

CHAPTER II

THE BALANCE OF PAYMENTS OF MALAYSIA

1. Current Account

In the decade ending with 1960, Malaysia¹ always had a substantial current account surpluses in her balance of payments. Since then, large deficits have appeared. The year 1960 was probably the watershed dividing years of surpluses from the years of deficit. Table 3 shows in summary, the main trends in the balance of payments from 1961 to the end of 1965, with an estimate of the likely outcome for 1966.

TABLE 3

SUMMARY OF THE CURRENT ACCOUNT - 1961 to 1966 (M/million)

	1961	1962	1963	1964	1965 ^a	1966 ^(b)
Exports (f.o.b)	3,208	3,232	3,296	3,346	3,744	3,630
Imports (f.o.b)	2,652	2,892	3,010	3,056	3,202	3,290
Balance on Merchandise A/c	+ 556	+ 340	+ 286	+ 290	+ 542	+ 340
Current Invisibles	- 553	- 495	- 517	- 424	- 436	- 470
Balance on Current A/c	+ 3	- 155	- 231	- 134	+ 106	- 103

^a Preliminary (b) projected by the Dept. of Statistics, Malaysia

Source: Department of Statistics, Malaysia

¹Malaysia came into being on September 16th. However, the Department of Statistics, Malaysia has made an estimate of the balance of payments of the four territories of Malaysia prior to its formation. With the secession of Singapore in August 1965, the balance of payments have been revised, to maintain uniformity, to cover only the existing territories. The balance of payments in this exercise therefore excludes Singapore.

1.1. Merchandise Trade

The radical change in the balance of payments between 1960 and 1963 may be explained by the relative stagnation of export earnings and the sluggish rate of expansion in export volume and increasing volume of imports. The principal cause of this stagnation is the decline in the f.o.b. unit value of rubber from 106.57 cents a pound in 1960 to 71.5 cents a pound in 1963 arising out of increased competition from synthetic rubber and the stockpile releases by the United States General Services Administration. The trend of rubber prices can be seen in Table 4 below.

The failure of imports and exports to increase significantly in 1964 and 1965 was due to the severance of trade with Indonesia. In addition the further decline in f.o.b. unit value of rubber to 67.6 cents a pound in 1964 and 68.6 cents in 1965 also had its adverse effect on the value of exports. The annual growth rate of export value from rubber was - 6.1% while the rate of growth of physical volume was 2.3%. This inevitably lead to a fall in export earnings from rubber. The export performance of rubber, tin and iron ore is shown in Table 4.

Export Performance of Rubber

Rubber is the main export commodity of Malaysia accounting for more than 51% in 1961 and was three times as important as tin. However, its contribution to export proceeds had declined to only about 38% of total export proceeds in 1965. This is primarily due to the drastic and steady fall of its f.o.b. unit price.

In 1961, net export of natural rubber from Malaysia was 861,100 tons valued at \$1,566.9 million. This was about 21% lower than the value in 1960 as a result of a 23.5% fall in average unit price of rubber from 106.5 cents in 1960 to 81.5 cents in 1961. The decline in rubber prices which began in May 1960 continued until February 1961 when increased market strength lifted prices to their 1961 peak of 92.5 cents a pound (R.S.S.1 noon, f.o.b. Singapore)². The recovery was shortlived with prices settling down at about 84-85 cents a pound which is about 22% less than during the corresponding period of 1960. The announcement made by the United Kingdom Board of Trade and the United States General Services

² Bank Negara Tanah Melayu Report 1961 p. 5

EXPORT PERFORMANCE OF THREE MAJOR COMMODITIES OF MALAYSIA 1960-65

	1960	1961	1962	1963	1964	1965*	Annual growth rate (%)
<u>RUBBER</u>							
Volume ('000 tons)	838.8	861.1	857.2	907.5	922.1	941.0	+2.3
Price (ots/16)	106.5	81.2	76.9	72.6	67.6	69.0	
Value (\$million)	2,000.6	1,566.9	1,476.9	1,475.7	1,395.9	1,454.0	-6.2
% of Total Gross Export	51.7%	43.8%	40.7%	39.9%	36.3%	35.3%	
<u>TIN</u>							
Volume ('000 tons)	76.6	74.2	81.4	84.6	71.1	70.0	-1.8
Price (\$/ton)	6,623.0	7,414.0	7,571.0	7,539.0	10,166.0	11,760.0	
Value (\$ million)	507.3	550.1	616.3	637.8	722.8	823.0	+10.2
% of Total Gross Export	12.9%	15.3%	16.9%	17.1%	18.8%	20.0%	
<u>IRON-ORE</u>							
Volume ('000 tons)	5,500.0	6,435.0	6,441.0	6,582.0	6,317.0	6,500.0	+3.4
Price (\$/ton)	25.5	25.5	25.8	26.8	25.7	25.0	
Value (\$million)	140.2	163.8	166.1	176.3	162.5	163.0	+3.1
% of Total Gross Export	3.5%	4.6%	4.6%	4.7%	4.2%	3.9%	

* Preliminary

Source: First Malaysia Plan, p. 23

Administration on October 27th and November 1st, respectively to accelerate disposal of stockpile depressed the price immediately by 4 cents a pound and the decline continued almost without a pause until November 9th when price reached its lowest level at 73.75 cents.

The fluctuation in prices in any one year, for most part, is beyond the control of the Malaysian Government. Rubber prices like the prices of many other primary commodities depend on external events. Rubber prices depend very much on political condition and also the economic conditions of consuming countries. Increased buying of by the U.S.S.R. and West Irian political condition in early 1962, for example, buoyed-up rubber prices considerably. The Cuban crisis in the later part of the year, the Sino-Indian situation and the unconfirmed reports of revival of Chinese interest in purchases of Malaysian rubber had favourable influence on the price of rubber. However, in spite of all these, rubber prices were generally on the decline, part of the reason being the unpredictable nature of Russian purchase and the stockpile releases.

Coupled with the fact that net rubber exports fell by about 3,900 tons, the value of exports fell substantially in 1962 to \$1,476.9 million, a decline of \$90.0 million.

In 1963, rubber prices declined further to an average of 72.6 cents a pound, fluctuating between 80 cents and 61.6 cents a pound. However, this substantial decline in price was greatly offset by a substantial increase in net export, amounting to 207,500 tons, an increase of 50,300 tons. However, this did not completely offset the effect of the fall in price. Net earning fell by \$1.2 million to \$1,475.7 million. At the same time gross rubber exports (i.e. including re-exports) fell by about 0.2% from 1,208,724 tons in 1962 to 1,206,530 tons in 1963³. This is primarily due to the disruption of trade relation with Indonesia as a result of "Confrontation"⁴.

