
PUBLIC SECTOR FINANCE | 4

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Overview

Fiscal Policy in 2015

Structural reforms strengthen fiscal position

The Government remains committed to fiscal consolidation towards achieving a balanced budget in 2020. The consolidation, which aims to reduce the fiscal deficit and debt accumulation, requires further enhancement in revenue and prudent spending. The Government has undertaken important structural reform initiatives to further strengthen its fiscal position while continuing to promote sustainable economic growth. The initiatives are also vital to create fiscal space and provide greater flexibility to implement counter-cyclical measures to support the economy during a crisis.

The fiscal reform initiatives include the implementation of the Goods and Services Tax (GST) and rationalisation of subsidies. The GST, introduced in April 2015, has replaced the Sales Tax and Service Tax (SST) to broaden the tax base and enhance the efficiency of the tax system. As for subsidy rationalisation, the managed float fuel pricing mechanism was extended to petrol RON95 and diesel in December 2014 leading to a substantial reduction in fuel subsidies. In addition, the Government has adopted the Medium-Term Fiscal Framework (MTFF) as a guide in formulating strategies to achieve fiscal targets over the medium term (3 to 5 years). The Fiscal Policy Committee (FPC), established as part of the reform initiatives, continues to play an important role in strengthening public finances and ensuring long-term fiscal sustainability.

Reflecting the Government's steadfast commitment to fiscal consolidation, the fiscal deficit thus far has been successfully reduced from 6.7% in 2009 to 3.4% of GDP in 2014. Given the current global challenges, particularly the volatility in commodity prices, the reform initiatives will be intensified and strengthened. Hence, in line with measures to enhance revenue and rationalise expenditure, the deficit is expected to further narrow to 3.2% of GDP in 2015.

Medium-Term Fiscal Framework (MTFF)

The MTFF outlines fiscal projections beyond the annual budget horizon, along with required key fiscal policy initiatives. The framework mainly takes into account macroeconomic and policy assumptions, revenue projections and expenditure commitments. The MTFF drives the formulation of the budget process by providing an indicative multi-year expenditure ceiling for ministries. This will also enable ministries to undertake medium-term expenditure planning and provide flexibilities to ministries in prioritising programmes and activities.

Under the framework, the deficit level will be further reduced to achieve a balanced budget in 2020. Although the deficit level, as a share of GDP, has been reduced by 3.3 percentage points from 2009 to 2014, the adoption of MTFF is crucial to manage and keep focus on various elements and commitments as well as in ensuring fiscal consolidation. It provides an integrated view of the Government's financial position and helps to sustain the consolidation momentum. The implementation of MTFF will enhance prudent fiscal management and provide better policy guidance in ensuring long-term fiscal sustainability.

Federal Government

The Government announced pre-emptive measures and adjusted the Budget on 20 January 2015 to address the impact of declining crude oil prices on revenue. With lower crude oil prices, the revenue shortfall is projected at RM12.8 billion. However, savings from the implementation of the fuel float pricing mechanism amounting to RM10.7 billion is insufficient to offset the shortfall and accommodate the 2015 Budget measures. Thus, in order to stay the course of the consolidation path, the Government has taken steps to reduce discretionary spending and implement more stringent cost-cutting measures.

In 2015, revenue collection is anticipated to reduce by 5.4% or 0.8% of GDP from the original estimates due to the sharp decline in oil-related revenue. However, the impact will be cushioned by an estimated higher GST

TABLE 4.1

Federal Government Financial Position 2014 – 2016

	RM million			% Change			% of GDP		
	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²
Revenue	220,626	222,455	225,656	3.4	0.8	1.4	19.9	19.2	18.2
Operating expenditure	219,589	213,314	215,224	3.9	-2.9	0.9	19.8	18.4	17.3
Current balance	1,037	9,141	10,432	-50.6	781.5	14.1	0.1	0.8	0.8
Gross development expenditure	39,503	47,423	50,000	-6.4	20.0	5.4	3.6	4.1	4.0
Less: Loan recovery	1,052	1,033	785	-31.1	-1.8	-24.0	0.1	0.1	0.1
Net development expenditure	38,451	46,390	49,215	-5.5	20.6	6.1	3.5	4.0	4.0
Overall balance	-37,414	-37,249	-38,783	-3.0	-0.4	4.1	-3.4	-3.2	-3.1

¹ Revised estimate.

² Budget estimate, excluding 2016 Budget measures.

collection. Meanwhile, total expenditure, as a percentage of GDP, is expected to decline by 0.6% from the original budget. Consequently, the Government revised the 2015 fiscal deficit from the initial target of 3% to 3.2% of GDP, lower than the 3.4% achieved in 2014, reflecting commitment towards fiscal consolidation.

Revenue

GST cushions impact of lower crude oil prices

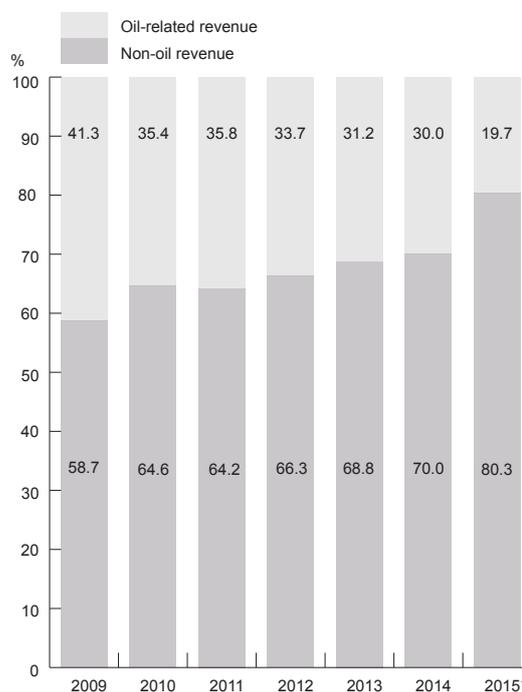
The Government continues to strengthen its fiscal management by broadening and diversifying the revenue base. The implementation of the GST provides a fairer and more transparent tax system as well as ensuring a sound and sustainable source of revenue. In 2015, the Federal Government revenue is expected to increase marginally by 0.8% (2014: 3.4%) to RM222.5 billion while its share to GDP is projected to sustain at 19.2% amid lower collection from oil-related revenue and non-tax revenue.

The Government continues its efforts towards reducing the reliance on oil-related revenue. The share of oil-related revenue to total revenue has declined from 41.3% in 2009 to 30% in 2014, though average crude oil prices remained high at USD95 per barrel during the period. The share is expected to further decline to 19.7% of total revenue in 2015 due to a sharp drop in crude oil prices. On the other hand, the share of non-oil revenue has increased from 58.7% in 2009 to 70% in 2014 and is expected to further increase to 80.3% in 2015. In terms of share to GDP, oil-related revenue is estimated to register 3.8% while non-oil revenue at 15.4% in 2015 (2014: 6%; 13.9%). The GST has also contributed to the increase in the share of non-oil revenue.

Tax revenue, the major contributor to the Federal Government revenue, with a share of 76.4%, is estimated to increase by 3.5% in 2015 to RM170 billion and remains high at 15.1% of GDP (2014: 14.8%). **Direct tax**, which constitutes 52.5% of total revenue, is estimated to decline by 7.9% to RM116.8 billion in 2015 (2014: 5.2%; RM126.7 billion) due to lower Dated Brent price averaging USD50 per barrel (2014: USD99 per barrel). However, corporate income tax, the largest component, representing 40.2% of total tax revenue, is expected to increase by 4.7% to RM68.3 billion (2014: 12.1%; RM65.2 billion). This will be contributed by improved tax compliance following continuous efforts in enhancing tax administration and strengthening tax audits. In addition, individual income tax is expected to grow by 15.3% to RM28.2 billion, underpinned by stable employment and wage growth despite a reduction in tax rate between 1% and 3% for all income brackets effective 2015. Meanwhile, petroleum income tax (PITA), constituting 5.6% of total tax revenue,

CHART 4.1

Share of Oil-Related and Non-Oil Revenue to Total Revenue



¹ Revised estimate.
Source: Ministry of Finance, Malaysia.

is estimated to decline to RM9.5 billion due to lower crude oil prices despite stable production. In addition, the Real Property Gains Tax (RPGT) is expected to increase to RM2.1 billion, mainly attributed to the revision of tax rate as well as higher property value.

Indirect tax is forecast to surge by 42.2% to RM53.3 billion, driven by the introduction of GST. Since its implementation, the number of registered companies has increased to 390,378 as of September 2015 compared to a lower initial estimate of 146,000 companies. The higher number of registrants will lead to improved tax compliance among companies. In 2015, GST collection is estimated at RM27 billion compared with the original projection of RM21.7 billion. During the period January to March 2015, the Government also collected SST amounting to RM7.6 billion. In addition, import duties are expected to grow by 2.1% to RM2.7 billion in line with strong demand for intermediate and capital goods. However, excise duties are forecast to decline by 5.9% to RM12.2 billion (2014: RM12.9 billion) due to lower sales of motor vehicles from January to June 2015 by 3.3% to 322,184 units (January – June 2014: 333,156 units)¹. The downward trend is expected to continue for the rest of the year. Similarly, export duties are projected at RM1.1 billion (2014: RM1.9 billion), consistent with weaker export volume and lower crude oil prices.

