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BOOK REVIEW

Crisis and Response in the Malaysian Economy edited by Jomo K. S., Khong How Ling, and Shamsulbahriah Ku Ahmad, Kuala Lumpur, Malaysian Economic Association, 1987, xv+239 pp.

Every two years, the Malaysian Economic Association holds its Malaysian Economic Convention. These meetings are convened under an assigned theme of current merit which provides a forum where economists in bureaucracy, the academic world, and other areas can exchange ideas. These forum bring out in clear relief the problems that the Malaysian economy confronts at any one particular time. The book at hand contains twelve of the fifteen papers and three of the four keynote speeches that were presented at MEA's eighth convention on September 19–21, 1985.

The theme of that convention was "The Malaysian Economy: Challenge and Response," a quite general topic that made possible the submission and delivery of papers written from many different points of view. A look at the book's contributors, including the guests who gave keynote addresses, shows a wide range: governor of the central bank, former secretary general of the treasury, scholars from universities, executives of private corporations, and people active in the consumer movement. Anyone expecting to find certain propositions and a consistent pattern of logic running through the entire book will have a difficult task. However, the editors supply a rather strong thematic perspective by implying in the title the idea of crisis in the Malaysian economy. For the editors to provide evidence that such is the case, they must either show the majority of contributors to be aware of crisis or that the Malaysian economy actually faced crisis in the period subsequent to the convention. I will examine those two points in this review in light of trends that have occurred in the economy. Defining the changes that have taken place in the economy from 1985 on is a very important first step in analyzing the present situation in Malaysian politics and the economy.

Before discussing the most important problems that the contributors may or may not commonly recognize as critical, I will describe the trends in the Malaysian economy of the 1980s from the business-cycle aspect. In doing this, I will use statistical data made public prior to March 1986, which it would have been possible for the contributors to have access to. As I will show later, the subsequent statistics, especially those for 1985 and 1986, have been substantially revised downward, which changes the economic picture quite a bit.

The business-cycle index, a composite index, that was test-prepared by the Bank Negara Malaysia (only the coincident indicators made up of five variables were released by the end of March 1986, however) shows three business cycles during this period: (1) trough (February 1978) to peak (January 1980) to trough (January 1982); (2) trough (January 1982) to peak (August 1982) to trough (February 1984); (3) trough (February 1984) to peak (November 1984). On the third cycle, (3), Dato' Jaffar Hussein, governor of the Bank Negara, inferred in June 1986 that the economy had already passed its worst period. (I assume that the cycle trough is anywhere from the middle of 1985 to the end of the first quarter of 1986.)

There are, ostensibly, three characteristics of business cycles in the 1980s. First, previous business cycles in Malaysia lagged a maximum of six months behind those of the industrial countries, but despite a continuing expansionary trend in the industrial economies from the end of 1983, the Malaysian economy began to contract in November 1984. Second, economic expansionary periods during the 1970s averaged twenty-two months each but during the 1980s they averaged only eight months, while the periods of contraction lengthened from an average of nineteen months in the 1970s to twenty-two months in the 1980s (if we exclude the third cycle). Third, average annual growth in real-term GDP gradually lowered from 7.3 per cent in the first cycle to 6.1 per cent in the second cycle and 4.5 per cent in the third cycle (from statistics released by Bank Negara in March 1986). These three characteristics are attributable to fluctuations in the world economy, declines in the price of primary commodities through the wider use of resource-saving technologies, increases in the ability to supply primary products, and concentrations of investment, under high interest, in financial instruments. But there is also a strong implication that the characteristics are attributable to structural factors within the Malaysian economy that have prolonged economic contraction and deprived mid-term growth potential.

Now for the aforementioned first problem. Despite their diverse backgrounds, the contributors are very similar in how they perceive the structural problems confronted by the Malaysian economy.

The editors have grouped the articles in the book into four parts: "A. The External Environment," which examines the problems of foreign debt and balance of payments deficit; "B. Government Initiatives and Responses," which discusses policies from the aspects of both monetary and fiscal policy; "C. The Case for Deregulation," which focuses particularly on the necessity to deregulate; and "D. Whither the NEP" which reports on restructuring the ownership of capital under the New Economic Policy and the limits that existing policy has in its ability to eliminate poverty from the rural sector. The four articles in part A, which begin with former secretary general of the treasury Tan Sri Thong Yaw Hong's keynote address, and the five in part B, beginning with the keynote address by Dato' Jaffar Hussein, either concentrate on, or take as their starting point, the close relation between worsening balance of payments and expanding deficit in the public sector.

