



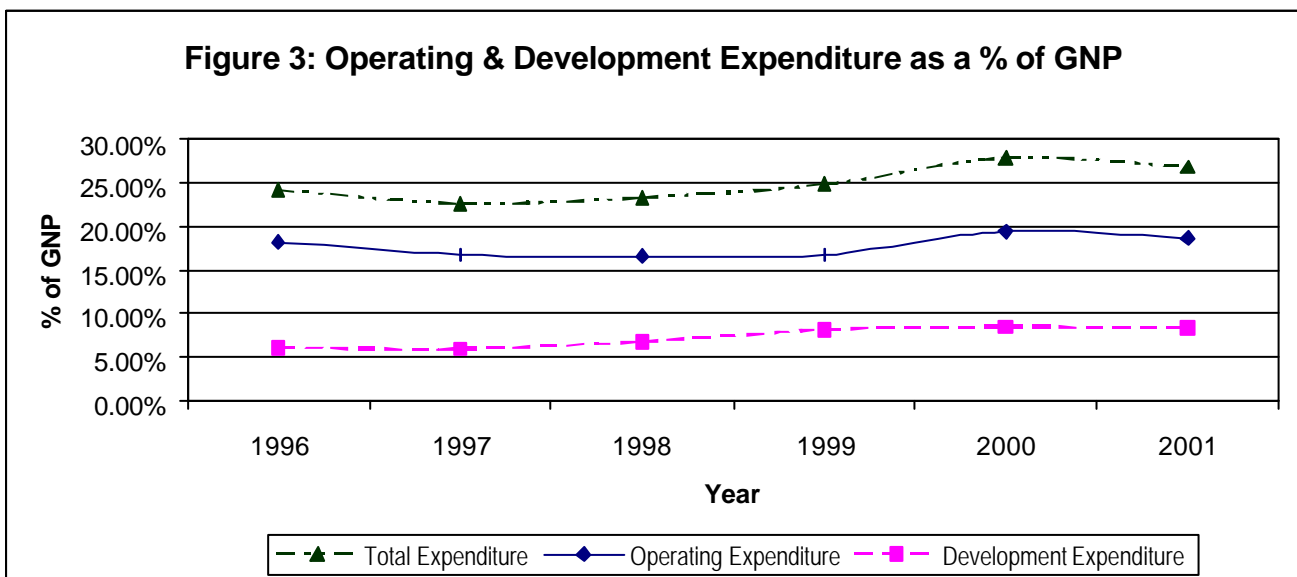
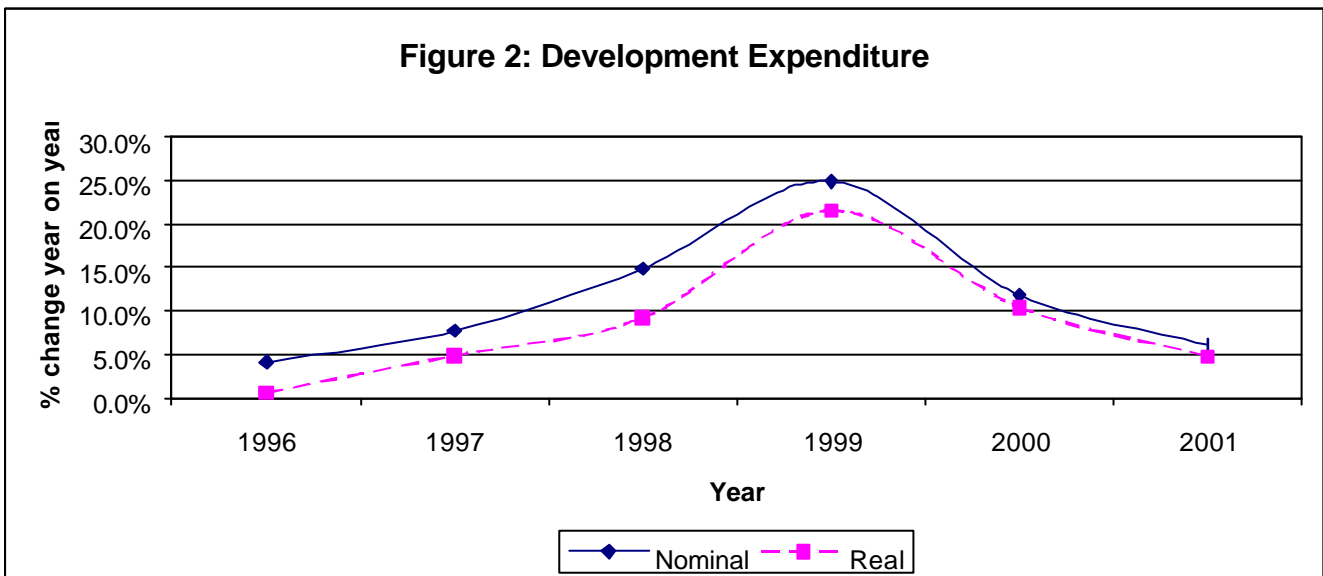


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The 2001 budget shows an attempt to once again moderate the role played by government in the country's economy. It has been widely claimed that we have come out of recession after several quarters of continued positive growth. As such we might expect to see a reversal in the government's budget figures compared to those found during recent years. In the following sections, the pattern of government fiscal spending and its allocations across sectors as well as states and local governments are discussed with respect to the trends that have occurred over the recent years.

### Cyclical Rate In Government Fiscal Spending

There was a downward trend to government fiscal spending immediately prior to the onset of the 1997 recession suggesting that the government was giving emphasis to the private sector as the engine of growth. However, since 1997 government fiscal spending went on the uptrend to help boost the economy. Figure 1 shows that year on year changes to the federal government's operating expenditure initially fell from between 15% and 20% in 1996 to between -5% and 0% in 1998. By 2000, however, annual growth of fed-



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eral operating expenditure had surpassed 20%. Annual increases to the development expenditure of the federal government had increased steadily from less than 5% in 1996 to four times that rate by 1999 as shown in Figure 2.

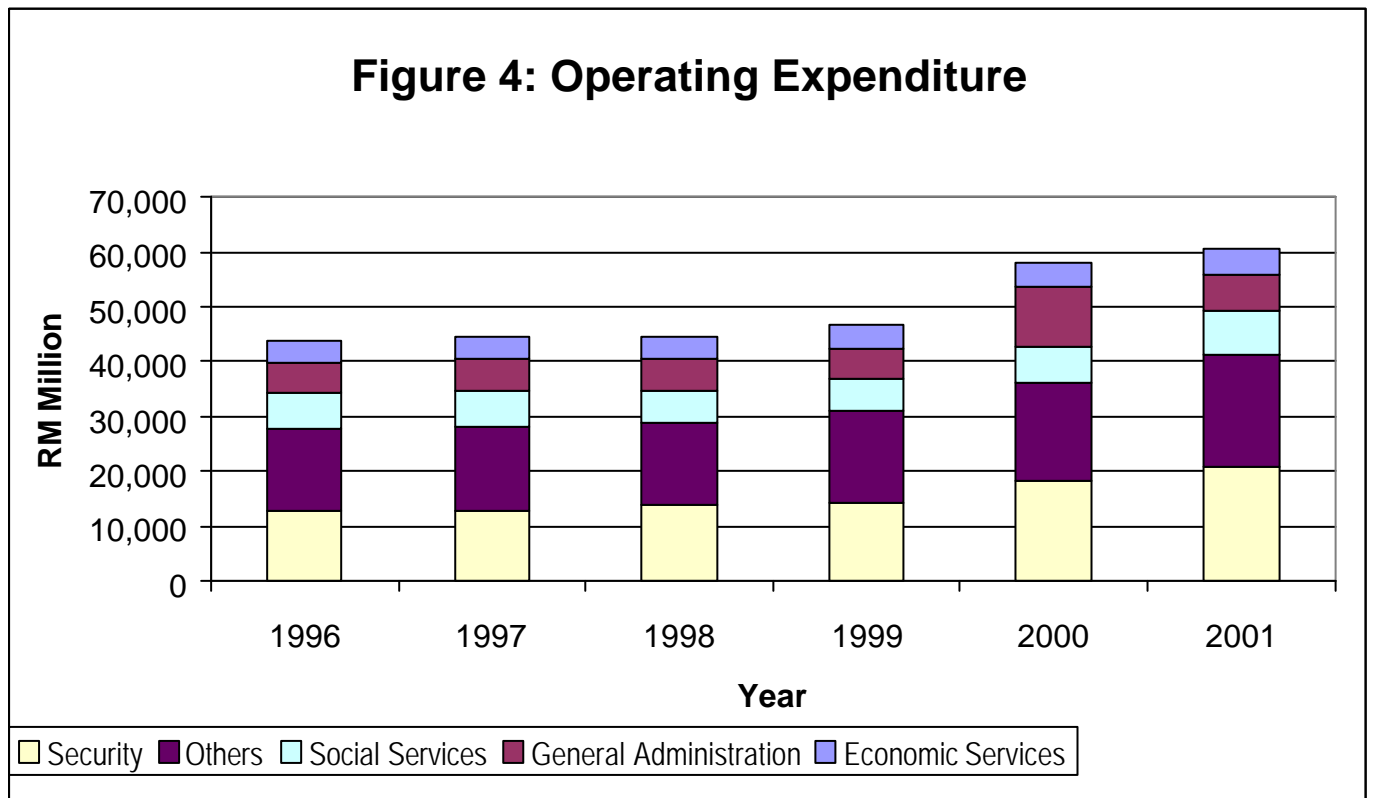
Relative to the rest of the economy, the total federal expenditure constitutes about a quarter of the nation's GNP in nominal terms. The proportion of federal expenditure to GNP, as shown in Figure 3, had fallen by a few percentage points in 1997 but since then federal expenditure had climbed passed the 25% mark.

