SECTION 1

Fiscal Policy Overview

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Overview

Against the backdrop of the prolonged COVID-19 pandemic, fiscal policy assumes a primary role in economic recovery. The third wave of the COVID-19 outbreak poses a major challenge to the Government's fiscal burden, particularly in balancing its impact on the future generation. With an exponential rise in positive cases, a national state of emergency was declared effective from 11 January until 1 August 2021 to enhance enforcement, improve containment measures and tighten border control. In view of the extraordinary situation, the Government has proactively extended its policy flexibility and pragmatism to protect the people and businesses as well as supporting the economy.

The Government continues to provide substantial fiscal support in 2021 in the form of additional assistance and stimulus packages to cushion the adverse impact of the pandemic and containment measures. A series of four packages totalling RM225 billion has been introduced this year, namely the *Perlindungan Ekonomi dan Rakyat Malaysia* (PERMAI), Strategic Programme to Empower the People and Economy (PEMERKASA), Strategic Programme to Empower the People and Economy Plus (PEMERKASA+) and National People's Well-Being and Economic Recovery Package (PEMULIH). Additional fiscal injection under these packages, estimated at RM25 billion, aims to boost healthcare spending, ensure business continuity and ease the burden of the rakyat. Overall, the Government has announced eight assistance and stimulus packages totalling RM530 billion since the pandemic last year with fiscal support of RM80 billion provided under the COVID-19 Fund.

Recognising that vaccination is the key factor in addressing the pandemic, the Government launched the National COVID-19 Immunisation Programme (PICK) on 24 February 2021. The rollout of PICK signifies the Government commitment to ensure at least 80% of the adult population receives full vaccination by the end of October 2021. Subsequently, in June 2021, the Government unveiled the National Recovery Plan (NRP), a roadmap to exit from the pandemic and accelerate economic recovery. The NRP, tabled in Parliament in July 2021, provides clear guidance for reopening the economy and social activities through a four-transitional phase strategy based on data analytics. As a policy continuation, the NRP consolidates all containment and economic assistance measures into a comprehensive and whole-of-nation approach in uniting the country to combat the pandemic.

Expansionary Fiscal Policy Underpins Economic Recovery

The Federal Government's fiscal stance continue to prioritise steering the nation out of the pandemic crisis. The provision of significant fiscal support is expected to contain the outbreak, sustain domestic economic activity, generate investments, stimulate consumer spending and create job opportunities. The rollout of more targeted recovery measures has positively impacted the economy, as reflected by the strong economic growth of 7.1% in the first half of this year. The Government is confident that with the smooth political transition as well as policy continuation and clarity, the economy will recover and record positive growth in 2021.

As the global economic recovery continues to be uneven and volatile, fiscal operations remain proactive and agile to respond to dynamic economic environments and policy priorities. Efforts to enhance spending effectiveness and efficiency will be supported by prudent expenditure measures as well as optimising the operating environment in adjusting to the new normal. Furthermore, strategies to improve revenue buoyancy will be implemented more orderly without disrupting the recovery momentum.

To drive health and economic recovery, the Government has mobilised various fiscal tools to balance the spending needs and fiscal sustainability. This includes partial utilisation of the National Trust Fund (NTF) to ensure sufficient funding and accelerate the implementation of vaccination programmes under PICK. As a result, Malaysia's vaccination rate is among the fastest globally, thus allowing the Government to reopen more economic sectors to boost the economy. The number of daily vaccinations has recorded a sharp increase to around 500,000 doses in July 2021 compared to 30,000 in the early stages of implementation due to a higher supply of vaccines. As at end-August, the Government has secured more than 87 million vaccine doses worth around RM4.3 billion to ensure a smooth PICK implementation. Malaysia achieved its target of inoculating 80% of the adult population in September 2021.

In addition, the socioeconomic and development agenda remains the top priority for the Government in the medium term, as stipulated in the Twelfth Malaysia Plan, 2021 – 2025 (12MP). Consequently, fiscal resources will also be directed to implement programmes and projects under the 12MP, which will serve as a catalyst in charting the path for a prosperous, inclusive and sustainable nation. In this extraordinary situation, the Government has tabled a motion in Parliament to increase its statutory debt limit, taking into account the financing needs of the recovery measures and the implementation of 12MP. In ensuring medium-term fiscal sustainability, the fiscal consolidation trajectory is envisaged to be more gradual than initially projected. This is to provide sufficient fiscal support for the nation's economic recovery and development agenda.

INFORMATION BOX

National Trust Fund

Introduction

A sovereign wealth fund (SWF) is a fund established by a government to manage and grow the country's wealth. The source of the wealth may be in various forms, such as revenue from natural resources, fiscal or budgetary surpluses and even direct transfers from the government to achieve specific economic and development purposes. SWF usually serves as a contingent asset to preserve the wealth from the country's non-renewable resources and may be utilised to cushion any unexpected shocks such as an economic downturn or impact from a natural disaster. There are various types of SWF established around the world based on their source of funds and purpose, which is summarised as follows:

FIGURE 1. *Type of SWF*

STABILISATION FUND

To function as a buffer mechanism to cushion a country's budget from the volatility of commodity prices or economic shocks. The source is usually from the proceeds of natural resources and budget surpluses.

Example: State Oil Fund of Republic Azerbaijan, SOFAZ; Chile Economic & Social Stabilization Fund

SAVINGS FUND

To serve as savings for future generations, especially when a country is dependent on non-renewable resources such as petroleum. Therefore, the resources can be shared across generations by converting the non-renewable wealth into investment portfolios. Savings fund usually has a defined timeframe before any utilisation is allowed.

Example: Government Pension Fund Global, Norway and Abu Dhabi Investment Authority

STRATEGIC AND DEVELOPMENT FUND

To serve a broad macroeconomic purpose, such as driving the domestic capital market or investing in strategic sectors. The source of the fund does not necessarily come from the excess of government budget or other reserves but also from debt and equity instruments.

Example: Temasek Holdings, Singapore; Public Investment Fund, Saudi Arabia

PENSION RESERVE FUND

To function as reserve for pension liabilities that need to be fulfilled by the government. The source of fund is mainly from annual government transfers where it will be invested to build up the fund sufficiently to cover the pension liabilities.

Example: Government Pension Investment Fund, Japan; Danish Labour Market Supplementary Pension Fund (ATP), Denmark

Source: IMF Global Financial Stability Report 2007 and Global SWF Annual Report 2020

Each SWF has its own investment strategy and risk appetite to achieve its objective and ensure its sustainability. For example, a stabilisation fund usually invests in more liquid and less risky instruments, such as bonds and sukuk. However, SWFs with a long-term obligation such as savings, strategic and pension funds, focus on a long-term investment strategy to achieve stable and consistent returns while balancing its risks and return profile.