¹ Market Review First Half 2015, Malaysian Automotive Association.

Feature Article 1

Update on Implementation of Goods and Services Tax

Introduction

The Goods and Services Tax (GST) was implemented on 1 April 2015 to replace the Sales Tax and Service Tax (SST). The GST aims to streamline the structure of the previous consumption taxes to make it more efficient, effective, transparent and business-friendly. The GST simplifies the previous tax system, which has multiple rates and different thresholds to a single rate at 6% and single threshold at RM500,000 for businesses. Essentially, GST will broaden the tax base in line with the overall Government initiative to strengthen its fiscal position.

Pre-GST Implementation

The Goods and Services Tax Act 2014 was gazetted on 19 June 2014 while the relevant subsidiary legislations were gazetted on 1 July 2014. More than 70 GST Guides were issued to assist industry in better understanding the GST. In addition, intensive hand-holding programmes were carried out prior to GST implementation to help businesses understand the technical aspects of GST and comply with the GST rules. A total of 6,420 training programmes were conducted involving more than 500,000 participants from industries, associations, non-governmental organisations, professionals and government agencies. Furthermore, handbooks on 'Salient Features of GST, Accounting for Tax and Business Preparations', 'Frequently Asked Questions on GST for Businesses' and 'GST Guide of Sundry Goods for Consumers' were also published and made available online via the GST portal. To ensure the smooth implementation of the GST and adherence to the GST laws, related regulations and guidelines, the GST Oversight Executive Committee was established in May 2014. The Committee also addresses concerns of the rakyat and takes into account their views to further improve the implementation of the GST.

GST Registration

A total of 390,378 business entities have registered under GST as of September 2015 compared to 300,811 registrants during the mandatory period which ended on 31 December 2014. The large number of registrants, including voluntary registrants, is a positive indication that businesses are becoming more tax-compliant as they begin to realise the benefits of registering under the GST system. This indirectly enhances the potential revenue to be generated as some of these businesses were not captured within the previous tax system. To encourage more businesses to register, the Government continues to facilitate the registration process through the following measures:

- Enhancement of MyGST portal for registration with simplified features;
- Special sessions on registration process in all GST training programmes carried out nationwide;
- A step-by-step video demonstration guide on how to register; and
- Extensive promotion through mainstream and social media.

CHART 1

Number of Registrants by Sector

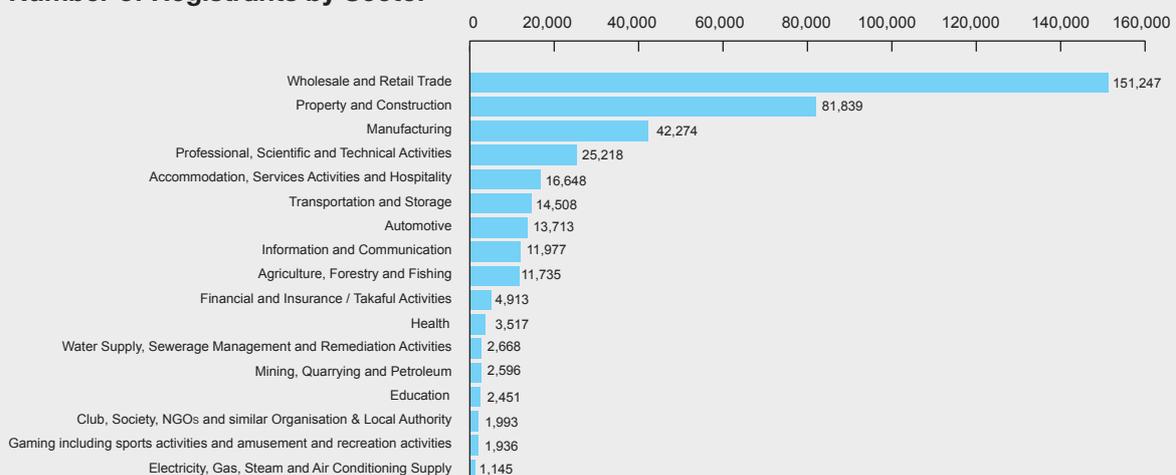
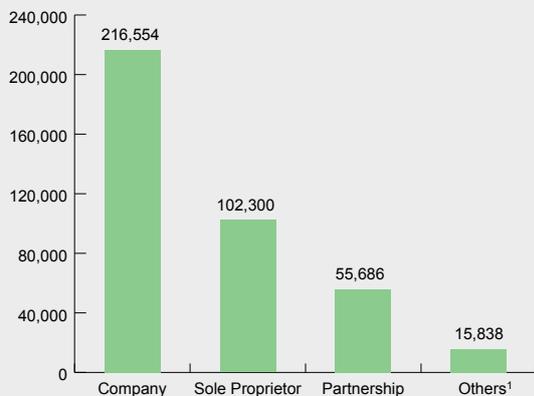


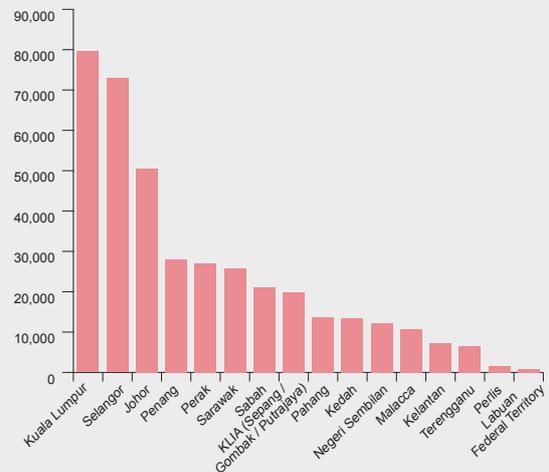
CHART 2

Number of Registrants by Entity

¹Includes professionals, individuals, associations, limited liability partnerships and public authorities.

Source: Royal Malaysian Customs Department.

CHART 3

Number of Registrants by Customs Administration**GST Assistance Packages**

The Government has provided tax and non-tax assistance package for businesses and consumers. These assistance include:

- A grant of RM1,000 for SMEs for the purchase of GST-compliant accounting software, benefiting more than 120,000 businesses;
- Deductions on secretarial fee and tax filing fee of up to RM5,000 and RM10,000, respectively;
- Accelerated Capital Allowance until year of assessment 2016 on the cost of purchasing ICT equipment and software;
- Further tax deduction for years of assessment 2014 and 2015 for expenses incurred on training in accounting and ICT relating to GST;
- Corporate income tax rate reduced from 25% to 24% while income tax rate for small and medium companies reduced from 20% to 19% from the year of assessment 2016;
- Decrease in personal income tax rates ranging from 1% – 3% for all groups of taxable income effective from the year of assessment 2015;
- The chargeable income bracket subject to the maximum tax rate was increased from RM100,000 to RM400,000;
- The maximum tax rate of 26% was reduced to 24% (RM100,001-RM250,000), 24.5% (RM250,001-RM400,000) and 25% (exceeding RM400,000); and
- A one-off cash assistance of RM300 to BR1M recipients.

Issues and Challenges in GST Implementation

The GST implementation has been relatively smooth due to the early preparations and cooperation of all stakeholders. Issues raised during the initial period of implementation were clarified and conveyed to the public and businesses through media releases, briefs and updates on MyGST portal. A GST Coordination Centre was also set up to monitor and provide clarification on GST issues through social media. As a result of continuous engagement and communication with businesses and the public, the number of complaints has dropped significantly, from 4,564 in April 2015 to 147 in August 2015.

Issues and challenges arising from GST implementation include:

- Improper issuance of tax invoices
Some businesses were not well prepared to issue proper tax invoices due to failure in procuring and installing GST-compliant software and hardware on time. To accommodate them, handwritten tax invoices to charge the GST were allowed till end of September 2015 provided they fulfilled certain minimum criteria to enable businesses to be GST-ready.

- Confusion between service charge and service tax

Service charge is a fee charged by the service provider in the hospitality industry. It is not a tax collected by the Government. Service tax, on the other hand, was a form of tax collected by the Government. Prior to the implementation of GST, service tax was not imposed on service charge. However, with the implementation of GST, service charge is deemed as part of payment for the supply of services and GST is imposed on the service charge. To provide certainty and clarity to consumers, service providers who impose service charge are required to display a notice informing customers that service charge is imposed at their premises.

- Increase in prices

To protect the interest of consumers, the Government ensures that traders do not use GST as an excuse to raise prices of goods indiscriminately. Among the measures taken to protect consumers include the enforcement of the Price Control and Anti-Profitteering Act 2011 as well as the publication of a Shoppers' Guide to assist consumers in comparing prices before and after the implementation of GST. Under the "Ops Catut" programme, inspections are also carried out at business premises to reduce profiteering while action is taken against errant traders.