³Bank Negara Malaysia Annual Report, 1963 p. 14

⁴Indonesia embarked on a policy of "Confrontation" when Malaysia was formed on September 16th 1963.

Price of rubber declined further in 1964 from 72.6 cents a pound to 67.6 cents. The severance of trade with Indonesia was felt when gross export fell by about 16% in volume and about 80% in value, mainly as a result of discontinuance of imports of Indonesian rubber for re-export. However, domestic production of rubber increased by about 4% and net exports increased by 14,600 tons. But the drastic fall in price lead to a fall in the value of net export by about 5% from \$1,475.7 million in 1963 to \$1,395.9 million in 1964⁵.

The fall in rubber price may be explained by decrease in rubber demanded by the United States, United Kingdom, Japan and Western Europe, as well as the Soviet bloc countries and Communist China. Export of Malaysian rubber to the United States fell by over 19% from 152,300 tons in 1963 to 123,000 tons in 1964 and those to the United Kingdom declined by 4% to 121,000 tons, while Japanese purchases were reduced by about 24% to 87,200 tons. Similar decline was also seen in Western Europe where exports declined by about 4% to 270,000 tons in 1964. Exports to the Soviet bloc and Communist China in 1964 were estimated at 143,000 tons which is 45% lower than 1963⁶.

The average price in 1965 fell to 68.6 cents. Again, (except for the United States and Soviet bloc countries and Communist China) export to the industrialised countries declined. Exports to the United Kingdom fell by 6%, to the European Economic Community countries by 10.7% and to Japan by 21.1%⁷.

The high prices at the beginning of the year was mainly due to the deteriorating political developments in Southeast Asia, particularly in Vietnam and the wide-spread speculation on the volume of purchases by the Soviet bloc countries. The main factor affecting price in the third quarter was the slackening demand in consumer countries and the announcement by the United States G.S.A. of its intension to seek permission to dispose of another substantial quantity of stockpile rubber without the usual notice. However, disruption of Indonesian supplies towards the end of the year arising out of unsettled political conditions as a result of the abortive "October Coup" and

⁵Bank Negara op.cit 1964, p. 19

⁶ibid p. 20

⁷ibid p. 24

the resumption of purchases by Communist China in the Singapore market, prevented what would have been a runaway downward trend in price⁸.

The behavior of price during the period under consideration confirms the view that the position of natural rubber in total world supply and demand for rubber is such that substantial increases in rubber prices are unlikely to occur. The decline in prices was merely a reflection of the changes of a major nature in the character of world rubber market. Firstly even in 1961, synthetic rubber production, already nearly half of total world rubber production, increased at a rate more than three times that of natural rubber⁹. Since 1961 also, the world saw the commercial production and use of stereo-regular rubbers which are claimed to have properties akin to natural rubber.

Another basic change in the character of the market is that though consumption of new rubber is increasing, it is becoming evident that the everwidening gap between consumption and production is being filled by synthetic rubber. Table 5 below shows the proportion of natural rubber to total rubber consumption in five major industrial countries.

TABLE 5

PROPORTION OF NATURAL RUBBER TO TOTAL RUBBER CONSUMPTION

	1959	1960	1961	1962	1963	1964	1965
United States	34	31	28	27	26	25	26
United Kingdom	70	61	58	56	55	52	50.7
Canada	44	39	34	32	-	-	-
W. Germany	66	58	54	53	51	49	44.8
France	-	-	57	54	50	48	44.4

Source: Bank Negara Reports 1961 to 1965

⁸ibid. p. 24

⁹Bank Negara op.cit. 1961 p. 6

World synthetic rubber production had, for the first time overtaken natural rubber in 1962. Synthetic rubber output at 2,242,500 tons was 13.3% more than 1,980,000 tons of natural rubber produced in 1961. The International Rubber Study Group placed synthetic rubber production at 2,300,000 tons in 1963.¹⁰ In 1964, of total rubber consumption, 54.2% was synthetic rubber and in 1965 it was 55.4%. Japan too is using increasing amounts of synthetic, from 39% in 1962 to 41% in 1963, 44% in 1964 and 43.8% in 1965. Thus an assured future of natural rubber can be envisaged only if producers could reduce production cost and improve technical qualities, because prices are not expected to remain as they were. There is no doubt that consumption will increase significantly with the growth in automobile industry and the rising level of industrial production generally, but synthetic rubber continues to make inroads into natural rubber's share of total rubber usage.

It is clear that there will be no shortage of rubber. In fact in 1964 world rubber production (both natural and synthetic) for the first time exceeded consumption. Due to the competition from synthetic, natural rubber price will tend to be equal the short-term marginal cost of the cheapest type of synthetic with which it has to compete in order to sell the world supply of natural rubber. The above analysis suggests that all we can say about the price of rubber with reasonable safety, is the very trite comment that its price in the long run will in all probability be downwards.

The declining rubber prices adversely affected the balance of trade, and explains the relative stagnation in exports during the period under consideration. However, the effects of declining prices was offset somewhat by the better performance of tin exports, the second most important export commodity. During the period 1961 to 1965, tin fared very favourably indeed as an export commodity. Table 4 above shows in brief, the performance of tin between 1960 and 1965.

¹⁰ Bank Negara op.cit. 1962 p. 18.

