

OCCASIONAL PAPER SERIES NO. 3

# **COPING WITH THE RECESSION IN MALAYSIA**

**ZAINAL AZNAM YUSOF**

**SINGAPORE INSTITUTE OF INTERNATIONAL AFFAIRS**

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## COPING WITH THE RECESSION IN MALAYSIA

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**Zainal Aznam Yusof\***

On October 24, 1986, Encik Daim Zainuddin, the Minister of Finance of Malaysia introduced the Malaysian Budget to Parliament. The budget officially confirmed the worst fears that the Malaysian economy was deep in recession, that the economy had shrunk and for the first time since 1975 a growth rate of minus 1 per cent was recorded for 1985, and 1986 will be almost equally bad, with the economy growing at only 0.5 per cent per annum. The *per capita* income of Malaysia had declined from \$4,581 in 1985 to \$4,094 in 1986, a decline of 15 per cent, but even more worrying was that the level for 1986 had fallen to the level of 1982. The Federal Government was suffering from a budgetary deficit and the current account of the balance of payments was also in deficit. It was also alleged that the economy was haemorrhaging from a flight of capital. Private investment slid very badly and unemployment in 1986 had increased to 8.7 per cent. In short, the recession was still very much alive, and biting hard into the Malaysian economy. For 1987, the economy is expected to grow at only 1 per cent. All this was a far cry from the almost 8 per cent growth rates achieved in the decade of the 1970s. The Budget, therefore, unveiled a package of painful measures, designed to strengthen the financial position of the nation, increase the role of the private sector, promote growth of exports, reduce imports so as to improve the balance of payments, and improve the environment of the private sector for investment and stimulate business confidence.

The budgetary package which introduced measures to strengthen the collection of revenue to reduce the Budget appropriation for 1987, also

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\* Text of a talk organised by the Singapore Institute of International Affairs on 21 November, 1986.

introduced further incentives for exports, and liberally amended the conditions attached to the license issued under the Industrial Co-ordination Act (ICA). But the seriousness of the situation was clearly revealed in the measures which will fall on the public sector and public officials. Entertainment and housing allowances and allowances for official travel of Ministers, Deputy Ministers and other members of the administration will be reduced by 10 to 20 per cent. The budget imposed a 100 per cent tax on second and subsequent pensions, reduced entertainment and housing allowances of superscale officers by 10 per cent and reduced travel allowances for Government officers. On the other hand, it increased interest rates payable on Government housing and car loans from 4 per cent to 6 per cent. It modified the scholarship scheme by increasing educational loans and reducing scholarships. It announced that new employees and those not yet on the pensionable establishment, will be required to contribute to the Employees Provident Fund, and proposed a national voluntary moratorium on wage increases for three years.

The Malaysian Budget for 1987 was preceded by a global economic environment which continued to be depressive, showing no clear signs of a strong recovery. International and domestic events in the decade of the 1970s have been close to calamitous. On hindsight, the post-war decades of the 1950s and 1960s have been somewhat staid and uneventful. Starting with the oil shocks in 1972 – 1973, and sharp increases in the oil price, the world economic environment has been in a state of turmoil. There has been a slowdown in growth of the economies of the industrialized countries, growing unemployment, rapid inflation, rising interest rates, and growing protectionism. Just before the end of the decade, there was a second oil shock in 1979 – 1980, when oil prices again increased. Non-oil producing economies suffered more than the oil producing economies. In the industrialized countries, the close of the decade also witnessed the rise of monetarism, a persistent trend towards more protectionism, rising unemployment and far gloomier prospects for growth, rising debt problems, rising unemployment, and more severe balance of payments problems. Some less developed countries suffered a sharp decline in income levels in their overall standard of living. Growing misery governed the lot of many of these unfortunate countries. And now, towards the latter part of 1980s, we are still in the throes of a recession. All major indicators of economic growth and development point towards a prolonged period of pessimism.