The present budget for fiscal year 2001 has made an attempt to reverse the above trends. Year on year growth of both the federal government's operating expenditure and development expenditure has been reduced to only around 5%. The proportion of total federal expenditure would also fall nearer to the 25% mark relative to the GNP.

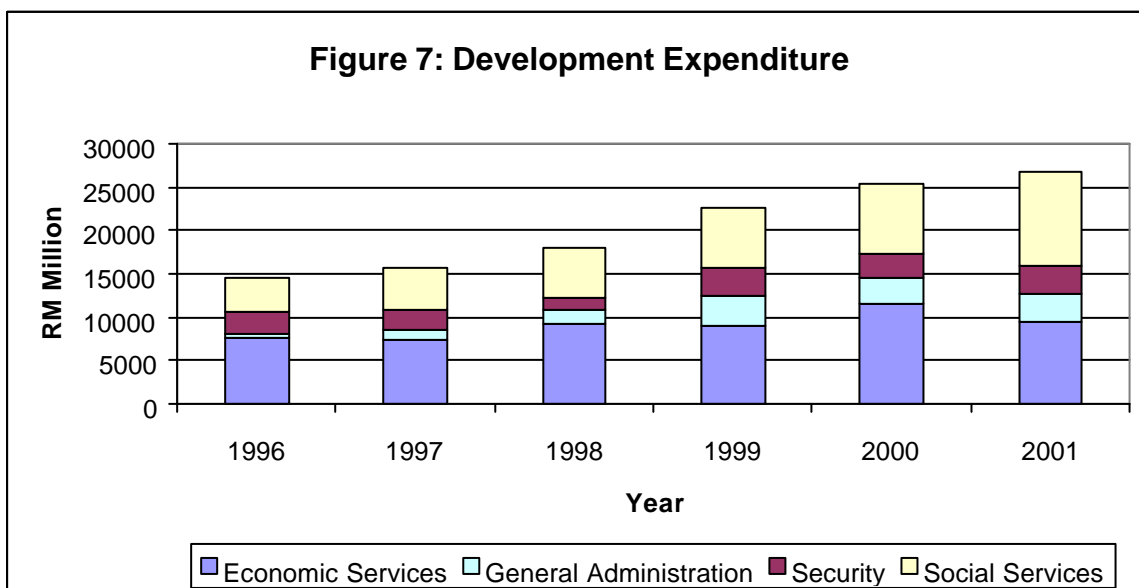
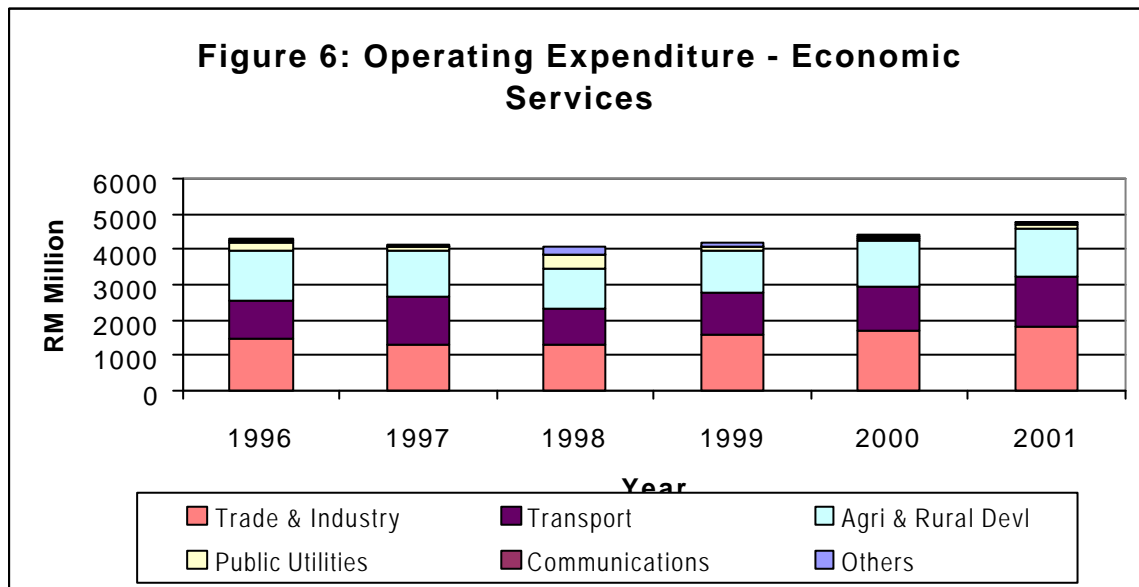
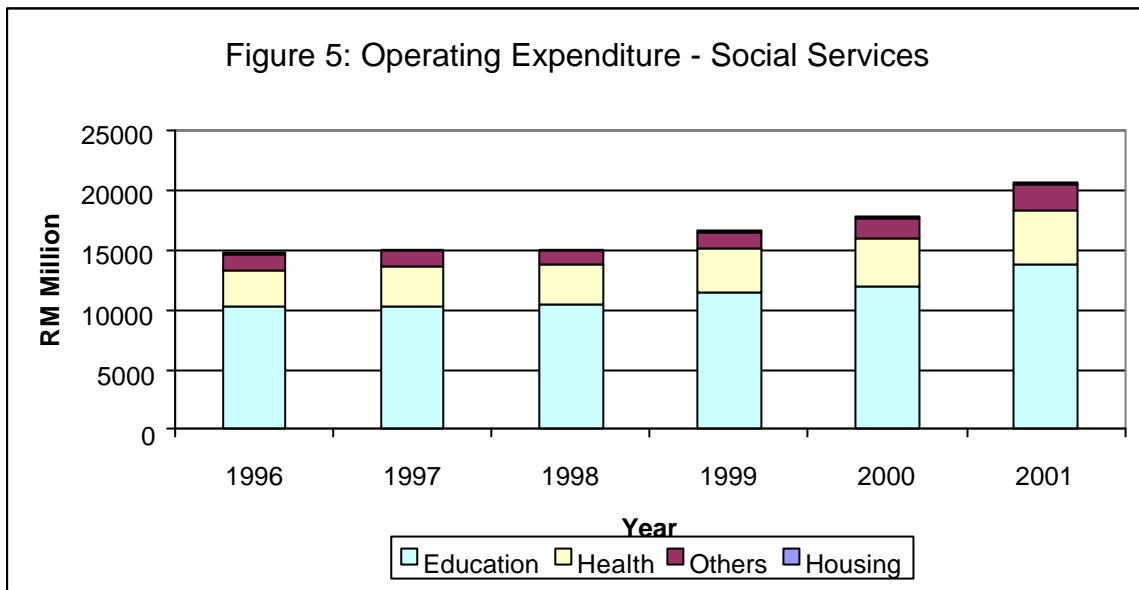
If circumstances do not change drastically during 2001, we might expect to see in the following year's budget a continuation of the government's retreat in favour of the private sector. Unfortunately, 2001 is fraught with uncertainties. To date, the American presidency remains in doubt and that might further aggravate the current slow down of the U.S. economy. The conversion of the ringgit relative to the world's currencies will move exactly in tandem to how the U.S. dollar performs. If oil prices remain persistently high private sector growth in the country as well as demand levels in the exports market would perform below expectations. Foreign direct investments remains critically important and the government has introduced additional measures to attract them. How successful these measures will be during 2001 has to be carefully watched.