DIAGRAM 1A

RUBBER
EXPORT VALUE
1961 - 1965

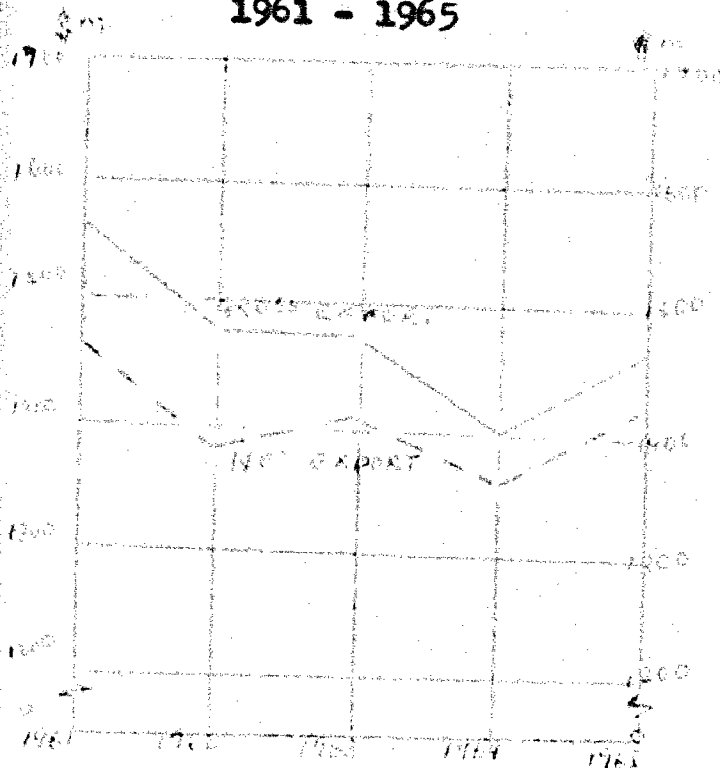
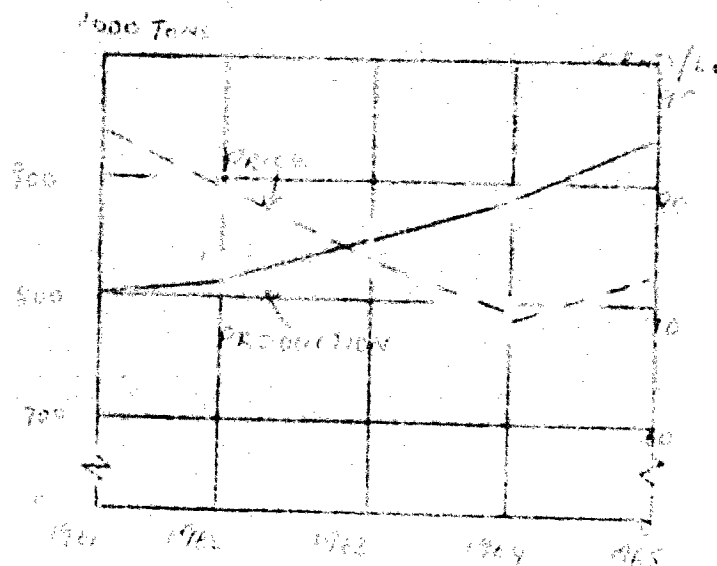


DIAGRAM 1B

PRODUCTION AND PRICE
1961 - 1965



Export Performance of Tin

The price of tin for the period under consideration shows a steady increase from \$6,632 a ton in 1960 to \$7,538 in 1963. There was a sharp increase in 1964 to \$10,166, an increase of \$2,627 a ton over the 1963 price. In 1965 price rose by \$1,599 a ton to \$11,765.

The main reason why price of tin is on the increase is primarily because world consumption continues to outstrip world production. In 1961 world production (including those of the Soviet bloc and Communist China

and the International Tin Council Bufferstock) was 156,500 tons while consumption (excluding Soviet bloc and Communist China) was 160,800 tons or 2.7% more than production.¹¹ If the Soviet bloc and Communist China were included, demand would exceed supply by a greater margin. Indeed so marked was the increase in world demand for tin in 1961 that only the timely disposal of about 7,500 tons of stockpile metal by the governments of Canada, Italy, and the United States prevented what appeared at one time a runaway market situation developing. However in spite of stockpile and bufferstock releases, consumption continues to outstrip production. Table 6 below shows the estimated world consumption and world production of tin.

TABLE 6

ESTIMATES OF WORLD PRODUCTION AND
CONSUMPTION OF TIN 1961 - 1965

	WORLD PRODUCTION*	WORLD CONSUMPTION*
1961	135,000 tons	160,800 tons
1962	143,200	156,200
1963	141,000	161,500
1964	146,000	167,500
1965	152,000	164,400

*Excluding Soviet bloc and Communist China.

Adapted from: Bank Negara Reports 1961-1965.

There is little doubt that unless sizeable quantities of tin ore are sold by the U.S.S.R. or China outside the Soviet bloc or a substantial increase in world production is forthcoming, the future of International tin market lies in the hands of the United States Government as the only holder of stocks large enough to effectively supplement world supplies against higher consumption levels.¹² The world market price for tin depends mainly on the method by which the General Services Administration disposes the tin

¹¹ Bank Negara Cp.cit. p. 2

¹² Ibid p. 3

that it considered in excess of strategic requirements. However price of tin did not fall below £350 per ton level in spite of the announcement of the G.S.A's 1962 disposal programme. In fact prices surged upwards in the latter half of 1963, due mainly to the inability of Indonesia to meet her sales commitments and the interruption after September 1962 of supplies from Indonesia as a result of her decision to divert tin ore for smelting from Malaya to the Netherlands. A further contributing factor was the increase in purchase by the Soviet bloc and Japan.

As a result of continuing world shortage tin prices showed a strong upward trend in 1964 and 1965. The world shortage was further aggravated by a fall in tin production in Bolivia, Nigeria and the Congo caused by sporadic strikes in mines and political unrest. Uncertainty about the political situation in Southeast Asia and fear of a further rise in prices resulted in an increase in commercial stock building, particularly in the United States. In 1965 price was influenced by labour unrest in Bolivia, resulting in the closure of its biggest mining complex and by the Indo-Pakistan conflict. As a result of these two factors price improved further in that year.

All these factors affected favourably on the Malaysian balance of payments. Due to large increases in price, the export earnings from tin increased at an annual rate of 10.2%. This has greatly contained the downward trend in the balance of visible trade caused by declining rubber price.

Export earnings from tin increased steadily in spite of the fact that volume exported has decreased in 1964 and 1965, and even in 1961, production was well below the 1960 level. The sharp decline in volume from 84,600 tons in 1963 to 71,100 tons in 1964 was primarily due to the discontinuance of import of Indonesian tin-in-concentrates to Penang for smelting. But as a result of extremely favourable price, the value of tin export increased from ¥637.8 million in 1963 to ¥722.3 million in 1964. Gross export of tin metal in 1965 valued at ¥822 million was about 19% higher than that in 1964 because the price at ¥11,760 a ton was about 16% higher than 1964.

This favourable performance of tin export partially offset the unfavourable performance of rubber, with the result that the decline in trade surplus was contained.

Table 4 shows the export performance of tin from 1960 to 1965.