How is Malaysia coping with the recession? This will be the main theme of my talk and I shall attempt to summarize and provide more of

an overview rather than an extended answer to the question. But before that, a brief background of the Malaysian economy, and similarly, on the nature of the recession.

### **The Malaysian Economy and Malaysian Economic Development**

By all accounts, Malaysia has been lauded as a success story. Its economic growth and development have been impressive. It achieved a growth rate of more than 6 per cent throughout the 1960s, and for the 1970s the economy grew at a rate of almost 8 per cent per annum. By 1980, its *per capita* income had reached \$3,650, and it had joined the 'middle-income' club. More than satisfactory progress was also achieved in equity. The framework and thrust was provided by the New Economic Policy (NEP), which was essentially concerned with reducing racial economic imbalances between the major ethnic groups. The incidence of poverty declined from about half in 1970 to about 18 per cent in 1984. Life expectancy by 1980 had reached about 67 years for males and 72 years for females. Income of all races increased and the glaring imbalances in income between the Malays and non-Malays had narrowed, and the restructuring of society to correct the identification of race with economic function, progressed rapidly. More Malays were now employed in the modern sectors of the economy and increased their ownership and control over the economy.

Economic growth was overwhelmingly externally driven. Throughout the post-independence period, Malaysia remained an open economy and exports and imports accounted for a substantial proportion of the GNP. An open economy such as Malaysia, is heavily influenced by the economies of its major trading partners – USA and Japan – and the pace of growth of world trade. More than this, Malaysia's traditional reliance on a few major primary commodities meant that a down-swing in the prices of rubber, tin, oil palm, and oil for example, will have far reaching repercussions on the economy. Export earnings from the exports of these commodities will fall, government revenue will consequently decline, and development programmes will have to be trimmed to accommodate the reduction in financial resources.

With growth, there have been structural changes in the composition of Malaysia's exports. Rubber and tin, for example, have declined in importance, and manufactured exports have increased their share. Petroleum exports have, more than any other exports, become more important. In 1970, rubber, for example, accounted for about a third of total commodity exports, and manufactured exports about 16 per cent.



Ten years later, in 1980, rubber's share had declined to just about 17 per cent and manufactured exports increased to about a quarter of total exports. Petroleum exports had grown phenomenally; in 1970 crude petroleum accounted for about 3 per cent of total exports but by 1980 it had reached 25 per cent.

Structurally, the Malaysian economy reflected the features of an economy which exhibited the growing importance of its industrial sector. Agriculture still remained sizeable but it was no longer as dominant as it was two decades ago; by 1980, its share of the GDP had declined to about 22 per cent compared to 31 per cent in 1970. Along with this decline in the share of agriculture was the rising importance of the manufacturing sector; its share of the GDP increased from 13.5 per cent in 1970 to about a fifth in 1980. Even so, in terms of employment, agriculture was still the largest employer and by 1980 as much as 40 per cent of the total employed was found in this sector. Another important structural change in the Malaysian economy was the increasing importance of the public feature of the sector, a trend which accelerated in the 1970s, a period of intense stress on equity matters and institution building. Public enterprises, especially in the form of 'trust agencies' grew very rapidly, as they became the vanguard of increasing Malay participation in industry and commerce, and the major instruments for reducing the glaring racial economic imbalances. So, the record of development has been impressive. By 1983, the GNP per capita had reached US\$2,860, which was slightly above that of Chile (US\$1,870) and Brazil (US\$1,880) and Malaysia has now been classified as an 'Upper Middle Income' country by the World Bank.

All this was achieved, particularly during the 1960s, with what was considered by many observers as sensible development strategies. A lot of emphasis was put on growth in the post-independence years up to the end of the 1960s. Agriculture and rural development were given a great deal of emphasis. Industrialization came somewhat late and there was little of the excessive exuberance and over emphasis on import substitution. Tariff policies did become an important part of the industrialization drive in the late 1960s, but comparatively speaking, as Malaysia moved into the 1970s, it was not seriously encumbered by a regime of very highly protected industries. Conservatism and prudence constituted the hallmark of monetary policies.

