The 2007 Federal Budget

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PENANG ECONOMIC MONTHLY

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"Goodies for almost every sector", "Many pleasant surprises in store", "A Budget that addresses our concerns", "Groups: Govt has listened to us", "CEOs and MDs: A generous budget"

The quotes above are but some of the headlines that were featured in the Star newspaper after the 2007 Federal Budget was tabled by our Prime Minister cum Finance Minister, Dato' Seri Abdullah Ahmad Badawi in the Parliament on 1 September 2006. Every year, there is nearly always a certain sense of positivism that brings in the accolades for the Government's plans for the year ahead, as the quotes above can tell, but of course, there is also almost a certainty of brickbats that ensues from the announcement, for one reason or another.

It is without a doubt that the tabling of the Federal Budget every year is perceived somewhat differently by all levels of society. For some, this is the season where excitement looms ahead for them as they anticipate the positive measures that will be carried out by the Government which will bring positive outcomes for their businesses, while for others; it is a time of "gift" announcements by the Government for the people. Not to be forgotten are some who still do not know what the Budget is all about or would rather take a stance of indifference towards it.

The truth, of course, is that regardless of our background or what our stand may be, the Federal Budget will undoubtedly affect us all. In very lay man terms, the Budget announcement is a time by which the Government tables its annual plans to the people on what they want to do with the nation's finances, where the allocations are going and the sort of measures are going to take place. It also reveals the fiscal policy measures that will give an inkling of the direction in which the nation is heading towards in the upcoming year. Most of all, it reflects the Government's prudence in spending the money that has been entrusted in its care by the people of this nation.

What is in store in the 2007 Federal Budget?

For the 2007, a grand total of RM159.4 billion has been allocated for Government spending, of which the bigger bulk of RM 112.9 billion has been allocated for Operating Expenditure, a significant rise from an estimated RM105.37 billion this year. Meanwhile, in terms of Development Expenditure, a total of RM 44.5 billion has been budgeted, a whopping 24.3 percent higher than of last year's allocation.

The Federal Government has tasked the private sector to spearhead development in the country and help propel growth and as such, it is only natural for the Government to propose steps to facilitate the growth of the private sector. Thus, it is not surprising to see that there are many perks in store for the private sector under the new Budget. The reduction of the corporate tax from 28 percent to 27 percent for the year assessment 2007 and to 26 percent for year of assessment 2008 came as a pleasant, and in some ways, unexpected surprise for many as it has been pursued by the private sector for quite some time but had not materialised until now.

Venture capital companies that have invested at least 50 percent of their investment funds in seed capital will also be given tax exemption for 10 years. Besides that, in order to boost investments into the biotechnology industry, bionexus[1] companies will also be given income tax exemption for 10 years

[1] The Government has replaced the previous 'BioValley' concept with the 'BioNexus Malaysia'. Essentially, BioNexus is a network of companies and research institutions with three main centres: agrotechnology at the Malaysian Agriculture Research and Development Institute (Mardi) and Universiti Putra Malaysia in Serdang; genomics and molecular biology at Universiti Kebangsaan Malaysia, Bangi; and pharmaceutical and nutraceuticals at the former BioValley site in Dengkil. Bionexus is not a geographical location but a net of research facilities in Malaysia. It is a business model for biotech companies to adapt science and technology to make market sense. *Source:* *http://www.biotechcorp.com.my and www.mida.gov.my*

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beginning from the first year the company is profitable, on top of the present incentives which are already in place. The tax cuts and exemptions would help maintain cost competitiveness for the businesses as profits can be ploughed back into their businesses and together with the Government's pledge to make the nation's tax administration more simple and transparent, the exemptions are expected to encourage and raise both local and foreign investments and re-investment into the country.

The perception of the agriculture sector as old school and a thing-of-the-past may no longer be true. The agriculture sector is expected to go through rejuvenation as the Federal Government aims to transform it into a modern and competitive sector. The 2007 Budget has shown an emphasis on the commercialisation of R&D findings, modern technology and improvement in the supply chain of the sector. An allocation of RM3.6 billion has been allocated to increase productivity and efficiency in production and for the industry to expand its marketing capabilities. More funding opportunities can be seen as the Government continues to push for a greater measure of investment into high technology agriculture, in which Khazanah Nasional will establish an agriculture fund of RM200 million that will provide venture capital to finance new technology intensive agriculture projects while BNM will establish another agriculture fund of RM200 million for integrated agriculture and livestock projects. This will provide more opportunities especially for the smaller players to gain access to funding. The expansion of the Fund for Food (3F) loans by RM300 million to RM1.9 billion is also expected to further promote investment in the food production activities.

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The 9th Malaysia Plan has identified the Northern region for commercial agriculture, agro-based and high tech industries and one of the major plans on the cards is the development of the aquaculture industry in the Nothern Corridor. Being one of the major exporting sources of ornamental fish in the region and country, Penang is set to benefit from the rollout of the Ornamental Fish Cluster Project next year. The State Government has recently signed a memorandum of understanding with the Agriculture and Agro-Based Industry Ministry to set up two hatchery farms in Penaga and Juru. Besides that, on a broader perspective, the SME Bank has also allotted RM20 million to finance *halal* entrepreneurs in the country, in which the manufacturing industries within the State can tap into, leveraging on their manufacturing experience and proximity to the sources of raw materials in the region.