DIAGRAM 2A

TIN EXPORT VALUE
1961 - 1965

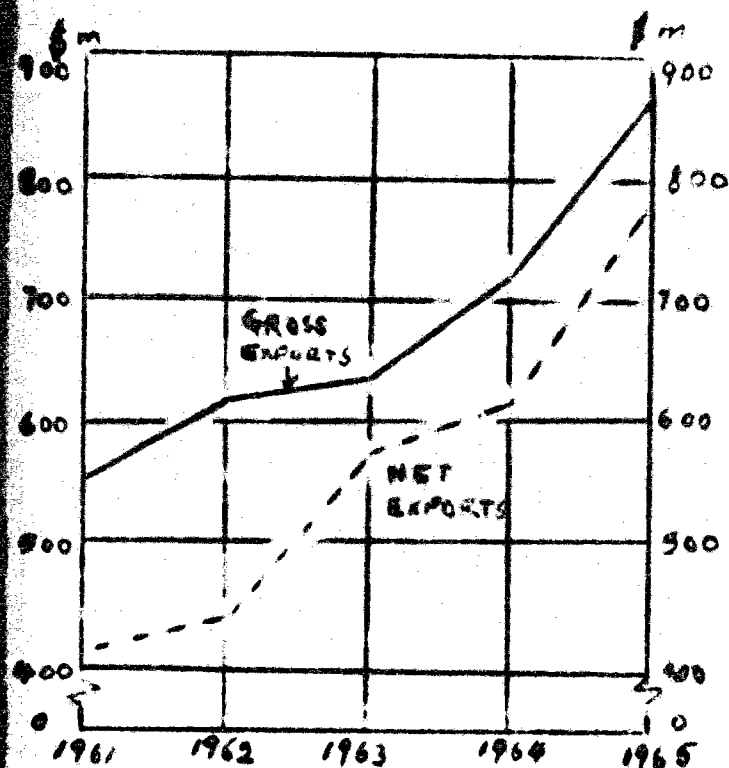
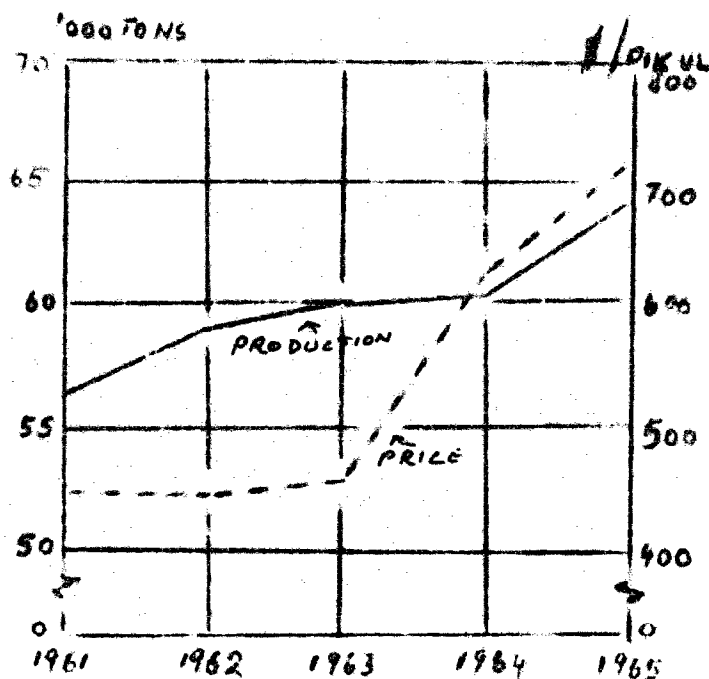


DIAGRAM 2B

PRODUCTION AND PRICE
1961 - 1965



Export Performance of Iron-ore

In addition to the stagnation of earning from rubber there were other less important causes for the sluggish growth of exports. Iron-ore, Malaysia's third largest export failed to expand its export volume and value after 1963, when the period of rapid production growth came to an end. The iron-ore industry suffered a setback as a result of curtailment of Japanese imports from Malaysia early in 1962. However exports increased by 0.1% to 6,441,000 tons in that year and with a slightly higher price the value

increased slightly from \$163.8 million to \$166.1 million. In 1963, Japan announced the continuance of its plan to curtail iron-ore imports by about 24% but this did not materialise fully¹³ and Japanese imports of Malaysian iron-ore increased substantially resulting in a slight increase both in value and volume of export.

However the value and volume of iron-ore export which has been rising in previous years declined in 1964 mainly owing to diversion of Japanese purchase to other sources of supply. The result of this was that the volume exported fell to 6,317,000 tons and the value to \$162.5 million. Preliminary estimates for 1965 showed that export volume increased again by 5% to 6,630,000 tons. However, export earnings fell to \$161.4 million due mainly to the decline of about 5% in f.o.b. export unit value from \$25.7 a ton in 1964 to \$24.3 a ton in 1965. Japan continued to be the sole market for Malaysian iron-ore. However with Japan diversifying its sources of supply, Malaysia's iron-ore is facing increasing competition. Table 4 shows in summary the export performance of iron-ore from 1960 to 1965.

DIAGRAM 3A

IRON ORE EXPORT VALUE
1961 - 1965

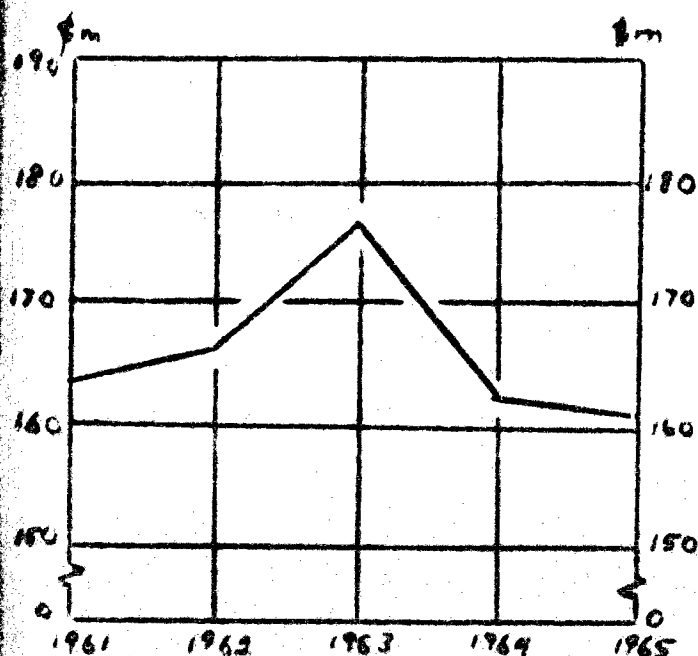
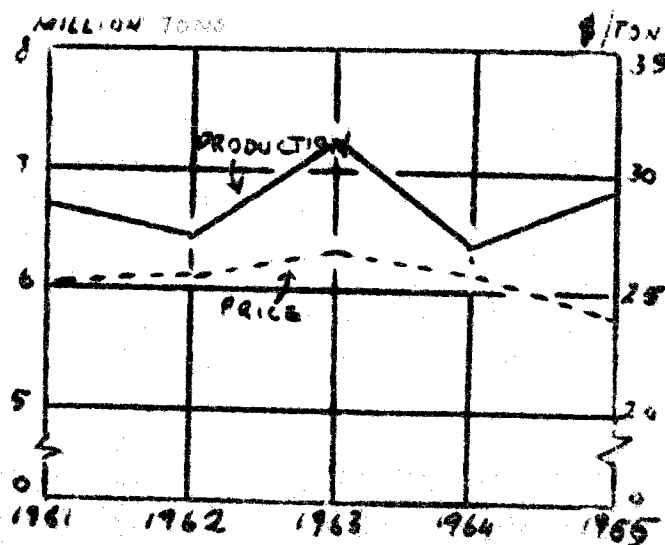


