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Author 1	Wee, Chong Hui
Author 2	NA
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Abstract

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Title of paper	Public Finance In Sarawak
Author	Wee Chong Hui
Panel	Public Policy
Affiliation of author	Lecturer, Universiti Teknologi Mara Sarawak
e-mail	*chonghuiwee@yahoo.com*

Biodata

Wee Chong Hui is an economics lecturer of Universiti Teknologi MARA Sarawak. Her studies of the Malaysian public sector include health services, taxation, regional development and centralisation in the Malaysian Federation. Her interests include socio-economic conditions and gender in low-income communities in Kuching. She is the Advisor of the Women's Development Program of the Sarawak Family Planning Association.

Abstract

Within the Malaysian Federation, Sarawak has a small public sector. Over time, the State Government is increasing its expenditure and revenue to slightly more than the Federal Government's share in the state. State Government revenue has been dependent on depleting natural resources such as forests, lands and mines, indicating its constraints in continuing overall deficits to finance development. The Federal Government has also incurred overall deficits because of development expenditure, which should be more than adequately covered by non-tax revenues such as royalties from petroleum production in the state. Individual income taxation levied by the Federal Government seems to serve its expected equity objective within the state, though there has been counter-proposal to the uniform statutory tax schedule on grounds of the state's higher costs of living. Generally, it appears that fiscal policy has not been designed to be significantly counter-cyclical, at least for the recession of the early eighties and the aftermath of the 1997-98 financial crisis.

Introduction

The public sector in Sarawak is small. It has contributed some 5 to 15 per cent of the state's gross domestic product (GDP) since 1970 (Table 1). Government services as a proportion of GDP grew from 5.2 per cent in 1970 to a peak 13.7 per cent in 1983, before declining to 5.7 per cent in 2000.

Table 1. Sarawak: Government Services as a Proportion of Gross Domestic Product in Purchasers' Prices, 1970-2000

Year	%
1970	5.2
1975	5.2
1980	6.8
1983	13.7
1985	10.1
1986	8.6
1988	8.7
1990	6.4
1996	7.0
1997	9.0
2000	5.7

Sources: Calculated with data from various Malaysia Plans and *Yearbook of Statistics, Sarawak*, various issues

The public sector is expected to focus on the macroeconomic objectives of growth, stability and equity. Consequently, this paper will discuss public finance with respect to these objectives. It examines public finance in Sarawak from the sixties until the present in terms of:

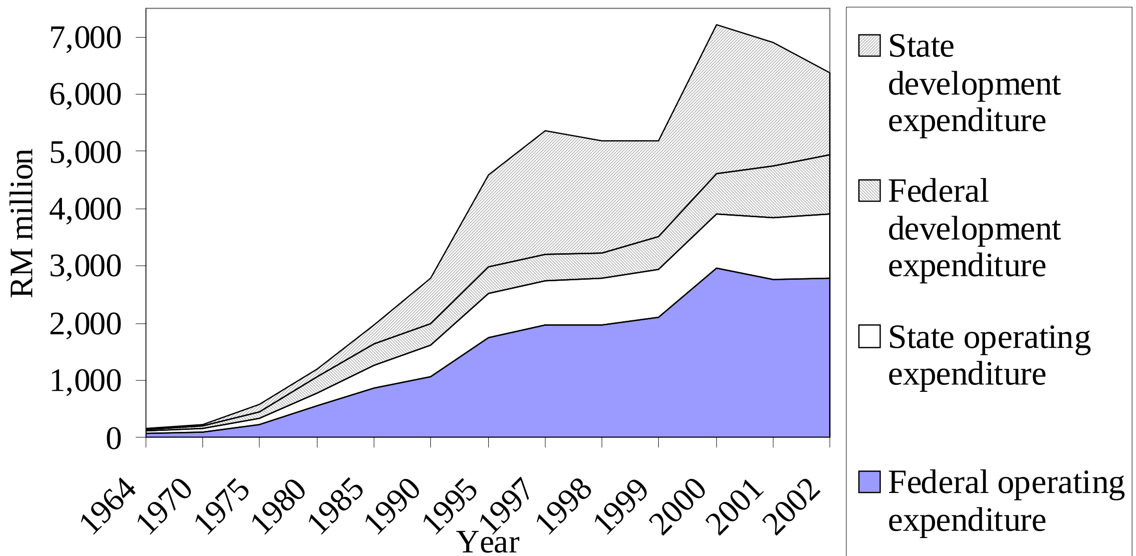
(1) The changing size of the public sector, highlighting the general role of the government during the various phases of economic cycles over the years,
(2) Government expenditure by functional classification as indicative of government priorities and fiscal arrangements in the organisational structure, including the federal set-up,
(3) Government revenue, emphasising on the incidence of taxation – the major source of government revenue, and
(4) Government budgetary balances and debts from the perspective of financial management.