Input Tax Claim and Refund

More than 90% of GST registrants submitted their monthly and quarterly Input Tax Claim returns within the stipulated period, reflecting a high level of compliance. Of this, more than 99% of the returns were submitted electronically. However, the refund process for electronic submission took more than 14 working days due to several factors including:

- Claims made in the wrong taxable period;
- Entries in the returns for input tax claim were incorrect, incomplete or supplies declared in wrong boxes;
- The company could not be contacted after seven days from the date of issuance of the notice for verification and request for information;
- Slow or no response received from the applicants to the queries by GST refund officers;
- False or doubtful claims that required further review by GST refund officers;
- Input Tax Claim made on 'Blocked Input Tax' or other non-allowable expenses;
- Multiple companies under a group registration submitting returns individually; and
- Incorrect or incomplete banking information of the companies.

Changes to the GST Structure and Treatments

To ensure smooth implementation of GST, the Government has updated and made some changes to the GST structure and treatments such as:

- Relief on the supply of goods made between and within free zone areas;
- Transaction between land owner and developer in a joint venture in property development is not treated as a supply;
- Relief from payment of GST on the acquisition of services for embassy, consular and international organisation for its official use;
- Increase zero-rated medicines from 2,900 to 4,215 items and medical equipment to 128 items;
- Exempt additional types of education services (vocational education provided by the skills training provider who conducts approved and accredited programme under the National Skills Development Act 2006);
- Allow places of worship to register separately or independently from their governing body; and
- Zero rate the supply of e-books and e-journals.

Conclusion

The introduction of GST is an important tax reform as it is a fair and efficient tax system as well as broadens the tax base. The Government will continue to address policy and implementation issues to ensure a high level of compliance. The GST was implemented with minimal disruption due to close cooperation between the Government and businesses as well as wider public acceptance.

TABLE 4.2

Federal Government Revenue 2014 – 2016

	RM million			% Change			% Share		
	2014	2015 ²	2016 ³	2014	2015 ²	2016 ³	2014	2015 ²	2016 ³
Tax revenue	164,205	170,018	183,553	5.3	3.5	8.0	74.4	76.4	81.3
Direct tax	126,743	116,760	125,566	5.2	-7.9	7.5	57.4	52.5	55.6
of which:									
Companies	65,240	68,320	74,381	12.1	4.7	8.9	29.6	30.7	33.0
PITA ¹	26,956	9,529	9,331	-9.4	-64.6	-2.1	12.2	4.3	4.1
Individuals	24,423	28,155	30,266	5.9	15.3	7.5	11.1	12.7	13.4
Indirect tax	37,462	53,258	57,987	5.7	42.2	8.9	17.0	23.9	25.7
of which:									
Excise duties	12,925	12,168	12,408	6.0	-5.9	2.0	5.9	5.5	5.5
Sales tax	10,939	4,784	-	8.7	-56.3	-	5.0	2.2	-
Service tax	6,277	2,851	-	5.6	-54.6	-	2.8	1.3	-
GST	-	27,000	39,000	-	-	44.4	-	12.1	17.3
Non-tax revenue	56,421	52,437	42,103	-1.7	-7.1	-19.7	25.6	23.6	18.7
of which:									
Licences and permits	14,254	12,460	12,626	6.2	-12.6	1.3	6.5	5.6	5.6
Investment income	33,756	32,172	21,452	-4.4	-4.7	-33.3	15.3	14.5	9.5
Total revenue	220,626	222,455	225,656	3.4	0.8	1.4	100.0	100.0	100.0
% of GDP	19.9	19.2	18.2						

¹ Petroleum income tax.

² Revised estimate.

³ Budget estimate, excluding 2016 tax measures.

Non-tax revenue² is expected to decline by 7.1% to RM52.4 billion, primarily due to lower receipts from petroleum royalties. Investment income, mainly contributed by Petroliaam Nasional Bhd (PETRONAS), Bank Negara Malaysia and Khazanah Nasional Bhd, remains the largest component in non-tax revenue with a share of 61.4%. Total receipts from licences and permits are expected to decline by 12.6% due to significantly lower receipts from petroleum royalties despite an increase in motor vehicle licences and levy on foreign workers.

Expenditure

Prudent management of expenditure

The Federal Government allocation will continue to be channelled towards strengthening economic growth, creating a conducive environment for businesses and prioritising spending for the well-being of the rakyat. Considering the slower revenue growth in 2015, fiscal allocation is managed in a more prudent and cost-effective manner. In this regard, expenditures are being reprioritised towards programmes and projects with larger multiplier effects to support consumption and enhance future productive capacity. In 2015, total expenditure is estimated to increase moderately by 0.6% to RM260.7 billion (2014: 2.2%; RM259.1 billion), while its share to

GDP is anticipated to decline to 22.5% (2014: 23.4%). Operating expenditure is allocated a sum of RM213.3 billion (81.8%) while the balance, RM47.4 billion (18.2%) is for development expenditure.

In tandem with expenditure rationalisation measures, **operating expenditure (OE)** is expected to decline by 2.9% to RM213.3 billion in 2015 (2014: 3.9%; RM219.6 billion). **Emoluments**, which constitute 32.4% (6% of GDP), remain the largest component of OE. This item is projected to grow marginally by 3.2% to RM69.1 billion, attributed to the provisions for annual salary increments and special financial assistance for Hari Raya. In efforts towards a leaner civil service, creation of new posts has been frozen and existing posts will be filled through redeployment. In addition, under the public service transformation initiatives, the Government will continue to highlight the importance of increasing competency, performance, productivity and innovation of civil servants.

Supplies and services, constituting 17.2% of OE, are estimated to grow by 6.9% to register RM36.6 billion. The growth in supplies and services is primarily due to higher outlays on repairs and maintenance as well as payment for services acquired. However, the Government has undertaken various rationalisation measures, which include minimising expenses on events and functions, travel and transport, utilities as well as postponement of the

² Consists of licences and permits (including petroleum royalties and levy), investment income, service fees, fines, sales of goods, non-revenue receipts and revenue from the Federal Territories.

TABLE 4.3

Federal Government Operating Expenditure by Object 2014 – 2016

	RM million			% Change			% Share		
	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²
Emoluments	66,947	69,113	70,466	9.7	3.2	2.0	30.5	32.4	32.7
Debt service charges	22,588	24,379	26,639	8.7	7.9	9.3	10.3	11.4	12.4
Grants and transfers to state governments	6,530	7,384	7,611	8.0	13.1	3.1	3.0	3.5	3.5
Retirement charges	18,218	18,153	19,496	22.7	-0.4	7.4	8.3	8.5	9.1
Supplies and services	34,259	36,638	36,315	1.2	6.9	-0.9	15.6	17.2	16.9
Subsidies	39,703	26,219	26,090	-8.4	-34.0	-0.5	18.1	12.3	12.1
Grants to statutory bodies	16,353	15,655	12,908	10.8	-4.3	-17.5	7.4	7.3	6.0
Refunds and write-off	1,336	1,664	924	21.8	24.6	-44.5	0.6	0.8	0.4
Others	13,655	14,109	14,775	-12.1	3.3	4.7	6.2	6.6	6.9
Total	219,589	213,314	215,224	3.9	-2.9	0.9	100.0	100.0	100.0
% of GDP	19.8	18.4	17.3						

¹ Revised estimate.

² Budget estimate, excluding 2016 Budget measures.

National Service Training Programme (PLKN) to contain the growth in supplies and services. Furthermore, discretionary expenditure will be reduced by rescheduling purchase of non-critical assets; saving on rentals by optimising the utilisation of Government premises; as well as minimising renovation and refurbishment of Government offices.

Expenditure on **subsidies**, which include assistance and incentives, representing 12.3% of total OE, is expected to decrease to RM26.2 billion in 2015 (2014: 18.1%; RM39.7 billion) due to the lower fuel subsidy payments following the implementation of a managed float fuel pricing mechanism for petrol RON95 and diesel. Allocation is still provided for cash assistance and social welfare programmes; educational assistance; incentives for farmers and fishermen; as well as various subsidies such as cooking oil and toll compensation. Fuel subsidies continue to be provided for public transportation and fishermen as well as liquefied petroleum gas (LPG). Meanwhile, the Government has increased the *Bantuan Rakyat 1Malaysia* (BR1M) assistance to a maximum of RM950 for households with an overall allocation of RM5.2 billion.

Debt service charges³ are estimated to increase by 7.9% to RM24.4 billion (2014: 8.7%; RM22.6 billion) and represent 11.4% of total OE. As one of the mandated items, debt service charges take priority over other commitments. With 97% of total Federal Government debt denominated in ringgit and fixed coupon rates, the exposure to currency exchange and interest rate risks is well-contained. **Retirement charges**⁴, accounting for 8.5% of OE, are expected to register RM18.2 billion. Of this, pension payments and gratuities are estimated to grow by 5.6% in 2015.

