

APPENDIX I

COMPOSITION OF THE BALANCE OF PAYMENTS

The balance of payments accounting is generally broken up horizontally into a number of categories, depending upon the nature of transactions involved. It would not give us a clear picture of the balance of payments if we are to include the thousands of items of the total foreign transaction of the country. It is therefore the practise to lump all foreign transactions into several major categories. We shall break up the balance of payments into several categories as followed by the Malaysian balance of payments statements. These are "Merchandise Trade" also sometimes termed "Balance on (visible) Trade", and "Invisible Trade making up the "Current Account" the "Capital Account" and the "Monetary Gold Account".¹

1. Merchandise Trade

This item covers, with a few exceptions, all non-military merchandise transactions, both commercial and non-commercial (gifts, reparations, etc)². In accordance with the I.M.F. procedures gold is not included, being placed under a separate item "Non-Monetary Gold"³. Purchase of goods by travellers and purchase and sale of ships stores are also excluded and placed under the item "Foreign Travel" and "Transportation" respectively.⁴ With regards to transaction of military supplies and equipments, only purchase of goods actually imported into the reporting country and sales actually exported to the purchasing country are entered under this item. Military supplies and equipments imported and exported under grants however are not included anywhere

¹Statistics Department of Malaysia: "Annual Summary of Malaysia's Balance of Payments Estimates 1961-1965".

²Balance of Payments Yearbook Vol.5, 1949-53 (IMF. Wash. 1964)

³Statistics Department Malaysia, Op.cit.

⁴IMF. Op. cit. p.7.

in the balance of payments. This exclusion is done to ensure maximum comparability from country to country, since in the majority of countries, data on governments grants of military item are not available.⁵

With this exception, the "Merchandise" item is intended to include all changes in ownership of merchandise.

Data for this item is usually based on customs returns and/or exchange control records. However, various adjustments must be made before they are entered into the balance of payments, adjustments with regards to coverage, valuation and timing. For example, silver (except currency coins), goods sent by parcel posts, ships and aircrafts, marine products sold directly in foreign ports, etc., are not included in customs returns, while they should be included in the balance of payments. With regards to valuation, customs returns value exports f.o.b. while imports c.i.f. whereas in the balance of payments consistent valuation is necessary.

What does this item reveal? In and of itself, merchandise trade is without analytical significance.⁶ Its balance is simply the difference between the value of merchandise exports and the value of merchandise imports. However, this is usually the largest component of the balance of payments.

It is important that imports and exports must be valued on a consistent basis. It had been the usual practise to record the value of goods in the balance of payments and other trade statistics as of the country's border. This practise means that exports are valued f.o.b. and imports c.i.f. (i.e. free on board and charges including cost, insurance and freight respectively). This practise gives rise to difficulties when comparing the world's export and imports. When converted in a single currency and added up, we will find that the value of imports exceeds the value of exports by the amount of insurance and freight. Today those countries following the procedures laid down by the I.M.F. value both their imports and exports on f.o.b. or f.a.s. (free alongside) basis. The difference between f.o.b. and

⁵ibid. p. 7

⁶ibid. p. 3

f.a.s. is the cost of stevedoring or loading merchandise into a carrier. In the Malaysian balance of payments, both exports and imports are valued f.o.b. Figures on merchandise trade in this study have been adjusted to exclude bankers, samples, returned goods etc.⁷

Ascertaining the totals of a country's exports and imports involve many difficulties. We have already discussed briefly⁸ certain aspects regarding valuation, coverage and timing. But there are other difficulties.

In the first place, there is the question of how to regard imports for re-export and re-exports of merchandise which had been imported. Some countries ignore both imports for re-export and re-exports in the merchandise trade item. The general principle laid down by the I.M.F. is that this item should include merchandise transaction abroad, i.e. merchandise purchase in one foreign country and sold in another without being imported and re-exported for the merchant's country.⁹

With regard to the problem of valuation, apart from the fact that they must consistently valued, there arises another problem. For example goods such as parcel post and immigrants household effects, being partly non-merchandise in character, cannot be easily evaluated. A more difficult problem is posed by inter-company transaction, where wholly arbitrary valuation may be placed upon raw materials or semi-finished goods.¹⁰ Further the existence of foreign exchange control or of tariffs based on the value of merchandise has lead dealers in foreign trade to represent false values.¹¹

Finally, certain commodities may not be commodities or at least may not be commodity exports. This is true of films shipped abroad or imported. Films are rented rather than should not be recorded under "merchandise trade" but rather under "Services". The same principle applies to certain types of contract to rent machinery rather than sell (or buy).

⁷Dept. of Statistics Op.cit.