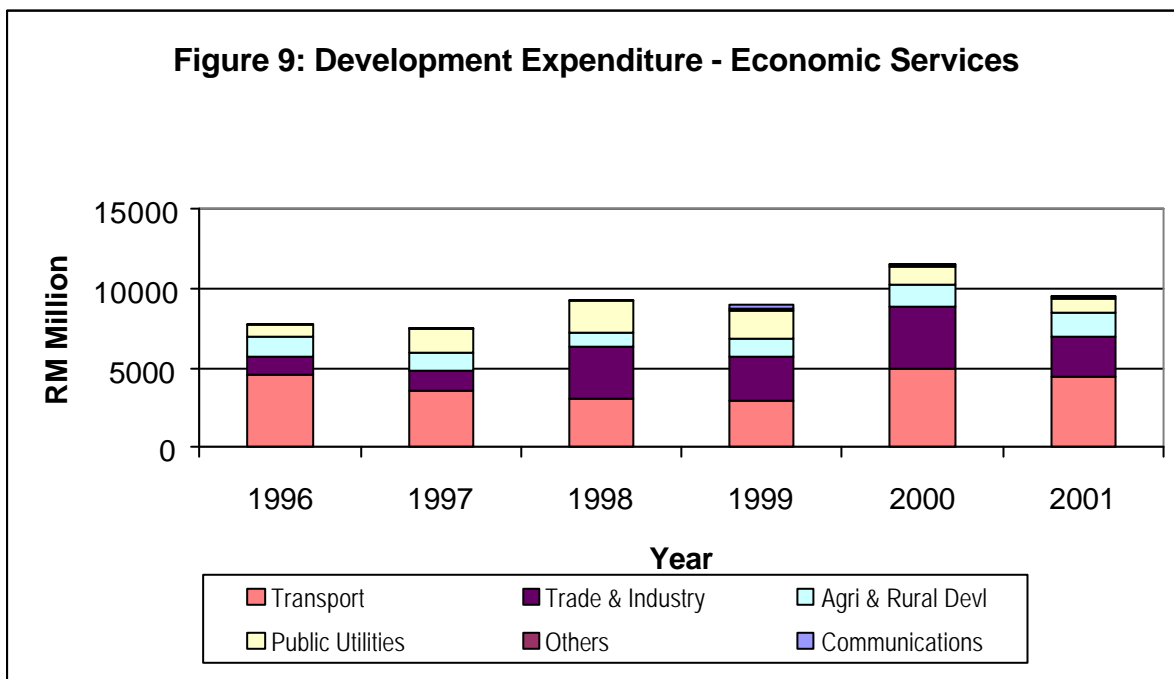
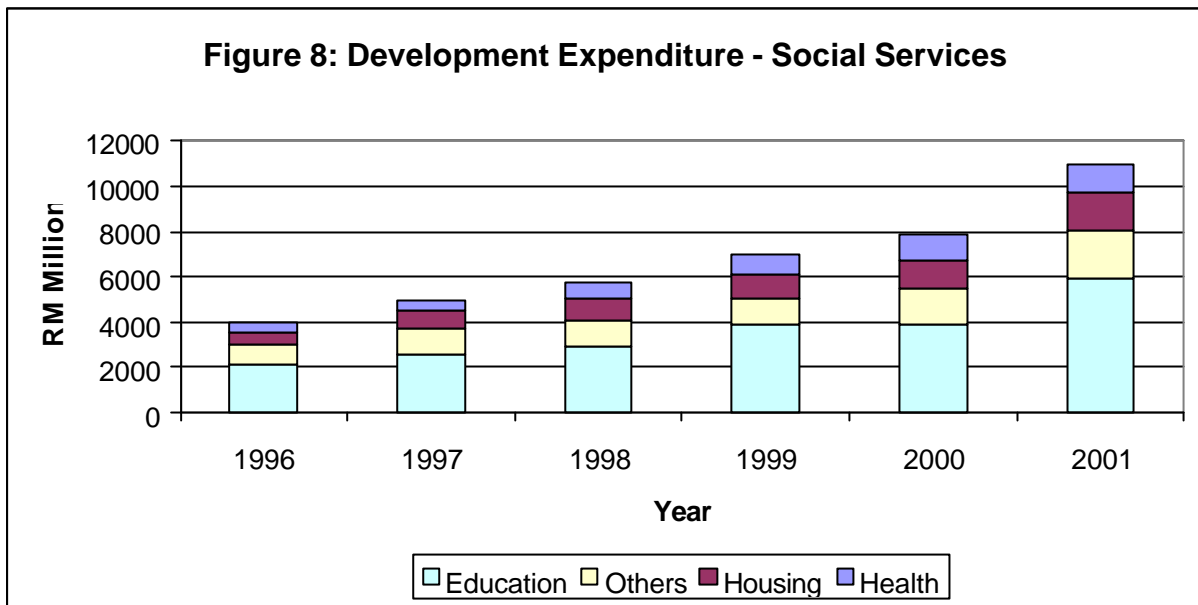
#### Government Allocations Kept In Balance

Although growth in federal government expenditures have been at an unsteady pace, their fiscal allocations across the various sectors have been kept generally in balance with only minor changes in proportions. Operating expenditure allocations for 2001 are 13% for security, 34% for others (inclusive of debt servicing and transfer payments), 34% social services, 11% for general administration and 8% for economic services as shown in Figure 4. Allocations of operating expenditures within social services have also maintained their relative proportions as shown in Figure 5. Most of the allocations for social services goes to education, comprising 67% in 2001. Health will take up 22% and various other social services, 11%. Only a small 1% goes to hous-



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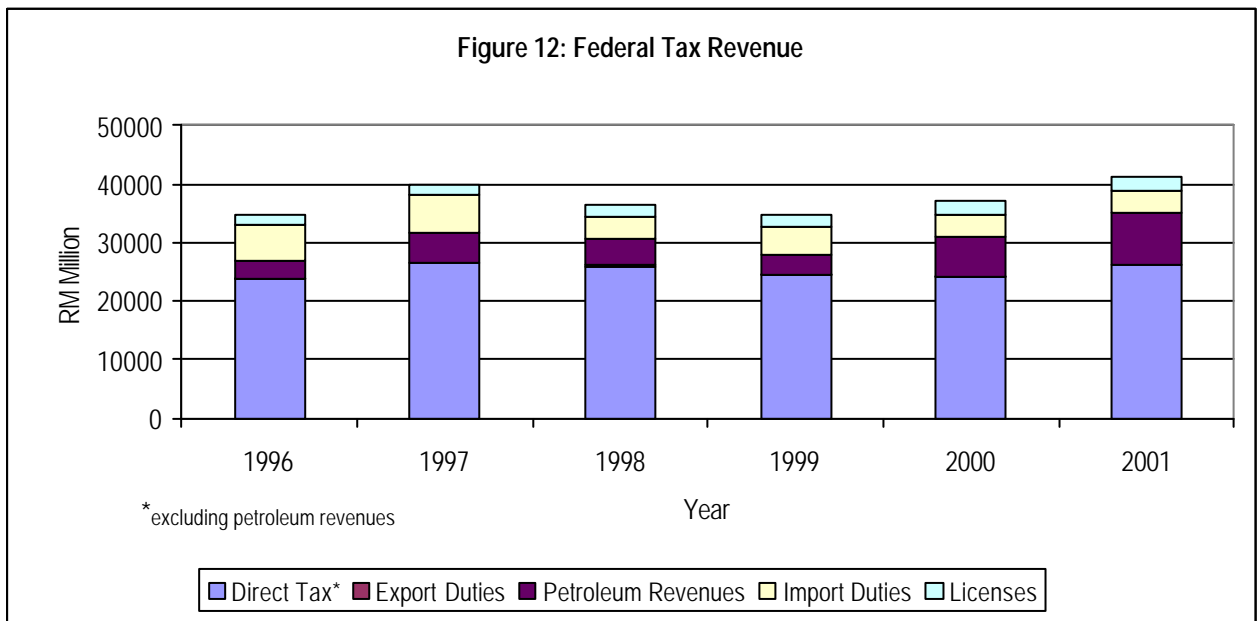
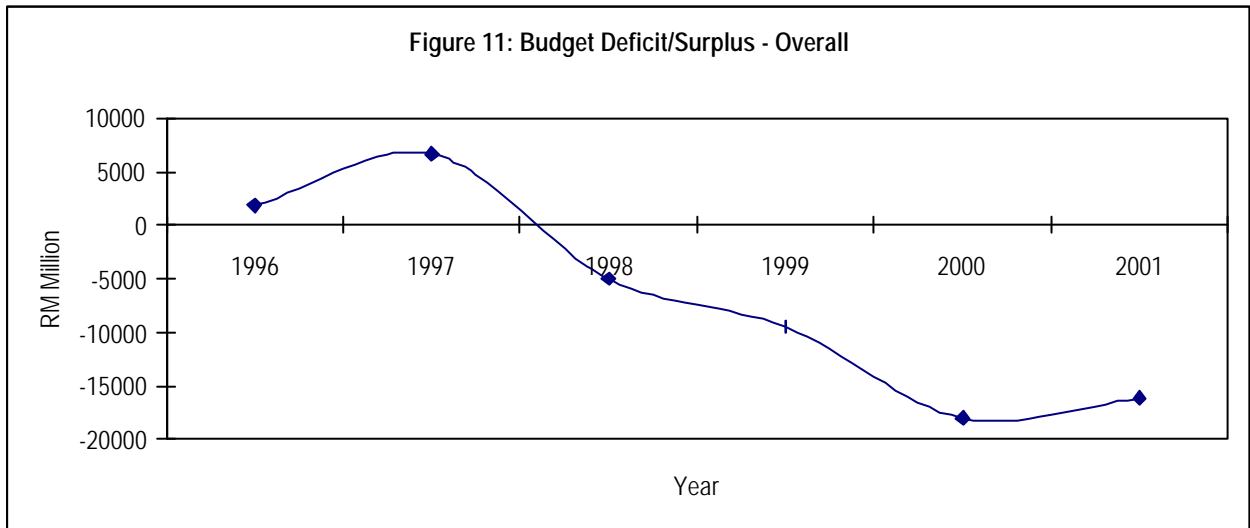
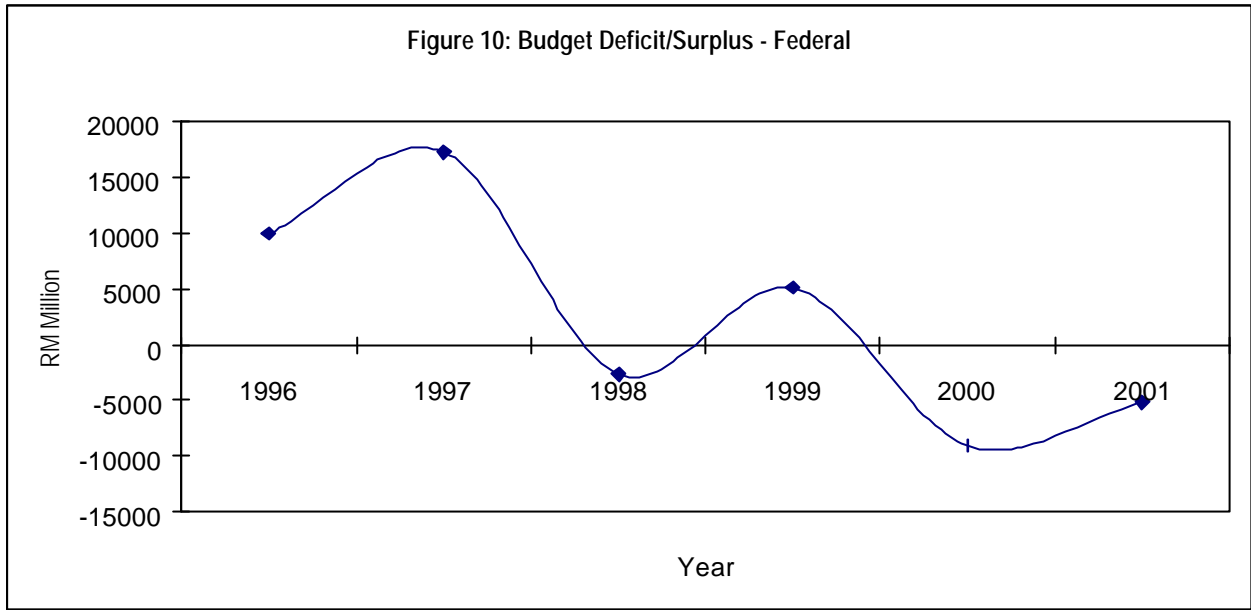


