SECTION 3

Federal Government Expenditure

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Overview

The year 2022 saw the COVID-19 pandemic subsided with most countries moving towards endemic phase as economic and social activities normalised. The situation has provided temporary relief to most sovereigns around the world allowing governments to rebuild fiscal strength. Nevertheless, the recent global commodity prices hike and growing inflationary pressures resulting from geopolitical tensions, leading many nations to raise spending in order to provide policy support measures. Thus, the narrowing fiscal space poses challenges to governments in managing expenditure while safeguarding citizens' wellbeing and ensuring businesses' continuity.

As an open economy, Malaysia is no exception to the impact of these external shocks albeit at a relatively lesser extent as Malaysia is a commodity exporting country. The higher commodity prices has provided additional revenue which act as natural hedge against rising expenditures particularly subsidies and social assistance. The implementation of consumption subsidies for essential items has managed to contain inflation at 3.1% for the first eight months of 2022 as compared to around 11% if the subsidies are not provided. Although these subsidies, which are blanket in nature, help in the economic recovery in the short term, they are unsustainable in the longer term.

Against this backdrop, the Government will continue its expansionary fiscal stance while gradually embarking on public spending reforms, including moving towards a more targeted subsidy mechanism. During the year, the Government has implemented expenditure saving measures, such as reducing discretionary spending. In addition, public expenditure will be continuously reviewed to improve efficiency, effectiveness and productivity of public spending. This exercise will also optimise financial resources, reduce wastages and leakages, thus contributing towards fiscal consolidation and long-term sustainability.

Performance 2022

The Budget 2022 of RM332.1 billion was formulated based on the prospects of an improving economy as well as the normalisation of businesses and social activities. Of the total Budget, allocation for the operating expenditure (OE) was RM233.5 billion, development expenditure (DE) was RM75.6 billion while the COVID-19 Fund was RM23 billion based on the expectation that economic recovery will gain momentum in line with a steady progress of the National COVID-19 Immunisation Programme (PICK) and the implementation of the National Recovery Plan (NRP).

However, the geopolitical tensions particularly Russia-Ukraine conflict, have resulted in compounded global commodity prices increase. The Brent crude oil price surged from an average of USD71 per barrel in 2021 to breach USD100 per barrel in the first half of 2022 and reaching its peak of daily price at USD134 per barrel in March 2022. The crude palm oil (CPO) price also soared from an average of RM4,400 per tonne in 2021 to its peak of daily price at RM8,077 per tonne in March 2022. Meanwhile, the coal price escalated from averaging around USD80 per tonne in 2021 to more than USD400 per tonne in May 2022.

The higher commodity prices have necessitated the Government to allocate additional subsidies to contain inflation and cushion the rising cost of living. Hence, the estimated total expenditure is revised upward to RM385.3 billion in 2022, with the increase in OE to RM284.7 billion and the COVID-19 Fund to RM28.8 billion, while DE is reduced to RM71.8 billion. The social sector continues to receive the largest allocation with 36.8% of the total expenditure or 8.3% of GDP followed by other sectors, namely economic (17.1%; 3.8% of GDP), security (8.8%; 2% of GDP) and general administration (4.3%; 1% of GDP). Charged expenditures and transfer payments, including for debt service charges (DSC), retirement charges and transfers to state governments, account for 33% of total expenditure.

The revised **OE** is estimated to expand by 23% to RM284.7 billion (2021: RM231.5 billion), representing 16.6% of GDP mainly due to the significant increase in fuel and cooking oil subsidies. Emoluments, which constitutes 30.4% of total OE, is estimated at RM86.5 billion (2021: RM85.9 billion) due to annual salary increments for about 1.6 million civil servants. Retirement charges, which account for 10.1% of total OE, is anticipated to remain stable at RM28.7 billion (2021: RM29.1 billion) to accommodate about 921,500 pensioners and beneficiaries. In line with higher debt level, DSC are envisaged to expand by 13.2% to RM43.1 billion (2021: RM38.1 billion).

The outlays for subsidies and social assistance under OE is estimated to spike by 155.6% to RM58.9 billion (2021: RM23 billion) mainly due to significantly higher global crude oil price, as the retail prices are fixed at RM2.05 per litre for RON95 and RM2.15 per litre for diesel. To further ease the *rakyat*'s burden of higher cost of living, the Government provided subsidies for bottled cooking oil from August 2021 until June 2022 as well as for poultry products since early 2022. The significant provision for subsidies and social assistance has impacted the Government's budget and prompted for

TABLE 3.1. *Federal Government Operating Expenditure by Component, 2021 – 2023*

COMPONENT	RM MILLION			CHANGE (%)			SHARE (%)		
	2021	2022[1]	2023[2]	2021	2022[1]	2023[2]	2021	2022[1]	2023[2]
Emoluments	85,854	86,510	90,765	*3.4*	*0.8*	*4.9*	*37.1*	*30.4*	*33.3*
Retirement charges	29,095	28,674	29,079	*5.7*	*-1.4*	*1.4*	*12.6*	*10.1*	*10.7*
Debt service charges	38,069	43,100	46,100	*10.4*	*13.2*	*7.0*	*16.4*	*15.1*	*16.9*
Grants and transfers to state governments	7,547	8,025	8,077	*-1.6*	*6.3*	*0.6*	*3.3*	*2.8*	*3.0*
Supplies and services	24,924	33,296	32,035	*-15.0*	*33.6*	*-3.8*	*10.8*	*11.7*	*11.8*
Subsidies and social assistance	23,041	58,900	42,016	*16.6*	*155.6*	*-28.7*	*10.0*	*20.7*	*15.4*
Asset acquisition	596	533	911	*-5.7*	*-10.6*	*71.1*	*0.3*	*0.2*	*0.3*
Refunds and write-offs	482	375	459	*-26.3*	*-22.2*	*22.4*	*0.2*	*0.1*	*0.2*
Grants to statutory bodies	13,391	13,483	15,117	*27.2*	*0.7*	*12.1*	*5.8*	*4.7*	*5.6*
Others	8,517	11,804	7,781	*-22.6*	*38.6*	*-34.1*	*3.5*	*4.2*	*2.8*
Total	**231,516**	**284,700**	**272,340**	***3.1***	***23.0***	***-4.3***	***100.0***	***100.0***	***100.0***
Share of GDP (%)	***15.0***	***16.6***	***15.0***						

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

the implementation of cost saving measures. Consequently, a circular was issued in July 2022 on Guidelines on Public Expenditure Savings whereby the savings is being used to partially finance the additional subsidy-related expenditure.

Supplies and services are projected to be higher at RM33.3 billion (2021: RM24.9 billion) mainly due to higher outlays for repairs and maintenances, procurement of medical supplies as well as expenses for professional services, especially for contract personnel. The supplies and services spending have normalised to its pre-COVID-19 level in line with the lifting of containment measures and resumption of physical operation in Government offices.

