Società italiana di economia pubblica

WORKING PAPER
No 398
Gennaio 2005

TAX SYSTEMS AND TAX REFORMS IN SOUTH AND EAST ASIA: MALAYSIA

GIANPAOLO FANARA

University of Eastern Piedmont - Italy

JEL CLASSIFICATION: H20, H24, H25

KEYWORDS: Taxation, Tax Reforms, Malaysia

TAX SYSTEMS AND TAX REFORMS IN SOUTH AND EAST ASIA: MALAYSIA

by

Gianpaolo Fanara

University of Eastern Piedmont - Italy

Abstract
This paper is part of a wider research on South and East Asia countries' taxation carried on at this Department, under the direction of L. Bernardi, A. Fraschini and P. Shome, and the supervision of V. Tanzi. It aims to describe and discuss the Malaysian tax system and its recent development from an economic point of view. After an introduction about the economic and institutional Malaysian context, we consider the trends from the early 1990s of the main fiscal variables: total revenue, tax revenue (either direct and indirect) and the main taxes. Then a comparative view of Malaysian tax system with respect of those of some similar developing countries and some developed countries is depicted.. In the following section, we focus on the institutional features of the main direct and indirect taxes, such as the Personal Income Tax (PIT), the Corporate Income Tax (CIT), the Sales Tax and some excises.. Then we discuss some quantitative and qualitative aspects of the distribution and incidence of fiscal burden. At the end of the paper some relevant fiscal reforms of last years, under way and planned are presented and discussed.

JEL Classification numbers : H20, H24, H25
Key words: Taxation, Tax Reforms, Malaysia
E-mail Address: **gianpaolo.fanara@sp.unipmn.it**
Tel. +39 0382 504 413 - **Fax**: *402

Department of Public and Environmental Economics
University of Pavia - Italy
January 2005

1. Introduction, contents and main conclusions

This chapter aims to discuss the case of Malaysia, showing the most significant features of its tax system and its more recent changes and reforms. The interest in the Malaysian case is due to the fact that this country is actually one of the most growing countries of the Asian region; so that it could be interesting and useful to illustrate some data and features concerning its physical, political and economical context before to go on to discuss about taxation issues.

Malaysia is strategically located in the heart of Southeast Asia, one of the world's fastest growing regions; Malaysia is well serviced by all major air and shipping lines: this easy access from the rest of the world has today made it an attractive centre for trade, investment and tourism. Malaysia is composed by a peninsular region, which stretches from Thailand in the North Singapore in the South, and an insular part (the states of Sabah and Sarawak), which straddles the northern and western coasts of Borneo; about four-fifths of Malaysia's land area (much or less 330,000 Km^2) is covered by tropical rainforests, while major land-uses include cultivation of rice, rubber and oil palm.

Concerning political features, Malaysia gained independence from United Kingdom in 1957 through peaceful negotiations. Malaysia is a constitutional monarchy made up of states and federal territories; the states have sovereign monarchs or sultans: every five years, a system of rotation allows the sultans to elect the King ("the Yang Pertuan Agong") among themselves. A federal form of government exists with a bicameral Parliament consisting of a House of Representative, a body of 180 members fully elected on the basis of universal adult suffrage, and a Senate, whose members are appointed by the King and the State Legislatures.

The Barisan National, the coalition representing the multiracial composition of the country, commands a two-thirds majority in Parliament: this has ensured Malaysia a strong and stable government committed to the development of the country. This stability helps the design and development of short and long-term policies plans such as the Third Outline Perspective Plan 2001-2005, which projected the year 2020 as the target for the nation to achieve the "developed-country" status.