Government Expenditure

Government expenditure in Sarawak – a state in the Malaysian Federation – comprises Federal Government expenditure in the state and Sarawak State Government expenditure.

Consolidated government expenditure increased from RM149 million in 1964 to RM7,220 million in 2000, before falling to RM6,370 million in 2002 (Figure 1).

Figure 1. Sarawak: Federal and State Government Operating and Development Expendture, 1964-2002



Sources: Yearbook of Statistics, Sarawak, various issues

Operating expenditure has exceeded development expenditure, contributing at least 60 to 70 per cent of total expenditure in the seventies, 65 per cent in the eighties, 50 to 60 per cent in the nineties and 60 per cent in 2002. The value of operating expenditure is directly related to the size of the public sector and normally not manipulated in the short run.

Conversely, development expenditure may be appropriately used as counter-cyclical measures. However, there is no evidence to suggest that development expenditure has been intentionally increased at times of recession. During the recessionary early eighties, development expenditure increased by some 10.0 per cent per annum compared to 10.4 per cent for operating expenditure. The decrease in development expenditure in the aftermath of the recent financial crisis 99 (6 to 9 per cent decrease over the expenditure the previous year for 1998-99) was contrary to the increase in operating expenditure (2 to 6 per cent increase).

Federal government expenditure grew from 56 per cent of consolidated federal and government expenditure in 1964 to 71 per cent in 1980, before declining to 45 per cent in 1997 and growing thereafter to 60 per cent in 2002. It has contributed more than the state government in the recession of the early eighties but played a diminished role in the 1997-98 crisis.

At least 65 per cent of federal government expenditure has been for current operation, indicating its relatively low priority to development in the state. On the other hand, the state government has incurred increasingly more development. Development expenditure share of total state government expenditure increased from 36 per cent in 1964 to a peak 74 per cent in 2000, and 56 per cent in 2002. In fact, direct state government development expenditure has exceeded federal government development expenditure since 1990.

Government Expenditure by Functional Classification

The functional classification of expenditures incurred by the Federal and State Governments reflect their respective constitutional jurisdictions. The Federal Government is exclusively responsible for national defence and security, law and justice, stabilisation and economic growth functions such as finance, trade, commerce and industry as well as national interests such as include shipping, navigation and fishery, communication and transport, works and power, medicine and health, labour and social security, professional licensing, societies, agricultural pest control, publications, censorship, theatres and cinemas as well as the prevention and extinguishment of fires. As for other state government, the Sarawak State Government is in charge of local and regional affairs such as land, agriculture and forestry as well as turtle and riverine fishery in addition to sharing the social welfare function with the Federal Government. Unlike the peninsular state governments but similar to Sabah's, the Sarawak State Government's participation in the federation as a separate entity from the eleven states of Peninsular Malaysia (together with the Sabah State Government) led to its jurisdiction over state authorities, ports and harbours other than those declared federal.

The Federal Government has incurred most on education as well as medical and health services (Table 2). However, it is noteworthy that defence and security – proposed for exclusion in equity analysis (see Meerman, 1975 and 1979) – has taken a substantial 11 to 23 per cent of operating expenditure.