Government was active in the 1960s, but never on the scale envisaged and realized during the 1970s. Gradually, the *laissez faire* development approach to development became more and more muted and Malaysia took on the features of a mixed economy. The 'invisible hand', while not



really truly remaining invisible, did become more and more invisible, if that is ever possible, as the Government moved in and became active in industry and commerce. The paraphernalia of the bureaucracy and regulation became a permanent feature of the Malaysian bureaucratic landscape. If there ever was a break or a turning point in the post-independence development of Malaysia, it came in 1969 with the racial riots in May and the enunciation of the NEP. More than anything else, the NEP changed the framework of race relations. There was a heightened and acute sense of racial economic imbalances. An important part of the approach to rectify the racial economic imbalances was a much greater role assigned to the Government. Suspicions were cast on a *laissez faire* approach to development, and market forces were looked down upon.

### **Growth of the Recession**

Economic shocks, generally, take a certain amount of time before their full impact is felt. Even then, perceptions may differ as to the severity of the recession. Many statistics deal with the average and, therefore, do not tell the full story nor can they really capture the intensity of economic shocks. The roots of the recession can be traced back to what was happening to the economies of the industrialized countries.

The GNP of the OECD declined from 2.3 per cent in 1981 to minus 0.8 per cent in 1982. Large cumulative deficits of about US\$75,000 on the current account of the balance of payments of the OECD countries, excluding the UK, West Germany and Japan, were recorded. Interest rates then increased. Investment became sluggish and unemployment in OECD increased from 5.7 per cent in 1980 to 8.1 per cent in 1982. Although the US economy, which accounted for 44 per cent of the output of the industrialized countries, showed signs of recovery towards the end of 1983, the growth momentum was not sustained. Japan showed a better recovery during 1982 and 1983. For the other OECD countries the recovery was much slower with the GNP of the European economy growing at 1.3 per cent in 1983 and 2.4 per cent in 1984 but declining to 2.2 per cent in 1985. This dismal performance was compounded by structural rigidities, rising unemployment and high interest rates.

The slight recovery in world output since the end of 1983 was accompanied, however, by rising protectionism, and especially disappointing was the growth of non-tariff barriers. World trade was,

therefore, further dampened. But especially worrying was the debt problem of the Third World countries, since 1980. The decline in the flow of foreign direct investment, greater reliance on loans to finance investments, rising interest rates, and the shift in capital flows from official sources to private banks, all contributed to the worsening debt problem of the Third World, which reached about US\$90,000 million in 1984.

The behaviour of Malaysia's major exports of primary commodities in the early 1980s, tell a very familiar story. The downward slide in prices, more than ever, became entrenched and pervasive. In 1980, the value of rubber exports reached \$4,617 million but declined to \$3,712 in 1981. Sawlogs also dropped from \$2,621 in 1980 to \$2,473 in 1981. Rubber prices declined; the RSSI f.o.b. price fell from 312 cents per kg. in 1980 to 259 cents per kg. in 1981. Exports of tin and tin-in-concentrates also fell from \$2,505 million in 1980 to \$2,138 in 1981 and sawn timber from \$1,179 in 1980 to \$971 in 1981. Between 1980 – 1981 the exports of palm oil and crude petroleum were still firm and showed an increase. But palm oil (crude) price was softening but the price of petroleum remained high at about US\$36 per barrel in 1980 and increasing to US\$39 per barrel in 1981.

Between 1981 – 1984 it could still be said that the behaviour of commodity prices and the total value of commodity exports were not something to have caused excessive alarm. Rubber exports declined in value from 1981 to 1982 but had picked up to \$3,668 million in 1984 and although the RSSI f.o.b. price of rubber dropped sharply in 1982 to 201 cents per kg. by 1984 it had increased to 224 cents per kg. Palm oil exports also performed quite well, with total exports receipts more or less doubling from \$2,710 million in 1981 to \$4,528 in 1984. But palm oil (crude) prices began to exhibit some erratic movements, declining from \$1,177 per tonne (f.o.b.) in 1981 to \$893 in 1982, \$999 in 1983 and going up again to \$1,611 in 1984. Export values for sawlogs registered a slight increase, but for sawn timber there was a decline. Tin export receipts also began to slide.