Malaysia has several SWFs with different purposes, such as the Khazanah Nasional Berhad (Khazanah), Retirement Fund (Incorporated) (KWAP) and also the National Trust Fund (NTF). Khazanah was established as a Minister of Finance Incorporated (MOF Inc.) company that serves as the Government's strategic investment arm, while KWAP was formed in 2007 to assist in funding the Government's pension liability. Both entities are governed by their own board of directors with a dedicated management team.

The National Trust Fund

The NTF was established in 1988 through the National Trust Fund Act 1988 [Act 339]. The objective of the NTF is to ensure the optimisation of the country's non-renewable natural resources as a more sustainable source of revenue for future generations.

Governance

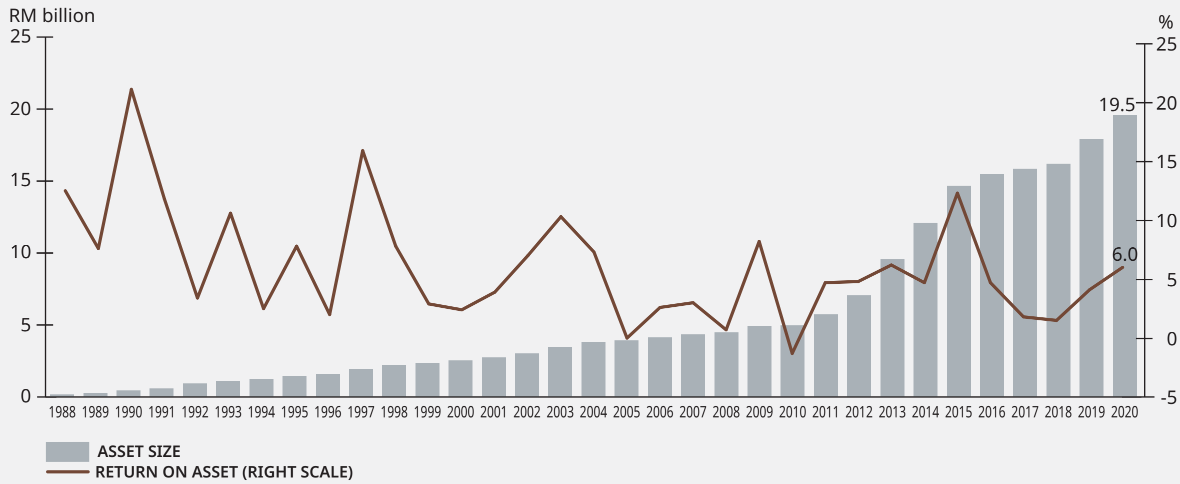
Section 4 of Act 339 provides for the establishment of a panel of trustees as an oversight committee to monitor and govern the operations of the NTF. Members of the Panel consist of a Chairman, a Deputy Chairman (an officer from the Ministry of Finance), a representative from the Prime Minister's Department and two members with business and financial experience. Trustees are responsible for investment decisions, accounting and reporting of the Fund to the Finance Minister, while Bank Negara Malaysia (BNM) is mandated for the daily operation of the NTF.

The Act also requires the NTF account to be annually audited by the National Audit Department no later than three months after its financial year ends. The NTF's audited financial statement, together with an annual report, which includes its investment profile, are submitted to the Finance Minister, which will then be laid in Parliament.

Performance

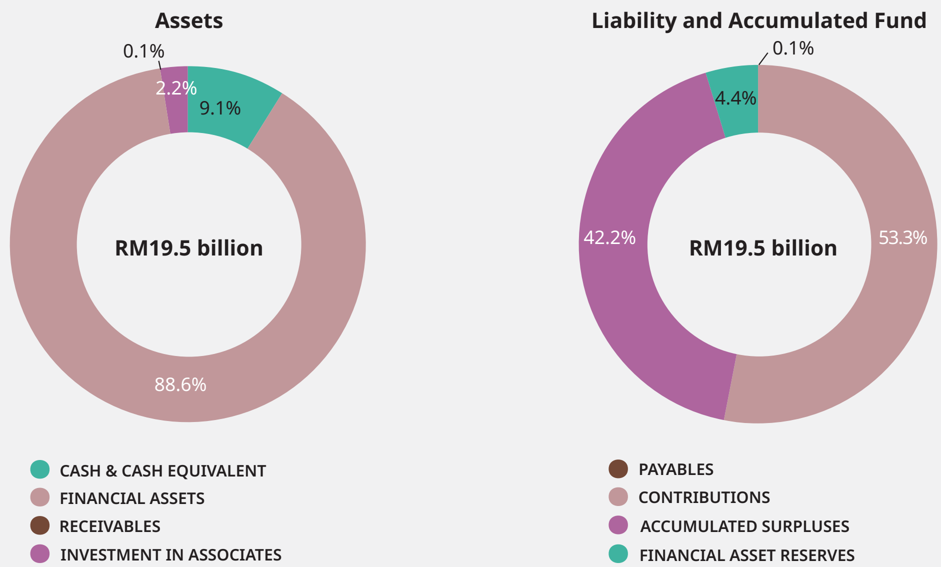
According to Section 5 of Act 339, parties that should contribute to the Fund include Petroliam Nasional Berhad (PETRONAS), state governments that receive royalties from the exploitation of petroleum or other non-renewable natural resources and any parties that are involved in the research and development of natural resources. The NTF started with a fund of RM114 million in 1988, which subsequently grew to RM19.5 billion as at end December 2020. The growth of the fund was on account of the increased contribution from PETRONAS as well as returns on investment through strategies and a diversified portfolio. Investment portfolio of the NTF include, among others, in equity, bonds, real estate investment trusts (REITs), gold and deposits. As of 31 December 2020, accumulated surpluses of the NTF stood at RM8.2 billion while contribution to the fund totalled RM10.4 billion.

