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Economic Stimulus Package: How Effective Are They??

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Abstract

Keynesian Theory emphasizes on Government spending to revive a stagnant or decelerating economy. This fiscal policy was practised by many countries negatively impacted by economic downturns. This move , though , has a certain degree of limitations, as the Government need to realize longer term solutions are need for its budget deficits, if any. Nonetheless, such measures are proven, time and again to be effective in revive the stagnating economy. This paper is thus to examine, from the Malaysian context, the success or otherwise, of such strategy with analysis using trends and descriptive readings from statistical data from BNM and IMF.

JEL classifications: G01 ; E12 ; O 23

Keywords: stimulus ; global credit crisis; effectiveness; growth

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1.0 OVERVIEW

I believe by now, most of us are aware, the global credit crunch is full blown with severe impact to the world economies and The United States, the largest economy, already confirmed to be in recession. Other countries in such predicament are UK, Italy, Germany, & Ireland. Closer to home, we have Singapore, Hong Kong, Japan and New Zealand suffering the same fate.

This paper is not to deal with the reasons or causes as to why the Financial Crisis happen, but rather the strategies that the Government has put into place to minimise the effects of the global slowdown of the country's main trading partners. Malaysia's trade with the top 10 nations constitute about 70.7% of the country's exports. The 10 countries are : US, Japan, China, Singapore, Thailand, Korea, Germany, Taiwan, Hong Kong and Indonesia.

Therefore, to counter the negative effects of the slowdown, and maintain economic growth , it is pertinent that Malaysia proceeds swiftly with the various strategic measures. As with normal cycle, the impact will be felt after a time lag of 3 to 6 months i.e. as Malaysia enters 1st Qtr 2009.. As it is, the country is ranked top 20 in terms of its exports, and our export figures are rapidly decelerating.

BNM's figures for Sept'08 and Oct '08 show the following :-

	Sept'08	**Oct'08**
Exports	RM62.3 billion	RM54.8 billion
Imports	RM47.5 billion	RM43.8 billion

Exports registered a double digit decline of 12% m-to-m. However, imports recorded a smaller decline of 1%, indicating a cautious business approach. At this stage, data of Nov'08 is yet to be released , and one can only make a guess at the performance. The pattern is unlikely to be very far off.

Economic stimulus packages are fiscal tools used to create and speed up economic activities in a slowdown due to the onslaught of severe macro-economic events, mostly external. In this paper, I shall deal with the outcomes of such economic stimulus packages implemented in the Malaysian context. The findings are based on IMF and Bank Negara Malaysia's statistics . I shall look at

(1) 1997/1998 - Asian Currency Crisis

(2) 2001/2002 - US Recession

These 2 crisis periods were chosen as they were within a 10/11 year time frame. In 1998, Malaysia's GDP figures were in negative territory whilst in Yr 2001, it only registered GDP growth of 0.5% compared to an average of 7% to 8% in the preceding years prior to 1998.

The scope of coverage will thus be an analysis of the above 2 periods of economic upheavals and the fiscal stimulus measures implemented. After outlining brief details of the stimulus packages, I shall examine the data of subsequent years to ascertain their effectiveness.

Of course, we also had recession in 1985/1986. However, I shall exclude these as they were way too long and circumstances were different then. Having said that, I also wish to state that economic conditions especially macro-economic forces of 1997/1998 and today's are very much different. Besides, with today's rapid globalization, the operating environment is more complex and sophisticated. We have many new financial products termed derivatives which is marketed all over the world.

2.0 PAST STIMULUS PACKAGES :

I shall now outline the stimulus packages implemented during the 2 periods of economic downturns.

2.1 Years 1997/1998

To restore economic growth, in the fiscal stimulus, an allocation of RM7 billion was injected into development expenditure. The funds were distributed as follows:-

RM350 million	-	Agriculture
RM200 million	-	Housing
RM1.5 billion	-	Infrastructure & public amenities
RM1.0 billion	-	Education
RM 200 million	-	Industrial Development
RM200 million	-	Rural Development
RM300 million	-	Health
RM300 million	-	Poverty eradication
RM650 million	-	Cyberview
RM2.2 billion	-	Dana Pengurusan Harta

Year 1998 witnessed Malaysia did the unorthodox method of pegging the RM against the USD at RM3-80.Initially this move was widely criticized, but subsequently, economists felt that this was indeed the right medicine. Of course we shall not debate on this policy as it is not within the ambit of this paper.