⁸Op.cit. p. 3

⁹IMF. Op.cit. p. 3

¹⁰Kindleberger, Op.cit. p. 25

¹¹ibid. p. 25

2. Others (mainly "invisibles")

In the Malaysian balance of payments, this item includes "Non-Monetary Gold", "Official Grants Received" and other "invisibles" namely, freight and insurance; other transportation; travel; investment income; Government transaction (not included elsewhere), other services; private transfers, and Government transfers.

a. Non-Monetary Gold

The entries for non-monetary gold are equal to the private sector's net gold sales to (credits) or purchase from (debits) foreign and domestic monetary authorities.¹² It is also equal to the reporting country's gold production (credit) less its gold consumption (debit). Consumption is taken to mean the movement of gold into arts, industrial use, mine inventories and private hoard. Gold production and negative consumption¹³ increase the international reserves of the reporting country, and therefore treated as a balance of payments credit in the same way as exports of goods and services.

b. Services

The services item in the balance of payments, sometimes called "invisible" export and imports, include net insurance, banking, freight, film rentals, royalties, tourist expenses, etc. However we shall only deal with the items in the Malaysian balance of payments. Gathering information on the service accounts of a country is by no means easy. By and large, figures are approached by estimates rather than by enumeration. Income-tax returns are used to estimate interest and dividends, and these are supplemented by questionnaires for largest corporations operating in the foreign field.

The shipping account may or may not include payments to the country's nationals for imports, depending on the system of valuation of imports and exports. If they are valued c.i.f. they already cover payments for freight. However as we value imports f.o.b. this item is included under "Services" in the Malaysian balance of payments. However,

¹²I.M.F. Op.cit. p. 8

¹³"Negative Consumption" is the recovery of gold from arts and industrial use, decrease in mine inventories and private hoard.

even so, it may be desirable, in order to have a complete record of the freight bill for imports, to record all freight as debit, including freight on imports carried by the country's nationals, with an offsetting credit for the later portion of it. If a country wants to keep a record of total freight on export (a credit item), there would have to be an offsetting debit for exports, carried on foreign ships.

Other transportation (non-freight) includes ship repairs, ships' stores and similar supplies, harbour fees, expenditure of crew and other port disbursement, charter hire, mail transportation fees, and passenger fares and shipboard expenses arising from international travel.

Foreign travel include all receipts for goods and services provided to foreigners visiting the reporting country, including transportation within the country (credit) and all payments for goods and services provided by foreigners to residents of the reporting country travelling abroad (debit). Receipt and expenditure on account of tourists, business travellers, students, those undergoing medical treatment, military personnel on leave and travelling Government officials. Though passenger fares and shipboard expenses should strictly speaking be included under "freight", they are sometimes included here because of inadequate statistics.

Data on foreign travel is usually estimated by applying an average per diem expenditure to the number of days spent by residents abroad and by foreigners in the reporting country. This estimate is often based on enquiries made of travel agents, banks, hotels, shops, etc. It is thus open to a wide margin of error.

Insurance covers only direct insurance and re-insurance contracts between residents and foreigners. Foreign branches and subsidiaries of domestic insurance companies are regarded as direct investment and so is not included. However, insurance item in the balance of payments from a small item in the balance of payments and in Malaysia it is grouped together under "freight and insurance".

Investment income which is quite substantial in the balance of payments, covers income from investment after deduction of taxes paid to the country in which the income originates. The credits are income received by residents of the reporting country from investment abroad.

Direct investment is investment in enterprises located in one country but effectively controlled by residents of another country. It takes the form of investment in branches and subsidiaries by parent companies located in another country. Control by residents of another country is said to be effective if they have 50% or more voting power.

Under the item "invisible" is also included Government transaction which was not been included elsewhere. This is a residual item which is not appropriate to other categories of the basic presentation. Thus Government imports and exports are included under merchandise; interest on Government debt in item "investment income"; Government grants under "official donation"; and Government capital transaction under "Capital account".

"Government Transaction" are of two categories, namely military and non-military. Military transaction and "extraordinary" transaction and distinguished from non-military transaction which covers diplomatic and consular expenditures, pensions, contribution to international agencies for administrative purposes and spending of such funds, taxes and Government payments to, or receipt from, dependent territories (insofar as they are not grants).

Military transactions cover, on the credit side, expenditure in the country by foreign countries, military establishment including expenditure by troops stationed here as for example Commonwealth troops stationed in Eastern Malaysia. It includes procurement in our country of supplies used by foreign troops stationed here. Military expenditures usually account for the bulk of the change from year to year in this item because other government transaction are quite small and relatively stable.¹⁴

Whereas "Private Transfers" and "Government transfers" are included under "Donations" in the I.M.F. Basic presentation, they are included under "other Invisibles" in the Malaysian Presentation.

