1 Malaysia

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I. Introduction

Background of Malaysia

Malaya (what is now Peninsula Malaysia) gained its independence from Britain on 31 August 1957. On 19 September 1963, Malaya, Sarawak, Sabah, and initially Singapore united to form Malaysia. Singapore left the Federation in on 9 August 1965.

Malaysia is physically situated in the centre of Southeast Asia at 7 degrees north of the equator. It covers an area of about 329,758 square kilometres in two geographically distinct areas which is separated by about 650 kilometers of the South China Sea. Eleven of its thirteen states and two federal territories (Kuala Lumpur and Putrajaya) are in Peninsular Malaysia, with Thailand to the north and Singapore and Indonesia to the south. The other two states, Sabah and Sarawak, as well as the federal territory of Labuan, are on the north and west coasts of the island of Borneo, bordering Indonesia and Brunei. Malaysia has a warm and humid equatorial climate. The humidity is about 80% all year round and temperatures range from 21 to 32°C. The climate is affected by the northeast and southwest monsoons, tropical winds that alternate during the course of the year. The northeast monsoon blows from November to March, and the southwest monsoon from May to September. The periods between the monsoons are marked by heavy rainfall.

Malaysia's population is estimated at 25.05 by the end of year 2003 which consists mainly of the Malay and other indigenous people of Sarawak and Sabah which include Iban, Bidayuh, Kadazans, Bajau, Melanau and murut (65.5%), Chinese (25.6%), Indians (7.5%) and others 1.4%. One of the unique features of Malaysia is its multiracial population which practices various religions such as Islam, Buddhism, Taoism, Hinduism and Christianity. The official language is Malay. However the people are free to use their mother tongue and other languages. English as the second language is widely used in business.

Malaysia practises a system of parliamentary democracy and is ruled as a Constitutional Monarchy, with His Majesty the Yang di-Pertuan Agong as the Head of the country. The Yang di-Pertuan Agong is elected to the throne for a five-year term from one of the hereditary Rulers of the nine states in the Federation which are ruled by Sultans. The states are Perlis, Kedah, Perak, Selangor, Negeri Sembilan, Johor, Pahang, Terengganu and Kelantan. In the other states, namely Melaka, Pulau Pinang, Sabah and Sarawak, the Head of State is the Yang di-Pertua Negeri of Governor of the State. The Yang di-Pertua Negeri is appointed by the Yang di-Pertuan Agong for a four-year term.

The Federal Constitution of Malaysia clearly divides the authority of the Federation into its Legislative Authority, Judicial Authority and Executive Authority. The separation of power occurs both at federal and state levels, as in keeping with the concept of federalism, which form the basis of the government administration. Executive Authority, that is, the power to govern, is vested by Article 39 in the Yang di-Pertuan Agong but is exercised by a Cabinet of Ministers headed by the Prime Minister. The Cabinet is responsible to the Yang di Pertuan Agong. Every executive act of the Federal Government flows from the Royal authority, whether directly or indirectly. However, in accordance with the principle of a democratic ruling system, the Chief Executive is the Prime Minister. On 31 October 2003 Prime Minister Abdullah bin Ahmad Badawi was appointed to take over the office from the former Tun Mahathir bin Mohammad.

II. Overview of Macroeconomic Activity and Fiscal Position

Malaysia's official development strategies are based on a medium term series of five year which are backed by long term ten-year outline perspective plans (OPPs). The current medium term plan is the Eighth Malaysian Plan (EMP) covers period from year 2001 to 2005, which aims to achieve 7.5% annual growth growth with the objective of becoming a fully developed nation by year 2020.

Table 1 Selected Macroeconomic Indicator.

Macroeconomic Indicator	Annual change (%growth)				
	1999	2000	2001	2002	2003p
GDP 1987 real prices	6.1	8.5	0.3	4.1	5.2
Agriculture	0.5	2.6	-0.9	3.0	5.5
mining & quarrying	6.9	0.3	-0.8	3.7	4.8
manufacturing	11.7	18.3	-5.8	4.0	8.2
construction	-4.4	0.6	2.1	2.3	1.9
services	4.5	6.7	5.8	4.1	4.1
GNP (current prices)	3.8	7.2	8.9	8.7	10.1
GNP (1987 real prices)	3.7	6.6	7.1	4.7	6.6
GNP (current prices)	1.5	-2.8	3.8	7.2	18.1
Per capita Income (current prices)	1.4	4.7	6.4	6.4	5.4
Revenue	3.5	8.2	9.6	5	11.1
Total exports(f.o.b)	12.1	15	8.7	7	11.5
Total imports(c.i.f)	9.1	25.2	11.1	8.1	4.8
Consumer Price Index (2000=100)	2.8	1.9	0.7	1.8	1.2
Producer Price Index (1989=100)	-3.3	3.1	-5.0	4.4	5.7
Labour force	1.5	2.0	3.1	3.1	3.3

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source: Department of Statistics, Malaysia and Bank Negara Malaysia

In 2003, Malaysian economy is optimistic for a stronger economic performance in an anticipation of an improved world economic outlook. The prospect for a global economic recovery was however affected by the war in Iraq and sporadic incidences of militancy and outbreak of the Severe Acute Respiratory Syndrome (SARS). Against this adverse global environment and concerns of further weakening of the already sluggish global economy, the Government put in place a Package of New Strategies which are broad-based pro-growth. The Package of New Strategies was launched in May 2003 to contain the budget deficit with the bulk of financing (77%) from the financial system. Hence, minimising the impact of additional budgetary requirements of Government finances. The Package has a medium to longer objective of enhancing the nation's competitiveness, encompassing 90 specific tax and non-tax measures aimed at generating economic activities with emphasis on mobilising domestic sources of growth and reducing overdependence on the external sector. The main strategies include promoting private sector investment, strengthening the nation's competitive, developing new sources of growth and enhancing effectiveness of the delivery system.

Monetary policy complements fiscal policy to support private sector activities. Measures to stimulate and strengthen the capital market were introduced which include the delegation of Foreign Investment Committee (FIC) approvals to the Securities Commission for public listed companies, the introduction of performances incentive schemes and the enhancement of capital market skills as well as the role of intermediaries.

Malaysia's sound economic fundamentals and expansionary fiscal and accommodative monetary policies, supplemented by the Government's proactive stimulus package, have contributed to the strengthening of the economy. In 2003, the Malaysian real gross domestic product (GDP) expanded by 5.2% (2002: 4.1%), exceeding the official forecast of 4.5%. The

GDP growth was private sector-driven - broad based and balanced across sectors. The manufacturing sector grew by 8.2% on the back of strong production growth, both in the export-oriented and domestic-oriented industries. Export-oriented industries, particularly the electronics and chemicals industries, benefited from the recovery in the global electronics sector as investment demand picked up in most major economies.

The external sector's contribution to growth turned positive (2 percentage points; 2002: –1.3 percentage points), primarily due to the acceleration of exports of goods in the trade account by 11.5% (2002: 7%). The trade surplus increased to RM81.1 billion (2002: RM54.6 billion). Sustained consumer demand and the pick-up in investment activity in the major industrial economies as well as higher commodity prices spurred the growth in exports of manufactures and primary commodities. On the other hand, import growth moderated to 4.8% (2002: 8.1%) as exports of primary commodities, unlike manufactured exports, had low import content. Further, the changing pattern of investment, especially foreign direct investment (FDI), into the services sector were smaller in scale but had higher potential to generate value added. As a result, imports of capital goods remained relatively stable (0.7%).

The large trade surplus, coupled with a smaller income account deficit brought about by the repatriation of earnings from overseas investments by Malaysian firms, more than compensated for the larger services account deficit (RM15 billion) due to lower tourism receipts. As a result, the current account surplus increased to RM50.8 billion, equivalent to 13.7% of gross national product (GNP) (2002: 9.1% of GNP).

The financial account in the balance of payments remained stable, recording a deficit of RM12.1 billion (2002: -RM11.9 billion). Stronger inflows of funds for investment were balanced by higher repayments and prepayments of external debt by the public sector and overseas investments by Malaysian companies. FDI into Malaysia remained significant while funds for portfolio investment turned around to record an inflow as the KLSE staged a markedly improved performance, especially since the third quarter.

As a result of the large current account surplus, sustained inflows of funds for investment, including FDI, and revaluation gains from the translation of non-US dollar assets into ringgit terms, the net international reserves of Bank Negara Malaysia increased to RM170.5 billion, or equivalent to US$44.9 billion at the end of 2003. This represented an increase of RM39.1 billion or US$10.3 billion during the year. Malaysia's external debt position remained stable in 2003, standing at RM187.2 billion or 50.7% of GNP (2002: RM185.6 billion or 55.3% of GNP) in spite of a RM4.1 billion revaluation adjustment that resulted mainly from the appreciation of the euro and yen. Malaysia's external debt position remains sustainable with the debt service ratio improving from 6.7% in 2002 to 6.1% in 2003. In addition, the nation's debt profile remains healthy, with short-term debt accounting for only 18.4% of total external debt.

II.I Macroeconomic Activity

International Environment

A. Trade Balance

In 2003, trade balance increased to RM 81.14 billion (2002: RM 54.34billion). The total export amounted to RM 398.88 billion (2002: RM357.43 billion) where as the total import was RM 317.75 Billion (2002: RM303.09 billion). Amidst the improvement in the external environment, gross exports expanded strongly by 11.5% in 2003 (2002: 7%). The stronger export performance was due to higher manufactured exports, as well as robust growth in exports of primary commodities. Gross imports registered a moderate growth of 4.8% (2002: 8.1%) attributable to imports of capital and intermediate goods, which picked up in the fourth quarter. Import prices increased by 2.3%, reflecting higher prices of imports of manufactured goods, mineral fuel and chemicals.

Table 2 Malaysian Trade with the World 1992-2003 (RM Billion)

Year	Export	Import	Balance
1992	103.66	101.44	2.22
1993	121.24	117.4	3.83
1994	153.92	155.92	-2.0
1995	184.99	194.34	-9.36
1996	197.03	197.28	-0.25
1997	220.89	220.94	-0.05
1998	286.56	228.12	58.44
1999	321.56	248.48	73.08
2000	373.27	311.46	61.81
2001	334.28	280.23	54.05
2002	357.43	303.09	54.34
2003	398.88	317.75	81.14

Source: Malaysian External Trade Development Corporation, Dept. of Statistic Malaysia.

A stronger external environment and improved investor sentiment, particularly in the second half of the year, contributed to the strengthening of the external position in 2003. The overall balance of payments registered a significantly higher surplus on the back of a larger current account surplus, sustained inflows of foreign direct investment and higher inflows of portfolio funds. Errors and omissions, including exchange gain from the revaluation of Bank Negara Malaysia' international reserves due to the appreciation of the major currencies against the US dollar (RM11.9 billion), was RM0.4 billion. After adjusting for the errors and omissions, the overall balance of payments recorded a large surplus of RM39.1 billion or US$10.3 billion. Consequently, the net international reserves of Bank Negara Malaysia increased to RM170.5 billion or US$44.9 billion at end-2003. The reserves increased further to RM194.9 billion or US$51.3 billion as at 15 March 2004. This level of reserves represented 7.8 months of retained imports and 5.2 times coverage of the short-term external debt. Malaysia' reserves are usable and unencumbered.