In line with Malaysia's aim to be a leading Islamic financial hub, the sector, as expected, was given a big boost in the 2007 Budget. Islamic banks and takaful companies will be given full tax exemption for 10 years on income derived from Islamic banking businesses conducted in international currencies. Full income tax exemption for 10 years on management fees is also applicable for both local and foreign companies managing funds of foreign investors established under the Syariah principle while deduction on expenses incurred prior to commencement on an Islamic stock broking firm will also be allowed. Nevertheless, the impact of these provisions would be rather minimal to Penang and the State can only expect indirect impacts as most of these financial institutions are headquartered in Kuala Lumpur.

2007 will be a very big year for the tourism sector as the nation kicks off the Visit Malaysia Year 2007 (VMY2007) in commemoration of the 50th year of the nation's birth. As part of the perks in store for those involved in the tourism industry, the Government has proposed for income tax exemption for tour operators with at least 500 inbound tourists or 1,200 local tourists per year be extended until 2011 and excise duty of 50 percent will be exempted on locally assembled four wheel drive vehicles. On the administrative side, to help encourage more tourist arrivals, multiple entry visas (MEVs), which are currently given to visitors from China and India for a period of one year, will also be given to tourists from West Asia. Visa on arrival will also be given to all foreign tourists for a stay of one month from now on.

As tourism is one of Penang's major sectors, the provisions are timely, more so as both the industry players and authorities are making preparations to herald in the VMY2007. This will be quite a treat for the tour operators especially the bigger players as the tax exemptions would account for quite a significant sum of savings for these operators. It will also allow more reinvestment of profits into their businesses and as such, the operators will indirectly have a bit more finances to help them to improve on the quality of their services. The easing of entry visa ruling will definitely be a very important plus point as it would allow a more hassle-free immigration process for foreign tourists to enter the country and the MEVs would be especially important to enable the country to tap into the lucrative Western Asia market.

However, while the Government has made provisions to upgrading tourist facilities and developing new tourism products, there is an obvious void in terms of continuous maintenance of these tourism products. The upgrading and development of new tourism products should have started earlier and to be ready before the turn of the year to ensure that the new tourist products are ready and the existing tourist attractions are perpetually maintained.

One of the biggest beneficiaries of the 2007 Federal Budget would have to be the construction sector. After running on negative growth since the second quarter of 2004, the Government has proposed a substantial amount of projects and allocations to help improve the situation of this sector. In 2007, there will be a greater rollout of projects under the 9^{th} Malaysia Plan whereby the Government has allocated RM27.5 billion to build roads, quarters and other infrastructure facilities to spur growth in this sector while some RM4 billion worth of Private Funding Initiative (PFI) projects are also expected to be executed. The Government will also allow deductions for expenses incurred by property developers within the defects liability or warrant period for projects while losses incurred in the last year of project would also be allowed as deductions from profits received from the previous years of that project.

An additional sum of RM1 billion have also be allocated for maintenance of buildings and facilities to inculcate the culture of proper maintenance of buildings and public facilities. Small players, especially contractors in Class E and F would benefit from this allocation as contracts for building and facility maintenance will be specially awarded to small contractors. However, as much as it would help to rejuvenate the construction sector of the nation, what it holds of the Penang contractors remains unknown and unseen as there is no certainty that projects for the State of Penang will be awarded to contractors within the state.

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In terms of human capital development, under the 2007 Budget, the Human Resource Development Fund is set to be expanded to include internships and training programmes for graduates. Malaysian Biotechnology Corporation will commence on training programmes for unemployed graduates in bio-life sciences while various established ICT firms will also conduct a specialised skills training programme that will be introduced by the Government to further increase the number of skilled ICT workers and at the same time, the Multimedia Development Corporation (MDeC) and the Securities Commission will continue to further expand their respective training programme to cater to more unemployed graduates. The expansions are quintessentially, a good move as more graduates will be trained to be better equipped with skills and ultimately increase their marketability and employability. Besides that, immigration units will also be set up at Malaysian Industrial Development Authority (MIDA) and MDeC to help to facilitate the expedition of visas and work permits. This, together with the green light given to spouses of expatriates, with professional qualifications, to work in Malaysia will promote the inflow of the needed foreign skilled workers and this will definitely augur well for the State as it is in dire need for more skilled workers for its industries to grow further.

The lion's share of 17.8 percent of the development expenditure of the 2007 Budget deservedly went to the education sector. The Prime Minister has mentioned in his Budget speech that more scholarships will be offered to outstanding students to pursue courses in science, pharmacy, medicine and engineering at graduate and post-graduate levels. More importantly, the Government has pledged to give scholarships to students with 10 A1s in SPM, from families with monthly income of RM1,500 and below, to pursue their tertiary education. This move is very timely and is much lauded as it would give a fresh breath of hope for high-achieving students from poor families to further their education. On top of that, all examination fees will also be abolished effective from year 2007 onwards. This is certainly a cheer for both parents and teachers as it would mean extra savings for families, especially those with school-going children and less administrative hassle for the teachers.

In terms of infrastructure, the Government has proposed for the setting up of Universiti Darul Iman Malaysia and Universiti Darul Naim in Terengganu and Kelantan respectively to cater to the increasing tertiary education needs within the nation while some RM195 million have also been allocated to upgrade and improve facilities in the existing universities. Allocations have also been made to construct and upgrade polytechnics, training institutes and community colleges. In terms of primary and secondary schools, an additional 198 schools will be built and more allocation will be given for the procurement of computers and peripherals for Access Centres in 1,000 schools and all teachers' training colleges.