Table 2. Sarawak: Federal Government Operating Expenditure by Functional Classification, 1964-2002 (%)

	1964	1970	1975	1980	1985	1990	1995	2000	2001	2002
Defence and security	21.4	23.3	28.2	19.3	16.5	17.4	14.3	11.2	13.9	14.7
Medical and health	14.5	11.3	13.9	12.9	12.8	13.3	13.7	17.6	17.6	18.8
Social welfare	0.1	0.2	0.1	0.1	0.1	0.1	0.3	0.2	0.4	0.7
Education	24.9	28.9	35.2	35.6	42.8	44.9	42.8	53.1	45.5	50.4
Public works	0.9	0.9	1.2	-	0.1	2.0	6.2	-	-	0.2
Others	24.9	22.9	17.2	25.2	19.5	16.0	13.6	12.1	18.3	10.9

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues

State operating expenditure on its constitutional functions in agriculture, forestry, land, local authorities, public works and welfare has totalled 55 to 75 per cent since the sixties (Table 3). Public works took the major share of one third of the expenditure until the eighties, before declining to its recent one fifth share. Sarawak is a large state and its state government appears to be have directly incurred more expenditure on public works than the Federal Government has. The State Government's administration has also increased from 8 per cent of operating expenditure in 1964 to 32 per cent in 2002, while its debt servicing doubled from 5 per cent to 10 per cent for the same period.

Table 3. Sarawak: State Government Operating Expenditure by Functional Classification, 1964-2002 (%)

	1964	1970	1975	1980	1985	1990	1995	2000	2002
Agriculture and& forestry	12.9	13.7	20.2	19.8	19.0	17.2	18.4	19.0	16.6
Land and surveys	11.4	10.8	12.4	10.4	8.4	7.1	7.9	7.6	7.0
Allocation to local authorities	7.6	8.3	5.8	4.4	11.8	5.5	7.8	6.3	6.0
Public works	32.6	33.3	35.7	33.5	29.1	23.9	25.3	20.0	18.5
Welfare	-	-	1.6	1.5	2.1	6.7	6.1	7.9	7.8
Administration	8.0	6.0	19.1	18.3	19.7	19.9	21.3	30.9	32.1
Public debt charges	4.6	5.7	4.3	7.1	9.2	14.6	10.7	5.7	9.7

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues

State government development expenditure on agriculture, land development, urban development, housing, transport and utilities grew from a total of 70 per cent in 1964 to 95 per cent in 1980, before decreasing to 57 per cent in 2002 (Table 4). Roads and bridges claimed the largest share, declining from 41 per cent in 1964 to 22 per cent in 2002 as infrastructure improves. Relative development expenditure on smallholder agriculture has given way to large scale agriculture, for which land development expenditure peaked at 14 per cent in 1985 before returning to its 2002 share of 6 per cent, as was in the introductory period in the late seventies.

Table 4. Sarawak: State Government Development Expenditure by Functional Classification, 1964-2002 (%)

	1964	1970	1975	1980	1985	1990	1995	2000	2002
Agriculture	8.9	17.8	9.7	14.5	12.2	7.5	6.3	4.1	7.6
Land development	-	-	5.0	6.7	14.3	8.6	7.6	3.3	5.6
Urban development & recreation	13.7	5.5	2.4	4.0	5.5	3.9	2.7	1.8	2.4
Housing & resettlement	-	-	12.9	25.0	9.6	5.5	9.9	14.0	7.9
Ports	2.3	4.7	2.4	9.0	3.1	2.6	1.6	1.1	1.3
Roads and bridges	41.1	24.4	15.2	15.2	10.3	15.9	17.9	15.2	22.3
Water, gas, electricity & power	4.0	8.1	5.2	20.2	11.4	9.2	6.1	7.9	10.2
Industries & investments	1.0	1.8	7.4	6.9	9.1	29.6	33.7	44.7	23.1
Minor rural projects	3.8	1.4	0.3	1.7	4.7	15.2	7.3	7.2	13.1

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues

State government efforts in industrialisation also saw increasing development expenditure on industries as well as related works and power, especially from the eighties. By the nineties, industries and investments had the largest share of development expenditure – 30 per cent in 1990 and 45 per cent in 2000.