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ing. Operating expenditures for economic services are also in balance. In the fiscal allocations for 2001, trade and industry will comprise 38%, transport, 30% and agriculture and rural development, 28% as shown in Figure 6.

Fiscal spending by the federal government on development has increased with respect to social services relative to the other sectors as shown in Figure 7. In the 2001 budget, social services will take up 41% (from 34% in 2000) of the development budget, leaving 12% for security, 12% for general administration and 35% for economic services. Within social services, the education sector will make up 54% of the development budget, while 19% are allocated to other social services, 16% to housing and 11% to health services as shown in Figure 8. Development allocations within the economic services in the 2001 budget are 47% for transport, 1% for other economic services, 26% for trade and industry, 16% for agriculture and rural development and 10% for public utilities as shown in Figure 9.

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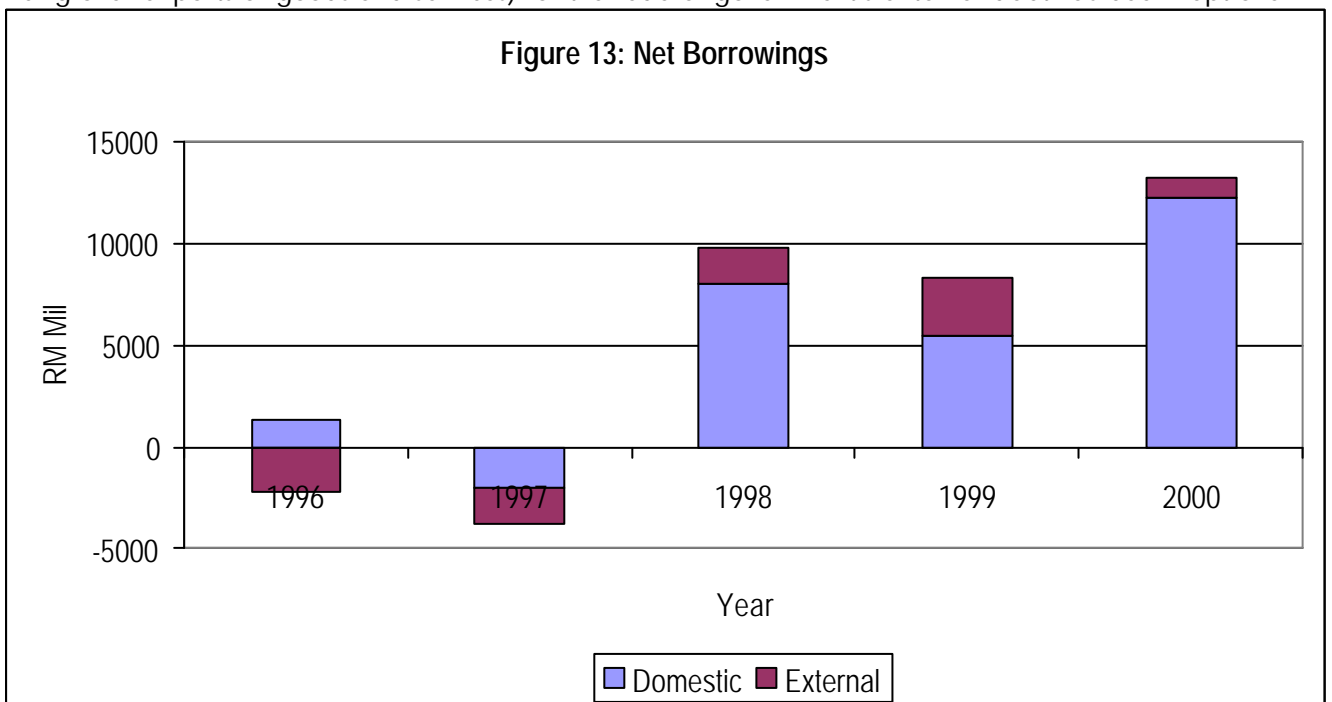
It may generally be accepted that there is no reason to alter the proportions for funding the various government sectors. But the expansion in government spending amidst privatised alternatives that have emerged in the country in recent years needs explanation. There are today many private colleges and private hospitals which are supposed to be viable supplements to their state run counterparts. Since the recession, local universities have significantly increased their enrolment as the weakened ringgit have placed avenues overseas beyond the reach of many Malaysians. Thus the government sees its continuing role in supporting education alongside private sector alternatives as part of the overall strategy of achieving the knowledge economy. Health services are also being expanded to upgrade existing facilities since the government has called off the original privatisation plans even though private hospitals have begun to play a larger role in health care services than before.

**The Federal Budget Cycled Into A Deficit During Recent Years**

Prior to the 1997 recession, the federal budget was at a healthy surplus that reached in excess of RM15 billion as shown in Figure 10. However, because of the government's effort to stimulate the economy by fiscal means, the federal budget had been cycling into a deficit of almost RM10 billion by 2000. The 2001 budget attempts to half that level of deficit. The overall budget of the government comprising fiscal spending by the federal, state and local governments as well as those of non-financial public enterprises (NFPE) and statutory bodies had been in deficit since 1998 and amounted to nearly RM20 billion in 2000. The 2001 budget attempts to marginally reduce this deficit as shown in Figure 11.

Funding sources for federal revenues are shown in Figure 12. Direct taxes excluding petroleum taxes only raise 64% of total federal revenues. Revenues from petroleum adds another 21% with smaller proportions, 10% and 5% obtained from import duties and licenses respectively.

The deficit fiscal spending by the government has been mostly covered by the increase in net borrowings which amounted to RM12.2 billion in 2000 from domestic sources and a further RM1 billion from external sources as shown in Figure 13. As a result, domestic debt servicing as a proportion of the total federal operating expenditure has cycled up from 13% in 1997 to nearly 14.5% in the budget for the 2001 fiscal year as shown in Figure 14. Servicing the external debt has also cycled upwards from less than 1.5% of total federal operating expenditure in 1997 to around 2.5% in the 2001 budget as shown in Table 15. The absolute amount of interest payments on both external and domestic debt is shown in Figure 16. The debt service ratio (debt servicing over exports of goods and services) for the federal government's external debt has been kept over