2.2 Year 2001

Initial fiscal stimulus of RM3 billion in March with another RM4.3 billion (in Sept) were announced for new projects :-

RM2 billion	-	200 single session schools under Phase II

RM0.9 billion - 193 community colleges in all Parliamentary constituencies, with 11 to be immediate

RM1.6 billion - 4 Universities located in Melaka, Negeri Sembilan, Perlis and Pahang

RM1.5 billion - 6,600 housing units for Malaysian Armed Forces in Kuala Lumpur

RM0.6 billion - Oil palm replanting subsidies & special assistance to rubber plantation smallholders

A host of other measures were also implemented. One of the key strategy was to drive domestic demand to counter the slowdown. Other measures to promote greater consumption, financing of SMEs and services sector, include various funding schemes, & reduction of employee's EPF contributions.

3.0 STATISTICS

3.1 GDP ; INTERNATIONAL RESERVES ; FDI FROM 1996 TO 2007

Year	GDP (%)	International Reserves (RM billion)	Retained Imports (Months)	Net FDI	
				RM (billion)	(Percentage of GDP)
1996	10.0	70.0	4.4	14.4	6.6 (Av)
1997	7.3	59.0	3.4	19.2	6.6 (Av)
1998	(7.4)	99.4	5.7	10.6	4
1999	6.1	117.2	5.9	13.4	4.9 (Av)
2000	8.9	113.5	4.5	14.7	4.9 (Av)
2001	0.5	117.2	5.2	2.1	1.0

2002	5.4	131.4	5.3	12.2	3.6
2003	5.8	170.5	7.8	9.4	2.5
2004	6.8	253.5	8.6	17.9	5.9
2005	5.3	266.3	6.7	15.6	3.3
2006	5.8	290.4	8.2	25.9	4.9
2007	6.4	335.7	9.6	29.1	4.6

1) Source : IMF , 2) GDP in brackets denotes negative , 3) Av = Average

3.1.1 Analysis

i) 1998 & 2001 were difficult years. It was observed that there exists a relationship between GDP growth and net FDI flows. 1998 was the year Malaysia imposed capital controls and pegging the RM to the USD. This withheld repatriation of portfolio investments as certain conditions were to be fulfilled by investors. Thus, as a result of foreign investor sentiment and unhappiness of such capital controls, net FDI registered a decline to RM10.6 billion (1998) compared to RM19.2 billion in 1997.

ii) The fiscal packages implemented were successful in stimulating the lethargic economy into "action", with GDP registering a small growth of 0.5%. GDP expanded further by 4.1% in Year 2002.

iii) Of course in 1997/1998 , there were other measures implemented :-

(a) Banking recapitalization - Danamodal

(b) Divestment of NPLs - Danaharta

(c) Lending - Dedicated Funding for SMEs

(d) Interest Rates - borrowing rates were eased

iv) Arising from the above, GDP for 1999 recorded a positive growth of 6.1% compared to negative 7.4% in previous year. This is commendable by any standards.

3.2 GROWTH (%) IN KEY SECTORS FROM 1995 TO 2001

ITEM	1995	1996	1997	1998	1999	2000	2001	2002
Manufacturing	14.5%	12.2%	10.4%	(13.7%)	13.5%	19.1%	(5.8%)	4.0%
Agriculture	1.1%	2.2%	0.4%	(4.5%)	3.9%	2.0%	(0.9%)	3.0%
Construction	17.3%	14.2%	10.6%	(23.0%)	(5.6%)	2.1%	2.3%	1.9%
Services	9.4%	9.7%	9.9%	0.8%	2.9%	5.7%	5.8%	4.1%
Consumption:	8.9%	4.9%	4.9%	(10.3%)	6.1%	-	-	-
Private	-	-	-	-	-	12.5%	2.8%	4.4%
Public	-	-	-	-	-	3.0%	17.6%	10.8%

1) Source : BNM ; 2) Brackets denote negative

3.2.1 Analysis

i) Due to the time lag , the full impact of the 1997 downturn manifested only in 1998. With the exception of Services, all other economic activities showed declines. Construction registered a drop of 23.0 %. This sector would see recovery only in Year 2000, with growth of 2.1%.

ii) Being a export oriented economy particularly in Electrical & electronics products, the manufacturing sector rebounded a massive 19.1% growth in 2000. As expected, the electronics industry is extremely cyclical and repercussions of slowdown will very quickly impact this sector.

iii) Growth trends for construction activities reveal a time lag for expansionary stimulus activities to take effect. This is probably due to levels of bureaucratic approvals required in order to start certain projects. Nonetheless, it is normal that construction needs a longer gestation period to see results where the benefits are really long term.

iv) Of importance is the services sector which was growing at a slower rate. The Government is targeting this Sector for growth to prevent the economy from contracting further.

