

The Public Sector Programme and its Financing

I.—INTRODUCTION

147. The public sector development expenditure programme encompasses expenditure on the economic, social, administrative and security programmes of the Federal and State Governments and public and local authorities during the period of the First Malaysia Plan, 1966-70. The phasing of development expenditure for each year of the Plan period will be undertaken in the course of the preparation of the annual development budgets. Any firm indication of the phasing of the total five-year expenditure target would not be realistic at this stage as account has to be taken of changing economic and financial conditions, which will largely dictate the annual level of expenditure within the framework of the Plan. Nevertheless, it will be government policy to achieve a phasing and level of expenditure which will be consistent with the financial, technical and organizational capacities of the economy at large and the government in particular.

148. The public sector development expenditure programme also does not indicate at this stage the amount of expenditure to be financed by specific public agencies for specific purposes, although in formulating the programme the expected financial resources of all levels of government have been taken into account. Changes will inevitably arise in the specific assumptions which have been made in estimating the likely financial resources of the public sector over the next five years. It would be unrealistic at present to foresee this in greater detail than is required and therefore the distribution of financial responsibility between the different levels of government for expenditure to be incurred annually will be the subject of arrangement to be made from year to year.

II.—SIZE OF THE PUBLIC SECTOR DEVELOPMENT EXPENDITURE PROGRAMME

149. The estimated public sector development expenditure needed to attain the objectives of the First Malaysia Plan amounts to a total of \$4,550 million for the period 1966-70. This is 46% more than the expenditure of about \$3,110 million during the last five years. Economic and social development expenditure of \$3,810 million will be 36% more than similar expenditure in the corresponding past period, while defence and internal security expenditure will be 138% more. This vast increase in planned defence and internal security expenditure has been made necessary by the need to strengthen the ability of the country to withstand military confrontation. To a large extent the requisite build-up of military and police capabilities underlies the substantial financial difficulties with which the public sector will have to contend in the immediate future.

150. The necessary increases in defence and police expenditure would have been sufficient to warrant a drastic curtailment of expenditure for economic and social development. However, as is evident from the planned public sector development expenditure programme, the government is not prepared to adopt this course. Through more intensive mobilisation of domestic financial resources and recourse to external financial assistance, the government is intent on ensuring that there will be no retardation in the momentum of economic and social development which has been generated by past development plans. The government is determined to ensure that Malaysia will advance and continue to prosper through the strengthening of its military defences and by rapid economic and social development.

III.—SECTORAL ALLOCATION OF PUBLIC ECONOMIC AND SOCIAL DEVELOPMENT EXPENDITURE

151. The income and employment objectives of the First Malaysia Plan are stated in Chapter I. The attainment of these objectives will require that advances be made in reducing the dependence of the economy on a limited number of primary activities through agricultural diversification and industrialisation. In view of the private enterprise character of the economy, the direct operational responsibility for the implementation of this strategy will lie with the private sector. The government in turn will strive to provide the necessary capital and technical assistance and establish as rapidly as possible the physical and human pre-requisites for rapid and diversified economic growth. It will also facilitate private sector activity through the implementation of policies that will induce private entrepreneurs to move at the pace and in the directions required for soundly-based economic development.

152. The main emphasis of the government's development programme will therefore be on projects which are designed to increase productivity and investment in a widening range of primary and secondary industries. Of the total allocation for economic and social development expenditure, about 24% will be for agriculture and rural development projects. The amount to be so expended is more than double the expenditure in the last five years. The main items of expenditure include (i) a large programme to open new land for settlement and cultivation of oil palm, rubber and a number of other crops; (ii) continuation of rubber replanting; (iii) irrigation and drainage projects to extend the area of double-cropping and otherwise improve and expand the cultivation of padi and other crops; (iv) expanded programmes of agricultural research in order to improve existing practices of production and develop new production possibilities; and (v) provision of technical and material assistance to farmers to enable them to increase their productivity and encourage diversification in agricultural production.

153. In the field of industrial development, the provision allocated is for (i) further development of industrial estates; (ii) establishment of industrial research facilities; (iii) launching of the Federal Industrial Development Authority; (iv) strengthening of MARA to enable it to expand material and technical assistance to indigenous entrepreneurs interested in industrial development; and (v) provision of further assistance to MIDFL and the Borneo Development Corporation Ltd. to enable them to expand their industrial credit activities.

