ECONOMIC REFORMS AND DEVELOPMENT IN MALAYSIA

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Countries with different economic and political systems are increasingly using privatization of their state-owned enterprises (SOEs) as a tool with which to improve the efficiency of the enterprises and to lessen the financial burden of the enterprises on the national budget. This paper examines the public investment and privatization programmes in Malaysia so as to draw relevant lessons for other developing countries embarking on the path of privatization.

I. INTRODUCTION

After two decades of relatively stable development, the Malaysian economy performed erratically in the 1980s. From 1965 to 1980, the economy grew steadily, averaging an annual growth rate of 7.3 per cent. Inflation was low, remaining below 5 per cent throughout the 1960s and for most of the 1970s, and there were no large imbalances in the current account of the balance of payments. In contrast, the macroeconomic record over the period of the Fourth Malaysian Plan, 1981-1985, was the worst in the post-independence era. Growth averaged 5.1 per cent and the economy experienced large budget and trade deficits. In 1985-1986, there was a sharp recession and real per capita income fell by 18 per cent. The subsequent recovery has been strong such that real GNP has grown at an average annual rate of 8.5 per cent. In 1991, Malaysia was the world's fastest growing economy. It is regarded as one of the economies that will soon join the ranks of the Newly Industrialised Countries (NICs).

Malaysia's development can be divided into three phases — stable gowth in the 1970s, poor performance in the early 1980s and a strong and sustained recovery since 1987. In the 1970s, development was orchestrated under the New Economic Policy (NEP), which gave priority to social objectives over rapid growth. Following the accession of Prime Minister Mahathir in 1981, there was a reduction in the importance attached to equity and increased attention was given to stimulating growth. In particular, the government attempted to orchestrate an industrial tansformation through large scale public investments and an expansion in the state's direct economic role. In the later 1980s, this has given way to an increased role for the private sector in promoting development. The government is committed to "downsizing" its productive activities and liberalizing its approach to economic policy. The privatization effort started in earnest in October 1983 with the concept of "Malaysia Incorporated", outlined by the Prime Minister. It aimed at increasing the role of the private sector, especially in providing commercial

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expertise. Susequently, in January 1985, the government published a general "Guideline" to explain the policy. National Development Policy was formulated in 1991 with emphasis on growth. Under this approach, Mahathir has established the objective that Malaysia should become a developed nation by the year 2020 ("Vision 2020"), requiring average annual growth rate of 7 per cent to be sustained over the next twenty four years.

The Seventh Malaysian Plan (1996-2000) and the Second Industrial Master Plan, both approved during 1996, are putting greater emphasis on privatization of SOEs. Against the background of a tight labour market and a high rate of investment, the Seventh Malaysian Plan aims to promote a shift in focus from input-driven to productivity driven growth. The emphasis is on growth led by the private sector, successfully pursued during the Sixth Plan period, to continue with further privatization of services and infrastructure. The Second Industrial Master Plan was launched to chart the course of industrial development over the next ten years. This builds upon the success of the first Industrial Master Plan (1986-1995). Also, over the period 1996-2000, private investment in areas that are strongly associated with the public sector, including privatization schemes, is expected to reach RM 68.3 billion.

II. PUBLIC SECTOR PERFORMANCE (1957-1985)

In the period after independence was granted in 1957, the economy maintained a high rate of economic growth, price stability and balance of payments strength. However, violent racial riots in May 1969 prompted a widespread reevaluation of the record and, in particular, led to the realization that the benefits of growth, had not been evenly distributed. This resulted in the adoption of the NEP in 1971, which aimed to reduce poverty in Malaysia and, more specifically, to resturcture society so as to improve the position of the 'Bumiputera' (indigenous Malaysians). The twin aims of poverty alleviation and restructuring society to eliminate the identification of race with economic function guided series of state interventions. During 1976-1980, 38.2 per cent of total development expenditure was allocated to poverty reduction and a further 19 per cent to restructuring. The Second Malaysian Plan (1971-1975) justified the publication of growth targets by noting that the NEP can best be undertaken in the context of an expanding economy. The government felt that by establishing new industrial activities in selected growth areas and placing them under 'Bumiputera' management, it could act as a catalyst in creating an indigenous business community. The Mid-term Review of the Second Malaysian Plan, published in 1973, established the "30:40:30" ownership restructuring target by 1990, referring to the proportion of corporate wealth that should be owned by indigenous Malaysians, other Malaysians and overseas investors, respectively.