4.0 YEAR 2008

We shall look at data for the last 3 Quarters and compare the trends :

Key Economic **Indicators** :

Item	**1st Qtr 2008**	**2nd Qtr 2008**	**3rd Qtr 2008**
GDP (Growth %)	7.1%	6.7%	4.7%
International Reserves	RM384.7 billion	RM410.9 billion	RM379.3 billion
FDI (Net)	RM1.4 billion	RM8.6 billion	RM2.7 billion

Source : BNM

Key Economic **Activity** :
(Growth %)

Item	**1st Qtr 2008**	**2nd Qtr 2008**	**3rd Qtr 2008**
Domestic Demand	10.1 %	8.3%	6.5%
Manufacturing	6.9%	5.6%	1.8%
Construction	5.3%	3.9%	1.2%
Agriculture	6.3%	6%	3%

Source : BNM

Analysis : Trends indicate the various sectors are on rapid contraction especially in the 3rd Qtr .The 3 economic sectors of Manufacturing, Construction and Agriculture are core areas with multiplier effects. As such it is appropriate that the Government focus on these areas.

5.0 RM7 BILLION STIMULUS PACKAGE

Briefly, the money is targeted to be spent as follows:-

RM (billion)	Objective /Economic Activity
1.8	Improvement including construction, maintenance and upgrading of social infrastructure & public amenities such as – schools; hospitals and roads especially in rural areas.
1.5	An Investment Fund to boost private sector investments with priority to high value added strategic sectors and high impact projects
1.2	Construction of low cost housing
0.5	Upgrade, repair and maintenance of police, armed forces stations, camps and living quarters
0.5	Improvement and maintenance of public transportation sector e.g. train services (LRT ; KTM Komuter and bus services)
0.4	Speed up high speed broad band project
0.3	Skills training programs for tourism, health, construction and business process outsourcing
0.3	Social programs (early education 1-6 yrs old) eg. Rakan Muda
0.2	Development of human capital via allocations for youth training by private training institutions
0.2	Rejuvenate viable abandoned housing schemes
0.1	Small & Medium Scale Enterprises.

Total : RM7 billion

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6.0 MEASUREMENTS

Let us look at results of those past fiscal stimulus measures :

<u>Year 1997/1998</u> :

- Pegging of the Ringgit :
  - effectively carried out .
  - control currency outflow
  - stabilize foreign exchange
  - strengthen the Ringgit

- Reduction of SRR:
  - increase availability of credit at reasonable cost to business community
  - enhance economic production
  - C/A balance in surplus

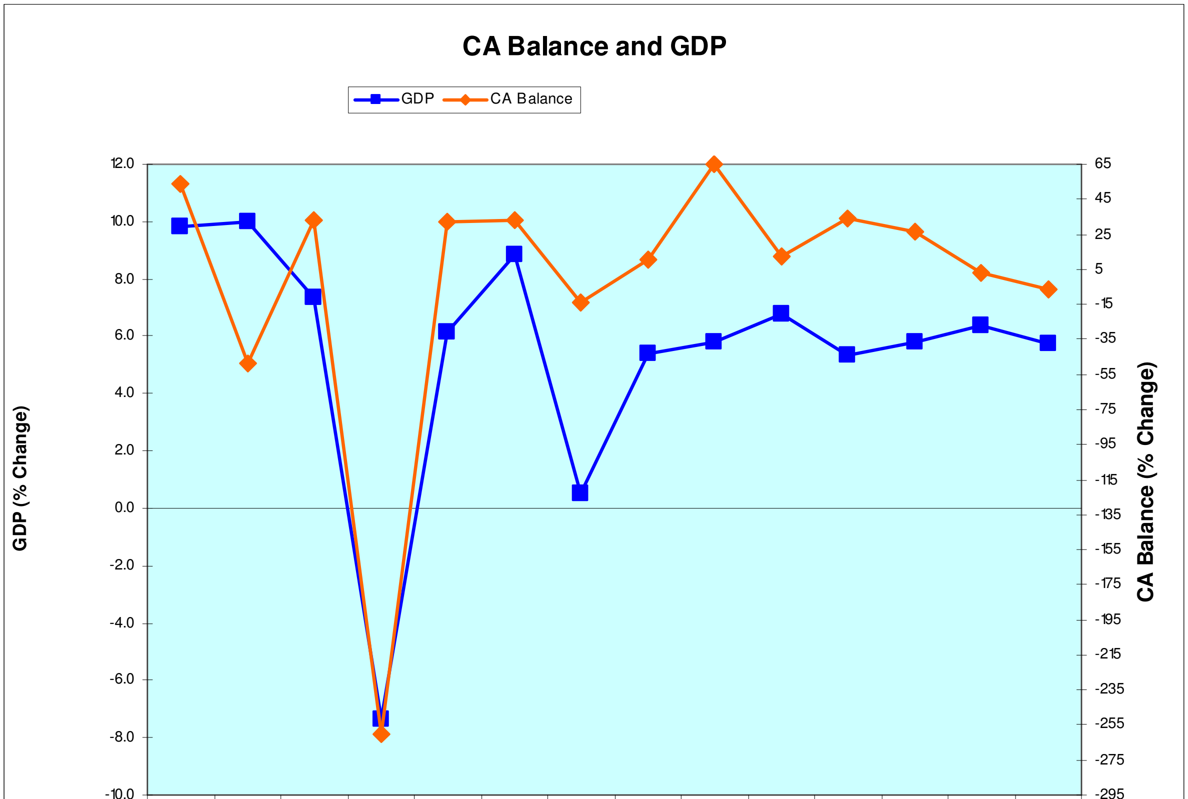
- Net international Res:
  - increased to RM117.2 billion (1999)
  - compared to RM99 billion (1998)