Grants to statutory bodies, which are mainly for emoluments as well as supplies and services, are anticipated to decline by 4.3% to RM15.7 billion

(2014: 10.8%; RM16.4 billion). This is in line with efforts to encourage statutory bodies to be less reliant on Federal grants, especially for entities with a steady income stream and high reserves. More than 60% of the grants will be channelled to public universities, in tandem with the Government's continuous efforts to develop highly skilled and employable graduates. The remaining grants are allocated mostly for regional and agricultural development authorities as well as trade and investment promotion agencies. Meanwhile, RM7.4 billion is provided for **state governments** under the constitutional grants as well as other transfers.

Development expenditure (DE) is estimated to grow by 20% to RM47.4 billion in 2015 (2014: -6.4%; RM39.5 billion). The economic sector remains the largest recipient at 59.7% followed by social (26.3%), security (10.4%) and general administration (3.6%) sectors. The 2015 DE also marks the final year of the Tenth Malaysia Plan (10MP), which accounts for 20.6% of the total 5-year ceiling.

The **economic sector** is allocated RM28.3 billion (2014: RM23.3 billion), consistent with efforts to enhance the productivity and competitiveness of the economy. This is to finance the development of transport infrastructure, small and medium enterprises (SMEs) and entrepreneurial programmes, improving public utilities as well as agriculture and rural projects. The *transport subsector* remains the largest recipient at 30.8% or RM8.7 billion, mainly for construction, maintenance and upgrading of roads and bridges, airports and ports as well as railways. Among the ongoing projects include the construction of West Coast Expressway from Taiping to Banting, construction of a 6.6-km electrified double-track railway from Subang Jaya to Sri Subang; acquisition of 10 electric train sets; upgrading airports in Kota Kinabalu, Miri and Mukah; as well as upgrading services and repairing of railway lines between Gua Musang and Tumpat, which were severely damaged during the massive floods in 2014.

³ Consist of coupon and interest payments, as well as management charges and fees.

⁴ Consist of pension payments, gratuities (including cash awards in lieu of leave) and transfers to the Retirement Fund Incorporated (KWAP).

TABLE 4.4

Federal Government Development Expenditure by Sector 2014 – 2016

	RM million			% Change			% Share		
	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²
Economic	23,338	28,316	30,303	-5.3	21.3	7.0	59.0	59.7	60.6
of which:									
Agriculture and rural development	2,875	3,213	3,394	6.8	11.8	5.6	7.3	6.8	6.8
Trade and industry	4,688	6,768	8,349	-24.9	44.4	23.4	11.9	14.3	16.7
Transport	7,271	8,734	8,440	-10.8	20.1	-3.4	18.4	18.4	16.9
Social	10,490	12,474	13,094	-3.6	18.9	5.0	26.6	26.3	26.2
of which:									
Education and training	4,928	5,629	4,691	-23.5	14.2	-16.7	12.5	11.9	9.4
Health	1,385	1,564	1,780	-20.3	12.9	13.8	3.5	3.3	3.6
Housing	618	2,293	2,588	-27.4	271.0	12.9	1.6	4.8	5.2
Security	4,332	4,932	5,010	-6.8	13.9	1.6	11.0	10.4	10.0
General administration	1,343	1,701	1,593	-33.9	26.6	-6.3	3.4	3.6	3.2
Total	39,503	47,423	50,000	-6.4	20.0	5.4	100.0	100.0	100.0
% of GDP	3.6	4.1	4.0						

¹ Revised estimate.

² Budget estimate, excluding 2016 Budget measures.

In 2015, the *trade and industry subsector* is allocated RM6.8 billion or 23.9% of the economic sector. Of this, RM1.9 billion (27.4%) is channelled to regional corridor development which will focus on projects such as the Kuantan Port City, Kuala Terengganu City Centre Phase II, South Kelantan Agropolitan, access road to Murum Dam in Kapit and the palm oil industrial cluster in Lahad Datu. In addition, RM1.1 billion is channelled to entrepreneurship development programmes to develop successful and competitive entrepreneurs. Allocation is also provided for tourism activities, namely the promotion of Malaysia Year of Festivals 2015 and tourism development programmes such as eco-tourism. The *public utilities and energy subsector* is allocated RM4.5 billion (16% of the economic sector) in 2015. A substantial allocation is given for the improvement and upgrading of water and electricity supply, especially in rural areas of Sabah and Sarawak as well as the improvement of sewerage services particularly in the Federal Territories.

The **social sector**, the second largest recipient of DE, is provided RM12.5 billion. Of this, RM5.6 billion (45.1%) is set aside for the *education and training subsector* mainly for construction of schools and training institutes, expansion of university buildings, maintenance and upgrading of equipment as well as enhancement of skills training and intensifying research programmes. In tandem with the Government's commitment to provide affordable and quality houses for the rakyat, RM2.3 billion is allocated for the *housing subsector*. The Government has channelled RM1.3 billion to the Perumahan Rakyat 1Malaysia Corporation (PR1MA) to build houses for the middle-income group with a household monthly income between RM2,500 and RM10,000. As at end-June 2015, 560 units have been completed in Putrajaya while 41,263 units

are under construction nationwide, mostly in Balik Pulau, Sungai Petani, Sepang, Santubong, Sandakan, Bukit Katil and Johor Bahru. An allocation of RM648 million will be utilised on People's Housing Programme (PPR) for low-income households earning below RM2,500 monthly. The PPR programme was established to enable the low-income group to rent or own affordable houses, hence improving their quality of life. Currently, 900 units have been completed while 15,996 units are under construction.

The Government will continue to provide quality healthcare services for the rakyat and has allocated RM1.6 billion to the *health subsector*, mainly for upgrading and maintaining hospitals and clinics, purchase of medical equipment and improving accessibility to health services. Major ongoing projects include the expansion of hospitals in Putrajaya, Seberang Jaya and Kuala Terengganu as well as upgrading surgery and haemodialysis facilities at Papar Hospital, Sabah.

National security and public safety remain the key concern of the Government. Towards this, the **security sector** is allocated RM4.9 billion in 2015. In safeguarding national border and security, the armed forces including the Eastern Sabah Security Command (ESSCOM), has been given a substantial allocation of RM3.6 billion. The expenses include improvement on surveillance, upgrade and purchase of military equipment as well as building and refurbishing quarters and camps. To further improve internal security and public safety, RM1.3 billion is provided to enhance the capacity and capability of the uniformed personnel through upgrading forensic equipment and system, refurbishing district police headquarters as well as skills and training enhancement especially on cyber-crime.

The spending for the **general administration sector** is estimated at RM1.7 billion in 2015. The bulk of the allocation is given mainly for new ICT procurement and enhancement of the application systems in government departments. The allocation is also for land acquisition, as well as building, refurbishment and maintenance of government facilities such as quarters and judicial courts.

Financing

Islamic financial instruments gain momentum

Federal Government funding requirements will be raised mainly from domestic sources given the ample liquidity in the domestic financial market. Total gross borrowings for 2015 are expected to be higher at RM96.5 billion mainly for repayment of existing loans amounting to RM59 billion, while the balance is for deficit financing. Domestic borrowing is estimated to account for 93.8% or RM90.5 billion with the remaining RM6 billion (6.2%) from external sources.

In 2015, the issuance of Malaysian Government Securities (MGS) is estimated to register RM50 billion or 55.2% of gross domestic borrowings while RM40.5 billion will be raised through Malaysian Government Investment Issues (MGII). In efforts to promote Malaysia as a premier Islamic financial market, the share of MGII issuance has increased and is expected to account for 44.8% of total gross domestic borrowings, compared to 36.9% in 2014. Furthermore, the inclusion of MGII in major global indices such as the HSBC Asian Local Bond Index in 2014 and Barclays Global Aggregate Index in 2015, also contributed to the increasing demand for quality Shariah-compliant debt papers.

During the first six months of 2015, yields on 5-year MGS ranged between 3.59% – 3.67%, while yields on 10-year MGS ranged between 3.83% – 4.03%. The yields on 10-year MGS has widened by 20 basis points during the period, following concerns over the anticipated rate hike by the US Federal Reserve (Fed) and continued deterioration in commodity prices. Notwithstanding the heightened uncertainties in global capital markets, MGS and MGII yields continued to remain attractive. On average, the issuance for 10-year MGS has attracted a bid-to-cover ratio of two times, reflecting strong demand for high-quality Government papers.

Gross offshore borrowings for 2015 are expected to increase to RM6 billion through market loan issuance and project loan drawdowns. In April 2015, market loan was raised via a benchmark global sukuk amounting to USD1.5 billion (RM5.7 billion) to redeem an existing USD1.25 billion (RM4.8 billion) sukuk, which was due in June 2015 as well as to finance DE. The global sukuk was split into a USD1 billion 10-year tranche and USD0.5 billion 30-year tranche. The 10-year tranche was priced at 3.043% while the 30-year tranche at 4.236%.