Table 3 Balance of Payment (In Ringgit Malaysia)

	ITEM	Year 2000	2001	2002	2003*
A	Goods and services	68474	61488	66121	82675
	1 Goods	79144	69854	72117	97701
	2 Services	-10670	-8366	-5996	-15026
	2.1 Transportation	-11736	-11352	-11572	-11297
	2.2 Travel	11158	16148	17102	13308
	2.3 Other services	-10030	-13187	-11242	-10369
	2.4 Government Transactions	-62	25	-284	-100
B	Income	-28909	-25623	-25061	-22614
	1 Compensation of Employees	-975	-1014	-1179	-950
	2 Investment Income	-27934	-24609	-23882	-21664
C	Current Transfer	-7313	-8178	-10566	-9300
D	Balance on Current Account (A+B+C)	32252	27687	30494	50761
E	Capital Account	0	0	0	0
	1 Capital Transfer	0	0	0	0
	Non- produced Non-financial Assets	0	0	0	0
F	Financial Account	-23848	-14791	-11941	-12063
	1 Direct Investment	6694	1091	4935	4242
	2. Portfolio Investment	-9395	-2466	-6506	4176
	3.Other Investment	-21147	-13416	-10370	-20481
G	Errors & Omissions	-12107	-9234	-4362	-360
H	Overall Balance (D+E+F+G)	-3703	3662	14191	39059
I	Reserves Assets	-3703	3662	14191	39059
	Net Change in Bank Negara Malaysia's External Reserves [increase(-)/decrease(+)]	-3703	3662	14191	39059

* Estimate by Ministry of Finance
Source: Department of Statistics, Malaysia

B. Current Account

The surplus in the current account remains large while reserves continue to rise. In 2003, the current account recorded a larger surplus of RM50.8 billion or 13.7% of GNP due to a higher trade surplus. The stronger growth in manufacturing exports and robust expansion in export of commodities, which have low import content, contributed to the larger trade surplus. The larger surplus in the goods account generated more than sufficient foreign exchange earnings to finance the deficits in the services (4.1% of GNP), income and current transfers accounts. The services account deficit widened due to the impact of SARS, which lowered travel receipts. On the other hand, the income account deficit was reduced, reflecting higher profits and dividends accrued to Malaysian companies from their investments abroad and higher returns from other investment. Net outflows in the current transfers account declined as a result of lower remittances by foreign workers.

C.Exchange Rate

The monetary framework in 2003 continued to operate under a pegged exchange rate regime. The ringgit remained fixed at RM3.80=US$1, an arrangement that has been in place since September 1998. In 2003, the ringgit remained close to its fair value and has been well supported by strengthened economic fundamentals. In 2003, the system of a fixed exchange rate for ringgit at RM3.80 to US$1 was maintained with strengthening economic fundamentals. The fixed exchange rate regime has been in place for the sixth year since it was introduced in September 1998. Amidst volatility in the foreign exchange markets and debates on effects of the volatility of major currencies on the ringgit peg, the ringgit continues to fulfil its intended objective of supporting the expansion of trade and investments in Malaysia. Developments in the ringgit foreign exchange market were driven mainly by the depreciation of the US dollar and the consequent realignments in the currencies of most major and several regional economies. Throughout the year, the US dollar was mainly affected by concerns over the large US current account deficit and the positive interest rate differentials in favour of other major economies. The corresponding adjustments to the US dollar were seen mainly in major currencies, including the Australian dollar, the Canadian dollar and the euro, which appreciated by 32.7%, 21.7% and 20% in 2003. The yen and pound sterling appreciated to a lesser degree of 11% and 11.1% respectively.

Given the pegged exchange rate regime, the ringgit depreciated against the euro (-16.7%), the pound sterling (-10%) and the yen (-9.9%), along with the US dollar in 2003. The ringgit depreciated to a lesser extent against most regional currencies in the range of 2 – 8%. Against the Korean won and the Philippine peso, the ringgit appreciated. The ringgit remained stable against the Chinese renminbi and the Hong Kong dollar, as these currencies are also pegged to the US dollar.

Despite considerable volatility in the foreign exchange market, the pegged exchange rate regime has remained sustainable with the ringgit close to its fair value. There are no signs of the ringgit being Misaligned. The ringgit peg, on balance, continues to provide significant advantages to the overall economy. The stability of the exchange rate has been effective in improving the longer-term competitiveness of the Malaysian corporate sector by creating incentives for structural adjustments to increase productivity, thereby enhancing the country's future growth prospects.

Table 4 Exchange Rates of the Malaysian Ringgit*

End of period	100 unit					1 unit				
	Singapore/ Brunei $	Indonesian Rupiah	Thailand Baht	Philippines Peso	Japanese ¥	US $	Euro #	British £	AU$	SDR[n]
1998	228.79	0.05	10.36	9.71	3.31	3.80	-	6.33	2.33	5.35
1999	228.09	0.05	10.12	9.48	3.71	3.80	3.83	6.14	2.48	5.21
2000	219.46	0.04	8.78	7.61	3.31	3.80	3.53	5.67	2.11	4.95
2001	216.86	0.04	8.60	7.36	2.90	3.80	3.37	5.52	1.93	4.77
2002	218.87	0.04	8.81	7.15	3.20	3.80	3.98	6.09	2.15	5.15
2003										
Jan.	218.68	0.04	8.89	7.06	3.19	3.80	4.11	6.29	2.23	5.22
Feb.	218.65	0.04	8.91	6.97	3.23	3.80	4.09	6.00	2.30	5.22
Mar.	215.23	0.04	8.86	7.09	3.18	3.80	4.11	5.99	2.29	5.18
Apr.	214.21	0.04	8.87	7.23	3.18	3.80	4.22	6.06	2.37	5.23
May	215.21	0.04	9.10	7.14	3.21	3.80	4.51	6.28	2.48	5.38
June	216.31	0.05	9.05	7.10	3.17	3.80	4.35	6.28	2.54	5.32
July	215.94	0.04	9.05	6.94	3.16	3.80	4.31	6.15	2.48	5.32
Aug.	216.27	0.04	9.23	6.91	3.24	3.80	4.13	5.99	2.43	5.21

*Interbank rates at 12.00 noon in Kuala Lumpur (rates are an average of the highest buying and lowest selling quotes)
[#] Euro was introduced in January 1999
[n]Special Drawing Rights

D. Foreign Direct Investment

In 2003, the total amount of foreign investment in approved projects records RM 15638 millions (2002: RM 11578) amongst which 24.8 % comes from the United Kingdom, United States 14.0%, Japan 8.3% and Singapore 7.8%. Malaysia' strength in fundamentals such as trade openness, legal protection of patents, low tax rates, commitment to market pricing, a highly educated workforce, an efficient and diversified financial system for raising long-term capital, strong corporate governance, well-developed infrastructure and a wide array of tax incentives continue to be recognised as strong points in attracting FDI. While previous policies were more broad-based in nature, incentives have been repackaged and are increasingly customized and tailor-made for specific investors and industries. There are three broad philosophies governing policies specific to FDI:

- Tax and non-tax incentives to promote specific industries;
- Sequential liberalization of sectors in terms of market access, regulations governing employment of expatriates, equity ownership and relaxing rules and regulations; and
- Improvement in the administrative processes and minimize costs of establishing and operating a business enterprise in Malaysia.

Table 5 MITI Approved Projects

	Unit	1990	1999	2000	2001	2002	2003
MITI Approved Projects							
Number of projects approved		906	725	805	928	792	965
Potential employment	000s	169.8	65.9	88.1	89.4	64.7	77.2
Proposed called-up capital	RM mil	9679.1	3162.8	3577.8	4142.2	2498.4	6578.7
Loans	RM mil	18489.0	7532.5	15694.7	9971.5	5336.8	12843.5
Total proposed capital investment	RM mil	28168.1	17020.8	33610.3	25774.9	17876.9	29096.0
Foreign Investment In Approved Projects (By Selected Countries) (% of total)							
Australia		0.3	0.4	0.7	0.8	0.9	0.7
France		0.1	0.1	0	0.4	0.6	0.3
Japan		23.9	8.2	14.5	17.8	5.1	8.3
Singapore		5.1	7.4	9	11.8	8.8	7.8
Taiwan		36.0	2.2	4.6	6.0	2.2	4.0
United Kingdom		4.9	1.6	3.9	0.7	1.5	24.8
United States		3.2	42.1	37.8	18.0	23.0	14.0
Germany		0.7	1.5	8.3	13.8	43.7	1.1
Others		25.8	36.6	21.2	30.7	14.2	39.2
TOTAL	**RM mil**	**17629.1**	**12273.8**	**19848.5**	**18907.2**	**11578**	**15638.0**

Source: Ministry of International Trade & Industry (MITI)

Within this framework, there are a wide range of measures that are specific, targeted and, most importantly, benefit investors. Further, as the investment framework is goal-oriented rather than incentive-oriented, incentives are regularly fine-tuned to meet investor needs through the existing mechanism for consultation between the Government and the MNCs. This is acknowledged by the 2003 World Competitiveness Yearbook, which ranked Malaysia as second best in the world in terms of firms' perception of the ability of the Government to adapt policy to changes in the economy. In addition to fiscal and other specific incentives, the sequential sector liberalization measures offer new opportunities to foreign investors, in both the goods and services sectors.

Gross foreign direct investment (FDI) in Malaysia was higher in 2003 at RM21.8 billion (2002: RM20.5 billion), reflecting largely broad-based inflows into the services and manufacturing sectors, as well as the oil and gas sector. On a net basis, however, FDI moderated to RM9.4 billion or 2.5% of GNP in 2003 (2002: RM12.2 billion), due largely to the acquisition of foreign interests in the oil and gas sector by a Malaysian company upon the expiry of joint venture contracts, as well as large loan repayments to parent companies abroad.

Malaysian direct investment abroad remained large, albeit at a moderately lower level, at RM5.2 billion in 2003 (2002: -RM7.2 billion) after several major overseas acquisitions in 2002. Investment abroad was mainly to diversify and reinforce principal activities in Malaysia. Notably, the scope of investment has become increasingly broad-based. A large share of overseas investments was channelled into both the oil and gas and services sectors, followed by the manufacturing sector. In the oil and gas sector, Malaysia continues to operate through 64.2%. Foreign patients were mainly from Indonesia (72.5%), other ASEAN countries, West Asian countries and Japan.

The UNCTAD World Investment Report 2003 listed Malaysia as one of the top ten economies that had defied the global FDI slowdown in 2002. Similarly, the A.T.Kearney FDI 2003 report stated that Malaysia has enhanced its attractiveness as a destination for FDI, by improving to 23rd position (previous: 42nd) in the overall FDI confidence index. More specifically, Malaysia is in the top ten positions for FDI in primary industries as well as improving its standing in sectors such as electronics, mining, petrochemical, stone/glass and chemicals/plastics sectors and consultancy.