If we arrange these articles in order of shared awareness, we find that they devote a great deal of attention to the mistaken view of the federal government, during the 1980–82 economic recession, that the slump in the industrial countries was simply a cyclical matter in which a strong anti-cyclical fiscal policy would be effective. Then, even after beginning a policy of fiscal tightening in the middle of 1982, non-financial public enterprises (NFPE) found it difficult to cope with federal government regulations and continued their inefficient management and investment expansion until 1984. This resulted in (1) the federal government's accumulated debt rapidly rising from 1980's 23.4 billion ringgit (45.6 per cent of GNP) to 1983's 51.7 billion ringgit (79.3 per cent of GNP); (2) a large import factor in anti-cyclical expenditure and NFPE investment that continually expanded imports and shifted the trade balance from traditional surplus to deficit; and (3) an increase in foreign borrowing to finance the deficit that raised the government's debt service ratio from 2.6 per cent in 1980 to 6.5 per cent in 1985 and the government's guaranteed portion (mainly for NFPE) from 1.2 per cent to 2.5 per cent.

This process exposed the weaknesses of the Malaysian economic structure. According to Dato' Jaffar Hussein, on the demand side, a situation of excess consumption arose and private investment flowed mainly into construction and import-substitution industries that are highly dependent on imported raw materials. On the supply side, manufacturing divided into import-substitution types and a narrow range of export-led industries such as electronics parts and textiles, all of which were weakly linked between industrial sub-sectors. Aris Othman, deputy director general of the EPU, points out that an additional structural weak-point now materializing is the inability of agriculture to raise its productivity, an inability that is attributable to minuscule farm size, financial and other constraints on new land-development projects, and the young members of the farm labor force leaving for the city.

To deal with the situation, the government has continued fiscal tightening and has from 1984 on issued a series of policies for adjustment. The major points of Aris' paper are: (1) promote commercialization of farming based on the January 1984 National Agriculture Policy, which includes development of new crops for domestic processing as well as for export; (2) develop, based on the February 1986 Industrial Master Plan, export-oriented manufacturing in which Malaysia has comparative advantage, manufacturing types with greater linkage to the rest of the economy, and heavy industry that contributes to acquiring technologies and techniques with a high spin-off effect for small and medium business; (3) use resources more efficiently and improve productivity in the public sector through privatization; (4) relax regulation on the rate of foreign participation; and (5) implement the Industrial Coordination Act more flexibly to increase domestic private investment.

The last issue is dealt with more extensively in part C on deregulation. Mokhtar Tamin and G. Naidu, professors at the University of Malaya, and Yong Poh Kon, managing director of Selangor Pewter, point out that limits in bureaucratic ability and political pressures from vested interests have made the Industrial Coordination Act, the National Tobacco Act, and the Road Traffic Ordinance inefficient and devoid of the principles of free competition. R. Thillainathan, general manager of the Bank Buruh, points out that such inefficiencies as cross-subsidization and growing gaps between loan and deposit interest are unavoidable because in statutory reserve requirement, liquid assets ratio, and preferential lending rate for the priority sector, commercial banks have not been favored as much as other financial institutions have. However, these criticisms are by and large based on the same logic as the adjustment policies undertaken by the government since 1984. Thus, the Industrial Coordination Act, for example, was applied to medium and large corporations in the fiscal 1986 and 1987 budget proposals, differences between reserves were reduced in February 1986, and the margin between general loan interest and preferential interest to priority areas was partially eliminated in April 1987.

This indicates that almost all contributors to the book view structural weaknesses in the Malaysian economy in similar fashion. They do, however, divide into two groups according to the level of importance that they assign to various factors and how they view those factors. The group having the most members claims that implementing the export-led development strategy advocated by the government will raise economic growth above the low two per cent level of 1985.

The minority view, including that of the editors, is, however, more pessimistic. In the editors' introduction, they argue, as the majority does, that the main causal factors of crisis lie in a changing world economic environment and an overgrown public sector. They also say that the government's strategy will not get the amount of foreign investment it seeks because of competition between developing countries in attracting foreign investment and that it is unlikely that the series of policies designed to restore private sector confidence in the economy, including privatization and deregulation, will succeed. The minority points out that these factors restrict Malaysia to two choices in getting itself out of the present crisis: wait until the international environment recovers or thoroughly reexamine the export-led development strategy and construct a new strategy for economic self-reliance.

Of the very few papers in this book that empirically and thematically develop the minority view, Mukul G. Asher of the National University of Singapore and Jomo K. S. of the University of Malaya jointly investigate changes in the Malaysian tax system during the first half of the 1980s and conclude, in part, that the public sector has lost the strength to drive the economy. They make two particularly good points: (1) Lowering personal income tax rates, simplifying the sacle of personal income tax, and accelerating the rates of depreciation for corporate taxpayers did little to increase savings and investment, as hoped. Rather, tax base shrunk and will shrink further over the long run, resulting (2) in increased proportions of oil-related taxable income. Coupled with the introduction of a linked export tax on product costs as a policy for encouraging exports, tax revenue became unstable because it is determined more by fluctuations in the market for primary commodities. Add to that the forecasts of mid-range stagnation in primary commodity prices and the government's hanging fast to fiscal tightening policies, gives a public sector that will continue to hold growth down for the time being.

