Making the Stimulus Package Work

by

Azmi Setapa

As a small open economy, Malaysia requires a good economic policy to cushion the impact arising from uncertainty in the international market. Since our economic growth is heavily dependent on export receipts, we wish to see a stable global economic and political environment to expedite our recovery process. However, the international economic and political scene has been very volatile since the financial crisis of 1997. This debacle continues to cause a lot of difficulties as it limits the choices available to domestic policy makers and thus puts additional pressure on them.

Even after the economic crisis, there was the September 11 disaster, followed by the war in Iraq. Even as the whole world was breathing a sigh of relief over the short duration and relatively small impact of the war on Iraq on the world economy, then came along the SARS disease which has badly affected, among others, the tourism and manufacturing industry. This highly infectious epidemic has not only had a negative impact on tourism and related industries, but also been disrupting other economic activities through its effect on the mobility of people across borders.

It is against this backdrop that the government has announced yet another fiscal stimulus package to further strengthen the domestic economy, and to enhance our resilience amid gloomy world economic prospects.

It is hoped that the stimulus package of RM7.3 billion with an array of 90 measures would be able to further stimulate domestic economic activities, reduce the effect of declining receipts from international trade,and enable the country to achieve its target of around 4.5 per cent GDP growth for 2003.

Although the domestic as well as global economic environment for the past 7 years has been cloudy and has disrupted the government's good fiscal standing, the present domestic liquidity position is still adequate for the government to finance the package using domestic sources. This strong liquidity and credible performance of the banking sector is ascribed to the successful recapitalisation and merger exercise carried out by the government after the financial crisis. For instance, a year after the merger and consolidation exercise in 2000, the Risk-Weighted Capital Ratio (RWCR) of all banking institutions has risen, with the commercial banks and finance companies registering higher RWCR of 12.8 and 12.1 per cent, respectively, indicating improved asset quality in the banking industry. Indeed, Malaysia's banking sector has performed reasonably well and has managed to avoid severe deterioration of efficiency and steep escalation in the cost of operation.

It is important for the government to finance the package using government revenue and to avoid large debt, particularly foreign debt. Although our national debt to GDP ratio is still below 50 per cent, and thus still manageable, it should not be allowed to increase any further as over-borrowing will derail the government"s objective to achieve a balanced budget by 2005. At the same time, the government has also to examine ways of broadening its tax base and raising more revenue.

One of traditional issues related to the budget is the speed of implementation. It is a well-known fact that many ministries and agencies fail to spend large sums of monies allocated to them. Despite serious attention given to stemming this problem, it continues to exist and represents a major stumbling block for the budget to achieve the set target. In addition, various development projects, either through tenders or direct negotiation, become stuck at various levels for reasons such as waiting for the mid-term review of the economy. The problem associated with the implementation process should be resolved quickly if we want to see the effect of this stimulus package filter down before the end of the year. Otherwise the effect will only be felt next year and it will be too late to make a difference.

One marked difference from previous other stimulus packages is that, this time around, a special emphasis is laid on small and medium scale enterprises (SMEs). In addition to the RM1 billion allocation under the fund for food, another RM1 billion allocation has been made to SMEs. More importantly, the government has made it clear that it will look into the problems which have normally caused these funds to be under-utilised. However, to ensure efficient disbursement and to avoid any misuse of funds, the government has to maintain certain standards and procedures.

The onus to make this effort work cannot be put solely on the government. Just as important as the government’s positive attitude and its willingness to improve the framework of the fund delivery system, is the willingness of the SMEs themselves to make necessary adjustments to update their system and records, in order to keep pace with latest developments so as to remain competitive.

While welcoming government efforts in introducing various funds for SMEs, it is important also to point out that the ultimate solution to the financial problem faced by SMEs is to improve their access to banking facilities. Our financial sector, particularly after the merger exercise, is very well equipped with various financial instruments which could be utilised by SMEs. To improve the access to these facilities, banks should have more aggressive marketing strategies. Highly professional bankers are not those who are risk averse, but those who have the market knowledge, possess excellent communication skills and are brave and aggressive in exploring business opportunities—in other words, willing to take up and manage business risks in order to maximise profit. Apparently, the local financial sector seems to be highly risk averse. Understandably, the preference is to finance government projects and many are not willing to evaluate private projects professionally and manage the risks involved, even though that risk may well be very small. This, if left unchecked, is not only bad for the SMEs, but also for the development of the financial sector itself.

In line with the government intention to raise domestic consumption, a half-month bonus for public servants and a reduction in the monthly contribution to the Employment Provident fund (EPF) have been introduced. This action of putting money into customer's pockets would be very effective in stimulating weak domestic demand arising from sluggish export earnings. It is anticipated that not much of this extra income will go into savings since the rate of return on savings is low. Malaysians are likely to spend their extra income given that the general price levels in the country is still fairly low. This is, of course, in line with the government's objective.

It is also worth noting that putting money into peoples' pockets is only suitable for an economy with low inflation and high productivity. Too much money disbursed could lead to large rise in nominal income, which would push up nominal demand, causing the economy to overheat. However, for the purposes of the stimulus package where the volume of money involved is very small and coupled with the present low level of inflation, it is just right to stimulate the economy. Since this money will cause nominal income to rise, it would be wise if government ministries and agencies could formulate a plan of action, to increase productivity so as to neutralise the rise in nominal income.

The package has also announced a 50 basis-point reduction in interest rates. This reduction would reduce the present level of base lending rate (BLR) of commercial bank from 6.42 to 6.0 per cent. The BLR of finance companies, meanwhile, would decline from 7.46 to 6.94 per cent. Theoretically, this reduction is not quite suitable as it would slow down the inflow of foreign capital into Malaysia. The reduction on the rate of return on savings would be soon followed by the rate of return on other types of investment including the rate of return in Kuala Lumpur Stock Exchange (KLSE).

However, the government has valid reasons to defend the interest rate policy. The purpose of this policy is to stimulate domestic consumption and economic activities and not to attract foreign capital. Furthermore, the present behaviour of capital in international market is not influenced much by traditional factors such as interest rates. For instance, low interest rates in China of 5.4 per cent and 3.0 per cent for lending and saving rates respectively, have not thwarted the inflow of USD42.6 billion of net direct investment in 2002, thanks presumably to the low labour costs and large domestic market. Similarly is the case of Hong Kong where interest rates are also very low at around 5 per cent (BLR). On the other hand, Indonesia has not been very successful in attracting foreign capital lately, despite the very high interest rate of around 20 per cent for BLR in 2002.

Therefore, to improve the environment for FDI, the government has to focus on improving the physical as well as technological infrastructure, as well as the standard of ICT and the efficiency of financial system and the judiciary.

In addition, reforming and strengthening corporate governance and transparency is a very important determinant for the inflow of FDI. In the post-crisis scenario, Malaysia has been giving serious thought to matters of transparency and corporate governance. The government, through Bank Negara Malaysia and the Securities Commission, is working hard to improve the level of transparency and corporate governance of businesses to be on par with the world standards. This policy has been implemented together with mergers and corporate restructuring in an integrated manner.

Given the vast experience gained from managing the budget during the economic crisis, this package, which has been drafted based on a careful evaluation of the 2003 budget, should have a positive impact on the economy. It has paved the way for the policy makers in formulating a sound budget for 2004.

The writer is a Senior Research Fellow with the Malaysian Institute of Economic Research (MIER).