154. The public sector programme also gives emphasis to education projects. Education will account for about 10% of total development expenditure, or about 60% more than the sum expended during 1961-65. The object of the programme is to expand and improve the education system so that the required quantity and quality of skilled personnel, particularly in the fields of agriculture and industry, will be produced.

155. As a result of the measures taken under the first and second Malayan five-year development plans, Malaya embarks upon the First Malaysia Plan with a reasonably sound economic infrastructure of transport and communication facilities and electricity and water supply systems. The programmes in these areas during the next five years will therefore be geared to ensuring that there will be sufficient capacity to meet foreseen demand. This will involve about the same level of expenditure as in the last five years. In the Borneo States, however, the infrastructure is relatively underdeveloped. The government has therefore an important role to play in the immediate future in developing the infrastructure of these States to an adequate level. Expenditures about 35% higher than those of the last five years will be utilised for this purpose.

156. The government's development programme also provides for improved housing, community facilities, welfare and other services. The largest allocation in this area will be for low-cost housing. The amount allocated for this purpose is more than three times the expenditure in the last five years. The programme will enable an intensified phase of housing development to take place so that the most immediate problems posed by the housing shortage, particularly in the densely populated urban areas, will be met. Progress in this sphere of social and community services, however, necessarily has to be subordinated to the economic objectives of the Plan, since revenues for this purpose can only come from increases in the income of the economy and the government. Only by placing emphasis on economic programmes and projects at this stage will the country be in a position to provide for an adequate scale of amenities in the future.

157. The government is confident that the implementation of the growth strategy of the Plan will lead to increases in *per capita* income and employment from existing levels and will create a sound basis for accelerated development in the future. Several groups in the country, however, will be in a relatively weaker position to participate effectively in the development of Malaysia and enjoy fully the rewards therefrom. Special attention has therefore been given in the allocation of expenditure to projects which will offer opportunities to low-income groups in the country to improve their levels of economic and social well-being.

158. The sectoral allocations of public economic and social development expenditure reflect the priorities indicated above and are shown in Table 4-1. The detailed development programmes for each main sector are described in Chapters VII-XIV.

TABLE 4-1

MALAYSIA: SECTORAL ALLOCATION OF PUBLIC DEVELOPMENT EXPENDITURE IN 1966-70 AS COMPARED WITH 1961-65

Sectors	Development Expenditure, 1961-65 (estimate)				Development Expenditure, 1966-70 (target)				
	Malaya*	Sabah	Sarawak	Malaysia	Malaya	Sabah	Sarawak	Malaysia	
	(\$ millions)	(\$ millions)	(\$ millions)	(\$ millions)	(\$ millions)	(\$ millions)	(\$ millions)	(\$ millions)	
Agriculture and Rural Development									
Agriculture	411.1	18.0	46.5	475.6	15.3	900.2	55.0	131.4	1,086.6
Animal Husbandry .. .	151.1	13.2	34.9	199.2	6.4	166.5	11.7	89.3	267.5
Fisheries	11.3	0.1	0.8	12.2	0.4	28.0	2.1	3.7	33.8
Forestry	2.5	—	0.4	2.9	0.1	17.0	1.3	4.0	22.3
Drainage and Irrigation .. .	6.6	0.2	1.7	8.5	0.3	10.0	1.1	1.3	12.4
Land Development	108.5	1.1	2.5	112.1	3.6	319.2	7.0	6.5	332.7
Rural Credit and Marketing .. .	129.8	3.4	6.2	139.4	4.5	335.0	27.8	13.1	375.9
Emergency Contract Personnel Services	1.3	—	—	1.3	—	19.5	4.0	13.5	37.0
Mining	—	—	—	—	—	5.0	—	—	5.0
Mines Department	0.9	—	—	0.9	—	1.3	—	—	1.3
Geological Survey Department .. .	0.4	—	—	0.4	—	0.5	—	—	0.5
	0.5	—	—	0.5	—	0.8	—	—	0.8
Industrial Development	59.1	4.6	5.5	69.2	2.2	110.3	1.7	2.5	114.5
Malaysian Industrial Development Finance Ltd.	24.1	—	—	24.1	0.8	16.0	—	—	16.0
Industrial Estates	24.5	—	—	24.5	0.8	14.0	—	—	14.0
National Institute for Scientific and Standards Institute	—	—	—	—	—	5.0	—	—	5.0
National Research	—	—	—	—	—	0.1	—	—	0.1
National Productivity Centre .. .	(0.3)	—	—	(0.3)	—	0.2	—	—	0.2
Federal Industrial Development Authority	—	—	—	—	—	5.0	—	—	5.0
Majlis Amanah Ra'ayat	10.5	—	—	10.5	0.3	70.0	—	—	70.0
Borneo Development Corporation Ltd.	—	4.6	5.5	10.1	0.3	—	1.7	2.5	4.2
Transport	588.5	67.9	90.6	747.0	24.0	365.3	68.8	111.9	546.0
Roads	417.0	50.3	76.2	543.5	17.5	255.5	54.2	79.8	389.5
Railways	50.9	1.4	—	52.3	1.7	20.0	1.3	—	21.3
Civil Aviation	59.6	8.4	5.1	73.1	2.3	9.0	6.0	6.5	21.5
Ports	61.0	7.8	9.3	78.1	2.5	80.8	7.3	25.6	113.7

