SECTION 1

Fiscal Policy Overview

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Overview

Fiscal policy has played an important role in driving the nation's economic recovery towards achieving the pre-pandemic levels. Swift and bold policy which includes financing for extensive vaccination programmes and implementing immediate measures to ease the burden of people and businesses have enabled the Government to mitigate the impact of the pandemic effectively. Furthermore, the reopening of the international borders has rejuvenated business and social activities, thus accelerating the economic recovery process. Consequently, the economy grew strongly by 6.9% in the first half of 2022 with improved labour market conditions.

Although the domestic economy has strengthened, the task to contain inflationary pressures continues to be a challenge. The geopolitical turmoil in Eastern Europe has aggravated the inflationary pressures resulting in increased prices of major commodities and disruption of the global supply chain. Therefore, the Government has taken pre-emptive measures to contain price hikes by providing additional subsidies on several essential goods and services in order to minimise the increase in cost of living. In addition, the Government continues to provide fiscal support through initiatives financed by the COVID-19 Fund.

The Government is formulating policies taking into account uneven recovery across sectors and demographic groups. Emphasis will be placed on developing strategies tailored to vulnerable groups that are still struggling to recover in the post-pandemic period, particularly the bottom 40% household income group (B40) as well as micro, small and medium enterprises (MSMEs). In addition, the Government continues to accelerate digitalisation and automation to enhance productivity and competitiveness. Meanwhile, sustainable and inclusive development agenda remains as one of the key focus areas for the Government in formulating the annual budget. In terms of public finances, the Government will gradually consolidate the fiscal position in order to balance between sustaining the economic recovery momentum and long-term fiscal sustainability.

Strengthening Fiscal Framework in the Post-Pandemic Period

The pandemic has affected public finances and derailed the Government's fiscal consolidation from the original trajectory due to the implementation of stimulus packages and economic recovery plan which led to a higher spending and revenue foregone. Consequently, the budget deficit and government debt have increased significantly since 2020 which necessitate a holistic fiscal reform in the medium term. Although the reform is vital to achieve sustainable public finances, the Government will not prematurely withdraw the fiscal support as the action could undermine the post-pandemic economic recovery.

The main objectives of fiscal reform are to broaden revenue base, improve spending efficiency and enhance transparency in fiscal management. Immediate reform measures such as reviewing tax framework and implementing more targeted subsidies are crucial to ensure sustainable revenue collection and effective spending. These measures are part of the forthcoming Medium-Term Revenue Strategy (MTRS) and Public Expenditure Review, pursued by the Government along with the impending Fiscal Responsibility Act (FRA). The Cabinet has approved in principle the proposed framework for the FRA which is expected to be tabled in Parliament by the end of 2022.

Overall, the Government is committed to strengthen the fiscal policy framework while supporting economic recovery momentum, ensuring sustainable growth and enhancing wellbeing of the *rakyat*. In the meantime, the pace of fiscal consolidation will be accelerated through revenue enhancement and prudent spending. The Government will also formulate fiscal policy that focus on creating fiscal buffer, building economic resilience and boosting investors' confidence in the long run.

Fiscal Position in 2022

In the Budget 2022, the Government projected fiscal deficit at 6% of GDP based on the better economic outlook following the reopening of economic and social sectors. The fiscal position continued to improve in the first half of 2022, mainly attributed to a strong domestic demand leading to a more favourable revenue collection. However, higher commodity prices resulting from the uncertainties at the global level has forced the Government to reprioritise the spending towards providing fiscal support, particularly additional subsidies in reducing the financial burden of the *rakyat* amid the rising inflation and cost of living. The increase in subsidy allocation is expected to be partially offset by the additional revenue from commodity-related taxes and dividends.

The projected strong domestic economic performance and high commodity prices are expected to contribute to better revenue collection in 2022. Therefore, revenue is estimated to surge to RM285.2 billion or 16.7% of GDP, an increase of 21.9% from budget estimates, mainly from tax and non-tax revenue. The increase in tax revenue is expected to be mainly derived from Prosperity Tax, Special Voluntary Disclosure Programme and commodity-related taxes while non-tax revenue mainly from additional dividend from PETRONAS of RM25 billion.

In providing sufficient fiscal support to protect the *rakyat* and businesses from the rising inflation and cost of living, the total Government expenditure is expected to expand by 16% to RM385.3 billion as compared to the budget estimates of RM332.1 billion. The operating expenditure (OE) is expected to increase by RM51.2 billion or 21.9% to RM284.7 billion, of which RM58.9 billion is allocated for subsidies and social assistance. In contrast, the development expenditure (DE) is expected to reduce by 5% from budget estimates to RM71.8 billion following the reprioritisation of programmes and projects as well as expenditure recalibration in line with the implementation progress. In July 2022, the Ministry of Finance issued a circular on public expenditure guidelines which requires line ministries to reprioritise allocation for critical spending and optimise expenditure with cost-saving measures. Meanwhile, the COVID-19 Fund spending is projected at RM28.8 billion to further support the recovery of businesses and ease households financial burden arising from the pandemic.

