WHEN SLOWER GROWTH MAKES BETTER SENSE

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A lot of water has flowed under the bridge since the 2001 Budget was unveiled last October. The budget has received both bouquets and brickbats. After all, there is no such thing as a perfect budget. It is impossible to craft a budget that would please all segments of society and at the same time serve a potent macroeconomic instrument.

There are several “firsts” about the new Budget. It is the first budget for the new millennium. It is also the first budget for the Eighth Malaysia Plan period. What is more, it also happens to be the first post-crisis budget, now that per capita income in ringgit terms has reverted to the pre-crisis level. Accordingly, the Budget has to set the tone and pave the way. Understandably, expectations were high.

Contrary to the anticipation of a surplus budget which the Prime Minister had hinted at, the RM91 billion budget turned out to be yet another deficit one, fourth in a row. In any case, the situation clearly does not warrant a surplus budget. Although the Malaysian economy has recovered robustly, the recovery cannot be taken for granted, as there are still many uncertainties that would render it somewhat fragile, to put it mildly. After a strong expansion of 10.3 per cent in the first half of the year, there are already signs of some deceleration. All indications are that this slight downtrend will continue into 2001, in view of the expected slowdown in the US economy and the projected decline in export demand for electronic products. A surplus budget at the present juncture would have been grossly inappropriate, as it would have a contractionary effect on the economy.

Arguably, this is not the time even to balance the books with a balanced budget. A sizeably smaller deficit is what one may have at best hoped for at times such as these. However, the budget deficit planned for this year is not too different from the preceding one. This time around, the budget deficit of RM16 billion stands at 4.9 per cent of GNP (gross national income) which is considered relatively high, if international macroeconomic benchmarking is anything to go by. A saving grace is that the deficit this time is slightly smaller than RM18 billion in 2000 or 5.9 per cent of GNP. Besides, there is a surplus of RM8.9 billion over operating expenditure, although this is too small to finance the planned net development expenditure of RM25 billion.

The budget deficit, to be sure, is not unmanageable. It can be financed quite easily. For one thing, there is still a lot of excess of liquidity in the system despite increased private sector demand for bank loans. The Government should be able to borrow domestically without any "crowding out" effect. For another, Malaysia's credit rating has improved so much that it will not be difficult for the country to raise external loans. It cannot, however, be denied that all these can pose a problem in the future in terms of repayments with interest.

Budget deficits will definitely add to public debt which now stands at RM120.7 billion or 40.3 per cent of GNP. The new budget will add another RM16 billion. It is noteworthy that the bulk of the public debt is financed locally, with external borrowing accounting for only 14.8 per cent of the total. In the final analysis, however, debts are debts regardless of whether they are external or domestic. Like all debts, deficits imply trading off the future for the present.

The budget deficit will, no doubt, stimulate the economy and lock-in the recovery that is currently underway, although it is unlikely to ensure 7 per cent GDP (gross domestic product) growth in 2001 as targeted. The latter would depend critically on external factors, especially export demand for electronic goods. The budget is bent on boosting growth to make up for the slack any slowdown in the US economy or the electronics sector would bring about this year. It would probably take a much bigger deficit for the economy to grow at 7.0 per cent. It is not impertinent to question if high growth now is really in the medium and long term interest of the nation.

It may appear that economic growth has reverted fully to pre-crisis level. One must not, however, lose sight of the fact that the current high growth rate is partly, if not largely, due to the low base in the aftermath of the crisis. As the low-base effect wears out, further growth may well be relatively moderate. An important lesson learned from the crisis, in fact, is that runaway growth is extremely dangerous. Hence the importance of reining in the GDP growth.

All signs suggest that the budget's reading of last year's growth (7.5 per cent) was an underestimate. The economy grew at 10.3 per cent in the first half of last year, and to secure 7.5 per cent growth for the whole year, the economy had to grow only at 4.7 per cent in the second half. It appears that that growth in the second half was in the region of 6.5 per cent, which suggests that growth for 2000 could exceed 8.0 per cent. Growth this year will be more subdued. MIER's forecast of 6.3 per cent growth for this year falls short of the budget target of 7.0 per cent. Growth may well turn out to be even slower. MIER's forecast was based on the assumption that the slowdown in the US economy will not cause the US growth rate to sink below 3.0 per cent this year. This assumption now appears to be overly optimistic. Under such circumstances a growth rate of 5-6 per cent for Malaysia in 2001 would be quite creditable.

There are many positive things that one can say about Budget 2001. It is a caring budget by any measure. It has something to offer to almost everyone. It addresses a wide spectrum of issues ranging from the environment to the handicapped, including social policy, information technology and knowledge-economy. It offers a variety of titbits and attempts to please many. The corporate sector, however, was displeased, if the stock market response was any indicator. In fairness, one must point out that the nation cannot afford tax cuts at the present juncture. Any tax cut would have meant an even larger budget deficit to cope with.

In terms of overall strategy, however, there is disappointingly no major shift. It is essentially more of the same, in the sense that the budget continues to rely on fiscal stimulus and export expansion for economic growth, a strategy which Japan has been adopting for a decade without much success. Curiously, current account surpluses in the balance of payments (BOP) and budget deficits are common to both Malaysia and Japan. Interestingly, in the United States, it is exactly the opposite, with BOP deficit and budget surplus, similar to that of Malaysia in the pre-crisis years, which experience has shown to be just as untenable. All this serves to show how dangerous external and internal imbalances can be, if they persist.

A slower pace of growth at times such as these would make a much better sense than a faster pace induced by fiscal stimulus. It would be imprudent to rely on budget deficits to boost growth. It is for this reason that one may prefer slower growth with a smaller deficit to faster growth with a bigger deficit. For, clearly, budget deficits will weigh heavily on posterity.

Government revenue would have fallen short of the target in 2000, had it not been for the high prices of petroleum. With a somewhat sedated economy this year, the chances are that the deficit may even exceed the target. It does seem that Malaysia has to wrestle with budget deficits for some time before it can balance the books. Care must, however, be taken to ensure that budget deficits diminish over time, even if it means slower GDP growth.