Development Expenditure, 1966-70
(target)

Development Expenditure, 1961-65
(estimate)

Sectors

	Development Expenditure, 1966-70 (target)			Development Expenditure, 1961-65 (estimate)		
	Malaya*	Sarawak	Malaysia %	Malaya	Sabah	Malaysia %
Communications	113.3	8.2	129.8	156.6	25.6	205.5
Telecommunications	84.9	5.0	96.9	105.0	19.0	142.5
Broadcasting	23.0	2.8	27.1	42.3	6.0	53.1
Posts	4.9	0.4	5.3	9.0	0.6	9.6
Meteorological Services	0.5	—	0.5	0.3	—	0.3
Utilities	527.4	28.5	590.2	695.0	58.0	786.3
Electricity	352.5	13.9	382.8	545.0	15.0	584.3
Water	174.9	14.6	207.4	150.0	43.0	202.0
Education and Training	236.5	18.2	277.4	368.0	27.2	440.8
Health and Family Planning	101.9	7.2	117.1	150.4	18.0	189.4
Social and Community Services	182.1	17.5	214.0	279.0	16.5	315.1
Housing	69.4	9.8	86.7	173.2	7.4	188.1
Major Sewerage Schemes	8.0	—	8.0	21.6	—	21.6
Fire Services	4.0	—	4.0	4.6	—	4.6
Culture, Youth and Sports	—	—	—	11.6	0.4	12.4
Community Services	92.4	7.7	106.9	55.5	8.3	74.8
Welfare	5.8	—	0.1	8.7	0.4	9.8
Aborigines	2.5	—	2.5	3.8	—	3.8
General Administration	123.6	32.8	191.8	87.9	26.9	126.4
Defence	244.7	—	244.7	502.0	53.5	600.0
Accommodation	—	—	—	150.0	53.5	248.0
Equipment	—	—	—	352.0	—	352.0
Internal Security	62.6	—	4.1	97.6	22.4	139.0
Accommodation	—	—	—	55.1	22.4	96.5
Equipment	—	—	—	42.5	—	42.5
TOTAL	2,651.7	202.9	2,541.1	3,713.6	373.6	4,550.9
			100.0			100.0

* Sectoral estimates may differ from those given in Table 2-6 because of re-classification.

† Allocation for Postal Services is included under that provided for Telecommunications.

IV.—GEOGRAPHICAL DISTRIBUTION OF PUBLIC ECONOMIC AND SOCIAL DEVELOPMENT EXPENDITURE

159. The geographical distribution of economic and social development expenditure under the First Malaysia Plan is about \$3,110 million for Malaya, \$300 million for Sabah and \$400 million for Sarawak, making a total of some \$3,810 million. A number of factors were taken into account in the determination of this distribution among the three main parts of the country. These factors include their populations, development potentials, needs for economic and social infrastructure investment, financial capacities and their respective abilities to implement expanded development programmes without inflationary consequences.