E. Borrowing and Aid from Abroad

Prudent external debt management strategy remained an integral part of macroeconomic policy in 2003. Malaysia continues to maintain an active external debt management strategy, which incorporates the guiding principles that minimise risk with balanced currency and maturity profile. Prudential regulations to achieve these objectives have been effective in keeping the nation’s external debt low and its risk profile balanced

In 2003, total external debt outstanding increased marginally by 0.9% to RM 187.2 billion (US$49.3 billion). The increase in external debt reflected mainly a small net borrowing by the private sector and the exchange revaluation loss, arising from the weakening of the US dollar. External debt of the public sector, comprising the Federal Government and NFPEs, declined in 2003 due to significantly higher net repayment and prepayment. The external debt to GNP and exports of goods and services ratios improved further to 50.7% and 40.4% respectively (2002: 55.3% and 44.3% respectively). Accordingly, the overall debt service ratio (excluding prepayments) declined to 6.1% in 2003 (2002:6.7%). Of significance is that the share of short-term debt to total debt continued to remain low, accounting for only 18.4% of total external debt. The ratio of short-term debt to international reserves also improved further, to account for 20.2% of reserves (end-2002: 24.4%).

The outstanding medium and long-term external debt was sustained at RM152.8 billion (US$40.2 billion) at the end of 2003 (2002: RM153.6 billion). Amidst lower drawdown (-12.1%), repayment of medium and long-term loans increased significantly by 25.1%. For the first time since 1992, the public sector recorded a large net repayment of RM11 billion (2002: +RM4.7 billion), reflecting net repayments by both the Federal Government (-RM3.7 billion) and NFPEs (-RM7.3 billion). Meanwhile, the private sector debt turned around to register a net borrowing of RM3.1 billion (2002: -RM4 billion). Nevertheless, after taking into account an exchange revaluation loss of RM4.1 billion following the appreciation of major currencies, particularly the euro and yen against the US dollar, and a reclassification of a domestic foreign currency loan raised previously from an offshore bank in the Labuan International Offshore Financial Centre into an external loan, the medium and long-term loans declined only marginally by RM0.8 billion.

In 2003, short-term external debt (maturity of one year or less) rose by RM2.4 billion to RM34.5 billion (US$9.1 billion), reflecting largely the increase in external borrowing by the banking sector, particularly in the second quarter. The bulk of the medium and long-term debt continued to be denominated in US dollars (stabilised at 77% as at end 2003), as settlements for trade and investment were mainly in US dollars. The appreciation of the yen and euro in 2003 has therefore led to only a small exchange revaluation loss equivalent to 2.6% of the total medium and long-term debt. In 2003, the share of yen denominated debt declined marginally to 13%

(2002: 14%) due partly to a bullet payment of a yen denominated loan by the Federal Government, while that of the euro increased marginally to 5% (2002: 4%). The remaining 5% of the debt was denominated in other international currencies, including the pound sterling, Swiss franc and Singapore dollar.

Table 6 External Debt

End Period	Total	External debt outstanding							External debt service ratio[1]	
		Medium and long term-debt				Short-term debt				
		Federal Government	NFPEs	Private Sectors	Sub-total	Banking sector[2]	Non-bank sector	Sub-total	Total	Federal Government
	RM million								%	
1999	162133	18369	57021	64315	139706	12661	9766	22427	6.3	0.7
2000	161065	18821	59566	65077	143465	9271	8329	17626	5.8	1.2
2001	173419	24326	67415	57604	149346	11926	12147	24072	6.8	0.5
2002	185643	36283	64330	52974	153587	21894	10162	32055	6.7	1.0
2003p	187250	37284	59558	55946	152788	24597	9865	34462	6.1	1.2

[1]Data on MAS was included under private sector up to 2000 and under NFPEs from 2001

[2]Excludes currency and deposits held by non-residents with resident banking institutions

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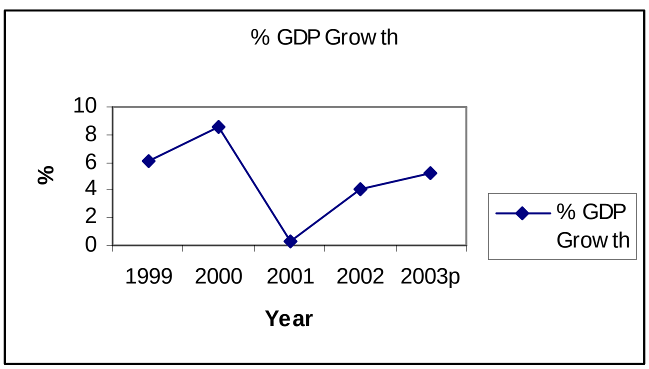
2. Domestic Environment

A. Economic growth

Figure 1



Source: Bank Negara Malaysia

In 2003 the Malaysian economy demonstrated greater resilience in the face of uncertainties to expand by 5.2%, more rapidly than previously forecast. The real gross domestic product (GDP) expanded by 5.2% (2002: 4.1%), exceeding the official forecast of 4.5%.

During the high growth years of the early 1990s, actual output closely followed its potential. Amidst the pronounced contraction in output experienced after the Asian financial crisis, the output gap had widened significantly in 1998 but as the economy recovered, the gap narrowed. In 2002, the output gap was 4.8% compared to 6.9% in 2001. Subsequently, in 2003, the stronger pickup in economic activity compared to the growth in potential output led to a further narrowing of the output gap. Bank Negara Malaysia' latest estimates of potential output indicated that actual GDP increased at a faster pace (5.2%) compared to potential GDP (3.4%). Nevertheless, the faster growth of GDP did not exert inflationary pressures as actual GDP would have to increase by more than 8% before the output gap could be bridged in 2003. The potential growth rate doubled in 2003, due mainly to stronger growth in capital investment (2.7%; 2002: 0.3%) as business sentiment improved amidst higher capital utilisation rates in selected sectors of the economy.

The estimated short-run elasticity of capital is significantly higher than the short-run elasticity of labour, implying that changes in capital have a greater impact on output and that returns to capital have continued to improve. This has encouraged firms to accelerate their investment activities, including the upgrading of technological capabilities that, in turn, could have had an immediate impact on output. In line with previous findings, the long-run elasticity of capital, which is estimated to be 0.50, is higher than its short-run counterpart. This higher return to capital implies more efficient capital utilisation, as calculated by the ratio of output to capital, which has had a faster rate of increase compared to the ratio of output to labour. Previous supportive infrastructure investments, which have long gestation periods, have begun to show positive returns, while stronger investment activities were visible in the services sector, mainly in technology and logistics infrastructure. With the greater focus and emphasis placed on a knowledge-driven economy, expectations are for potential output to expand further.

B.Inflation Rate

Table 7 Price Indicator

	Weight	2002	2003
Consumer Price Index	Annual change %		
(2000=100)	**100**	**1.8**	**1.2**
Of which:			
Food	33.8	0.7	1.3
Beverages and tobacco	3.1	4.2	1.6
Clothing and footwear	3.4	-2.3	-2.0
Gross rent, fuel and power	22.4	0.7	0.9
Furniture, furnishings and household equipment and operation	5.3	-0.4	0.6
Medical care and health expenses	1.8	2.4	1.7
Transport and communication	18.8	6.6	1.6
Recreation, entertainment, education and cultural services	5.9	0.2	0.6
Miscellaneous good and services	5.5	1.1	1.3
Producer Price Index (1989=100)	**100**	**4.4**	**5.8**
Of which:			
Local Production	79.3	5.7	7.0
Imports	20.7	-0.7	0.9

Source: Department of Statistics, Malaysia

Inflation remained low and stable in 2003 in spite of higher domestic demand supported by pro-growth measures of the Government. Generally, there is an absence of pressure on the general price level. Although capacity utilization is higher in tandem with improving economic prospects, excess capacity still prevails in some sectors of the economy. Declining import prices further restrained increases in domestic price levels. The environment of low inflation, since 1999 averaging below 2%, has provided the Government the flexibility to implement pro-growth policies to stimulate economic activities and to sustain the growth momentum.

The overall inflation rate, as measured by the annual change in the Consumer Price Index (CPI), was slightly lower at 1.2%, compared with 1.8% in the previous year. Core inflation, which is inflation excluding price-controlled and price-volatile items as well as items that are subject to one-off price adjustments, remained broadly stable at 0.6% in 2003 (2002: 0.5%). Several factors combined to ensure that inflation was benign. While domestic demand strengthened, excess capacity in selected sectors and the absence of wage cost pressures, amidst improving labour productivity, helped to contain price pressures. Small price adjustments, in March 2003, in retail prices of petrol, diesel and cooking gas and telephone rental contributed to about 0.4 percentage point to the overall inflation during the year.

Transport and communication prices moderated significantly in 2003 due in part to the higher base in 2002, despite higher prices of petroleum and petroleum-related products. Prices for clothing and footwear, furniture, furnishing and household equipment continued to decline during the year amidst increased capacity and rising competition from imported goods.

Stronger demand was reflected mainly in higher prices for food, rental, fuel and power. Generally, higher prices for food items reflected stronger demand amidst higher commodity prices, and higher prices for selected imported food items. Meanwhile, the increase in rental was moderate. Rental for lower-end houses rose by 1%, while the increase for the higher-end houses was 0.8%.

Producer prices, as measured by the Producer Price Index (PPI), rose at a higher annual rate of 5.7% in 2003 (2002: 3.7%), reflecting largely higher prices for commodity-related products, following higher prices of crude palm oil, rubber and crude petroleum. Excluding commodity-related products, producer prices remained subdued, increasing by 0.5% (2002: 0.1%). Prices paid for imported goods increased by 0.8% (2002: -0.7%), reflecting mainly higher petroleum prices and the appreciation of major currencies against the ringgit.

C: Consumption

Domestic demand conditions strengthened further in 2003, as the economy successfully weathered the uncertainty in the external environment, including the outbreak of SARS and the geopolitical tensions in the first half of the year. Growth was driven mainly by stronger private sector activities and supported by public sector expenditure. The improved external environment in the second half-year, which led to rising consumer and business confidence, as well as the positive effects of the Government' Economic Package translated into higher private sector activities. The low interest rate environment, stable employment prospects, high commodity prices, improvement in corporate cash flow positions as well as further liberalisation of foreign equity ownership in the manufacturing sector reinforced the positive spill-over benefits from the Economic Package. As a result, the private sector resumed its role as the main driver of growth in 2003, led by the strengthening in consumer spending and a recovery in private investment. Meanwhile, growth in public sector expenditure moderated with the Government continuing to provide an enabling environment to support private sector activities. Overall, growth in aggregate domestic demand (excluding stocks) strengthened to 4.8% from 4.2% in 2002. Further improvement in consumer confidence arising from higher disposable income, better job prospects and low interest rate will encourage stronger private consumption.