DIAGRAM 3B

PRODUCTION AND PRICE
1961 - 1965



Other Export Commodities

In addition, export of copra and coconut oil continued to decline rapidly over the entire period. Earnings from coconut and coconut products fell steadily from \$88.7 million in 1960 to \$83.1 million in 1961 and \$58.0 million in 1962. There was a slight increase in 1963 to \$61.7 million but fell again in 1964 to \$39.2 million. It was estimated to increase slightly in 1965.¹⁴

This unfavourable development was offset by more favourable performance in other export products. Timber exports grew rapidly in both volume and value and certain less important exports such as oil palm product and pineapple products continued to expand. However, the dominant factor in the balance of visible trade was and is rubber, accounting between 51.1% of total export value in 1960 and 35.3% in 1965. As such, its earnings will be reflected in the balance of payments.

The steady and drastic fall in unit value of rubber as shown in Table 4 led to a reduction in the surplus of merchandise account. Trade surplus in 1962 as compared to 1961 declined by about 43.7% from \$556 million to \$340 million. It fell further in 1963 by \$154 million to \$286 million. The surplus in 1964 increased slightly to \$290 million, and this trend was followed in 1965 when there was a substantial increase in the surplus

Imports

At the same time when export value stagnated, imports have grown steadily during the period 1961 to 1965. This has been due to the stepped up implementation of development programme both in the public and private sectors, which, apart from directly stimulating imports of capital goods, has also indirectly (through the multiplier effect) increased imports of consumer and intermediate goods. An added factor has been the continuing rapid population growth which is averaged 3% per annum.

The increasing imports has greatly accentuated the declining surplus in the merchandise account. Imports have steadily grown since 1955, due partly to meet the requirements of expanding population which has been increasing at the rate of 3% per annum and to fulfill requirements of the

¹⁴First Malaysia Plan p. 23-24.

First and Second Five-Year Malayan Development Plans. The stepped up implementation of the development plans has thus contributed directly to the increase in imports.

In 1961 imports amounted to \$2,652.4 million and increased to \$2,892.2 million, an increase of about \$239.8 million compared to an increase of only \$23.5 million in exports. This has the effect of reducing the surplus of \$555.8 million in the merchandise trade in 1961 to \$339.5 million in 1962.

Imports of food in 1962 show a slight decline from about 28.2% in 1961 to 25.9% in 1962 reflecting increased rice production. The main increase, however, is in the imports of machinery and transport equipment, i.e. capital goods, and manufactured goods which increased both absolutely and relatively. Imports of capital goods, mainly machinery and transport equipment increased by about 2.2% to 18.5% over the year while imports of manufactured goods increased by 0.5%¹⁵. In absolute terms, all other essential imports, namely, mineral fuel, inedible crude material, chemicals, foods, etc., had shown some increases reflecting the population increase. The point is that the composition of imports has shown some changes, with greater emphasis on machinery and manufactured goods and luxury goods while imports on food have not increased appreciably.

In 1963, imports again increase, this time by \$117.7 million compared to an increase of only \$63.9 million, reducing further the merchandise surplus. The composition of imports has shown no significant change, manufactured goods, machinery and equipment still being dominant, accounting for about 42.2% of total imports. However, imports of food increased substantially in 1963 due mainly to the larger rice imports necessitated by reduced rice harvest in Malaya and substantially higher cost of imported sugar.¹⁶

The rising trend of imports paused somewhat in 1964. In that year imports increased only by \$46.3 million in 1963. Exports on the other hand showed a larger increase rising from \$3,295.5 million in 1963 to \$3,345.9 million in

¹⁵Bank Negara Op.cit. 1962, p. 11

¹⁶Bank Negara Op.cit. 1963, p. 20

1964 an increase of \$50.4 million. As a result, the surplus on Merchandise trade increased slightly from \$285.7 million in 1963 to \$289.7 million in 1964. This, and in addition to other factors to be discussed below, has the effect of reducing the deficit in the current account in 1964.

The small increase in imports in 1964 is not the result of a deliberative move to curtail imports but rather as a result of a 10% decline in gross imports c.i.f. due primarily to the severance of trade with Indonesia. Indonesia had been sending rubber for milling and grading to Malaysia and large amounts of tin-in-concentrates were exported to Malaysia to be smelted in Penang and re-exported. The severance of trade as a result of "Confrontation" has put a stop to this, with the result that imports did not increase substantially in 1964.

Preliminary estimate for 1965 showed that the surplus on Merchandise trade increased substantially from \$289.7 million in 1964 to \$542.8 million in 1965. This was due to the fact that while exports increased significantly from \$3,345.9 million to \$3,744.3 million, imports rose only by \$145.6 million to \$3,201.8 million.

We have seen that the increase in imports was a reflection of rising per capita income and increased public and private investment. For the period 1961 - 1964 imports of food and beverages, and manufactured consumer goods have shown marked increases reflecting the rising per capita increase and the expanding population. In the same period, capital goods, i.e. machinery and equipments showed a similar trend reflecting the stepped up implementation of development programme in the public and private sector.¹⁷ However, in 1965 imports of food, beverages and tobacco declined by 8.1% mainly due to higher rice production and increased local food manufacturers. But following the previous trends, imports of machinery and equipments, manufactured goods and crude materials and chemicals continued to increase.

Table 7 below shows a breakdown of gross imports by major groups for the period 1961 - 1965.

¹⁷Bank Negara Op.cit. 1965, p. 30.

TABLE 7

MALAYSIA: GROSS IMPORTS 1961-1965

	1961		1962		1963		1964		1965	
	\$m.	%	\$m.	%	\$m.	%	\$m.	%	\$m.	%
Food:										
Food, beverages and tobacco ..	793	28.2	796	25.9	914	28.5	950	27.4	873	25.8
Raw Materials:										
Inedible crude material ..	311	11.0	361	11.8	307	9.6	241	7.5	237	7.0
Animals and Vegetable oil and fats ..	15	0.5	16	0.5	14	0.4	15	0.5	18	0.5
Chemicals ..	182	6.5	173	5.6	190	5.9	201	6.1	235	7.0
Manufactured Goods	634	22.7	706	23.0	733	22.8	736	22.8	805	23.8
Capital Goods										
Machinery and Transport Equipment ..	458	16.3	569	18.5	624	19.4	655	20.3	752	22.2
Other Imports	64	2.3	74	2.4	72	2.3	66	2.0	74	2.2
Total	2,816	100.0	3,071	100.0	3,210	100.0	3,229	100.0	3,383	100.0

Source: Bank Negara Malaysia Annual Report p. 29

Writer's Note: The table above shows Gross Imports (c.i.f). It therefore does not tally with the figures for imports in the Main Balance of Payments Table. However, it does give us a rough idea about the rising trend of imports during the period.