Grants to statutory bodies, which are predominantly for emoluments and outlays of supplies and services, are expected to remain stable at RM13.5 billion (2021: RM13.4 billion). Meanwhile, grants and transfers to state governments are estimated at RM8 billion (2021: RM7.5 billion), of which RM6 billion are constitutional transfers as stipulated under the Federal Constitution.

The **DE** in 2022 is revised downward to RM71.8 billion from the original budget of RM75.6 billion in line with expenditure recalibration and moderate progress of development programmes and projects, which are still undergoing cost review exercises following the increase in the cost of raw materials. Apart from programmes and projects outlined under the five-year Malaysia Plans, financial obligations related to strategic projects as well as public-private partnership (PPP) and private finance initiatives (PFI) are also covered under DE.

The economic sector remains the largest recipient at 52.1% followed by other sectors, namely social (30.9%), security (12.2%) and general administration (4.8%). The outlays for economic sector are estimated at RM37.4 billion (2021: RM31.3 billion), mainly for upgrading public transportation infrastructure, improving public utilities, enhancing agriculture as well as intensifying trade and industrial activities. Transport; energy and public utilities; as well as agriculture subsectors constitute 27.2% of the total DE. The transport subsector is allocated RM14.1 billion (2021: RM13 billion) mainly to finance infrastructure development such as Rapid Transit System Link, construction and upgrading of Pulau Indah Ring Road Phase 3 and upgrading and expansion of Sultan Ismail Petra Airport in Kelantan. In addition, allocation was also provided for financial obligations arising from strategic projects such as Light Rail Transit Line 3 and Jambatan Sultan Abdul Halim Mu'adzam Shah, Pulau Pinang.

Energy and public utilities subsector is allocated RM2.6 billion (2021: RM2.1 billion) to finance, among others construction and upgrading of sewerage treatment plant and pipes in Kinta Barat, Perak, and Seberang Perai Utara, Pulau Pinang; construction of water treatment facilities in Sik, Kedah and Keningau, Sabah; National Non-Revenue Water (NRW) Programme as well as water and electricity supplies projects in rural areas nationwide. Meanwhile, the agriculture subsector is allocated RM2.8 billion (2021: RM2.5 billion) mainly for oil palm replantation endowment fund and Settler's Development Programme under Federal Land Development Authority (FELDA) as well as improving rice cultivation in Muda Agricultural Development Authority (MADA) areas.

Spending for social sector is expected to decline slightly by 1.9% to RM22.2 billion in 2022 (2021: RM22.6 billion). The education and training as well as health subsectors continue to receive the highest allocation under the sector. A sum of RM11.7 billion will be channelled to the education and training subsector, particularly for construction, upgrading and renovation of schools and higher education institutions, enhancing technical and vocational education training (TVET) programmes and providing professional and skills programme. Meanwhile, expenditure on health subsector is expected to decrease to RM4.5 billion (2021: RM8.7 billion) since supply of medicine for health facilities has been reclassified to OE. The spending is mainly for the construction, upgrading, renovation and repair works of health facilities all over Malaysia.

TABLE 3.2. *Federal Government Development Expenditure by Sector, 2021 – 2023*

SECTOR	RM MILLION			CHANGE (%)			SHARE (%)		
	2021	2022[1]	2023[2]	2021	2022[1]	2023[2]	2021	2022[1]	2023[2]
Economic	**31,284**	**37,431**	**54,051**	***9.0***	***19.6***	***44.4***	***48.7***	***52.1***	***56.9***
of which:									
Transport	12,988	14,110	16,460	*1.6*	*8.6*	*16.7*	*20.2*	*19.7*	*17.3*
Trade and industry	1,756	2,084	2,682	*-31.8*	*18.7*	*28.7*	*2.7*	*2.9*	*2.8*
Energy and public utilities	2,115	2,557	3,251	*-8.6*	*20.9*	*27.2*	*3.3*	*3.6*	*3.4*
Agriculture	2,463	2,789	3,095	*23.0*	*13.2*	*11.0*	*3.8*	*3.9*	*3.3*
Environment	1,310	2,059	2,333	*-1.1*	*57.2*	*13.3*	*2.0*	*2.9*	*2.5*
Social	**22,603**	**22,167**	**25,156**	***63.5***	***-1.9***	***13.5***	***35.2***	***30.9***	***26.5***
of which:									
Education and training	8,230	11,708	12,788	*22.2*	*42.3*	*9.2*	*12.8*	*16.3*	*13.5*
Health	8,719	4,457	4,714	*118.9*	*-48.9*	*5.8*	*13.6*	*6.2*	*5.0*
Housing	1,360	1,660	2,053	*34.0*	*22.1*	*23.6*	*2.1*	*2.3*	*2.2*
Security	**7,498**	**8,752**	**10,831**	***29.6***	***16.7***	***23.8***	***11.7***	***12.2***	***11.4***
General administration	**2,872**	**3,450**	**4,962**	***-5.4***	***20.1***	***43.8***	***4.4***	***4.8***	***5.2***
Total	**64,257**	**71,800**	**95,000**	***25.1***	***11.7***	***32.3***	***100.0***	***100.0***	***100.0***
Share of GDP (%)	***4.2***	***4.2***	***5.2***						

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

The outlays of the security sector is estimated to increase by 16.7% to RM8.8 billion (2021: RM7.5 billion) mainly for acquisition and enhancement of military and internal security equipment as well as ongoing construction of offices, quarters and camps. Likewise, the general administration sector expenditure is expected to increase by 20.1% to RM3.5 billion (2021: RM2.9 billion) where the bulk of the outlays is for the development of network systems as well as the refurbishment and upgrading of Government's facilities and building.

COVID-19 Fund

The COVID-19 Fund allocation for 2022 is revised from RM23 billion to RM28.8 billion to finance electricity subsidies of RM5.8 billion as the Government maintains the Imbalance Cost Pass-Through (ICPT) rate. As of August 2022, RM10.2 billion has been utilised mainly for Bantuan Keluarga Malaysia (BKM)[1] amounting to RM3.7 billion to ease the burden of the *rakyat.* The programme has benefitted 8.6 million recipients, from the lower income group. In addition, RM1.9 billion was disbursed for the Wage Subsidy Programme, sustaining about 685,000 workers while RM1.1 billion for social support assistance to vulnerable groups. The Government has also disbursed RM1.1 billion for COVID-19 related expenses to enhance health equipment and bedding capacity in hospitals' intensive care units as well as to procure among others, test kits, reagents, medicines and sanitizers. In total, RM86 billion or 78.2% of the RM110 billion COVID-19 Fund ceiling has been utilised as of August 2022.

[1] Formerly known as Bantuan Prihatin Nasional.