This paper is organized as follows: section 2 outlines a brief reminder of Malaysian public sector, the current structure of the tax system and its development during the last decade, to conclude with a short comparison with other countries (developing, such as Mexico and Vietnam, and developed, such as United States, Japan and Germany). Section 3 is devoted to the institutional features of the main Malaysian taxes (both direct and indirect, such as PIT, CIT, taxes on good and services, excises,...). Then in section 4 Malaysian fiscal burden by economic functions and by implicit rates is analyzed. Section 5 concludes by discussing the most relevant tax reforms of last years and those expected for the future. The main purposes are the reviewing and rationalizing of the incentive structure, the modernization of the fiscal administration (through the self-assessment and the transparency of the system), the reduction of the fiscal burden on firms: These mid-term objectives are consistent with the aim of Malaysian government to enhance the growth, competitiveness and resilience of the economy.

2. A broad view of tax system and its developments from the early 1990s

2.1 A short reminder of Malaysian economy and public sector outline

During the last three decades, the Malaysian economy was characterized by a fast development. From 1971 to 1990 the GDP grew at an average yearly rate of 6.7 percent, but growth was especially impressive during the last years of the 1980s, the 1990s (except in 1997-98, because of the Asian financial crisis) and the 2000s, when growth rates reached near 12 percent , both in 1996 and 2000.

As a consequence of this growth, during the last forty years Malaysia became an industrialized economy .In fact, as to 1960 about 44 percent of GDP was produced by agricultural sector and only 12 percent by the industry, while in 2002 these percentages were respectively of 8 percent and 45 percent (Table 1). From the expenditure side, (year 2000) consumption was about 57 percent (of which 11 percent public consumption and 46 percent private consumption), investment 31 percent and net exports close to 12 percent (IMF 2001).

Table 1 - Malaysian GDP by sector of origin, 1960-95 (percent values of GDP).

	1960	*1970*	*1980*	*1990*	*1995*	*2002*
Primary	44	39	31	28	21	8
Industry	12	18	25	30	36	44
Services	44	43	44	42	43	56

Source: International Monetary Found for 1960-1995; Department of Statistics of Malaysia for 2002.

In line with the growing trend of the GDP and the development of the economy, since the late 1980s, the main public finance indicators of the Malaysian Federal Government show a steep increasing trend both for the total revenue and the total expenditures (current and development components). Except than during the early and middle 1990s, government budget was imbalanced for the most part of the years here considered, and the deficit reached a huge amount from the late 1990s.

In 2002 public sector's expenditure was 40.3 percent of GDP; in particular, federal government's expenditure represents 28.8 percent of GDP, while state and local governments' expenditure represents about 12 percent of GDP.

Federal government's expenditure is composed by expenditure for general services (18.8 percent of GDP), including general public services, defense, education, health and social security, by expenditure for the economic development (5.3 percent of GDP, including agriculture, industry, transport,...) and by expenditure for interest payment and transfers to state and local government (about 5 points percentage).

In 2002 per capita GDP was about 3,450 U.S. $ (not PPP corrected). In the UN's 2004 Human Development Report, Malaysia occupies the 59th place in the High Human Development index, with a life expectancy at birth of 73 years, an infant mortality rate of 8 per 1,000 live births (46 in the 1970), an adult literacy rate of 88.7 percent and a total fertility rate of 2,9 births for woman in the period 2000-2005 (it was 5,2 in the period 1970-75). In 2002 the population is 24 million, of which 14,8 percent are under age 15 and 16,3 percent are above 65 age; labor force participation is 64,5 percent with an unemployment rate of 3,5 percent; for the period 2002-2015 the estimated annual population growth rate is 1,6 percent (it was 2.5 percent in the period 1970-2002). The health situation is not very excellent: the public-private health expenditure is about 4 percent and about 20 percent of population has not access to essential drugs; the HIV incidence is not very high (0,4 percent for 15-69 years old people), but there is a quite high incidence of malaria cases (57 per 100,000 people) and tuberculosis (120 per 1000,000 people).

2.2 The tax system

2.2.1 The current structure and its development

In 2002 Malaysian GDP reached the value of 217,453 million of Ringgits (RM)[1]. Total revenue were 73,167 million of RM (of which approximately 39,000 from direct taxes, 18,000 from indirect taxes and 15,000 from non-tax revenues) Total expenditures were close to 94,000 million of RM (of which 65,342 of current expenditures and 28,382 of development expenditures). The budged deficit reached 18,857 million of RM.