2 "Invisible" Trade

The reduction in the Merchandise account surplus has been offset somewhat by the more favourable outturn in the invisible account. However, it is the normal feature for Malaysia's balance of payments to have a deficit on transfers and services. At between 1961 and 1965 the traditional deficit decreased substantially from \$553 million in 1961 to \$436 million in 1965.

There was a substantial fall from \$533 million to \$495 million in 1962, a fall of \$58 million, offsetting somewhat the greater fall in the surplus of the merchandise account. Details of the "Invisible" Account is given in the accompanying Table below.

The decrease in the deficit was due to the fact that net investment income paid in 1962 was slightly lower because income paid or accrued abroad on direct investment was less. Investment income paid was \$336.9 million in 1962 compared to \$363.7 million in 1961 while investment income accrued increased from \$133.4 million to \$164.8 million. However in 1963 the deficit on investment income again rose, to \$180.0 million in 1963, \$208.4 in 1964 and \$248.6 in 1965.

There was a decrease in net transfers from \$343.9 million in 1961 to \$238.2 million in 1963 after which it increased again. The decrease/primarily due to a decrease in net transfer payments by the Government. Private transfers abroad was almost constant throughout the period, but private transfers into the country increased slightly.

Freight and insurance continued to show large deficits, increasing as it were, from \$133.1 million in 1961 to \$162.1 million in 1965. This is due to the fact that while our "export" of freight and insurance did not show any sign of expanding, our "import" of such services was on the increase.

At the same time payments abroad on account of travel increased. But the net payment has not increased appreciably because our "export" of such services has also shown some improvement, increasing from \$9.7 million in 1961 to \$21.7 million, an increase of \$12 million over the five years. We can improve this position further by providing a more efficient and attractive tourist service.

In 1963 the deficit in "invisible" increased slightly to \$517 million, due to lower official grants received and also larger payments with regard to insurance and freight. Net payments abroad of investment income and transfers were also slightly higher than 1962. However, the situation improved considerably in 1964 when the deficit was reduced to \$424 million, an improvement of over \$93 million. This improvement is reflected in the balance of payments by a reduction in the current account deficit in 1964.

This sharp improvement in 1964 is principally explained by the increasing receipts arising out of larger expenditure by Commonwealth Forces in Malaysia, the lower net payments on account of investment income and lower net transfer payments.¹⁸

Details on invisible items are shown in the Annual Summary of Malaysia's Balance of Payments Estimates 1961 to 1965.

The analysis above shows that there was a deficit in the balance of payments of Malaysia from 1962 to 1964. However, preliminary estimates in 1965 showed that Malaysia's overall balance of payments improved considerably. There was a surplus of \$106 million in 1965 compared to a deficit of \$134 million in 1964, \$231 million in 1963 and \$155 million in 1962. The reversal in the balance of payments position was brought about by a substantial increase in export receipts and a smaller increase in imports. 1965 was an extremely favourable year where exports were concerned. Every export commodity showed an improvement over the 1964 performance. At the same time official grants remained at \$170.0 million.

As a result of higher volume and value of export in 1965 the current account which has been in deficit since 1962 showed a surplus of over \$106 million, an improvement of about \$240 million over 1964 figure.