TABLE 3.3. *COVID-19 Fund Allocation*

NO.	PROGRAMMES	RM MILLION	
		2022[1]	2023[2]
1	Wage subsidy, job retention and workers' hiring incentive and training assistance programmes	2,942	-
2	Bantuan Prihatin Nasional	8,350	-
3	Small scale projects	2,203	-
4	Skill and upskilling programmes	600	-
5	PENJANA SME financing	2,000	-
6	PRIHATIN SME grant	-	-
7	Micro credit loans under Bank Simpanan Nasional and TEKUN Nasional	1,200	-
8	Allocation for COVID-19 related expenses	2,000	-
9	Food security fund	130	-
10	COVID-19 special allowance for frontliners	-	-
11	PENJANA National Fund	-	-
12	ePenjana	350	-
13	Electricity bill discounts	5,920	-
14	Additional RM100 for Bantuan Sara Hidup	-	-
15	Special assistance to students of higher education institutions	-	-
16	Bumiputera Relief Financing	-	-
17	MY30 public transport subsidy	200	-
18	Social assistance for taxi drivers, school bus drivers, tour bus drivers, tour guides, trishaw operators and e-hailing drivers	10	-
19	Social assistance support to vulnerable groups	2,000	5,000
20	Smart automation grant	400	-
21	Soft Loan under MyCreative Venture	40	-
22	Social protection and training for gig economy workers	50	-
23	E-Dagang campaign for SME and micro enterprises	150	-
24	"Shop Malaysia Online" for online consumption	-	-
25	PEKA B40 health care support	-	-
26	Grant for child care centers and kindergartens	10	-
27	Digital content fund	100	-
28	Assistance to non-governmental organisations	110	-
29	Digitalisation of government service delivery	25	-
30	Digitalisation marketing and promotion fund under the Cultural Economy Development Agency (CENDANA)	10	-
31	MyAssist SME One Stop Centre	-	-
	TOTAL	**28,800**	**5,000**

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

Outlook for 2023

The Budget 2023 is formulated in anticipation of a more challenging environment due to slower global growth prospect and prolonged geopolitical tensions. With persisting global inflationary pressures and limited fiscal space, the Government has to balance between sustaining economic growth and safeguarding the wellbeing of the *rakyat*. Allocation will be channelled towards facilitating post-pandemic recovery to enhance business competitiveness and strengthening of the nation's economic resilience. At the same time, the Government is embarking on Public Expenditure Review (PER) and targeted subsidy initiatives to consolidate fiscal position. This is in line with the Government's commitment to maintain fiscal prudence and discipline in order to ensure fiscal sustainability in the long-term.

The Budget 2023 continues to provide substantial support to the economy with a total allocation of RM372.3 billion or 20.5% of GDP. Of this amount, RM272.3 billion or 73.1% will be allocated for OE while RM95 billion or 25.5% for DE. The remaining RM5 billion is for outstanding payments of the COVID-19 Fund commitments made in 2022 as stipulated in Section 8(1), Act 830[2].

In terms of sectoral allocation, 37.2% is allocated for programmes and projects under social sector, followed by economic (19.5%), security (9.9%) and general administration (5.5%) sectors. The balance of 27.9% is allocated for charged expenditures and transfer payments. The top three recipients of the Budget 2023 are the Ministry of Finance (RM67.2 billion), Ministry of Education (RM55.6 billion) and Ministry of Health (RM36.1 billion), constituting 43.3% of total expenditure.

The allocation for **OE** is estimated at RM272.3 billion or 15% of GDP in 2023. The amount is slightly lower by 4.3% attributed to reduced allocation for subsidies and social assistance due to expected moderation in commodity prices coupled with the gradual implementation of targeted subsidy mechanism. Nevertheless, higher allocation is provided for emoluments, retirement charges, DSC and grants to statutory bodies.

Emoluments for civil servants remains the largest component constituting 33.3% of OE. The component is estimated to increase by 4.9% to RM90.8 billion mainly due to provision of special annual salary increment for civil servants as well as absorption of contract officers to permanent positions, particularly in the health and education services. The absorption is estimated to benefit about 5,700 medical officers and 18,100 teachers.

Meanwhile, retirement charges is estimated to increase by 1.4% to RM29.1 billion representing 10.7% of total OE. A total of RM21.9 billion or 75.3% of retirement charges comprise pension payments for about 958,700 pensioners and beneficiaries while the remaining are mainly for gratuity payments and cash award in lieu of accumulated leave. As Malaysia is now an ageing nation based on the definition by the United Nations, pension liabilities are expected to expand further. Therefore, the Government is exploring options to efficiently manage future pension obligations.

As stipulated in the Federal Constitution, DSC is a charged item that must be prioritised before all other OE. The DSC is estimated to grow by 7% to RM46.1 billion in tandem with higher financing needs for DE and COVID-19 Fund. Of the amount, 98.4% is allocated for the payment of coupons on domestic debts, particularly Malaysian Government Securities (MGS) and Malaysian Government Investment Issues (MGII), while the balance is for offshore loans. The DSC ratio to revenue is estimated at 16.9% as compared to the 15% threshold in accordance to international best practices.

Supplies and services, which represent 11.8% of OE, is expected to decline by 3.8% to RM32 billion. The reduction is attributed to the Government's initiative to absorb contract personnel into the service, resulting in the shift of allocation from supplies and services to emoluments. Ministry of Health will receive

[2] Section 8(1), Act 830 states that any outstanding amount payable from the Fund shall be paid within six months from its expiration date on 31 December 2022.

the highest allocation for supplies and services (35%), mainly for the procurement of medical supplies and professional services as well as repairs and maintenance.

Subsidies and social assistance is projected to register RM42 billion mainly for fuel and agriculture-related subsidies; cash and welfare assistance; toll compensation; as well as education-related assistance. Fuel subsidies are estimated to decline with the expectation of lower global crude oil price in 2023 averaging USD90 per barrel and in line with the gradual move towards targeted subsidies in ensuring economic efficiency and equitable distribution of resources. Meanwhile, the Government will continue to provide BKM assistance aimed at easing the financial burden of the lower income group.

Allocation for grants to statutory bodies is expected to increase by 12.1% to RM15.1 billion. The bulk of the allocation is for operational expenses of 20 public universities and nine teaching hospitals, which account for 60.2% of the disbursement. The Federal Government also provides grants and transfers to state governments amounting to RM8.1 billion, of which RM6.1 billion are constitutional grants as provided under the Federal Constitution.

The implementation of **DE** programmes and projects is expected to gain momentum as the nation enters the third year of the Twelfth Malaysia Plan (12MP). As such, a total of RM95 billion will be allocated in 2023 mainly to support economic growth and the post COVID-19 recovery. The allocations will be channelled to programmes and projects with high socio-economic impacts and in line with Sustainable Development Goals (SDG). The Government will also continue to provide allocation to meet PPP/PFI-related commitments and financial obligations mainly to redeem the USD3 billion 1MDB's maturing bond in March 2023. About 1,700 new projects have been approved with an allocation of RM13.7 billion on top of the existing 5,900 projects. In terms of allocation by sector, economic sector remains the largest recipient of DE at 56.9%, followed by social (26.5%), security (11.4%) and general administration (5.2%).

