THE MALAYSIAN BALANCE OF PAYMENTS: KEYNESIAN APPROACH VERSUS MONETARY APPROACH

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ABSTRACT

There are two competing theories of balance of payments: the Keynesian and the monetary theories. Each of the two approaches provides distinct explanations on how the determinants of the balance of payments could lead to equilibrium and disequilibrium of the balance of payments account and both theories also rank differently the importance of real/merchandise account and monetary/official reserve transactions balance account of the balance of payments. The paper aims to examine the two theories on Malaysian balance of payments based on two tests: test of correctness of signs of regressors and test of speed adjustment. The results show that signs of regressors of the Trade Balance (TB) equation support the Keynesian view while signs of regressors of the Official Reserve Transactions Balance (ORTB) equation support both Keynesian and Monetary views. It is also found that the ORTB dominates the TB in terms of quickness of adjustment, so the ORTB is an autonomous account and the TB is an accommodating account.

Keywords: Keynesian theory; Monetary theory; Trade Balance; Official Reserves Transaction Balance.
JEL Classification: C2; E0; E6

1. Introduction

The Malaysian economy has gone through rapid structural changes since its independence in 1957. Despite its rapid economic growth particularly between 1970 and 1990, with an average of 6.7 per cent per annum, the current account of the balance of payments has been in deficit since 1989. Over the Sixth Malaysian Plan period (1991-1995), the current account remained in deficit at about 0.8% of GNP.

Most studies on the balance of payments of Malaysia are highly descriptive and limited. Chew(1975), for example, in his book entitled 'Malaysian Balance of Paymenys:1960-1970' only concentrated on the development of Malaysian balance of payments up tp 1970. Meanwhile, studies by Boadway and Flatters(1991) and Ariff and Semudram(1987) interestingly attempt to discuss the problems and policies of balance of payments of Malaysia and how to deal with them, but no attempt was made to develop any econometric model for it. A study by Salleh(1991) is one attempt made to construct an econometric model for balance of payments of Malaysia according to the nature of its economy using time-series data. The model based on three multiple regression estimation techniques, namely Ordinary Least-Squares, Two-Stage Least Squares and Three-Stage Least Squares. The study also derives some suggestion for the balance of payments policy. Most literatures on modeling balance of payments account are widely found in studies of other countries such as Sri Lanka (Wijesinghe, 1986), Switzerland (Rich,

1990), Japan and European countries (Bhar and Malliaris, 1998) and the Federal Republic of Germany (Malindretos, 1991).

Thus, this paper attempts to analyze the Malaysian balance of payments not only by examining different theories might applied to the accounts of the balance of payments but also by investigating which account, real or monetary account, has faster influence on the overall balance of payments account. The conclusion of the paper will be useful in policies designed by the government to influence international financial and trade movements. The outline of the paper is as follows. Section 2 explains the theoretical framework. This is followed by Section 3, which explains the data and methods used to construct the models. Section 4 interprets the results of the tests and Section 5 concludes.

2. The Theoretical Framework

A nation's balance of payments is a system that accounts for flows of income, expenditures as well as the flow of financial assets. It consists of a number of different accounts, mainly three accounts: the *current account*, the *private capital account* and the *official settlements balance*. While current account covers income earning and spending in the course of the year with balance of trade as part of it, the capital account shows the movement of capital in and out of the country. It tabulates the flows of financial assets between domestic private residents and foreign private residents. The final account, the official settlements balance, measures the transaction of financial assets and deposits by official government agencies, which typically conducted by the central banks and finance ministries or treasuries of national governments. The overall balance of payments is the sum of credits and debits in these three accounts and the statistical discrepancy. The balance of payments is in equilibrium when the sum of the debits and credits in the current account and capital account equal to zero, so that the official settlements balance is zero. If the official settlements balance is positive or negative, the balance of payments is not in equilibrium or disequilibrium. A positive official settlements balance reflects a balance of payments deficit and a negative official settlements balance reflects a balance of payments surplus.