Overall, the absolute deficit level is estimated to be marginally higher at RM99.5 billion following the higher spending projected for OE and COVID-19 Fund. However, in terms of percentage of GDP, the overall fiscal deficit is projected to further consolidate at 5.8%, in line with a higher revenue collection coupled with better-than-expected economic growth. Consequently, after excluding debt service charges, the primary deficit is expected to record 3.3% of GDP.

TABLE 1.1. *Federal Government Financial Position, 2021 – 2023*

	RM MILLION			CHANGE (%)			SHARE OF GDP (%)		
	2021	**2022[3]**	**2023[4]**	**2021**	**2022[3]**	**2023[4]**	**2021**	**2022[3]**	**2023[4]**
Revenue	233,752	285,217	272,570	*3.9*	*22.0*	*-4.4*	*15.1*	*16.7*	*15.0*
Operating expenditure	231,516	284,700	272,340	*3.1*	*23.0*	*-4.3*	*15.0*	*16.6*	*15.0*
Current balance	**2,236**	**517**	**230**				***0.0***	***0.1***	***0.0***
Gross development expenditure	64,257	71,800	95,000	*25.1*	*11.7*	*32.3*	*4.2*	*4.2*	*5.2*
Less: Loan recovery	990	600	700	*-21.4*	*-39.4*	*16.7*	*0.1*	*0.0*	*0.0*
Net development expenditure	63,267	71,200	94,300	*26.3*	*12.5*	*32.4*	*4.1*	*4.2*	*5.2*
COVID-19 Fund[1]	37,711	28,800	5,000	*-0.8*	*-23.6*	*-82.6*	*2.4*	*1.7*	*0.3*
Overall balance	**-98,742**	**-99,483**	**-99,070**				***-6.4***	***-5.8***	***-5.5***
Primary balance[2]	**-60,673**	**-56,383**	**-52,970**				***-3.9***	***-3.3***	***-2.9***

[1] A specific trust fund established under the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 to finance economic stimulus packages and recovery plan
[2] Excluding debt service charges
[3] Revised estimate
[4] Budget estimate, excluding Budget 2023 measures
Source: Ministry of Finance, Malaysia

Outlook for 2023

The global environment remains uncertain as geopolitical tensions persist and growth is expected to slow down while major commodity prices are anticipated to be lower following lower demand mainly for energy. Therefore, the fiscal policy in 2023 will continue to be agile, supporting the growth momentum towards achieving the national development agenda. The fiscal resources will be channelled in a more targeted approach and allocated in priority areas, particularly to enhance economic capacity and competitiveness. The Government's budget remains expansionary to provide sufficient fiscal support in ensuring the *rakyat's* wellbeing and undertaking economic reforms while continuing the fiscal consolidation plan.

The Federal Government's revenue collection in 2023 is projected to be lower at RM272.6 billion or 15% of GDP due to anticipated lower non-tax revenue collection. The non-tax revenue is expected at RM67 billion, declining 23% from 2022 due to lower dividends from government entities. However, tax revenue remains as the major contributor and is anticipated to grow moderately by 3.7% to RM205.6 billion, in line with the projected slower economic recovery.

In the past three years, the Government has provided substantial fiscal injection to support the economy, businesses and *rakyat*. In line with the targeted spending approach, total expenditure in 2023 is projected to be slightly lower at RM372.3 billion or 20.5% of GDP mainly due to expiry of COVID-19 Fund. The allocation for OE is reduced to RM272.3 billion primarily due to lower allocation for subsidies following the expected moderation in commodity prices and gradual move towards targeted subsidy approach. Meanwhile, the DE allocation is projected to increase significantly to RM95 billion on account of higher allocation for the Twelfth Malaysia Plan (12MP) programmes and projects such as construction of highways and railways, medical facilities as well as educational institutions. In addition, a sum of USD3 billion is provided for the redemption of 1Malaysia Development Berhad (1MDB) bond. Moreover, a sum of RM5 billion is for outstanding payments of the COVID-19

Fund commitments made in 2022, as stipulated in Section 8 (1) of the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 [Act 830].

Overall, the fiscal deficit is expected to reduce to 5.5% of GDP in line with the Government's commitment towards consolidating the fiscal position for a more sustainable public finance in the medium term. Similarly, the primary deficit is estimated to reduce to 2.9% of GDP. Guided by the Medium-Term Fiscal Framework (MTFF), the fiscal consolidation will be accelerated once the inflationary pressure dissipates and economy fully recovers.