The crisis of which the minority speaks is one in which increases in the internal and external imbalances and a loss in the speed of growth can be forecast as long as the country continues its export-led development strategy in an international environment that is disadvantageous to a primary commodities producing nation.

The way the Malaysian economy moved during 1986–87 lends credence to the minority forecast. The average export price for tin was 42.2 per cent lower and for palm oil 46.4 per cent lower, in the first half of 1986 than in the first half of 1985, as if they had been dragged down by the collapse in oil prices in the first half of 1986. As if being adjusted to the season, the real growth rate in GDP was corrected downward to −1.0 per cent for 1985 and 0.5 per cent for 1986 (Ministry of the Treasury, *Economic Report, 1986/87*, published October 1986). Malaysia thus recorded its first minus growth since its formation as a country. Annual federal revenue for 1986 decreased 13.4 per cent from the initial budget, a loss in revenue unknown in recent years. Compared to the initial budget for 1986, the 1987 budget declined 18.5 per cent in annual income with a 5.5 per cent decline in current account expenditures and a 24.6 per cent decline in development expenditures. The decline in revenue for those two years is greatly affected by the crash in the prices for primary commodities, including those for oil. These facts tend to support the Asher-Jomo thesis.

Be that as it may, it would be irresponsible to base an argument on downward-revised estimates of official statistics that completely change the economic picture and then assign too much importance to the minority's theories of crisis and say that the majority is wrong. I would have to point out that, in this book, the minority has failed to define what it means by crisis and has failed to give adequate proof and to develop its views based on that proof. The majority view has great expectations of what privatization and the export-led development strategy will accomplish, but it does not adequately examine the foundations for these two programs, i.e., the growth capabilities of the private sector itself. Such overly optimistic views of the situation are open to question.

Growth in the Malaysian private sector since the 1970s has depended largely on an expanding public sector. A number of public sector programs in the 1970s sought to build up the agricultural and industrial infrastructure, develop petroleum resources, and develop housing; and in the 1980s to develop heavy industry, redevelop urban areas, and construct transportation and tourist facilities. However, the government officials contributing to this book, most notably Dato' Jaffar Hussein, who voice concern about the concentration of private funds in real estate and construction over the past several years have made no attempt to analyze the relationship between public and private sectors.

Even under the policies of fiscal tightening since the mid-1980s, investment in real estate and construction has continually rebounded to create surpluses in housing and office space from 1984 on and cause financial institutions to rapidly increase their number of bad loans and irrecoverable investments. Then, 1987's definite improvement in crude oil prices and recovery in prices for lumber, rubber, and palm oil made investment flow into the domestic arena, but created a situation where funds stayed in the stock market rather than going to expand producive investment. In July, the National Malay Chamber of Commerce and Industry requested the government and financial institutions for a two year moratorium and the establishment of a 500 million ringgit running fund. But, under pressure from non-performing loans (private estimates say the would-be default is about 20 per cent of outstanding loans from commercial banks), and despite repeated requests from the central bank, the financial institutions have resisted lowering their interest rates on ordinary loans.

The pronounced imbalance in domestic and foreign demand for the 1987 Malaysian economy shows, I think, that the public sector's prolonged fiscal tightening has caused the private sector, which is growing more and more dependent on the public sector, to lose its sense of direction and its confidence in the economy. I believe this to be the main factor in the ongoing crisis, and must thus conclude that before they talk about this or that strategy, the major task for economists is to clearly delineate the economic linkage between the Malaysian public and private sectors.

It would be very difficult to declare that this book, as its title leads us to believe, adequately defines and explains the crises facing the economy. Considering that the use of official statistics is a restriction on the majority argument and makes its views overly optimistic, and that the minority has failed in adequately developing its argument, the implication of the book, then, is one of a crisis of perception on both sides. What are the book's strong points? To clarify their points of argument, I have taken it upon myself to divide the contributors into groups of either majority or minority view. But, the main arguments of these papers are diverse enough to make difficult a clear classification into one or the other category. The book's strongest point is that showing the diversity as is gives the reader an opportunity to ruminate on the complex problems faced by the Malaysian economy. I want to express my admiration of the Malaysian Economic Association for the many years in which it has continued to open the doors of discussion between economists in academia, the bureaucracy, and other areas. (Michio Kimura)