The Malaysian structure of taxation and expenditure in percentage of GDP is depicted in the following Table 2. The main features are the high level of budget deficit, the relevant amount of development expenditures (about 33 percent of total spending) and the low value of total fiscal pressure (about 26 percent both of direct taxes - including income tax and petroleum tax - and indirect taxes - including sales taxes, excises on goods and duties). The light fiscal burden is allowed by the fact that in the Malaysian pension social contributions are irrelevant (about 800 million of RM) either because pension benefits are limited to public sector employees and further are very low: the maximum pension treatment is half of the last drawn salary.

Table 2 - Fiscal revenue and public expenditures in Malaysia as percent of GDP, year 2002.

[1] RM / US$ =0.28.

	Percentage of GDP
Total Revenues	33,6
of which: Direct Taxes	17,9
Indirect Taxes	8,4
No-Tax Revenues	6,9
Expenditures	43,2
of which: Current Expenditures	30,1
Development Expenditures	13,1
Deficit	8,6

Source: Own elaboration on data from the International Monetary Found and the Department of Statistics.

The current structure of Malaysian tax system may be better understood looking at its developments from the early 1990s. A first general feature is the decreasing trend of revenue (either tax and no-tax components) during most of the 1990s, when compared with GDP. In particular, in Malaysia the ratio between total revenue and GDP decreased from 25.7 percent in 1992 to 18.3 percent in 2000 but increased again to 33.6 percent in 2002,[2] in particular, the tax revenues share of total revenues decreased from 20.3 percent in 1992 to 14.3 percent in 2000. Thereafter a sudden jump increased tax revenue until 26 percent in 2002 (see Table 3 below).

A possible understanding of the trends above described is from one hand the Asian crisis of 1997/98 and, from the other hand, the shift (from 1998) from a restrictive fiscal policy to an expansive one in order to recovery the slowdown of economic activity.

A second general feature of Malaysian tax system development is the change in the share of direct *vs.* indirect taxes. In particular, in 1992 direct taxes and indirect taxes were still more or less similar as percentage of total revenues (both at about 38 percent of total revenues), but as to 2000 direct taxes became quite larger (about 53 percent of total revenues) with respect to indirect taxes (only 25 percent). A possible explanation for the increasing trend of direct taxes on total revenues is the general reduction of the incidence of poverty and its counterpart of the increase of personal incomes due to the growth of the economy and the Malaysian government's policy of eradicating poverty

[2] Data from 1992 to 2000 are from IMF Statistical Appendix while for 2002 are from reference the Department of Statistics of Malaysia.

and improving social and economic status of population (see, for example, the New Economic Policy Plan of 1971).

Table 3 - Structure and development of government revenue in Malaysia as percentage of GDP.

	1992	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2002*
Direct taxes of which:	*9,8*	*9,6*	*9,2*	*9,4*	*9,1*	*9,9*	*10,0*	*8,5*	*8,1*	*17,8*
Tax on Net Income and Profits	-	-	-	-	-	-	8,2	7,1	5,8	10,2
Petroleum Tax Revenues	-	-	-	-	-	-	1,7	1,3	2,0	2,3
Indirect Taxes of which:	*9,8*	*9,6*	*9,9*	*9,4*	*9,1*	*9,2*	*6*	*6,7*	*6,0*	*8,4*
Sales Taxes and Excises	-	-	-	-	-	-	3,3	3,7	3,9	5,0
Tax on International Trade	-	-	-	-	-	-	0,9	1,1	1,1	1,0
Total Tax revenue:	*20,3*	*20,1*	*20,5*	*19,8*	*19,5*	*19,6*	*16,7*	*16,0*	*14,3*	*26,0*
Total Non-tax revenues:	*5,4*	*5,1*	*4,3*	*3,6*	*3,9*	*3,7*	*3,3*	*3,7*	*4,0*	*7,6*
Total revenue:	25,7	25,2	24,8	23,4	23,3	23,5	20,0	19,7	18,3	33,6

Source: IMF since 1992 to 2000; Department of Statistics of Malaysia for 2002.

