# CHAPTER V

# CONCLUSION

## 1. Balance of Payments Prospects 1966 - 70

"Malaysia will have a potentially serious balance of payments problem during the period 1966-70 but if the targets for output growth, foreign assistance for the public investment programme and foreign private investment are met and the level of public savings is maintained the problem will be kept well in hand. The balance of payments problem arises from the fact that the value of Malaysian exports is growing very slowly at precisely the time when import requirements are on the increase."[1]

Imports for the period 1966 to 1970 are envisaged to increase greatly so that payments will exceed export receipts by a wide margin. The growth in imports is primarily a reflection of rising population of Malaysia. It also reflects the increased comsumption from higher income levels for there appears to be a close relationship between imports of consumer goods and the private disposable income of the previous year. Even if output targets under the First Malaysia Plan are met, "many but not all of these needs will be met from increased local production."[2] However, there is a restraining factor in the growth of imports in the form of increasing import replacing production. But there are still many types of goods and services which cannot be produced locally, at least during the next few years. "Moreover, import substitution itself has its import component the imported capital goods and raw or semi-finished materials needed by growing local industries."[3] It is not therefore envisaged that imports will remain constant, much less decrease during the next five years. "Even if all the (Plan) targets ......are achieved, then payments for imported goods and services in 1966-70 will exceed export proceed by $1,579 million. To the extent that there are shortfalls on the output or financing targets or breakthroughs of the public consumption expenditure ceiling, the goods and services deficit will be increased."[4]

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[1] First Malaysia Plan, p. 57

[2] Ibid. p. 58

[3] Ibid. p. 58

[4] Ibid. p. 58

In addition to the money required to pay for the imports of goods and services, foreign exchange is also needed to meet private foreign transfers. It will be noted that immigrants remittance to their families abroad in cash and kind constitutes an important net foreign payments from Malaysia. Excluding profit remittances, which is considered factor incomes rather than transfer payments, private remittances have amounted to more than $200 million in recent years (see Table 9(A) above). But as the ties linking the one time immigrants to Malaysia with their countries of origin gradually weaken, such remittances may show some tendency to decline. Thus during the next five years, net private remittances are projected to be only $874 million. Together with a deficit of about $1,579 million in the balance on goods and services account, the deficit on current account will be about $2,450 million. (See Table 13 below).

Imports of capital goods will certainly increase substantially during 1966-70. Government investment during the period is schedule to rise to $715 million in 1970 against $705 in 1965 while private investment will increase from $1,010 million in 1965 to $1,405 million in 1970.[5] The import content of such capital formation is usually high. Even if we allow for the government's falling slightly below its investment target, imports of capital goods in 1970 will still be very high. But it is the declared policy of the government that development progress must continue and not be curtailed except marginally. Thus there seems to be no likelihood of a let up in imports of capital goods during the forecaste period. Imports are therefore expected to increase - perhaps in the region of 4% in 1966 and this trend is expected to continue.

The balance of payments outlook is greatly influenced by the long-term decline in f.o.b. price of natural rubber. The volume of rubber exports will undoubtedly increase substantially as gains from replanting and new planting will be felt. The government replanting programme, particularly in Malaya, gives it a better chance to withstand the pressure of competition from synthetic rubber than other rubber producing countries. However, we must

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[5] ibid. p. 49.

recognise the fact that synthetic rubber technology will continue to be improved and production of synthetic rubber will increase, depressing the price of natural rubber on world market. Nevertheless, even though technological development of synthetics is continually occuring, cost of production of synthetic may not fall as much as expected if inflation of the "Cost-push" type continues in the industrial nations of the world. This point is sometimes overlooked.

The First Malaysia Plan envisaged that by 1970 price of rubber will fall to about 55 cents,[6] but production for export will increase greatly. However, in spite of the increase in export volume, proceeds is expected to increase only by about $130 million due mainly to the decline in prices. It is calculated that on the average, a one-cent fall in world rubber price during the 1965-70 period will lead to a fall of $25 million a year in export receipts of Malaysia.[7]

Apart from competition with synthetic rubber which brings down the price, there is also the complication of sales from the American stockpile. We cannot forecaste accurately the amount of future releases but we can be certain that the releases would affect rubber prices unfavourably.