According to the Third Malaysian Plan (1976-1980), foreign ownership of share capital in limited companies measured 63 per cent in 1976. The Industrial Coordination Act (ICA) of 1975 provided the state with the means to implement its ownership restructuring policies. From the mid-1970s government-sponsored takeovers of foreign companies became an integral part of the restructuring process. The acquisition of established companies allowed the state to move more quickly in its attempts to increase Malay ownership and reflected a widespread frustration at the difficulties involved in meeting the wealth targets.

The social agenda pursued by development policy under the aegis of the NEP introduced a number of economic distortions. SOEs were oriented towards emplyment creation, regional development and other social objectives, causing large operating inefficiencies. Many SOEs continued to incur losses throughout the 1970s. Scarce national savings were allocated in line with restructuring priorties as opposed to investment needs. The returns on concessionary loans to 'Bumiputera' enterprises were low and frequently often lacked adequate managerial skills. A study by the Economic Planning Unit in 1976 revealed that the supervisory agencies were short-staffed and were not providing effective assistance. The absence of monitoring and even basic accounting arrangements led to the accumulation of sizeable bad debts. Moreover, the ambitious restructuring targets created pressures for continued financial assistance, even when the enterprises were obviously not viable.

Further, following the second oil crisis in 1979, recession in the OECD economies caused a sharp deterioration in Malaysia's export performance. In the early 1980's the merchandise account moved into deficit, producing a large current account deficit which measured 14.1 per cent of GDP in 1982. The decline in export performance was accompained by an equally sharp fall in private investment. Manufacturing remained heavily concentrated in a few activities and industrial exports continued to be supplied mainly from the free trade zones. Private investment also failed to exhibit any sustained dynamism.

To overcome these problems, the government attempted to stimulate a broader-based phase of industrial development by expanding its direct role in the economy. In 1981, there was a real increase of 41.5 per cent in public investment, followed by a 20.7 per cent increase in 1982. The massive increase in public expenditure was caused by a series of ambitious development projects, notably for the heavy industrialization drive. A number of these projects arose as the result of government companies (commonly known as the Non Financial Public Enterprises, NFPEs) venturing into business. Part of the increased government spending was directed toward infrastructure such as transport, irrigation and education facilities. In addition to the increase in development expenditure, there was also higher general administration expenditure due to the expansion in the number of civil servants.

However, this stimulus produced a large budget deficit, measuring 20 per cent of GDP in 1981 and 1982. Industrial growth, although rapid in the early 1980s, was inefficient and costly. The result was that PE sector was dominated by a few large firms. There were over 700 smaller SOEs which were particularly inefficient, recording an aggregate loss of over M$800 million per year in the early 1980s.

The budget deficits created by high levels of public investment led to a sharp increase in the amount of internal and external debt. The Malaysian government managed its external debt level effectively by limiting new borrowings and refinancing old, high interest rate debt. However, in doing so, it has steadily accumulated internal debt. When debt is expressed as a proportion of GDP, Malaysia has one of the highest levels of indebtedness among both the developing and developed nations. The interest burden alone amounted to 10 per cent of GDP in 1990 and will be subject to wide fluctuations in line with interest rate and exchange rate movements.

In response to its deteriorating financial position, the government imposed a tight fiscal squeeze in the mid-1980s. During 1982-1984, there was a 33 per cent cut in nominal development expenditures, concentrated in defence and commerce and industry. The expenditure and tax changes, announced in 1985, amounted to an 11 per cent reduction in domestic demand. However, the retrenchment was short-lived. As the recession hit in 1985-86, the government responded by expanding public spending. The broad swings in public expenditure, which characterize the period of the Fourth Malaysian Plan, produced substantial inefficiencies. In the expansionary phase, inappropriate project selection, widespread over-engineering and inadequate supervision resulted in a significant waste of scarce national savings. Sharp cutbacks in 1983 and 1984 reduced the supply of funds to productive and non-productive projects alike. In particular, there was no attempt to protect important maintenance expenditures, which were required to maintain the capacity of previous public investments. By 1985, the economy was again showing signs of weakness.