The economic sector will be allocated RM54.1 billion in line with the efforts to enhance economic activities. The main subsectors under this sector are transport, agriculture as well as energy and public utilities. The transport subsector accounts for the largest share constituting 17.3% of total DE or RM16.5 billion. Among new projects that will be undertaken are construction of the Trans Borneo Highway; Sarawak Sabah Link Road Phase 2; Pengalat – Papar bypass road in Sabah; and upgrading of Pasir Gudang Highway.

The agriculture subsector will be allocated RM3.1 billion or 3.3% of total DE to address rising concern regarding the nation's food security. New programmes and projects under the subsector include establishment of Dana Modenisasi Agromakanan, replanting of oil palm and rubber trees, as well as upgrading of agriculture facilities and infrastructure. As for the energy and public utilities subsector, a sum of RM3.3 billion or 3.4% of DE will be earmarked for projects to improve rural public amenities as well as provide clean water, sanitation and affordable clean energy. Among the new projects are construction of water treatment plant in Landeh, Sarawak; solar hybrid system in Beluran, Sabah; and upgrading of regional sewerage treatment plant in Pasir Gudang, Johor.

Social sector is the second largest recipient amounting to RM25.2 billion or 26.5% of total DE. Education and training subsector is allocated RM12.8 billion to provide better education facilities for the *rakyat* mainly through construction and upgrading of schools as well as higher learning and training institutions such as SMK Nabalu, Sabah; SMK Denai Alam, Selangor; as well as Melaka Matriculation College building. Health and housing subsectors will receive RM4.7 billion and RM2.1 billion, respectively to build, upgrade and repair health facilities and affordable housing. New projects include construction of women and children's block in Melaka General Hospital and People's Housing Project (PPR) in Arau, Perlis; Marang, Terengganu; and Machang, Kelantan.

The security sector comprising defence and internal security will receive RM10.8 billion, of which RM6 billion will be allocated to defence subsector while the remaining RM4.8 billion to internal security subsector. These allocations are for upgrading military and security equipment, developing integrated network services as well as construction and upgrading of military camps, police stations, prisons and quarters for security personnel.

The general administration sector will be allocated RM5 billion mainly to improve productivity and quality of public service delivery through the enhancement of information and communications technology (ICT) systems as well as refurbishments and maintenance of Government buildings and facilities. The projects include expanding of MYGOVNET network infrastructure and construction of new building for Road Transport Department in Kajang, Selangor.

FEATURE ARTICLE

The Rise of Public Expenditure: The Need for Review and Optimisation

Introduction

The Federal Government expenditure is part of fiscal policy tools along with taxes and public debt. The two main categories for Federal Government expenditure are operating and development expenditure. Salaries, pension, purchase of supplies and services as well as subsidies are part of the Federal Government's operating expenditure (OE). Meanwhile, the development expenditure (DE) consists of capital investment encompassing physical and non-physical programmes and projects, such as construction of schools, roads, offices and hospitals as well as human capital development grants.

The Federal Government expenditure in Malaysia is governed by the Federal Constitution and the Financial Procedure Act 1957 [Act 61]. Under these legislations, OE can only be financed through revenue while the DE can be financed either through revenue or borrowings.

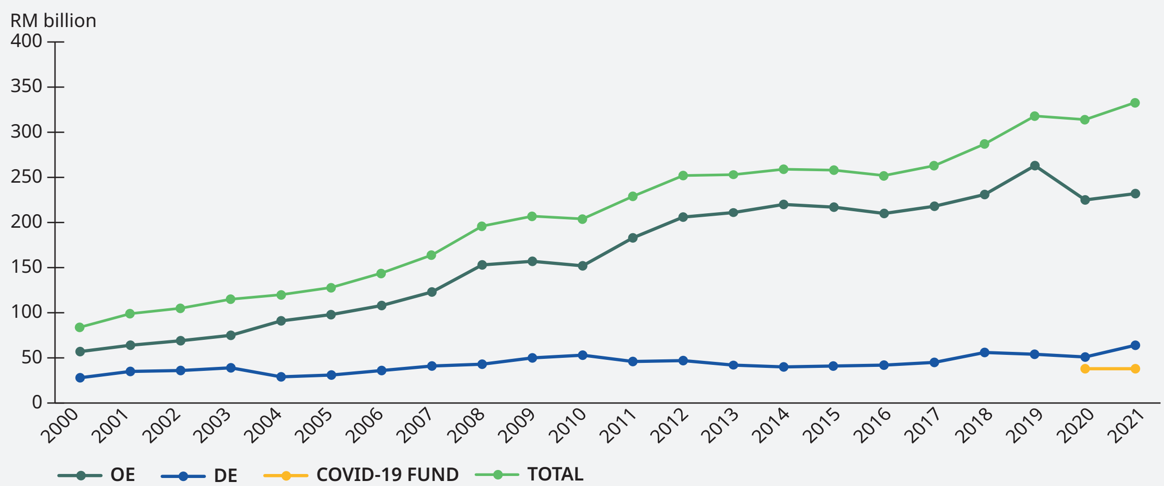
However, a special exemption was made during the COVID-19 crisis to allow crisis mitigation fiscal measures, including of OE in nature, to be funded through borrowings via the enactment of the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 (COVID-19 Act) [Act 830]. The COVID-19 Act allows the Government to increase the statutory limit of the Federal Government's outstanding debt under the Loan (Local) Act 1959 [Act 637] and Government Funding Act 1983 [Act 275]. The additional borrowing is being channelled into the COVID-19 Fund, a specific trust fund established under the COVID-19 Act. The Fund assists the Government in providing sufficient vaccinations for the population, facilitating businesses, revitalising the economy as well as easing the burden of the *rakyat*.

The prevalence of COVID-19 crisis and the implementation of a series of economic stimulus packages have affected the Federal Government revenue and increased total expenditure significantly thus limiting the Government's fiscal space. As such, there is a need for the Government to carefully balance between the responsibility of ensuring a healthy fiscal balance and improving wellbeing of the *rakyat*. In this regard, a review of the Government expenditure is needed, particularly on spending priorities, to improve the effectiveness and efficiency of public expenditure. This is in line with the Government's fiscal consolidation efforts towards strengthening public finance and ensuring long-term fiscal sustainability.

Trend Analysis of OE and DE

From 2000 until 2021, Government spending increased on an annual average of 7% from RM85 billion to RM333 billion. This was mainly due to the significant increase in OE, as shown in Figure 1. Meanwhile, DE increased from RM27.9 billion in 2000 to RM64.3 billion in 2021 with a slower average annual growth of 3.9%.