a. Keynesian Approach versus Monetary Approach

There are two competing theories of international finance (balance of payments): the Keynesian and Monetary theories of disequilibrium and adjustment. The Keynesian approach (KA) to balance of payments was developed basically based on the work of John M. Keynes in the twentieth century The most well known theories are 'elasticities theories' and 'absorption theories' of balance of trade and payments. The elasticities approach provides an analysis of how devaluations of exchange rate and price level will affect the balance of trade depending on the elasticities of supply and demand for foreign exchange and foreign goods. The theory of elasticities lead to what is called the "J-curve effect", which refers to the pattern of the balance of trade following a devaluation. The absorption approach to the balance of trade is a theory that emphasizes how domestic spending on domestic goods changes relative to domestic output. In other words, the balance of trade is viewed as the difference between what the economy produces and

what it takes for domestic use or absorbs (Melvin, 1992). However, these theories can only be viewed as theories of the balance of payments in a world without capital flows. The balance of trade (TB) regression function of KA could simply be written as

$$(X - M)_t = \beta_0 + \beta_1 Y_t + \beta_2 P_t + \beta_3 ER_t \qquad (1)$$

where Y is income level, P is price level, X is exports, M is imports, ER is exchange rate (the units of foreign currency given for domestic currency) and t is time period.

The Monetary approach (MA) to the balance of payments, which came to popularity in the 1970s, emphasizes the monetary aspects of the balance of payments. It looked beyond merchandise trade and incorporated the important role of financial assets (Melvin, 1992). Under this approach, money market disequilibrium is seen as a crucial factor provoking balance of payments disequilibrium. The stock imbalance between the demand for and supply of money causes external disequilibrium or balance of payments disequilibrium. If people demand more money than is being supplied by the central bank, then the excess demand for money would be satisfied by inflows of money from abroad. On the other hand, if the central bank is supplying more money than is demanded, the excess supply of money is eliminated by outflows of money to other countries. In this approach, balance of payments imbalances will restore equality between the demand for and supply of money in the absence of official intervention. In other words, external disequilibrium are transitory and will self-equilibriate in the long-run[1]. Since MA emphasizes on money demand and money supply as determinants of balance of payments, the TB regression function of MA could be written as:

$$(X - M)_t = \beta_0' + \beta_1' Y_t + \beta_2' P_t + \beta_3' Ms_t \qquad (2)$$

where Ms is money supply.

The Official Reserves Transaction Balance (ORTB) is another account of the balance of payments, which viewed differently by Monetarists and Keynesians. In this account, a stock of reserves made up of foreign currency assets are held primarily by a central bank to enable it to purchase its currency should it wish to prevent it from depreciating. Any total currency outflow has to be covered by the authorities by drawing on the reserves, or borrowing money from foreign central banks or the IMF (recorded as plus in the account). On the other hand, total currency inflow, that is surplus, can be covered by the government increasing official reserves or repaying debts to the IMF or other sources overseas (recorded as a minus since money leaves the country) (Pilbeam, 1992). This settlement concept of a surplus or deficit by using reserves is not as relevant to countries that have floating exchange rates as it is to those with fixed exchange rates. Under floating exchange rate regime, the balance for official financing will tend to be zero

[1] MA applies equally to fixed and floating exchange rates though the adjustment process for each system is different. A country that opts to fix its exchange rate will lose its monetary autonomy and a monetary expansion can lead to temporary balance of payments deficit. Whereas a country that allows its currency to float will have monetary autonomy but a monetary expansion then leads to a depreciation of its currency (Pilbeam, 1992).

because the central authorities do not buy or sell the home currency and there will be no changes in their reserves. Thus, the home currency is left to appreciate or depreciate. Under fixed exchange rate system, the settlement concept shows the amount of pressure on the authorities to devalue and revalue the currency. The regression equation of ORTB of KA could be written as (Malindretos, 1991):

$$IR_t = \beta_0 + \beta_1 Y_t + \beta_2 P_t + \beta_3 Ms_t + \beta_4 i_t + \beta_5 ER_t \qquad (3)$$

The MA of ORTB equation is:

$$IR_t = \beta_0^{'} + \beta_1^{'} Y_t + \beta_2^{'} P_t + \beta_3^{'} Ms_t + \beta_4^{'} i_t \qquad (4)$$

where *i* is the interest rate and *IR* is the international reserves.

The important point here is that both approaches to TB and ORTB accounts are different in terms of how independent variables affect the dependent variables. In other words, the signs of parameters of KA in equations of both accounts are, in most cases, different from the signs of the parameters of MA. The comparison of signs for each coefficient of independent variables in the accounts of TB and ORTB is displayed in Table 1.

