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Malaysia's Budget 2020: A Tough Balancing Act

*Yeah Kim Leng**

EXECUTIVE SUMMARY

- The Pakatan government's second budget, themed "Driving growth and equitable outcomes towards shared prosperity", is cast amid heightened concerns over global and domestic growth prospects for 2020. Within limited fiscal space, it has to ensure adequate spending to stimulate growth and employment creation, and manage cost of living for low income households.

- Despite the bleak external environment, Budget 2020 projects a marginal pick-up in GDP growth, premised on the anticipated dividends from a 'mildly expansionary' budget. The total allocation rises by 6.5% to RM297 billion, of which 81% is for operating expenditures and 19% for development. The increased allocations for key sectors and fiscal and financial incentives seek to balance the expansionary fiscal stance with a pragmatic fiscal consolidation.

- To boost growth and investment, customised incentives are being given to large multinationals and local companies to invest over the next 5 years.

- To address the country's long-standing issues of high reliance on unskilled foreign workers, depressed skilled wages, antiquated employment laws, low women participation and high youth unemployment, a special jobs programme, Malaysians@Work , is introduced to increase job opportunities for graduates, women and Malaysian citizens.

- The budget is prudently crafted with coherent intent and strategy in alignment with the socio-economic and technological challenges facing the country. It demonstrates restraint in not spending aggressively while preserving fiscal space to face any unexpected downturn of the global economy.

- Effective implementation of the budget thrusts and strategies will be critical for achieving the overarching objectives of sustaining growth and accelerating structural transformation of the economy through quality investments, faster adoption of advanced technology and productivity improvements in the public and private sectors.

* *Guest writer, Yeah Kim Leng, is Professor of Economics and Director of the Economic Studies Program at Jeffrey Cheah Institute on Southeast Asia (JCI) at Sunway University, Malaysia.*

INTRODUCTION

Malaysia's new government under Pakatan Harapan (Coalition of Hope) has unveiled its second budget since it won the May 2018 general election. Its first budget for 2019 navigated the trillion ringgit debts left by the previous government's financial scandals, the gaping fiscal hole caused by huge tax refunds owed by the previous administration, and the scrapping of the unpopular Goods and Services Tax (GST) as promised in its election manifesto.

Tabled in Parliament on 11 October 2019, its second budget had to contend with a slowing global economy and an economic landscape fraught with uncertainties wrought by the US-China trade war, Brexit and other geo-political as well as recession risks in 2020. Domestically, Prime Minister Mahathir Mohamad recently launched the Shared Prosperity Vision 2030 that will succeed his unfulfilled Vision 2020.

This article focuses on the extent to which Budget 2020, in balancing the need for an expansionary budget and belt tightening to ensure fiscal sustainability, can be a catalyst for the country's new Shared Prosperity Vision 2030, and sustain the growth momentum while effecting the necessary transformation into a digital economy and helping the low and middle income groups cope with depressed wages and high cost of living.

ECONOMIC SETTING AND FISCAL LANDSCAPE

While the new government's budget for 2019 was formulated with the expectation of a more challenging environment, its 2020 budget faces an even more uncertain setting. The further deterioration of the external environment anticipated by budget officials was premised on the pronounced global trade slowdown and downward revisions in global growth for both 2019 and 2020 amid uncertainty over US-China trade talks. Adding to this was the extension of Britain's exit with or without a deal from the European Union to early 2020. More critically, a decelerating global economy marked by weakening growth in both the advanced and developing economies as well as an uptick in recession risk in the US have led to heightened concerns over growth prospects for 2020.

Despite the less sanguine external environment, Budget 2020 anticipates a marginal pick-up in growth to 4.8% in 2020 from an estimated 4.7% in 2019 (Table 1). While it appears to be optimistic when compared to market consensus forecasts that range between 4.3% and 4.6%, the projected growth likely imputes the anticipated positive impact from a 'mildly expansionary' budget.

A key reason for the budget to be considered 'expansionary' is the increase in the total allocation to RM297 billion, a 6.5% rise over the previous year if the tax refund of RM37 billion spent in 2019 is excluded (Table 1). The other reasons underpinning an expansionary budget are the higher allocations for the key ministries or sectors and the slew of fiscal incentives to stimulate growth. In addition, the government kept its promise of no new major taxes such as a wealth tax or capital gains tax. A technical analysis of the stimulus or fiscal impulse adjusted for business cycle effects however shows that it is less contractionary than the previous budget. While this appears to contradict the expansionary budget characterised

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earlier, it supports the analysis that the higher government spending is not overly expansionary.

