

Chapter 1: Introduction

This chapter will discuss on the introduction of the balance of payments and the current account deficit, the objective of the study, its methodology, organisation of the study as well as its limitations and problems.

1.1 Balance of Payments and the Current Account Deficit

In general, a country's balance of payment depicts the record of a country's transactions in goods, services and assets with the rest of the world, also the record of a country's sources (supply) and uses (demand) of foreign exchange.¹ This is basically made up of two main accounts. First, the current account which consists of the balance of payments on trade items, net services account as well as net transfer payments. Second, the capital account which consists of long term and short term net capital balances and the bank reserves.²

From past data and reports on the balance of payment in Malaysia, the current account has been in a deficit position for most of the years since the beginning of the 1960's. The years of surplus were 1965-1966, 1968-1970, 1973, 1976-79 and 1987-89. This particular trend reflects efforts taken to

¹ Case and Fair, *Principles of Macroeconomics*. US: Prentice Hall International, 3rd ed, 1994, p. 508-510

² S.H Lim, *Macroeconomics STPM*, Kuala Lumpur: Pustaka Zaman, 1993, p. 355-368

sustain economic development through imports of machinery and equipment, outflows on payments of investment income and increasing payments for services.³ Table 1 and Graph 1 below reflects the Malaysian Balance of Payments and the Current Account position from 1981 – 1998.

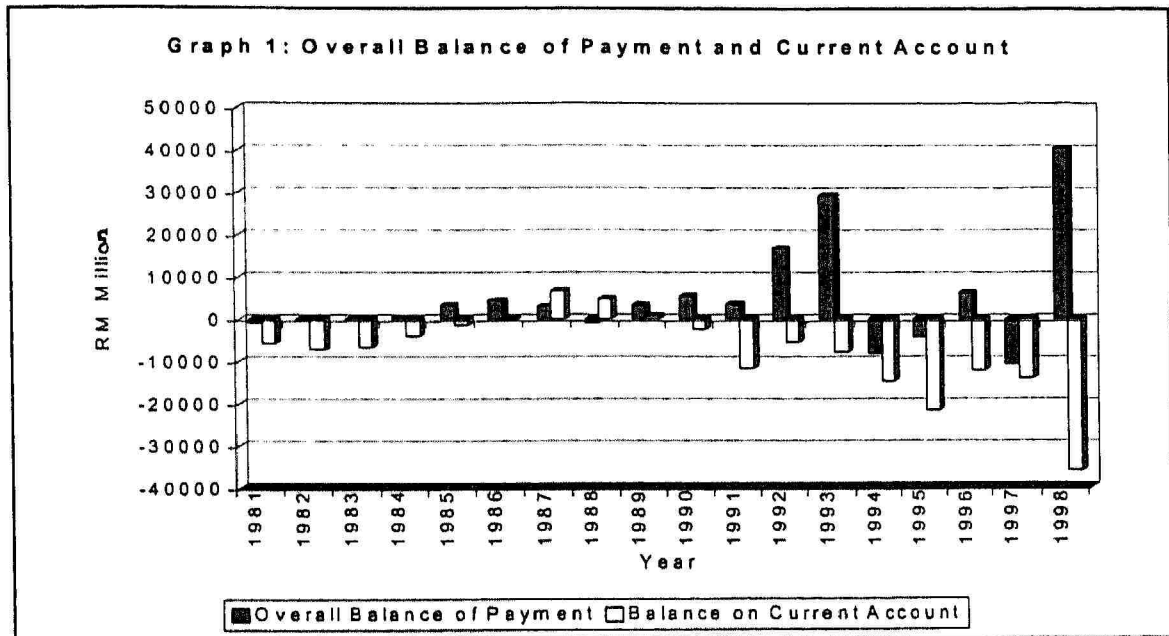
Table 1: Malaysia's Balance of Payments and the Current Account

Year	Balance of Payments (net)	Current Account
1981	-1093	-5787
1982	-614	-7298
1983	-55	-6714
1984	312	-4147
1985	3209	-1522
1986	4345	-316
1987	2893	6642
1988	-1104	4739
1989	3332	698
1990	5365	-2483
1991	3427	-11664
1992	16744	-5622
1993	29239	-7926
1994	-8262	-14770
1995	-4403	-21647
1996	6245	-12196
1997	-10892	-14153
1998	40301	-36068

