

Chapter 2: Literature Review

This chapter will highlight all literature review carried out on the balance of payment, current account and its components. Research on past studies includes working papers by international organisations, magazines, journals, thesis, published books as well as local studies conducted by past researchers.

Jonathan Ostry conducted a research on the current account imbalances in ASEAN Countries which was tabled as an IMF working paper at a conference on macroeconomics issues facing ASEAN Countries in Jakarta on 7-8 November 1996. His study, of the five ASEAN countries revealed that excessive private consumption tended to characterise their widening external imbalances in recent years, except to a small degree in Indonesia and Malaysia. Jonathan argued that beyond consumption factor, a number of other factors still influenced the desirability of running large external deficits, including the level and composition of external liabilities, the flexibility of macroeconomic policies and the health of banking system. According to Ostry, even when the current account deficit appears sustainable, there is a case to reduce them in order to decrease the risks arising from such factors.⁷

⁷ Jonathan Ostry 1997, "*Current Account Imbalances in ASEAN Countries: Are They A Problem?*", *International Monetary Fund Working Paper*, IMF: Washington D.C, 1997.

**Table 3: Average Current Account Balance for ASEAN countries
1991-1995 in percent of GDP**

	Malaysia	Indonesia	Philippines	Singapore	Thailand
Current Account Balance	-6.4	-2.5	-5.3	14.4	-6.3
External Debt	45.2	192.8	170.6	77.3	106.2

(Source: Jonathan Ostry 1997, "Current Account Imbalances in ASEAN Countries: Are They A Problem?, International Monetary Fund Working Paper," IMF: Washington D.C, 1997. p.25)

Ostry further commented on the current account position in several ASEAN countries as well as their external debt as reflected in Table 3 above. Thailand and Malaysia were seen as the two countries with high current account deficits amounting to -6.3% of the GDP and -6.4% of the GDP respectively. Singapore on the other hand recorded a positive current account balance. External debt for Indonesia, Philippines and Thailand exceeded 100% of their respective countries GDP.

The Economists on the other hand has reported that since the beginning of 1990s, current account imbalances in a number of ASEAN countries have widened considerably, generating concerns in some quarters that policy measures may be required if costly and destabilising shifts in market sentiment are to be avoided.⁸

⁸ *The Economists*, "Malaysia Current Account Deficits", Nov 4, 1995, p. 39

The Financial Times highlighted that the current account deficits of Malaysia and Thailand widened to over 8% of Gross National Product (GNP) in 1995. Indonesia on the other hand recorded a 4% deficit of GNP, significantly smaller than Malaysia and Thailand. This has raised concerns relating to the impact of a widening deficit on the country's external debt and debt services levels, which are significantly higher than else-where in the region.

The report reflects concern about the size of Malaysia and Thailand's external deficits. The report further concluded that the Economists Intelligence Unit downgraded both countries medium-term lending risk rating at the end of 1995.⁹

Another paper by Diwa C. Guinigundo for The South East Asian Central Banks (SEACEN) Research and Training Centre provided some analysis of migrants earnings, the current account and central bank policies. The study focused on overseas workers remittance (OWR) as a means to assist the current account position in the region. It concluded that overseas employment provides more than OWRS to mitigate the balance of payment for a number of SEACEN Countries; this includes income, housing, education and basic necessities.¹⁰

⁹ *The Financial Times*, "External Deficits in Malaysia and Thailand" Oct 6, 1995.

¹⁰ Diwa C. Guinigundo, *Some Analytics of Migrant Earnings: The Current Account and Central Bank Policies*, The SEACEN Centre, 1993

An interesting study on the monetary approach to the balance of payment was also carried out by Mordechai E. Krenin and Lawrence H. Officer 1978. The study introduced a monetary approach to curb external imbalances. This includes money multiplier and money supply approach in the supply side and elasticity and interest rate in the demand side.¹¹

The services sector has indeed come a long way since Adam Smith. Smith and the traditional economists in the 18th Century suggested that the service sector is not important and is non-existent in economic models. However, in the 1930's this statement was challenged by Colin Clark and Allan Fisher. According to their findings, the services sector exists as part of the economy but has no significant role. This was further supported by V.R Fuchs in the 1960's whose his study concluded that the services sector is seen as productive but is interpreted as a problem with no significant positive contribution.¹²

In 1980's, the services sector gets to be viewed differently in its contribution to the economy. According to Dorothy Riddle, growth in the services sector contributes to general economic growth. Riddle's study highlighted Danielle Bell's findings in the 1960's where the services sector is perceived as productive and contributes positively to growth in the other sectors.¹³

¹¹ Mordechai E. Krenin & Lawrence H. Officer, *The Monetary Approach to the Balance of Payment: A Survey*, New Jersey: Princeton University Press, 1978

¹² Fuchs, V.R, *Service Economy*, National Bureau of Economics Research, New York 1983, p.3

¹³ Riddle, Dorothy, *Services-led Growth*, Praeger Publishers, New York, 1986, p.12

A study by Adrian Bull on the economics of travel and tourism put forth how the travel and tourism industry can assist a country's Gross National Product and its effects on the balance of payments. The study examined the various purposes of travelers visiting a country. Bull's study incorporated the elasticity analysis in policy implementation.¹⁴

Several local studies and research have also brought forth concerns of the deficit in the current account caused by the services sector.

Phang highlighted the increase in servicing outflow of freight and insurance costs by foreign firms in Malaysia and how this widened the deficits and affect the overall Balance of Payments.¹⁵

Another interesting study was conducted by Yap Lee Sun on the role of the services sector in the economic development of Malaysia. Yap's findings through econometric modeling concluded that growth in the services sector caused growth in the country's GDP.¹⁶

Other than the study conducted by Yap, S.Y Lee writings on the balance of payments of the states of Malaya and Singapore for 1947-1964 showed that the

¹⁴ Adrian Bull, *The Economics of Travel and Tourism*, Aust: Addison Wesley Longman, 1993, p.45

¹⁵ Phang Hooi Eng, *Foreign Direct Investment-A Study of Malaysia's Balance of Payment*, Petaling Jaya: Pelanduk Publications (M) Sdn. Bhd, 1998.

¹⁶ Yap Lee Sun, *The Role of The Services Sector in the Economic Development of Malaysia: A Macro Approach*, Unpublished Masters Thesis, University Malaya, 1989

services account has incurred a negative value from pre and post-colonial times.

Lee's study, among other things, highlighted tourist expenditure.¹⁷

A more recent study was conducted by Zarinah Yusof (1993), on the balance of payments in Malaysia for 1967-1988. Zarinah's study highlighted the negative values in the travel account in the services sector.¹⁸

¹⁷ S.Y Lee, *The Balance of Payments of The States of Malaya and Singapore 1947-64*, Unpublished Masters Thesis, University Malaya, 1967, p. 6-7

¹⁸ Zarinah Yusof, *Model of The Balance of Payment Structure in Malaysia*, Unpublished Masters Thesis, University Malaya, 1993