

THE 1996 NATIONAL ECONOMIC FORUM

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It is indeed a pleasure for me to be here today among the distinguished members of the economic fraternity to officiate the opening of the 1996 National Economic Forum entitled "Reducing the Balance of Payment Deficit: Challenge and Response".

2. Once again Malaysia is being warned by economists and even by Malaysian businessmen that its economy is overheating. This time the principal sign of overheating is said to be the deficit in the balance of payment which has gone up to RM18 billion from a total trade figure of RM383.4 billion approximately.

3. The solution according to the experts is to slow down the economy. For eight years now the Malaysian economy has been growing at well over eight percent per annum. This, according to the experts, has caused the balance of payment deficit and therefore overheating.

4. If the economy is made to grow at a lower rate, then the deficit will disappear and the economy will cool down, or the cooling down of the economy will result in the deficit being reduced.

5. One of the instruments for slowing down the economy is to increase the interest rate and to take other fiscal measures. With the higher cost of money, investments and consumption would be reduced and growth would therefore be slowed. Overheating would be dampened and would disappear. Presumably the economy would be restored to good health with the trade deficit turning into a surplus or it would at least be balanced.

6. However we know only too well that many countries with low rates of growth are not economically healthy. Some developing countries with low or negative growth have been forced to rely on aid. Poverty abounds and public amenities and infrastructure are deficient. Unable to exploit their own resources themselves through lack of capital and knowhow, they have to accept foreign ownership of their mineral resources, agricultural and forest lands and their fishing potentials.

7. Capital formation is negligible. The currency depreciates as the inflation becomes uncontrollable. More and more money is needed in order to buy less and less imports. Foreign debts increase and become more costly as the currency devalues against the borrowed currency. Reliance on foreign aid brings the country to its knees with a begging bowl in the hand. The

country becomes hardly recognisable as a nation. International agencies of all kinds and foreign powers literally take over the economy and even the political direction of the nation.

8. But then one would say that a poor developing country is not a good example of the benefits of low growth. But the health of the rich is not any better when growth is low. We see these developed countries suffering high unemployment rates, inflation, stagnation and deficits in the balance of payment. The political climate is not healthy either. Governments are changed in rapid succession with no improvement in either the political climate or the economic performance. Indeed in some of these developed countries low growth is often accompanied by riots and demonstrations and loss of productivity. One is hard put to think of this situation as being better than high growth with full employment and stability even though there is a balance of payment deficit.

9. The relationship between growth and payment balances is not constant. Low growth in many European and North American countries are accompanied by high deficits in the balance of payment. But low growth in Japan does not result in a deficit in the balance of payment. Instead the big trade surpluses persist.

10. When Japan was experiencing high growth, Malaysia's trade with that country was roughly balanced. But now that Japan is experiencing low growth Malaysia's trade deficit with Japan actually increases. Today Malaysia's deficit in trade with Japan amounts to RM19.5 billion i.e more than Malaysia's total trade deficit. In other words, Malaysia has a favourable trade balance with almost all its trading partners. It is the deficit with Japan that is causing the negative imbalances in Malaysia's total trade. If the trade with Japan is corrected then there should be no deficit in Malaysia's trade.

11. Clearly trade balances and the performance of the economy are not directly related. Correcting one will not rectify the other.

12. Still some would continue to say that sustained high growth is not healthy. If there is no inflation, high growth can result in rising property prices. If for some reason the property prices collapse then the economy would plunge into a recession.

13. Japan's present economic problem is due, at least partly, to the collapse of property prices. Similarly a collapse of property prices in the mid-80's resulted in a recession in Hong Kong.

14. Property prices in Malaysia have gone up but they are nowhere near those of Japan or Hong Kong. In fact they are so low compared with Singapore that a lot of Singaporeans are snapping up houses and commercial buildings. Such is the cheapness of Malaysian property that the Government has to step in and impose a tax on foreign purchases so as to reduce their attractiveness to foreigners.

15. But to return to the problem of the balance of payment, there is obviously some connection between the deficit and Malaysia's high economic growth. But the bigger import bill is largely for investment in increased production for export. Capital goods are needed if Malaysia is to produce more goods for export. Similarly most Malaysian manufactured goods contain a fair amount of imported inputs.

16. The building of Malaysian infrastructure and the production of building material such as steel and cement also require imported inputs. Yet without this infrastructure Malaysia would not be attractive for export oriented manufacturing. For example, much of the cost of plants for power generation is due to imported machinery. Without adequate power supply the economy will fail. Infrastructural inadequacy is another sign of overheating. Slowing down growth may help but it is not the ultimate solution. The real solution is to improve infrastructure.

17. Then there is the problem of transportation. Although Malaysia is now able to produce motor vehicles, the imported CKD packs still constitute a large component of the motor vehicles. And most of these motor vehicles are sold locally, thus failing to mitigate the imported cost.

18. The so-called bulky purchases such as aircrafts and ships also result in outflows of funds. Yet if these are not purchased Malaysia would not be able to earn anything at all from the travelling of Malaysians and the freighting of some of its exports.

19. Of course the bigger the trade, i.e. both import and export, the bigger is the freight and insurance bill. With the growth of trade, the cost of freight and insurance which accrue largely to foreign companies will increase, thus contributing to the deficit.

20. More Malaysians travel abroad than foreigners come to Malaysia. In addition a large number of Malaysians study abroad, paying board and lodging and fees to foreigners. The outflow due to Malaysians going abroad to study or to tour far exceeds the earnings from inbound tourists and other travellers. Travelling abroad is possible because Malaysians

have money to spend as a result of the growth in the economy. But the cost of travel and studying abroad enhances the deficits in the trade balance.