Table 1: Signs of parameters on TB and ORTB equations for KA and MA

Trade Balance (TB)		
	Keynesian Approach	***Monetary Approach***
Independent variable	Dependent variable: $(X\text{-}M)_t$	
Y_t	-	+
P_t	-	+
Ms_t		-
ER_t	-	
Official Reserves Transaction Balance (ORTB)		
	Keynesian Approach	***Monetary Approach***
	Dependent variable: IR_t	
Y_t	-	+
P_t	-	+
Ms_t	-	-
i_t	+	-
ER_t	-	

Note: All variables, dependent and independent variables, are for home country (domestic variables)

In the TB equation, the KA outlines that a change in domestic income (Y) will relate in a negative way to a change in the TB because a rise in actual domestic income increases absorption and therefore increases imports (M) and worsens the TB. As far as price is concerned, the lower domestic price will increase demand for exports (X) and lower demand for imports, which will improve the TB. As for exchange rate, a devaluation

improves the TB, vice versa, given that the Marshall-Lerner condition is fulfilled, that is the demand elasticities of exports and imports are more than one or elastic.

According to MA, TB depends on the supply of and demand for money. If there is excess supply of money domestically (Ms), it will flow abroad in exchange for goods and services as well as for securities. This will worsen the TB and balance of payments. If there is excess demand for money (Md), the TB will improve and reserves will flow into the country in exchange of exported goods and securities. As applied, a rise in domestic real income increases the demand for money and therefore increases exports and improves TB. But a rise in foreign income will have the opposite effect on TB as there will be an outflow of money from home country due to high demand for money abroad. Similarly, increase price level domestically improves the TB as money demanded rises, but increase foreign price level implies an excess foreign demand for money which is satisfied by importing reserves and therefore worsen the TB.

In the ORTB equation, the KA signs of the coefficients for domestic and foreign incomes have the same signs as in the TB equation. The signs of the domestic and foreign prices coefficients are also similar to the TB equation. As domestic income or price increase for example, imports will increase and this reduces demand for domestic currency, which will lead to outflow of reserves (reduce IR). The domestic interest rate relates positively to the reserves variable. When it rises, it makes foreigners more willing to send capital at home and at the same time our residents less willing to send their money abroad. Both imply that the ORTB of home country improves as there is increasing demand for domestic currency and, therefore, inflow of reserves (increase IR). As for the exchange rate, depreciation will increase exports and demand for domestic currency, which leads to inflow of reserves and increases IR.

The MA of ORTB is somehow different. The relationship of the interest rate to international reserves is negative. An increase in the interest rate domestically causes demand for foreign exchange to fall (reduce IR) and a decrease in interest rate makes foreign exchange holdings rises (increase IR). The rest of the variables relate to the reserves of the nation in a manner similar to the way they relate to the TB. A rise in domestic income raises the demand for money, and in the absence of domestic money expansion, induces an inflow of reserves (increase IR). Foreign income, once it raises, foreign demand for money rises and foreigners import money (reduce IR domestically). When it falls, foreign demand falls and foreigners export money. The demand for money depends on the price level as well. A rise in domestic price level will increase the country's demand for money and therefore it has to import international reserves to satisfy the excess demand. But if foreign price rises, reserves will flow out and the ORTB will worsen.

b. The importance of TB and ORTB: KA vs. MA

The fundamental difference between the KA and the MA is that the later concentrates on the money account or ORTB. The KA claims that TB is the most important account of the balance of payments. The independent variables such as price, income level, interest

rate, exchange rate and money supply will affect the TB first and then influence the balance of payments. This implies that disequilibrium in the balance of payments occurs because of the disequilibrium of real forces (Wanniski, 1975). Thus, the Keynesian theory concentrates on the real account (TB) which is autonomous and the ORTB is therefore the accommodating account. On the other hand, the MA claims that disequilibrium occurs because the mentioned independent variables disequilibriate the money account (ORTB) and therefore believes that disequilibrium in the balance of payments happens due to disequilibrium in money forces. In other words, the money account (ORTB) is autonomous and the real account (TB) is accomodating account.

3. Data and Methodology

Since Malaysia is a small open economy where her balance of payments account is largely affected by external shocks from foreign countries, especially her trading partners, data on the *rest of the world* are collected together with Malaysian data for model development. In this study, the rest of the world is defined as three major trading partners of Malaysia, namely Singapore, Japan and the United States. The Malaysian data are mostly obtained from *Bank Negara Malaysia (BNM) Annual Reports* and the world data are obtained from variety of sources including the *International Financial Statistics Yearbook* and the *OECD Reports*. The period of study is from the first quarter of 1974 to the fourth quarter of 1995, in which the world monetary system evolved into a "managed float" regime after the collapse of the Bretton Woods system in 1971.