(Source: BNM Annual Reports 1981-1998)

² Bank Negara Malaysia, *Money and Banking In Malaysia*, 35th Anniversary edition, Kuala Lumpur, 1994, p. 12

Graph 1: Malaysia's Balance of Payments and the Current Account



(Source: Adapted from Table 1)

From table 1 in the previous page, the balance of payments for the first three years from 1981-1983 reflects a deficit position. This is due to the financing of foreign debts towards the heavy industrialisation policy. The heavy industrialisation policy sparked the growth of import-substituting manufacturing industries. Imports of intermediate inputs and capital good increase outflow of money from the merchandise account balances causing the current account and overall Balance of Payments to fall. Nevertheless the situation improved during the recession in the mid 1980's (1985-1987) where policies to curb excessive imports took place. In 1988, Balance of Payments recorded a deficit again due to the rise in imports after the recession period. Imports rose markedly at an average annual rate of 29.3% during 1987 to 1992.

Nevertheless, from 1989 to 1993, the rise in imports did not bring about deficit position in the balance of payments which is mainly attributable to the large influx of foreign private investment in the late 1980's and early 1990's contributing to the surplus in the capital account again before surfacing for a surplus in 1996. The Balance of Payments dropped to a negative position in 1997. There was a surplus in 1998 due to the aftermath of the crisis. Export commodities such as palm oil and crude oil contributed largely to a surplus in the merchandise account.

The current account on the other hand recorded large deficits between 1981-1985, although the deficits decline from 1982-1986 before its first surplus for the decade. The largest component contributing to this was the services account. (Refer to Table 2 and Graph 2)

As discussed above, the initial deficits in the early 1980's was caused by external borrowings by the government. To rectify the problem, the government promoted investments in 1986 to encourage foreign investment in the manufacturing sector to accelerate the development process. However, the contractionary impact of both the government's pull back on these investment as well as the shock of falling prices of major export commodities led to a contraction in domestic demand, which also caused the current account to turn around to record a surplus in 1987-1989. However, the surplus was not sustained. From the start of the 1990s up to 1998, the current account recorded deficits. The largest deficit was recorded during 1998 with balances amounting to – RM36, 068 million. Generally the long-standing deficit was

caused by the implementation of large projects to address infrastructure constraints. There was hardly any immediate generation of foreign exchange earnings. Increase in imports increased services payments abroad such as freight and insurance. Therefore as input grew, services deficits were enlarged.

The deficits in the current account were assisted by the capital account surpluses for most of the years as confirmed by annual reports obtained from Bank Negara Malaysia. However, the capital account or rather the basic balance does not always guarantee a surplus each year to assist the current account deficit. Given the fact that the services account contributed largely to the current account deficit, there is a need to promote strategies to assist the current account deficit through the services sector, including the travel account.

1.2 Services Account and its Component

The Annual Reports of Bank Negara Malaysia provide fairly detailed data on the services sector in the Current Account of Malaysia's Balance of Payment. Data are available on:

- 1) Freight and Insurance (For import and export of goods)
- 2) Travel (Overseas student expenditure, pilgrimage, leisure and business travel)
- 3) Investment Income (Interest payments on external loans and repatriation of profits & division)
- 4) Other services (payments for contract and professional charges associated with public investment projects, rents and royalties and agencies fees).

The services account position for Malaysia for 1981 – 1998 are presented in the following table and graphs.