21. With better incomes Malaysians can afford to expend on imported luxuries, including cars, furniture and jewellery. Again Malaysian money flows abroad.

22. The rapid growth of the manufacturing and construction sectors as well as other sectors has resulted in a shortage of labour. Foreign labour has to be brought in. And the foreign workers naturally repatriate most of what they earn here, thus contributing to the outflow of funds.

23. Yes, it would seem that the growth of the Malaysian economy has contributed to the deficit in the balance of payment. But is it necessary that it must result in such an outflow? If Japan's and Korea's growth has not, why should Malaysia's growth be accompanied by the deficit?

24. Like all things there is no single or simple reason for the deficit in trade. A whole lot of factors have gone into the making of this deficit. This is clear from what has been enumerated. Similarly if the balance of payment is to be corrected, a lot of things have to be done.

25. Merely slowing down growth is not the answer since many countries with slow growth have also been faced with balance of payment deficits. Fiddling with the interest rates is a two-edged weapon. Increasing it would dampen investments and consumption. But it will result in inflation. While total trade may decrease and with it the import bill, but as a percentage of total trade, the import bill can still remain high and the deficit uncorrected. Exports will cost more and become uncompetitive. This will cause a reduction in export earnings without reducing the deficit. The end result may be an intractable depression.

26. Devaluation may bring about an increase in exports. But when a lot of the inputs for the goods produced are imported, the reduction in production cost would not be as much as the percentage of the devaluation. Unless the increase in the exports balances the percentage of devaluation, the export earnings would actually be less than before devaluation. In the meantime imports will cost more thus keeping the import bill high. Again this will not reduce the deficit unless imports are drastically reduced. But imports of materials and components, as well as machinery for export oriented and domestic production cannot be reduced much without affecting exports and aggravating the deficit in the trade balance.

27. Slowing down growth, fiddling with interest rates and the exchange rates are not the solution to the deficit in the balance of payment problem. The solution lies in increasing exports and reducing imports. How do we do this?

28. In the production of rubber, palm oil, cocoa, timber, petroleum and even tin Malaysia never depended upon nor cared about the local market. All these raw materials are produced for the world market. Consequently export earnings from these products, though smaller than the manufactured goods, are actually more wholesome. This is because their production does not involve imported inputs. Naturally the more we export these products the more will be the contribution to the reduction in the deficit. Unfortunately we cannot increase the export of these products much more without depressing the prices. Indeed we don't have much land left for plantations.

29. The export of manufactured goods from Malaysia is mainly by foreign-owned industries. These industries are largely based on the assembly of imported components. Thus with the increase in the production and exports of these manufactured goods, there is an increase in the import of components. The imported cost must be deducted from the export earnings in order to arrive at the true export earnings of the nation.

30. To overcome this more of the components must be produced locally. The stress must be on local components if the export earnings are to be maximised.

31. Malaysian manufacturers on their own or in joint-venture with foreigners tend to produce largely for the domestic market. Because the domestic market is small they cannot achieve economies of scale. Their cost is higher and they rely on Government support and protection in order to sell locally. Since they cannot and they don't export their high cost products and on the other hand a portion at least of their inputs is made up of tax-exempt imported items, they increase the import bill without contributing to export earnings.

32. To overcome this, Malaysians must manufacture in sufficient quantities in order to maximise economies of scale and market only a fraction of the products locally. Export must be maximised. Then Malaysian-owned industries will not deprive Government of tax revenue but will increase the nation's export earnings while reducing imports.

33. This strategy of manufacturing for export should apply to most Malaysian-owned industries. Cement and other building materials, steel and steel fabricated components, plastic products, ships, motor vehicles including buses, trucks and motor cycles, electrical appliances and components, products

using locally produced raw materials such as rubber, timber and palm oil; all these and many others must be produced in large quantities in order to maximise economies of scale, stimulate support industries, minimise imports and earn export earnings.

34. Malaysian companies operating abroad should help by sourcing their requirements as much as possible from Malaysia.

35. The enlarged volume of exports will require adequate transportation facilities. This means that goods should be carried on Malaysian carriers and should use Malaysian ports and airports and be insured by Malaysian companies.

36. As I mentioned earlier, today more Malaysians travel abroad than foreigners travel to Malaysia. Whereas only 10 percent of the Japanese go abroad every year, 30 percent of Malaysians travel abroad yearly. Mostly they are vacationers and students. Since students stay for very long periods abroad, the drain on foreign exchange by them is very big.

37. To counter this outflow, domestic tourism must be highly developed. Tourist destination in Malaysia must have all the amenities and "products" to entice as many Malaysians as possible.

38. To reduce the number of students going abroad more educational institutions must be set up within the country. They must be of high quality and where necessary twinning with foreign institutions or partnerships in the setting up of branch campuses should be encouraged. Indeed Malaysian educational institutions should be designed to attract as many foreign students as possible so that we will earn foreign currency even as we reduce the expenditure on our students going abroad.

39. These are some of the things which can be done in order to reduce the import bill and increase export earnings, thus mitigating the balance of payment problem. There are many other things that we can do in order to achieve this. And all these things can be done without having to slow down the economic growth or to fiddle with interest rates.

40. It is counter-productive to talk loosely about economic growth and overheating without really identifying the signs of overheating and taking measures to improve them.

41. Malaysia must continue its high growth path but it must correct the balance of payment deficit through the right measures. The chances are good that given the correct approach the balance of payment deficit will be corrected.

