal repayment and interest charges against the country's exports of goods and services, is projected to remain low at 4.6%, reflecting the sustainability of export earnings to service the external debt.

State Governments

The financial position of state governments remains sustainable...

The consolidated financial position of the state governments is expected to record a larger overall deficit, following higher expenditure growth over revenue growth. Total revenue is projected to grow by 13.9% to RM9,727 million during the year, with 80% of the total generated from own sources, while the balance comes from Federal Government grants. Petroleum and forestry royalties, land premium and taxes as well as profits and dividends from investment together contributed 57.6% of state governments' own sources of revenue. Other sources include fees from licences and permits, rents as well as sales of goods and services. In addition, in line with

efforts of the Federal Government to improve tax administration and enforcement, state governments will intensify revenue collection efforts, particularly targetting on assessment arrears and unpaid dues including imposing caveats on properties.

State governments are expected to incur higher operating and development expenditure in their efforts to improve public amenities and service quality to the *rakyat*. As in the case of Federal Government, the 26.7% rise in operating expenditure is higher than gross development expenditure, which is expected to increase by 10.6%. The higher operating expenditure is on account of higher emolument, supply and services, while agriculture and rural development as well as public utilities are expected to constitute the bulk of the increase in development expenditure.

The higher operating and development expenditure is expected to increase the overall deficit of state governments to RM1,707 million (2003: RM583 million), as shown in *Table 4.8*. As in previous years, the deficit is financed by

Federal Government loans and the use of accumulated financial assets of state governments.

General Government

Financial position of general government improving...

The financial position of the general government, which consists of the consolidated accounts of the Federal Government, state governments, local authorities and statutory bodies after netting out intra-general government transfers and net lending, is estimated to register a deficit of RM20,605 million or 4.7% of GDP, slightly better than in 2003. However, the deficit is marginally larger than the Federal Government deficit of RM19,914 million or 4.5% of GDP. The slightly larger deficit is on account of Federal Government transfers to statutory bodies, state governments and local authorities being smaller than the total deficit incurred by these entities.

TABLE 4.9

Consolidated General Government Financial Position 2003-2005

	RM million			Change (%)		
	2003	2004 ¹	2005 ²	2003	2004	2005
Current account						
Revenue	107,055	112,904	115,139	8.3	5.5	2.0
Operating expenditure	84,163	102,291	100,170	10.1	21.5	-2.0
Current account balance	22,892	10,613	14,969	2.0	-53.6	41.0
Development expenditure	43,860	31,218	32,937	9.1	-28.8	5.5
Overall balance	-20,968	-20,605	-17,968	18.1	1.7	12.8
% of GDP	-5.3	-4.7	-3.9			

¹ Revised estimate.

² Budget estimate, excluding 2005 tax measures.

Non-Financial Public Enterprises (NFPEs)

Strong NFPEs financial position...surpluses continues...

The overall financial position of NFPEs is estimated to continue to register a healthy surplus of RM18,297 million, an increase of 12.4% (2003: RM16,278 million; 22.3%). This is the fifth consecutive year of surplus recorded by NFPEs, reflecting increasing profitability and in consonance with the improving economy both domestically and globally. The higher revenue outturn of RM162,495 million or an increase of 4.3% is largely contributed by major NFPEs due to higher electricity consumption, better telecommunications sales as well as higher crude oil and liquefied natural gas (LNG) prices, as shown in *Table 4.10*.

The operating expenditure of NFPEs, as a group, is expected to expand by 11.4% to RM110,744 million (2003: 22.8%; RM99,429 million), in line with higher costs of materials and inputs, technology upgrading and higher production capacity. On the other hand, capital expenditure is lower at RM33,454 million (2003: RM40,160 million), due to the step-like nature of capital spending as well as outsourcing activities. Most of the development projects are carried out by the larger NFPEs such as Tenaga Nasional Berhad (TNB), Telekom Malaysia Berhad (TMB) and PETRONAS and their major subsidiaries to increase capacity and improve productivity. TNB's major capital expenditure continues to focus on upgrading and expanding its transmission and distribution networks and power generation capacity, which among others include the Tuanku Jaafar Power Station in Port Dickson and Cameron Highland-Batang Padang Hydroelectric project. As for TMB, the major projects, aimed at expanding infrastructure and improving data support services, are Digitaline II-Phase 7, Asymmetrical Digital Subscriber Line (ADSL) - Streamyx ports, Asia Pacific Cable Network and cable systems for South East Asia, Middle East and Western Europe.

TABLE 4.10

Consolidated NFPEs Financial Position¹ 2003-2004

	RM million		Change (%)	
	2003	2004 ²	2003	2004
Revenue	155,867	162,495	23.2	4.3
Current expenditure	99,429	110,744	22.8	11.4
Retained income	56,438	51,751	23.7	-8.3
<i>% of GDP</i>	<i>14.3</i>	<i>11.8</i>		
Development expenditure	40,160	33,454	24.3	-16.7
Overall balance	16,278	18,297	22.3	12.4
<i>% of GDP</i>	<i>4.1</i>	<i>4.2</i>		

¹ Refers to 34 NFPEs.