Medium-Term Fiscal Framework, 2023 – 2025

The medium-term period of 2023 – 2025 projection is based on the latest macroeconomic assumptions after considering the current global environment and commodity prices. Consequently, the 2023 – 2025 MTFF has been revised with underlying assumptions of real GDP growth averaging 6%, crude oil prices at USD90 per barrel and stable crude oil production of 530,000 barrels per day. These assumptions offer conservative estimates of revenue and prudent expenditure allocation during the MTFF period.

Total revenue in the medium-term is projected at RM854.3 billion or 14.7% of GDP, mainly contributed by non-petroleum revenue which is estimated at RM699.5 billion or 12% of GDP. Petroleum-related revenue is forecast at RM154.8 billion or 2.7% of GDP. The Government will continue efforts to improve revenue collection by enhancing revenue base, reducing leakages and exploring new sources of revenue guided by the adoption of MTRS.

TABLE 1.2. *Medium-Term Fiscal Framework (MTFF), 2023 – 2025*

	2023 – 2025	
	RM BILLION	**SHARE OF GDP (%)**
Revenue	854.3	*14.7*
Non-petroleum	*699.5*	*12.0*
Petroleum-related	*154.8*	*2.7*
Operating expenditure	842.8	*14.5*
Current balance	**11.5**	***0.2***
Gross development expenditure	263.9	*4.5*
Less: Loan recovery	*1.9*	*0.0*
Net development expenditure	262.0	*4.5*
COVID-19 Fund[1]	5.0	*0.1*
Overall balance	**-255.5**	***-4.4***
Primary balance	**-106.4**	***-1.8***
Underlying assumptions:		
Average real GDP growth (%)	4.5	
Average nominal GDP growth (%)	6.4	
Average crude oil price (USD per barrel)	90	
Average oil production (barrels per day)	530,000	

[1] A specific trust fund established under the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 to finance economic stimulus packages and recovery plan
Note: MTFF estimate, excluding budget measures
Source: Ministry of Finance, Malaysia

Meanwhile, on the expenditure side, the total indicative ceiling for the three years is estimated at RM1,111.7 billion or 19.1% of GDP with OE allocation projected at RM842.8 billion or 14.5% of GDP, while DE at RM263.9 billion or 4.5% of GDP. Overall, the fiscal deficit is expected to consolidate at a gradual pace with the overall balance averaging at 4.4% of GDP for the MTFF period. The lower deficit will give flexibility for the Government to regain fiscal room and provide counter-cyclical measures for future crises.

Conclusion

The post-pandemic period provides an opportunity for the Government to resume the reform initiatives to strengthen the economic and public finance resilience against future shocks. The publication of public consultation papers on environment, social and governance (ESG); research and development procurement; green procurement; tax legislation; targeted subsidy; and financing for sustainable development signifies the Government's commitment towards facilitating comprehensive reforms in the economic and social aspects as well as public finance management. Feedback and input from the public and relevant stakeholders will be taken into consideration in formulating Government's policies.

Moving forward, the Government is committed to improve the credibility of the fiscal policy conduct and framework through holistic reforms. Proactive fiscal reforms are imperative to ensure long-term fiscal sustainability, given the severity of the recent pandemic's adverse impacts on countries with fragile economic fundamentals. The experience of other countries in reforming their fiscal framework provides a valuable reference for the Government in adopting fiscal reform initiatives based on international best practices. These reforms include revenue enhancement measures and subsidy rationalisation programme to ensure fiscal sustainability and debt affordability. Overall, the Government has the responsibility to ensure effective and efficient fiscal framework to enhance the credibility of fiscal policy while maintaining macroeconomic stability and safeguarding wellbeing of the *rakyat*.