According to the Malaysian Constitution, trade, commerce and industry are under federal jurisdiction. However, the Sarawak State Government appear to be incurring more direct expenditure than the Federal Government on the matters. This scenario suggests the need for collaboration between the State and Federal Governments, as in any federal set-up. In fact, the Federal Government provides grants and reimbursements to the State Government for implementing federal projects or joint projects.

Minor rural projects (MRP) have claimed an increasingly significant share of development expenditure. The share increased from 3.8 per cent in 1964 to a peak 15.2 per cent in 1990, before decreasing to 7.2 per cent in 2000 and increasing to 13.1 per cent in 2002.

Allocations for MRP are provided for community activities and disbursed via the government general administrative machinery, namely the district office. The allocations may be increased during an election year, such as the high MRP share of the development expenditure in 2002. Communities can approach their state assemblyman to support their applications for MRP grants. With some district offices known to act on advices/instructions from assemblymen in the ruling coalition in the past, political patronage has been entrenched in the public finance structure.

The MRP has featured prominently in some politicians' frequent interactions with communities in their constituencies, the latter even taking elected representatives from parliamentary sessions. In fact, the code of ethics for Members of Parliament recently released by the prime minister is supposedly also relevant for Members of the Sarawak State Assembly.

Government Revenue

Revenue assignments take cognisance of the constitutional jurisdiction of the respective level of government. The assignment of income taxes, property and capital gains taxes, international trade taxes, as well as production and consumption taxes to the Federal Government parallels its macroeconomic functions. As in pre-federation days, the State Government collects natural resource-related taxes such as revenue from lands and mines, as well as forests.

Consolidated federal and state government revenue grew from RM113 million in 1964 to RM4,786 million at the start of the financial crisis in 1997, before dropping to RM4,649 million in 1998 and rising thereafter to RM5,120 million in 2002 (Table 5). Its growth rate has accelerated from 15.3 per cent per annum for the early seventies to 24.9 per cent in the late seventies, before slowing down to 13.2 per cent for the early eighties, 6 per cent for the late eighties and the early nineties and 4.4 per cent for the late nineties.

The Federal Government collected slightly more than half of the consolidated revenue until the eighties, after which the State Government collected slightly more.

Table 5. Sarawak: Federal and State Government Revenue, 1964-2002 (RM million)

	Federal Government	State Government	Total
1964	59 (52.2%)	53 (46.9%)	113
1970	103 (55.4%)	83 (44.6%)	186
1975	173 (45.6%)	206 (54.4%)	379
1980	727 (64.4%)	402 (35.6%)	1,129
1985	1,160 (55.2%)	940 (44.8%)	2,100
1990	1,331 (47.6%)	1,467 (52.4%)	2,798
1995	1,554 (41.4%)	2,199 (58.6%)	3,754
1996	1,807 (44.1%)	2,296 (56.0%)	4,102
1997	2,277 (47.6%)	2,509 (52.4%)	4,786
1998	1,905 (44.7%)	2,358 (55.3%)	4,263
1999	1,924 (43.6%)	2,489 (56.4%)	4,413
2000	2,258 (48.6%)	2,391 (51.4%)	4,649
2001	2,348 (49.5%)	2,391 (50.5%)	4,739
2002	2,835 (55.4%)	2,285 (44.6%)	5,120

Source: *Yearbook of Statistics, Sarawak*, various issues

The bulk of federal government revenue has been from taxation (Table 6). Revenue from taxes increased from 81 per cent in 1985 to 91 per cent in 2002. Direct taxes – on income – has grown with monetary income. Contributions from direct taxes grew from 21 per cent in 1985 to 67 per cent in 2002. Meanwhile, indirect taxes fell from 60 per cent to 24 per cent due to the relative increase in direct taxes and relative decreases in custom duties.

Table 6. Sarawak: Major Sources of Federal Government Revenue, 1985-2002 (%)

	1985	1990	1995	2000	2002
Taxes	81.4	92.4	91.7	89.2	90.5
Direct Taxes	21.2	37.6	58.3	56.2	66.6
Indirect taxes	60.1	54.8	33.4	33.0	23.8
Custom duties	54.1	46.0	21.2	22.1	12.3
Excise duties	2.1	4.5	5.0	3.8	0.8
Sales and services taxes	3.9	4.3	7.2	7.0	10.7

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues

Prior to the nineties, custom duties decreased because of poor market conditions for traditional exports such as the export price of natural rubber falling below the taxable threshold and declines in export volume. In the nineties, custom duty rates were reduced and some duties were abolished with liberalisation, including agreements with trading partners in the World Trade Organisation and other trading blocs.