160. The overall economic and social development expenditure target for Malaya is 32% more than the amount expended during 1961-65, while the targets for Sabah and Sarawak represent respectively increases of 47% and 57% over the expenditure achievement of the last five years. The substantial expenditure increases which are planned for the Borneo States are clearly indicative of the government's determination to ensure that as large an allocation is provided as can be expected to be achieved within the technical and administrative capacities of these States.

V.—THE FINANCING PROBLEM

161. The task of financing the public sector development expenditure programme will be more difficult than in the last five years. There are several reasons for this. In the first place, the trends in income of the country and in revenue of the government are expected to be less buoyant than in recent years because of the anticipated slow growth of exports associated with declining rubber prices and diminishing mineral resources.

162. A second reason for expecting increasing difficulty in financing development expenditure is the large and rising expenditure on current account that is required to cover the mounting day-to-day cost of the ordinary operations of the government including the expanded and widened variety of services in the fields of education, health, communications and defence and internal security. In the last five years, recurrent expenditure has increased by 67%, as a result of which the current budget surplus which was available for investment financing to the extent of \$330 million in 1960 has now just about vanished. A much more austere view of further growth in recurrent government spending will be necessary if a surplus is again to be created to help meet the cost of Malaysia's investment needs.

163. Finally, there is the need to provide for the expansion of the defence and police capabilities of the country. Fortunately, in this critical task of defence, Malaysia is able to rely on the generous support of its friends

abroad. But with all their help the country's own domestic resources will still be increasingly drawn upon in the next five years for defence and internal security. In addition to a large increase in recurrent security expenditure, the capital cost of security installations and equipment during 1966-70 are now expected to require almost \$740 million. This is considerably more than twice the comparable figure of \$311 million during 1961-65.

164. As it is the resolve of the government to continue to develop this country without upsetting its existing monetary and financial stability, the financial framework of the First Malaysia Plan has been formulated on the following principles. Firstly, the Plan assumes a cumulative ordinary budget surplus over the period 1966-70 which will contribute to the financing of public development expenditure and preserve a satisfactory fiscal base for continued development beyond the period of the First Malaysia Plan. A second financial principle of the Plan is that reliance on credit from the banking system will be limited to amounts which can be used without inflationary effects and without more than a reasonable use of the foreign exchange reserves. Finally, the financial framework of the Plan has been prepared on the principle of continuing to place major reliance for Malaysian development on the private sector. The mobilisation of resources for public investment through taxation and domestic borrowing will therefore be limited so as to leave ample means for the financing of the private investment which is crucial for Malaysia's economic progress.

165. These financial principles severely limit the ability of the government to raise money from Malaysian sources for the scale of public investment that is contemplated in the First Malaysia Plan. It is therefore necessary to plan on the basis of major reliance on financing from abroad. The targets for foreign borrowing and foreign grant assistance have thus been set at much higher levels in 1966-70 than the actual levels of 1961-65. The government believes that these targets are realistic in terms of Malaysia's creditworthiness and its ability to service and repay external loans. They also appear realistic in terms of assistance levels widely considered reasonable by aid-giving countries and institutions for developing countries which are managing their economic and financial affairs satisfactorily.

VI.—FINANCING THE PUBLIC SECTOR PROGRAMME

166. The specific means of financing the public sector development expenditure programme under the First Malaysia Plan are discussed in the remainder of this chapter. It is estimated that revenue of the Federal and State Governments will rise from about \$1,670 million in 1965 to about \$2,200 million in 1970. This projection takes account of a probable drop in rubber prices and other aspects of the export outlook. It is based on

expected growth of revenues at existing tax rates together with an allowance for additional income from tax changes in the course of the Plan period. For the period as a whole the estimate of accumulated government revenue is \$9,800 million. This is about a third larger than the revenue of the Federal and State Governments during 1961-65 and implies an average annual rate of increase of about 5%, which is about the same as the rate of increase during 1961-65.