Table 8 Consumption

(RM million)

	1999	2000	2001	2002	2003p
Consumption at Current prices	**158100**	**181031**	**192741**	**209521**	**223706**
Private consumption	125056	145355	150644	159506	169813
Public consumption	33044	35676	42097	50015	53893
Consumption at Constant 1987 Prices	**107862**	**119238**	**125549**	**133282**	**140927**
Private consumption	84377	95370	97630	101946	107111
Public consumption	23485	23868	27919	31336	33816

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

D. Employment

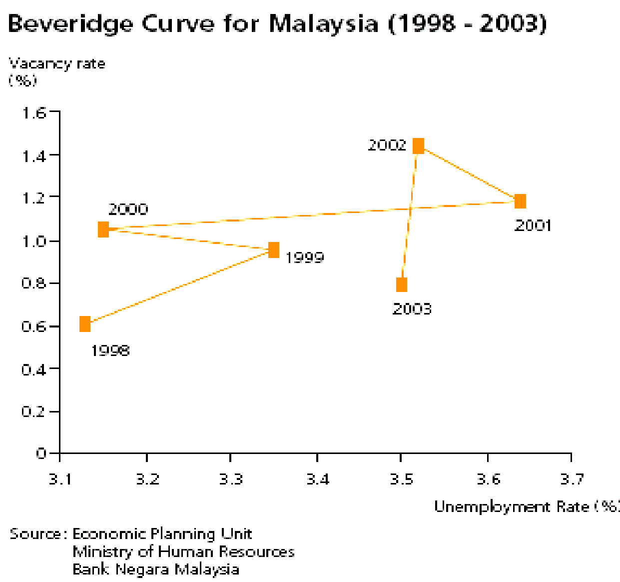
The domestic labour market conditions remained stable and healthy. In 2003, overall growth in total employment and the labour force expanded moderately by the same rate of 3.3% to 10.2 million workers and 10.5 million persons respectively. The unemployment rate remained low at 3.5%. Further measures were undertaken in 2003 to improve the quality of labour, narrow the skills mismatches and address the changing demands of the economy.

Table 9 Labour Market Indicators

	1999	2000	2001	2002	2003e
Labour force ('000)	9177.8	9572.5	9892.1	10198.8	10535.3
(annual change in %)	3.7	4.3	3.3	3.1	3.3
Employment('000)	8869.6	9271.2	9532.5	9840.0	10166.2
(annual change in %)	3.5	4.5	2.8	3.2	3.3
Unemployment rate (%)	3.4	3.1	3.6	3.5	3.5
Labour productivity (GDP/Employment)					
(annual change in %)	2.6	3.9	-2.4	0.9	2
Real wage per employee in manufacturing sector					
(annual change in %)	3.1	5.0	1.6	3.2	2.6

e Estimates
Source : Department of Statistics, Malaysia,
Economic Planning Unit and Bank Negara Malaysia

Figure 2



The Beveridge Curve, which tracks the pattern of unemployment and vacancies in the labour market, shifted downwards and inwards in 2003, indicating lower turnover in the labour market and increased efficiency in the worker-job matching process. This was corroborated by the findings of other surveys. The Salary, Benefits and Employment Conditions Survey in the Manufacturing Sector conducted by the Federation of Malaysian Manufacturers (FMM) showed that the overall average monthly turnover rate was lower at 1.76% in 2003 (2002: 4.1%). Similarly, the Salary and Fringe Benefits Survey undertaken by the Malaysian Employers

Federation (MEF), which also included firms from the non-manufacturing sectors, showed that the overall average monthly turnover rate remained low at 1.76% in 2003 (2002: 1.66%).

The low turnover in the labour market was also reflected in data on vacancies and retrenchment for 2003, while data on placements and unplaced job seekers mirrored the efficiency in the job matching process. Growth in the number of vacancies reported, which were mainly in the manufacturing, agriculture, services and construction sectors, moderated by 40% to 96,918 (2002: 162,787). Retrenchments, which occurred mainly in the manufacturing and tourism-related sectors, were also lower by 20% (21,206 persons; 2002: 26,452). The main reasons for retrenchment included reduction in demand for products, company reorganisation and closure of company. Other reasons included completion of projects, reduction in production and employment, and outsourcing. Growth in the number of placements during the year moderated by 16%, although the slowdown in the growth of vacancies was higher. Concurrently, the number of registered unplaced job seekers reached 28,404 at end-2003, the lowest since January 2001. Both developments indicate greater efficiency in the matching of workers to jobs available.

E. Investment

Reflecting the public sector' role of providing a supportive environment for private sector activities, public investment continued to increase in 2003, albeit moderately. The increase in public investment reflected higher outlays to improve and upgrade the country' infrastructure, including roads and highways, and rail, port and airport facilities. Higher outlays were also expended on the construction and upgrading of hospitals as well as rural and health clinics. In addition, expenditure on agriculture and rural development increased in 2003 in line with the Government' effort to modernise the agriculture sector and to narrow income disparities between urban and rural areas by encouraging agro-based industries. A large share of the expenditure continued to be channelled towards education and training, especially skills development and training in technical fields and on information and communication technology to facilitate the move towards a knowledge-based economy. This is in line with the Government's continuous efforts to encourage the private sector, particularly domestic investors, to venture into new growth areas, including the services and agriculture sectors. More buoyant activities are anticipated for high value-added industries as well as information technology, telecommunications, transport and finance. It is also envisaged that SMEs will respond positively to the Government's strategies and measures, including the recent Package of New Strategies towards stimulating the nation's economic growth, with funding continuing into 2004.

Table 10 Investment

(RM million)

	1999	2000	2001	2002	2003p
Investment at Current prices	**65841**	**87729**	**83345**	**83764**	**87089**
Private investment	31375	44102	34528	30066	30785
Public investment	34466	43627	48817	53698	56304
Investment at Constant 1987 Prices	**51568**	**64840**	**63050**	**63249**	**64960**
Private investment	24574	32596	26120	22702	22956
Public investment	26994	32244	36930	40547	42004

p Preliminary

Source: Department of Statistics, Malaysia and Bank Negara Malaysia

Of significance, private investment turned around to record positive growth beginning from the third quarter of 2003. For the year as a whole, private investment increased by 1.1% following two years of contraction. The expansion in private sector investment reflected the improvement in business confidence, particularly in the second half-year. In addition, improved capacity utilisation due to rising external demand and higher production underpinned capital spending activities, particularly in the manufacturing sector. Other factors supporting the improvement in investment activities were the low interest rates as well as improved profitability and cash flow positions of companies in line with higher sales and profits.

F. Stock Exchange

In 2003, the Kuala Lumpur Stock Exchange Composite Index (KLSE CI) ended the year on a stronger note, following stronger economic growth and improved economic outlook. For the year as a whole, the KLSE CI registered a strong annual growth of 22.8%, while average daily trading activities rose significantly by 103.3% in terms of volume and by 58.5% in value. The higher turnover was supported by both higher retail and institutional participation.

Table 11 Kuala Lumpur Stock Exchange: Selected Indicators

	2001	2002	2003
Price Indices			
Composite	696.09	646.32	793.9
EMAS	165.23	157.3	195.6
Second Board	134.13	98.2	140.6
MESDAQ	88.08	83.3	152.3
Total turnover			
Volume(billion units)	204.4	55.6	112.2
Value (RM million)	349.8	117.0	183.9
Market Capitalisation (RM billion)	465	481.6	640.5
Total No. Of Companies Listed	812	865	906
Main Board	520	561	598
Second Board	292	292	276
MESDAQ	5	12	32

Source: Kuala Lumpur Stock Exchange

The performance of the KLSE in the first four months was subdued, with sentiments affected by uncertainties on the global economic outlook. Market sentiments turned more positive since May, driven by improved economic outlook, stronger corporate earnings and significant progress achieved in corporate restructuring. Policy measures introduced by the Government to promote capital market developments also created a more conducive environment for Investors.

The Malaysian Exchange of Securities Dealing & Automated Quotation (MESDAQ) Market Composite Index (MCI) was the best performing index in 2003. The MCI posted a substantial gain of 82.9% (-5.5% as at end-2002). The strong performance of the index and higher trading activities were due to increased new listings of small but high-growth potential companies. The Second Board Index also posted a significant gain of 43.2%, reflecting investors' preference for smaller companies with higher potential for earnings growth. Listed stocks on the Main Board saw more moderate price performances across all Sectors. Total funds raised were, however, lower at RM7.8 billion compared with RM13.3 billion in 2002 due to the small size of the initial public offerings (IPOs). The new funds were mainly raised through IPOs (51%) and rights issues (29.4%). A total of 58 new companies was listed, the highest number since 1998. Of this total, 16 companies were listed on the Main Board, 22 on the Second Board and 20 on the MESDAQ Market. Prices of 52 new listings traded at a sizeable premium over the offer prices at the end of the first day of trading, influenced mainly by widespread investor interests and more active retail trading activities. The total number of companies listed on the KLSE was 906 as at end- 2003, the second largest number of listed companies on a stock exchange after Hong Kong China in the East Asian region, excluding Japan. The liberalisation of the listing policy to allow the listing of

Malaysian businesses abroad and foreign-based businesses with Malaysian operations resulted in the listing of a large foreign company on the KLSE. The IPO, which raised RM2.03 billion, was the largest in 2003.

II. Fiscal Position

A. Government Expenditure & Public Borrowing

The Government presented on 20 September 2002 a moderately expansionary budget for 2003. The fiscal deficit was, therefore, budgeted at 4% of GDP, lower than the fiscal deficit of 5.6% in 2002.

The actual outturn of fiscal deficit for 2003 was 5.3% of GDP, due mainly to counter-cyclical expenditure to support growth. Revenue performance was strong in 2003 with higher proceeds from the sale of Government's shares in selected public listed companies. The Federal Government debt amounted to 48.2% of GDP as at end-2003.

Table 12 Federal Government Revenue

(RM million)

		2000	2001	2002	2003p
Tax Revenue		47173	61492	66860	64891
% of GDP		13.9	18.4	18.5	16.6
Direct taxes		29156	42097	44351	43016
	Income taxes	27016	40135	42237	40690
	Companies	13905	20770	24642	23990
	Petroleum	6010	9858	7636	8466
	Individuals	7015	9436	9889	7984
Others		87	70	69	251
Real property gains tax		247	227	319	264
Stamp duties		1799	1650	1732	2008
Others		94	85	63	53
Indirect taxes		18017	19395	22509	21875
	Export duties	1032	867	803	1157
	Import duties	3599	3193	3668	3919
	Excise duties	3803	4130	4745	5031
	Sales tax	5968	7356	9243	7965
	Service tax	1701	1927	2214	2038
	Others	1914	1922	1836	1765
Non-tax revenue		14691	10075	16655	27913
Total revenue		61864	79567	83515	92804
% of GDP		18.2	23.8	23.2	23.7

p Preliminary
Source : Ministry of Finance

Federal Government Finance**.** The Federal Government registered an overall deficit of 5.3% of GDP in 2003 (2002: -5.6%), higher than the 4% targeted in the 2003 Budget. Despite the higher fiscal deficit, the total debt of the Federal Government remained manageable at 48.2% of GDP as at end-2003. External debt to GDP ratio declined in 2003 as the bulk of financing was raised from non-inflationary domestic sources. In 2003, Federal Government revenue increased by 11.1% to RM92.8 billion, accounting for 23.7% of GDP. The better revenue performance was due to significantly higher non-tax revenue, which accounted for a larger share of total revenue (30%).