Another notable feature of the 2020 budget is the uptick in the share of development allocation, which had been on a downtrend in recent years. Development expenditure constitutes 19% (RM56 billion) of the 2020 budget, compared to an average of 17% over the last 5 years (2015-2019). By contrast, the annual development expenditure averaged 27% of total government spending in the 1990s and 2000s.

Table 1. Budget 2020 Summary, Key Forecasts and Assumptions

Item	Value (RM bn)			Annual change (%)		Share of GDP (%)	
	2018	Budget 2019	Budget 2020	Budget 2019	Budget 2020	Budget 2019	Budget 2020
Revenue	232.9	263.3	244.5	13.1%	-7.1%	17.4%	15.2%
Direct tax	130.0	135.6	142.7	4.3%	5.2%	8.9%	8.9%
Indirect tax	44.0	44.4	47.2	0.8%	6.3%	2.9%	2.9%
Non-tax revenue	58.8	53.3	54.6	-9.4%	2.4%	3.5%	3.4%
PETRONAS special dividend	-	30.0	-	-	-	2.0%	-
Operating Expenditure	231.0	262.3	241.0	13.6%	-8.1%	17.3%	15.0%
Includes transfers to tax refund funds	-	*37.0*	-			2.4%	-
Current Balance	1.9	1.0	3.5	-48.0%	250.0%	0.1%	0.2%
Development Expenditure	56.1	53.7	56.0	-4.3%	4.3%	3.5%	3.5%
Less: Loan Recovery	0.8	0.9	0.8				
Overall Balance	-53.4	-51.8	-51.7	-3.0%	-0.2%	-3.4%	-3.2%
% GDP	*-3.7%*	*-3.4%*	*-3.2%*				
Total (exclude transfers to tax refund funds)	286.3	279.0	297.0	-2.5%	6.5%	18.4%	18.5%
Key forecasts and assumptions							
Gross Domestic Product (GDP)							
Current prices	1,446.9	1,517.5	1,607.9	4.9%	6.0%		
Constant prices (2015)	1361.5	1424.9	1493.8	4.7%	4.8%		
Consumer price index (CPI)	120.7	121.8	124.2	0.9%	2.0%		
Unemployment ('000)	511.1	514.0	523.8	0.6%	1.9%	3.3%	3.3%
Current account balance	30.6	43.4	29.0	41.9%	-33.3%	2.9%	1.8%
Global GDP growth (IMF)				3.0%	3.4%		
Brent crude oil price (USD per barrel)	71.2	63.0	62.0	-11.5%	-1.6%		

Source: Compiled from 2020 Budget Speech, Economic Outlook 2020 and Fiscal Outlook and Federal Government Revenue Estimates, Ministry of Finance, Malaysia

Despite the economy bucking the moderating growth trend in most advanced and developing countries in 2019 with second quarter year-on-year GDP growth rising to 4.7% from 4.5% for the first quarter, there was mounting concern over the knock-on effects of the deteriorating performance of the global economy. The International Monetary Fund marked down global economic growth, in October 2019 projecting 3.0% for the year 2019, compared to 3.7% forecast a year ago. Moreover, the Malaysia central bank in a pre-emptive move cut its overnight policy rate by 25 basis points to 3.00% in May 2019, taking cognisance of the increasing downside risks as the US-China trade war took a toll on the global economy.

Having successfully navigated a potential sovereign credit rating downgrade over its fiscal slippage in its 2019 Budget, the government is likely able to meet the 3.4% fiscal deficit as budgeted for the year despite the huge tax refunds and lower revenue (estimated at RM20 billion) arising from the reversion to the Sales and Service Tax (SST) system from the

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consumption-based Goods and Services Tax (GST) system. For Budget 2020, the government's flexibility to craft a larger counter-cyclical budget is therefore constrained.

It therefore has to navigate a tight fiscal space while lending sufficient support to the economy so that desired economic growth and employment creation can be sustained. Importantly, the new administration has to meet high public expectations stemming from its election manifesto that it will bring down the cost of living, abolish tolls, institute targeted fuel subsidies, provide more affordable housing and healthcare, and increase income and jobs.

While a much higher level of spending is needed to meet these demands, the government has balanced these demands against the fiscal constraints by opting for a more gradual pace of fiscal consolidation. It struck a middle ground by relaxing the earlier fiscal deficit target of 3.0% for 2020 to 3.2% and not exceeding the 3.4% deficit target that it will likely achieve in 2019.