The first test of comparison between KA and MA is the ***test of signs of coefficients*** of the independent variables in the two international accounts: TB and ORTB. The regression equations adopted in this test are:

$$TB_t = \alpha_t + \sum_{k=0}^{n} b_k (Yd - Yf)_{t-k} + \sum_{k=0}^{n} c_k (id - if)_{t-k} + \sum_{k=0}^{n} d_k (Msd - Msf)_{t-k} + \sum_{k=0}^{n} e_k (P)_{t-k} + \sum_{k=0}^{n} f_k (ER)_{t-k} + gD_t + u_t \quad (5)$$

$$IR_t = \alpha_t' + \sum_{k=0}^{n} b_k' (Yd - Yf)_{t-k} + \sum_{k=0}^{n} c_k' (id - if)_{t-k} + \sum_{k=0}^{n} d_k' (Msd - Msf)_{t-k} + \sum_{k=0}^{n} e_k' (P)_{t-k} + \sum_{k=0}^{n} f_k' (ER)_{t-k} + g' D_t + u_t' \quad (6)$$

where *Yd*=domestic income level
Yf=foreign income level
id=domestic interest rate
if=foreign interest rate
Msd=domestic money supply
Msf=foreign money supply
TB=trade balance(value of exports minus value of imports)
IR=International Reserves (domestically)
P=relative prices (foreign price divided by domestic price)
ER=exchange rate (a composite currency)

D=dummy variable (D=1, recession period, 1980-1985; D=0, otherwise)
u=disturbance
t=a certain time period
k=time lag

Obviously, foreign variables are taken into consideration in the equations as the home country actions can affect the world as the world can affect her. Nonetheless, on the empirical level this is preferable because the regressors are so interdependent that they could induce *multicollinearity*. The inclusion of foreign variables should mitigate the multicollinearity of determining variables (Malindretos, 1991). Since the period of study is between 1974 and 1995, in which the global recession occurred in early 1980s, a dummy variable is added to both TB and ORTB equations to analyze the impact of the recession on TB and ORTB. The dummy variable takes *zero* value for *non-recession* period and *one* for *recession* period (1980-1985).

The sign test is done by using the *Almon or Polynomial Distributed Lag (PDL)* model. The model used is a *polynomial of degree three*, which implies that it has the possibility of *two* peaks and/or *two* humps, and the lag is of *four* periods applicable to all independent variables. This model is used as the study involves time series data. The regression model includes not only the current but also the lagged (past) values of the explanatory variables, as very often a dependence variable (Y) responds to independent variables (Xs) with lapse of time, which is called lag. The PDL model assumes that β's follow a cyclical pattern and one can express β_k as a function of k, the length of the lag (time) and fit suitable curves to reflect the functional relationship between the two. The maximum length of the lag k must be specified in advance. Having specified k, the degree of polynomial, m, must also be specified. The choice of m is largely subjective depending on the expected number of turning points in the curve relating β_k and k. As mentioned earlier, the pattern of β's of all independent variables in this study is pre-determined with two peaks and two humps (two turning points). It represents a polynomial of degree three and the lag of four periods to all independent variables, which satisfies the requirement that the degree of the polynomial should be less than the maximum length of the lag.

The second test involves the ***test of speed of adjustment*** in order to test whether the real account (TB) or monetary account (ORTB) has preeminence in international accounts. For this purpose, the Almon mean lag model is used. The test is done to examine the mean lag of the same independent variable in the TB and the ORTB. If it is shorter in the TB, the implication is that the disturbance of the said variable affects the real account first. If the mean lag is shorter in the ORTB, the disturbances disequilibriate the money market first and then it disturbs the TB. The formula of the mean lag could be written as (Gujarati, 1988):

$$Mean - lag = \frac{\sum_{0}^{\infty} k\beta_k}{\sum_{0}^{\infty} \beta_k} \qquad (7)$$

Provided all β_k are positive, the mean or average lag is simply the weighted average of all the lags involved with the respective β coefficients serving as weights. In short, it is a lag-weighted average of time. The mean lag serves as a summary measure of the speed with which the dependent variable responds to the independent variables.