The slide in receipts from commodity exports continued up to 1985 and 1986. Export earnings fell further to \$2,872 million in 1985 and are estimated to have reached \$2,712 in 1986. The R.S.S.I. price fell to 189 cents per kg. in 1985 and is expected to increase to 200 cents per kg. in 1986. Palm oil continued to register a dismal performance; export earnings are estimated to reach only \$470 million in 1986 down from \$1,611 in 1984. The same dismal conclusion can be made for sawlogs while the outlook for tin is even worse. What is most remarkable is the behaviour

of oil prices. It was nothing less than a dramatic plummeting, with prices dropping from about US\$29 per barrel in 1984 to about US\$14 per barrel in 1986. Receipts from petroleum fell from \$8,737 million in 1984 to an estimated \$5,457 in 1986.

These developments in the prices of the major commodities began to bite into the economy and became increasingly painful by 1985. Just about all of the major economic indicators reflected the impact of the recession, but, surprisingly there seemed to be a gap between what was actually happening and the perception of what was actually happening. In 1980, the economy chalked up a growth rate of 7.8 per cent (real terms). It fell to 5.6 per cent in 1982, but went up to 6.3 per cent in 1983. Growth, again, peaked to about 7.6 per cent in 1984. But 1985 was a somewhat traumatic year. The most recent statistics available indicate that the economy recorded a growth rate of minus 1 per cent in 1985. All the major sectors, (mining, manufacturing, construction, wholesale and retail) with the exception of agriculture, recorded minus growth rates. But, this unwelcome news was only made known, officially, sometime in October 1986.

Thus at this stage the severity of the recession in Malaysia was really signalled by the performance in 1985, and the growth track record for 1980 – 1984 really clouded the intensity and severity of the recession to Malaysians and Malaysia-watchers. But there is no doubt that those whose interests were affected by the severity of the recession probably had discounted the past track record and had taken positions. On top of that the elections of 1986, in a sense, added further to the prevailing climate of uncertainty.

But this, quite apart from the dismal growth rates, is not the full story of the recession. More can be told, but they basically support the depressing general theme. Some of these developments can be quickly summarized. The Government still pursued its traditional counter-cyclical approach in 1981 and early 1982, and public investment increased by 41.5 per cent and 20.7 per cent respectively, thus raising its share in total investment from 37.4 per cent in 1980 to 51 per cent in 1983. Private investment, however, which was envisaged to grow at 10.7 per cent per annum, never really reached this level and grew very disappointingly at 1.8 per cent per annum over the 1981 – 1985 period. Thus, by 1985 its share in total investment had declined to about half (50.4 per cent) compared to about 63 per cent (62.6 per cent) in 1980. Investment by the 'Non-Financial Public Enterprises' (NFPEs) grew rapidly and accounted for about 38 per cent of the total public investment during the period 1981 – 1985. As export prices fell and

import prices increased, the terms of trade deteriorated, declining by about 1.4 per cent per annum. The gap between savings and investment widened – a development largely attributable to the rapid increase in public investment during the early years of the Fourth Malaysia Plan. To bridge this gap foreign borrowings increased.

All these developments were made worse by the deterioration in the balance of payments position. The current account recorded a deficit of about \$620 million (1.2 per cent of GNP) in 1980 and increased very sharply to \$8,409 million or 14.1 per cent of GNP in 1982, but improved to \$2,330 million or 3.1 per cent of GNP in 1985. The services account recorded continuing deficits. These deficits were due to the larger outflows in investment income, especially interest payments, and to the higher payments for freight and insurance. Because of this deficit in the current account, Malaysia continued to be a net capital importer and the substantial net inflow of long-term capital was able to offset the large current account deficit and net outflow of short-term capital.