Higher receipts were registered in almost all components; investment income, licence and permits, petroleum royalties and service fees. In particular, investment income was higher due to proceeds from the sale of the Government's shares in selected public listed companies. The Government disposed of some of its assets to optimise returns from the ownership of high-value assets and achieve a greater flexibility in fiscal Management. Collection from taxes declined slightly by 2.9% (-RM2 billion), mainly attributable to lower receipts from income taxes and sales tax on petroleum products.

Tax initiatives included the reduction of the tax rate from 28% to 20% on chargeable income of up to RM100,000 for small and medium-scale companies and the suspension of income tax instalment payments for travel agencies beginning 1 June to 31 December 2003. Additionally, the lower company income tax collection was due to the implementation of the current year tax assessment system in 2000 and self-assessment system in 2001. As companies overpaid income taxes during the transition period, these were set off against tax expenses in 2003. Meanwhile, petroleum income tax rose by 10.9% due mainly to higher crude oil prices. Import and excise duties collected were higher reflecting the stronger aggregate domestic demand. Other indirect taxes collected, namely sales and service tax, were lower. In particular, the lower sales tax was due to the higher tax exemption for petroleum products. In 2003, a higher tax exemption was provided to oil companies to stabilise the retail prices of petroleum products. The weighted average price of Malaysian crude oil was higher at US$30.30 per barrel in 2003, compared with US$25.24 per barrel in 2002. The decline in service tax collected (-7.9%) was mainly the result of tax exemption. In the restaurants and hotels sub-sector, the exemption on service tax was granted for the period June-December 2003. In the 2003 Budget, courier services and selected professional services provided to companies within the same group were given tax exemption. The expansionary budgetary operations and the Government's Economic Package implemented in May to support growth and strengthen further the long-term productive capacity of the economy resulted in gross expenditure rising by 9.5% to RM114.6 billion.

Operating expenditure, which accounted for two thirds of total Federal Government expenditure, increased by 9.5% to RM75.2 billion. The total wage bill, which was the largest component of operating expenditure (29%), was higher, due to the implementation of the Malaysian Remuneration System as well as the payment of monthly critical allowances for doctors and medical staff arising from the outbreak of SARS. While debt-service charges increased, their share to operating expenditure was contained at 14% (2002: 14.1%). Outlays on supplies and services were higher due to measures introduced to enhance productivity and efficiency (increased expenditure for professional services and small repairs and maintenance). Other transfer payments were higher due mainly to grants and transfers to Government agencies for development and maintenance purposes. Payment for subsidies in 2003 was lower. As part of the Government's policy to reduce the subsidy on petroleum products, the retail prices of petrol, diesel and liquefied petroleum gas (LPG) were raised by two sen with effect from 1 March.

During the year, gross development expenditure rose by 9.4% to RM39.4 billion. The bulk of the outlays were extended to the social and economic services sectors (80%). As in the past, the thrust of expenditure was on human resource development. In 2003, education and training expenses continued to be the largest component of development expenditure (26% of total). Expenses were channelled mainly towards constructing and upgrading schools, matriculation centres, polytechnics and other institutions of higher learning as well as for computerisation programmes and the acquisition of teaching aids. Meanwhile, the construction of new hospitals as well as upgrading existing hospitals and rural and health clinics were the main factors accounting for the increase in spending for health. Expenditure on housing was also higher as the Government continued to implement housing programmes for public sector personnel and the lower income group. The Government also increased spending on social and community services, mainly for youth programmes, small projects in new local housing estates, development work carried out in Putrajaya and Cyberjaya and acquisition of vehicles for community work. In the economic services sector, a higher amount was spent on transportation, mainly in constructing new roads and bridges, upgrading existing roads and improving and increasing the capacity of the railroad system, ports and airports. Spending under the trade and industry sub-sector was focussed on the provision of infrastructure facilities, promotion of small and medium-sized industries (SMIs), industrial research and technological development and promotion of tourism.

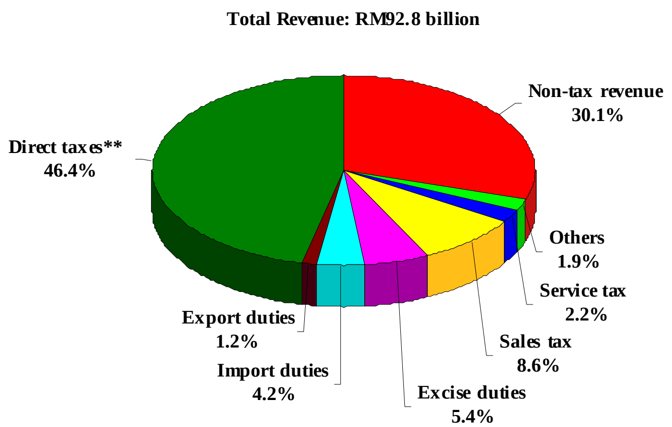
The increase in expenditure for general administration was largely to cater for ICT development in various Government agencies to further improve the quality and delivery of services. Spending for defence and internal security was mainly under the modernisation programme for the armed forces and police.

Federal Government total debt outstanding increased by 14.4% to RM188.8 billion or 48.2% of GDP as at end-2003. Higher borrowings from the domestic market resulted in domestic debt outstanding rising to RM151.5 billion as at end-2003 or 38.6% of GDP (35.7% of GDP). The bulk of Government's financing requirements (93%) was financed from domestic sources. Recourse to external borrowings was limited to the drawdown of loans while several external loans were refinanced to take advantage of tighter spreads arising from Malaysia's improved ratings. In 2003, total gross borrowings of the Federal Government amounted to RM45 billion, compared with RM28.5 billion in 2002. The higher gross funds raised was to finance both the fiscal deficit as well as to roll-over maturing debt. Net borrowings of the Federal Government rose to RM19.5 billion, from RM14.1 billion in 2002. Malaysian Government Securities (MGS) with maturities of 5 and 10 years were issued at coupon rates ranging between 3.702-3.917% (3.15- 4.053% for funds raised in 2002) and between 4.24-4.41% for those with a maturity of 15 years. There were no issues of 15-year MGS in 2002. During the year, the Federal Government floated twelve issues of MGS totalling RM39.9 billion by open tender through principal dealers and private placements and raised a single issue of the Government Investment Issues (GIIs) amounting to RM2 billion. The issuance of Treasury Bills (TBs) facilitated the roll-over of maturing bills. MGS issued continued to be absorbed mainly by provident, pension and insurance funds (76% of the outstanding MGS), while the ownership of GIIs and TBs was mainly dominated by the banking sector (94% and 76% of the respective amounts outstanding). After taking into account repayments, the net domestic borrowing of the Federal Government as at end-2003 amounted to RM23.3 billion.

Overall, the Federal Government registered a net repayment of RM3.7 billion in 2003. Due to the Government's restraint on recourse to external borrowings and the prepayment exercise, the share of external debt outstanding to GDP declined to 9.5% of GDP (10.1% of GDP in 2002). The debt servicing expenditure remained within prudent levels. Debt charges as percentage of operating expenditure, revenue and GDP were kept low at 14%, 11.4% and 2.7% respectively in 2003 (2002: 14.1%, 11.6% and 2.7% respectively). The external debt service ratio of the Federal Government also remained low at 1.3% in 2003 (2002: 1%) while foreign exposure declined to account for 20% of the total debt outstanding (2002: 22%). Proactive and sound debt management enabled the Government to avoid a bunching of repayments. As at end-2003, about 60% of loans outstanding had a remaining maturity exceeding three years and most were at fixed interest rates, reducing exposure to fluctuations in interest rates.

Figure 3

Composition of Federal Government Revenue, 2003 (% share)

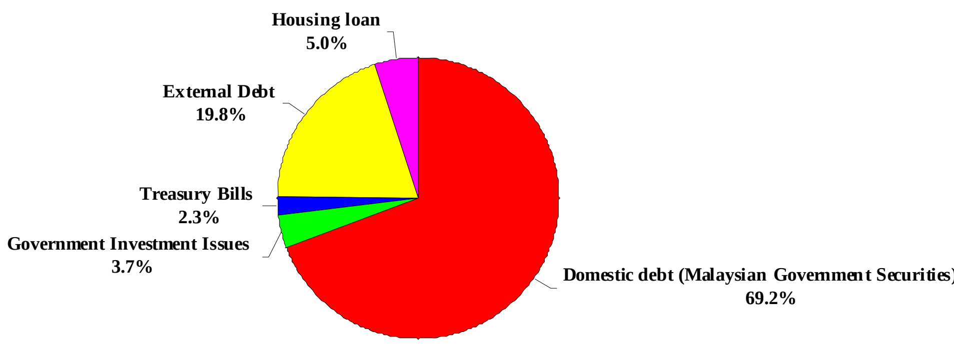


**Direct Taxes:
Companies: 25.9%
Petroleum: 9.1%
Individuals: 8.6%
Others: 2.8%

Source: Bank Negara Malaysia

Figure 4

Federal Government Outstanding Debt as at end-2003p (% share)



Total Debt: RM188.8 billion
Domestic: RM151.5 billion
External: RM37.3 billion

p Preliminary
Source: Bank Negera Malaysia

III. Tax Structure: Institution and The Reality

Taxation is stipulated by Article 96 of the Constitutional Provisions. Tax revenue is a main source of income for Malaysia. All revenues and money raised and received by the federation are to be paid to the consolidated fund. However, revenue from lands, mines and forest, receipts from water supply, zakat, fitrah and baitulmal (religious revenue) and entertainment duty are dues assigned to the states.

Taxation is one of the economic tools used by the government to ensure sustained and continuous economic growth. The Tax Analysis Division within the Ministry of Finance is responsible for the analysis and formulation of tax policies and tax incentives for the economy of the nation. The Malaysian government generally imposes two broad types of taxes, namely direct and indirect taxes. Apart from income tax (individual, company and petroleum) where as the other direct taxes are stamp duty, real property gains tax and Labuan Offshore business activity tax. Indirect taxes comprises of sales tax, service tax, excise duty, import duty and export duty.

While the direct tax is administered by the Inland Revenue Board of Malaysia while the direct taxes fall under the jurisdiction of the Royal Customs and Excise Department.