² Revised estimate.

PETRONAS continues to channel capital expenditure towards expanding capacities both domestically and overseas. The bulk of its development expenditure within the country is incurred by new production sharing contracts (PSCs). Substantial growth in development expenditure by PETRONAS is also recorded for exploration and production projects in Egypt, Vietnam, Myanmar, Indonesia and Chad.

In upstream activities, a number of development projects are expected to come on stream, include the West Delta Deep Marine (WDDM) project, Tapis-F oil project, oil fields projects in Block PM3, which are being developed under PETRONAS' Commercial Arrangement with Vietnam, Jintan and Helang fields in Sarawak for the gas supply to Malaysia Liquefied Natural Gas (MLNG) plants as well as the plant rejuvenation project in Bintulu. On downstream activities, major projects include the development of the Trans Thailand-Malaysia pipeline that will deliver gas from the Joint Development Area (JDA) to Malaysia and the construction of LNG tankers and vessels. As for Putrajaya Holdings Sdn. Bhd., its capital outlay will be for the construction of the remaining government buildings and quarters, as well as commercial buildings and infrastructure works, such as roads and parks.

TABLE 4.11

Consolidated Public Sector Financial Position 2003-2005

	RM million			Change (%)		
	2003	2004 ¹	2005 ²	2003	2004	2005
Revenue ³	107,055	112,904	115,139	-9.6	5.5	2.0
Operating expenditure	84,163	102,291	100,170	-10.4	21.5	-2.1
NFPEs current surplus	55,651	51,688	53,894	-18.6	-7.1	4.3
Public sector current balance	78,543	62,301	68,863	-15.2	-20.7	10.5
Development expenditure	83,315	64,707	64,125	-17.0	-22.3	-0.9
General government ⁴	43,155	31,253	32,984	-14.7	-27.6	5.5
NFPEs	40,160	33,454	31,141	-19.6	-16.7	-6.9
Overall balance	-4,772	-2,406	4,738	-47.9	49.6	296.9
% of GDP	-1.2	-0.5	1.0			

¹ Revised estimate.

² Budget estimate, excluding 2005 tax measures.

³ Excludes transfer within general government.

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

Consolidated Public Sector

A much improved consolidated public sector financial position...

The consolidated public sector finance is expected to record a much lower deficit amounting to RM2,406 million or only 0.5% of GDP (2003: RM4,772 million; 1.2% of GDP), as shown in *Table 4.11*. The lower deficit is due to the effective measures of the Federal Government to rein in expenditure as well as the enhanced profitability and surpluses of NFPEs.

Outlook 2005

Fiscal consolidation path expected to continue...

The continued positive outlook for both the global and domestic economy is a favourable factor

that will enable the Government to continue to pursue its consolidation path to further strengthen its financial position. With the private sector playing the locomotive role more entrenched as private investment continues to accelerate, the Government will concentrate increasingly on improving the accessibility to and quality of the public services. Greater efforts will be geared towards enhancing social services, increasing security and safety, improving environmental management and resources conservation, intensifying culture and heritage preservation, amplifying family values as well as augmenting sports and youth development.

The Federal Government financial position will show a more healthy position. Expenditure, both operating and development, will decline by 4.2% on account that 2005 represents the balance of the new RM170 billion ceiling for the 8MP. Revenue is expected to remain at the same level as the previous year as the higher revenue in 2004 from one-off sources, mainly investment

income, will not feature so prominently in 2005. The Federal Government overall position is envisaged to improve further, with deficit targetted to decline to 3.8% of GDP.

The Government will continue to stress on efficiency and effectiveness in its financial management. In this regard, measures will be taken to streamline tax measures as well as improve tax administration and enforcement. As a medium-term measure, a review of the tax structure and system is currently underway. Expenditure efficiency will be achieved through cost containment by expunging superfluous expenses, more stringent allocation by more thorough evaluation and scrutiny of project scope and size, as well as reprioritising projects and implementing smaller-scale projects that will benefit a larger segment of the population. In this context, smaller projects like rural roads will be given priority. As the thrust of the Government is to reduce the rural-urban socio-

economic gap, a larger share of allocation is given for the rural and agriculture sector. This is in line with the impetus to revitalise the sector as the third engine of growth.

Expenditure on utilities and amenities, amounting to RM1,796 million, will also be given priority, particularly for water and electricity supply, community development, and environmental projects. For 2005, the operating and development allocation will be RM89,141 million and RM28,304 million, respectively.

With a more positive economic outlook, coupled with prudent spending and improved tax administration, the financial positions of the Federal Government and the consolidated public sector are expected to improve further. The Federal Government deficit is targetted to decline to 3.8% of GDP, while the consolidated public sector is envisaged to turn around to record a surplus of 1.0% of GDP.