- Stimulus package:
  - massive government spending in key economic sectors

<u>Year 2001</u> :

- External Debt dropped to 55.4% of GDP against 64% at the peak of the Asian crisis.
- Current Account surplus of 8% of GDP
- Increased expenditure in Human Resource Development, education, training and skills development; resulting in continued growth momentum at 5.8% for Services.
- Consumption registered more than 10% growth as a result of tax incentives, rebates, reductions in EPF and personal tax.

Below is the Table depicting the relationship of GDP growth against Current Account Balance from 1995 till 2008 : -



	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008 (Oct)
GDP	9.8	10.0	7.3	-7.4	6.1	8.9	0.5	5.4	5.8	6.8	5.3	5.8	6.4	5.8
CA Balance	53.6	-48.4	33.0	-260.6	32.3	32.7	-14.2	10.1	64.6	12.6	34.4	26.2	2.9	-6.8

Year

Source : IMF

As you can see, the basic ingredient for revival of the economy is to encourage and more importantly ensure spending is continued . The “multiplier “ effect is enormous provided strategies were effectively implemented. However, in such times, instead of spending further, prudent minded Asians, especially in business as well as common folks like you and me, will have a stronger tendency to save (for a rainy day!). Thus, the Government also needs to enhance the **social safety net** to minimize such **precautionary savings**.

This is where **KEYNESIAN** theory economics come in. **JOHN MAYNARD KEYNES** , the UK economist, believes that in a slow & stagnating economy, the State has to directly stimulate demand by spending ! The state will need to inject money (by borrowing, if necessary) into public work projects. e.g. build roads, bridges, schools, hospitals, and other infrastructure.

Economic sectors targeted are similar over the years. These are big ticket items and has maximum cascading effects to the economy. For the record, CHINA's USD 582 billion stimulus package is also targeting at the same sectors. Similarly, other countries are also engaged in these areas as well.

Recently, we hear of "**intangible** " infrastructure which was highlighted by the incoming US President elect BARACK OBAMA. This so called intangible infrastructure is education and healthcare in which human capital comes into play.

You & I are part of this intangible infrastructure. With your skills and knowledge all of you will be the new human resource that the country will need in future. Human resource is an important component which cannot be left behind. It is important that training must be continuously held as it really takes time to see results.

7.0 CONCLUSION

Both SRR and OPR were reduced in Year 2008. The RM7 billion stimulus package was already announced; and the Government has indicated it would ensure swift implementation. However, time is not on our side. Net FDIs had reduced to RM2.7 billion compared to RM8.6 billion in the 2nd Qtr.

The Government indicated it will prepare for the worst & would unleash another economic package in February 2009 if circumstances warrant. It is understood, authorities are closely monitoring global events.

Realistic acceptance of the current global scenario is vital to address the attendant problems. The government has recognize this and cut GDP growth for Year 2009 to 3.5% instead of 5.4% forecasted. Thus, the rationale for the measures announced to keep the economy ticking.

Though its fundamentals remain strong, the country will still be impacted by the global downturn. It has no choice but to ensure continued economic growth via expansionary fiscal policy with stimulus packages. Fiscal stimulus is a “sister” strategy to monetary policy. Government spending policies influence broad macro-economic conditions. Notwithstanding these measures, the deficit will creep up to 4.8% of GDP.

Recognising the strategy of export-led recovery used in 1997/1998 cannot be applied for today’s financial meltdown, because the country’s trading partners are in recession, the government has rightly focus on domestic demand and related economic activities. Herein is also the reason, why the country should not even consider to revert to a low RM/USD regime to export our way out of this global downturn. The government has done correctly so far.

The actions and strategies were set at the “right areas”. However, one concern is “leakages”. These can be in the form of further savings, and siphoning of funds (via “underground “ banking avenues) outside the country as happened during the previous downturns.

In the management of this complex global financial tsunami, and to realize the objectives in the shortest possible manner, the implementation of the stimulus package demands **EFFICIENCY to achieve EFFECTIVENESS** .

As the saying goes : **IT IS THE END RESULT THAT COUNTS.**

Thank you for your attention.

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