In 1985 GDP contracted by 1 per cent and unemployment rose to 7 per cent. There was a decline in a number of other indicators, including private investment, manufacturing and exports, The short recovery in 1983 and 1984 and sudden recession of 1985 led to a growing conviction that there were basic shortcomings in the Malaysian eocnomy.

III. OBJECTIVES OF PRIVATIZATION

In view of the severe recession and the fact that the economy did not respond flexibly to external shocks, the government embarked on new structural transformation programmes which saw the private sector take a leading role as the new engine of growth. In January, 1985, the Government of Malaysia issued "Guidelines on Privatization" for the purpose of "elaborating and clarifying the government policy on privatization to both the public and private sectors...and also to enlighten the employees and general public on (this) subject". According to the guidelines, the objectives of privatization are (1) to relieve the financial and administrative burden of the government with respect to public enterprises (PEs); (2) to promote competition, improve efficiency and increase the productivity of these enterprises; (3) to stimulate private enterpreneurship and investment in order to accelerate the rate of growth of the economy; (4) to assist in the reduction of the size of the public sector and its monopolistic and bureaucratic tendencies; (5) to contribute towards meeting the objectives of the NEP, with particular attention on the role of 'Bumiputera' entrepreneurship.

After issuing its "Guidelines on Privatization" the government established an "institutional machinery for privatization" called the Privatization (Main) Committee to operate as an inter-departmental committee under the chairmanship of the Director General of the Economic Planning Unit (EPU). There is also the secretariat referred to as the Privatization Task Force which basically functions as the organizational arm of the Main Committee. Completed background reports are prepared and analysed by the Technical Committees. Recommendations are sent to the Main Committee for detailed negotiations. Finally, the Cabinet has to give its stamp of approval.

IV. PRIVATIZATION : EXPERIENCES AND IMPACT

The performance of the Malaysian economy in the late 1980s indicates that the economic recovery has been both strong and sustained. Following its growth of 5.4 per cent in 1987, the economy has continued to expand at rates in excess of 8 per cent per annum. In 1990, real GDP grew at a rate of 9.8 per cent. This impressive performance has been accompanied by a further change in the nature of development policy. Realizing that the state-led expansion of the early 1980s was not sustainable, the government is now committed to a policy of stable growth driven mainly by the private sector. The Fifth Malaysian Plan, published in early 1986, states that "the emphasis of development for the second half of the 1980s will be based on growth with stability. At the same time, in view of resource constraints, increased efforts will be made to mobilize resources and improve efficiency".

The expiration of the NEP in 1990 provided the government with the opportunity to establish its priorities for the medium-term development of the economy. The new strategic document, the National Development Policy (NDP), reaffirms the emphasis that is being placed on economic development objectives. The state's new approach to development has been further clarified by a number of other policy statements, including the Industrial Master Plan and Prime Minister Mahathir's view of "The Way Forward". The latter forms a framework for the development of the Malaysian economy until the year 2020 and is accorded particular importance in official policy statments. It establishes the objectives that Malaysia should become a "developed nation" by the year 2020.

This approach to development policy was illustrated by relaxation of the NEP conditons which govened industrial licensing, particularly those applying to foreign investment. The large level of external debt, accumulated in the early 1980s, established the need to attract more foreign direct investment. Moreover, figures published in 1985 indicated that foreign interests controlled only one-quarter of share capital, already below the 30 per cent target for 1990 that had been established by the NEP. The liberalization policies created an economic climate which attracted foreign direct investment (FDI) into the country. FDI was US $ 5800 million in 1995.

The Fifth and Sixth Malaysian Plans stress the role of manufacturing in driving the future expansion of the economy. Government policies towards the development of the manufacturing sector have been determined in line with the Industrial Master Plan (IMP), 1986-1995. The IMP provides an indicative plan for the development of specific manufacturing sub-sectors and "areas of special emphasis".