TABLE 4.5

Federal Government Financing 2014 – 2015

	RM million		% Share	
	2014	2015 ²	2014	2015 ²
Gross borrowings	91,017	96,485	100.0	100.0
Domestic	90,740	90,500	99.7	93.8
MGS	57,240	50,000	62.9	51.8
MGII	33,500	40,500	36.8	42.0
External	277	5,985	0.3	6.2
Market loans	-	5,718	-	5.9
Project loans	277	267	0.3	0.3
Repayments	53,816	59,007	100.0	100.0
Domestic	53,183	53,569	98.8	90.8
External	633	5,438	1.2	9.2
Net borrowings	37,201	37,478	-	-
Domestic	37,557	36,931	-	-
External	-356	547	-	-
Change in assets¹	213	-229	-	-
Total financing needs	37,414	37,249	-	-

¹ (+) indicates a drawdown of assets; (-) indicates accumulation of assets.

² Estimate.

The issuance of this sukuk reaffirms Malaysia as the leader in sukuk issuance and Islamic finance innovation. The 30-year tranche also set a new benchmark as the longest tenure for sovereign sukuk. During the year, RM267 million of project loans are expected to be drawn down from bilateral (government-to-government) and multilateral (international financial institutions) sources to finance ongoing projects and programmes related to education, energy, raw water transfer as well as agricultural development.

Debt

Debt remains within prudent limit

The Government is committed to sound debt management through the adherence to fiscal rules and regulations. In this regard, the fiscal consolidation, while minimising the deficit, is also aimed at curtailing the creation of new debt. As at end-June 2015, **Federal Government debt**, comprising the cumulative total of all Federal Government borrowings, stood at RM627.5 billion (54% of GDP). The debt has increased mainly due to higher domestic debt issuance to meet deficit financing requirements. Domestic debt remains the major portion of total debt at 97% (RM608.7 billion) with MGS and MGII constituting 87.8% of the total debt (47.4% of GDP). The remaining 3% (RM18.8 billion) of total Federal Government debt is from offshore borrowing, which is mainly denominated in US dollar. Offshore borrowing remained manageable at 1.6% of GDP, despite the appreciation of the US dollar. The Federal Government debt is well capped at 55% to GDP, placing Malaysia among medium-indebted countries.

Feature Article 2

Wakala Global Sukuk 2015

Introduction

Sukuk, the plural of the Arabic word *sakk*, refers to an investment certificate which allows investors to have rights of ownership of the assets, including cash flow and risks associated with such ownership¹. Generally, sukuk can be defined as transferable certificates representing a share in the ownership of underlying assets or businesses, where the sukuk holders are entitled to receive periodic returns and full redemption upon maturity. The global sukuk market continues to grow with more cross-border issuances and innovative structures.

The global sukuk market has recorded a substantial growth, with issuance almost tripling, from USD45 billion in 2011 to USD118.8 billion in 2014². The growth was driven by Malaysia, Saudi Arabia and United Arab Emirates (UAE) as the key players, as well as other emerging economies such as Turkey and Indonesia. The established legal, regulatory and Shariah frameworks in accordance with best practices together with a neutral tax policy, positioned Malaysia as a leader in global sukuk issuance, accounting for 49.9% (USD19.8 billion)³ as at end-June 2015. In addition, to further facilitate and support the development of the Islamic capital market, the Government has established a single trading platform, Bursa Suq al-Sila', which integrates three markets, namely financial, capital and commodity. The Government also set up a Law Harmonisation Committee in 2010 to provide a more conducive legal system. The issuance of sukuk in Malaysia is also cost-effective as international issuers have the flexibility to issue either ringgit or other foreign currency-denominated sukuk using internationally-accepted documentation.

After the successful issuance of USD2 billion sukuk in 2011, the Government re-entered the global sukuk market in April 2015 with an issuance of USD1.5 billion. The dual-tranche sukuk of 10-year (USD1 billion) and 30-year (USD500 million) tenures, attracted a bid-to-cover ratio of approximately six times, despite heightened uncertainty in the global economy. The 30-year tranche set a new benchmark as the longest-tenured sovereign sukuk. The 2015 global sukuk is the world's first sovereign sukuk to be offered under the *Wakala* structure utilising non-physical revenue-generating assets in the form of rights to participate in transportation services. This type of asset is part of the pool of underlying assets, which also includes *ijarah* assets and a commodity *murabahah*. The *Wakala* sukuk has enabled Malaysia to push the boundaries for innovative sukuk structures.

Highlights of the Sukuk

Objectives

- To redeem an existing sukuk of USD1.25 billion due in June 2015;
- To finance development expenditure;
- To meet growing demand for high-quality Shariah-compliant securities; and
- To reaffirm Malaysia's position at the cutting-edge of innovation in Islamic finance.

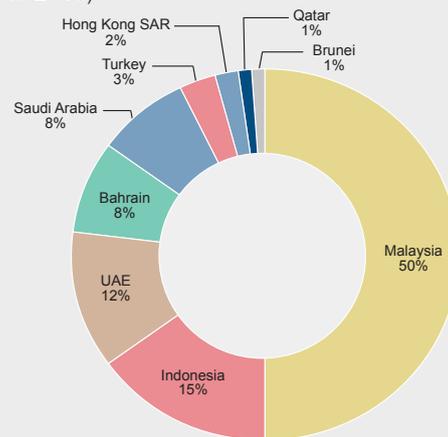
Type of Offering

- A 10-year benchmark USD1 billion sukuk due in 2025; and
- A 30-year benchmark USD500 million sukuk due in 2045.

The 2015 sukuk was issued through a special-purpose vehicle, Malaysia Sovereign Sukuk Bhd, and was listed on the Hong Kong Stock Exchange, Labuan International Financial Exchange and Bursa Malaysia. The issuance was Malaysia's fourth USD-denominated sukuk, having previously issued in 2011 (USD2 billion), in 2010 (USD1.25 billion) and in 2001 (USD600 million).

CHART 1

New Sukuk Issuance by Country (H1 2015)



Source: Zawya, ISRA.

¹ Rafe Haneef (2009) From Asset-Backed to Asset-Light Structures: The Intricate History of Sukuk. ISRA International Journal of Islamic Finance 1(1): 103-126.

² Based on International Shari'ah Research Academy for Islamic Finance (ISRA) estimates.

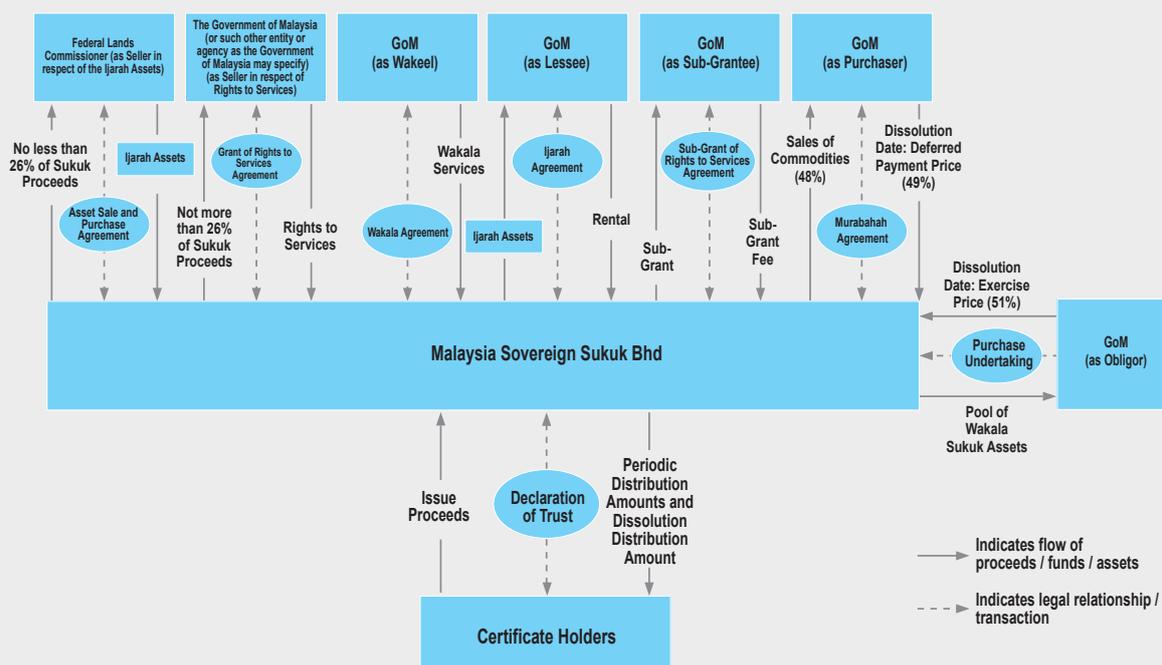
³ Source: Malaysia International Islamic Financial Centre (MIFC).