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The allocations and plans for education further confirm the country's continuous emphasis and commitment towards building a knowledge-based society. While the Government is not short of zest in terms of constructing physical infrastructures of schools, training centres and supplying the necessary equipment, there is much work that still needs to be done on the other more pertinent and pressing issue of the quality of education in Malaysia. The measure of education excellence is not based on the number of schools or universities available. Although physically infrastructures are vital in facilitating education, it takes more than just having the physical building and hardware to make better teachers and student. The nagging problem of the shabby quality of education across all levels; be it in schools or in institutes of higher learning, has yet to be fully addressed and instead of solely concentrating on the hardware, more allocations and emphasis have to be given to the "soft" side, such as revamping the curriculum, providing better training for teachers, giving equal emphasis to both hard skills and soft skills and inculcating the intrinsic foundation of values and civility into the education system.

Moving on to the social side, to encourage computer ownership and inculcate the reading habit among Malaysian, the present RM500 rebate given once in every 5 years on the purchase of PCs will be replaced by a tax relief of RM3,000, which will be given once in every three years while tax relief on the purchase of books will be increased from RM700 to RM1,000. It is beyond any doubt that these provisions are more than welcomed, but it is an incentive that will only aid those who are earning within the taxable range. There is no provision for the people who are not earning a taxable income and those people are usually the ones who need to be aided in terms of book purchase.

The measures to increase taxes on liquor and cigarettes are almost a permanent part of our Federal Budget as the Government continues its quest to advocate and promote a healthy lifestyle. However, the extent to which it would deter smokers from smoking and heavy drinkers from consuming more hard liquors is expected to be fairly minimal as the increase of one sen per stick increase is barely a hit to smokers. The same can also be said about the RM5 duty increase on every litre of liquor with alcohol content of more than 40 percent.

Reality check: Pump-priming Revisited

Being the first budget announcement under the 9th Malaysia Plan (9MP), the 2007 Federal Budget will kickstart the Government development plans and policies based on the 5 major thrusts of the 9MP. The programmes and policies moves point to an obvious notion that the Government is seemingly pump-priming the economy to initiate and enable sustainability amidst an anticipated slowing business environment and at the same time, enabling them to grow and generate growth and economic development. Whether it is a sustainable method will take time to tell.

On the macro viewpoint, GDP growth for 2007 is projected to hit 6.0 percent in 2007, an even faster pace than the expected 5.8 percent growth for this year. The surprising thing is that the Government has maintained rather optimistic about the economy despite the challenging circumstances that are expected to set in next year. On the global stage, the trend depicts a contrary viewpoint whereby the world GDP growth is expected to slow to 4.7 percent in 2007 in comparison with the expected expansion of 4.9 percent this year.

Albeit many positive views of the expansionary budget, there are still areas being left out that are pertinent to the State and to the general public. Apart from the company tax cuts, there were not many provisions that are specifically directed to the manufacturing sector. The Federation of Malaysian Manufacturers (FMM), in their statement on the 2007 Budget, said that the manufacturing sector had also hoped to receive concrete assurance from the Government that there would not be any further increases to energy prices, specifically in natural gas pricing but there was no mention of the subject in the Federal Budget.[2]

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[2] Source: www.fmm.org.my

The Government's emphasis, in terms of improving the quality of public transportation, is still very much centred on the Klang Valley and Kuala Lumpur. The condition and the quality of the public transportation system in Penang leave much to be desired and in many ways, the public has given up hope on the system to ever work out. The Federal Budget has no mention of this and it is hoped that there will be a more concerted effort and support from the Federal Government in easing Penang's traffic woes in the next Budget announcement.

The Government should aim to achieve greater cost savings in both its operational and development expenditures.

For the man on the street, many had also hoped and expected the Government to lower income taxes to help ease the burden of the people at a time where inflation has started to creep in as a result of higher oil and energy prices. Nevertheless, logically, it would be quite a hefty set back for the Government in terms of revenue generation if both corporate taxes and income taxes were to be slashed at the same time. Personal income tax cuts would probably not come into place until the GST is implemented tentatively in 2009.

It's back to tightening our belts.

Conclusion

All in all, the 2007 Federal Budget has its positive points and limitations. In essence, all looks good on paper but the real challenge is in the implementation of those measures. The Prime Minister, in his budget speech, promised that the formulation of strategies and programmes in the 2007 Budget will be accompanied by the commitment to implement them effectively and further added that the authorities should facilitate and not frustrate in processing approvals. It is a promise that many of us would like to see it fulfilled as the delivery system is one of the most important determinants of the make or break of the nation. With constant improvement in the effectiveness of its delivery system, the Government should aim to achieve greater cost savings in both its operational and development expenditures. Prudence is vital in ensuring that money is well and correctly spent. ***§ Tan Yin Hooi***

A Macro Perspective of the Third Industrial Master Plan (IMP3)