FIGURE 2. *Growth and Return on Asset of the NTF*



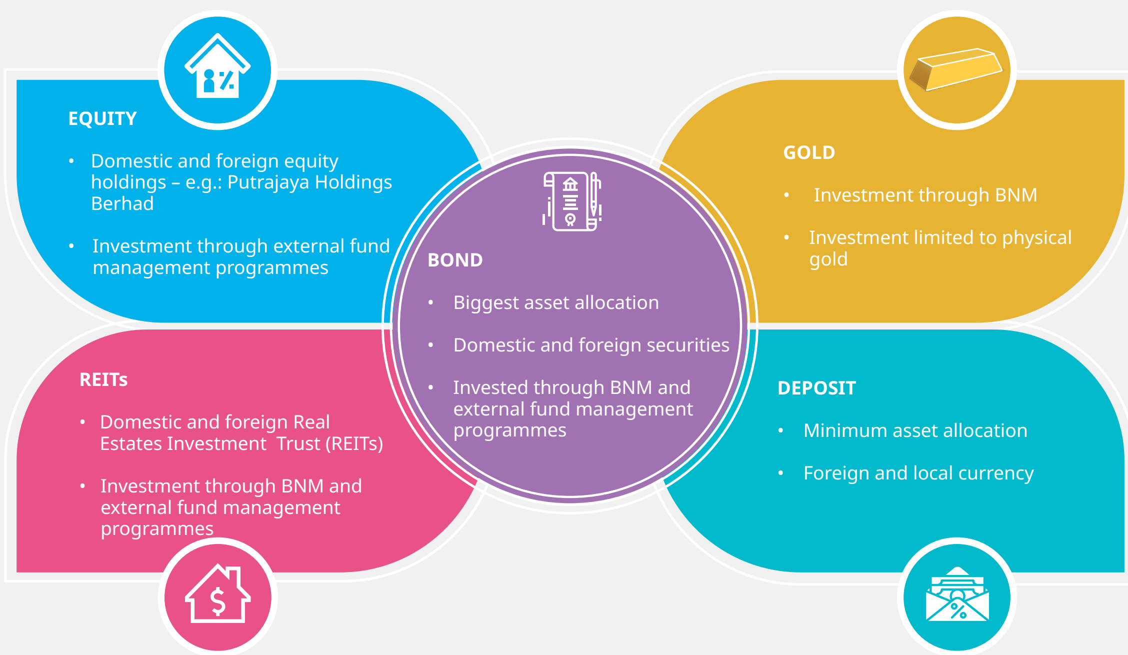
Source: NTF Annual Report

FIGURE 3. *Financial Position of the NTF, as at 31 December 2020*



Source: NTF Audited Financial Statement 2020

FIGURE 4. *Summary of the NTF's Investment Portfolios*



Source: NTF Annual Report

Utilisation

Section 6 of the Act 339 authorises the utilisation of the NTF after ten years from the commencement of the Act, with prior approval of the Finance Minister. Section 6(a) provides for the utilisation for development expenditure as specified in the First Schedule of the Development Funds Act 1966 [Act 406], while Section 6(b) allows for loans or advances to the Federal Government or state governments. Since its inception, the NTF was utilised in 1998 to finance the development of Paya Indah Wetlands, amounting to RM42 million. However, no loan or advance was ever provided to either the Federal Government or state governments. Nevertheless, the NTF holds Malaysian Government Securities (MGS) as part of their investment portfolio, as provided under Section 7 of Act 339.

In early 2020, Malaysia was hit by the COVID-19 pandemic, which necessitated the implementation of various movement control orders (MCO) to curb the spread of the virus. To cushion the economic impact of the MCO and to assist the rakyat, several stimulus packages and recovery plans were introduced by the Government. As vaccines became available in 2021, the COVID-19 National Immunisation Programme (PICK) was initiated with an initial cost estimated at RM3 billion as announced in the 2021 Budget. Given the Government's limited fiscal space, a total of RM5 billion is earmarked to be utilised from the NTF to widen the coverage and expedite the nationwide vaccination programme. The expenditure under this programme is allocated for the procurement of vaccines and costs related to administrating the vaccine, such as equipment, logistics, venues and others.

The utilisation of the NTF for PICK was made in consideration of the following factors:

a) Malaysia was hit by the second and third waves of the COVID-19 pandemic that came with highly contagious variants of the virus. This has led to an exponential increase in infection cases that strained the national health system. Hence, it demands the Government to expedite PICK to achieve the target of inoculating 80% of the adult population by October 2021, ahead of the initial target by first quarter of 2022;

b) The extended MCO necessitated the roll-out of various stimulus and assistance packages to protect the livelihood of the rakyat (such as *Bantuan Prihatin Nasional* and Food Basket programmes) and survivability of businesses (such as Prihatin SME Grant and Wage Subsidy Programme). This situation requires the Government to optimise its financing to provide certainty in managing cash flows, given the slower revenue performance that limits its fiscal space;

c) The fiscal space was also limited by increasing financial obligations arising from liabilities that have to be served by the Federal Government. Thus, the Government has to look for an alternative financing option that is readily available and will not incur additional debt burden in the short and medium term; and

d) The Government will only utilise the accumulated profits and not the accumulated contribution. The Government's intention is not to burden future generations with debt if procurement of vaccines is to be financed through additional borrowings.

Though Act 339 provides for the utilisation of development expenditure, among others, for the health sector (First Schedule, Act 406), such as the construction of hospitals and clinics as well as procurement of medical equipment and assets, the procurement of vaccines is not part of the expenditure list. Therefore, the Government had to amend Section 6 of Act 339 for vaccine procurement, which was executed through an Emergency Ordinance in April 2021 with a temporary clause added to the Act as follows:

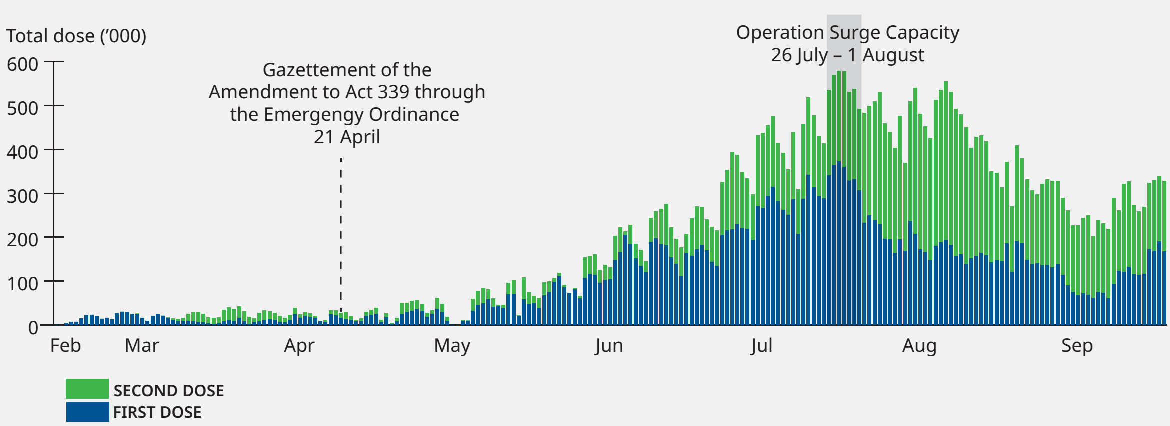
"Section 6(c)
the procurement of vaccines and any expenditure incurred in relation to the vaccines for an epidemic of any infectious disease as specified under the Prevention and Control of Infectious Diseases Act 1988 [Act 342]."