Structure

- The innovative structure was based on the Shariah principle of *Wakala Bil-Istithmar* comprising tangible assets consisting of *ijarah* assets (at least 26%) and rights to participate in transportation services (not more than 26%) as well as murabahah receivable of Shariah-compliant commodities (48%).
- Under this structure, as the trustee and the issuer of the sukuk, Malaysia Sovereign Sukuk Bhd (MSSB) will issue Trust Certificates to investors in exchange for proceeds. Not less than 26% proceeds from the issuance will be used to purchase the beneficial interest in *ijarah* (lease) assets including land and buildings while not more than 26% proceeds from the issuance will be used to purchase rights to participate in transportation services by way of a grant.
- The Government of Malaysia (GOM) shall be appointed as the wakeel (agent) by the issuer to provide certain wakala services in relation to the *ijarah* assets and rights to participate in transportation services.
- MSSB, as the trustee shall lease the *ijarah* assets to the GOM for a period equivalent to the tenor of the Trust Certificates in return for periodic rental payments, which will be used to pay the periodic distribution amounts to the certificate holders. MSSB shall also sub-grant the rights to participate in transportation services to the GOM for a period equivalent to the tenor of the Trust Certificates in return for a fee.
- The remaining proceeds from the issuance of not more than 48% will be utilised by the trustee to purchase Shariah-compliant commodities from Bursa Suq Al-Sila' through an agent, and thereafter, sell these commodities to the GOM, at a deferred payment price payable on a dissolution date or such other date(s) as may be provided in the *Murabahah Agreement*.
- The GOM, as the obligor, at the dissolution date, will undertake to purchase the *ijarah* assets and rights to participate in transportation services, from the trustee at the sukuk exercise price, which shall be at least equal in value to 51% of the aggregate face amount of the outstanding certificates and all unpaid periodic distribution amounts, as provided in the Purchase Undertaking.
- MSSB, as the issuer will use the proceeds from the sale of the *ijarah* assets and rights to participate in transportation services, and the payment of the deferred payment price to redeem the certificates.

CHART 2

Wakala Structure Diagram



Rating

The global sukuk was assigned a credit rating of A3 (Positive) and A- (Stable) by two international credit rating agencies, namely Moody's and Standard & Poor's, respectively.

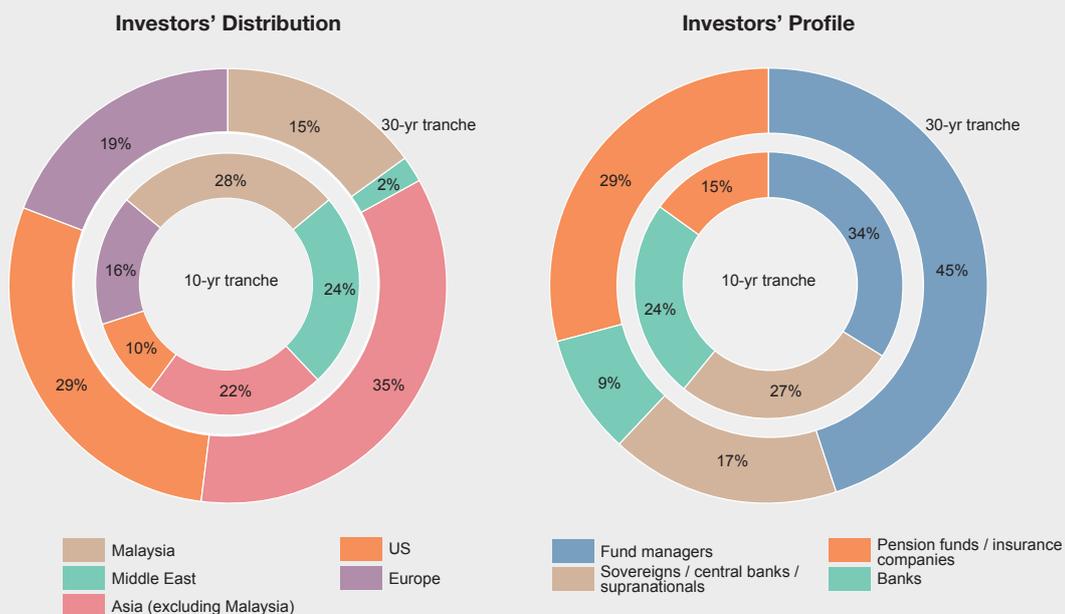
Distribution and Profile of Investors

The transaction received overwhelming response from international investors, particularly from the Middle East. The book building resulted in the largest combined order at approximately USD9 billion. Both tranches were competitively priced with the 10-year tranche (USD1 billion) at 3.043% and the 30-year (USD500 million) at 4.236%.

The final allocation was well distributed, with Malaysia and the Middle East as the major takers at 28% and 24%, respectively for the 10-year tranche. For this tranche, in terms of investors' profile, fund managers were the largest investors at 34%, followed by sovereigns, central banks and supranationals (27%), banks (24%), as well as pension funds and insurance companies (15%). Meanwhile, for the 30-year tranche, Asia (excluding Malaysia) and the US were the largest and second largest investors at 35% and 29%, respectively. Fund managers also dominated the 30-year tranche at 45%, followed by pension funds and insurance companies (29%), sovereigns, central banks and supranationals (17%) and banks (9%).

CHART 3

Investors' Distribution and Profile



Achievements

The landmark transaction further cements Malaysia as the clear leader in the global sukuk space and achieved several notable 'firsts' in the sovereign sukuk market including:

- World's first 30-year sukuk issuance by a sovereign, enabling the GOM to establish a new benchmark tenure for sovereigns; and
- World's first sovereign sukuk to utilise rights to participate in Government services as an underlying asset.

The highly successful sukuk issuance signalled international investors' confidence in Malaysia's creditworthiness and resilient macroeconomic fundamentals, accommodative monetary policy, sound fiscal position as well as a diversified and competitive economy. The leading-edge sukuk structure served as a breakthrough from the commonly used tangible assets such as land, offices and buildings. This has certainly established a new asset class that paves the way for both sovereigns and corporates to utilise such innovative structures widely.

TABLE 4.6

Federal Government Debt 2014 – 2015

	RM million		% Share		% of GDP	
	2014	2015 ¹	2014	2015 ¹	2014	2015 ¹
Domestic debt	566,052	608,676	97.1	97.0	51.2	52.4
Treasury bills	4,320	5,840	0.7	0.9	0.4	0.5
MGS	329,632	343,836	56.6	54.8	29.8	29.6
MGII	185,500	207,000	31.8	33.0	16.8	17.8
HLF	46,600	52,000	8.0	8.3	4.2	4.5
Offshore borrowing	16,776	18,824	2.9	3.0	1.5	1.6
Market loans	11,469	13,343	2.0	2.1	1.0	1.1
Project loans	5,307	5,481	0.9	0.9	0.5	0.5
Total	582,828	627,500	100.0	100.0	52.7	54.0
<i>Memorandum item:</i>						
Non-resident holdings of ringgit-denominated Government debt securities	151,377	180,104	26.0	28.7	13.7	15.5

¹ As at end-June 2015.

Total Federal Government debt reflects the accumulated funding requirements to meet deficit financing and civil servants' housing loan scheme. As at end-June 2015, the debt used to finance the deficit, which comprises the outstanding issuance of MGS, MGII, market loans and project loans, stood at RM569.7 billion (49.1% of GDP). To observe fiscal discipline and adhere to the administrative guidelines, the debt is merely to finance DE. Thus, the OE is kept within revenue estimates to ensure the fiscal current account remains in surplus.

As at end-June 2015, MGS remained the largest debt instrument of the Government with an outstanding amount of RM343.8 billion or 54.8% of total Federal Government debt while MGII stood at RM207 billion (33%). Financial institutions continued to be the largest holder of MGS and MGII at 31.3%, followed by the Employees Provident Fund (23.2%) and insurance companies (5.5%). Outstanding market loans of RM13.3 billion (70.9%) remained the largest component of accumulated offshore borrowing, while project loans stood at RM5.5 billion.

Under the Housing Loan Fund Act 1971, the Housing Loan Fund (HLF) was established to provide loans for civil servants to purchase houses. The HLF sourced its annual funding from the domestic market in the form of term loans and *Sukuk Perumahan Kerajaan* (SPK). As at end-June 2015, the outstanding debt of HLF stood at RM52 billion (4.5% of GDP), constituting 8.3% of total Federal Government debt. In June 2015, the Government established a statutory body known as the Public Sector Home Financing Board (LPPSA) under the Ministry of Finance, which will succeed the existing Housing Loan Division, to further improve the management of the housing loan scheme for civil servants. The exercise will allow LPPSA to become self-sustaining and independent in managing its assets and liabilities. LPPSA will manage all matters

relating to housing loans more efficiently while maintaining all existing terms and conditions of loan facilities to civil servants. LPPSA is expected to commence operations by end of 2015.

As cash-flow management instruments, Malaysian Treasury Bills (MTB) and Malaysian Islamic Treasury Bills (MITB) were issued on a regular basis with maturities of 3-month, 6-month, 9-month and 12-month. The issuances of MTB and MITB have been restructured starting from June 2015 to provide better short-term cash-flow management flexibility. The restructuring involves combining the smaller size and frequent issuances into benchmark sizes and less frequent issuances. The exercise is in line with global best practices where active management of treasury bills serves as a cost-effective and efficient tool for short-term cash-flow management. Furthermore, the benchmark size of issuances will be able to meet the rising demand from financial institutions following the Basel III requirement for high-quality liquid assets. As at end-June 2015, total outstanding MTB and MITB stood at RM5.8 billion (0.5% of GDP) and accounted for 0.9% of total Federal Government debt.