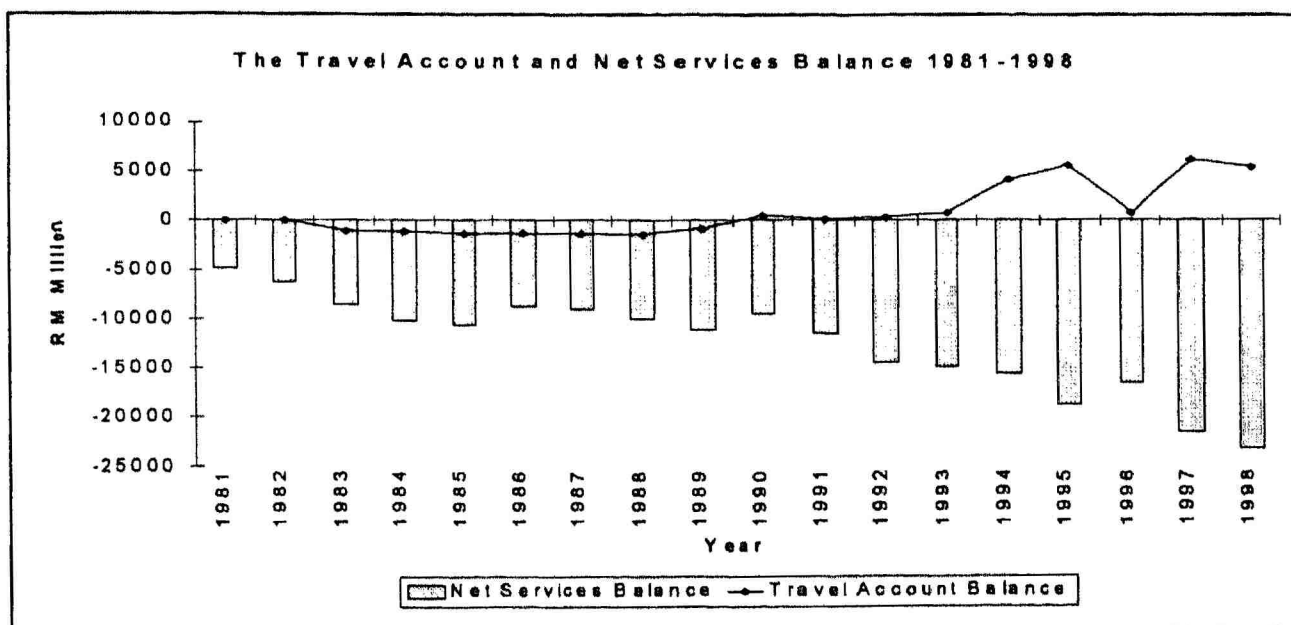
Table 2: Details of the Net Services Balance

Year	Services Balance	Freight & Insurance	Travel Account	Net Investment	Others
1981	-4918	-2048	*	-1416	-1455.728
1982	-6290	-2180	*	-2338	-1773.78
1983	-8594	-2169	-1104	-3707	-1614
1984	-10289	-2279	-1217	-4806	-1987
1985	-10728	-1753	-1396	-5692	-1887
1986	-8787	-1252	-1357	-4347	-1779
1987	-9148	-1377	-1400	5188	1128
1988	-10145	-2357	-1461	4936	-1346
1989	-11201	-3093	-916	-5674	-1273
1990	-9634	-3672	471	-4912	-1590
1991	-11617	-4587	74	-5304	-1855
1992	-14568	-4265	302	-7920	-2685
1993	-14951	-4890	680	-8174	-2567
1994	-15672	-7154	4125	-8896	-3745
1995	-18845	-8835	5572	-11209	-4373
1996	-16670	-4890	710	-8174	-4316
1997	-21792	-9526	6123	-13827	-4562
1998	-23381	-8652	5340	-15711	-4214

(Source: BNM Annual Reports 1981-1998)

* Data incorporated into freight and insurance)

Graph 2: The Travel Account and Net Services Balances



(Source: Adapted from Table 2)

From the table and graph above, it can be seen that the deficits in the services balance have been increasing throughout the years except for 1986-1987 as well as 1990. The transition period from 1985-1986 witnessed a slow down in the economy due to the economy depression.⁴ This has resulted in decreasing numbers of demand usage of freights and insurance, as well as payments on contracts of public investment project, rents and royalty. As for the 1989-1990 year of transition, the decrease in the services account deficit was mainly due to the increase of receipts through the travel account. In the past, declines in the services deficits were only recorded in periods of recession or slow growth, as in 1985-87. The travel account for the first time recorded surplus and this remarkable record witnessed a chain of sustainable

⁴Bank Negara Malaysia, *Money and Banking In Malaysia*, 35th Anniversary edition, p. 12

surplus in the following years. The year 1990 was also the visit Malaysia year.⁵ Significant success was recorded in the tourism sector which was a major contributor to the 44.1% expansion in total services receipts to reach RM15.8 billion during the year.⁶ The structural change in the travel account from a deficit position to a surplus position from 1990 onwards was also due to the significant inflows of foreign students in Malaysia and the regulatory amendment in the education system which allows student to complete a full external degree locally, besides the inflow of tourists in-conjunction with Visit Malaysia Year. This will be further elaborated in Chapter 3.