This amendment was subsequently tabled in Parliament in October 2021 to maintain this clause in Act 339.

The Progress of PICK

With financial support from NTF, Malaysia is progressing well in its vaccination drive, where the nation is currently ranked among the highest in the world in terms of daily COVID-19 vaccination rate. As at 30 September 2021, a total of 20 million individuals or 85.7% of the adult population, have been fully vaccinated. This has enabled the gradual opening of economic sectors and subsequently accelerating the economic recovery of the nation.

FIGURE 5. *Malaysia: Vaccination Rate, End-September 2021*

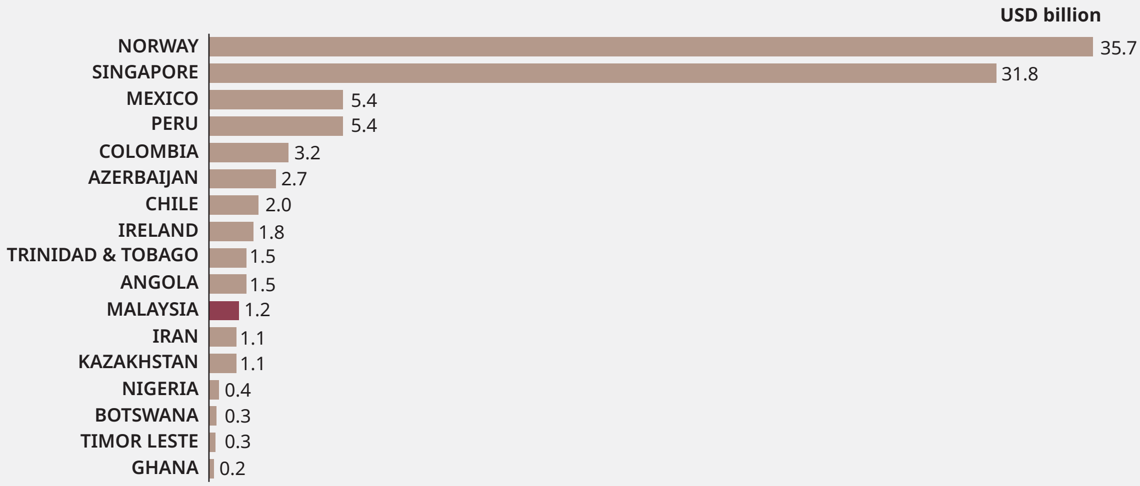


Source: The COVID-19 Immunisation Task Force (CITF)

Experience of Other Global Sovereign Wealth Funds

Like Malaysia, other countries have also utilised their savings and stabilisation funds, particularly funds sourced from natural resources, to finance their assistance and stimulus measures in tackling the COVID-19 pandemic (Figure 6). This is in line with one of the purposes of establishment of the SWFs which is to provide immediate fiscal support during a crisis. For example, the Norway Government Pension Fund Global has contributed USD35.7 billion in 2020 and allocated USD30.7 billion in 2021 to finance Norway's national budget, including measures related to the COVID-19 crisis. Singapore also has earmarked USD31.8 billion from its reserve to finance its COVID-19 Resilience Package in 2020 and USD8.2 billion in 2021.

FIGURE 6. *Global Sovereign Wealth Fund Utilisation 2020*



Source: Natural Resource Governance Institute, Ministry of Finance Norway and Ministry of Finance Singapore

Conclusion

SWFs are vital for sovereigns to safeguard the interest of future generations. However, with the worst ever crisis brought by the COVID-19 pandemic, SWFs became a useful financial option for sovereigns in financing their recovery strategies. Malaysia is no exception in this case. In view of its limited fiscal space, the Government partly utilised its NTF to combat the pandemic. The utilisation of the NTF for the national vaccination drive is a critical component of Malaysia's national recovery plan to exit from the crisis, accelerate economic recovery and safeguard its future. Once the economy stabilises and returns to its growth trajectory, the Government is committed to replenishing the Fund.

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Fiscal Position in 2021

In the 2021 Budget, the Government initially projected fiscal deficit to reduce to 5.4% to GDP, based on the assumption of steady economic recovery in the second half of 2020 and the expected spillover into 2021. However, the emergence of new COVID-19 variants, which is more virulent and contagious, poses big challenges to the Government in protecting the rakyat, businesses and economy. Consequently, the Government re-imposed the movement control orders (MCO) and announced additional assistance and stimulus packages to ease the burden of the rakyat and businesses.

These initiatives further affected the Federal Government financial position. Revenue is estimated to be lower at RM221 billion or 14.6% to GDP in 2021, a shortfall of 6.7% from the budget estimates. The shortfall is mainly due to lower tax revenue. However, the shortfall will be cushioned by additional revenue from higher average crude oil and palm oil prices as well as additional dividends and a special payment from Government's entities.

Given the growing fiscal needs, the Government has recalibrated its spending priority towards supporting the healthcare system, easing the burden of the rakyat and ensuring business continuity. Consequently, expenditure has been reprioritised to accommodate the additional assistance and economic stimulus packages, resulting in higher spending requirements under the COVID-19 Fund. Thus, total expenditure is expected to remain significant at RM320.6 billion, marginally lower by 0.6% than budget estimates of RM322.5 billion.

The operating expenditure (OE) will be rationalised by 7.1% or RM16.9 billion at RM219.6 billion, mainly from supplies and services as well as grants to statutory bodies with high reserves. Similarly, development expenditure (DE) is expected to fall by 10.1% to RM62 billion from budget estimates of RM69 billion. Several development projects were reviewed and rescheduled following the implementation of the MCO, which affected the progress of the projects. However, the COVID-19 Fund allocation is estimated to increase by 129.4% or RM22 billion to RM39 billion to finance the additional assistance and stimulus packages.