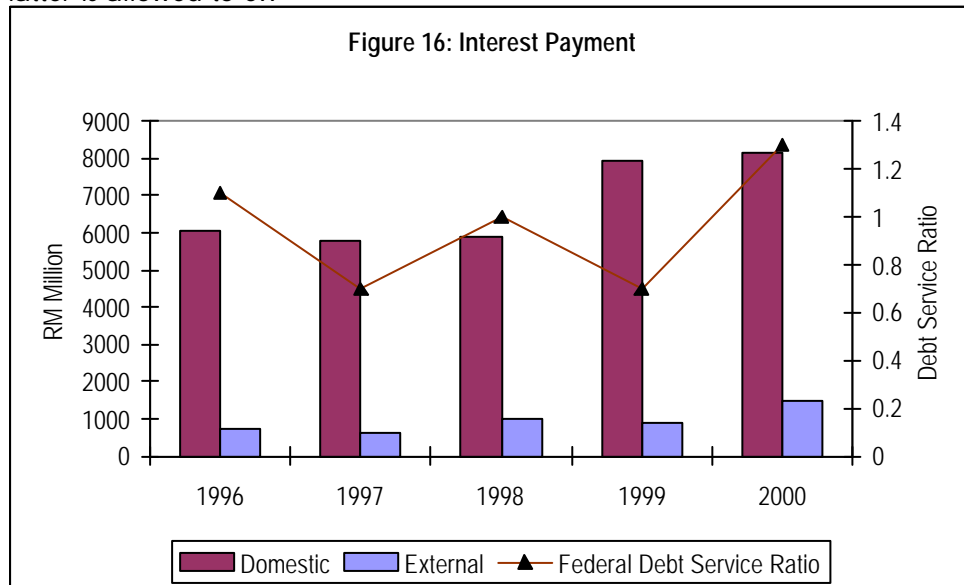
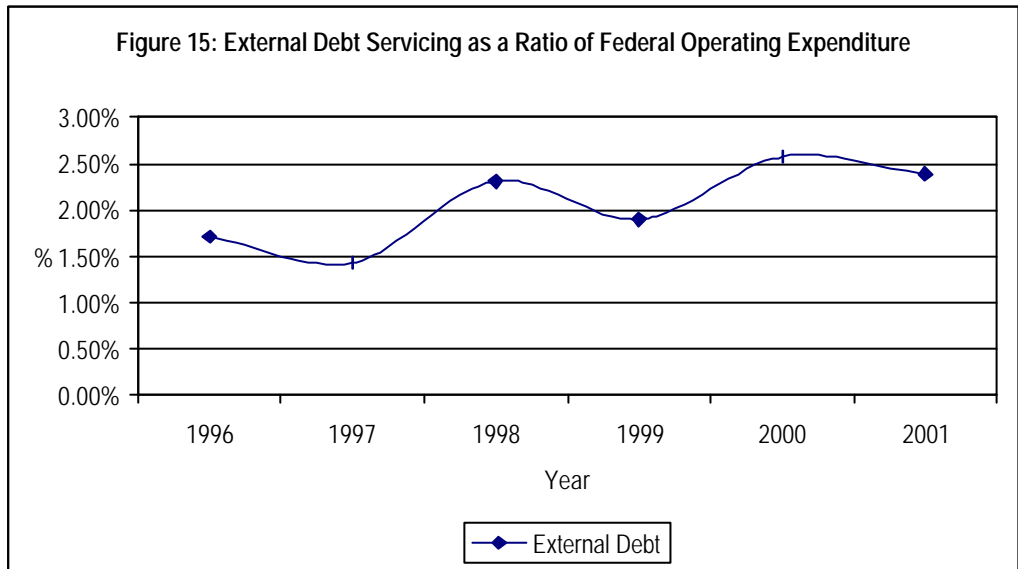
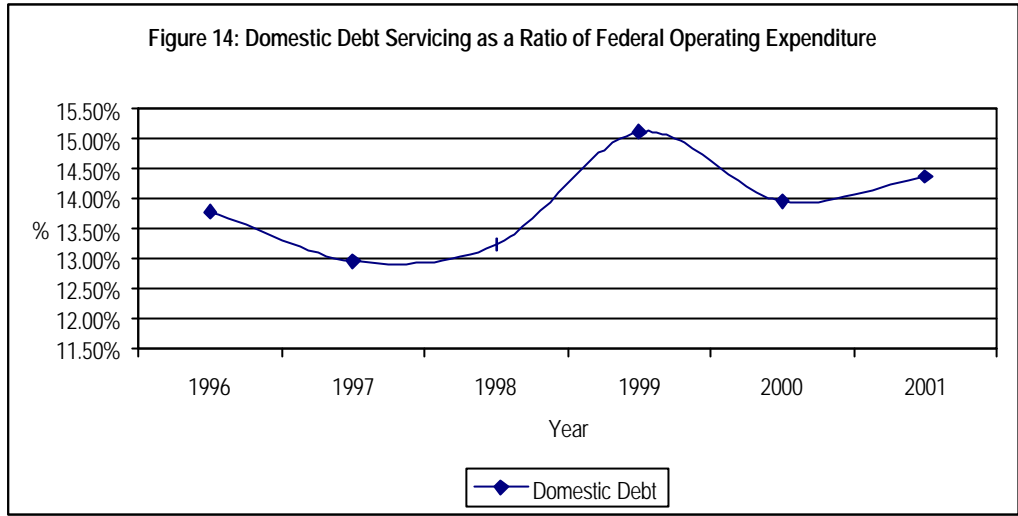
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the years over a narrow base of only around 1%. This may be compared to the overall national debt service ratio which is about 6%.

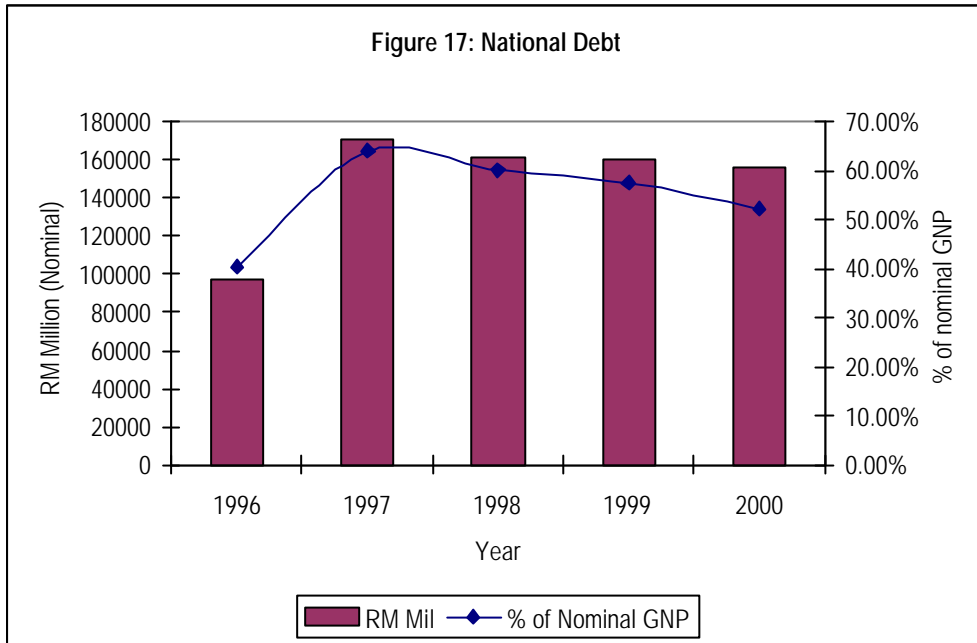
Malaysia's national external debt was at the RM160 billion mark in 1997 and had surpassed 60% of the nation's GNP. This sudden rise is attributed to the lower exchange rate of the ringgit relative to other currencies since the recession in 1997. To stem this, the government has consistently attempted to reduce the national debt over the recent years. By 2000, the national debt stood at RM156.6 billion or 52.3% of GNP as shown in Figure 17.

The decision to resort to deficit spending by government is to avoid crowding out the private sector through higher taxes so that the latter is allowed to ex-



pand. Normally, the government has to raise the deficit through the debts market which would put the public sector directly in competition with the private sector for available financing. This would drive up interest rates and as a consequence moderate private investments. However, in the case of Malaysia low interest rates could be maintain through the injection of capital into the banking system via very soft monetary policy. This has led to the increase in the na-

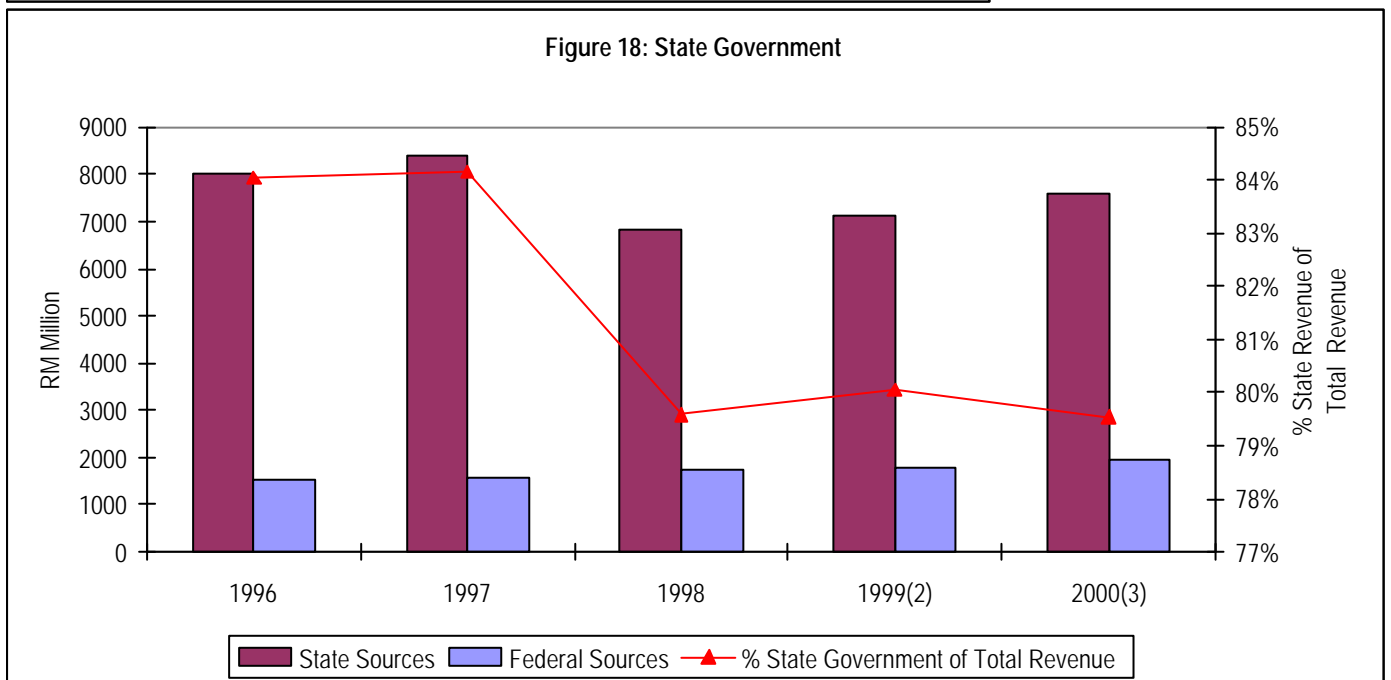
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tional debt when compared to pre-1997 levels even though the government has attempted to cap this at present levels.