Private transfers include all personal and institutional transfers in cash and kind. Data on this item is collected from statistics on money orders and also exchange control records.

Other Services include services transactions such as management and brokerage fees, communication, advertisement, subscription to foreign press and film rentals. It also includes net earnings sent home by residents temporarily working abroad. Also included are other service transactions which, for statistical reasons are not included elsewhere.

3. Capital Account

The Capital Account records changes in the claims of residents of the reporting country and residents of other countries. When recording in the balance, capital outflow is recorded as a debit even though such an outflow makes the country a creditor. An inflow, on the other hand is recorded as a credit. This is because capital inflow involves the "export" of securities, bank deposit books or IOU's.

Another way to look at this problem is to concentrate on the direction of payment.¹⁵ An export (or outflow) of capital will inevitably give rise to a payment to foreigners just as imports of goods and services would.

The Capital account, while is divided into debits and credits have also been divided into "induced" and "autonomous"; "Stabilizing" and "distabilizing"; "real" and "equalizing"; "abnormal" and "normal"; or "equilibrating"; "speculative income" and "autonomous" capital movements.¹⁶ The most usual division, however, is into "short-term" and "long-term". Short-term capital movement is one in which the credit instrument is of less than a year's maturity. If the instrument matures after a year or more, or consists of a title to ownership, such as a share of stock or a deed to property, the capital movement is long-term.

Capital transaction are further divided into two groups: those of the private sector and those of official and banking sector.¹⁷ This division reflect the status of the party to the transaction in the reporting country and is independent of the status of the foreinger involved.

¹⁵Kindleberger, Op.cit. p.29

¹⁶ibid. p. 323

¹⁷I.M.F. Op.cit. p. 6

Private short-term capital movement are inadequate due to statistical difficulties in estimating them. In the Malaysian balance of payments private short-term capital movement includes changes in non-residents holdings of Malayan currency and changes in Monetary and other short-term capital. No attempt is however made to distinguish the two sub-items.

Long-term capital movement includes private long-term capital, Central and Local Government issues abroad, official capital, I.B.R.D., I.D.A., and I.F.C.¹⁸ and other official long-term capital, of these private long-term capital and official long-term capital are most important.

Long-term capital transaction can be further divided into three groups,¹⁹ namely transaction in portfolio securities, amortization and other debt repayments and miscellaneous transactions. Where possible they are shown separately. (But this is not done in Malaysia). Portfolio security transactions are private purchase and sales of existing securities, new issues abroad of private domestic securities and all private subscription to new foreign issues on domestic market. Miscellaneous transactions include purchases and sales of non-commercial real estate and transactions that cannot be classified elsewhere because of the type of investment is not known.

Official long-term capital is the most reliable in the balance of payments, since it is obtained from Government records. The principle types of transaction covered are official lending and borrowing, repayments on official loans, transactions in long-term securities by official of the reporting country, original gold, etc. Subscription to I.B.R.D., I.M.F. etc. are classified under a different sub-heading in Malaysia.

As mentioned earlier, there are many ways of dividing capital account. We must bear in mind, therefore, that capital account, like the balance of payments as a whole, may be arranged in a number of ways, depending upon the use to which the information is going to be put.²⁰

¹⁸Dept. of Statistics. Op.cit.

¹⁹I.M.F. Op.cit. p. 12

²⁰Kindleberger Op.cit. p.30

4. Monetary Movement

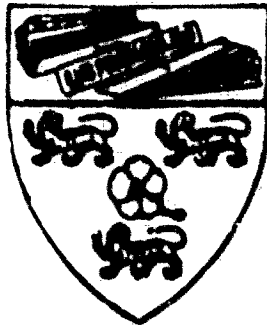
In the Malaysian balance of payments, this item includes changes in Gold and Foreign exchange holding of the Central Government, of the monetary authorities and of the commercial banks; changes in account with I.M.F.; changes in Non-resident holdings of Malayan currency and changes in Monetary and other short-term capital.

Non-monetary gold are included under Current Account. Monetary gold exports are entered as credit as is true of merchandise and non-monetary gold. Included in gold movement are changes in titles to gold at central banks, where gold is not in fact physically transferred between countries. An increase in gold under earmark for foreign account in a country is the same as gold export and is thus entered as credit.

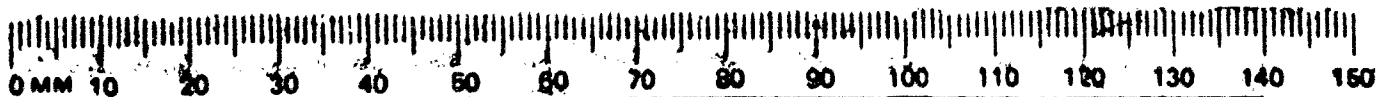
We have above described the composition of the balance of payment.

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