TABLE 1.1. *Federal Government Financial Position, 2020 – 2022*

	RM MILLION			CHANGE (%)			SHARE TO GDP (%)		
	2020	2021[3]	2022[4]	2020	2021[3]	2022[4]	2020	2021[3]	2022[4]
Revenue	225,076	221,023	234,011	*-14.9*	*-1.8*	*5.9*	*15.9*	*14.6*	*14.3*
Operating expenditure	224,600	219,600	233,500	*-14.7*	*-2.2*	*6.3*	*15.9*	*14.5*	*14.3*
Current balance	**476**	**1,423**	**511**				***0.0***	***0.1***	***0.0***
Gross development expenditure	51,360	62,000	75,600	-5.2	20.7	21.9	3.6	4.1	4.6
Less: Loan recovery	1,259	800	600	-21.5	-36.5	-25.0	0.1	0.1	0.0
Net development expenditure	50,101	61,200	75,000	-4.7	22.2	22.5	3.5	4.0	4.6
COVID-19 Fund[1]	38,019	39,000	23,000		2.6	-41.0	2.7	2.6	1.4
Overall balance	**-87,644**	**-98,777**	**-97,489**				***-6.2***	***-6.5***	***-6.0***
Primary balance[2]	**-53,149**	**-59,777**	**-54,389**				***-3.8***	***-3.9***	***-3.3***

[1] A specific trust fund established under 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 2022 Budget measures
Source: Ministry of Finance, Malaysia

The longer-than-expected pandemic has forced the Government to increase its spending capacity in providing additional fiscal support. Thus, the Federal Government's fiscal deficit is projected to widen to 6.5% to GDP due to additional fiscal injection coupled with lower GDP projections. Similarly, excluding debt service charges, the primary balance is expected to increase to 3.9% to GDP.

Outlook for 2022

As the global economy remains uncertain, there is a need to revitalise domestic economic and social activities to expedite the recovery. The vaccination programme is one of the key enablers in reopening the social and economic sectors. In 2022, the economic outlook is expected to improve further and return to its potential growth trajectory, supported by broader vaccination coverage and stable domestic and external demand. As published in the inaugural Pre-Budget Statement, the 2022 Budget is formulated with three main objectives: protecting and driving the recovery of lives and livelihoods, rebuilding national resilience and catalysing reforms. The Government will continue its expansionary budget policy in supporting the national development agenda, as outlined in the 12MP.

The Federal Government's revenue collection in 2022 is estimated to be higher at RM234 billion or 14.3% to GDP, driven by the anticipated increase in tax revenue collection to RM171.4 billion and non-tax revenue to RM62.6 billion. Similarly, total expenditure is budgeted to be slightly higher at RM332.1 billion or 20.3% to GDP, attributed to higher OE at RM233.5 billion and DE at RM75.6 billion. The remaining RM23 billion is for the disbursement under the COVID-19 Fund. The increase in OE is mainly due to supplies and services, debt service charges as well as emoluments. DE allocation will be mainly directed towards the implementation of programmes and projects under 12MP, among others include the Electrified Double Track Rail Gemas - Johor Bahru, Rapid Transit System Link and Pan Borneo Highway.

With a higher ceiling for the COVID-19 Fund, the Government will allocate RM23 billion for the stimulus and economic recovery measures. The allocation will support programmes and projects such as wage subsidy and cash assistance programmes as well as small-scale projects. As stipulated under the Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020 [Act 830], the Fund will continue to remain in operation until end-2022.

After considering revenue growth and expenditure requirement, the fiscal deficit is expected to moderate to 6% to GDP. Similarly, excluding the debt service charges, the primary deficit is estimated at 3.3% to GDP. The Government is committed to providing adequate fiscal support to revitalise the domestic economy back to its growth potential. Hence, the resumption of fiscal consolidation will be on a more gradual trajectory, guided by the medium-term fiscal framework.

Medium-Term Fiscal Framework, 2022 – 2024

In the medium term, fiscal strategy will be guided by the Medium-Term Fiscal Framework (MTFF). MTFF serves as guidance for budgetary planning by setting a three-year macro-fiscal projection, including revenue and expenditure. Hence, the MTFF is an important tool for public finance management and operations to promote fiscal discipline, ensure effective and efficient spending and embark on institutional reforms.

In the 2021 – 2023 MTFF, published in the 2021 Budget, the Government projected the fiscal consolidation to average 4.5% to GDP over the three years. The projection was based on the assumptions of steady economic recovery with real GDP growth between 4.5% - 5.5%, stable crude oil prices (USD45 - USD55 per barrel) and crude oil production of 580,000 barrels per day. Total revenue was estimated at 14.7% to GDP, while total expenditure was projected at 19.3% to GDP.

However, due to the prolonged COVID-19 pandemic, the Government has provided more fiscal injection and increase its statutory debt ceiling to ensure adequate spending for economic stimulus and recovery measures as well as implementation of 12MP. Consequently, the 2022 – 2024 MTFF has been revised with a more gradual fiscal consolidation on the assumption of nominal GDP growth averaging 7.7%, average crude oil prices at USD67 per barrel as well as average crude oil production of 580,000 barrels per day.

Total revenue in the medium term is projected at RM736 billion or 13.9% to GDP, contributed mainly from non-petroleum revenue estimated at RM600.7 billion or 11.3% to GDP. Petroleum-related revenue is forecast at RM135.3 billion or 2.6% to GDP. Efforts to enhance the revenue base will be guided by the Medium-Term Revenue Strategy (MTRS) that outlines the mobilisation stages of revenue measures, review of tax legislation and modernisation of revenue administration.

The total indicative expenditure ceiling for the 2022 – 2024 period, including the COVID-19 Fund, is estimated at RM999.9 billion or 18.9% to GDP. OE allocation is projected at RM726.9 billion or 13.7% to GDP, while DE at RM250 billion or 4.7% to GDP. The ceiling will provide broad guidance to ministries and agencies for budget planning, hence facilitating a smooth implementation and financing of programmes and projects.

In the medium term, the fiscal consolidation trajectory is expected to be more gradual than initially projected, with the overall fiscal deficit averaging at 5% to GDP for the 2022 – 2024 MTFF period. The Government will continue implementing reform initiatives to ensure fiscal sustainability and improve debt affordability while at the same time continuously supporting economic recovery.

TABLE 1.2. *Medium-Term Fiscal Framework (MTFF), 2022 – 2024*

	2022 – 2024	
	RM BILLION	**SHARE TO GDP (%)**
Revenue	736.0	*13.9*
Non-petroleum	600.7	*11.3*
Petroleum-related	135.3	*2.6*
Operating expenditure	726.9	*13.7*
Current balance	**9.1**	***0.2***
Gross development expenditure	250.0	*4.7*
Less: Loan recovery	1.8	*0.0*
Net development expenditure	248.2	*4.7*
COVID-19 Fund[1]	23.0	*0.5*
Overall balance	**-262.1**	***-5.0***
Primary balance	**-122.6**	***-2.3***
Underlying assumptions:		
Average real GDP growth (%)	5.5	
Average nominal GDP growth (%)	7.7	
Average crude oil price (USD per barrel)	67	
Average oil production (barrels per day)	580,000	

[1] A specific trust fund established under 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

FEATURE ARTICLE

Fiscal Responsibility Act Framework

Introduction

The Malaysian economy has evolved from agriculture-based towards a highly diversified economy through a series of national development plans anchored by effective fiscal and monetary policies and management. The COVID-19 pandemic crisis has elevated, in particular, the role of fiscal policy, which is imperative in supporting economic and health recovery as well as remaining agile in any economic circumstances. At the same time, the Government has to balance the nation's immediate needs with the effort to ensure public finances remain sustainable in the medium- and long-term. This includes initiatives to enhance its institutional and governance structure, transparent reporting and effective risk management through responsible and progressive fiscal reforms.