Easy capital whether through fiscal or monetary policies or both as in the case of Malaysia helps keep the economy buoyant but they are at best temporary measures. The economy quickly overheats as it comes under inflationary pressures such that at some point in the near future, interest rates must be brought to correspond more closely with



available funding. Tighter money situations could be looming at the horizon. Does this then mean that there will be a rush for investment funds in the immediate future in anticipation of harder times ahead?

These kinds of uncertainties that will accompany 2001 as it rolls in a month from now give rise to difficult decision making. Much guess work becomes necessary. It will help if the government's plans be made known well ahead of time at least to reduce uncertainties.

### Allocations to states has marginally increased

Prior to the 1997 recession, state governments raised 84% of their total budgets on their own and depended on federal allocations for the remaining 16% of the required funding. Since 1998, federal government allocations have comprised 20% of the total budget requirements at the state level as shown in Figure 18.

Federal allocations to statutory bodies have been kept steady despite the 1997 recession making up about 30% of their total budget requirements as shown in Figure 19. In the case of local governments, however, exter-

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nal allocations have been reduced. Local governments used to raise only three-quarters of their total budget requirements from their own funding sources. However, from 1996 the proportion of external allocations from state and federal governments have been steadily reduced to less than 20 by 2000 as shown in Figure 20.

The increase in federal allocation to state governments as a proportion of total state budget revenues, have allowed state budgets to grow marginally higher than the federal budget, 7% year-on-year compared to 5%, and up from 4% and 1% respectively the year before as shown in Figure 21. Statutory budgets have seen enormous changes in their growth rising from -1% through 7% and 13% year-on-year. In contrast, the lower allocation by the federal and state governments have led to a decline in budget growth rates of local governments.

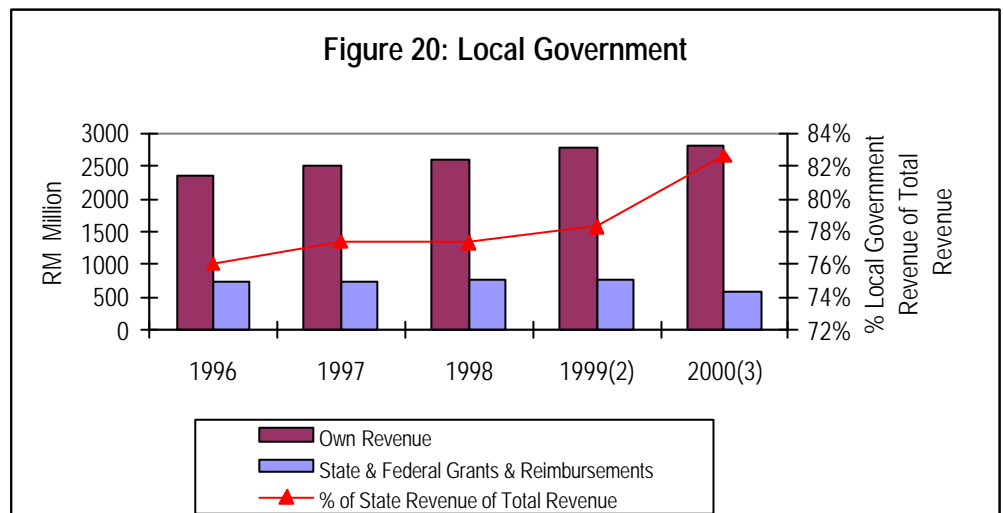
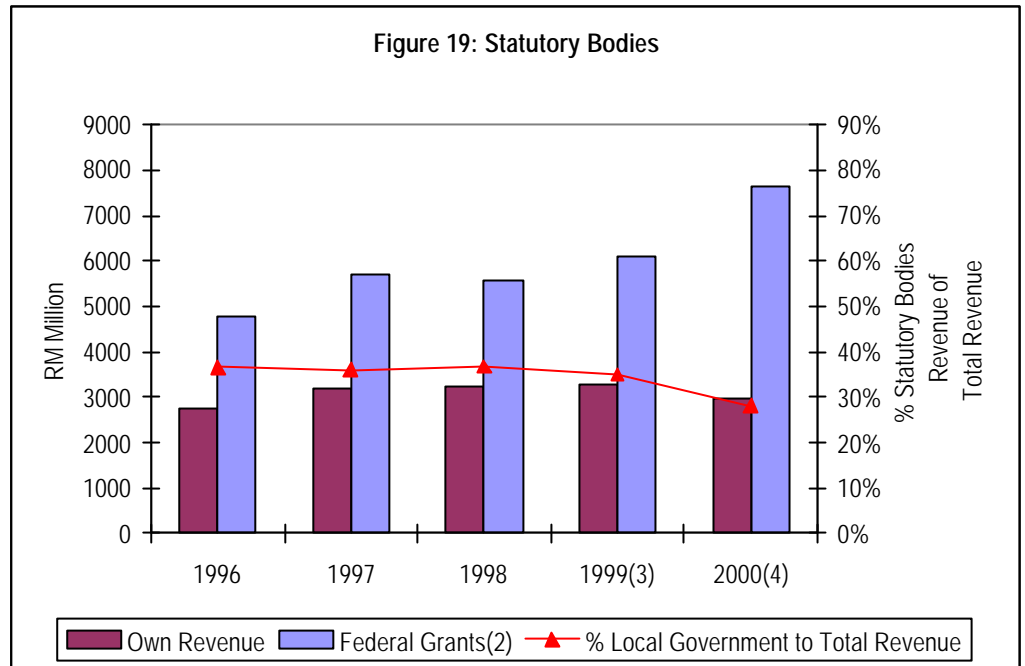
The recent years have therefore been turbulent times in state and local government financing. This can only translate to uncertain times for decision making by state and local governments. Attempts must be made to increase the level of certainty so that the way state and local governments budgeting complements the federal government allocations can be made more definite. This means a more stable formula for financing from within state and local governments. The result will be the implementation of more stable and holistic plans instead of piece-meal efforts which are often mismatched.

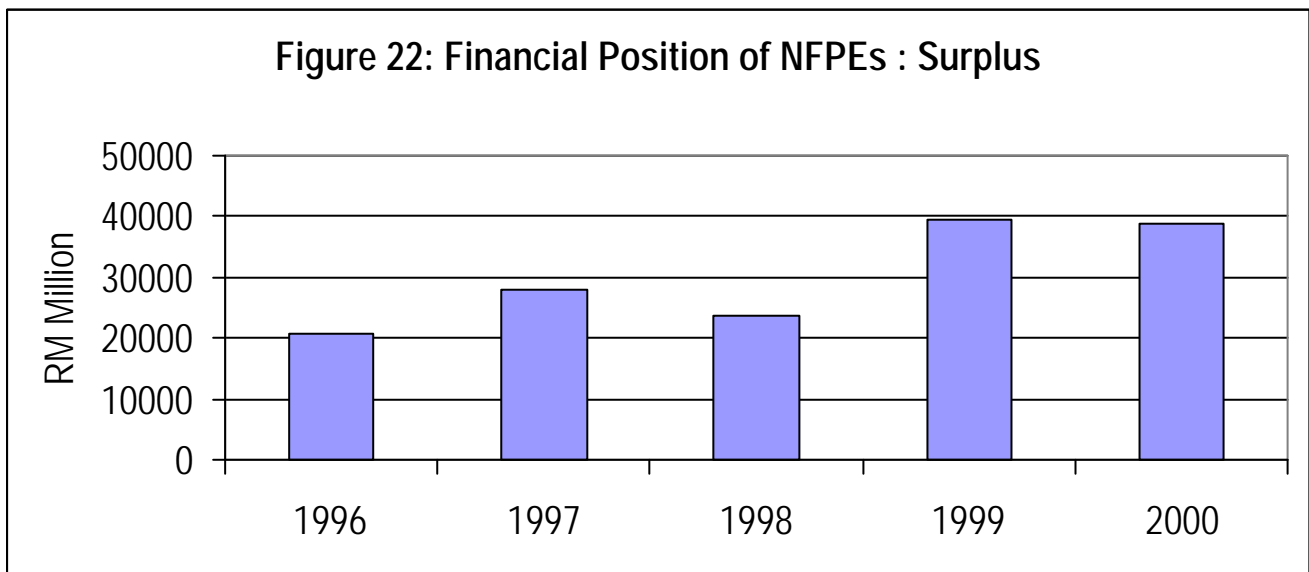
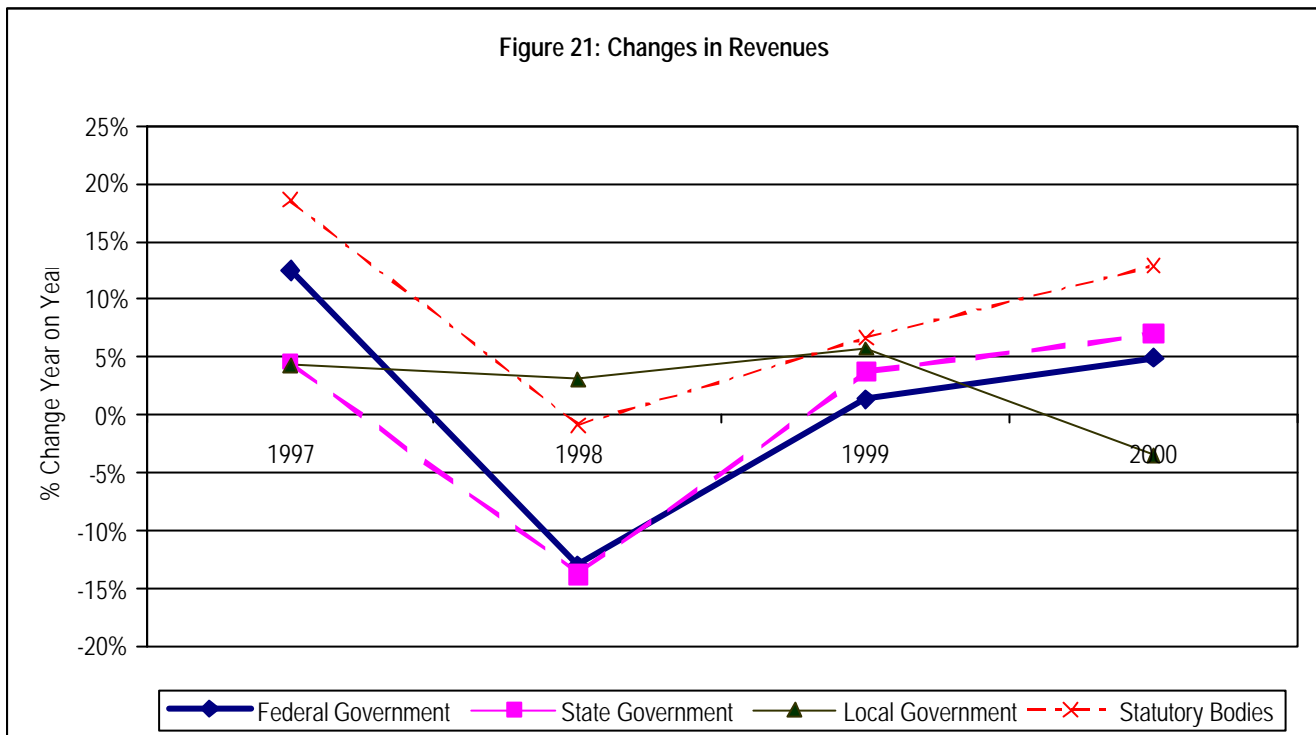
### NFPEs Make Positive Financial Impacts