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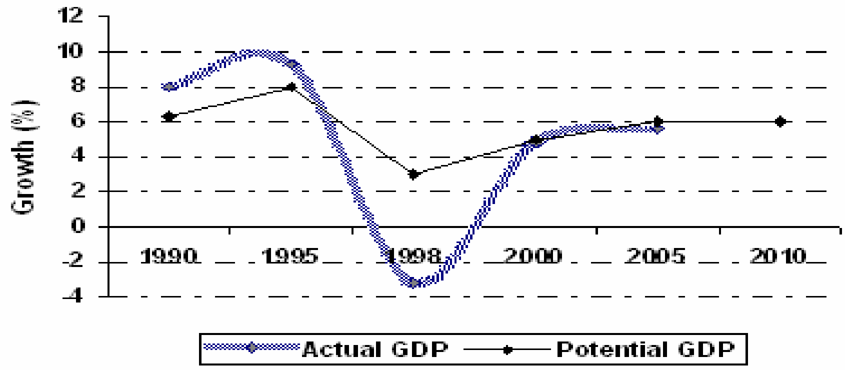
Introduction

The Third Industrial Master Plan (IMP3), 2006-2020 outlines the industrial strategies and policies which form part of the country's continuing efforts towards realizing Malaysia's objective of becoming a fully developed nation by 2020. The overriding objective of the IMP3 is to achieve global competitiveness through innovation and transformation of the manufacturing and services sectors while contributing to the other development thrusts of the National Mission embedded within the Ninth Malaysian Plan (RMK-9) framework, 2006-2010.

Macro Framework of IMP3

Chart 1: Malaysia— Growth Target of Real GDP (1990—2010)



Source: MITI & EPU

Chart 1 depicts the actual GDP of Malaysia registering a moderate expansion at an average annual rate of 4.6 percent during IMP2. Global slowdown due to higher energy cost and tightening of monetary policies in most emerging markets crowded- out the increase from oil revenue and trade boom experienced during this period.

For the duration of IMP3 the economy is forecasted to expanded at a higher rate of 6.0 percent during the period of 2006-2010, subsequently registering a projected average annual growth of 6.5 percent over the period of 2011-2020. Acceleration in the manufacturing, agriculture, service and mining sectors are seen as fueling this projected growth rate.

IMP3 main thrust is to develop the private sector and lead the growth trajectory while the public sector will act as a facilitator and regulator over the Plan period. The plan envisages 11.0 percent annual growth in private sector investment, far surpassing the 5.0 percent in projected public sector investment. Strategies outlined in IMP3 include timely disbursement of funds and effective implementation to ensure maximum impact on domestic growth.

Table 1 further emphasizes the importance of IMP3 and the successful outcome during the execution of RMK-9 in achieving a sustainable growth rate projected for 2020.

It is clearly evident that the manufacturing sector will continue to remain as an important source of growth, increasing at a rate of 5.6 percent annually during the Plan period while contributing 28.5 percent to the economy by 2020. It is expected that the non-Government service sector will assume a major role during this period, expanding at a rate of 7.5 percent annually and further contributing 59.7 percent to the economy over the next two decades. IMP3 has put in place strategic mechanisms for these two sectors to continue contributing positive growth rates for the nation.

Table 1: Malaysia - Growth and Contribution to Gross Domestic Product by Sector

Sector	2006-2020 Average Annual Growth (%)	2020 Share of GDP* (%)
Manufacturing	5.6	28.5
Non-Government Services	7.5	59.7
Government Services	5.6	6.8
Agriculture, forestry & fishing	5.2	7.0
Mining & Quarrying	3.4	4.4
Construction	5.7	2.5
(-) Imputed bank service charges	7.0	10.0
(+) Import Duties	2.5	1.1
Real GDP	6.3	100.0

* 1987 prices; Source: MITI

Based on the projections from Table 2 comparing key economic indicators, the government had painted a realistic macro picture when comparing 8MP to 9MP. The planned strategies within IMP3, when executed effectively will witness real GDP to gain traction and correspond in line with the country's estimated growth of 6.0 percent over 2006-10.

Table 2: Macroeconomic Target (% growth)

	8MP	9MP
Real GDP	4.5	6.0
Consumption	7.4	6.5
Investment	1.6	7.9
Exports	5.2	7.1
Fiscal Deficits (% of GDP)	-3.8	-3.4
BOP current account surplus (% of GNP)	12.7	14.9

Source: Ninth Malaysian Plan

The rationale behind this is that growth would be driven by productivity and innovation. In the 9MP, the projected capital output ratio (ICOR) would average at a rate of 4.6 percent from 6.2 percent in the previous Plan indicating better efficiency of capital and utilization of assets. This is a strong indicator for an increase in future investment and further enhancing the growth of export-oriented industries (EOI). However, consumption demand would register a decrease by 0.9 percent due to fears of higher inflationary pressure, energy cost and further interest rates hikes. Fiscal consolidation would still remain as an important agenda to ensure sustainable growth. This is clearly evident from the allocation of the 2007 budget where subsidy payments were capped at 12 percent (Malaysian Economic Report 2006/07, MOF). Current account is expected to continue to register a large surplus where the goods and service account is seen as major drivers and forecasted to register a higher inflow during 9MP.

IMP3 framework has been constructed to address the need for sustainable growth. Strategies within this framework are formulated to ensure the efficient implementation of RMK-9 that primarily focuses on traditional sectors while obtaining new sources of growth in order to maintain domestic and regional competitiveness.