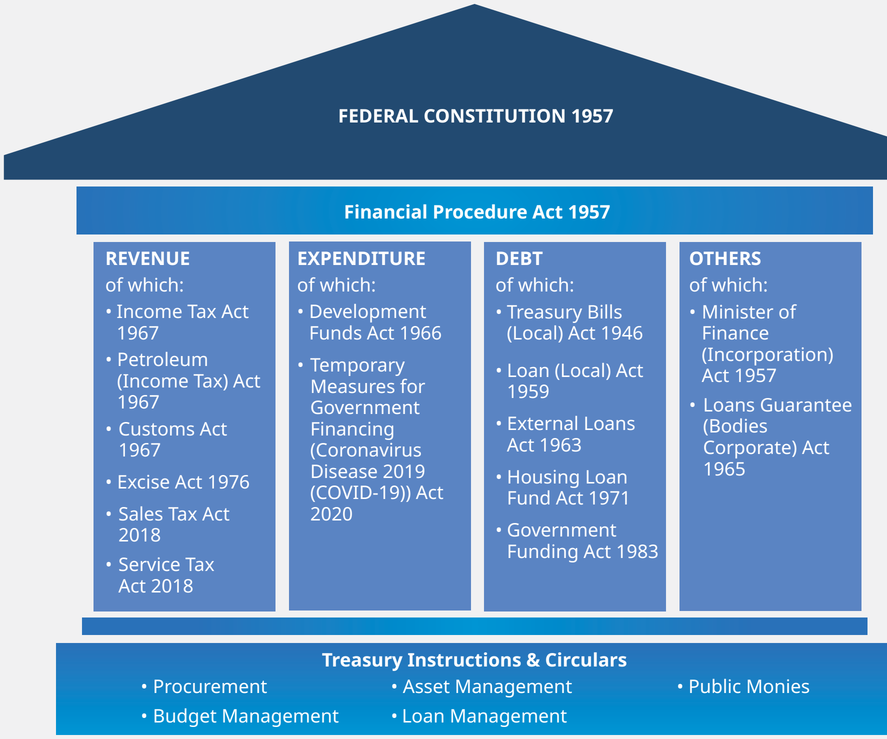
The Government remains committed to continuing its fiscal reform initiatives to strengthen public finances while supporting economic recovery, although the pandemic has hampered its fiscal consolidation plan. Currently, the Government is formulating the Fiscal Responsibility Act (FRA) to further enhance governance, accountability and transparency in fiscal management. In this regard, the Fiscal Policy Committee (FPC) endorsed the FRA framework in May 2021. Subsequently, a consultation paper on the proposed framework has been made available to the public for feedback.

Current Legal Framework

The current fiscal policy framework is governed by various laws and regulations. The Federal Constitution 1957 is the supreme law of the Federation. It extends to the governance of public monies, particularly budgetary procedures, and the roles and functions of Parliament in approving and monitoring the annual supply bill. The Constitution also specifies the relationship between the Federal Government and state governments, particularly the Federal, State and Concurrent Lists. Under the Constitution, state governments, except Sabah and Sarawak, can only borrow from or with the approval of the Federal Government. Meanwhile, state governments are not allowed to issue guarantees without the Federal Government's approval, hence limiting most of the debt and liabilities exposure at the Federal Government level.

The primary legislation, which provides guidance for controlling and managing public finances, is outlined under the Financial Procedure Act 1957 [Act 61]. The procedure and guidelines are further expanded in Treasury Instructions and Circulars, which are regularly updated. Several other acts provide legal basis for tax administration, collection and governance, such as Income Tax Act 1967 [Act 53], Sales Tax Act 2018 [Act 806], Service Tax Act 2018 [Act 807] and Customs Act 1967 [Act 235]. Meanwhile, the Development Funds Act 1966 [Act 406], which governs development expenditure, only allows expenditures specified in the First Schedule of the Act. In response to the COVID-19 pandemic crisis, the Government has established a temporary trust fund, namely the COVID-19 Fund, to comprehensively finance all pandemic- and stimulus-related measures. In relation to financial governance for the extra-budgetary entity, particularly Federal Statutory Bodies, apart from their respective establishment acts, there are three legislations that need to be adhered to, namely the Statutory Bodies (Accounts and Annual Reports) Act 1980 [Act 240], the Statutory Bodies (Power to Borrow) Act 1999 [Act 598] and the Statutory Bodies (Discipline and Surcharge) Act 2000 [Act 605].

FIGURE 1. *Fiscal Regulatory Framework*



Source: Ministry of Finance, Malaysia

There are several legislations that govern the Government's debt and liabilities, such as the Loan (Local) Act 1959 [Act 637], Government Funding Act 1983 [Act 275], Treasury Bills (Local) Act 1946 [Act 188], External Loans Act 1963 [Act 403], Minister of Finance (Incorporation) Act 1957 [Act 375] and Loans Guarantee (Bodies Corporate) Act 1965 [Act 96]. In addition, the Government has applied several fiscal rules to enhance the budgetary discipline, such as a debt rule and golden rule. The debt rule refers to the statutory debt ceiling of 65% to GDP, while the golden rule dictates that borrowings are only allowed to finance development expenditure. The debt acts and rules are as in **Table 1**.

TABLE 1: *Debt Acts and Rules*

Rules	Acts
Domestic debt[1] ceiling not exceeding 65% to GDP	Temporary Measures for Government Financing (Coronavirus Disease 2019 (COVID-19)) Act 2020
MTB ceiling not exceeding RM10 billion	Treasury Bills (Local) Act 1946
Offshore borrowing ceiling not exceeding RM35 billion	External Loans Act 1963

Note: [1] Refers only to Malaysian Government Securities (MGS), Malaysian Government Investment Issues (MGII) and Malaysian Islamic Treasury Bills (MITB)
Source: Ministry of Finance, Malaysia

The Fiscal Policy Committee (FPC) was established in 2013 as part of the fiscal reform initiative to strengthen public finances and ensure long-term fiscal sustainability. The FPC is chaired by the Prime Minister and members comprised of selected Cabinet Ministers, the Chief Secretary to the Government and several key central agencies. It meets at least twice a year and the Federal Treasury acts as its secretariat.