At the same time exports of tin metal are likely to be lower as more tin dredges go out of production. Gains in production from new land alienated to tin-mining will be offset by exhaustion of some reserves. However, tin prices are favourable at present and are expected to remain at or above the present level over the next few years. 1965 was an outstanding year where tin is concerned and producers took full advantage of high prices by raising output. But as we have seen, known tin reserves are gradually being depleted and even if prices remain high, it will become increasingly difficult to maintain production at current level. In the long run, through prospecting in the Malay Reservation areas and exploitation of the possibilities of off-shore mining it may be possible to maintain

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[6] Ibid. p. 43

[7] Ibid. p. 43

production.[8] Therefore, unless price rises far above the present level, export receipts from tin will fall, "perhaps to a level $150 million lower in 1970 than in 1965".[9] This decline will completely offset the gain in export receipt from increased rubber production with the result that total receipts from these two most important export will remain unchanged.

In the case of iron-ore, Malaysia's third most important export, volume is expected to fall from 6.5 million tons in 1965 to 3 million in 1970 and the value is expected to fall by $103 million to $60 million.[10] A depressing factor in the iron-ore industry is the impact of restriction by Japan on the imports of Malaysian iron-ore due to the low quality of the ore and the desire by Japan to diversify her sources of supply.

However, all other less important exports are forecasted to grow at a steady rate over the next five years. Prices of timber and timber products are expected to rise as world consumption continues to outstrip world production. As Malaysian production continues to increase, though at a rate slower than during the last five years, export receipts from minor exports will increase. "By moving increasingly into saw-milling and further processing of round timber, the nation will be able to increase still further the value added by this industry."[11]

Other export products continue to be promising. Palm oil and kernels continue to offer the best immediate alternative to rubber and during the next five years many estates will have oil-palm acreage which will come into bearing. However, a decline in export price from the present high level is expected so that even though production may double in the next five years export proceeds may not rise as rapidly as output. Canned peneapple offers another bright prospect for export. Pineapple production can be stepped up just as foreign market can be developed for the canned fruits.

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[8] Ibid. p. 44

[9] Ibid. p. 44

[10] Ibid. p. 45

[11] Ibid. p. 44

Finally, it is hoped that with the rapid development of manufacturing industry (as discussed in Chapter III) exports of industrial products which are small at present will increase rapidly. However, overseas market will first have to be established and the establishment of a Trade Commissioners Service in July this year will certainly help to promote our industrial exports in the near future.

However, "The overall prospect for export growth under the First Malaysia Plan ......is not bright."[12] The projection in the Table below suggests that gross export proceeds are unlikely to rise by more than $120 million from 1965 to 1970. In part, this may be due to the fact that 1965 has been an excellent year for exports so that if we base our projection between 1964 to 1970 the rate of growth will only be 1.6%.[13] This is because although all other exports are forecasted to grow at a steady rate, it must be remembered that tin and rubber account for over one-half of export receipts. A depressing force on export receipt is the declining prices of rubber, iron-ore etc. as well as the declining production of tin. "These negative forces are not likely to be barely offset by the positive factors: rising timber prices and increasing production of rubber, timber, oil palm products, pineapple products and a host of minor export commodities."[14] Thus with such a slow rate of growth of export receipt in prospect, it is necessary to step up implementation of import substitution process and the development of industrial export products.

It has been traditional for Malaysia to have a deficit in "invisibles" or service exports and this will continue to be so for a long time to come. Among the "invisible" the best growth prospect lies in the field of tourism. The increasing international travel should bring more foreign travellers to Malaysia and attempts are made to woo tourist by the development of an efficient and attractive tourist industry.

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[12]Ibid. p. 44

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[12]ibid. p. 44

[13]ibid. p. 44

[14]ibid. p. 45

over, Commonwealth troops would be pulled out in large numbers so that we cannot expect any large receipt from that quarter any longer.