Impact of IMP3 on Penang

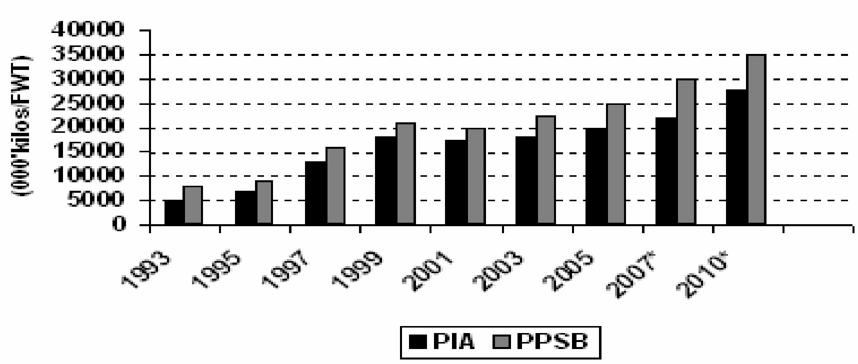
During the IMP3 period it is expected that the service and manufacturing sectors would continue to steer the state of Penang into a phase of long-term sustainability and resilience. The State Governments' focus on promoting investment, tourism, education, healthcare as well as ICT services would further facilitate the initial initiatives taken and further compliment the existing policies that are in-line with the Penang Strategic Development Plan 2 (PSDP2) guideline. The objective in execution of strategies would continue to enhance competitiveness by improving on quality and service competency in response to an increase in liberalization in trade while maintaining equality. Within this period Penang's economy is expected to record a healthy GDP growth that is in tandem with national forecast of 5.8 percent to 6.0 percent.

Services Sector

Logistics, Distribution and Storage

Penang is seen as having an edge and ability to be a strategic regional service hub that would provide opportunities for future capital inflow, employment and the emergence of new engines of growth. The service sector is projected to record and impressive 6.0 percent to 7.5 percent over the period of 2006-10, and its broad-based sub-sectors registering a healthy growth. The objective of services sector development is to support the logistics services industry and creating new growth sectors that is crucial for the future efficiency and competitiveness of manufacturing, trade and travel-related sectors in Penang.

Chart 2 : Cargo Through Penang International Airport and Penang Port Sdn Bhd (1993—2010*)



Source: PIA & PPSB

The graph above captures the rising trend and importance in air and sea cargo between 1993 and 2010. These two sectors would register an annual growth rate of 5 - 8 percent during the forecasted period and deemed to support and facilitate the development of the logistics services industry that is crucial for the future efficiency and competitiveness of the manufacturing sector.

With the large development expenditure allocated for 2007, Federal Government has since sanctioned mega-projects such as the Outer-Ring Road (PORR), Second Link Bridge and a monorail system that would serve as a testament to the realization of an improved supply-chain within the northern region.

In order to achieve this vision, certain strategies have been outlined in PSDP2 to facilitate the implementation in IMP3. These include:

- Promoting the emergence of new manufacturing- related services such as operational headquarters (OHQs), logistics and regional distribution centers (RDCs) and international procurement centers (IPCs) to further support growth of sub-sectors.
- The introduction of value-added services to transport operators, including expending distribution parks and support facilities, integrated infrastructure and comprehensive services.
- Improving government institutional support for services development by reviewing regulatory functions and hastening the processing of applications for manufacturing firms and their ancillary service supporting firm.
- Attracting local and foreign companies to undertake shared service and outsourcing (SSO) related activities such as marketing, project management, and supply chain management within existing logistics service providers. This strategy would further strengthen the SSO cluster and assistance to access funds for joint ventures, mergers and acquisition.

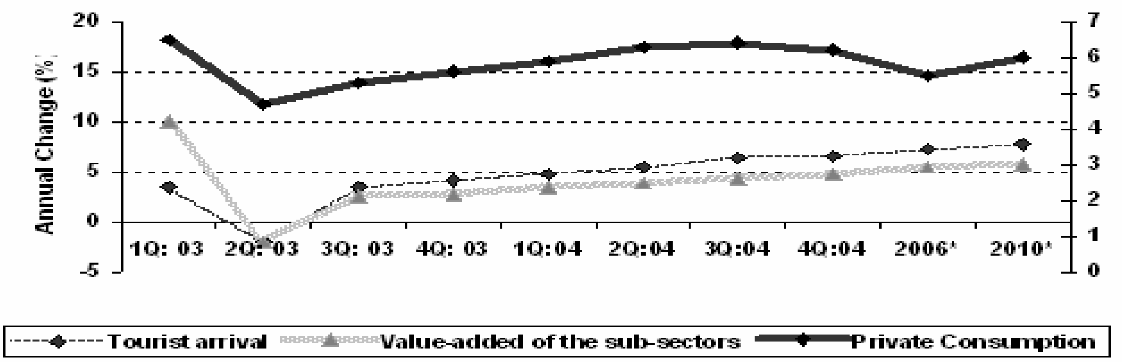
A positive and pro-active stance taken by the state Government in establishing the Logistic Planning Advisory Committee (LPAC) to monitor and assist in the development of the logistics industry is seen as a catalyst in improving cargo handling and storage while transferring and consolidating current cargo activities. These activities have always remained a challenge for logistic service providers as they face constrains due to certain structural defunct. This move would result in a continuous annual growth of 8 percent within this sector during the 9MP and in tune with international logistic standards. Expansion in Private Finance Initiatives (PFI) is equally important for the development of this sector. The PPSB proposed investment of RM 500 million would see an improvement in container-handling expansion projects and to generate a bulk to the growth within this sector.