Proposed FRA Framework

The FRA is intended to be a dedicated law to govern the fiscal policy conduct of the Government. This Act will be formulated based on the Malaysian context to provide a solid framework for prudent fiscal management. Similar to recent fiscal responsibility legislations in most countries, the FRA comprises a set of principles for sound fiscal management with a strong emphasis on transparency and accountability.

In addition, the proposed FRA framework requires the Government to publish its key measurable fiscal objectives that are consistent with the FRA principles. This includes fiscal objectives relating to sustainable budget balance, prudent debt and fiscal risk management. Countries, such as New Zealand and Australia, include principles and fiscal objectives in their fiscal responsibility legislations. In contrast, the United Kingdom's legislation requires the government to publish its key fiscal objectives in a separate document known as the Charter for Budget Responsibility. Some fiscal responsibility laws also include escape clauses that temporarily exempt governments from complying with the fiscal rules, particularly during unexpected events or crises.

There are four key components in fiscal management, namely revenue, expenditure, debt and fiscal risk. These components must be managed effectively and prudently, with a high degree and frequency of transparency and accountability for sound fiscal management. This includes managing fiscal risks associated with contingent liabilities as it may derail the fiscal consolidation objectives of the Government. Therefore, the FRA will include provisions relating to these four components to ensure long-term fiscal sustainability regarding sustainable revenue policy, effective spending, and prudent debt and fiscal risk management.

Another essential feature of fiscal legislation is the reporting requirement. The proposed FRA will include obligatory reporting requirements comprising *ex-ante* and *ex-post* documents such as economic dan fiscal forecasts, pre-budget statements, mid-year economic and fiscal updates, fiscal risk statement, tax expenditure, mid-year budget performance and annual financial report. Disclosure of these documents would enhance the transparency of fiscal objectives and performance. Furthermore, FRA would further strengthen the role of FPC by institutionalising the FPC as the high-level advisory committee on fiscal matters.

FIGURE 2. *Proposed Fiscal Responsibility Act Framework*

Source: Ministry of Finance, Malaysia

Stakeholder Engagement

Public Consultation

As part of its fiscal reform agenda, the Ministry of Finance (MOF) has since published a public consultation paper to obtain inputs and feedback on the formulation of the FRA. The consultation paper includes the rationale, issues related to fiscal management and the proposed framework for FRA. The consultation paper was made available to the public on the MOF Budget 2022 portal from 3 to 15 September 2021.

MOF has received positive feedback from the public on the proposed FRA framework as outlined in the consultation paper. In general, the public are very supportive of the Government's efforts to enhance its governance, transparency and accountability in fiscal management through the introduction of the FRA. All recommendations will be taken into consideration before finalising the FRA. Among the recommendations received are as follows:

a) Implement accrual accounting in accordance with international accounting standards;
b) Ensure predictable and stable tax rates;
c) Improve the management of government assets;
d) Review the FPC membership by including private sector experts;
e) Establish an independent fiscal institution;
f) Review the role of Minister of Finance (Incorporated) companies;
g) Enhance the management of government guarantees;
h) Review the pension scheme from defined benefit to defined contribution;
i) Increase public investment spending; and
j) Widen the revenue base by introducing new sources of revenue and reducing tax exemptions.

In addition, the MOF will continue to engage with the International Monetary Fund (IMF) for expert advice and technical assistance in formulating the FRA. At the same time, MOF will continue to consult relevant stakeholders for views and feedback in drafting the FRA. The draft bill of the FRA will then be tabled to the Cabinet for approval before tabling in Parliament.

Response from Local and International Communities

Since the announcement of the FRA, the Government has received positive feedback from various parties. Constructive feedback will be taken into consideration in improving the content and process of the FRA. Among the feedback received from local organisations are shown in **Table 2**.

TABLE 2: *Feedback from Local Organisations*

"In the long run, Malaysia's fiscal position is anticipated to achieve structural improvements through ongoing efforts to enhance its revenue, via achieving the goals set out by the Tax Reform Committee, and by enacting legislation under the Government Procurement Act 2020 and Fiscal Responsibility Act 2021. While details are currently limited, RAM expects better fiscal oversight and budgetary caps to elevate Malaysia's fiscal sustainability." RAM Rating Services Sdn. Bhd., Press Releases, November 2019
"Finally, it is hoped that the government takes fiscal transparency seriously, especially in its intention to table the Fiscal Responsibility Act in 2021." IDEAS, Media Statement, November 2020
"Furthermore, with the introduction of the Fiscal Responsibility Act, we believe the management of fiscal policy will likely be reinforced further, whereby the government will continue to introduce measures on fiscal consolidation." Affin Hwang Investment Bank Bhd, Economic Update Malaysia – Economic Outlook 2H2020, June 2020

International organisations, such as the IMF, Organisation for Economic Co-operation and Development (OECD) and rating agencies, also shared their views. They have complimented efforts by the Malaysian Government to further enhance its fiscal governance through the formulation of the FRA. This reform initiative will have a positive impact on credit rating assessment, especially on the governance. Among the feedback from international organisations are shown in **Table 3**.

TABLE 3: *Feedback from International Organisations*

"To better prepare for changes in the debt limit and better anchor public finances, the authorities should accelerate the preparation of the Fiscal Responsibility Act (FRA)."   IMF, Staff Report for the 2021 Article IV Consultation for Malaysia, February 2021
"In addition, the Government has announced in 2018 the introduction of a Fiscal Responsibility Act towards 2021. Like in some other countries, such as Ireland, New Zealand and Thailand, where a similar fiscal responsibility legislation was adopted, under the planned Fiscal Responsibility Act, government revenue, expenditure, budget balance and debt will be managed consistently with one another through pre-determined rules and reporting in order to enhance its transparency and accountability."   OECD, OECD Economic Surveys: Malaysia 2021, August 2021
"The government also continues to work on a Fiscal Responsibility Act to improve fiscal transparency and accountability and enhance overall fiscal management."   Fitch Ratings, Malaysia Rating Report, August 2021
"The reform agenda on strengthening institutions, governance, and the capacity of the administration remains an important complement to these efforts and should be maintained."   World Bank, Malaysia Economic Monitor, June 2020

Conclusion

The Government is committed to continuing its fiscal reforms agenda to strengthen public finances once the economy recovers. The formulation of the FRA reflects its commitment and strategy for sound fiscal management. This reform initiative will further enhance the credibility of its fiscal policy conduct towards achieving long-term public finance sustainability and macroeconomic stability. The FRA will also provide a robust framework for the Government to improve transparency and accountability in fiscal management.

