PREFACE

No thorough study of the balance of payments of Malaya or Malaysia has been done so far. Hence we cannot compare our result or analysis with any previous study relating to this region. The only sources of reference which are quite relevant to the study are the various Annual Reports of Bank Negara and the First Malaysia Plan 1966 - 1970. However the data in these sources are not comprehensive and the lack of details limits our analysis. The figures in the various Annual Reports of Bank Negara are not exactly comparable.

The only other source of information is the Department of Statistics, Malaysia, which has provided more accurate and up-to-date data on Malaysian balance of payments. The writer is very grateful to Mr. R. Chander, the Chief Statistician, for giving him access to these data.

Finally the writer would like to take this opportunity of thanking Dr. Syed Waseem Ahmad, his Supervisor, for his valuable suggestions and criticisms.

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SYNOPSIS

AN ANALYSIS OF THE MALAYSIAN BALANCE OF PAYMENTS - 1961 TO 1965

This study is mainly concerned with an analysis of the Malaysian balance of payments. However, discussions of the problems relating to the balance of payments are also included. The Introductory Chapter is aimed at giving a theoretical background to the study. In this Chapter, definitions of concepts used in the study are given. Also discussed in this Chapter is the purpose the balance of payments and the methods of classification.

Chapter II deals with the analysis proper. In this chapter we touch on the various items that make up the balance of payments. The merchandise account is discussed in great details together with the "Invisible" account and Capital Account. In the course of the analysis we find that after 1962 Malaysia's balance of payments on current account swing from sizeable surpluses to deficits after 1962.

In the latter part of the chapter we analysed briefly the regional trends in the balance of payments. The analysis shows that Malaysia always has deficits in her Current Account with the Sterling Area while her surplus with the rest of the world is diminishing.

In Chapter III we state the problem Malaysia is, and will, be facing, and try to suggest ways and means of containing the problem. The problem is mainly concerned with the deteriorating terms of trade. Unless prices of rubber remained at the present level Malaysia will face a serious balance of payments problem. Some of the ways in which this problem can be kept in hand is put forward in this Chapter. These include the intensification of import substitution process, manufacturing for export, diversification of exports, etc. The extents these have taken place is also discussed.

Foreign Exchange Reserves and the Monetary System, insofar as they are related to the balance of payments, is touched upon in Chapter IV. Suggestions are made on how the Reserves can be put use to. The automatic adjustment of the balance of payments under the 100% currency system is also discussed in this chapter.

Before concluding we considered the prospects of the balance of payments in the short-run and the long-run. In this respect we considered the extent to which import substitution and expansion of exports will bear fruit.

Throughout the analysis tables and figures are given to illustrate the points made.

1. Concepts and Definitions

The object of this exercise is to make an analysis of balance of payments. It is, therefore, a necessary preliminary that the terms be defined clearly and unambiguously. We shall define briefly:

(1) The Balance of Payments

(2) Concept of Economic Transaction

(3) Concept of Resident

(4) Balance of Trade

(5) Concept of "Surplus" and "Deficit"

Following I.M.F's definition, balance of payments is "a systematic record of all economic transactions during a given period between residents of a reporting country and residents of other countries referred to as foreigners"[1]. There are two concepts here that need to be defined, viz., "economic transaction" and "residents". We will begin by defining "economic transaction".

Concept of Economic Transaction

The economic transaction, included in the balance of payments comprise of changes in ownership of goods, the rendering of services (including those of capital and other factor of production) and transfers of money and other capital items between residents of one country and residents of another. Capital items are defined as including all financial claims (whether equity or creditor) and immovable property. The only exception to this rule is the fixed asset acquired abroad by military establishment and diplomatic missions. These are not considered capital items, the acquisition and liquidity are regarded as transactions in goods and services.

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[1] "I.M.F. Balance of Payments Manual" p.1

Economic transactions may be divided into two categories:

(1) transactions involving _quid pro quo_, that is, exchange of goods and services, or money and other capital items, against one another, that is to say, a two-way transaction, and

(2) transaction involving no _quid pro quo_, that is, transfers of goods, services, or money and other capital items, from one country to another without payment in any form, that is to say a one-way transaction. In the balance of payments accounting, this item is balanced by a contra-entry under "Donations".

Within this category five types of transactions may be distinguished as shown below. The first three transactions involve a _quid pro quo_ while the last two do not.