BUDGET THRUSTS AND HIGHLIGHTS

Centred on the theme "Driving growth and equitable outcomes towards shared prosperity", the budget contains 4 thrusts and 15 strategies. The 4 thrusts revolve around, firstly, boosting growth in the new economy and digital era; secondly, strengthening employment and human capital; thirdly, creating a united, inclusive and equitable, and finally, revitalising public institutions and finance.

Not surprisingly, as a counter-cyclical response, the first thrust is aimed at driving growth with emphasis on digitalisation and Industry 4.0 activities. It encompasses 4 strategies aimed appropriately at boosting investment, accelerating digital transformation, improving access to financing, and enhancing resilience through diversification of economic activities. To boost investment, the measures to be rolled out include investment facilitation through the setting up of a National Investment Committee, provision of customised incentives, and reviewing the investment incentives regime with the aim of making Malaysia the preferred investment destination.

Addressing Weak Private Investment to Boost Growth

Of concern to economists and policy makers in achieving a more balanced and sustainable growth is the 2.1% year-on-year decline in gross fixed capital investment in the first half of 2019. Its share to GDP at 24% remains low compared to the 30% average for upper middle income countries. To boost investment, a novel pitch is made to multinational companies, especially Fortune 500 companies and global unicorns in high technology sectors, to invest in the country. Special focus is being given to expedite the approval process and strategic investments of at least RM5 billion each in return for customised incentives amounting to RM1 billion allocation a year over the next 5 years. Likewise, large local companies will be provided with an incentive package of similar size and duration to grow their products and services internationally. These incentive packages, including the 10-year income tax exemption for electronic and electrical industries investing into knowledge-based services, extension of reinvestment tax allowance, and accelerated capital and automation allowances

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are likely to attract renewed interest among local and foreign firms in light of the potential trade and investment diversion arising from a protracted US-China trade war.

It is noted that besides undertaking an overdue review of the investment regulatory framework involving the Promotion of Investments Act 1986, Special Incentive Package and incentives under the Income Tax Act 1967, the investment thrust is more concerted in the 2020 Budget in that it focuses not solely on the provision of fiscal and financial incentives but also the operating environment especially the features related to the ease of doing business, a level-playing field and low regulatory burden. Nevertheless, it is noted that the foreign equity restrictions prevailing in the services sector and which account for the relatively high FDI restrictiveness in Malaysia based on the OECD FDI restrictiveness index, were not addressed. Critically, the ability of the country to absorb more local and foreign investment will depend on effective implementation of the investment facilitation measures. These include the establishment of the National Investment Committee,[1] the 'Special Channel' to attract Chinese investors,[2] post-approval investment realisation, and measures to improve ease of doing business.

The second growth-enhancing strategy focuses on accelerating the digital economy with funds, grants and special incentives being provided to expand high speed digital infrastructures (RM21.6 billion National Fiberisation and Connectivity Plan), developing 5G ecosystem and future technologies such as blockchain and artificial intelligence, and growing local champions in digital content such as eGames and animation, and building digital companies and technopreneurs through matching grants for digital adoption and automation. To accelerate the shift to a cashless society, another innovative measure is the gifting of one-off RM30 digital stimulus to qualified Malaysians aged 18 and above with annual income of less than RM100,000 through e-wallets. Incurring an allocation of up to RM450 million, the measure is aimed at exposing more Malaysians to the use of e-wallets and hopefully, spark continuing interest with the convenience and flexibility provided by e-wallets.

The third and fourth strategies to boost growth involve improving access to financing for businesses and strengthening economic diversity by emphasizing green growth and energy, agricultural growth, increasing R&D in government and academia, and leveraging on Visit Malaysia 2020 by expanding promotion campaigns and targeted incentives for the arts and tourism sector.

Malaysians@work and Nurturing IR4.0-Ready Human Capital

The budget's second thrust contains innovative strategies to address the country's long standing issue of high reliance on unskilled foreign workers, depressed skilled wages, antiquated employment laws, low women participation and high youth unemployment.

In addition to updating the Employment Act 1955, a special jobs programme, Malaysians@Work will be introduced to equalise hiring cost and increase job opportunities for graduates, women and local Malaysians. For the first time, a monthly wage incentive of RM350 or RM500 depending on the sector are being offered for a duration of two years to local workers recruited to replace foreign workers. Employers meanwhile will receive RM250 monthly for each Malaysian worker hired. It is a creative approach to equalise hiring cost between local and foreign employees. A similar but varying amount of wage and hiring

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incentives is also provided to spur employment of local graduates, women who have stopped work, and student interns.