A. Tax Administration – Direct Tax

The Malaysia Income Tax legislation was drafted by R.B. Heasmen and became the Income Tax Ordinance 1947, effective from 1 January 1948. The 1947 Ordinance was subsequently repealed and replaced by the Income Tax Act 1967 which came into effect on 1 January 1968. Prior to 1st March 1996, the Department of Inland Revenue is a government agency under the Ministry of Finance. But in 1996 it was then revamped into a statutory body under the Inland Revenue Board of Malaysia Act 1995 to give it more autonomy especially in financial and personnel management, to improve the quality and effectiveness of tax administration. The members of the IRB Board (who will be appointed by the Minister) are Chairman (ex-officio) (Secretary General to the Treasury), Attorney General or his representative, Director General of Public Service Department or his representative, 2 other persons representing the Government and 2 other persons from private sector.

The care and management of tax is in the hands of the Chief executive / Director General of Inland Revenue who is appointed by the Minister for Finance. With effect from 1 August 1997, the chief executive officer of the IRB will be appointed as the Director General.

The IRB is responsible for the administration of direct taxes under the Income Tax Act 1967, Petroleum (Income Tax) Act 1967, Promotion Investment Act 1986, Real Property Gains Tax Act 1976, Stamp Act 1949 and Labuan Offshore Business Activity Tax Act 1990.

Under the Act, every person who is chargeable to income tax is required to file a return of his income with the IRB. The main types of return forms issued by the IRB are Form B (resident individuals), form M (non-resident individuals), form C (companies), form C1 (co-operative societies), form P (partnerships), form T (trusts, deceased persons' estates, clubs, association, societies and other bodies of person and form E (employers).

After the Malaysian Currency crisis in 1999, a major tax reform measure to modernise and streamline the tax administration system was necessary. The reform main feature was to change the basis year for the assessment of income tax from the preceding year basis to a current year basis of assessment effective from the year 2000. This system allows for tax to be assessed and collected on income derived in the same year. At the same time, the implementation of the Self-Assessment System is being introduced in stages to replace the Official Assessment System starting with companies group of taxpayers from the year 2001. This Self-Assessment System will include the businesses, partnerships, cooperatives and salaried groups with effect from the year 2004.

a. Income Tax System

The basis of Malaysian taxation is currently territorial and not a residential basis. All income of companies and individuals accrued in, derived from or remitted to Malaysia, are liable to tax. However, income derived from outside Malaysia and remitted to Malaysia by resident companies (except those involved in the banking, insurance, air and sea transportation business), non-resident companies and non-resident individuals are exempted from tax. A person carrying on banking, insurance, air and sea transportation business is taxable to tax on worldwide income. Effective from the year of assessment 2004, income remitted to Malaysia by a resident individual is exempted from tax.

The income upon which tax is chargeable under the IRB Act 1995 are in respect of:

a. gains and profits from a trade, profession and business, for whatever period of time carried on;
b. gains or profits from an employment (salaries, remunerations, etc.);
c. dividends, interests or discounts;
d. rents, royalties or premiums;
e. pensions, annuities or other periodic payments not falling under any of the foregoing paragraphs;
f. other gains or profits of an income nature not falling under any of the foregoing paragraphs.

Section 4A of the IRB Act 1995 subjects Special classes of income chargeable to tax. These Special classes of income of a person not resident in Malaysia for a basis year for a year of assessment are in respect of:

a. Amounts paid in consideration of services rendered by the person or his employee in connection with the use of property rights belonging to, or installation operation of any plant, machinery or other apparatus purchased from such person;
b. Any amount paid in consideration of technical advice, assistance or services rendered in connection with technical management or administration or administration of any specific, industrial or commercial undertakings, venture project or scheme;
c. Rent or other payments made under any agreement or arrangement for the use of any moveable property.

b. Notification of chargeability to tax

Individuals, who are taxable and have never received any income tax Return Form before, must notify their chargeability to the nearest IRB office and request for an income tax Return Form. However, if they already have an income tax file but have not received an income tax Return Form by the **31st. March** in the year, they must immediately write in to the IRB office (i.e. the office which issued the last return form) for a Return Form for the relevant year. A foreigner employed in this country, must give notice of his/her chargeability to the nearest IRB office within 2 months of his/her arrival in Malaysia.

c. Residence Status

Although Malaysian income tax is imposed on a territorial basis, the residence status is important for the determination of the tax rates as well as eligibility for personal relief for individual taxpayers. The residence status of an individual is determined by the duration of stay in Malaysia in a basis year. Specifically, an individual is regarded as a resident if:

i. he is in Malaysia for at least 182 days in a calendar year;

ii. he is in Malaysia for a period of less than 182 days but that period is linked to another period of physical presence of at least 182 consecutives days in an adjoining year;

iii. he is in Malaysia for 90 days or more during the year and was in Malaysia for at least 90 days or a resident in any 3 basis years for the 4 years of assessment immediately preceding that particular year of assessment; or

iv. he is a resident for the immediately following year and also for each of the 3 immediately preceding years.

The implication of residence status for companies is that section 108 of the IRB Act 1995 for full imputation system is applicable to resident companies. Also certain Promotion Investment Incentives are only applicable to resident companies.

Section 8 of the IRB Act 1995 provides that a company is considered a resident in Malaysia if the control and management of its affairs are exercised in Malaysia. Management and control is normally considered to be exercised at the place where the directors' meetings are held.

d. Company Tax

A company, whether resident or not, is assessable on income accrued in or derived from Malaysia. Income derived from sources outside Malaysia and remitted by a resident company is exempted from tax, except in the case of the banking and insurance business, and sea and air transport undertakings for which the scope of taxation is based on world wide income.

The taxation of company is based on a full imputation system where the tax of a company is in fact an advance tax of the shareholders who receive dividend from the company. Upon declaration of the dividends, the shareholders are taxed on the gross dividends at their own respective tax rates and are given full tax credit in respect of the tax deducted at source by a company.

Under the full imputation system, the income tax chargeable on a resident company is credited into a tax account which can be utilised to frank payment of dividends to shareholders. Income tax paid by a company is imputed to the shareholders by means of imputation credits attached to dividends. Where the franking of payment of dividends exceeds the tax credit available in the tax account, the deficit becomes a debt due which is payable by the company upon requisition.The imputation system does not apply to a non-resident company and such companies are not subject to dividend franking.

The computation of the chargeable income is arrived at after adjusting for allowable expenses incurred in the production of the income, capital allowances and incentives where applicable. Section 34 of the Income Tax Act 1967 allows specific provisions for bad or doubtful debts. However, no deduction for book depreciation is allowed although capital allowances are granted. Unabsorbed business losses may be carried forward indefinitely to offset against business income, except for companies with Pioneer Status (other than contract R&D companies).

A tax rate of 28% applies to both resident and non-resident companies. However, companies with paid-up capital of RM2.5 million and below are subjected to a corporate tax of 20% on chargeable income of up to RM500,000. The remaining chargeable income is maintained at 28%. Dividends distributed will be given a tax credit of 28% in the hands of shareholders. In the case of a company carrying on petroleum upstream operations is subject to a Petroleum Income Tax of 38%. Insurance companies are taxed at 8% on the investment income and capital gains of life fund and 28% on the income of a shareholders' fund.

e. Individual Income Tax

All individuals are liable to tax on income accrued in, derived from or remitted to Malaysia. However, a non-resident individual will be taxed only on income earned in Malaysia. Effective from the year of assessment 2004, income remitted to Malaysia by a resident individual is exempted from tax.

The rate of tax depends on the individual's resident status, which is determined by the duration of his stay in the country as stipulated under Section 7 of the Income Tax Act 1967.

f. Personal Reliefs

The chargeable income of a resident individual is arrived at after making several deductions. These include the personal reliefs for self (a further RM5,000 for that individual if he is a disabled person), spouse and unmarried children below 18 years of age; parents' medical expenses; medical expenses on serious diseases including medical examinations for individual, spouse or child; expenditure for purchase of basic support equipment for the individual, spouse, child or parent who is disabled; and contributions to the Employees Provident Fund (EPF), life insurance premiums, and insurance premiums for education or medical benefits.

An amount limited to a maximum of RM5,000 on fees expended by the individual for any course of study up to tertiary level for the purpose of acquiring scientific, technical, vocational, industrial, and information and communications technology (ICT) skills at the local institutions of higher learning in Malaysia recognized by the Government is also allowed as a deduction.

g. Tax rebate

The tax liability of a resident individual is reduced by way of the following rebates:

(i) An individual with a chargeable income not exceeding RM35,000 enjoys a rebate of RM350. Where the wife is not working or the wife's income is jointly assessed, she also enjoys a further rebate of RM350. Similarly, a wife who is assessed separately will also enjoy a RM350 rebate, provided her chargeable income does not exceed RM35,000

(ii) The amount paid in respect of any zakat, fitrah or other obligatory Islamic religious dues

(iii) RM400 towards the purchase of a personal computer once every five years per family

(iv) Any fee paid to the government for the issue of an employment pass, visit pass or work permit The rate of tax depends on the individual's resident status, which is determined by the duration of his stay in the country as stipulated under Section 7 of the Income Tax Act 1967.

h. Tax Rate

A resident individual is taxed on his chargeable income at a graduated rate from 0% to 28% after deducting tax reliefs.

A non-resident individual is liable to tax at the rate of 28% without any personal relief unless double tax treaty exist. However, he can claim rebates in respect of levy paid to the government for the issuance of an employment work permit. Other sources of income received by non-residents are subject to withholding tax at the following rates:

Royalties 10%

Rental of moveable properties 10%

Technical fees 10%

Interest 10%

Non-resident public entertainers are taxed at 15% of gross income.

Table 13 Income Tax Rates for Resident Individuals with Effect from Year of Assessment '04

Chargeable Income	RM	Rate	Tax (RM)
On the first	2,500	0%	0
On the next	2,500	1%	25
On the first	5,000	-	25
On the next	15,000	3%	475
On the first	20,000	-	475
On the next	15,000	7%	1,050
On the first	35,000	-	1,525
On the next	15,000	13%	1,950
On the first	50,000	-	3,475
On the next	20,000	19%	3,800
On the first	70,000	-	7,275
On the next	30,000	24%	7,200
On the first	100,000	-	14,475
On the next	150,000	27%	27,975
On the first	250,000	-	54,975
Exceeding	250,000	28%	-

Non-Resident Individual Rates ; Non-resident employees (including directors) professionals and sole proprietors is at fl rate of 28%

i. Petroleum Tax

By virtue of the Petroleum (Income Tax) Act 1967[Act 543], petroleum tax is charged on income derived from the sale of crude oil and natural gas extracted from Malaysia under a petroleum agreement entered into with either PETRONAS (Petroleum Nasional Berhad) or the MTJA (Malaysian-Thailand Joint Authority for special joint development areas) would be subject to petroleum income tax. Petroleum income tax is assessed on the income earned in the preceding year. The income and dividends paid out from such income are not subject to the other income taxes. In Malaysia, extraction of crude oil and natural gas is under the purview of PETRONAS as under Article 2 of the Petroleum Development Act 1974 [Act 144], the entire ownership in, and the exclusive rights, powers, liberties and privileges of exploring, exploiting, winning and obtaining petroleum whether onshore or offshore of Malaysia is vested in PETRONAS. Currently, exploration, development and production of crude oil and natural gas are actively being undertaken and managed through petroleum agreements or the model of production sharing contracts entered into between PETRONAS and a number of international oil and gas companies as well as with its subsidiary Petronas Carigali Sdn Bhd.