FIGURE 1.1. *Federal Government Overall and Primary Balance*

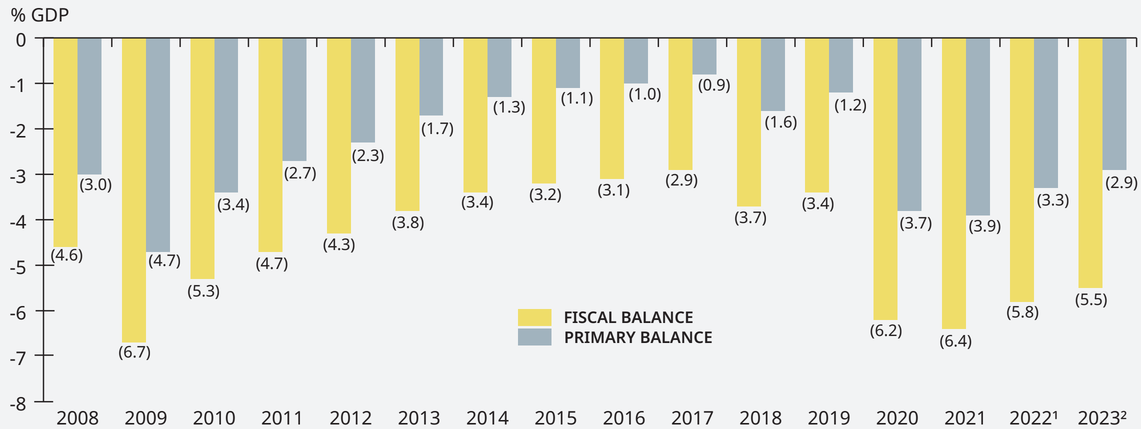


FIGURE 1.2. *Federal Government Revenue, Operating Expenditure and Current Balance*

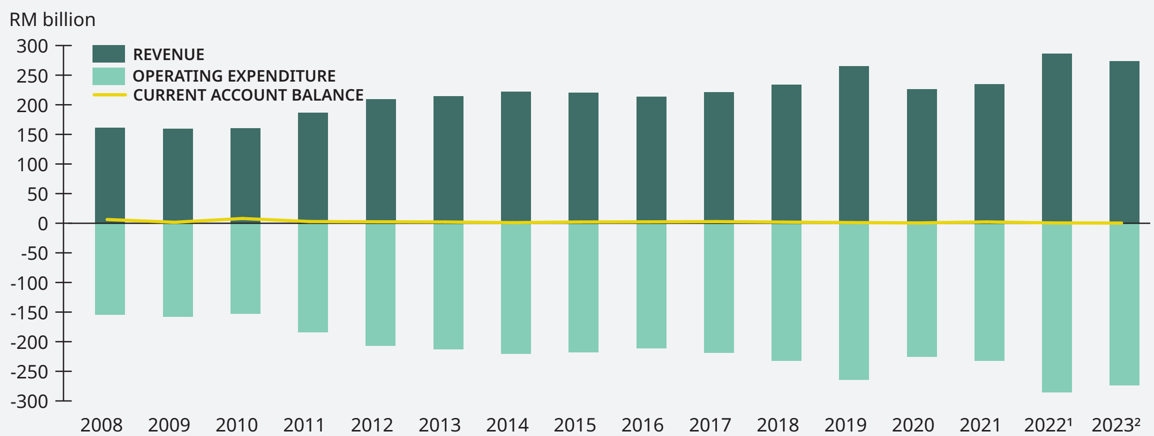


FIGURE 1.3. *Federal Government MTFF Overall Balance*

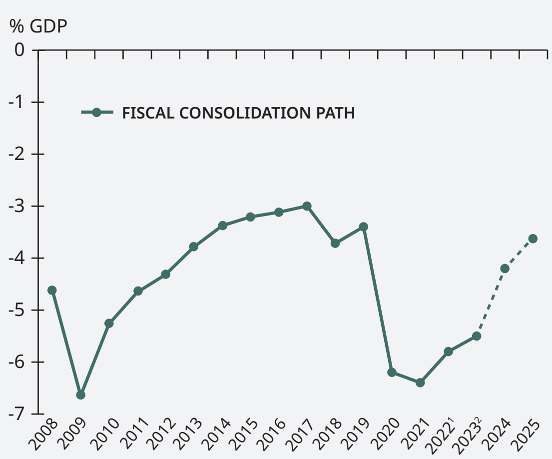
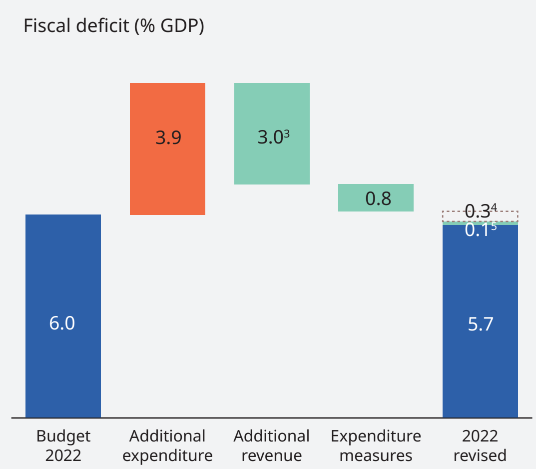


FIGURE 1.4. *Revised Fiscal Position in 2022*



[1]Revised estimate
[2]Budget estimate, excluding Budget 2023 measures
Source: Ministry of Finance, Malaysia

[3]Including additional dividend from PETRONAS (RM25 billion)
[4]Reflecting higher revised nominal GDP
[5]Additional borrowings