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Budget to focus on increasing domestic demand

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BUDGET 2002 is being closely watched for what relief and incentives the Finance Minister will offer employers, employees and the business and investing community. But beyond the tax reduction, duty cuts and incentives, the policy announcements which will set the direction of the economy in the face of a worldwide recession are equally, if not more, important.

The post September 11 world economic environment is vastly different and has been changed even further by the military attacks on Afghanistan. Budget 2002 will have to anticipate the effects and impact of these developments on the Malaysian economy.

Malaysia, an open economy and one that is highly dependent on trade, will have to focus on its domestic economy to tide over the period of an uncertain and slowing external economy. Structural changes will have to be made to adapt to the changed economic environment.

Undoubtedly Budget 2002 will be expansionary and aim to strengthen domestic demand, encourage domestic spending, promote domestic growth, enhance competitiveness and increase productivity.

The economic fundamentals remain strong and inflation is low. With the high saving rate and ample liquidity in the system, financing a deficit budget will not pose problem. The country's foreign reserves at US\$29.7 billion (US\$1 = RM3.80) are sufficient to finance 4.6 months of retained imports and 6.2 times the short term external debt.

The policies to strengthen the domestic economy will have to be targeted at sectors which offer the best rate of return and biggest "bang for the buck". Every ringgit allocated and spent must yield the best returns and benefits on the home front.

The need and urgency for self help has been further strengthened by the rapidly weakening world economy and Malaysia's external sector. The US economy, which was already tittering on the verge of a recession before the September 11 attacks, will be pushed over the brink even faster.

In a month since the attacks, the combined value of US equity markets has dropped by about US\$129 billion. Consumer spending and confidence, which held up the US economy, has been badly affected. Instead of going out to spend, as many American leaders, including President George W. Bush and New York Mayor Rudolph Guiliani, have urged their fellow Americans to do, they have actually increased their savings.

Former Japanese Vice Finance Minister for International Affairs Eisuke Sakakibara, in an interview in Langkawi last week, said "The American savings rate in August, when they had the first round of tax cuts, increased by 3 per cent. They saved all. After September 11 they may save more". This will affect the US economy which is already fragile.

The international and multilateral organisations, including the International Monetary Fund, World Bank and the United Nations, have all revised their forecasts downwards for individual economies and for the world.

The United Nations (UN) is the latest to slice its forecast for world economic growth. The attacks came just as the world economy was already weakening and its forecast trims global growth this year by a full percentage point to 1.4 per cent from the previous 2.4 per cent. This, according to a UN official, means a US\$350 billion shortfall compared to the earlier forecast, for the US\$35 trillion world economy.

For Asia the forecast is that Asia's gross domestic product will be sliced by 2.4 percentage points and is now seen as growing at a rate of 1.7 per cent - excluding Japan and China - this year. This is equivalent to about US\$50 billion in lost economic activity.

Japan's economy will shrink by 0.5 per cent. China remains the only economy that is forecast to register a robust growth of 7.5 per cent.

World trade is also badly hit and is expected to finish the current year at a level unchanged from the previous year. Even next year it is expected to register a growth of 5 per cent against the earlier expectation of 6.5 per cent.

To cushion the adverse impact from the slowing world economy and trade, countries around the world, from the world's largest economy - the US - to Singapore, Malaysia and South Korea have announced pump-priming measures.

In addition to a US\$15 billion bailout for the airlines, the US Congress has approved US\$100 billion. Singapore, which registered its worst ever quarter with a minus 5.6 per cent contraction in the third quarter, unveiled a S\$11.3 billion (S\$1 = RM2.13) stimulus package and Hong Kong unveiled HK\$15 billion (HK\$100 = RM49.69) package.

Prime Minister Datuk Seri Dr Mahathir, who is also Finance Minister, and who will table Budget 2002 in Parliament this Friday, had unveiled a RM4.3 billion stimulus package last month. This is in addition to the RM3 billion announced in August.

But allocation and provision of funds by the Government, which may be in the budget and perhaps even off budget allocation, will not achieve the desired results if they are not disbursed and remain unutilised. Of the RM3 billion that was announced in August only some RM200 million has been disbursed.

It is essential that various government departments and agencies speed up the disbursement, cut red tape and bureaucratic procedures. The focus on infrastructure projects in the rural areas, including education and medical facilities, is essential.

Sakakibara says Malaysia's efforts to develop infrastructure around the country will help in generating economic activities domestically.

"In Malaysia's case public investment could be an effective tool to cushion external slowdown".

He adds that infrastructure investment helps generate domestic demand and with this Malaysia should try to substitute some of the decline in the external demand with domestic demand. "There is a genuine infrastructure demand in your country. In rural Japan we do not any more roads, you need them."

Budget 2002 is expected to outline the incentives for infrastructure projects, welfare, training and retraining of the unemployed and tourism promotion.

These measures, in addition to the policy announcements, will aim to strengthen the domestic economy, generate business and income opportunities, assist the poor, cushion the impact of external economic slowdown and facilitate private sector growth by reducing red tape and bureaucracy.