Sales and services taxes are relatively new. Nonetheless, they have been increasing in coverage and rates. Their share of federal government revenue grew from 4 per cent of federal government revenue in 1985 to 11 per cent in 2002.

The major portion of state government revenue has been from natural resources. Revenues from forest as well as land and mines such as licences, rents and royalties grew from 19 per cent in the mid sixties to 62 per cent in 1990 and declined to 38 per cent in 1999 (Table 7). Custom duties on the export of forest produce, import of petroleum products and export of minerals increased from 11 per cent in 1964 to 15 per cent in 1985 before declining to 3.5 per cent in 1999. Excise duties grew from 1 per cent in 1964 to 7.5 per cent in 1995 and fell to 5.9 per cent in 1999.

Table 7. Sarawak: Major Sources of State Government Revenue, 1964-1998 (%)

	1964	1970	1975	1985	1990	1995	1999
Revenue from forests	14.2	21.1	5.5	21.2	48.0	44.4	35.2
Revenue from land & mines	4.7	6.5	54.4	22.4	13.7	13.3	3.0
Custom duties	10.9	12.6	7.8	15.0	3.4	6.4	3.5
Excise duties	1.0	1.2	0.3	6.1	6.0	7.5	5.9

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues and *Sarawak Estimate of Revenue and Expenditure for the Year 1998*

Taxation has been a major source of government revenue. However, consolidated federal and state taxes as burdens of GDP fell from 13.3 per cent in 1985 to 10.5 per cent in 1990 and 6.5 per cent in 2000.

Indirect taxes was more burdensome than direct taxes up to the eighties. Export duties included those imposed by the federal Government on commodities such as natural rubber – burdensome on poor smallholder farmers (see also Wee, forthcoming for a discussion on taxation in Malaysia) – pepper and palm oil. Significant import duties included that imposed by the State Government on petroleum product and those imposed by the Federal Government on consumer manufactures such as beverages and tobacco, liquor as well as cloth and clothing, in addition to crude petroleum. Import duties on petroleum products and consumer manufactures burden consumers while duties on crude petroleum affect industries. The Federal Government also levies relatively significant excise duties on food industries.

Table 8. Sarawak: Taxes as a Proportion of Gross Domestic Product, 1985-2000 (%)

	1985	1990	1995	1997	1998	1999	2000
Total taxes	13.3	10.5	10.2	10.5	8.4	7.6	6.5
Direct taxes	2.9	3.9	5.3	5.9	5.7	4.6	4.1
Indirect taxes	10.4	6.7	4.9	4.6	2.7	3.0	2.4
Custom duties	8.9	5.1	2.8	2.8	1.6	1.8	1.6
Import duties	1.2	1.2	1.5	1.3	0.8	0.8	0.4
Export duties	7.7	3.9	1.2	1.6	0.8	1.0	1.2
Excise duties	1.0	1.1	1.4	1.2	0.7	0.8	0.3
Sales & services taxes	0.5	0.4	0.7	0.6	0.4	0.4	0.5
Sales taxes	0.5	0.4	0.5	0.4	0.3	0.3	0.4
Services tax	0.1	0.1	0.2	0.2	0.2	0.1	0.1

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues and various Malaysia plan documents

Direct taxes became more significant in the nineties. This happened in spite of reduction in statutory income tax rates because of growth in (monetary) income. Personal income tax is the most widespread. It is progressive and serves the equity objective (Table 9). In 1990, the Gini ratio for the distribution of residents' individual income fell 9.4 per cent with the levying of individual income tax i.e. from 0.3952 to 0.3587. In 1998, it fell 9.2 per cent from 0.3726 to 0.3384.