The total public sector budget comprises the budget for general government (made up of federal, state and local government plus statutory bodies) and that for the non-formal public enterprises. In Malaysia, the total public operating expenditure has always been kept in the surplus vis-à-vis public revenue with the NFPE contributing about RM 40 billion to it in the last couple of years as shown in Figure 22.

During recent years, inclusion of development expenditures caused the public sector budget to go into deficit. However, the overall balance (operating expenditure plus development expenditure) remains positive among NFPEs as shown in Figure 23 indicating that the budget deficit did not arise from NFPEs

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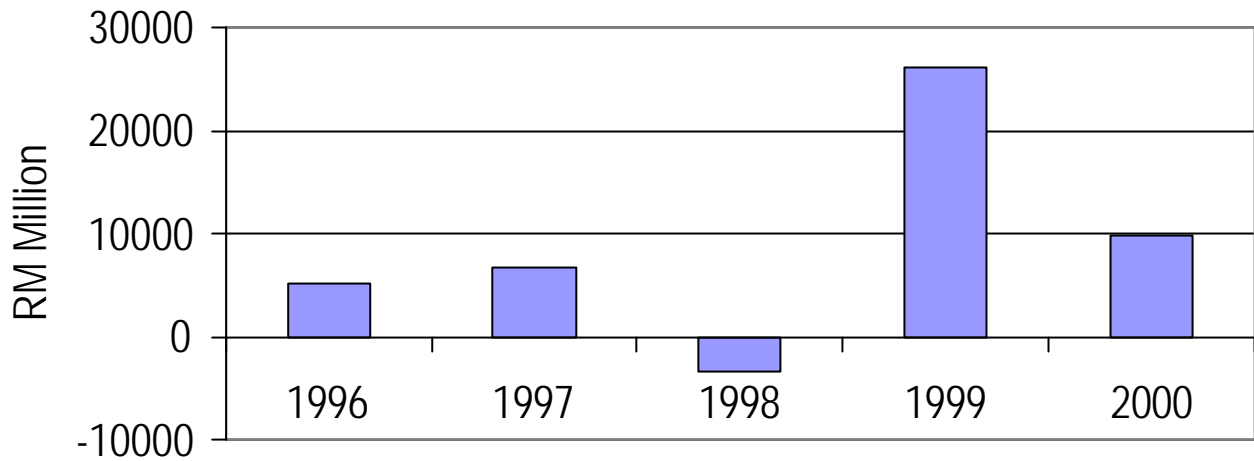
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On the books, Malaysian NFPEs remain viable through the recent recession years. On the operating side, revenues over expenditures among NFPEs is well in the surplus. Furthermore, even after factoring in the development expenditures among NFPEs, the overall balance remains positive. However, one must concede that many of the NFPEs have near monopoly powers which give them direct control over raising revenues through price prescriptions. They will, however, need government approval to do this. Many complains have been made because privatised government enterprises charge higher prices for the services traditionally provided by the public services. If this be the case, then expansion in the NFPE part of the public sector budget should be matched by a proportional decline in the general government part of the public sector budget. Yet this is not the case revealed in the budget report suggesting that privatisation implies more taxes, in absolute terms, for the public budget and higher fees for the services received through NFPEs.

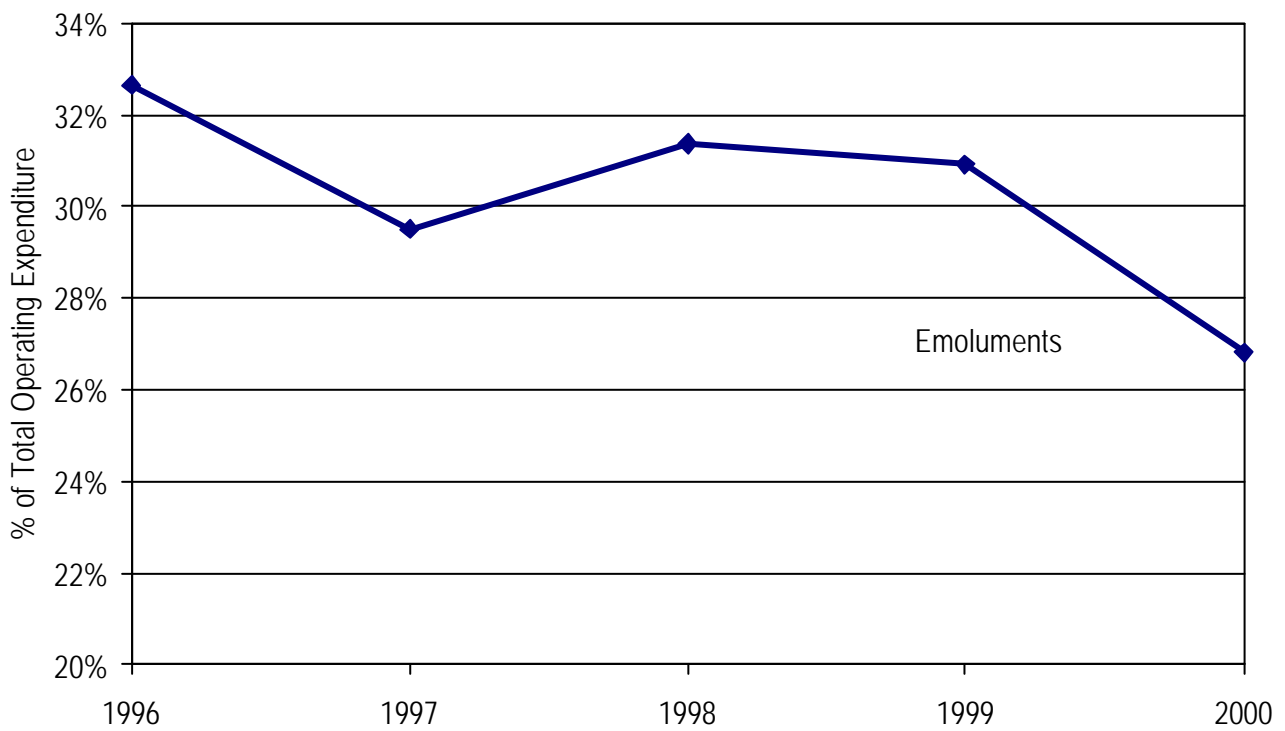
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**Figure 23: Financial Position of NFPEs : Overall Balance**



**Figure 24: Administrative Efficiency**





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### **Government servants are marginally more efficient**

For every ringgit of operating expenditure that the government spends, a third of it used to be paid as salaries to government employees. By the year 2000, however, the government has been able to provide a larger volume of services through higher budget allocations but with less than proportionate increase in payments as emoluments. As a result payment of emoluments out of total operating expenditure has dropped from 33% in 1966 to 27% in 2000 as shown in Figure 24.