Within the ICT sector, the establishment of Penang Network Competitive Committee (PNCC) is expected to spearhead, coordinate and monitor the growth within knowledge clusters that would enable the state to nurture its K-Economy aspirations. The IMP3 thrust of developing this sector has gained importance in policy measures taken by the state and they include promoting e-commerce, developing high-technological workers and society while enriching business processes. These would result in stronger public and private sector activities, hence increasing wealth distribution within the state.

Nevertheless in order to develop the services sector as one of the many engines of growth for Penang, the state government needs to re-emphasize and improve the current policy framework. These policies need to be intensified to face challenges from global players and adapting a pragmatic approach on technology transfer. A decision needs to be taken immediately to develop the existing vicinity and equip it with creative and innovative infrastructure to encourage a stronger performance from this sector.

Wholesale and Retail, Hotels, Restaurants and Sub-Sectors

Chart 3: Malaysia - Trends in Wholesale and Retail Trade, Hotels and Restaurants compared with Private Consumption and Tourist Arrivals (2003 - 2010)



*forecasted figures
sources Department of Statisitics

Chart 3 graphically explains the national trend and growth-path in value-added sub-sectors that is used as a close proxy to compare the likely impact to Penang.

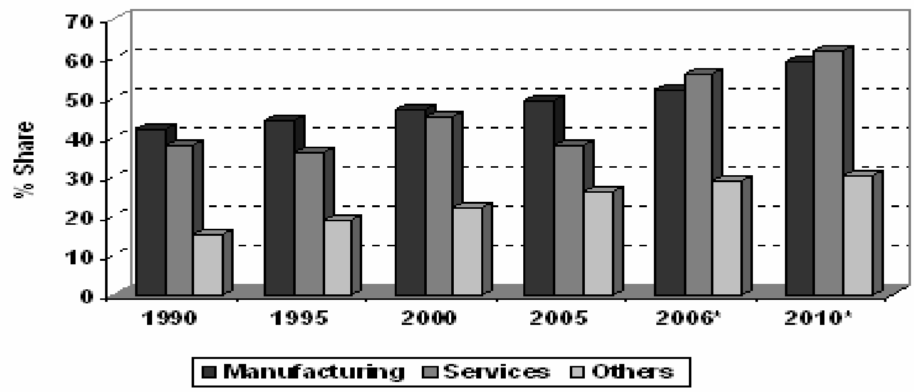
This sector experienced a transformation by rebounding strongly from the effects of SARS in the second quarter of 2003 and expand at a range of 7.0 percent annually. The IMP3 framework has been aligned to expect growth to be supported by an increase in consumer activity arising from higher disposable income and improvement consumer confidence. The 'spill-over' effect would be a robust growth in tourist arrivals from high-spending markets. This would in-turn support the dynamic expansion in hotels, restaurants and specialty retail stores in this state.

On the grounds of Penang's attractiveness and re-packing initiatives taken by the relevant authorities, value-added sub-sectors is expected to register an annual growth of 8.5 percent in the next five years permitting buoyant consumer confidence and relatively stable external environment. With state of the art medical service providers, acknowledgement as having "World Heritage" architecture, improved air, sea and land connectivity among other attractive features, would further reinforce Penang's position as a niche major travel destination for years to come.

Manufacturing

The manufacturing sector can be attributed as the primary architecture of Penang's growth throughout the last two decades and would continue do so as IMP3 will orchestra a calculated development in strategies to further facilitate the expansion of this sector. Double-digit growths are expected when the RMK-9 polices are firmly put in place where the electrical and electronics is expected to expand impressively and to hold a 70 percent share of the total manufacturing sector while the fabricated metals and textile industries continue to support and broaden the market share of the state.

Chart 4: Penang - GDP by Industrial Origin (1990—2010)



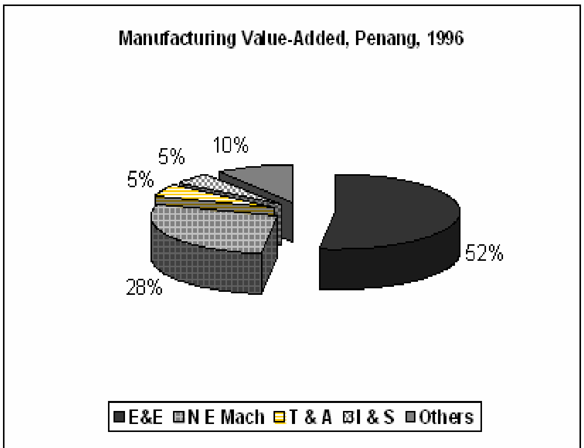
*forecasted figures; Source: SERI databank

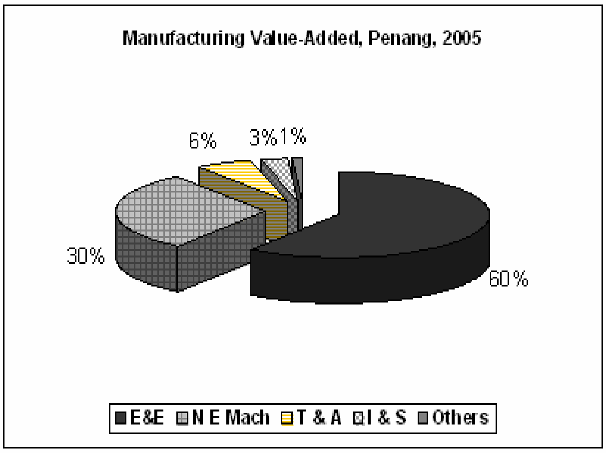
The manufacturing sector in Penang has remained resilient amid persistent high energy and inflationary pressure to register an annual growth rate of 7 percent over the IMP2 period that was consistent with national growth rates of 7.3 - 8.0 percent.