2.2.2 An international comparison

In this section it is compared the Malaysian fiscal pressure and its composition on GDP with that of some developing countries (e.g. Vietnam and Mexico) and the most industrialized countries (e.g. United States, Japan and Germany); this choice is made in order to make a comparison between countries with different level of development and, consequently, to underline their peculiar features (see Table 4 below).

First, we may notice how it is relevant the gap between the Malaysian fiscal pressure (23.6 percent on GDP) and some of the most developed countries' figures (e.g. 36.8 percent on GDP in Germany) due in part to the differences in taxation but also to the considerable gap in the social contributions, which are irrelevant in Malaysia such as in other developing countries where the social security systems is not well established yet.

Second, it is interesting to observe the difference between the PIT and CIT relevance in the developing countries (Malaysia and Vietnam) and the most industrialized countries: in fact, in the developing countries PIT incidence on GDP is very low (2.8 percent in Malaysia and 0.4 percent in Vietnam), while CIT incidence is higher (6.8 percent in Malaysia and 5.6 percent in Vietnam); on the contrary, in the most developed countries CIT incidence is lower than PIT incidence (e.g. in United States, PIT is 12.2 percent while CIT is only 1.9 percent on GDP): these data show that in Malaysia, personal income taxation is still a weak and marginal source of revenues.

To conclude,, by finally considering the taxation on goods and services, it is possible to see that the incidence in Malaysia (about 4.0 percent on GDP) is very similar to the one of some developed countries (e.g. 5.2 percent in Japan and 4.6 percent in the United States) and very dissimilar from the ones of developing countries (e.g. about 10 percent in Vietnam and Mexico); this feature is probably due to the fact that Malaysian government prefer a low taxation on goods and services in order to improve the economic activity.

Table 4 - Comparison with the fiscal revenue structure of some selected countries as percentage of GDP, 2001.

	Malaysia	Vietnam	Japan	Hungary	Germany	Mexico	USA
Fiscal Revenues	23.6	n.a.	27.3	39	36.8	18.9	28.9
Tax Revenues	18.4	16.6	17	27.5	22.2	15.7	21.8
Taxes on net income and profits	12.6	n.a	8.9	10.0	10.6	5.3	14.1
PIT	2.8	0.4	5.5	7.6	10	n.a	12.2
CIT	6.8	5.6	3.5	2.4	0.6	n.a.	1.9
Taxes on good and services	4.0	9.7	5.2	15.1	10.6	9.7	4.6
Social Contributions	n.a.	n.a.	10.3	11.6	14.6	3.2	7.1

Sources: Own elaboration on Malaysian Department Statistics' data, OECD 2001, IMF 2003.

3. Some quantitative and institutional features of the main taxes

3.1 Direct Taxes

3.1.1 *Personal Income Tax (PIT)*

The Personal Income Tax is an annual tax on the taxable income from all sources accrued or derived from Malaysia and income received in Malaysia from outside Malaysia by a resident.

These sources include gains or profits from any profession, vocation or employment, pension or annuity and rent. Dividend income is taxed at gross and the tax deducted at source by the company under an imputation system will be given as a tax credit to the shareholders.

The residence status of an individual determines his/her claim for personal relieves and tax at graduated rates; in particular, an individual is regarded as a resident if (i)s/he is in Malaysia for at least 182 days in a calendar year; (ii) s/he is in Malaysia for a period of less than 182 days but that period is linked to another period of presence of at least 182 consecutive days in an adjoining year; (iii) s/he is a resident for the immediately following year and also for each of the three immediately preceding years.