Table 9. Sarawak: Average Income Tax by Residents' Income, 1990 and 1998

1990		1998	
Average Income (RM)	Average Tax (%)	Average Income (RM)	Average Tax (%)
5,823	0.6		
8,769	1.5	10,769	0
12,238	2.8		
		13,177	0.2
		16,140	1.1
17,345	4.9	22,939	2.2
24,226	7.2	35,964	4.0
37,778	10.7		
		52,828	6.4
67,200	16.9	70,502	9.3
		95,203	12.9
134,243	26.1	133,021	17.1
		185,017	20.5
		234,790	22.5
		288,352	23.9
321,381	34.2	335,611	24.8
		386,979	25.5
		866,654	28.0

Sources: Calculated with data from Inland Revenue Board, Malaysia

The same statutory tax rate on individual income is enforced nationwide. There has been proposals to levy lower statutory tax rates on Sarawak (and Sabah) residents because of higher costs of living in compared to most other states.

Government Budgetary Balances and Debts

The Federal Government has been incurring current deficits in the state since the financial crisis in 1997-98 (Table 10). It has had overall balances as it incurred development expenditure in the state. Nonetheless, federal expenditure can be financed from non-tax revenues such as royalties collected from petroleum resources in the state through Petrolium Nasional Berhad.

Table 10. Sarawak: Federal and State Government Budgetary Balances, 1964-2002 (RM million)

	Federal Government		State Government	
	Current Balance	Overall Balance	Current Balance	Overall Balance
1964	-4	-24	-17	-41
1970	8	-31	18	-15
1975	-47	-162	-36	-173
1980	173	-125	132	-6
1985	291	-87	223	-101
1990	272	-95	343	-449
1995	-196	-665	-57	-1,654
1997	312	-153	107	-2,046
1998	-57	-494	-572	-2,523
1999	-167	-730	112	-1,561
2000	-696	-1,410	-18	-2,626
2001	-405	-1,289	-155	-2,324
2002	49	-982	-51	-1,491

Sources: Calculated with data from *Yearbook of Statistics, Sarawak*, various issues

The State Government has had fluctuating current deficits, which may require improved management. In fact, the State Government's operating expenditure for allocations to local authorities may have to be increased with increasing urbanisation in the state. In recent years, some local authorities in major towns have had deficits. Although most local authorities seem to be containing their deficits, they claimed to have financial difficulties. Local authorities have just increased the annual payable tax by 10 per cent, postponing its proposal after public outcry last year (2003). State government overall deficits have also ballooned with development expenditure since the nineties.

The major source of state government revenue has been from depletable forests, land and mines. As the government opted to borrow to cover shortfalls in revenues, its debts escalated – we have seen debt servicing increasing from 4.6 per cent of operating expenditure (RM2.0 million) to 9.7 per cent (RM107.7 million) in 2002.

Federal support in the form of grants to the State Government grew from 4.7 per cent of state government revenue in 1964 to a peak 22.4 per cent in 1985, before falling to 13.3 per cent in 1995. Over the years, federal support to state governments have shifted from grants to loans. As for most states, grants as a proportion of the Sarawak state government revenue was only increased during the financial crisis (17.2 per cent in 1997 and declining to 3.0 per cent by 1999).

Conclusion

Both the Federal Government and the State Government have played their respective roles, although small, in public finance in Sarawak. The need for government financial commitments in this less developed state is demanding. With depleting traditional resource-based sources of revenue, the State Government's development expenditure in recent years will be difficult to sustain.

Residents have not participated actively in community affairs – except for the opposition to proposed increases in annual rateable values by the local authorities for tax payment in 2003. In fact, most questions raised by community representatives in a "national unity" dialogue in the capital city of Kuching on 14 May 2004 with the Minister in the Prime Minister's Department were on increased allocations without much proposals on community involvements or consultations with local authorities. The government has also been inexperienced in facilitating community participation in line with Local Agenda 21.

The government has not taken timely counter-cyclical measures during crucial downturns. However, its appropriate response to the 1997-98 financial crisis – option for increased expenditure and rejection of IMF proposal to reduce it – albeit slow, will be an experience it can draw on.

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