4. Results and Analysis

The estimated distributed-lag models of TB and ORTB are displayed in Table 2 below where figures in the parentheses represent the t-value, R^2 and *adjusted* R^2 are the coefficients of determination, ρ is the coefficient of correlation and the asterisk (*) reflects the significant coefficient.

a. Analysis results of the test of signs

In the TB equation, all income coefficients are negative and they are statistically significant particularly for the first two coefficients. Thus, the income variables support the KA. The money supply coefficients are all positive except for the first coefficient. But all the coefficients are statistically insignificant. Thus, the money supply neither supports the MA nor the KA. In fact, in KA the money supply and interest rate are not considered as the main variables determine the TB. The price variables first negatively and then positively affect the TB, but the negative effect is statistically significant only for the first variable while the rest of price variables are insignificant. This, therefore, supports the KA. The exchange rate, finally, supports the KA since it is negative throughout and two of them are statistically significant. However, the TB has low 'goodness fit' as the R square and adjusted R square are only 0.578 and 0.444, respectively. But the coefficient of correlation of 0.76 shows that the dependent and independent variables are highly correlated. The overall results on the TB equations suggest that the Malaysian trade balance account highly supports the KA with most of the coefficients following the signs suggested by the KA.

In the ORTB equation, the income variable is often positive with a few coefficients are statistically significant, which strengthen the MA. The money supply has all positive signs and not significant except the first coefficient. Thus, money supply signs disagree with both theoretical views. The interest rate coefficients first negatively and then positively affect the IR, but there is one significant coefficient always support the MA. The price supports the KA since it is usually negative and one of them is marginally significant. The exchange rate sign disagrees with both theoretical views because it is always positive and statistically significant. One explanation for this is that it takes a long time for the exchange rate to show the correct effect (a negative one) and this is why the coefficients are always positive except the last coefficient, which has a lag of 4 periods. The result of the regression is generally good with high R square of 0.869 and adjusted R square of 0.827. This suggests that the sample regression line fit the data quite well. The high coefficient of correlation of 0.932 implies that the dependent and independent variables are very highly positively correlated. Unlike the TB equation, the ORTB

Table 2: The results of the Distributed-lag Models of TB and ORTB

Independent variable	Dependent variable	
	TB_t	IR_t
Constant	-37962.6 (-4.35)***	298593.3 (5.06)***
$(Yd-Yf)_t$	-9500.02 (-2.75)***	34201.73 (1.74)*
$(Yd-Yf)_{t-1}$	-9773.59 (-1.79)*	24981.7 (0.68)
$(Yd-Yf)_{t-2}$	-9284.07 (-1.15)*	15804.31 (0.28)
$(Yd-Yf)_{t-3}$	-8032.68 (-0.62)	6629.12 (0.094)
$(Yd-Yf)_{t-4}$	-6020.61 (-0.33)	-2584.32 (-0.027)
$(Msd-Msf)_t$	-2844.8 (-0.73)	60847.04 (2.31)**
$(Msd-Msf)_{t-1}$	973.65 (0.099)	43016.5 (0.65)
$(Msd-Msf)_{t-2}$	2982.58 (0.16)	28053.98 (0.23)
$(Msd-Msf)_{t-3}$	3179.38 (0.11)	16069.78 (0.026)
$(Msd-Msf)_{t-4}$	1561.45 (0.037)	7174.16 (0.0081)
$(id-if)_t$	-83.08 (-0.50)	-1036.25 (-1.93)*
$(id-if)_{t-1}$	-98.2 (-0.27)	-660.34 (-0.28)
$(id-if)_{t-2}$	-61.39 (-0.097)	4.05 (0.001)
$(id-if)_{t-3}$	87.04 (0.083)	1248.2 (0.23)
$(id-if)_{t-4}$	406.8 (0.24)	3363.38 (0.32)
P_t	-152.87 (-1.71)*	-255.04 (-1.73)*
P_{t-1}	-24.07 (-0.098)	-589.16 (-0.35)
P_{t-2}	89.97 (0.22)	-797.08 (-0.29)
P_{t-3}	179.19 (0.27)	-872.61 (-0.18)
P_{t-4}	233.54 (0.22)	2411.8 (0.34)
ER_t	-2358.93 (-2.72)***	17135.48 (2.92)***
ER_{t-1}	-1888.02 (-1.86)*	15785.58 (1.86)*
ER_{t-2}	-1495.64 (-0.78)	12772.3 (0.99)
ER_{t-3}	-1321.2 (-0.43)	6555.67 (0.32)
ER_{t-4}	-1504.11 (-0.31)	-4404.35 (-0.13)