(1) Sales of goods or the rendering of services against payments in money, other credit instrument or titles to investment i.e., capital items.

(2) Barter, i.e., exchange of goods directly for goods without the media of money, credit instruments, etc.

(3) The interchange of capital items, such as sales of securities against securities, sales of currency against another currency, payments of debt, etc.

The following are transactions involving no _quid pro quo_:

(1) Gifts of money and other capital goods.

(2) Gifts in kind, i.e., in the form of goods and services.

These two items of transaction can also be termed "Donations".

For all these five types of transactions equal credit and debit entries must be made in the balance of payments. The two sides of transaction for the first three types yield equal credit and debit. For the last two types a credit entry for transfer abroad of goods, services or capital items without payment is matched by a debit entry under "donation" and vice versa for transfers into the country of goods, services or capital items received from abroad. The term "donation" covers voluntary gifts, compulsory transfers such as reparation and the automatic transfer of migrants properties. These shall be discussed below.

Definition of "Resident"

The term "Resident" is divided into three categories, namely, "Resident Individual", "Resident Institution", and "International Institutions".

(a) Resident Individual

Resident Individual are used to include all the residents of the reporting country who are living permanently in the country. However, diplomatic representatives and members of the armed force stationed abroad, and students and citizens undergoing medical treatment abroad are considered residents of their own country (i.e., the reporting country) rather than the country where they are residing temporarily. The extent to which others living abroad are considered to be residents (travellers) or foreigners (emigrants) depend on a variety of factors. They include permanence of the residence abroad and the extent to which they concentrate abroad their earning activities and their investment, that is to say, the extent to which they shift their "general centre of interest." However, there is no really scientific basis of determining how to treat this concept of resident.

The same principle of "centre of interest" determines whether a citizen of a foreign country staying in the reporting country should be considered a resident of the latter. In bo derline cases the exact contact of the resident concept is left to the discretion of the reporting country.

(b) Resident Institution

Resident Institutions of a given country include the central and all local governments and all the business enterprises and profit organisations located in the country but not their foreign branches or subsidiaries which are considered as resident institutions of the country in which they are physically located. A distinction must be made between branches and subsidiaries on the one hand and agencies on the other. A branch although owned by a foreign institution acts as a principal for its own account whereas an agency acts for the account of principals abroad.

(c) <u>International Institutions</u>

International Institutions are not considered residents of the country in which they are located but rather as international areas outside national boundaries. For example, even though the International Monetary Fund (I.M.F.) and the International Bank for Reconstruction and Development (I.B.R.D.) are located in the United States, the subscription to them and purchases by U.S. citizens of I.B.R.D. securities are recorded as U.S. foreign investment in the U.S. balance of payments. Similarly, credit extended abroad by these institutions are not recorded as credit extended by the United States. Administrative expenditure and expenditure of the staff of such agencies are considered receipts by that country from a foreign government.

An international institution is defined as a political, administrative or financial organisation in which the members are governments or official institutions. Inter-governmental organisation conducting ordinary business undertaking are not treated as international institution.

However, in the regional presentation of the balance of payments data, it is sometimes been found convenient to show transaction with the international institution such as I.M.F. and I.B.R.D. in combination with transaction with specific countries or areas when this procedures simplifies the study of currency relationship. For example, transaction in U.S. currency with I.M.F. have frequently been combined with transaction with the United States and similarly, transaction in sterling with the I.M.F. have sometimes been included as transaction with the United Kingdom or Sterling Area.

However, transaction with the international institutions are as a rule shown as separate items in the tables. To combine them with transaction with countries and areas does not alter the principles that international institutions are considered international areas outside national boundaries.

<u>Balance of Trade</u>

The popular misconception is to identify the balance of trade with the balance of payments. A nation's balance of trade is the difference between the value of goods and services sold to foreigners by residents of the reporting country and the value of goods and services purchased from foreigners by them[2]. Some writers defined the balance of

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[2]Scammell, "International Monetary Policy" (London, Macmillan 1961) p.21.

trade as the difference between the value of merchandise exports and the value of merchandise imports, making it the same as the balance of merchandise trade[3]. Most writers[4], however, adhere to the first definition. To avoid confusion, therefore, we shall use the term balance of visible trade to denote the difference between the value of merchandise exports and imports, and balance of invisible trade to denote the difference between the value of services exported and imported. The balance of trade, therefore, is the sum total of the balance of visible trade and the balance of invisible trade.