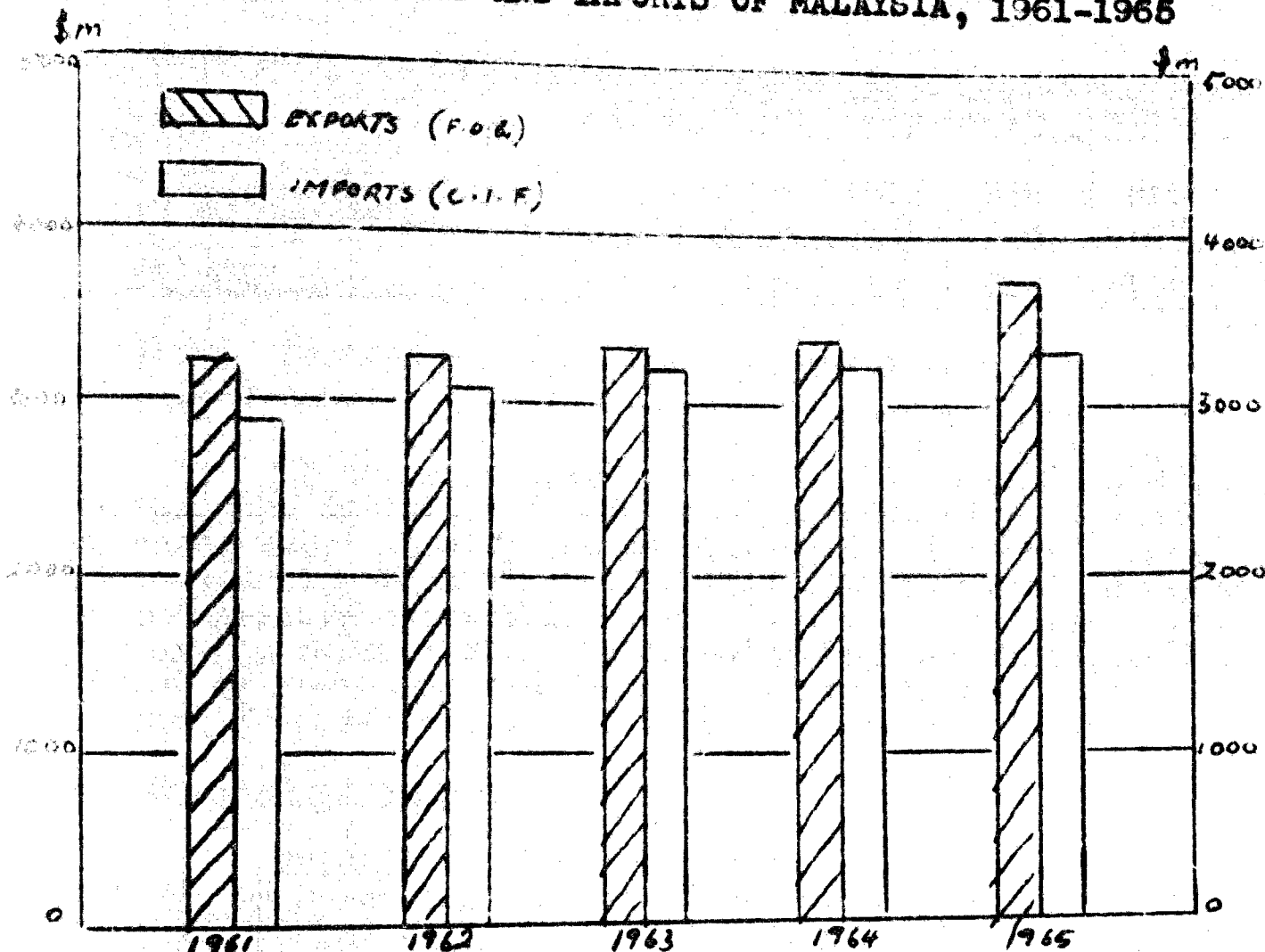
1.3. Regional Current Balance

It has been traditional for Malaysia to have a current account deficit in her balance of payments with the Sterling Area and a surplus with the Rest of the World. Between 1961 and 1963 the deficit with Sterling Area increased persistently. This is due to the fact that over 50% of our imports come from the United Kingdom, and 18.7% from Commonwealth countries. These imports have increased persistently over the years. However Malaysia exports to these countries are not as substantial as those to the United States (our main buyer of rubber and tin), Canada, the European Economic Community Countries and Japan, our sole purchaser of our iron-ore.

¹⁸ Bank Negara Annual Report 1964 p. 25.

DIAGRAM 4

GROSS EXPORTS AND IMPORTS OF MALAYSIA, 1961-1965



However since 1964, there has been a reversal in the trend. This is mainly because of the higher expenditure in Malaysia of the Commonwealth forces stationed here. But at the same time, the favourable balance with the Rest of the World has been deteriorating sharply over the period. The extremely large change between 1963 and 1964 is accounted by the break in trade between Malaysia and Indonesia and by reduced purchase of rubber by the non-Sterling countries such as the United States, and the Soviet bloc. The United States, Canada, the U.S.S.R., the EEC countries and Japan has been using more and more synthetic rubber, resulting in reduction in their purchases of natural rubber from Malaysia. At the same time however, imports from the United States and other non-Sterling industrialised countries in the forms of manufactured goods, machinery and equipments have not decline. Table 8 below summaries the position.

TABLE 8
REGIONAL CURRENT BALANCE 1961-1965

	1961	1962	1963	1964	1965
Current Account with Sterling Areas	-791	-874	-1013	-848	-850
Rest of the World	+794	+718	+781	+714	+956
Balance	+3	-156	-232	-134	+106

Source: Department of Statistics, Malaysia.

We see a reversal in regional balance in 1965. Whereas the deficit with the sterling countries did not increase substantially the surplus with the non-sterling increased significantly, reflecting the increased purchases of our exports especially by the U.S.S.R. and Japan. The favourable balance with the non-sterling countries had the effect of reversing the trend of the balance on current account from deficit to a substantial surplus in 1965.

2. Capital Account.

In spite of the substantial and persistent current deficit in Malaysian balance of payments during the past four years, her capital account remained healthy. Between 1962 and 1964 the current account deficits were largely financed by inflows of private long-term capital and official loan receipts. Net private long-term capital increased from \$180.0 million in 1961 to \$235.0 million in 1962. This reflected the higher inflow of private capital for direct investment and a lower private outflow for portfolio investment abroad. The remaining deficit in current account for 1962 was met from loan receipts and a drawing down on the foreign exchange reserves of the government sector which amounted to \$91.6 million.

In 1963, there was a larger increase in private long-term capital inflow from \$235.0 million in 1962 to \$320.0 million as Malaysia remained one of the most attractive countries in this region for private foreign investment due to political stability and economic viability. The large current deficit was also financed by a further drawing on the foreign exchange reserve to the extent of \$39.4 million.

As a result of large long-term private capital inflows and official loan receipts, the balance on current account and long-term capital account showed a surplus of \$204.7 million in 1961, \$127.8 million in 1962 and \$172.7 million in 1963. This was followed by a surplus of \$134.8 million in 1964.

Private long-term capital (net) in 1964 fell to \$250.0 million due primarily to reduced borrowings by commercial banks. This decline, together with a sharp decline in official capital (which refers to loans raised abroad by the government and its agencies less repayments) resulted in a smaller surplus in the current and long-term capital account. Loans by Central and Local Governments abroad fell from \$42.9 million in 1963 to zero in 1964, while other official long-term capital increased by \$7.8 million to \$8.4 million in 1964.

In 1965 there was again an increase in the surplus in current and long-term capital account. The large increase from \$134.8 million to \$468.0 million in 1965 was due to the surplus in the current account and also the larger net private long-term capital and a sharp increase of official capital (which increased from \$13.0 million in 1964 to \$29.5 million in 1965).

Net inflow of private long-term capital was estimated at \$260 million in 1965 compared to \$250 in the previous year.¹⁹ Net inflow of official long-term capital at \$104.5 million was \$86.0 million more than in 1964, reflecting mainly from the loan of US\$25 million (MY\$75 million) raised by the government in the New York Market in April 1965. This fact has led to an increase in the surplus on current and long-term capital account.

From the point of view of official foreign reserves (including gold tranche) there was an increase since 1961. Malaysia's gross holdings of gold and foreign exchange reserves, including those of commercial banks amounted to about \$2760 million at the end of 1965. This represented approximately eight to nine months of imports at 1965 level.

(A more detailed treatment of foreign exchange reserve will be made in Chapter IV).

3. General Conclusions

From the above analysis we can make some general conclusions. Firstly from the analysis of the merchandise account we can see that the terms of trade is against Malaysia. Price of rubber, Malaysia's main export is on a downward trend. At the same time both the value and volume of export has increased. The prospect of a further fall in the value of our main export suggests that we must diversify our economy, instead of depending on only a few commodities. This point is further developed in Chapter III.

With regards to invisibles we can reduce our deficits by expanding our shipping services and domestic insurance service. An efficient and attractive tourist service will certainly help to reduce the deficit in the "invisible" account.

We have seen that Malaysia is and will be facing with balance of payments problems. Something must be done to in order to keep the problem well in hand before we are faced with a more serious problem. One of the best ways to contain this problem is to step up the process of import substitution and to increase manufacturing for exports. The export of services too can be increased. These various measures and discussed in greater details in the next chapter.