The Government will ensure its financing needs and debt service charge obligations are met at the lowest possible cost over the medium and long term. In 2015, debt service charges, which mainly consist of coupon and interest payments, remain manageable at 11% of Federal Government revenue, well below the threshold of 15%.

Malaysia's **external debt**⁵ stood at RM794.3 billion (68.4% of GDP) as at end-June 2015 (end-2014: RM747.5 billion; 67.5%). The bulk of the debt was contributed by non-resident holdings of ringgit-denominated debt securities and deposits at 26.2% of GDP, followed by private sector

⁵ Comprises offshore borrowing by the Federal Government, public corporations and the private sector as well as non-resident holdings of ringgit-denominated debt securities, non-resident deposits, trade credit provided by foreign trade counterparts and other debt liabilities.

TABLE 4.7

**External Debt
2014 – 2015**

	RM million		% Share		% of GDP	
	2014	2015 ³	2014	2015 ³	2014	2015 ³
Offshore borrowing	371,068	419,881	49.6	52.9	33.5	36.2
Medium and long-term debt	211,417	256,240	28.3	32.3	19.1	22.1
Public sector	93,119	119,435	12.5	15.0	8.4	10.3
Federal Government	16,776	18,824	2.2	2.4	1.5	1.6
Public corporations	76,343	100,611	10.2	12.7	6.9	8.7
Private sector	118,298	136,805	15.8	17.2	10.7	11.8
Short-term debt	159,651	163,641	21.4	20.6	14.4	14.1
Non-resident holdings of ringgit denominated debt securities	223,260	209,210	29.9	26.3	20.2	18.0
Medium and long-term debt	162,365	186,385	21.7	23.5	14.7	16.0
Federal Government	151,071	175,958	20.2	22.2	13.7	15.2
Others ¹	11,294	10,427	1.5	1.3	1.0	0.9
Short-term debt	60,895	22,825	8.1	2.9	5.5	2.0
Non-resident deposits	87,665	95,729	11.7	12.1	7.9	8.2
Others²	65,492	69,465	8.8	8.7	5.9	6.0
Total	747,485	794,285	100.0	100.0	67.5	68.4

¹ Include private sector and public corporations.

² Comprise trade credits, IMF allocation of Special Drawing Rights and miscellaneous.

³ As at end-June 2015.

debt at 11.8% of GDP. Meanwhile, the public sector offshore borrowing accounted for 10.3% of GDP, of which the Federal Government debt constituted only 1.6%. The increase in Malaysia's external debt was partly due to the valuation effect following the depreciation of ringgit, as about 60% of the external debt was denominated in foreign currencies.

Offshore borrowings increased to RM419.9 billion (52.9% of total external debt) as at end-June 2015, on account of higher net borrowing of medium and long-term debt by the non-bank private sector as well as public corporations. The Federal Government offshore debt showed a similar trend with an increase of 12.2% to RM18.8 billion, but remained low at 4.5% of total offshore borrowings. Meanwhile, the increase in short-term offshore borrowings was due to higher interbank borrowing activities. During the first six months of 2015, the debt service ratio⁶ for offshore borrowings, registered 16.3%.

Non-resident holdings of ringgit-denominated debt securities, largely in the form of medium and long-term securities, increased to RM209.2 billion as at end-June 2015. Foreign investors' holdings of MGS and MGII stood at 32.1% (end-2014: 29.2%). The continued foreign presence in the Malaysian bond and sukuk market reflects investors' confidence in the domestic macroeconomic fundamentals as they sought better quality instruments with higher returns. However, with the increased expectation of the Fed's interest rate hike and the appreciation of US dollar against major and regional currencies, including ringgit,

there was a slight reversal of foreign holdings in MGS from 48.5% in June to 45.6% in September 2015 but still higher than 44.9% as at end-2014. Nevertheless, the large and long-term domestic institutions as well as the well-developed domestic capital market are able to absorb any reversal of capital flows in the market. Meanwhile, foreign holdings of MGII have increased to 4.1% in September 2015 (end-2014: 2.8%) as MGII are more actively traded following its inclusion in major global indices.

State Governments

State-generated revenue remains high

In 2015, as the state governments' consolidated revenue continues to outpace OE, the current balance is expected to register a surplus of RM9.4 billion. However, with a higher DE, the overall balance is estimated to register a small deficit of RM939 million (0.1% of GDP).

Consolidated revenue of the states, which comprises direct and indirect taxes, non-tax revenue as well as non-revenue receipts, is expected to decline by 13.4% to RM21.6 billion. Direct taxes, which include land-based, mining and forestry taxes, are expected to increase by 27.8% to RM2.5 billion, while indirect taxes are anticipated to decline to RM1.8 billion, mainly due to lower collection of sales tax on crude palm oil (CPO). Meanwhile, non-tax revenue is estimated to decrease to RM11.1 billion,

⁶ Measures the principal repayment (excluding prepayment) and the interest payment of offshore borrowing as a proportion of gross exports of goods and services.

TABLE 4.8

Consolidated State Governments' Financial Position 2014 – 2015

	RM million		% Change	
	2014	2015 ¹	2014	2015 ¹
Revenue	24,989	21,631	6.1	-13.4
Operating expenditure	12,036	12,279	-7.3	2.0
Current balance	12,953	9,352	22.5	-27.8
Gross development expenditure	8,126	10,503	5.7	29.3
Development Fund	7,947	10,313	4.9	29.8
Water Supply Fund	179	190	53.0	6.1
Less: Loan recovery	286	212	5.1	-25.9
Net development expenditure	7,840	10,291	5.7	31.3
Overall balance	5,113	-939	62.2	-118.4
% of GDP	0.5	-0.1		

¹ Estimate.

mainly on account of lower receipts from investment income and petroleum royalties. Non-revenue receipts, mainly grants from the Federal Government, are expected to decrease to RM6.2 billion.

State-generated revenue constitutes 73.2% (RM15.8 billion) of total revenue while receipts from Federal Government grants and reimbursements represent 26.8% (RM5.8 billion). Royalties from petroleum, investment income, land premiums and taxes as well as sales tax on CPO contribute 72.8% (RM11.5 billion) to state-generated revenue. State governments continue to enhance revenue collection and recovery of arrears, particularly on land taxes as well as loan recoveries from state government-owned corporations.

Total expenditure of the state governments is projected to increase by 13% to RM22.8 billion in 2015 (2014: -2.5%; RM20.2 billion). OE is estimated to increase by 2% to RM12.3 billion, mainly due to higher payments

for emoluments as well as supplies and services. In 2015, DE is expected to increase by 29.3% to RM10.5 billion, with the bulk of the expenditure channelled for the construction of public housing, improvement of water supply, enhancement of education and training as well as agricultural and rural development. Collectively, Sarawak, Selangor, Johor and Sabah accounted for the largest portion of total DE. With revenue sufficient to finance OE and a part of DE, the shortfall will be funded through loans from the Federal Government and the state governments' reserves.

General Government

The consolidated financial position of the general government⁷, after netting off intra-government transfers and lending, is expected to register a higher current surplus of RM21.5 billion in 2015 (2014: RM19.6 billion). However, the DE of the general government is expected to rise to RM56.2 billion (2014: RM49 billion) largely due to the higher Federal Government DE. Thus, the general government is estimated to record an overall deficit of RM34.8 billion (3% of GDP) in 2015.

Non-Financial Public Corporations

Capital outlays remain high

The **non-financial public corporations (NFPCs)** continue to make a significant contribution to the economy in terms of capital formation and job creation, mainly in the energy, transportation and telecommunication sectors. Despite the challenging external environment, capital outlays of NFPCs are anticipated to continue to expand. Although the revenue is expected to be lower, the NFPCs' current balance is expected to remain in surplus at RM43 billion in 2015 (2014: RM68.2 billion). On a cash basis, after taking into account DE, the NFPCs are expected to register an overall deficit of RM68.4 billion.

TABLE 4.9

Consolidated General Government Financial Position 2014 – 2016

	RM million			% Change		
	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²
Revenue	263,276	260,316	267,733	4.9	-1.1	2.8
Operating expenditure	243,663	238,841	248,325	2.6	-2.0	4.0
Current balance	19,613	21,475	19,408	43.5	9.5	-9.6
Development expenditure	49,038	56,237	60,260	-1.1	14.7	7.2
Overall balance	-29,425	-34,762	-40,852	-18.1	18.1	17.5
% of GDP	-2.7	-3.0	-3.3			

¹ Revised estimate.

² Budget estimate, excluding 2016 Budget measures.

⁷ Consists of the Federal Government, state governments, local authorities and statutory bodies.

TABLE 4.10

**Consolidated NFPCs¹ Financial Position
2014 – 2015**

	RM million		% Change	
	2014	2015 ²	2014	2015 ²
Revenue	471,389	400,743	5.1	-15.0
Current expenditure	403,160	357,754	9.1	-11.3
Current balance	68,229	42,989	-13.9	-37.0
Capital expenditure	105,683	111,380	17.5	5.4
Overall balance	-37,454	-68,391	252.5	82.6
% of GDP	-3.4	-5.9		

¹ Refers to 29 major NFPCs.² Estimate.