I would like to talk about the recession in slightly more detail for the current year, 1986, and then go on to say something for what could be in store for 1987. Whenever it is useful I shall use 1985 as a sort of a comparative year. It should also be remembered that figures for 1986 are really estimates. All these figures are derived from the recently published Economic Report 1986/1987 of the Ministry of Finance.

As has been mentioned earlier, a growth rate (GDP) of 0.5 per cent (1978 prices) is expected to be realised for 1986. Growth in 1987 is not expected to increase to more than 1 per cent. GNP (at current prices) will rise absolutely by about half-per cent, to \$52,955 million in 1986, but will fall by 0.1 per cent in 1987 to \$52,926. With this decline, the *per capita* income of Malaysians will fall from \$4,581 in 1985 to \$4,094 in 1986 and to \$3,993 in 1987. So, by 1987, the level of *per capita* income will have regressed, roughly, to that of 1981.

Underlying these quite dismal growth prospects is the decline in the value of receipts from Malaysia's exports from \$38,017 million in 1985 to \$33,552 million in 1986. Exports are expected to increase slightly to \$34,360 in 1987. With the exception of manufactured exports, and the marginal increase for tin, all other exports are estimated either to decline or to remain stagnant in value, up to 1987. Prices of the major commodities are also not expected to increase, with rubber declining to 184 cents per kg. in 1987 from 200 cents per kg. in 1986 and crude palm oil remaining at \$470 per tonne, the level for 1986, in 1987. Petroleum prices, a crucial source of government revenue, are expected to reach only US\$13 per barrel, down from about US\$14 per barrel in 1986.

### *Coping with the Recession in Malaysia*

Central to the recession story are two major concerns, the so-called 'twin deficits' – on the Government's current account and on the current account of the balance of payments. More than anything else, these deficits have exercised a domineering influence on the entire approach towards overcoming the current recession. For Malaysia, the balance of payments problem is a novelty, unlike many other Third World countries which have either permanent, or recurrent problems with their balance of payments.

A combination of factors has conspired to increase the current deficit of the Federal Government. The growth of revenue has slowed down, and operating expenses, especially for salaries and wages, have increased and so has development expenditure. One assumption built into the original estimate on the growth rate of the economy of 5 per cent over the period of the Fifth Malaysia Plan 1986 – 1990, is that for oil, the price would reach US\$20 per barrel for the entire five year period. But this, of course, is no longer a feasible and realistic assumption to make. The decline in oil prices to well below US\$20 per barrel is a story which has been told and retold. Estimates by the Treasury indicate that the Federal Government revenue in 1986 will be lower (\$19,158 million) than the revenue level in 1985 (\$21,114 million) and it is forecasted to fall further (\$18,021 million) in 1987. As operating expenditure is not expected to come down dramatically at all in 1986 (\$20,498 million) and in 1987 (\$20,739 million), the current account will be in deficit, amounting to \$1,340 million in 1986 and rising to \$2,718 in 1987, an increase of about 102 per cent. But taking into account the Federal Government development expenditure for 1986 (\$7,521 million) and 1987 (\$5,573 million), the overall deficit, as a proportion of the GNP, is expected to increase from 9.3 per cent in 1985 to 13.4 per cent in 1986, but to fall to 12.5 per cent in 1987. Borrowings, therefore, will have to be increased (to \$6,293 million) but the bulk of the borrowings, as much as 71 per cent, will come from domestic sources. So, the Federal Government budgetary position in 1987 will not get very much better, with revenue declining by 5.9 per cent, operating expenditure increasing marginally, and with a substantial deficit in the current account. For the 'public sector' as a whole, the overall deficit will amount to 15.9 per cent of the GNP in 1987 compared with 19 per cent in 1986.

No dramatic improvements in the balance of payments position are envisaged for 1987. Falling commodity prices is further expected to adversely affect the balance of payments position in 1987. As the fall in the value of merchandise exports will be faster than the fall in imports, the deficit in the current accounts will be larger in 1986 than in 1985.