In ascertaining the taxable income of a resident individual, various forms of tax relief are given in order to reduce her/his tax liability. The different forms of relief are as follows:

1.	Personal	RM 8,000
2.	Wife/Husband	RM 3,000
3.	Disabled Tax Payer (additional)	RM 5,000
4.	Disabled Spouse (additional)	RM 2,500
5.	Each Child[3]	RM 800
6.	Disabled Child	RM 5,000
7.	Parents Medical Expenses	(max) RM 5,000
8.	Equipment for Disabled Individuals	(max) RM 5,000

[3] If the child is over 18 years of age and is receiving higher education at local university or college s/he is eligible for 4 times the normal relief of RM 800; if the higher education is received overseas, only normal relief is granted.

9. Life Insurance Premiums (max) RM 5,000
10. Insurance Premiums for Education or Medical Benefits (max) RM 3,000
11. Medical Expenses for Serious Diseases (max) RM 5,000
12. Contributions in Setting up Public Facilities for Disabled People
13. Donations to seriously ill individuals needing financial assistance

A tax rebate of RM 350 is given to individual whose chargeable income does not exceed RM 35,000; a further rebate of RM 350 is given if husband/wife has no income. Also a tax rebate of RM 400 will be granted to taxpayers who purchase a personal computer; this tax rebate can only be enjoyed every five years and is limited to one computer per family.

The income tax rates for resident individuals are as follows:

Taxable Income (RM)	Rates (%)
Up to 2,500	0
More than 2,500 to 5,000	1
More than 5,000 to 20,000	3
More than 20,000 to 35,000	7
More than 35,000 to 50,000	13
More than 50,000 to 70,000	19
More than 70,000 to 100,000	24
More than 100,000 to 250,000	27
More than 250,000	28

Interest received by a resident from licensed banks and financial institutions in Malaysia is subject to taxation at the rate of five percent.

Non-resident individuals are subject to taxation on income at the rate of 28 percent; for certain sources of income there are particular tax rates: in particular, the rate for royalties and technical fees is 10 percent, and for interests is 15 percent. Also, non-resident public entertainers are taxed at 15 percent of gross income.

3.1.2 *Corporate Income Tax (CIT)*

Before year of assessment 1995, the scope of income tax in Malaysia was based on derived and remittance basis, except for banking, insurance, air and sea transport for which the scope of taxation is based on world wide income. However, with effect of assessment year 1995, the scope of company income tax in Malaysia is based on derived basis.

For non-resident companies, tax is only imposed on income accrued in or derived from Malaysia, but not on income received in Malaysia from outside sources. A company is considered resident in Malaysia if its management and control is exercised in Malaysia; management and control are normally considered to be exercised at the place where the directors' meetings are held.

The taxation of companies is based on a full imputation system, i.e., the tax of a company is in fact an advance tax of the shareholders who receive dividends from the company; in other words, the shareholders are taxed on the gross dividends at their own respective tax rates and are given full tax credits in respect of the tax deducted at source by a company; effective from the assessment year 1998, the company income tax rate is 28 percent.

Deductions from the company income are given for:

A) Allowable Expenses, including the expenditure incurred wholly and exclusively in the production of the gross income, cash contributions to local, state or federal authorities or governments, cash contributions to build or equip public libraries, contributions of local artworks to the State or National Art Gallery, costs of the equipment supplied by the employer for the disabled employee to perform her/his duties, donations to a seriously ill person needing financial assistance, scholarships granted to students in local institutions, entertainment and promotional expenses.

B) Capital Allowances, including new plant and machinery, office equipment, information technology equipment, motor vehicles, environmental protection equipment.

C) Industrial Building Allowances (IBA): is granted to companies incurring capital expenditure on construction or purchase of a new building which is used for production purposes.

3.1.3 *Real Property Gains Tax (RPGT)*

Real Property Gains Tax (RPGT) is charged on gains accruing on the disposal of any real property situated in Malaysia or an interest, option or right over a real property company (RPC)[4].

Every person or company resident or not resident in Malaysia is chargeable to the RPGT in respect of any gain accruing on the disposal of any real property or RPC shares in Malaysia. A chargeable gain arises if the disposal price exceeds the acquisition price and an allowable loss is incurred if the disposal price is less than the acquisition price.