Thus trade items include all payments of goods and services in a given period of time. It includes respectively receipts from the sale of commodity exports to foreigners and the amount paid to foreigners in respect of commodity imports. The difference between these two items is referred to as the balance of merchandise trade. The invisible trade items are grouped the inward and outward payments in respect of services -- shipping freight, tourist expenditure, payments for financial and insurance services, and interest payments in respect of outstanding loans. The difference between the totals of the debit and credit trade items we refer to as the balance of trade.

The balance of trade is thus limited to a part of debits and credits of a country's balance of payments. Since the balance of payments is an organic whole, it follows that the balance of trade, though the largest component of the balance of payments, in and of itself, has no analytical significance. Only by relating it to the transfer items can we obtain a complete picture of the contents of international payment position.

<u>The Concept of "Surplus" and "Deficit"</u>

In the sense defined above and in the accounting sense, the balance of payments always balances since as in a double-entry accounting, total receipt must equal total payments if all transactions are included. Such a balance has no significance whatsoever. The important point is how this balance is achieved. This will show whether a country is facing a "deficit" or a "surplus".

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[3]Enke, S and Salera, V. "International Economics" (Tokyo, 1959) p. 81.

[4]For example see Meade, "Balance of Payments" (O.U.D. 1960, 4th Imp.) p. 7.

A deficit is measured by the actual amount of accommodating finance required over a given period of time (as debits). A deficit is "actual" if accommodating payments are taking place, and "potential" if the account is made to appear balanced by the government interfering directly to control imports, etc.

The deficit or surplus is termed as disequilibrium in the balance of payments.

2. Methods of Classification

The classification of the balance of payments is a matter of opinion and perhaps only a matter of academic interest. We shall consider a few ways in which the balance of payments is classified. The first method is one in which the balance of payments accounts are fundamentally divided into current account and capital account[5]. The current account includes all transactions in goods and services and current transfers which give rise or use up national income. Capital account records all charges in claim on or of a country owed by or owed to other countries. Capital item includes both long-term and short-term capital items. The net changes in capital account, together with the net change in the stock of monetary gold has a bearing on the change in savings of the country.

There is an alternative classification which can be maintained as a more representative basic categories than those of long-term and short-term capital movement and of monetary gold movement. This is the unrequited receipts, that is to say, gifts or indemnities. Accordingly we have another classification of the basic categories of the balance of payments accounting in which the balance of payments is divided into "Trade Items" which include unrequited transfers and capital items[6].

A third major classification is one in which the balance of payments accounts are classified into the current account; the capital account; the gold account, and errors and omissions[7].

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[5]Ohlin, B., "Interegional and International Trade" (Harvard, 1933) p. 331.

[6]Meade, op.cit. p.4.

[7]Kindleberger, C.P., "International Economics" (N.York, 1955) p. 22.

The necessary balance in the balance of payments statements is based on the principle of double-entry accounting just like any balance sheet account. However, it is possible in practice to collect data on one side of the transaction only. In this way, exports and imports in commodities and services, that is, the trade items are recorded as credits and debits, while net change in claims on and liabilities to foreign countries is recorded as the capital movement. Any discrepency in the total of debits and credits is offset by a balancing item "Errors and Omission".

As mentioned above, a balance of payments accounts must always balance. This is in keeping with the principles of double-entry accounting. This equilibrium need not necessarily mean an equilibrium in the balance of payments. Equilibrium in the balance of payments in the economic sense does not mean the automatic balance in total credits and debits, but balance in certain categories of the accounts.

The International Monetary Fund Standard Schedule

The International Monetary Fund has published a Balance of Payments Manual which gives a detailed instruction on the construction of the balance of payments accounts. It has also prepared a basic schedule for the presentation of the balance of payment accounts. The schedule is reproduced in Table 1 below.

The definitions of the concepts used by the I.M.F. has already been discussed above. However, a few rules laid down for the interpretation of the principles which have not been discussed will be touched on below.

For international comparisons, it has been found desirable that both exports and imports should be valued f.o.b. the frontier of the exporting country. Transportation and interest are thus uniformly treated as distinct services under the item "services". When goods are sold c.i.f. the exporter is considered to act as an agent for the importer in arranging for the transportation and insurance. This procedure seems to be preferable to the common practice of valuing exports f.o.b. and imports c.i.f. as exports and imports are in this way treated equally.