D_t	1805.11 (3.41)***	-26386.3 (-7.39)***
R^2	0.578	0.869
Adjusted R^2	0.444	0.827
ρ	0.76	0.932

Note: *** denotes statistically significant at 1% level
** denotes statistically significant at 5% level
* denotes statistically significant at 10% level

equation does not give more evidence for the MA or KA. Some variables support MA and others support KA.

b. Analysis results of the test of speed adjustment

Table 3 depicts the results of the test. The mean lag of income is shorter in the ORTB compared to the TB. The implication is that the disturbance of the income level affects the ORTB first, then the TB. Similarly, the mean lags of money supply and exchange rate are shorter in the ORTB than the TB. Thus, the disturbances in money supply and exchange rate disequilibriate the monetary account first before the real account. On the other hand, the mean lag for relative prices is shorter in TB compared to the ORTB but the difference is very small. Since almost all variables have shorter mean lags in the ORTB, it can be concluded that the MA, which states that the ORTB is the autonomous account, is correct. Thus, it is evidence that almost all times money account is being affected first by any disturbances in the Malaysian balance of payments.

Furthermore, the result could also be analyzed from a different ground, namely, *real versus monetary variables effects on balance of payments account*. The real variables in the balance of payments account are the income level and the relative prices. The monetary variables are the interest rate, the money supply and the exchange rate. It is expected that the real variables have shorter mean lags in the TB equation in support of the KA. On the other hand, the monetary variables support the MA, and therefore have a shorter lag in the ORTB than in the TB equation. The result shows that the TB does not respond immediately or very fast to all real variables except relative prices. Surprisingly, the ORTB quickly responds to all money variables, those are money supply, interest rate and exchange rate. Again, we can conclude that monetary regressors affect the monetary account first but not all real regressors influence the real account first. This indicates that monetary regressors solely determine the money account but real regresoors do not overwhelm the real account. Thus, similar to previous analysis, monetary view is the view which supports the Malaysian balance of payments account.

As for the dummy variable, which represents the recession period, the result from ORTB equation on Table 2 indicates that the Malaysian international reserves is lower during recession period compared to non-recession period, as the coefficient of dummy variable is negative and statistically significant. It is believed that the severity of 1980s recession caused reduction of all components of Malaysian external reserves, namely, Special Drawing Rights (SDR), IMF reserve position and gold foreign exchange. As a result, net official reserves dropped by 9.58% from 1980 to 1982. On the contrary, the result from

Table 3: The results of speed of adjustment test on each variable

Variable	Balance of payments Account	
	TB	**ORTB**
Income (Y)	1.796	1.031
Money supply (Ms)	1.969	1.134
Interest rate (i)	2.864	2.830
Price (P)	2.466	2.933
Exchange rate (ER)	1.73	1.388

the TB equation shows the opposite. Though the dummy variable is statistically significant, it shows that Malaysian trade balance is slightly lower in non-recession period compared to in recession period, as the sign of dummy variable is positive. The good explanation for this is that Malaysia has good merchandise balance performance since 1950s with consistent surplus, except in 1982. The recession in the early 1980s was not affecting the trade balance as much as it affected other parts of the balance of payments account.

5. Conclusion

The paper attempts to analyze whether the Keynesian or the Monetary approach is the correct theory applied on the balance of payments of Malaysia, so that the results will be a guide for future policies by the government on the Malaysian balance of payments. The balance of payments account was divided into the real account (TB) and the monetary account (ORTB), in which the Keynesians and Monetarists have different views theoretically. For the purpose of the study, two types of test were done based on the Almon or Polynomial Distributed Lag (PDL) model, namely the test of signs coefficients and the test of speed adjustment. The two tests were applied both on the Malaysian TB and ORTB accounts. The results show that the Malaysian TB supports the Keynesian view and the ORTB supports both Keynesian and Monetary views. The results also show that the ORTB is an account of the balance of payments, which will usually be affected first from any disturbance in the balance of payments account. Thus, it is an autonomous account of the balance of payments. Since the TB supports the KA, the policies undertaken to correct any disequilibrium in this account should mainly from the fiscal stance. On the other hand, the ORTB supports both views of Keynesians and Monetarists. Thus, fiscal as well as monetary policies should be considered and implemented to correct any disequilibrium of the account. Since the study finds that the monetary account (ORTB) of the balance of payments is the autonomous account, any policy to correct the balance of payment account of Malaysia should focus on this account first before proceeded to the TB account.

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