The services account will continue to be in deficit in 1987. The current account deficit, although improving slightly in 1987, will still remain large. As a percentage of the GNP, the current account deficit will reach almost 4.6 per cent compared with almost 5 per cent in 1986.

Much was earlier anticipated, in the Fifth Plan, of private investment assuming a bigger role in the period 1986 – 1990. The original target was for private investment to grow at about 7 per cent per annum compared with 1.8 per cent per annum which was attained for the previous five years. What was achieved in the last 3 years or so was considerably far below this original target; it was estimated that private investment declined (minus) by about 19 per cent in 1985, and by 13 per cent for 1986. What is envisaged for the entire Fifth Plan period, will be much lower than the original target. Already for 1987, it is forecasted that private investment is expected to grow only at 2.5 per cent.

With low growth and the recession, not surprisingly, the progress on moving towards the objectives of the NEP will be adversely affected. Much has been achieved in reducing the incidence of poverty: this has declined from about half in 1970 to about 18 per cent (18.4 per cent) in 1984. The full impact of the recession is expected to be felt after 1984. Also, the restructuring of the ownership of wealth and employment which has been predicted on growth or an expanding economy, will also be proceeding much more slowly. The original forecast, for example, that Bumiputra interests will own about 22 per cent of the share capital of companies operating in Malaysia will, in all likelihood, not be attained. And it is quite certain that the long-term target that Bumiputra should own at least 30 per cent of the share capital by 1990, cannot be reached.

### **Coping and Managing the Recession – Biting Back**

Coping with and overcoming the effects of the recession, will require clear and major readjustment policies. The readjustment policies can be divided into two broad types: macro-adjustment policies and micro-adjustment policies. At the macro level, adjustments will have to be made to the structure of demand and supply, to restore growth, while generating current account positions consistent with reduced external resource flows. The specific policies that will make up the package of the macro-adjustment policies will include the policy measures to reallocate resources into the export sector, i.e. emphasis on export expansion, tight fiscal-budgetary policies to reduce Government budgetary deficits, investment incentives to restore growth, policies to raise propensity to

save, and policies to reduce the debt-burden. Micro-adjustment policies are of a different nature but they should complement the macro-adjustment policies. These policies are to improve and increase the efficiency of the price system. Included also are the policy measures that would liberalize trade, domestic pricing, the financial sectors, public enterprises and in the fiscal system.

There is also a time dimension to these adjustment policies. It is best to think in terms of those policy measures that are more immediate in nature, short-term rather than long-term measures. There is some arbitrariness in assigning a specific length of time to distinguish between these measures. But immediate measures would be those policy measures that would have an impact within a period up to but less than a year: medium-term measures would span a period of 1 to 5 years while anything beyond 5 years would be long-term in nature.

Consider now the Malaysian approach to coping with the recession. Most, if not all, of the policy adjustments that have been mentioned have either been adopted or are in the process of being implemented by the Malaysian Government. The broad strategy as has been stressed many times, especially in the Fifth Plan, is to strive for growth with stability. Thus, all policy measures and the reforms have been designed to avoid destabilizing the economy and the wider adverse socio-economic repercussions these can have on the rest of society. The recent policy package of the Budget 1987 should really be seen as part of the Government's plan to contain the recession. If we were to trace the broad directions that the economy should take, it should be sought in the Mid-Term Review of the Fourth Malaysia Plan (MTR) which was published in 1983. The MTR introduced a number of major changes in strategy and in policy measures. These changes included the need to reduce the role and size of Government in the economy, increasing the role of private investment and enterprise, privatization and the adoption of Malaysia Incorporated as a means of facilitating a more collaborative working arrangement with the private sector. Further measures to weather the adverse economic conditions were then contained in the Budget for 1986. The Fifth Plan further reported on the economic conditions facing the nation and elaborated on the directions for the economy in the next five years up to 1990. The Budget of 1987 takes up the readjustments theme, makes a further assessment on the current economic conditions, on the basis of the latest information available, forecasts for the year ahead (1987), and presents additional measures to contain the adverse effects of the recession. Because the Budget 1987 contains the latest information on



the state of the economy, it should be given some additional attention.