The rate of the RPGT is dependent on the period of ownership of the property or RPC shares as follows:

Category of Disposal	**Individual**	**Company**
Disposal within 2 years	30%	30%
Disposal in the 3rd year	20%	20%
Disposal in the 4th year	15%	15%
Disposal in the 5th year	5%	5%
Disposal in the 6th year and subsequent years	0%	5%

These rates are applicable for disposals made on or after 27 October 1995 by citizen and permanent residents. With effect from 27 October 1997, disposal within 5 years from the date of acquisition of chargeable assets by non-citizen and a non-permanent resident are subject to 30 percent tax rate (but only five percent after the 5th year).

3.2 Indirect Taxes

3.2.1 *Taxes on International Trade of Goods and Services*

Import duties are usually ad valorem even if some specific duties are imposed on a number of items. Ad valorem rates of import duties are from 0 percent on basic foods to

[4] A RPC is a controlled company that owns real properties or shares with a defined value of not less than 75percent of its total tangible assets.

300 percent on some motorcars; Margin of Preference (MPO) from 25 percent to 59 percent is given for selected goods of ASEAN origin.

Export duties ad valorem are imposed on crude palm oil, processed palm oil and other oils.

3.2.2 *Excise Duties, Sales Tax and Service Tax*

The Excise Duties are levied on locally manufacture cigarettes, intoxicating liquors, motor vehicles and playing cards.

The Sales Taxes are ad valorem single stage taxes imposed at the import (all the export are not taxed in this case) and manufacturing levels. Current rates are as follows:

- general rate on all goods 10 percent
- fruits, certain foodstuffs and building materials 5 percent
- cigarettes and tobacco products 25 percent
- alcoholic beverages 29 percent
- petrol - RM 0.5862 per litre
- diesel – RM 0.1964 per litre

The Service Tax is a form of indirect tax on taxable services such as:

- hotels (having more than 25 rooms)
- restaurants, bar, snack-bar and coffee-houses
- night clubs, dance halls, health and massage centres and beer houses
- private clubs
- private hospitals
- professional services

3.2.3 *Other taxes*

Other less relevant Malaysian taxes are the Stamp Duties, the Tax/Licence/Duties on Gaming Activities and the Road Tax.

The Stamp Duties are imposed ad valorem on certain written documents varying to the nature of the documents and values referred to; however, some specific documents attract specific rates of stamp duties.

The Gaming Tax is imposed on punters placing their bets or investments in respect of any gaming authorized under any law and is collected by the promoter of the gaming so authorized and paid to the revenue of the Federation.

The Road Taxes are imposed on passengers cars, motorcycles, taxi, bus, tractors and are based on the engine capacity, the ownership (individual or company), the fuel used (petrol or diesel).

4. The fiscal burden

The analysis of the distribution of taxation charge is focused on the impact of direct and indirect taxes on main components of GDP (economic function method); in particular, on the percentage impact on GDP of the consumption taxation (general and specific indirect taxes), of the labor taxation (direct taxes paid by employees and social contributions) and of the capital taxation..

During the last decade, consumption’s taxation is relatively high before 1997 Asian crisis (above 9 percent) and lower after this year (between 6 and 7 percent, with the exception of 2002): this in part is due to the economic measures adopted by government to mitigate the impact of the crisis.

As to capital taxation, the average figure looks somewhat high. The trend is decreasing until 2000 (with exception of 1998) but from 1999 it is increasing (above 9 percent); nevertheless a lighter capital taxation is forecasted for the future, in order to attract more foreign direct investments in order to improve the economic development.

Labor taxation's stays at an average value. Its trend is quite regular, in fact the range of the rates is 2-3 percent during the last decade: this is in part due to the very low amount of social contributions.