It is seen therefore that Malaysia faces a potential balance of payments problem. From the table below we find that deficit on goods and services and private transfer will amount to $2,453 million during the First Malaysia Plan. Foreign exchange is needed to fill this gap. This need must be satisfied through some combination of receipts from official grants, from foreign Governments and International bodies, net foreign private investment, official loans, use of reserves and other short-term capital movement. However the current account deficit will be smaller than the deficit on goods and services if Plan target of $900 million official grant is fulfilled. Such a grant would have the effect of reducing the deficit on current account to $1,686 million (See Table below) and contributes to the stability of the balance of payments.

It is, however, difficult to forecaste the outcome of capital account in detail. The restriction placed on the outflow of capital by both the United States and the United Kingdom are likely to adversely affect the long-term capital account in 1966. The political situation in Southeast Asia would also have an inhibiting effect in this respect. However, Malaysia continues to offer most attraction to foreign capital among the countries in this region.

Between 1966 - 70 the Government expects the inflow of private long-term capital to be $1,000 million. This figure is lower than for the 1960 - 65 period. In spite of the efforts to encourage the flow of new investment from abroad, political uncertainties in Southeast Asia region and the impact of the tax changes recently imposed in the United Kingdom on profit remittances for trading companies are likely to be dampening factors. However, if the target for private long-term capital and public foreign assistance are achieved, major rundown will be avoided.

2. Prospects after 1970

The dominating factors seem likely to be the rising cresendo of the Malaysian Perspective Plan 1966 - 85 and the expected continued drift in the terms of trade, owing to the falling rubber price. A gross investment of perhaps $64,000

TABLE 13

MALAYSIA BALANCE OF PAYMENTS, 1965 - 70

($million)

| | 1965 | 1970 | Cumulative total 1966-70 |
|---|---|---|---|
| **Current Account** | | | |
| Goods and services | | | |
| Receipts | 4,115 | 4,233 | 20,581 |
| Payments | 3,956 | 4,724 | 22,160 |
| Net position | +159 | -491 | -1,579 |
| Private transfers | | | |
| Receipts | 25 | 36 | 161 |
| Payments | 225 | 190 | 1,036 |
| Net position | -200 | -154 | -874 |
| Balance on Goods, services and private transfers | - 41 | -645 | -2,453 |
| Government transfers | | | |
| Receipts | 156 | 200 | 900 |
| Payments | 82 | 25 | 133 |
| Net position | + 74 | +175 | +767 |
| Current Account balance | +33 | -470 | -1,686 |
| **Capital Account** | | | |
| Long-term capital (net) | | | |
| Private | +260 | +200 | +1,000 |
| Public | +107 | +250 | +1,000 |
| Monetary movements and short-term capital, including errors and omission | -400 | +20 | -315 |
| | -33 | +470 | +1,686 |

Source: First Malaysia Plan 1966-70, p. 59

million may be needed for the next twenty years.[15] Long-term capital inflow are unlikely to finance a substantial part of this investment and the use of foreign exchange reserve may offer only a temporary relief. If adequate domestic saving is not forthcoming, the high investment rate and rapid growth will impose a strain on the balance of payments.

The value of exports is assumed to grow gradually to 3% after 1970 and accelerated to 4% and eventually 5% per annum. If past experience is any guide, exports of goods and services are expected to grow rather slowly after 1970 from $4,233 million to $7,600 million in 1985.[16] At the same time imports of goods and services rise rapidly and exceed exports after 1965. 1965 has been an extremely good export year since 1962 so much so that there has been a surplus in the current account. However since 1962, with the exception of 1965 large deficits have appeared. Value of imports of goods and services is projected to be $8,100 million in 1985 compared to exports amounting to only $7,600 million in the same year. The deficits for 1980 and 1985 are expected to remain unchanged due to a large increase in exports and a correspondingly smaller increase in imports. The smaller increase in imports would probably be due to the effect of import replacing process. The larger increase in export cannot be attributed to rubber and tin so that one can conclude that other export have increased by then. In case of rubber, though production will continue to rise, further price decline may occur. Mining output is expected to stagnate after 1970 although sizeable new mineral discoveries could produce much more favourable performance.[17] Industrial output is expected to grow most rapidly of all, rising to nearly one quarter of total Gross Domestic Product by 1985[18] so that the deficit in 1980 and 1985 will be continued at $500 million, reflecting not only the increased industrial exports but also the effect of import substitution.