While it is difficult to gauge the efficacy of the fiscal incentives, including the raising of the minimum monthly wage from RM1,100 to RM1,200 in major cities, to address the structural issues facing the labour market, the short-term measures can facilitate the gradual shift in the structure of the economy toward higher value economic activities, which in turn is dependent on the quality and quantity of investment and the availability of skills and trained manpower.

Given the skill-constrained economy, investing in human capital development is paramount. Towards this end, the government continues to prioritise education and training with a bigger year-on-year increase of 5.1% in the 2020 allocation compared to the previous year's 3.0% rise. Its share of the total budget however showed a slight decline from 21.9% in 2019 to 20.4% largely due to sizeable "other expenditures' that include debt service charges and transfer payments which consumed 36.1% of the total budget in 2020 compared to 28.2% in 2019 (Table 2).

Besides raising allocation, the government continues to support the mainstreaming of technical and vocational education and training (TVET). The budgetary measures include the provision of matching grants for customised courses with industries, allowing Employees Provident Fund withdrawals to take professional certification related to Industrial Revolution 4.0 and creating pathways for TVET holders to pursue degrees through the Malaysia Technical University Network.

Table 2. Actual Expenditure and Budget Allocation by Sector

Sector	Value (RM bn)			Annual change (%)			Share of total (%)		
	2018	2019r	2020B	2018	2019r	2020B	2018	2019r	2020B
ECONOMIC	**50.2**	**44.2**	**48.1**	**22.2**	**-11.9**	**8.7**	**17.5**	**14.0**	**16.2**
Agriculture and rural development	6.8	5.3	6.5	0.8	-20.9	22.4	2.4	1.7	2.2
Public utilities	2.6	2.9	4.6	0.5	12.5	60.0	0.9	0.9	1.6
Trade and industry	5.2	5.9	6.0	-25.0	13.4	2.1	1.8	1.9	2.0
Transport	20.5	17.0	18.4	23.4	-16.9	8.1	7.1	5.4	6.2
Communications	0.2	0.2	0.4	-26.1	11.6	141.0	0.1	0.1	0.1
Environment	1.7	2.1	1.9	-19.7	19.5	-10.1	0.6	0.7	0.6
Others	13.3	10.8	10.2	126.1	-18.6	-5.9	4.6	3.4	3.4
SOCIAL	**103.8**	**107.8**	**112.7**	**4.0**	**3.8**	**4.5**	**36.2**	**34.1**	**37.9**
Education and training	62.7	64.6	67.9	3.6	3.0	5.1	21.9	20.4	22.9
Health	28.2	29.5	31.0	10.5	4.6	5.2	9.8	9.3	10.5
Housing	1.3	1.8	1.5	-13.5	41.0	-18.5	0.5	0.6	0.5
Others	11.6	11.9	12.2	-5.5	2.3	3.2	4.0	3.8	4.1
SECURITY	**32.2**	**30.2**	**33.6**	**2.6**	**-6.0**	**11.2**	**11.2**	**9.6**	**11.3**
Defence	19.5	13.7	15.7	22.2	-29.9	14.3	6.8	4.3	5.3
Internal security	12.6	16.5	17.9	-17.8	30.9	8.7	4.4	5.2	6.0
GENERAL ADMINISTRATION[1]	**19.8**	**19.7**	**22.3**	**32.0**	**-0.4**	**13.0**	**6.9**	**6.2**	**7.5**
OTHER EXPENDITURES[2]	**81.1**	**114.0**	**80.4**	**7.6**	**40.6**	**-29.5**	**28.2**	**36.1**	**27.1**
TOTAL	**287.1**	**316.0**	**297.0**	**9.3**	**10.1**	**-6.0**	**100.0**	**100.0**	**100.0**

r - revised budget; B - Budget 2020

[1] *Includes general services, refund and reimbursement and foreign affairs services.*

[2] *Includes debt service charges and transfer payments.*

Source: Compiled from Fiscal Outlook and Federal Government Revenue Estimates 2020, Ministry of Finance, Malaysia

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Thus far, the sustained high allocation for education is not commensurate with the expected outcomes, particularly in producing graduates in the STEM (science, technology, engineering and mathematics) fields. It is observed that easier access to job opportunities and high salaries in the technical profession are making TVET an attractive option for the young Malaysians. Additionally, graduates especially from industry-supported skills training centres are able to meet industry needs, thereby alleviating the growing graduate unemployment problem facing the country.