This trend is expected to continue during IMP3 phase as the manufacturing sector projected contribution to be around 50 percent of Penang's GDP while supporting the service and agriculture sector expansion. The introduction of reinvented incentives and new structured policies will boost the manufacturing sector as a whole over the nest two decades. The gradual reduction in corporate tax rate and restructured approach outlined in PSDP2 would see a number of critical issues being addressed fundamentally enhancing the role of Penang as a global manufacturing hub.

The PSDP2 just like its predecessor is influenced by the IMP by addressing critical issues and outlining strategies to further expand this sector. The importance to transform factor-intensities from labor-intensive to capital, skill and technological-intensive industries has helped expand inter-firm links, raise skill-intensity of the workforce and helped make Penang the most industrialized state in Malaysia.

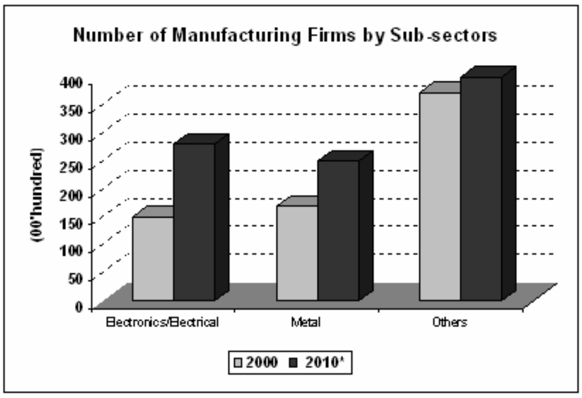
Chart 5: Penang - Manufacturing Value-Added, 1996 & 2005



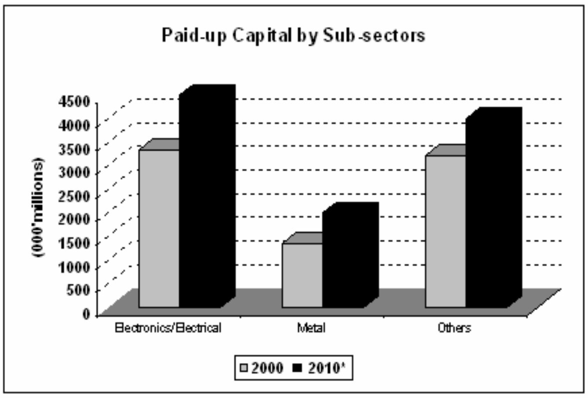


Source:Penang Development Corporation (PDC)

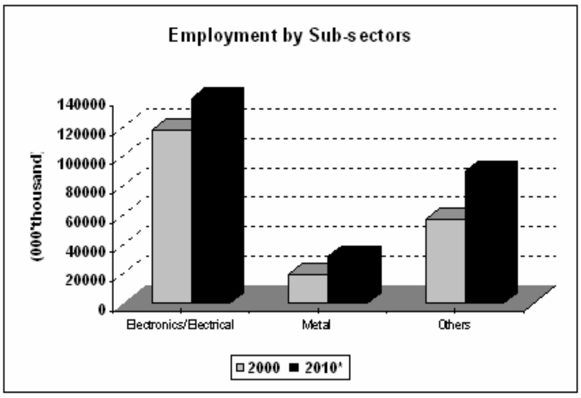
The successful strategies implemented by PDC capital such as facilitating the establishment of innovation networks between industries, enhancing marketing and service capabilities, developing new investment incentives and boosting venture capital investment has resulted in the acceleration in growth in value-added manufacturing sectors. The two graphs above compare the growth of this sector between 1996 and 2005. The electrical & electronic and non-electrical machinery sectors together will contribute approximately 90 percent to the manufacturing sector. This growth is substantiated as activities that embody higher end technology will continue to promote efficient market facilities and incentives for the development of R&D, marketing design capabilities while and further strengthening high quality infrastructures and employment opportunities in the state.