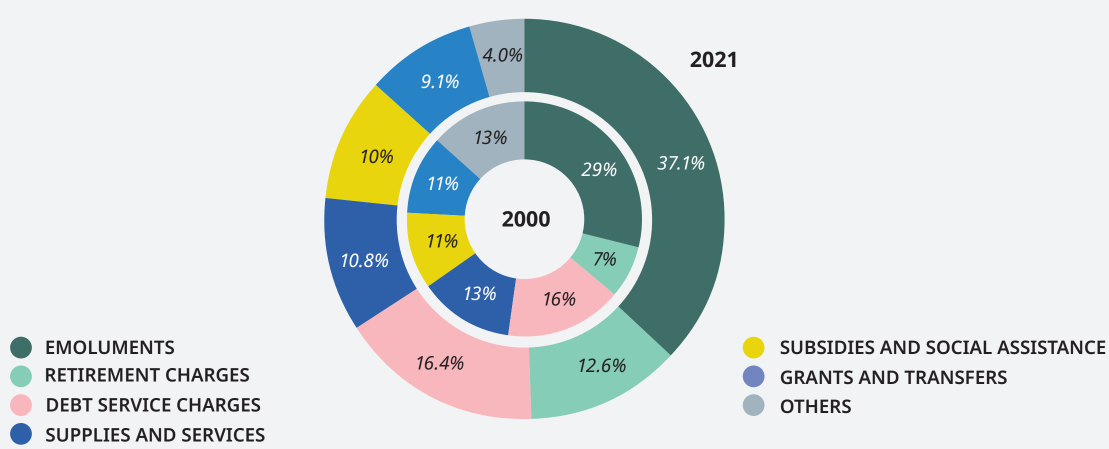
FIGURE 1. *Federal Government Expenditure, 2000 – 2021*



Source: Ministry of Finance, Malaysia

The OE components gradually grew from 2000 to 2021 with emoluments being the biggest component. The emoluments spending in 2021 was 37.1%, followed by debt service charges (DSC) (16.4%), retirement charges (12.6%), supplies and services (10.8%), subsidies and social assistance (10%), grants and transfers (9.1%) and other components (4%), as shown in Figure 2.

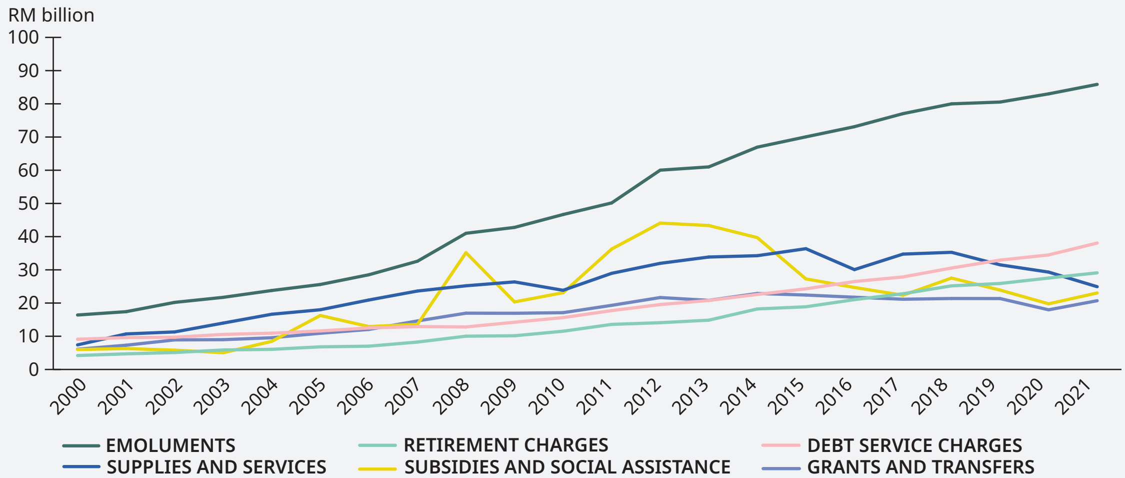
FIGURE 2. *Operating Expenditure Comparison by Component (% to total), 2000 and 2021*



Source: Ministry of Finance, Malaysia

Retirement charges, emoluments and DSC have continuously grown over the past 20 years as shown in Figure 3. The retirement charges recorded the highest growth at an annual average of 9%, from RM4.2 billion in 2000 to RM29.1 billion in 2021 in tandem with increasing life expectancy. Meanwhile, emoluments increased by 7.8% due to the annual salary increments and DSC grew by 6.7% attributed to higher borrowings.

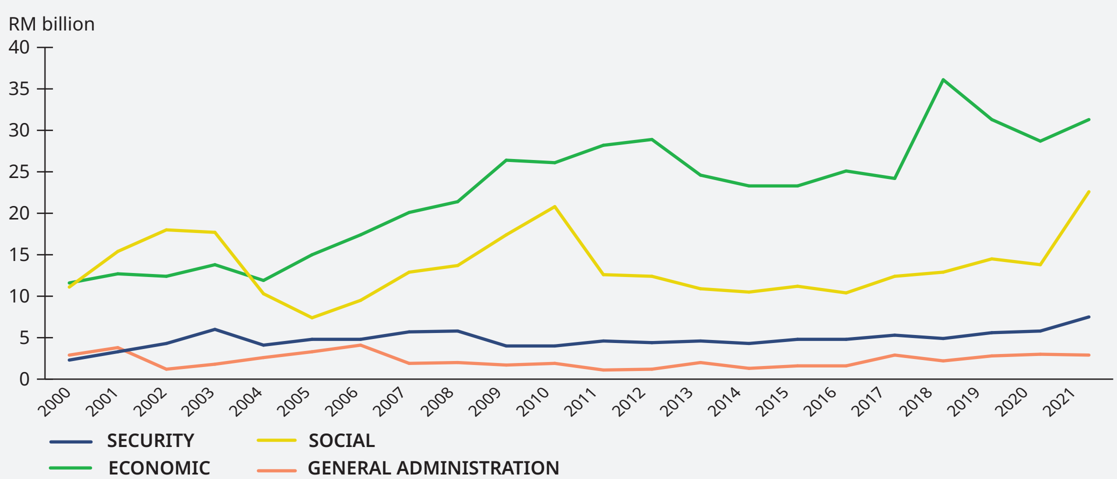
FIGURE 3. *Operating Expenditure by Major Component, 2000 – 2021*



Source: Ministry of Finance, Malaysia

In the early 2000s, the DE spending was mostly on social sector, particularly on education and training facilities. In line with the vision to become a developed country, starting from the year 2004, the Government has been continuously investing more in the economic sector, mainly for infrastructure and transportation projects as shown in Figure 4. However, in 2021 there was a sharp increase in social sector by 63.5% as compared to the previous year, particularly in the healthcare subsector, following the Government's effort in combating the COVID-19 pandemic.

