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Fiscal Reforms and the 13th Malaysia Plan

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The Public Finance and Fiscal Responsibility Act (FRA) enacted in 2023 forms the center piece legislation for fiscal reforms for the government. It is groundbreaking because at its heart is the dilution of the enormous powers of the Minister of Finance; it removes discretionary powers of the minister by imposing quantitative metrics on key fiscal parameters that only Parliament can change, it formalizes the Fiscal Policy Committee and make specific provisions on disclosures to Parliament.

The dilution of the powers of the minister elevates the role of Parliament, something that we would like to see other ministers do for the laws that they are responsible for. Legislation in Malaysia has historically contained specific language granting ministers with discretionary powers which has been a source of many abuses. The 1MDB scandal would not have been possible with the FRA, or at the very least, it would be uncovered so much earlier.

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The FRA sets numerical ceilings for annual budget deficits, total federal government debt and total federal government guarantees issued. The only floor it defines is on development expenditures; it requires that the Development Expenditures in the annual budget be no less than 3% of GDP. The concurrent imposition of these four limits defines a trade-off that the Federal Treasury must grapple with. The government must keep to a maximum level of deficit, 3% of GDP, in the budget, yet spend no less 3% of GDP for development expenditures.

Why these constraining constraints? Because this is what reforms mean. The starting point here is that by 2023 when the FRA came into effect, total federal government debt was RM1,173 billion. Debt servicing expenses in 2023 was RM46.3 billion which was larger than the total personal income tax collected that year, RM37.8 billion. Beyond that, there are also liabilities incurred from the guarantees extended to public entities totaling RM326 billion at the end of 2024, some of these requiring the treasury to service the debt thus eating into the annual budget. The FRA forces the government to decide on trade-offs; a smaller deficit requires either higher revenues or less expenditure, or some combination that obtains the targeted deficit. We cannot go on the existing trajectory without risking a sovereign downgrade which would be disastrous for the economy.

The 13th Malaysia Plan(13MP) to be tabled in the current sitting of Parliament represents the development expenditures plan of the government for 2026 – 2030. The operating expenditures in the budget which is dominated by emoluments, pension payments and debt servicing expenses—taking up 60% of the total amount—do not add new capacity to the economy. It represents the cost of maintaining current capacity. It is development expenditures that adds new capacity to the government, to do more things, better things. From a national accounting perspective, development expenditures represent public investments. From an economic perspective, we would like to see such public investments inducing much larger amounts of private investments. It is currently at 1:3 which must improve further.

Optimally, we would like to see public investments having long tail effects—their effects linger; they generate economic benefits beyond the current year they are expended. And if we have such effects every year, we obtain over-lapping effects over the years which would make for an efficient and effective fiscal spending.

However, fiscal resources are limited, very limited. Given the state of where the fiscal situation is, total revenues collected by the government is sufficient to just cover operating expenditures which therefore means that almost every ringgit spent for development expenditures has to be borrowed. The FRA itself imposes both limits on annual deficits and accumulated debts, so there is only so much that can be borrowed and allocated for development expenditures.

If the last few years is a reflection of reality, we see that annual development expenditures to be between 4 to 5 percent of current GDP, well above the FRA floor. In Budget 2025, it was RM86 billion or 4.1% of GDP. Suppose nominal GDP grows at 7% over the next five years. That will translate into an aggregated five-year development expenditure of some RM500 billion, the approximate size of 13MP. Simple extrapolation will obtain a nominal GDP of 2.9 trillion in 2030 with a development budget of RM122 billion. Assuming, of course, there are no structural shifts especially in the external environment which is appearing to be unlikely.

That notwithstanding, as long as nominal GDP is growing faster than the deficit, we will be within the FRA metrics, and that should be the overriding policy objective. The imperative is therefore: how to be more productive? Which translates into how to be more competitive? Which begs the question: where should government spend to improve productivity and competitiveness? While being disciplined fiscally. What are the kinds of development expenditures that increases the capacity of government to deliver its services in a manner that will deliver benefits over a long period?

Central to determining where government should spend fiscal resources on is the demarcation between public and private goods which is a more pointed consideration given scarce resources. Public resources should only be allocated to the provision of public goods which are essentially those things that have spillover effects, externalities in economics parlance, that generate social benefits when the externalities are positive or social costs when they are negative. An educated population, a healthy well-trained workforce, a safe and clean environment and functioning institutions are examples of social benefits arising from the provision of adequate and quality public goods. Of course, policy should minimize social costs.

The government would do well to prioritize its development expenditures for the next five years on basic public goods: on improving the quality of education and training institutions, ensuring adequate levels and quality of associated infrastructure, access to state of the art of technology including facilitating life-long learning, improving the provision of and access to health services, ensuring public safety, conservation and protection of the environment; basic services that improve overall quality of life. The government should revert to the bottoms up assessment of what is needed. Let the demand side of the fiscal equation determine the supply side. In the aggregate, the government footprint in the economy, as measured by the annual budget, is estimated to be just over 20% of GDP for 2025. That is the size of the fiscal policy lever. The overall public sector footprint is however larger as government also owns or control companies. In official documents accompanying annual budgets, the consolidated public sector includes 'non-financial public corporations' (NFPC) which are companies owned by the federal government such as Petronas, Prasarana, KTM as well as companies where government-owned entities like Khazanah has control over including publicly listed entities such as Telekom, Tenaga and Axiata.

This expansive view of the 'public sector' can sometimes blur the lines between who does what for whom. Direct fiscal resources at the Treasury and those in the balance sheets of these NFPCs are not fungible. They have distinct roles that should be clarified, not blurred. I am also wary of so called privately financed initiatives (PFIs) as well as Public-Private Partnership arrangements which will require a thorough re-evaluation. Malaysia, Inc has blurred the line between who provides private and public goods; by and large that has been to the detriment of the public sector. It is the government that typically ends up saddled with debts and obligations which has further impaired its overall fiscal capacity.

There will be calls for "government to lead" in investments, and by that they mean government investing in businesses the way government did via the various policies in the past; be it in the heavy industry policies that saw government investing heavily in automotive, motorcycles, steel production, electrical appliances or wafer fabrication during the information technology period or biotechnology or simply creating funds using debt to invest in businesses such as 1MDB. None of these made any money or generate any returns, financially or economically.

While there are compelling reasons for economic transformation, government leads via building capability and capacity, developing safety nets for those caught in the transition, and providing investors and businesses with institutional integrity to obtain their confidence. Of course, government can use tax policies to reward the desired investor behavior. Government should not use scarce fiscal resources, development expenditures funded by debt, to start or fund businesses.

Conclusion

Which brings us back to fiscal policy and the necessary and painful fiscal reforms. Being the development expenditures of the government, the 13MP is a part of that. The government and the beneficiaries of its largesse, households and firms, must learn to live with constraints and redefined priorities which is the only way to be more productive and therefore, more competitive. A good outcome.