167. Because of the sharp decline in the recurrent surplus of the government budget it will not be possible to maintain the recent growth of annually recurrent spending, which rose by 67% between 1960 and 1965. Considerable increases will nevertheless be necessary, especially in the coming two years, because of the transition to the comprehensive school system and the expansion of the armed forces. It is expected that these and other requirements can be met with increases in recurrent expenditure of 9% in 1966, a further 7% in 1967 and 6% thereafter. On this basis recurrent federal and state expenditure during the five years of the Plan will amount to \$9,600 million.

168. This growth of recurrent expenditure, in conjunction with the revenue forecasts, will maintain some margin of surplus in the ordinary budget but the amount will be small; for the entire 1966-70 period it will total about \$200 million, which is about one-fifth of the accumulated current surpluses of the Federal and State Governments during 1961-65.

169. Other aspects of the domestic fiscal picture are more favourable. There is a prospect of considerably larger current surpluses from the earnings of public authorities than in the last five years. This is almost entirely due to the favourable financial prospects of the National Electricity Board (NEB) because of the rapid expansion in residential, industrial and commercial demand for electricity that is taking place. It is estimated that the profits and other investment funds available from the earnings of public authorities during 1966-70 will be about \$425 million, or over twice as much as in 1961-65. About 80% of this is expected from the earnings of the NEB.

170. Prospects for government borrowing from domestic sources other than the banking system are also favourable and more public investment financing can be expected from these sources than was possible during 1961-65. This is mainly because of the growth and broadened coverage of the Employees Provident Fund (EPF) and the consequent increase in resources for public and private investment. EPF net accruals of funds available for investment during the coming five years are estimated at \$1,010 million. Part of these funds will be invested directly in private development; an allowance of about \$100 million would seem reasonable

on the basis of past and prospective patterns of EPF investment in approved private securities. The remaining \$910 million will be available for investment in government securities.

171. An additional demand for government securities can also be expected from domestic individual, business and institutional investors other than banks. This demand is assessed for the Plan period at about \$115 million net of repayments—a relatively low figure mainly because of disinvestments by the Rubber Industry Replanting Board. In total, therefore, the possibilities for financing public development expenditure from domestic borrowing outside the banking system are expected to amount to about \$1,025 million.

172. The limits to which public development expenditure can be financed from bank credit and the use of government balances without adverse inflationary or foreign exchange consequences depend on the extent to which they are offset by savings of the population in the form of either bank savings deposits or increased holdings of cash or demand deposits. Some increase in these holdings is usually associated with a general increase in economic activity and the need to keep larger amounts of money on hand as the volume of money transactions expands. So long as additional bank credit and the spending of government balances are no more than the increase in savings deposits and holdings of cash or demand deposits, there will be no resulting inflation or foreign exchange loss. Beyond this there will be one or the other or both and the extent to which inflation can be avoided in these circumstances will depend on the extent to which the country can afford to allow the inflationary influences to take the form of reductions in foreign exchange reserves rather than an increase in the price level.

173. It is difficult in practice to determine just where the lines can be drawn in this matter of financing through bank credit and the use of government accumulated assets. Some approximate assessments are, however, possible. Judging by past trends and prospects for the further growth of the economy, it is possible to forecast that private sector holdings of financial assets will increase by about \$2,230 million in 1966-70. Of this total, about \$1,025 million is expected to be invested in government securities as indicated in paragraph 171 above. The remaining \$1,205 million is projected to be held in the form of bank deposits or currency.

174. Past trends and the targets for development in the private sector suggest a need for the extension of credit from the banking system to the private sector of about \$500 million. The balance of about \$700 million is the amount expected to be available for financing public investment through the extension of credit to the government from the banking system and draw-down of the accumulated assets of the government without inflation or use of the country's foreign exchange reserves.

175. The target level of public investment financing by bank credit and the use of government accumulated assets is \$1,000 million. When taken in conjunction with prospective developments in private foreign financing, this will lead to some use of the country's foreign exchange reserves. However the use of these reserves is unlikely to be excessive. The country has a satisfactory foreign exchange position at the present time with official foreign exchange reserves and the net foreign assets of commercial banks amounting to about \$2,700 million, which is enough to pay for eight months' import requirements. On the other hand, it is most important to keep total reserves at a high level both for reasons of international confidence and also to ensure that there is still an adequate exchange reserve for the years beyond the period of the First Malaysia Plan. Thus if the target levels of private long-term capital inflow and public foreign assistance are achieved, serious balance of payments problems and a major reserve rundown will be avoided.