Fiscal incentives to promote investment have long been used in Malaysia. Under the NEP, however, they were designed more to facilitate the achievement of social than economic objectives. Consequently, the incentive pattern created by the variety of subsidies and tax exemptions was characterized by a number of inconsistencies and inefficiencies. For example, while the most significant exemptions in the corporate tax structure — including tax holdings, investment and depreciation allowances — favoured capital-intensive projects, the government also attempted to intorudce a labour utilization credit scheme and double tax deduction for training expenditure. The single most important fiscal inducement concerned the award of five year tax holidays, often renewed for a further five years, to producers accorded "pioneer status". This allowance reduced the marginal tax rate from its statutory level of 40 per cent to an effective level of 4 per cent, greatly outweighing the gains offered by other incentives. The tax system, therefore, became unresponsive to fine-tuning.

Under the IMP, industrial policy instruments have been consolidated and now focus more narrowly on attempts to promote reinvestments, industrial linkages, exports and training. The corporate tax structure now has fewer exemptions, allowing for a more effective use of selective incentives. For example, the 1991 budget reformed the incentives offered to pioneer status companies such that extensions beyond the initial five year holiday period are no longer allowed and only 70 per cent of corporate income will be tax exempt. Policies towards investment are now guided by economic as opposed to social criteria. Thus, the Sixth Malaysian Plan, notes that restrictions and incentives will be "rationalized further to ensure that they are consistent with the overriding policy of encouraging private sector growth and foreign investment".

In recent years, the government has moved to ensure that trade policy is designed more in line with the overall development strategy. Protection has been governed by dynamic notions of comparative advantage, promoting the development of industrial subsectors that are intended to replace light manufacturing activities as the main exporters. The success of the IMP has been reflected in the impressive growth rates recorded by the sub-sectors that it sponsors. Export performance ramained strong with the volume of exports rising by 19 per cent in 1995 (from 14.5 percent during 1987-1992). Malaysia has benefited from high concentration of its exports in the rapidly growing electrical and electronics industry. However, weaker international demand for these products affected export growth in 1996.

Changes in economic strategy under the Fifth and Sixth Malaysian Plans have enhanced the role of the private sector in guiding future development. Thus, the Sixth Malaysian Plan notes that " private-sector led growth has pushed Malaysia to a higher level of economic success" and will be "entrusted with a much bigger roll in generating growth". Public sector expenditure is forecast to account for 13 per cent of GNP during the Sixth Plan,as compared to the 24.1 per cent share recorded during the Fourth Plan (1981-85). Once again, the new Malaysian approach draws very closely on the NICs' experience; economic growth will be mainly a private sector phenomenon but SOEs will continue to have an important strategic role. Through the " Malaysia Incorporated" concept, the government has stressed the need for a parternship between the public and private sectors. Public investments will be designed to "support the expansion of the economy" and will be focussed ,on infrastructure, energy and education porojects.

The government's commitment to "downsizing" its direct role in the economy is reflected in the Privatization Master Plan, which was published in 1991. The document identifies some 246 enterprises as possible candidates for divestiture, of which 149 are listed as feasible in the short to medium term. The proposed sales cover enterprises in all major sectors of the economy, although utilities dominate, accounting for 43 per cent of the Plan's estimated value of M$ 16.4 billion (see Table 1).

The privatization programme in Malaysia has not progressed smoothly. Initially, privatization was undertaken on an ad hoc case-by-case basis. There exists capacity to manage privatization programme professionally. Management expertise and regionally specialized consultancy services are available to undertake privatization, while the government itself commands sufficient human resources to suggest that a capacity to manage and regulate privatization exists.