There are a number of priority areas which the Government is now focussing on during the period of the recession. First, it is important to generate as much employment opportunities as possible. Second, attention is also focussed on increasing domestic activities through increasing demand for domestic goods and services. Third, the financial position of the nation has to be improved, especially by reviewing priorities on its development projects. Fourth, private and public savings will have to be increased. Fifth, new incentives will have to be introduced to encourage greater private investment. Sixth, public confidence in the economy will have to be strengthened.

A number of major programmes have been launched to ameliorate the immediate adverse effects of the current recession. A large scale programme for low-cost housing has been implemented with the annual target of 80,000 low-cost houses for the next three years, that is, between 1986 – 1988. To facilitate this programme, a financial package has been instituted to make available the finance required for the low-cost housing programme. There is also a programme for the construction of roads and minor works, especially for the rural areas, including maintenance works. Agricultural activities have also been stressed and for this, land will be alienated to the private sector for the cultivation of crops and cash crops, such as vegetables and fruits. These programmes have been selected mainly because of their relatively short-gestation period, their use of domestic resources and capacity, and the employment opportunities that will be generated.

### **Controlling the Budgetary Deficits and the Government**

A critical policy measure to overcome the recession is for the Government to consolidate its position, and for this it must strive to contain, if not to reduce, its operating expenditure, and also to reduce its development expenditures. The two items under operating expenditure which account for about two thirds of the total (about 67 per cent in 1987) of operating expenditure are personal emolument (38 per cent) and debt servicing (29 per cent). In 1987, both items will reach an estimated \$13,785 million (\$7,812 million for personal emolument and \$5,973 million for debt servicing). The other items under operating expenditure include the expenditure on services and supplies which cover items such as transport and travelling expenses, purchases of goods and maintenance expenses.

The degree of freedom that is available to the Government to trim down its operating expenditure is somewhat limited, as a sizeable proportion of these expenditures is 'locked-in'. Nevertheless, there are a number of possible options and the kinds of policy measures that are now being undertaken, do indicate the direction of Government on this issue. Retrenchment would represent one policy measure that could be considered. An extreme policy measure, retrenchment has been voiced by certain quarters as one of the ways to reduce the size of the Government, and the amount of wages and salaries that the Government has to pay to its employees. Although touted as one likely option, no clear policy announcement has been made on this approach. The wage bill can also be contained and reduced by denying or containing wage increases. Also, recruitment into the public services can be stopped or sharply reduced. Overtime could also be controlled. For the pension payments, revisions could be made to the system, by either sharply reducing the liability of the Government to the payments of these pensions, or by designing a system of sharing the burden of the payment with the employers or employees. Various perks, for example, housing loans, and car loans of public officials, can either be stopped or sharply reduced. All these have been considered by the Government and as shown in the recent Budget many of these measures have already been announced for implementation.

Inevitably, also, the size of the development expenditure has to be reduced if the financial position of the Government is not to worsen. The original development allocation for the Fifth Plan amounted to \$74 billion which was already below the estimated expenditure for the Fourth Plan. But that allocation was made on a number of key assumptions concerning economic growth, the behaviour of major commodity prices, export earnings, and Government revenue. All these assumptions, on hindsight, were somewhat optimistic, and will need to be reviewed. Oil prices, for example, were assumed to remain at US\$20 per barrel throughout the Fifth Plan period when the plan was drawn up. The current oil prices have remained well below that level, and although they are marked by uncertainty, it is unlikely that it will reach US\$20 for the remaining years of the plan. Indeed, the Budget 1987 has assumed that the oil price for 1987, for example, will only reach US\$13 per barrel. Oil palm prices which were assumed to reach \$1,500 per tonne have fallen to \$400 per tonne. The persistence of such gloomy prospects on the prices of the major commodities will require a critical