Could Malaysia end up bankrupt in 2019?[1]

by Quah Boon Huat

In a recent speech, Datuk Seri Idris Jala warned that Malaysia could in 2019 end up bankrupt like Greece if the RM74 billion annual subsidies are not slashed. That speech attracted a lot of flak, and has been dismissed as more of a “scare tactic” to jolt “us to not live beyond our means”. More of that later.

What are the causes of national bankruptcy? A country can go bankrupt if, as a result of war or blatant mismanagement, it has gambled away all trust, can no longer service its debt or convince anyone to lend it any money, no matter how high an interest rate it promises to pay.

Greece has been in the spotlight with its debt problems. Though it didn’t actually default on its public debt, it is as good as bankrupt, as far as a lot of people are concerned. The European Union and the IMF kept the embattled Greek economy afloat by agreeing to a US$1 trillion loan package.

The crisis began when investors started getting nervous about Greece’s ability to refinance almost €17 billion of bonds (about US$23 billion) maturing in April and May this year. Greece certainly did not endear itself to investors when it was revealed in early 2010 that since 2001, it had help from Wall Street firms to quietly borrow so that it could continue to spend beyond its means while meeting the Euro-zone’s deficit rules.

The Greek government hasn’t balanced a budget in nearly 40 years. Its profligate and irresponsible spending had resulted in its public debt ballooning to a forecasted 125 percent of GDP in 2010. Measures to tackle its public finances problems are expected to cut its 2010 deficit to 9.3% of GDP, an improvement from 2009’s 12.7%.

Years of socialism have also resulted in an oversized government that has systematically crowded out the private sector and driven them underground. In fact, one third of Greeks work for the government where their jobs are guaranteed for life.

But the key cause of Greece’s debt crisis is corruption and impunity, which the Greek Prime Minister himself readily admits. Tax evasion, a way of life in Greece, could be costing the Greek government as much as US$30 billion a year. According to Transparency International’s Corruption Perceptions Index 2009, which measures the perceived levels of public sector corruption in 180 countries and territories, Greece scored 3.8 points out of a possible 10 (with 10 being perceived as having low levels of corruption) and was ranked number 71.

While Japan hasn’t yet run into the kind of solvency problems faced by Greece, some

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commentators have already started predicting that it could end up being the world's largest national bankruptcy. That's because Japan's public debt mountain is bigger than that of any other industrialized nation.

Japan's public debt is a legacy of massive half-baked economic stimulus packages during the "lost decade" of the 1990s, as well as during the recession that began in 2008. It is expected to hit 200% of GDP within 2010 as the government tries to spend its way out of the economic doldrums against a backdrop of plummeting tax revenues and soaring welfare costs.

The Japanese government expects its fiscal deficit in 2010 to hit 9.3% of GDP, and public debt to rise to 17 times its annual tax revenues by the end of the year. Japan's public debt situation seems irrecoverable, and its newly installed Prime Minister has warned that Japan could face a financial crisis of Greek proportions if it does not tackle its colossal debt.

Despite all that, Japan isn't in the kind of pickle Greece is in right now. In fact, credit rating agency Standard & Poor's rating on Japan's sovereign debt remains at AA, one step below its best possible rating, though it did in January raise the prospect of a downgrade on concerns about large fiscal deficits and a sluggish growth outlook.

Why isn't Japan in the same kind of mess as Greece? And why hasn't its sovereign credit rating been downgraded to junk status, like that of Greece's?

It is possible that Japan is perceived as being too big to fail. Japan is the world's second largest economy after the US, and even though it may have lost some of its shine, it remains a technological powerhouse with a diligent and highly trained workforce. Its default risk is low, as it has a huge current account surplus as well as the backing of massive domestic private sector savings to continue investing in government bonds.

And unlike Greece, Japan's credibility remains good, there being no fiddling with statistics to make Japan's public finances look good. Its institutions are strong, and there is no crowding out of the private sector by the public sector. And corruption is hardly an issue in Japan; according to TI's Corruption Perceptions Index 2009, Japan scored 7.7 points and was ranked number 17.

Malaysia's public finances are clearly better off than either Japan's or Greece's, and its current debt-to-GDP ratio is nowhere near that of either's. The CIA's list (The World Factbook) ranking countries based on public debt as a percentage of GDP (2009 estimates) puts Malaysia at number 50 (at 47.8%); that's far behind Japan at number 2 (192.1%), Singapore at number 6 (117.6%), and Greece at number 8 (113.4%).

However, according to Datuk Seri Idris Jala, Malaysia could in 2019 end up bankrupt like Greece if it does not cut its subsidies because its debt-to-GDP ratio would by then soar to 100% from the current 54%. Could Malaysia actually end up bankrupt like Greece?

As can be seen from the Greek and Japanese examples, the million-dollar question is actually not whether Malaysia could in 2019 end up bankrupt if its debt-to-GDP ratio soars to 100% but whether investors still find Malaysian government bonds attractive.

But this is an impossible question to answer because besides debt-to-GDP ratio, many other factors like economic strategies and policies, transparency and quality of governance, government efficiency, strength of institutions, etc. also figure significantly in investing decisions.

According to the National Economic Advisory Council's NEM (Part 1) Report, aggregate investment levels (in products and services) as percent of GDP have been declining ever since the Asian Financial Crisis of 1997-1998. The same report also mentioned that the contraction was driven mostly by a decline in private investment.

Is this an indication that investor interest in Malaysian government bonds could likely go the same way south as investor interest in the real sector in Malaysia?

Suffice to say that if Malaysia has more of the strengths of Japan and less of the weaknesses of Greece, we'll have fewer worries.

The author is a research fellow at the Malaysian Institute of Economic Research (MIER). The views expressed in this article are the author's and should not be reported as representing those of MIER.