Table 1 : Privatized Projects in Malaysia

Enterprise	Activity	Year	Method
TV 3	Entertainment	1983	Private sale
Sports Toto Malaysia	Lottery	1985	Private sale
Flyover Jin Kuching Kepong	Construction Transportation	1985	Private sale
Malaysian Airlines System(MAS)	Airline	1985 1992	Public offering n.a.
Aerospace Industrial Malaysia(AIM)/ RMAI Air-Craft Over-hauling Depot	Aircraft Maintenance & Repair	1985	Private sale Joint Venture Management Contract
North Kelang Bypass	Private Toll Road	1985	Private sale Management Contract
TUDM Aircraft Maintenance Depot	Manufacturing	1986	Leasing
Kelang Container Terminer (KCT)	Transportation and Storage	1986	Private sale
Malysian Int. Shipping Corpo-ration(MISC)	Shipping	1987	Public offering
Labuan Water Supply	Water Supply	1987	New Project to be developed by private sector (BOT)
Sun gai Semenyih Water Supply	Water Supply	1987	Contract
Jabatan Telkom Nagara (JTN)	Telephone/ Telex	1987	Public offering

Enterprise	Activity	Year	Method
Tourist facilities at Taman Negara	Recreational Services	1987	Leasing
National Electricity Board	Electricity	1990	Public offering
Perusahaan Otomooi Nasional	Automobiles	1991 1992	n.a.
Water Supply Jonoi State	Water Supply	1992	n.a.
K.L. Kepong Intercharge	Construction and Transportation	n.a.	BOT

Note : n.a. = not available.

With respect to personnel issues under privatization, the "Guidelines on Privatization" state that "All schemes for privatization must include provisions whereby the employees will not lose in any way the benefits they enjoyed while being employed by the Government". Employees are to be absorbed into privatized firms under terms "no less favourable" than those they enjoyed while working for the government. It was the responsibility of the Public Services Department (PSD) to translate the government's policy on personnel into a workable policy. The basic principles underlying the personnel policy are : (1) The new company that takes over the SOE must accept all the staff who choose to remain with the new company; (2) Except in response to disciplinary action, the new company cannot lay off workers within five years from the date of privatization; and (4) Finally, employees have two options — to join the new company or retire. (Presumably, if an employee has not reached retirement age but opts to join the new company, he has to resign).

Malaysia experienced financial system deepening, moderate real credit growth, reasonable real deposit rate and no recurrent banking problem. Malaysian restructuring affected only a small portion of the banking system, almost all the banks in Guinea were bankrupt in 1985, with just one institution remaining open (which accounted for 1 per cent of financial system deposits). The authorities opted to merge insolvent deposit institutions with healtheir ones and injected capital into marginally solvent institutions (with support from current share holders). The authorities managed to stabilize their banking system on a long term basis. Malaysia made efforts to shrink mecroeconomic imbalances — bringing the budget deficit under control, lowering inflation, and devaluing the currency.

V. CONCLUSION

Malaysia developed later than the four "Asian Tigers" (Hongkong, Taiwan, Singapore and South Korea), and to some extent has benefited from observing their efforts.

Many of the transformation measures introduced were learned from the experiences of those countries, which have generally enabled the Malaysian government to select and adopt the most appropriate strategies and, just as important, to introduce them at the right time. Progress has been slow but steady.

As the economy developed, new structural rigidities appeared. Some were corrected by the structural transformation, some were caused by the transformation itself, while others were simply the products of economic development. These new structural rigidities pose a challenge to Malaysia as it prepares itself to be an industrialised country by the year 2020.

The lessons relevant for the developing countries embarking on the path of privatization could be listed as follows :

Privatization should be structured and systematic. In particular, it should be able to establish institutional and administrative arrangements and make extensive use of professional expertise.

It should enjoy strong and sustained political commitment as in the case of Malaysia.

The political commitment should be aided by the positive role played by private investment — both domestic and foreign.

For privatization to be successful, it is essential to select and adopt the most appropriate strategy at the right time.

Like in the Malaysian privatization programme, a dominant concern should be to protect the special interest of the sons of the soil or the indigenous community and labour, for which built-in saftey clauses should be provided. Employment issues should be adequately tackled.

To overcome the problems and constraints arising from the privatization of PEs governments can formulate a Master Plan on the lines of the Malaysian Master Plan (1987-1996).

These lessons, of course, can only be preliminary, since the Malaysian privatization process is still continuing. Although the sale PEs is relatively successful, the government will have to watch the enterprises closely in the future to determine whether their operating efficiency continues to improve after privatization and help the government to achieve its ultimate goal: "VISION 2020".

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