Source: PDC; 'forecasted



Source: PDC; 'forecasted



Source: PDC; 'forecasted

The expansion of the manufacturing sector is in-line with national strategies outlined in IMP3 and projections stipulated in RMK-9 (refer charts above). Comparison of growth can be seen in the number of firms due to its respective improvements in capitalization and generated labor participation. The projected 7 percent average annual national growth rate in the manufacturing sector is used to forecast Penang's growth trend. With an expected expansion in gross fixed capital formation by domestic and foreign would see the number and size of firms increasing. The manufacturing sector is estimated to contribute 60 percent of Penang's GDP by 2010 and access to financial resources in venture capital markets to further improve. Number of manufacturing firms and its paid-up capital are projected to increase from 691 in 2000 to 1500 by 2010 and RM7,704 million to an excess of RM9,000 million respectively. Total number of employment in Penang from the manufacturing sector is expected to increase from 196,000 to an approximate 250,000 employed within this industry. The two most important strategies that emphasis should be placed by PDC to enhance the role of Penang as a global manufacturing help are:

- Providing incentives for further market research and design facilities to attract local and foreign firms. The benefit would be an improved inter and intra manufacturing linkage that would enable firms to enjoy economies of scale and scope. Upstream and downstream manufacturing activities would eventually converge resulting in joint- ventures and mergers and acquisition (especially in the iron and steel industry).
- Improve the information delivery system to provide adequate market exposure to SMIs. Though preliminary measures have been taken to curb market failures due to imperfect information the primary objective is provide ready information on products, parts and components to SMI's that depend on outsourcing contracts by MNCs.

Conclusion

IMP3 is rarely a single instrument but rather a complex combination of policy measures. This paper was aimed to provide an insight on the impact of IMP3 by exploring the effects of these strategies on national and Penang's growth trends. Using projected growth rates outlined in IMP3 and sectorial overview in the Malaysian Economic Report it could be deduced that sustainable growth in vital sectors such as service and manufacturing should begin with assimilating the key thrust within the IMP3 framework. These include the combination of high productivity and sustainability of the resource base that in-turn creates an intensely managed system resulting in mobilization, integration, and management combination of competencies while ensuring high appropriabilities of knowledge. Looking forward, it is suggested that efficient execution of policies during the RMK-9 would likely increase the degree of fiscal and monetary independence enjoyed by authorities permitting them to achieve its goals by 2020. ***§ Nawin Rajah***

INTERNATIONAL HEADLINES

Farm Output Lifts Philippine Economy
1 September 2006, The Wall Street Journal - Asia

The Philippine economy expanded by 5.5 percent in Quarter 2, led by robust growth in farm output. The GDP grew by a seasonally adjusted 1.7 percent in the second quarter of 2006 from the previous quarter and is the 21^{st} consecutive quarter of growth for the nation. Farm production in Quarter 2 increased by 6.7 percent y-o-y and is 3.7 percent higher than the previous quarter. Both its industry and services sector grew at a much slower pace, expanding only at the rate of 4.5 percent and 5.7 percent y-o-y respectively.

Thai Q2 GDP Accelerates On Strong Exports
4 September 2006, Reuters

The Thai economy grew 1.0 percent in the second quarter of 2006, benefiting from robust export momentum and from moderate public expenditure, despite easing domestic consumption and private investment. The growth in the second quarter marks the fifth consecutive quarter of export-driven growth. However analysts expect growth to be more subdued in the second half of 2006, restrained by further dips in domestic consumption and investment and political uncertainties in the country. Exports, amounting to about 70 percent of Thai GDP, would also feel the impact of a more sluggish global trade environment in the months ahead. The National Economic and Social Development Board (NESDB), the state planning agency, forecasts gross domestic product (GDP) growth of 4.2 - 4.7 percent for the full year, slightly narrower than a 4.2 - 4.9 percent range in its June forecast. Second-quarter GDP was 4.9 percent higher than a year earlier, down from a revised 6.1 percent annual rise in the first quarter and compared with market expectations of a 5.0 percent rise.

China trade surplus sets another monthly record
12 September 2006, The Wall Street Journal -Asia

China recorded a 33 percent y-o-y increase in its exports in the month of August, taking the year to date surplus to just shy of the full year total for 2005. The August trade surplus was $18.8 billion, a fourth straight monthly record that pushed the total surplus accumulated so far in 2006 to $95.65 billion. The 2005 surplus was $101.9 billion. The August data complete a full year of evidence that the mild appreciation of China's currency in July last year has had little effect in slowing China's export machine. It exported $90.77 billion of merchandise in August while imports rose about 25 percent from a year earlier to $71.97 billion. Total trade in the first eight months of 2006 rose nearly 24 percent from a year earlier to $1.105 trillion.

Official: More cooling measures unlikely
26 September 2006, Xinhua News Agency

China's statistics chief, Qiu Xiaohua said that the government is unlikely to have to take more steps to cool the economy given that fixed-asset investment is slowing and growth in property prices has eased. Qiu said that steps that have been taken to date to cool heated sectors of the economy are having their desired impact. Growth in fixed-asset investment slowed to 29.1 percent in the first eight months of this year, compared with 30.5 percent from January through July and 31.3 percent in the first half. Property prices rose 5.5 percent in August, compared with 5.7 percent in July and 5.8 percent in June. Thus, China will continue with the measures that have been put into place and keep a close eye on their outcome to ensure better implementation.

U.S. GDP revised lower on business inventories
29 September 2006, The Wall Street Journal - Asia

The U.S. economy grew a little slower in second-quarter than earlier believed, reflecting an adjustment to business inventory investment. The U.S. GDP grew at an annual rate of 2.6 percent in Quarter 2, a little lower than the earlier estimated 2.9 percent. Corporate profits in the second quarter were adjusted lower while prices rose a bit less than earlier believed. The 2.6 percent seasonally adjusted gain in GDP was well below the first quarter 5.6 percent push forward. The downward revision to real GDP mainly reflected a downward revision to inventory investment and an upward revision to import of services.