The petroleum tax rate is 38% but for joint development areas the following rates applies:

i. First 8 years of production 0%
ii. The next 7 years 10%
iii. Subsequent years of production 20%

j. Real Property Gains Tax

Capital gains are generally not subject to tax in Malaysia. Real property gains tax is charged on gains arising from the disposal of real property situated in Malaysia or of interest, options or other rights in or over such land as well as the disposal of shares in real property companies. The tax rates for Malaysian citizens and permanent residents are as follows:

Table 14: RPGT Rates

Disposal within 2 years	30%
Disposal in the 3rd year	20%
Disposal in the 4th year	15%
Disposal in the 5th year	5%
Disposal in the 6th year and thereafter - Company	5%
- Individual	nil

Citizens and permanent residents also enjoy an exemption of RM5,000 or 10% of the gains whichever is the greater, besides a one-time tax exemption on the gains arising from the disposal of one private residence.For non-citizens and non-permanent resident individuals, gains from the disposal of real property within five years are taxed at a flat rate of 30%, after which the tax rate will be 5%.

k. Stamp Duties.

The assessment and collection of Stamp Duties is sanctioned by statutory law described as the Stamp Act 1949. The purpose of stamping an instrument is to protect the parties to the contract in respect of the admissibility of the instrument as evidence in court ruling during a civil proceeding. An instrument that is not duly stamped is not enforceable in court as evidence. Stamp duties on written documents vary according to the nature of the documents and values referred to in the document.

Ad Valorem Duties are imposed on:

i. Instruments of transfer (implementing a sale or gift) of property including marketable securities (meaning loan stocks and shares of public companies listed on the Kuala Lumpur Stock Exchange), shares of other companies and other non tangible property such as book debts, benefits to legal rights and goodwill;
ii. Instruments creating interests in property such as Tenancies and Statutory Leases;
iii. Instrument of security for monies including instruments creating contracts for payment of monies or obligation for payment of monies (Bond)
iv. Certain capital market instrument such as Contract Notes

Fixed duties are imposed on:

i. other legal, commercial, mercantile or capital market instruments such as Power or Letter of Attorney, Articles of Association of a Company, Promissory Notes, Policy of Insurance and so on, and;
ii. A duplicate or a subsidiary or a collateral instrument when it can be shown that the original or principal or primary instrument has been duly stamped.

B. Labuan Offshore Financial Centre

Tax is imposed on an offshore company in or from Labuan that is carrying out offshore business activities as provided for under the Labuan Offshore Business Activity Tax Act 1990 (LOBAT) effective from the year of assessment 1991.

The federal territory is a group of tropical islands off the coast of Sabah. Labuan has its own offshore legislation to facilitate offshore business activities, which are categorised in offshore trading activity and offshore non-trading activities. Offshore trading activities include banking, insurance, trading, management, licensing, leasing or any other activity which is not an offshore non-trading activity but does not include shipping and petroleum operations. Offshore non-trading activities refers to activities relating to the holding of investments in securities, stocks, shares, loans, deposits and immovable properties by an offshore company on its own behalf. When both activities are carried out by an offshore company, that company is deemed to be carrying on an offshore trading activity.

a. Offshore Companies and offshore trusts

Preferential tax treatment is given to offshore companies incorporated or registered under the Offshore Companies Act 1990 and offshore trusts undertaking offshore business activities. Non-offshore business activities carried by an offshore company are subject to normal Malaysian income tax at 28% and are not eligible for any tax concession.

An offshore company carrying on an offshore trading activity for a basis period for a Y/A can elect either to pay tax at a rate of 3% of its audited net profits or elect to pay tax of RM20,000 for a Y/A.

Income derived from an offshore non-trading activity for the basis period for a Y/A is exempt from tax for that Y/A.

b. Resident Individuals

Individual residents in Labuan are subject to tax under the Principal Act, the Income Tax Act 1967. Thus, income accruing in or derived from Malaysia is taxable and foreign sourced income is taxed if received in Malaysia by a resident individual. The tax rate ranges from 0% to 28% for resident individuals and a flat rate of 28% for non-resident individuals.

Expatriates employed in a managerial capacity in Labuan by offshore companies are granted an exemption of 50% of their income from such employment up to Y/A 2004, provided the employment is exercised in Labuan.

Non-citizen individuals acting in the capacity of a director of an offshore company are exempted from payment of income tax in respect of directors' fees received from Y/A 2002 until Y/A 2006.

c. Capital Gains

For an offshore company carrying on an offshore trading activity, capital gains are reflected as part of the net profits and hence subject to 3% tax. However, if election is made, the liability is restricted to RM20,000.

Capital gains arising from sales of shares in an offshore company by the shareholders are not taxable assuming that the shareholders do not have a business presence in Malaysia and are not investment dealers.

d. Withholding Taxes

Royalties, interest and technical or management fees paid by an offshore company to a non-resident person or another offshore company are exempted from income tax and thus not subject to withholding tax. However, rental or moveable property paid to a non-resident person does not enjoy this exemption, with the exception of offshore banks or offshore companies carrying out leasing business.

Any interest paid by a Malaysian resident to offshore banks in Labuan is not subject to withholding tax.

e. Indirect Taxes

There are no indirect taxes (such as sales taxes, services taxes and custom duties) since Labuan enjoys free port status.

f. Stamp Duty

Offshore companies are exempted from stamp duty on all instruments which are made in connection with offshore business activities. The sale of shares in offshore companies and the Memorandum and Articles of Association of an offshore company are also exempted from stamp duty.

g. Other Incentives

Dividend paid by an offshore company in respect of income derived from an offshore business activity and distributions made by an offshore trust are not subject to tax in the hands of the recipients.

Dividends received by an offshore company are exempted from income tax. Labuan trust companies providing qualifying professional services (such as legal, accounting, financial and secretarial services) to an offshore company are granted 65% abatement of their statutory income for Y/A2000 (cyb) to 2004. However, with effect from 1.2.03, the Labuan Trust Companies Act 1990 has been amended to provide that only an offshore company incorporated or registered under the Offshore Companies Act 1990 may be registered as a trust company. Previously, any company which is incorporated under the Companies Act 1965 or which is registered as a foreign company under that Act may apply to be registered as a trust company to carry on a business in Labuan.

h. Tax Treaty Arrangements

Labuan has no tax treaties with any contracting state and relies on Malaysia's treaty partners to recognise the Labuan Offshore legislation as part of the Malaysian Tax regime. Currently, Labuan has been specifically excluded from Double Tax Agreements with Australia, United Kingdom, Japan, Netherlands, Luxembourg and Sweden.

C. Indirect Taxes

a. Sales Tax

Sales tax is a single stage tax levied on certain imported and locally manufactured goods, either at the time of importation or at the time the goods are sold or otherwise disposed of by the manufacturer. In Malaysia, manufacturers of taxable goods are required to be licensed under the Sales Tax Act 1972. Companies with a sales turnover of less than RM100,000 and companies with Licensed Manufacturing Warehouse(LMW) status are exempted from this licensing requirement. However, companies with a sales turnover of less than RM100,000 have to apply for a certificate of exemption from licensing.

Licensed manufacturers are taxed on their output while manufacturers that are not licensed or exempted from licensing need to pay tax on their inputs. To relieve small-scale manufacturers from paying sales tax upfront on their inputs, they can opt to be licensed under the Sales Tax Act 1972 in order to purchase tax-free inputs. With this, small-scale manufacturers can opt to pay sales tax only on their finished products.

Sales tax for general goods (including motor vehicles) is at 10%. However, raw materials and machinery for use in the manufacture of taxable goods are eligible for exemption from the tax, while inputs for selected non-taxable products are also exempted.

Certain non-essential foodstuffs and building materials are taxed at 5%, cigarettes and cheroots at 25% and liquor and alcoholic drinks at 20%. Certain primary commodities, basic foodstuffs, basic building materials, certain agricultural implements and heavy machinery for use in the construction industry are exempted. Certain tourism and sports goods, books, newspapers and reading materials are also exempted.

b. Service Tax

A service tax applies to certain prescribed goods and services in Malaysia including food, drinks and tobacco; provision of rooms for lodging and premises for meetings, conventions, and cultural and fashion shows; health services, and provision of accommodation and food by private hospitals.

The tax also applies to professional and consultancy services provided by lawyers, engineers, surveyors, architects, accountants, advertising agencies, consultancy firms, insurance companies, motor vehicle service and repair centres, telecommunication services companies, security and guard services agencies, recreational clubs, estate agents, parking space services operators, courier service firms and veterinary doctors.

Effective from 1 January 2003, professional services provided by a company to companies within the same group will be exempted from the current service tax of 5%. This applies to services provided by public accountants, advocates and solicitors, engineers, architects, surveyors (including valuers, assessors and real estate agents), consultants and management service providers. Courier services provided from a point within Malaysia to a destination outside Malaysia will also be exempted from the service tax of 5% with effect from 1 January 2003.

The tax base has been widened to include other services such as those provided by car rental agencies licensed under the Commercial Vehicles Licensing Board Act 1987 having an annual sales turnover of RM300,000 and above, employment agencies having an annual sales turnover of RM150,000 and above, and companies providing management services, including project management and coordination services, having an annual sales turnover of RM150,000 and above. Hotels having more than 25 rooms and restaurants within such hotels are also subject to this tax.

Generally, the imposition of service tax is subject to a specific threshold based on an annual turnover ranging from RM150,000 to RM300,000.

c. Import Duty

In Malaysia, import duty is mostly imposed ad valorem although some specific duties are imposed on a number of items. Nevertheless, over the last few years, Malaysia has abolished import duties on a wide range of raw materials, components and machinery.

Furthermore, Malaysia is committed to the ASEAN Common Effective Preferential Tariffs (CEPT) programme under which import duties imposed on most goods from ASEAN countries with a minimum 40% ASEAN content will be reduced to between 0% and 5% by the year 2003.

d.Excise Duty

Excise duties are levied on selected products manufactured in Malaysia, namely cigarettes, liquors, playing cards, mahjong tiles and motor vehicles.

To encourage the export of locally manufactured goods, companies with Licensed Manufacturing Warehouse (LMW) status that manufacture goods subject to excise duty are exempted from being licensed under the Excise Duty Act 1976.