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Conclusion

The prolonged COVID-19 crisis has forced the Government to continue providing additional fiscal support to bolster the healthcare system, safeguard the people and facilitate economic recovery. The Government is confident that the rollout of the NRP and the implementation of PICK will facilitate a safe and systematic reopening of the economic and social sectors, thus boosting the growth momentum. Furthermore, the 12MP will provide the overall policy framework for structural reforms and medium-term directions in terms of investment in public infrastructure, human capital, bridging the development gap between regions and narrowing income disparities between groups.

As one of the initiatives to enhance fiscal transparency and accountability and encourage public participation, the Government has published its inaugural Pre-Budget Statement and a series of public consultation papers on fiscal legislation, tax reforms, social assistance system and public procurement. The publications have received positive and constructive feedback from various stakeholders. These initiatives reinforce the Government's commitment to improving governance in budgetary and public finance management.

Recognising the importance of providing fiscal support to sustain growth, it is also imperative to strengthen public finance management and rebuild fiscal buffers promptly. As a responsible Government, the temporary increase in the statutory debt ceiling will be followed by revenue enhancement measures to reduce its fiscal burden. This will help the build-up of sufficient buffers to provide counter-cyclical measures in mitigating unexpected circumstances in the future. More importantly, institutional reform initiatives, such as the Fiscal Responsibility Act, MTRS and Public Expenditure Review, will be pursued in ensuring fiscal governance and medium-term sustainability.

FIGURE 1.1. *Federal Government Overall and Primary Balance*

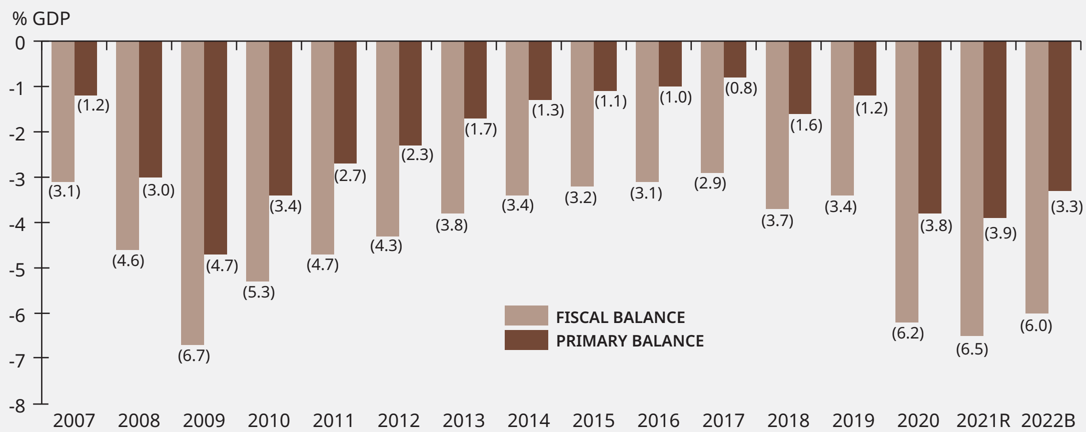


FIGURE 1.2. *Federal Government Revenue, Operating Expenditure and Current Balance*

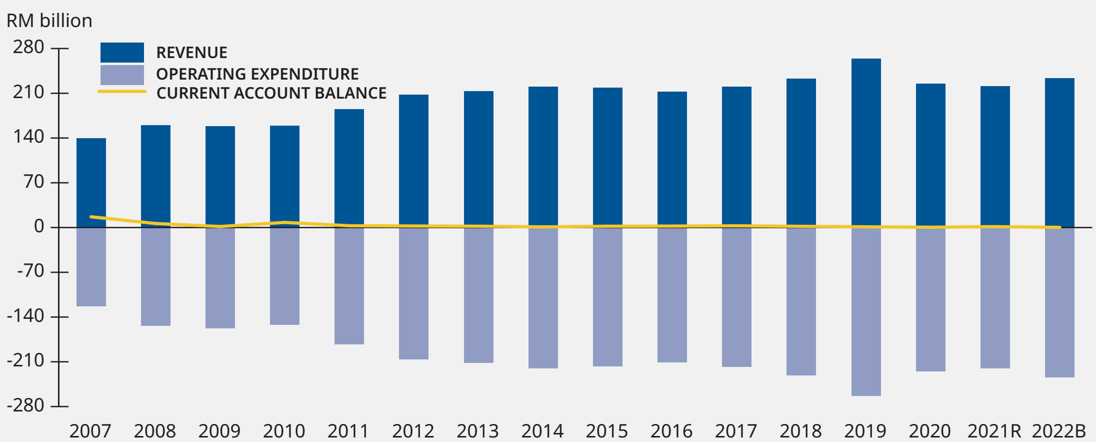


FIGURE 1.3. *Federal Government MTFF Overall Balance*

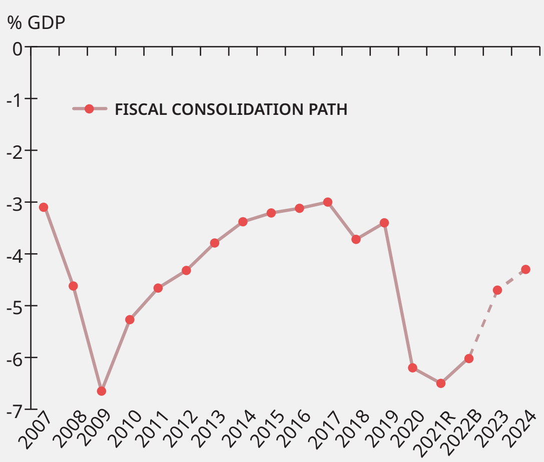
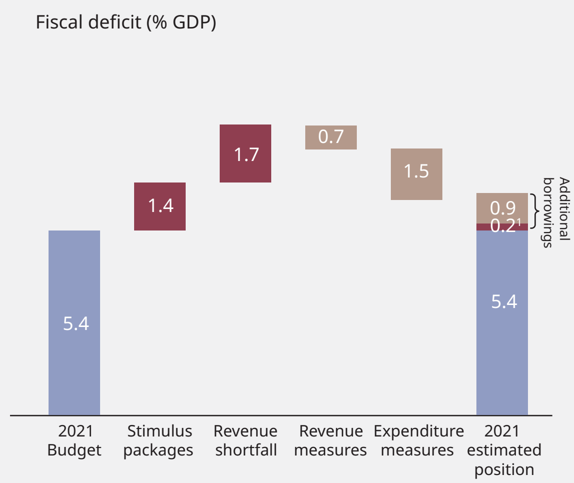


FIGURE 1.4. *Revised Fiscal Position in 2021*



Note: 2021: Revised estimate
2022: Budget estimate, excluding 2022 Budget measures
Source: Ministry of Finance, Malaysia

[1] Reflecting lower nominal GDP