Head Start to Shared Prosperity Vision 2030

The third budget thrust to create a united, inclusive and equitable society encapsulates the Shared Prosperity Vision 2030 (SPV2030) that was launched a week before the budget was unveiled. It continues the unfulfilled Vision 2020 of attaining developed nation status with a broadly similar agenda of restructuring the economy, addressing inequalities and building a united and prosperous nation.

The inclusive development strategy under this thrust revolves around narrowing the rural-urban divide through higher rural development spending on roads, electricity and water and a sizeable increase in allocation for Sabah and Sarawak. To address the rising cost of living, the income support for B40 (Bottom 40%) households is further enhanced with the number of recipients projected to increase from 3.9 million to 5.0 million and total subsidies raised from RM22.3 billion to RM24.2 billion or about 1.4% of the estimated GDP. The other inclusive development strategies are centred on supporting social enterprises and community development, upholding Islam and furthering the Bumiputera agenda.

The other strategies to create a united and inclusive society focus on enhancing health services that included the expansion of MySalam health insurance scheme for hospitalisation and critical illnesses covering 4.3 million individuals and PEKA B40 or non-communicable disease (NCD) screenings and early interventions benefit for 100,000 individuals in the B40 category. Other activities being promoted to foster national unity and equitable growth are sports and environmental sustainability where allocations to finance specific projects and programmes are provided in the budget.

Transportation and housing are the other two major needs being addressed in furtherance of the Shared Prosperity Vision. The former includes the introduction of a targeted fuel subsidy system in Peninsular Malaysia where a subsidy of 30 cents per litre of fuel subject to a maximum of 100 litres a month will be provided to eligible recipients. Another 'consumer-friendly' measure is the proposed 18% reduction in highway toll that seeks to partially fulfil the government's campaign promise to abolish toll.

On the affordable housing issue, the budget lends further support to the Rent-to-Own scheme with a RM10 billion fund where the government provides 30% guarantee. Not left out are developers who, facing an over-supplied market for medium to high end properties, will benefit from the proposal to lower the price ceiling for foreign purchasers from RM1 million to RM600,000. Following public outcry from consumer groups, the ceiling is now subject to variation by the various state governments depending on local supply and demand conditions.

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Revitalising Public Institutions and Finances

The fourth and final thrust is a follow-through from the previous budget's focus on restoring integrity, transparency and accountability in public finance and fiscal management. To reassure investors of its commitment to fiscal sustainability, the government reiterated its gradual approach to fiscal consolidation where it aims to lower gradually its fiscal deficit from 3.2% of GDP in 2020 to 2.8% in the medium term. It also announced the implementation of a Tax Identification Number by 2021 to enhance further the tax collection system.

The final strategy aimed at strengthening governance and integrity reiterates the implementation of the National Anti-Corruption Plan and establishment of the Independent Police Complaints and Misconduct Commission (IPCMC) as well as the creation of the Malaysian Ombudsman to replace the Bureau of Public Complaints. All these progressive measures augur well for enhancing the quality of the country's key institutions which had not received due attention under the previous administration, although there are some concerns regarding the scope and effectiveness of some reforms.

HOW WELL DOES THE BUDGET MEET EXPECTATIONS?

In conclusion, the second budget of the new government has been crafted in a comprehensive, compact and structured manner. It shows coherence in intent and strategy as well as alignment with the socio-economic and technological challenges facing the economy. It demonstrates restraint in not spending aggressively despite justifiable grounds of a weakening global economy and increasing downside risks in 2020. Given the uncertainty environment going into 2020, it is prudent to preserve as much fiscal space as possible so that the government can face any sudden downturn of the global economy with greater fiscal power.

Notwithstanding the fluidity of the external environment, effective execution and implementation of the budget thrusts and strategies remain the key to achieving the overarching objectives of not only sustaining or achieving a higher level of growth but to effect the structural transformation of the economy through high quality investment and a faster pace of technology adoption and productivity improvements, both in the government and the private sector.

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[1] Since the Guidelines of the Foreign Investment Committee (FIC), which governed foreign equity limits in the country, was removed in 2009, such limits are now determined by sectoral regulators. Although the removal of the guidelines allows greater flexibility for foreign participation in certain key sectors, the National Investment Committee announced in Budget 2020 is aimed at facilitating investment approvals, including the foreign equity limits, especially for the large investments targeted under the budgetary measures for 2020 and beyond.

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[2] The rationale is that despite being the country's largest trading partner, inward FDI from China, remains small compared to the US.