FIGURE 4. *Development Expenditure by Sector, 2000 – 2021*



Source: Ministry of Finance, Malaysia

Public Expenditure Review

Public Expenditure Review (PER) assesses options for improving public expenditure effectiveness and efficiency. As emphasised by the World Bank (2011), the review aims to assist the Government to gradually reduce wastage and inefficient spending in order to improve public sector performance and thereby strengthen service delivery. In the context of fiscal consolidation, the review will enhance the public services by increasing spending efficiency as well as reallocating resources from lower priorities to strategic initiatives.

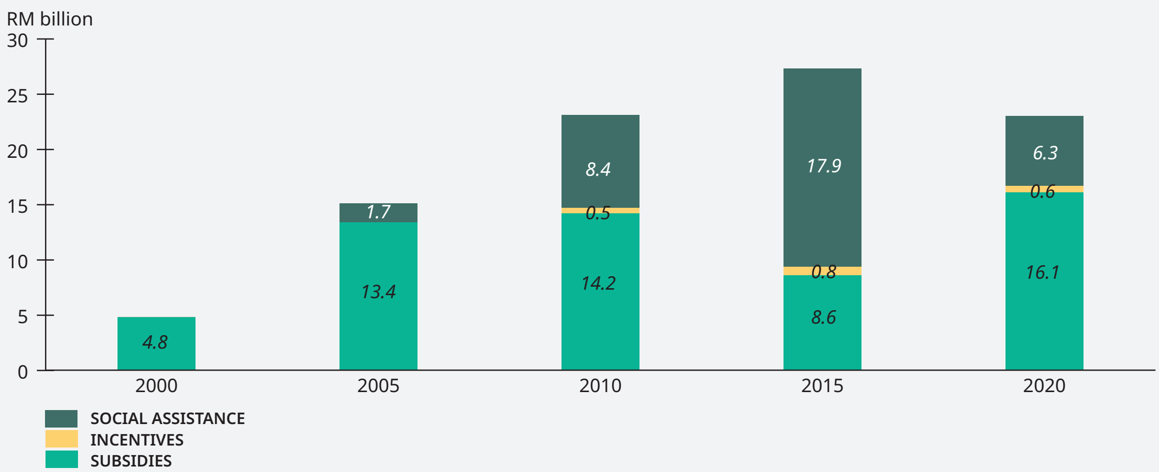
The total OE is expected to further increase due to the significant rise in subsidies and social assistance following the surge in commodity prices. The escalating spending on these components, which are part of the locked-in items, will significantly reduce the Government's ability to create fiscal space. Should additional spending needs arise in the future, this fiscal space will serve as buffer to provide sufficient allocation. Thus, there is a need for the Government to undertake PER. Among the expenditure components that should be further reviewed are subsidy programmes, pension, public-private partnership (PPP) spending and financial commitments, as well as transfers to statutory bodies.

Subsidies and social assistance

Subsidies, social assistance and incentives programmes is a form of benefit given to an individual, business or institution by the Government to reduce financial burden of the recipient and is considered to be in the overall interest of the public[1]. These programmes are generally categorised as subsidies and social assistance under OE and therefore, must be financed only by the Government revenue as stipulated under Act 61.

The subsidies and social assistance programme in Malaysia have been implemented to improve the wellbeing and alleviate the burden of the *rakyat,* especially the vulnerable groups. Since 2000 until 2021, the Government has spent more than RM485 billion on these programmes with an average of RM22 billion each year. Expenditure trends of the subsidies and social assistance categories are as shown in Figure 5. The component of the subsidies and social assistance in 2021 is fuel subsidies at 45%, followed by education (12.5%), welfare (9.6%), agriculture (6.9%), transport (6.8%) and basic necessity goods (4.4%).

FIGURE 5. *Subsidies and Social Assistance, 2000 – 2020*



Source: Ministry of Finance, Malaysia

Note: Examples of subsidies are fuel, electricity and agricultural input subsidies. Incentives include fisherman and agricultural output incentives. Among social assistance are education scholarship and cash assistance.

[1] https://www.investopedia.com/terms/s/subsidy.asap

Since 2021, subsidies and social assistance spending has surged, particularly for fuel and cooking oils, driven by higher commodity prices. In the first half of 2022, Malaysia benefited in the form of revenues from the high crude oil prices which soared above USD100 per barrel. However, the subsequent increase in fuel subsidies has more than doubled that of the petroleum-related revenue. Similarly, subsidies for cooking oils have far surpassed the revenue collected from the higher crude palm oil price. In total, subsidies and social assistance are estimated to cost the Government about RM80 billion in 2022, higher than the budgeted DE of RM76 billion for 2022.

Subsidies and social assistance programmes implemented independently by various ministries and agencies have posed a challenge in coordinating the implementation of the programmes efficiently, leading to overlapping, inefficiencies and ineffectiveness of the allocations and disbursements of funding. In addition, the current surge in the subsidies and social assistance bills has demanded the Government to review and consolidate the programmes to improve accountability of public spending.

Subsidy programmes that are blanket in nature leads to concerns of leakages and wastage of resources. The blanket subsidies disbursement, such as fuel subsidies for example, are inefficient and costly as it is also enjoyed by the high-income group. Blanket subsidies create inefficiency in energy consumption as well as is fiscally unsustainable. This leads to market distortion and affects energy supply growth to meet the demand from growing populations and economies (ADB, 2016). Therefore, implementation of targeted subsidies, especially on fuel and electricity, would optimise the Government's financial resources as the savings obtained can be redistributed for other priorities. However, the implementation of the targeted subsidies would need to be effectively coordinated to mitigate the potential impacts on the economy, particularly inflation. Hence, the Government is transitioning towards implementation of targeted subsidies to ensure that the nation's resources are equitably distributed, especially to those who are more in need of Government aid.

Pension reform

Currently, the Malaysian public sector adopts the defined benefit pension scheme[2] in which pensioners are entitled to retirement benefits comprising of pensions, gratuities, cash award in lieu of leave and medical benefits. The Government is responsible to provide remuneration[3] to members of public service as stipulated in the Federal Constitution. The pension scheme is governed under six key legislations[4] that cover the Federal Government and state governments; local authorities and statutory bodies; members of administration and secretaries; the judiciary; as well as Members of Parliament.

For the past decade, pension expenses have increased more than two-fold from RM13.6 billion in 2011 to RM29.1 billion in 2021. This trend is expected to continue and the expenses incurred will be unsustainable as Malaysia has become an ageing nation based on the United Nations definition (DOSM, 2022). As a result of the increasing life expectancy of Malaysians, the pension liabilities involving pension pay-out and derivatives will have to be committed for a longer period thus requiring higher allocation in the future.