Given that PETRONAS is the largest contributor to total revenue, the decline in global crude oil prices will significantly affect the consolidated NFPCs' revenue. However, revenue from the telecommunication, power and construction sectors is estimated to be higher. Overall, the revenue is expected to decline by 15% to RM400.7 billion (2014: 5.1%; RM471.4 billion). Meanwhile, the consolidated current expenditure of the NFPCs is also projected to decline by 11.3% to RM357.8 billion in 2015.

NFPCs continue to undertake capital investments to expand and diversify their business activities as well as to optimise value creation thus contributing significantly to overall socio-economic benefits. Capital outlays of the NFPCs are estimated to grow by 5.4% to RM111.4 billion (2014: 17.5%; RM105.7 billion) and will be utilised to finance ongoing and planned projects despite the challenging environment. The investment requirements will be financed mainly through retained profits and reserves. Among the major ongoing projects include the construction of refinery and petrochemical facilities in Pengerang as well as floating LNG in offshore Sabah and Sarawak; hydroelectric plant in Ulu Jelai, Pahang; high-speed broadband Phase 2 as well as the Mass Rapid Transit (MRT) Sg. Buloh – Kajang and extension of Light Rail Transit (LRT) lines.

Consolidated Public Sector

The consolidated public sector, which comprises the general government and NFPCs, is expected to record a current surplus of RM64.3 billion (2014: RM87.6 billion). The decrease of 26.7% is largely on account of the projected lower current surplus of the NFPCs arising from the fall in crude oil prices. Meanwhile, the consolidated DE of the public sector is projected to increase by 8.3% to RM167.5 billion (2014: RM154.6 billion) mainly due to the higher spending by the NFPCs and the Federal Government. Hence, the overall deficit of the consolidated public sector, after netting off all transfers and net lending, is estimated at RM103.2 billion (8.9% of GDP) in 2015.

Prospects

Financial Position for 2016

The thrust of fiscal policy in 2016 will continue to emphasise fiscal consolidation by further reducing the fiscal deficit towards achieving a balanced budget by 2020. While ensuring strong public finances, fiscal policy will continue to support economic growth and improve the well-being of the rakyat. However, the consolidation effort is more challenging, amid uncertainties in the global economy including prolonged low commodity prices, China's slower economic growth and the impending interest rate hike by the Fed. Despite these challenges, the Government will continue to intensify spending discipline by focusing on efficiency and cost-effectiveness. Furthermore, revenue enhancement efforts will be strengthened by broadening the tax base and narrowing the tax gap. With all measures in place, the fiscal deficit is projected at RM38.8 billion or 3.1% of GDP in 2016 (2015: 3.2%).

The Federal Government revenue collection in 2016 is expected to grow marginally by 1.4% to RM225.7 billion, largely due to higher collection of tax revenue. In tandem with the projected lower global crude oil prices, the collection from oil-related revenue is expected to be lower at 14.1% of total revenue compared to 19.7% (2015). Meanwhile, as collection in 2016 will reflect the 12-month implementation of GST, it is projected to

TABLE 4.11

**Consolidated Public Sector Financial Position
2014 – 2016**

	RM million			% Change		
	2014	2015 ¹	2016 ²	2014	2015 ¹	2016 ²
Revenue	204,941	215,188	234,832	6.5	5.0	9.1
Operating expenditure	243,393	238,602	248,049	2.7	-2.0	4.0
NFPCs current balance	126,090	87,687	94,518	-8.2	-30.5	7.8
Public sector current balance	87,638	64,273	81,301	-5.6	-26.7	26.5
Development expenditure	154,567	167,455	169,436	10.9	8.3	1.2
General government	48,884	56,075	60,042	-1.2	14.7	7.1
NFPCs	105,683	111,380	109,394	17.5	5.4	-1.8
Overall balance	-66,929	-103,182	-88,135	43.7	54.2	-14.6
% of GDP	-6.0	-8.9	-7.1			

¹ Estimate.² Budget estimate, excluding 2016 Budget measures.

be significantly higher at RM39 billion (3.1% of GDP), offsetting the contraction in oil-related revenue. Thus, the share of non-oil revenue is projected to increase to 85.9% (2015: 80.3%).

The Federal Government expenditure is expected to increase by 1.7% to RM265.2 billion (2015: RM260.7 billion), with 81.1% (RM215.2 billion) provided for OE and the remaining 18.9% (RM50 billion) for DE. OE is projected to increase marginally by 0.9% following continuous efforts to rationalise and optimise Government spending. Charged expenditure, which includes debt service charges, retirement charges and transfers to state governments, will amount to RM51.7 billion. Emoluments, the largest component of OE, will be provided RM70.5 billion (32.7%), while supplies and services, RM36.3 billion (16.9%). In line with the implementation of the managed float fuel pricing system, subsidies, incentives and assistance will remain relatively low at RM26.1 billion (12.1%), reflecting a more targeted subsidy mechanism to reduce market distortions and leakages.

DE is expected to increase by 5.4%, representing 19.2% of the total ceiling (RM260 billion) under the 11MP. The economic sector, the largest recipient of DE, will be provided RM30.3 billion (60.6%). The allocation will be utilised for public infrastructure and transportation projects to improve access and connectivity; construction, upgrading and maintenance of roads and bridges; enhancing water and electricity supply especially in remote areas; as well as implementation of agriculture programmes.

To provide a better quality of life for the rakyat, the social sector is allocated RM13.1 billion. Of this, RM4.7 billion is set aside for the education and training subsector to meet the growing demand for a talented, high-skilled, creative and innovative workforce. A total of RM4.4 billion is also allocated for the health and housing subsectors to provide better healthcare services and to build more affordable houses, especially for the low-income group. The security sector, which comprises defence and internal security, will be provided RM5 billion to enhance the capability and capacity of the armed forces and police through the purchase and upgrading of equipment as well as improving surveillance system. For the general administration sector, RM1.6 billion will be allocated for upgrading of government facilities nationwide.

Medium-Term Fiscal Framework (MTFF) 2016 – 2018

MTFF ensures fiscal consolidation commitment

The MTFF enables an efficient and effective public finance management as well as identifies potential deviation from the targets. The first phase of MTFF will focus on the period 2016 – 2018 and will be reviewed annually. During this period, the current balance is projected to remain in surplus at an annual average of 1.1% of GDP (2015: 0.8%). The improved surplus is supported by a reduction in OE by 1.3% of GDP to 17.1% (2015: 18.4%) despite a decline in revenue by 1% of GDP to 18.2% (2015: 19.2%) in revenue amid low commodity prices. Hence, the medium-term fiscal deficit is targeted

TABLE 4.12

Medium-Term Fiscal Framework (MTFF) 2016 – 2018

	RM billion	% of GDP
	2016 – 2018	2016 – 2018
Revenue	729.5	18.2
Non-oil	631.6	15.7
Oil-related	97.9	2.4
Operating expenditure	685.7	17.1
Current balance	43.8	1.1
Gross development expenditure	153.0	3.8
Less: Loan recovery	2.4	0.1
Net development expenditure	150.6	3.8
Overall balance	-106.8	-2.7
Underlying assumptions:		
Real GDP growth (%)	4.5 – 5.5	
Nominal GDP growth (%)	7.0 – 8.0	
Crude oil price (USD per barrel)	48 – 60	
Oil production (barrels per day)	600,000	

to average 2.7% of GDP. The gradual pace of deficit reduction will continue to support growth while providing sufficient fiscal space.

Total revenue during the MTFF period is expected to register 18.2% of GDP, with tax revenue estimated at 14.9% of GDP (2015: 14.6%) and non-tax revenue at 3.3% of GDP. The higher projected tax revenue is supported by continuous economic growth and rigorous efforts, primarily through the enhancement of tax education, compliance and auditing. In addition, a more comprehensive tax structure will reduce the tax gap in the form of evasion and avoidance as well as further enhance the tax buoyancy that has been averaging 1% for the past five years. In tandem with efforts to broaden the revenue base, the average share of non-oil revenue is expected to increase to 86.6% of total revenue or 15.7% of GDP (2015: 80.3%; 15.4%), while oil-related revenue is estimated to account for 2.4% of GDP during the MTFF period (2015: 3.8%).

Firm commitments to set an enveloped expenditure for the 3-year framework will enhance the Government's capacity to manage expenditure and implement reforms, guided by the medium-term agenda outlined in the 11MP. The total indicative ceiling for OE will stand at RM685.7 billion (17.1% of GDP) for 2016 – 2018 while the allocation for DE is contained within the 11MP total ceiling. The MTFF will indicate the total ceiling of OE for each ministry to ensure the consolidation is on the right track. In short, the new approach of a forward-looking indicative ceiling is to achieve an optimal level of spending towards the consolidation path. Among measures to contain expenditure include gradual subsidy rationalisation through a more targeted mechanism, cost-effective procurement and streamlining the civil service as well as further encouraging government entities to be financially-independent and less reliant on grants.