However one cannot expect the balance of payments to be as bright as the pre-1962 days when Malaysia always had a substantial surplus in the current account. From now onwards one can expect the balance of payment deficit to arise. One possible solution to this problem is to considerably

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[15] Ibid. p. 62

[16] Ibid. p. 63

[17] Ibid. p. 61

[18] Ibid. p. 61

change the pattern of both exports and imports as well as to consciously limit import expenditure. "Traditional exports will not prove capable of providing the growing levels of export receipts envisaged after 1970, the promotion of new agricultural and industrial exports will have to fill the gap".[19] On the import side, to contain amount of import restraint may be needed. In addition, if targets of investment for the next twenty years are to be achieved, it will be necessary that intermediate and investment goods take up a larger share of total imports as they do at present.

Table 14 shows the projected balance of payments up to 1985.

TABLE 14

PROJECTED BALANCE OF PAYMENTS* 1965-85

| | 1965 | 1970 | 1975 | 1980 | 1985 |
|---|---|---|---|---|---|
| Exports of goods and Services | 4,115 | 4,233 | 4,900 | 6,000 | 7,600 |
| Imports of goods and Services | 3,956 | 4,724 | 5,500 | 6,500 | 8,100 |
| Balance on goods and Services | +159 | -491 | -600 | -500 | -500 |
| Transfers (Net) | -126 | +21 | - | - | - |
| Balance on current A/c | +33 | -470 | -600 | -500 | -500 |
| Long-term Capital Inflow (Net) | +367 | +450 | +500 | +500 | +500 |
| Basic balance | +400 | -20 | -100 | - | - |

*At current prices

Source: First Malaysia Plan 1966-1970, p. 63

[19] Ibid. p. 63

## Conclusion

We have above analysed the balance of payments of Malaysia for a five-year period between 1961 to 1965 and also summarised the likely outcome projected beyond 1965. 1961 was probably the watershed dividing the years of surplus from years of deficit. The radical change in the balance of payments position between 1960 and the present can be explained by the relative stagnation of exports and increasing volume of imports. The main cause of the decline in exports as we have seen is due to the fall of the unit value of rubber from 106.57 cents in 1960 to 76.9 cents in 1962 and 68.6 cents in 1965, due primarily to competition from synthetic and the falling trend in the price of rubber which is expected to continue further.

At the same time, imports have grown steadily and rapidly during the period under consideration due to stepped up implementation of development programme both in public and private sectors which directly stimulated the imports of capital goods and also stimulating indirectly imports of consumer goods through the multiplier effect. An added factor has been the continuing rapid population growth which averaged 3% per annum.

Though price of tin and other major commodities have been at satisfactory levels, the overall increase in the value of these imports has not been sufficient to offset the adverse effects of lower f.o.b. unit value of rubber.

In spite of the substantial and persistent current deficit in the Malaysian balance of payments during the period under consideration the capital account remained healthy. During the period 1961-65 the current deficits were largely financed by inflows of private long-term capital and official loan receipts.

From the point of view of official foreign exchange reserves (including gold tranche) there was a continous increase from 1961 to 1963. Drawdown occurs in 1963 onwards but rose again in 1965. The drawdown in 1963 was quite substantial. However the foreign exchange reserve in any one year is sufficient to finance between nine to ten months of imports.

With the intensification of development of manufacturing industries with a view to export and restrict imports, and the continued research in high yielding rubber trees and the diversification of her economy, Malaysia could look to the future with equanimity and confidence. The Malaysia 20-year Prospective plan should ultimately yield good fruit.