In addressing the increasing pension liabilities, various reforms have been made to the pension scheme. In line with increasing life expectancy, the mandatory retirement age has been revised several times from 55 in 1951 to 60 in 2012. Furthermore, in managing the pension liabilities, the Pension Trust Fund was established under the Pensions Trust Fund Act 1991 [Act 454] with an initial endowment of RM500 million, which is expected to grow via investments as specified in the Act.

[2] A defined benefit pension scheme provides pension benefits accrues usually according to a function of one or more factors such as age, length of services and final salary, regardless of the contribution or return on investment of the pension scheme (IMF, 2014).
[3] In the Federal Constitution, remuneration includes salary or wages, allowances, pension rights, free or subsidised housing, free or subsidised transport and other privileges capable of being valued in money.
[4] Pensions Act 1980 [Act 227]; Statutory and Local Authorities Pension Act 1980 [Act 239]; Pensions Adjustment Act 1980 [Act 238]; Retirement Fund Act 2007 [Act 662]; Judges' Remuneration Act 1971 [Act 45]; and Members of Parliament (Remuneration) Act 1980 [Act 237].

In enhancing the governance and optimising the returns of the Fund, the Act 454 was later replaced by the Retirement Fund Act 2007 [Act 662] that led to the establishment of the Retirement Fund (Incorporated) (KWAP). Moving forward, KWAP is expected to further strengthen its ability to grow the fund size as well as elevate service levels for pensioners.

Public-private partnership spending and financial commitments

PPP is a form of cooperation between the public and private sector whereby a stand-alone business is created, funded and managed by the private sector as a package that encompasses construction management, maintenance and repair works as well as replacement of public amenities comprising buildings, infrastructures, equipment and facilities (UKAS, 2022). Meanwhile, the Government acts mainly as the regulator of the projects. In Malaysia, there are two types of PPPs, which are private finance initiatives and privatisation as illustrated in Figure 6.

FIGURE 6. *Comparison of Conventional, Private Finance Initiatives (PFI) and Privatisation Methods*

	PPP (Public-Private Partnerships)	
Conventional	**Private Finance Initiatives (PFI)**	**Privatisation**
Procurement funded directly through Government budget	Funding through private financial resources without Government guarantee	Funding through private financial resources without Government guarantee
Immediate impact on Government budget	Impact on Government budget spread over the duration of concession period	For user-pays model, there are no financial implication to the Government. While the government-pays model, there are financial implications
Risk entirely borned by Government	Risks are allocated to parties which can manage them most efficiently	Risk are entirely borne by the private sector
Extensive public sector involvement in each stage of project implementation and maintenance throughout life of project	Public sector involvement is through enforcement of pre-agreed KPIs	Government acts as regulator
Relationship with private contractor is short term	Relationship with private contractor is long term over entire project life	Relationship with private contractor is long term over entire project life
Suitable for projects with high socioeconomic returns and projects justified on strategic considerations	Suitable for projects with commercial viability	Suitable for projects with high commercial viability

Source: Public Private Partnership Unit (UKAS)

PPP aims to ease the Government's burden in providing high immediate capital for development projects. It also allows for improvement in public facilities and services as PPP encourages public and private sector innovation through the sharing of expertise and experience in implementing the PPP projects. Since the introduction of PPP during the Ninth Malaysia Plan, 116 projects have been implemented such as highways, government buildings as well as educational and medical facilities. However, the PPP concession commitment and lease payments for some of the projects have burdened the Government's finance.

The 1991 Privatisation Master Plan that serves as the guideline for PPP implementation, is being revised to further clarify and improve the processes involved as well as provide direction towards a more holistic execution of programmes and projects, in line with national priorities. Hence, as highlighted in the Twelfth Malaysia Plan (12MP), a new PPP blueprint will focus on a comprehensive revision of current policy frameworks.

The new PPP blueprint will include aspects for project implementation and financing business models to ensure better terms and conditions for both public and private sectors. The blueprint is expected to improve financial sustainability and commercial viability of future PPP projects as well as adhere to good governance and international best practices.

Grants to statutory bodies

Statutory body is defined by the Statutory Bodies (Accounts and Annual Reports) Act 1980 [Act 240] as "anybody corporate, irrespective of the name by which it is known, that is incorporated pursuant to the provisions of Federal law and is a public authority or an agency of the Government of Malaysia but does not include a local authority and a body corporate that is incorporated under the Companies Act 1965".

There are more than 130 statutory bodies at the Federal level as at July 2022. Examples of statutory bodies are Federal Land Development Authority, Majlis Amanah Rakyat, public higher education institutions such as University Malaya, regional development authorities such as East Coast Economic Region Development Council and port authorities such as Port Klang Authority. Meanwhile, statutory bodies established under state enactments are governed entirely by the state governments, such as the Selangor State Development Corporation and Johor Corporation.

Federal Statutory Bodies are governed by ministries subjected to their establishment acts to carry out specific Government functions in various sectors. The largest income source for Federal Statutory Bodies are grants from the Government, particularly to finance operational expenses including emoluments as well as supplies and services. The total amount of grants channelled to Federal Statutory Bodies has increased from RM4 billion in 2000 to RM13.2 billion in 2021.

The Auditor General's Reports and International Journal of Public Sector Performance Management revealed several issues concerning statutory bodies such as wastage of resources as well as duplication and poor management of projects. The 12MP has outlined the requirement to review policies and processes in managing statutory bodies to minimise the Government's risks exposure and enhance transparency of the statutory bodies. In addition, the statutory bodies are encouraged to improve transparency in reporting in accordance with international best practices and standards to reduce leakages and optimise public spending.

Conclusion

The Government is committed to maintain a sustainable fiscal position for the country's growth and development while ensuring the wellbeing of the *rakyat* is safeguarded at all times. In this regard, the Government will review its current expenditure practices including subsidy programmes, pension reform, PPP spending and financial commitments as well as grants to statutory bodies. The Government will continue to strive in improving public spending efficiency and effectiveness, reducing leakages, eliminating duplication of programmes and projects, as well as promoting and adopting best practices in public expenditure management and transparency in financial reporting.

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Federal Recoverable Loans

The total outstanding Federal Recoverable Loans[3] disbursed through the Development Fund as of 31 December 2021 stood at RM42 billion or 2.9% of GDP. The largest debtors were companies (RM25.8 billion), followed by state governments (RM11.2 billion), statutory bodies (RM4.9 billion), local governments (RM136 million), other organisations (RM97 million) and cooperatives (RM6.8 million).

The loan disbursement in 2022, estimated at RM1.4 billion, serves as financing facilities for long-term investment projects, particularly for water supply, sewerage and crop replantation. The companies are the largest recipients accounting for 50.9% of the total disbursement followed by state governments (35.7%), statutory bodies (11.5%), local governments (1.1%) and other organisations (0.8%).

In terms of loan repayments, the Government is expected to receive RM600 million of which RM213 million or 35.5% are from state governments mainly from Sabah and Sarawak.