MALAYSIA'S BALANCE OF PAYMENTS ESTIMATES 1961 TO 1965 (CURRENT ACCOUNT)

(In Millions)

	1 9 6 1			1 9 6 2			1 9 6 3			1 9 6 4			1 9 6 5 (Prel.)		
	Cr.	Dr.	Net	Cr.	Dr.	Net	Cr.	Dr.	Net	Cr.	Dr.	Net	Cr.	Dr.	Net
1. Merchandise Trade (f.o.b.)	3,208.2	2,692.4	+515.8	3,231.7	2,892.2	+339.5	3,295.6	3,009.9	+285.7	3,345.2	3,056.2	+289.7	3,744.3	3,201.8	+542.5
2. Non-Monetary Gold	0.2	28.6	- 28.4	0.2	3.2	- 3.0	0.2	2.6	- 2.4	0.2	3.0	- 2.8	0.2	2.0	- 4.8
3. Official Grants Received	49.0	-	+ 49.0	31.5	-	+ 31.5	24.3	-	+ 24.3	176.3	-	+176.3	170.0	-	+170.0
4. Other Invisibles:	365.3	938.3	-573.0	394.5	917.7	-523.2	420.6	959.6	-539.0	490.4	1,027.3	-536.9	531.2	1,133.2	-602.0
4.1 Freight & Insurance	4.7	137.8	-133.1	4.5	149.7	-145.2	4.9	160.4	-155.5	6.2	160.3	-154.1	5.5	167.6	-162.1
4.2 Other Transportation	26.8	22.8	+ 4.0	29.0	25.8	+ 3.2	29.9	27.3	+ 2.6	41.9	33.2	+ 8.7	51.5	36.9	+ 14.6
4.3 Travel	9.7	76.6	- 66.9	11.9	82.1	- 70.2	16.8	85.9	- 69.1	20.1	93.8	- 73.7	21.7	102.6	- 80.9
4.4 Investment Income	133.4	363.7	-230.3	164.8	336.9	-172.1	172.0	354.0	-182.0	170.2	378.6	-208.4	157.2	405.8	-248.6
4.5 Government Transactions NIE	162.3	10.7	+151.6	155.0	9.7	+145.3	166.2	8.1	+158.1	215.0	8.9	+206.1	258.7	14.0	+244.7
4.6 Other Services	16.8	71.2	- 54.4	17.3	66.0	- 48.7	15.9	70.8	- 54.9	13.3	77.7	- 64.4	11.2	85.0	- 73.8
4.7 Private Transfers	11.6	216.9	-205.3	12.0	219.2	-207.2	14.9	220.6	-205.7	23.7	224.6	-200.9	25.4	220.4	-195.0
4.8 Government Transfers	-	38.6	- 38.6	-	28.3	- 28.3	-	32.5	- 32.5	-	110.2	-110.2	-	100.9	-100.9
5. Balance on Current Account	3,622.7	3,619.3	+ 3.4	3,657.9	3,813.1	-155.2	3,740.7	3,972.1	-231.4	4,012.8	4,146.6	-133.7	4,445.7	4,340.0	+105.7

5. Balance on Current Account
6. Balance on Long-Term Capital Account
- 6.1 Private Long-Term Capital (Net)
- 6.2 Central and Local Government Issues Abroad
- 6.3 Official Capital (Net)
- 6.4 IBRD, IDA and IFC
- 6.5 Other Official Long-Term Capital
7. Balance on Current and Long-Term Capital Account
8. Balance on Monetary Movements (excluding Short-Term Capital)
- 8.1 Change in Gold and Foreign Exchange Holdings of Central Govt., Govt. Agencies and Public Authorities
- 8.2 Changes in Gold and Foreign Exchange Holdings of Monetary Authorities (Net)
- 8.3 Changes in Foreign Exchange Holdings of Commercial Banks (including Banks' Borrowings) Net
- 8.4 Changes in Account with I.M.F.
- 8.4 Changes in Non-Residents' Holdings of Malayan Currency (excluding I.M.F.)
- 8.5 Changes in Monetary and Other Short-Term Capital
- 8.6 Errors and Omissions

	1961			1962			1963			1964			1965		
	Sterling	Non-Sterling	Total	Sterling	Non-Sterling	Total	Sterling	Non-Sterling	Total	Sterling	Non-Sterling	Total	Sterling	Non-Sterling	Total
	-	-	+ 3.4	-	-	-155.2	-	-	-231.4	-	-	-133.7	-	-	+105.7
	-	-	+201.3	-	-	+283.0	-	-	+404.1	-	-	+268.5	-	-	+362.3
	n.a.	n.a.	+180.0	n.a.	n.a.	+235.0	n.a.	n.a.	+320.0	n.a.	n.a.	+250.0	n.a.	n.a.	+260.0
	+ 13.5	+15.4	+ 28.9	- 8.6	+59.4	+ 50.8	+42.9	-	+ 42.9	- 7.3	-	-	-	+75.7	+ 75.7
	-	- 3.1	- 3.1	-	- 2.9	- 2.9	- 5.8	+49.3	+ 43.5	-	+20.3	+ 13.0	- 7.7	+37.2	+ 29.5
	- 4.5	-	- 4.5	+ 0.1	-	+ 0.1	-	- 2.9	- 2.9	-	- 2.9	- 2.9	-	- 2.6	- 2.6
							+ 0.6	-	+ 0.6	+ 8.4	-	+ 8.4	- 0.3	-	- 0.3
	-	-	+204.7	-	-	+127.8	-	-	+172.7	-	-	+134.8	-	-	+468.2
	-	-	-204.7	-	-	-127.8	-	-	-172.7	-	-	-134.8	-	-	-468.0
	-172.7	-0.9	-173.6	+78.1	-39.4	- 38.7	+70.6	- 7.2	+ 63.4	+196.6	+ 4.1	+200.7	+ 66.3	+ 5.7	+ 72.0
	+ 3.0	+ 3.0	+ 6.0	-92.2	+ 0.6	- 91.6	-23.6	-15.8	- 39.4	- 76.0	+ 7.8	- 68.2	- 82.4	-30.8	-113.2
	+ 76.6	+ 0.5	+ 77.1	+25.7	- 2.4	+ 23.3	+52.3	+ 6.4	+ 58.7	-	+ 0.9	- 0.2	-110.4	- 5.3	-115.7
	-	- 1.9	- 1.9	-	- 1.9	- 1.9	-	-11.6	- 11.6	-	- 0.6	- 0.6	-	-19.5	- 19.5
	-	-	-112.3	-	-	- 96.3	-	-	-243.8	-	-	-266.5	-	-	-291.6