From table 2, a detailed observation found the net investment account to be a major contributor to the deficits in the services account. To a lower extent but still a major contributor in an important way was the contribution of the freight and insurance account. There have been no evidence of improvements in both these account so far.

However, the travel account is more promising. The constantly positive performance of the travel account since 1990 may open up further possibilities to ease such deficits from persisting further in the overall services account. This statement is further supported by the fact that

⁵ Tourism Malaysia, *Tourism Malaysian Annual Report 1990*, p. 4

⁶ Bank Negara Malaysia, *BNM Annual Report 1990*, p.264

currently most developing countries with rich historical, geographical and traditional heritage have tapped into the travel industry as a mean to increase the country's receipts. This indeed should be looked as a good alternative in Malaysia's case of generating more receipts to further assist the services account and indirectly the current account. Malaysia's efforts in promoting the country as a regional education hub is also a substantial reason to choose the travel account as a potential alternative in assisting the services sector. Details of the travel account will be further discussed in Chapter 3.

1.3 Objective of The Study

Given such situation above, there is a need to study the possible ways to decrease the persistent current account deficits in the services account. Therefore the purpose of this study is to:

1. To formulate a way to decrease the services account deficits and indirectly the current account deficit, through the travel account which consist of 4 major components namely travelling for education, tourism, business and pilgrimage purposes.
2. To examine factors which contribute to the inflows and outflows of travelers to and from the country.

3. To determine the factors which can generate more revenue from this sector and in the process assist or decrease the services account deficits
4. To formulate possible ways to promote the travel industry through the findings above with assistance from the government and private sector.

1.4 Methodology of Content

Several methods were used in this study to obtain the required information. These includes:

1. Research on past studies on the Balance of Payments and Current Account in comparison with neighbouring countries.
2. Research on past studies on the travel account globally in order to understand the economic value of how this industry can ease the current account deficit.
3. Research on past writings e.g. books, paper work, thesis and journals on the detail components in the Malaysia travel account e.g. tourism, education, business and convention as well as pilgrimage.
4. Interviews with officers from Ministry of Education, Ministry of Arts, Cultural and Tourism, Immigration Department as well as Ministry of Finance for opinions and views on the respective components involve in the travel account.

1.5 Organisation of the Study

This study consists of six chapters. The first chapter as discussed above will focus on the introduction of this study and the other necessary sections. The second chapter will reveal all literature survey carried out relevant to this topic. The third chapter will then discuss the travel account and its components in detail. The fourth chapter will highlight on the factors which influence inflows and outflows of travelers to and from the country and its effect on the travel account. It will include a discussion on existing policies and measures taken to increase inflows of travelers and decrease outflows of travelers to and from the country. The fifth chapter will attempt an economic analysis of traveler's behaviour. The final chapter will conclude on how the findings and suggestions in chapter five may assist the services account and indirectly the current account deficit.

1.6 Terms and Definition

Throughout the study, several terms will be frequently used to represent certain definitions. The term *travelers* refer to all travelers travelling for all purposes namely the four major purposes such as education, tourism, business and convention as well as pilgrimage. Occasionally, the term *visitors* may also be used. Visitors comprise of *tourists* and *excursionists*. Generally a visitor refers to any person who travels to a country other than that in which he has his usual residence but outside his usual environment for a period not exceeding 12

residence but outside his usual environment for a period not exceeding 12 months. Tourists refers to visitors who stay at least for one night in the country of visit where as excursionists refer to day tourists

1.7 Limitations and Problems

Throughout the study, several limitations and problems have hindered in-depth research to be carried out on the services account. This includes unavailability of breakdown records and data for the detailed component in the travel account of services sector. The number of out flow of students can only be obtained for government sponsored students. Nevertheless, the total number of overall students coming into Malaysia for education purposes is reflected by the total number of student passes approved by the Immigration Department. Tourism statistics are concentrated on incoming tourists rather than outgoing tourists. There is no clear distinction between data for outbound tourists which include travelers on business and education purposes. Segregation of data collected for tourism does not conform to the major 4 components in the travel account in the balance of payments.