D. International Taxation

Agreement for the Avoidance of Double Taxation

Agreements for the Avoidance of Double Taxation prevent incidences of double taxation on income such as business profits, dividends, interest and royalties that are derived in one country and remitted to another country. Currently, tax treaties between Malaysia and the following countries (by alphabetical order) are in force:

Table 15 Tax Treaty Agreement Status

Argentina *	Indonesia	Poland
Australia	Ireland	Romania
Austria	Italy	Russia
Bahrain	Japan#	Saudi Arabia *
Bangladesh	Jordan	Singapore
Belgium	Korea, South	Sri Lanka#
Canada	Malta	Sweden
China	Mauritius	Switzerland
Czech Republic	Mongolia	Thailand
Denmark	Netherlands	Turkey
Fiji	New Zealand	United Arab Emirates
Finland	Norway	United Kingdom #
France	Pakistan	United States of America*
Germany	Papua New Guinea	Uzbekistan
Hungary	Philippines	Vietnam
India		

In addition, an Agreement for the Avoidance of Double Taxation has been signed between the Malaysian Friendship and Trade Centre in Taipei (MFTC) and the Taipei Economic and Cultural Office in Kuala Lumpur (TECO).

** Limited to shipping and air transport services*

 # New agreement

IV. Malaysia – Specific Fiscal Issue

a. Private sector activity

Private sector investment is important in ensuring sustainable growth in the medium and long term. Since the last few years, contribution of the domestic sector to GDP, amidst slower external sector performance, has been on an increasing trend although the increase has been gradual, from 82.4% in 1999, rising to 89.6% in 2002, respectively forecasted to improve further to 90% in 2003. The Government instituted measures to enhance the domestic investment activity, particularly SMEs. Investment by private sectors remained which has remained below pre-crisis levels has shown some positive sign by 2% increase in 2003. Banks are reluctant to increase lending activities to SMEs due to their risk-averse attitude arising from the large magnitude of NPLs experienced during the crisis period. The government established RM1000 million micro credit schemes for small businesses and enterprises under the package to further improve accessibility of SMEs loans and to enable them to become catalyst in generating domestic investment and economic growth. Out of this RM500 million is provided for agriculture sector, RM300 million for non-agriculture sector and RM200 million to Amanah Ikhtiar Malaysia.

In order to enhance the accessibility to financing for small borrowers, loan condition under the micro credit scheme has been relaxed through waiver of collateral requirement with loan based on securitisation of cash flows. In addition, it also features a low rate of 4% per annum, loan repayments based on cash flow projections and the introduction of a mentoring system. In particular, the waiver on collateral requirement is deemed attractive.

b. Small and medium Enterprises(SMEs)

Small and medium enterprises (SMEs) represent an important segment of the Malaysian economy. They provide slightly more than one-third of total employment in Malaysia and more than half of total companies registered with the Companies Commission. SMEs are excellent seedbeds for energetic and dynamic individuals to test and develop their talents and skills in business. In Asian countries such as Japan, Taiwan, Korea and China, SMEs are the backbone of the industrial and manufacturing sector. SMEs in Malaysia form an integral part of the value chain in the overall production network, producing high value-added parts and components and developing themselves as downstream suppliers or service providers of the larger industries (LIs) and multinational corporations (MNCs). When the first national car was launched in 1983, SMEs spearheaded the development of supporting and ancillary industries, through the utilisation of local components required by the project. Local SME supplied RM397.9 million or 10.8% worth of parts and components for the national car in 2002 and RM154 million for the first six months of this year, or 77% of parts and components targeted to be supplied by the SMEs for 2003. SMEs form an important link as second and third tier suppliers or vendors of products such as plastic extrusions, metal stamping parts, wire harnesses and air bags.

SMEs constitute about 92% of the total 689,160 companies registered in Malaysia. In 2002, the output of SMEs to GDP recorded a 2.5% increase while their productivity rose by 2.7% with added value of RM35,043 per employee. The distribution of SMEs according to economic sectors tends to be concentrated in the trading, manufacturing and services sectors.

Currently, at least 12 ministries and 40 Government agencies are involved in the development of SMEs (including micro-enterprises) in Malaysia. The ministries and Government agencies provide a wide range of services for different target groups. In addition, various trade and business organizations also provide support services as well as represent the SMEs in various arenas. However, most agencies tend to focus on the development of SMEs in the manufacturing sector. Meanwhile, the Entrepreneur Development Ministry (KPUn) offers entrepreneurial development programmes such as the Franchise and Vendor Development Programmes. In order to ensure a better coordinated and focused approach to SMEs development and implementation, the Government is studying the formation of a central body to coordinate the present structure and develop a framework for the comprehensive development of SMEs.

c. Nation's competitiveness

Globalisation and liberalisation have intensified competition and resulted in the emergence of new players in the market, particularly lower cost-producing nations. This has prompted the government to strengthen further the nation's competitiveness. Additional measures were designed to build upon the present competitive edge, which hinges on the pillars of political stability, a business-friendly Government, educated and easily trained workforce, abundant natural resources as well as efficient economic management fundamentals. The excellent network of infrastructure, including high-speed broadband information and communication technology connectivity has further enhanced the nation's competitiveness. Further measures were focussed on reducing the cost of doing business, accelerating the transition to ICT as the enabling tool to enhance productivity as well as developing human resource to meet the demands of the new economy.

Particular emphasis was given to ensure the maintenance of pro-business and investor-friendly climate to encourage greater public-private sector cooperation. The Government commits to enhancing investors' confidence by the liberalisation of FIC rules as well as reinforcement efforts in improving the delivery system to reduce the cost of doing business to attract investors.

d. Improve quality of life

Arising from Government efforts in enhancing the economic well-being of the populace, there have been all-round improvements in the quality of life for Malaysians. Despite the anxiety with respect to SARS and sporadic incidents of terrorist attacks in neighbouring countries, Malaysian continue to enjoy a peaceful, harmonious and stable socio-economic environment..

Socio-economic issues are in respect of providing affordable houses for the low-income group as well as facilitating small business. Apart form the micro credit scheme provided to small business, Home Ownership Scheme programme was introduced. Under this scheme new house buyers of houses below RM100000 is subsidised on interests, interest-free loan for deposits, rebates and tax relief on interest payment.

As the economy continues to rely on the domestic sector, the contribution of construction sector to GDP growth will have to be further enhanced. The Government, under the Package, introduced several measures and incentives as well as cash payment to first home owners under the Home Ownership for the People (HOPE) project to stimulate the property and construction sector as will as to provide affordable housing to the lower income group. Individual income tax relief will be given on the specified interest payments of housing loans. Within a one-year period from 1 June 2003, purchases of houses below RM180,000 are eligible for stamp duty exemption and the secondary property market is exempted from real property gains tax.

Syarikat Perumahan Negara Berhad (SPNB), established in 1997 as part of its measures to accelerate the implementation of low-cost housing projects, will build at least 150,000 units of medium-cost and affordable houses within a 5-year period. SPNB will also purchase unsold completed apartments, estimated currently to total 4,400 units, at a minimum discount of 20% of the market price. These units will then be allocated to eligible Government employees including widows of Government employees as well as single mothers, who do not own houses, through a hire purchase and buy-back scheme. After paying a monthly rental of RM50 per month for three years, they will also be given the option to purchase their units. These measures are expected to result in higher demand in the residential sector, particularly for affordable houses.

V. Conclusion: Where We Stand and Where We Go

World growth and trade are expected to improve with most economic activities returning to normalcy. Business confidence and sentiment will, however, be cautiously optimistic against the backdrop of threats from terrorist attacks. Overall, indications points towards improved outlook and higher optimism for 2004, despite the downside risks.

On the regional front, with the containment of SARS and the positive impact following the implementation of various economic relief packages introduced by SARS-affected countries, regional growth is envisaged to further accelerate in 2004.

The underlying strategic thrusts of macroeconomic management for 2004 are premised on a more dynamic and vibrant private sector supported by the enabling and conducive environment put in place through various measures over the years. The Government will continue to play the facilitative role in enhancing the effectiveness of the delivery system. Complementing each other, the private and public sectors will work in close cooperation and partnership within the spirit of Malaysia Incorporated, thereby enhancing sovereign competitiveness and long term growth and sustainability. To enable the private sector to lead the economy, concerted efforts will be made to encourage private initiatives in new sources of growth, particularly in value-creating activities in services and agriculture. To address the issue of insufficient collateral of SMEs, measures have been taken to enhance the efficiency and scope of the Credit Guarantee Corporation (CGC). At the same time, the Enterprise Rehabilitation Fund Sendirian Berhad (ERF) has been enhanced as a one-stop centre to deal with issues pertaining to the development of Bumiputera entrepreneurs such as financing, training and advisory services. Other measures to improve financing to SMEs include expanding the size and scope of selected funds, liberalising the eligibility criteria and reducing lending rates as well as the RM1 billion micro credit facility announced in the Package of New Strategies in May. Of significant importance is the establishment of a special window for SMEs at financial institutions and a SME special unit at Bank Negara Malaysia. At the same time with the establishment of the special window for SMEs, financial institutions complemented Government efforts in enhancing financing for SMEs by providing advisory and consultative services to improve the financial understanding and management of SME.

Measures will be taken to develop and transform the agriculture and rural sector into a more dynamic income-generating economic base. This sector is expected to capitalise on the Government's pro-growth measures to unveil its potential and contribute higher value-added to the economy. In the trade sector, building upon its strength as the 17th trading nation in the world, efforts will be made to intensify the promotion and marketing of Malaysian products and brands. Emphasising on the creation of economic wealth, the social agenda towards a caring society will continue to be accorded due importance, particularly with respect to elevating the standard of living and the quality of life of the populace, especially the poor, handicapped, aged and the less fortunate.

In consonance with the commitment to balance the budget in the near term, the Government's fiscal stance will be the deliberate tightening of public spending to rein in the deficit that had occurred over the last six years. Total budgeted expenditure will be reduced by 1.1% with a larger decline in the development expenditure.

Development expenditure will be prioritised towards committed and approved projects under the mid-term review of the Eighth Malaysia Plan, especially those with strong linkages and value creation potential in the economy. Particular attention will be directed towards modernising and nurturing the agriculture and rural sectors to position them as significant growth-generating sectors of the economy. Expenditure for rural development programmed including roads, education, health, and basic amenities is expected to double. The public sector presence in the economy will focus on sustaining public services and improving the delivery system whilst lending support towards the development of a knowledge-based economy as a means to increase productivity and efficiency and, hence, sovereign competitiveness.

In order to support domestic economic activities, the monetary policy is expected to remain accommodative amid ample liquidity in the system and subdued inflation. Domestic consumption and business activity will be facilitated by making funds more accessible and at a lower cost to benefit a wider spectrum of society.

Growth is expected to be broad-based with all sectors in the economy registering higher output with services and manufacturing continuing to spearhead growth. Growth is expected in the domestic sector as well as pick up in the external sector, following improved world prospects. The strengthened macroeconomic fundamentals and a more broadly balanced economic structure with emerging new sources of growth will provide the foundation for sustained higher growth. Alongside pragmatic macroeconomic management and the pro-growth measure in place to support private sectors initiatives, competitiveness and resilience of the economy will be further enforced against destabilising external factors and garner higher economic growth for the country.