### **Conclusions**

The public budget for fiscal year 2001 may be regarded as a good budget as there is much moderation in the numbers laid down when compared to less healthy trends in the budget that had emerged during the preceding years. The government must be making an immediate response after having proclaimed that recession has ended and the economy is once more on the upswing. The year 2001 will be a critical year to watch, because if things go as anticipated the budget for fiscal year 2002 will see further moderation that will earn more concessions for the private sector. Unfortunately, 2001 will also be a year of uncertainties amidst relatively high oil prices, a new presidency in the U.S. faced with a softening economy, technology arriving at a juncture of change that could go in different possible directions that will impact on the international division of labour in which Malaysia plays a part. Given these uncertainties, the government should plan early and make their plans known well ahead so that the private sector can incorporate them with more confidence while making their own investment plans. *§ Chan Huan Chiang, Anna Ong, Terence Too & Tasha Merican*

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### **A General Appraisal Of Budget 2001 Recommendations**

tions. As such, it would be more beneficial if the government could provide some incentives that could help upgrade the educational level and skills capabilities of the disabled. Courses could be conducted and offered to different disabled groups to help them specialise in different skill areas. Incentive scheme in the form of bursary, scholarship or loans could be specially set up for these people. In this case, the disabled would be given the opportunity to improve themselves and not only to depend on the goodwill of others to assist them.

The government has provided incentives for employers of disabled people, however many of the employers are still not aware of this incentive. The government could organise 'awareness programmes' for the employers, where disabled organisations could also be invited to brief the human resource personnel on how to deal with people with disabilities and their needs in the workplace. *§ Anna Ong*



## WHAT IS THE BUDGET?

The budget is a plan describing expenditure allocations and revenue sources for the forthcoming fiscal year. In putting together the budget, existing public programmes and projects are reviewed considering among other things their operating efficiency and effects over the medium and long term. In making allocations, the government decides on the composition and level of its output in relation to overall economic production, i.e. the country's GDP, according to three criteria: stabilisation of the economy, distribution of income and output growth. The budget's announcement in Parliament is to ensure administrative accountability such that public revenues and expenditures are responsive to the wishes of the electorate.

### Market Efficiency

The budget reflects a disciplined examination process of public goals in deciding on resource allocation. But it cannot attain market efficiency. The market makes no decision and does not allocate resources but an impersonal mechanism for generating price signals for factors and products. The market provides information which is used by producers and consumers in relation to technology and to preferences to make decisions over production and sales of factors and products.

### Government programmes & the theory of 2nd best

Efficient production is achieved in the economy when resources are fully employed. This means producing on the possibilities frontier and is the first best if resources can be properly allocated. However, oftentimes a constraint is faced in the economy that meant that full employment of resources can only be achieved through a disproportionate allocation of resources. According to the theory of second best, society is better off if resource allocation remains proportionate even though resources would not be fully employed.

In the context of government programmes, first best in a society would be possible if it can allocate resources between the production of private and public goods. However, in real life this is not possible because void of price signals, government can only produce public goods via budget revenues. Deadweight losses from taxes that fund the budget becomes a constraint. As a result even though resources cannot be fully employed allocating resources properly between private and public goods as second best leads to higher overall welfare than if allocation becomes disproportionate in order to employ resources fully.

### Tax revenues

According to Stiglitz, marginal tax rates should decline not progress with rising incomes. The reason is Stiglitz saw society as being made up of less able and more able people. With declining marginal tax rates, both the less able and more able will have further incentive to increase their income through more production. The more able people still pay more taxes than the less able. It is only the marginal tax rate that declines. Even though Stiglitz's scheme of taxes is not politically feasible, the government has been mindful of it. Although taxes remain progressive in Malaysia, the tax burden of higher income earners have been systematically reduced over several tax revisions occurring over the years. **§ Chan Huan Chiang**

#### Reference:

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Stiglitz J E (1986) *Economics of public sector*. W W Norton & Co. N.Y.  
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their own distribution activities. Many foreign logistics companies have also begun to set up their operations here. The recruitment of personnel with the needed skills from overseas is at present the preferred short-term measure until such time when Penang and Malaysia as a whole can produce their own graduates who are equipped with these skills.

It will be important to ensure that these incentives are not wrongly used. Implementing agencies, particularly the Immigration Department must work closely with the private sector companies to identify the professionals who possess the skills that they need. It would also be appropriate if the government imposes a limit on the number of certificate of permanent residency that could be issued per annum similar to the practice in more developed countries like the U.S.

Relaxing procedures and regulations, however, may not be sufficient to attract professional Malaysians and their families if this is not accompanied by a **conducive living environment**. This includes facilities in areas such as education, health, recreation, arts and culture. The demands and requirements of these 'home-coming' Malaysians are likely to be very high. These 'homecoming' Malaysians have been accustomed to lifestyles overseas and may find some difficulty adapting to the lifestyle here in Malaysia.

Furthermore, this new incentive should not only be restricted to Malaysians but experts of other nationalities who might be willing to relocate to Malaysia. It would be easier to attract these professionals, particularly those from less developed countries than to attract Malaysians who have long resided in more developed countries.

#### *ICT Development*

The efforts by the government to move towards **ICT development** and the setting up of a Venture Capital Fund to promote ICT is a positive shift toward building a competitive Penang. In its quest to develop ICT and venture capital, the government has also expanded the IRPA (Intensification of Research in Priority Areas) funding to venture capital companies undertaking R&D activities in the MSC and locations approved by the government. To promote a competitive and modern nation, ICT activities should not only be confined to the MSC and locations approved by the government. ICT activities should be promoted nationwide and thus, the MSC should not be restricted to a physical area but extend virtually throughout the country to enable the business community to benefit from the incentives as well as facilities provided at the present MSC. Priority should be given to extending the incentives and privileges of the MSC to Penang to take advantage of its potentials as the electronics hub of the country. MSC incentives and privileges like good infrastructural facilities, no equity ruling, unrestricted employment of knowledge workers from overseas, globally competitive telecommunication tariffs and freedom of sourcing capital globally would be very significant to building Penang's competitiveness.

#### *The Disabled*

The concern shown by the government in providing **incentives to the disabled** has been much lauded by the public. However, it would better benefit the disabled if the incentives allow the disabled to increase their potential. It is indeed a good gesture that the disabled are provided with free healthcare in government hospitals as well as exemption from import duties and sales tax for the purchase of special equipment used by them. These incentives would definitely help them, especially those in the lower income category to have access to better healthcare and medical equipment and accessories. However, the incentives should not end there but help make the disabled become more competitive.

It is rather irrational to grant the disabled free travel documents (passports) as well as 50 per cent exemption on excise duties for the purchase of national cars and motorcycles. There are very few disabled people who are privileged enough to travel. Normally, those who have the opportunity to travel are the ones from the higher income category and they could very well afford to pay for their travel documents. Likewise, the disabled people who are privileged enough to drive could very well afford to purchase their own cars. As such, these two incentives would not bring much benefit to the disabled, but create more opportunities for the exploitation of such rights that are granted to the disabled, particularly on the purchase of national cars.

It is undeniable that many disabled people are still at the lower rung of the society. Except for a minority group, their educational level is relatively lower than the able people. The disabled are mainly employed either in the informal sector or as lower category workers in both public and private organisations.



## A General Appraisal Of Budget 2001 Recommendations

The government's decision to develop a K-economy as well as to enhance national competitiveness are essential strategies towards greater growth of the Malaysian economy. Several very good incentives and programmes were prescribed under these strategies in the budget. Equally constructive policies and programmes have been introduced before in past budgets but unfortunately, such programmes have either failed to meet the expectations of the populace in general or were not implemented and enforced in accordance to the initial objectives of the prescribed policies. The following are some examples:

- Recommendations made under the Second Industrial Master Plan (IMP2) to review laws governing Free Zones (FZs) and Licensed Manufacturing Warehouses (LMWs) have not yet been implemented even though five years have passed since the plan was launched.
- Another recommendation related to the development of the value chain under the IMP2 was to review financial encumbrances to facilitate greater linkages between MNCs/LSIs and SMLs. Although the government has introduced the Industrial Linkage Programme (ILP) to encourage greater linkages between the MNCs/LSIs, the programme has not been very successful due to poor response particularly from the MNCs/LSIs because the incentives are not appropriate to them.
- The government has also initiated the provision of various incentives and funding for Malaysian companies, particularly the SMLs but these incentives and funding were not fully taken up for various reasons such as the lack of information, compliance difficulties and documentation problems.

The Budget 2001 recommendations will similarly not meet its objectives, even though they are constructive, unless proper implementation could be ensured. This part of the bulletin attempts to highlight certain recommendations of Budget 2001, which have direct implications for Penang and that need to be implemented effectively.

### *Reverse Brain Drain*

One of the incentives provided under the strategy to stimulate economic growth is to **attract Malaysian professionals and experts** who are currently residing overseas to return and serve in Malaysia. This effort will definitely help to enhance the knowledge-base in the country. Penang has suffered from immense brain drain for decades, especially when Penang scholars refused to return home after their studies abroad. Many also migrate to more developed nations to seek greater career opportunities and greener pastures. The time has come to encourage these Malaysians to come home especially when Penang is progressing rapidly towards the era of information and communication technologies. All three incentives recommended to encourage the return of Malaysian professionals are very attractive.

#### Box 1: Incentives to attract Malaysian professionals & experts to return

- Income remitted to Malaysia within two years is tax exempted
- Tax exemption for all personal effects brought into Malaysia including two cars.
- Spouses and children who are not Malaysians to be given PR status

To build Penang's competitiveness, particularly in the manufacturing sector, companies are moving towards automation that would lead to productivity enhancement. To support automation and to improve productivity, more skilled personnel will be required. Today, in the age of ICT, companies are requiring more and more people with knowledge in IT, particularly software development skills. As Penang is also moving towards higher value-added activities, many large companies have begun

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