It is also possible to analyze the distribution of fiscal burden by means of the implicit rates method; in this case, the three main indicators are the implicit tax rates on consumption, on labor and on capital & business. They are obtained using respectively, as numerators the same values used for the economic function method, and, as denominator, three economic aggregates values drawn from the national accounts: the private consumption, the compensation of employees (wage and salaries), the gross operating surplus.[5]

As the table shows, the fiscal burden on consumption was high before the 1997 Asian crisis (between 19 and 20 percent), but lower in the last years (between 11 and 13 percent), while the fiscal burden on labor is increasing: this trend can be seen as an indicator of the growing room of personal income tax inside Malaysian tax system which is taking place from a number of years..

[5] The figures here calculated have to be considered as approximated measures of taxation distribution by implicit tax rate method, because of the lack of detailed data; in particular the implicit tax rate for capital & business could not be calculated due to the lack of data on the gross operating surplus.

Table 5 - Structure and developments of taxation by function and by implicit rates.

	1992	*1993*	*1994*	*1995*	*1996*	*1997*	*1998*	*1999*	*2000*	*2001*	*2002*
Economic Functions											
Consumption	9.8	9.6	9.9	9.4	9.1	9.2	6	6.7	6.0	7.0	8.4
Labor	2.3	2.6	2.4	2.8	2.5	2.4	2.5	2.2	2.1	2.9	2.8
Capital & Business	7.3	6.9	6.7	6.3	6.6	6.1	8.1	6.9	6.4	9.7	9.5
Implicit Tax Rates											
Consumption	19.4	19.8	20.5	19.5	19.7	20.1	11.3	12.7	11.1	11.5	13
Labor	7.0	7.7	7.3	8.3	7.6	7.2	7.4	6.7	6.3	8.6	8.5

Source: Own elaboration on IMF data.

5 Tax Reforms

5.1 A quick glance at macro economic and budget outlook

Malaysia sustained a robust growth in 2003, driven by strong domestic demand and sturdy export performance. Real GDP grew by 5.2 percent in 2003, up from 4.1 percent in 2002. Private consumption is expected to rise by 8.1 percent this year, compared with 5.1 percent in 2003. Private investment is projected to grow by 11.5 percent in 2004, substantially higher than the 1.1 percent in 2003. The overall inflation rate, as measured by the annual change in the Consumer Price Index (CPI) remained low at 1.2 percent in 2003.

From the supply side, all sectors of the economy expanded in 2003; the manufacturing sector improved to 8.2 percent growth in constant prices compared to 4.0 percent in 2002, the finance and business sector expended by 4.9 percent and the agriculture sector expanded by 5.5 percent in real terms.

From the demand side, final consumption expenditure achieved a 5.7 percent growth in costant prices in 2003, up from 4.6 percent in 2002; in particular, this increase was attributed primarily to a 7.9 percent growth in real government expenditure and second to a 5.1 percent growth in real private final consumption. Despite increased expenditures in 2003, public debt remains within a manageable level (48.2 percent of GDP); given the high savings rate and the excess of liquidity in the financial system, it can be financed from non-inflationary domestic sources (debt servicing is at 14 percent of operating expenditures and the total external debt is declined to 9.5 percent of GDP, lowering exposure to international risks).

In 2003, fixed capital formation rose 2.7 percent in real terms, compared to a marginal increase of 0.3 percent in 2002.

The strong export performance was attributed to the manufacturing sector, particularly electrical and electronic products and the primary commodities of palm oil, crude petroleum and liquefied natural gas. In 2003, Malaysia's external trade balance recorded a merchandise trade surplus of US $ 19.7 billion, up by 45.6 percent compared with US $ 13.6 billion in 2002; in 2003, the overall balance of payments recorded a surplus of US $ 10.3 billion, up by 175.4 percent compare with US $ 3.7 billion in 2002.

Macroeconomic policy in 2003 was focused on attenuating the impact of SARS and geopolitical concerns; a series of monetary and fiscal measures were implemented during the second quarter of 2003 in response to the SARS outbreak and the weaker than expected global economic conditions, namely slow growth in the U.S.; as a result of these developments, Bank Negara Malaysia reduced its policy rate and the Government announced a comprehensive economic stimulus and relief package of US $ 1.9 billion (2 percent of GDP), encompassing fiscal and financing measures that were designed to provide immediate relief to affected sectors, sustain a high level of consumer spending and contribute to stronger wage growth.