[3] The Federal Recoverable Loans is part of the Federal Government Financial Assets which consist of loans facilities due from state governments, local governments, statutory bodies, companies, cooperatives and various organisations.

Meanwhile, RM319.9 million are estimated to be received from companies, with RM221.5 million are from Sabah Electricity Sdn. Bhd., Pengurusan Aset Air Berhad and Bank Pertanian Malaysia. The remaining of the total loan repayments is from statutory bodies, local governments and other organisations.

In 2023, the Federal Government continues to provide financing facilities in achieving the socioeconomic development agenda. The total loan estimated to be disbursed is RM1.4 billion with state governments receiving the highest portion of RM793 million, followed by companies (RM338 million), statutory bodies (RM235 million) and other organisations (RM9.5 million). The loans will be utilised mainly for upgrading water, electricity supply and sewerage infrastructure; land rehabilitation; as well as financing crop plantations. Meanwhile, the loan repayments in 2023 are estimated at RM700 million of which 46.8% is from the state governments followed by companies (40.7%), statutory bodies (10.8%), local governments (1%) and other organisations (0.7%).

Conclusion

Moving forward, amid the challenging environment and slower economic growth, the Government will continue to emphasise on sustaining economic resilience in the post-pandemic period. The Government remains committed in supporting the smooth implementation of the 12MP to achieve sustainable economic growth and equitable distribution of wealth while ensuring environmental sustainability and safeguarding the wellbeing of the *rakyat.* The Government continues its expansionary fiscal stance while maintaining prudent public finance management amid the heightened global uncertainties. In this regard, efforts to enhance spending efficiency and effectiveness will be intensified. The roll-out of PER is timely given the need to improve fiscal transparency and accountability while ensuring value-for-money and fiscal sustainability.

FIGURE 3.1. *Total Expenditure by Sector*

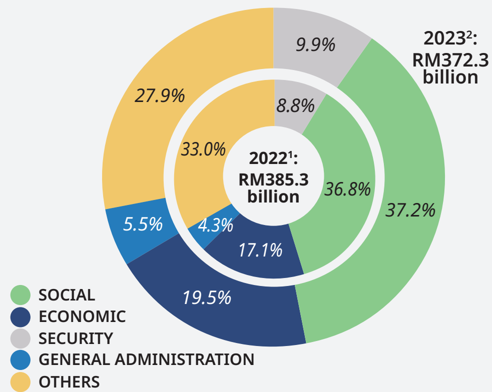


FIGURE 3.2. *Total Expenditure by Ministry and Agency*

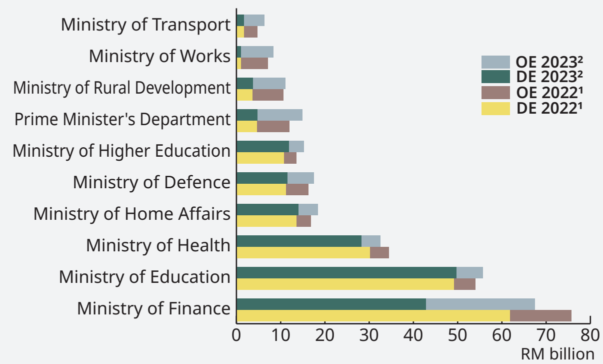


FIGURE 3.3. *Operating Expenditure by Component*

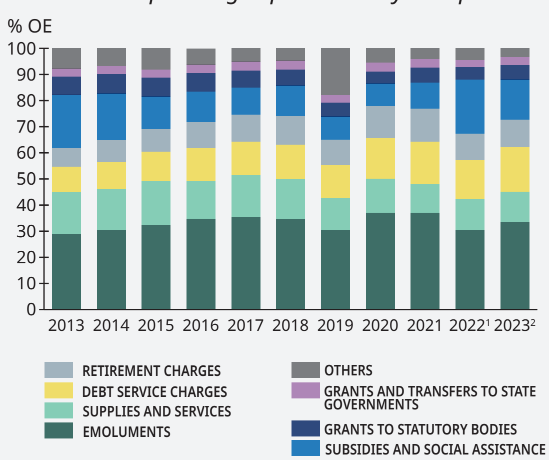


FIGURE 3.4. *Operating Expenditure by Sector*

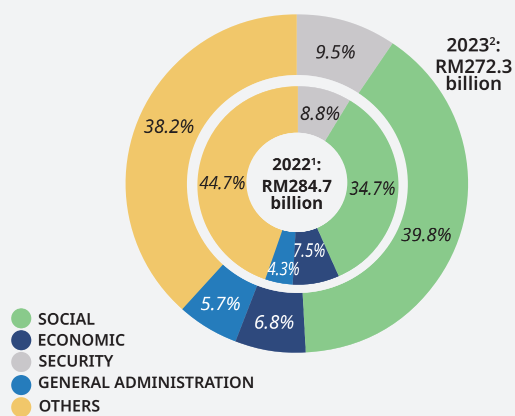


FIGURE 3.5. *Development Expenditure by Sector*

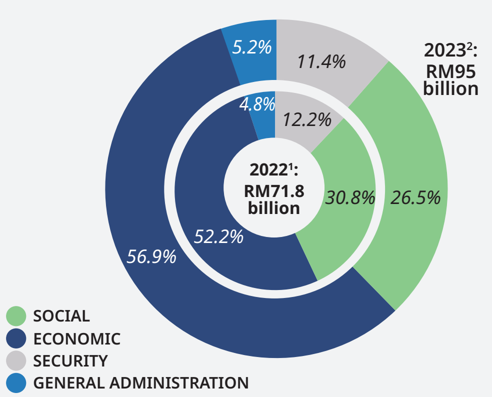
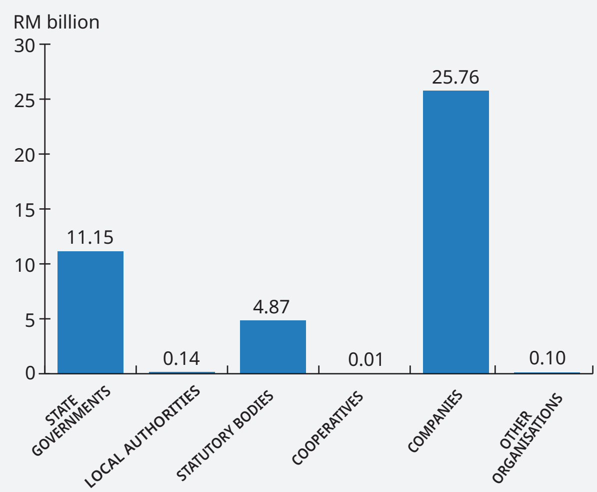


FIGURE 3.6. *Federal Recoverable Loans by Debtor³*



¹Revised estimate
²Budget estimate, excluding Budget 2023 measures
³Total outstanding as at end-2021
Source: Ministry of Finance, Malaysia