176. In summary, the resources that can be reasonably mobilised for public development expenditure from Malaysian funds, including the use of bank credit and government accumulated assets, are as indicated in Table 4-2.

TABLE 4-2

MALAYSIA: INTERNAL FINANCIAL RESOURCES FOR PUBLIC DEVELOPMENT EXPENDITURE, 1966-70

(\$ millions)

	<i>Cumulative total</i>
Federal and State Governments revenue	9,800
Federal and State Governments recurrent expenditure	9,600
Government surplus available for development expenditure	200
Surplus of public authorities	425
Net domestic non-bank borrowing	1,025
Bank credit and use of government accumulated assets	1,000
TOTAL	2,650

177. The total of internal resources is about the same amount raised during 1961-65. For the reasons previously explained, it is not possible to envisage a larger financial effort from Malaysian resources if financial stability is to be maintained and excessive inroads into the investment resources of the private sector are to be avoided. Yet the needs for public

development expenditure during the next five years are much larger than in 1961-65. Capital requirements for defence and security will take about \$740 million and economic and social development expenditures which are considered essential priorities amount to about \$3,810 million after severe pruning. Total public development expenditure amounts therefore to \$4,550 million or \$1,900 million more than can reasonably be financed from Malaysian resources.

178. The difference will be sought from foreign sources in the form of loans and grants. Malaysia's capacity for undertaking and meeting the payments on additional external debt is still large. The present foreign debt of about \$750 million is relatively modest. This is less than 10% of the national output and about 20% of the total public debt. The annual payments on this foreign debt at their peak will be less than 4% of government revenue and about 2% of Malaysian export earnings. This is a light burden by comparison with most developing countries. Considering only the foreign exchange and balance of payments position, Malaysia could probably afford the interest and principal payments that would be required if the entire \$1,900 million needed from foreign assistance were to be obtained in the form of loans. However, from the standpoint of the government budget, the annual service payments that would be required by such large amounts of foreign borrowing on conventional terms would be an extremely heavy financial burden. It would come on top of the already substantial burden that will fall on the budget from the considerable increase in domestic debt that is contemplated during the coming five years. If to the annual service of domestic debt, payments were required on an additional foreign debt of \$1,900 million, the annual domestic and foreign debt payments by 1970 would require at least 15% of total government revenue. A debt burden of this size would be a serious aggravation of the difficult financial future that the country is likely to face in the latter 1960s and the early 1970s.

179. For this reason it is the aim of the First Malaysia Plan to secure a large part of the foreign financing needs on a grant basis. It is difficult at this time to foresee the magnitudes of financial assistance that may be obtained from foreign countries and international agencies or to arrive at any very definite view of the terms on which such assistance may be forthcoming. In the light of Malaysia's successful record of financial management and development progress, the government is confident that in this period of financial difficulty the possibilities for financial support from abroad on liberal terms will be favourable. It is the determination of the government to justify such support through continued financial policies which are sound and development policies which take every possible advantage of favourable opportunities for private and public economic progress. On the assumption

of substantial foreign assistance for the First Malaysia Plan and in the hope of avoiding an excessively heavy budgetary burden from additional debt service, it will be an objective of the Plan to keep the foreign borrowing component to a maximum of \$1,000 million, of which it is anticipated that \$300 million will be loans raised in international markets, and to seek the remaining \$900 million needed from abroad in the form of grants. If foreign financial backing for the First Malaysia Plan on this scale and pattern is obtained, the resources available for public development expenditure during 1966-70 will be as shown in Table 4-3.

TABLE 4-3

MALAYSIA: RESOURCES FOR FINANCING PUBLIC DEVELOPMENT EXPENDITURE, 1966-70

(\$ millions)

	<i>Cumulative total</i>
Government surpluses	200
Public authorities surpluses	425
Domestic non-bank borrowing	1,025
Bank credit and government accumulated assets	1,000
Foreign borrowing (net)	1,000
Foreign grants	900
TOTAL ...	4,550