5.2 Tax reforms of last years, under way and planned

The Malaysian economy has recovered from the Asian financial crisis of 1997 with a strong growth of 8.3 percent in 2000; however, in the subsequent years, the growth moment was again affected by the global economic slowdown, in part due to the September 11 Twin Towers incident in U.S.

To mitigate the adverse impact of the external slowdown, government has designed and implemented some policies and strategies through the Pre-emptive Stimulus Package in 2002 and the Package of New Strategies in March 2004, containing also some relevant fiscal measures to improve investments. Now let's see some of these fiscal measures.

The existing incentives for small companies will be improved. Small companies before the Package reform was given the following incentives: a) Pioneer Status with 70 percent income tax exemption for 5 years or b) Investment Tax Allowance of 60 percent on capital expenditure incurred within 5 years to be offset against 70 percent of statutory income. The 2002 Package has improved existing incentives through: a) increasing income tax exemption under Pioneer Status from 70 percent to 100 percent and b) increasing statutory income that can be offset for Investment Tax Allowance from 70 percent to 100 percent.

Under the pre-Package reform, Pioneer Status with 100 percent tax exemption for 10 years or Investment Tax Allowance of 100 percent for 5 years was given on a case-by-case basis. The 2002 Package has improved as follows: a) extending the maximum period for Pioneer status from 10 to 15 years and b) extending the period for Investment Tax Allowance from 5 to 10 years.

Before the 2002 Reform the Malaysian International Trading Companies (MITCs) were provided with income tax exemption on statutory income equivalent to 10 percent of their increased export value. To promote export of locally produced goods, the rate of income tax exemption for MITCs is increased from 10 percent to 20 percent of their increased export value.

The 2002 Package contains also some measures in order to improve the skilled human resource and the productivity of workforce; in particular, a series of fiscal measures are implemented to facilitate in Malaysia the education programmes, the training of domestic and overseas human capital, the constructions of new schools, universities and libraries.

In the end, the 2002 Reforms provide also some relevant incentives to some considered strategic sectors of Malaysian economy, such as tourism, construction, manufacturing (e.g. electronic) and agriculture: in particular a series of expenditures allowances, deductions and relieves are implemented.

5.3 Suggestions for further improvements

Prospects for the next years are very promising for Malaysia: the economy is projected to grow a 5.5 percent in 2004 and 2005. Consequently, Malaysian government's structural agenda for the next years includes a further enhance of competitiveness and resilience of the economy in order to provide a business friendly environment in which domestic and international firms can flourish and prosper; the main actions include: a) improving fiscal administration and simplifying fiscal procedures through the self-assessment of the system, b) reviewing and rationalizing the tax incentive structure, c) reducing the regulatory and fiscal burden to promote private consumption and investment, d) improving the labor market and ensuring the supply of a skilled workforce, e) promoting greater usage of ICT by firms and increasing their ability to innovate through particular fiscal allowances and deductions.

References

International Monetary Fund, (2004), *"Malaysia: statistical appendix"*

Id., (2003), *"Vietnam: statistical appendix"*

Id., (2001), *"Malaysia: statistical appendix"*

Id., (2000), *"Malaysia: statistical appendix"*

Id., (1999), *"Malaysia: selected issues"*

Id., (1998), *"Malaysia: recent economic development"*

Id., (1998), "*Malaysia: selected issues"*

Organization for economic co-operation and development, (2003), *"Revenue statistics"*

United Nations, (2004), *"Human Development Report"*

Web Sites

Department of Statistics of Malaysia: www.statistics.gov.my

Government of Malaysia: www.gov.my

International Monetary Fund (IMF): www.imf.org

Ministry of Finance of Malaysia: www.finance.gov.my

Organization for economic co-operation and development (OECD): www.oecd.org

United Nations (UN): www.un.org

World Bank: www.worldbank.org