IS MALAYSIA GOING SUPPLY-SIDE?

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I. INTRODUCTION

Malaysia's economic planners may have not deliberately implemented policies with a dogmatic philosophical adherence to supply-side economics. Even if they had done so, some of the policies implemented which parallels supply-side economics as preached and practised by the Reagan and Tatcher Administrations for example, may have been out of fiscal necessity rather than a reflection of the prevailing philosophy of the Mahathir Administration. Whatever the case may be, it is evident that there have been significant aspects of supply-side economics in some of the policies introduced especially since the 'recession' years.

The Mahathir Administration inherited an economy which was and has been strong for the last decade, but one which was beginning to show signs of tiredness. The years 1981 and 1982 began to show signs of slowdown in the economy, initially through the weakening of Malaysia's major commodity prices which was mainly due to increasing recessionary pressures in industrialized economies.

This slack in demand affected the primary industries and resulted in a chain reaction. Construction, a thriving sector in the economy throughout the 1970s was badly affected. The eventual collapse of housing and construction affected the financial sector which was itself overexposed. A study of government policy reactions reveals an interesting pattern. There was a switch in policy orientation from 1984 onwards; a set of policy was formulated and implemented in anticipation of a downturn, but a different set was actually used in dealing with it. The pro market orientation after 1984 presents an interesting opportunity for the examination of the underlying contributing factors.

This departure from a Keynesian demand management orientation in fiscal and monetary policies can be regarded as being a radical change. More so if one looks at it in the perspective of the New Economic Policy which is a
deliberate attempt at interfering with market forces in achieving its objectives. Though the private sector has long been urged to play a bigger and leading role in the economy, this is the first time it has gone beyond mere encouragement. Indeed, if elements of supply-side economics are proven to exist, it is an indication of the faith laid on the private sector despite their lacklustre performance in the past in playing a more dominant role in the economy. The ramifications, of which, extend beyond economics given the public’s expectations of the role of government in their daily lives. This apparent reliance on the private sector and the inevitable emphasis on industrialization as the agent of future growth, perceived to be at the expense of more traditional areas such as rural development and equitable distribution of wealth, both of which requires government intervention, have become sources of political discontentment. It is not an exaggeration to conclude that beneath and beyond the political vested interests in today’s political scenario is the debate on the role and extent of government in the economy. The political conservatives are for liberal economics, and vice-versa. So much for labels!

II. REVIVAL OF CLASSICAL ECONOMICS

The economic recovery following the Great Depression of the 1930s gave credence to Keynesian demand, management policies. The assumptions of such policies were central to economic planning for governments of developed capitalist economies for much of the post war period. Indeed, by virtue of its dominance in economic literature since then, many developing economies, including Malaysia, has adopted such policies. The growth experienced by these countries throughout the period was short of phenomenal, further affirmation of the pre-eminence of the Keynesian school of thought. It was not until the 1960s before this Keynesian orthodoxy was really challenged.

Monetarism, which found its beginning with Friedman & Schwartz’s A Monetary History of the United States, 1867 — 1960. (1963). represented a revival of the classical school. Apart from criticizing the effectiveness of the use of fiscal policy in economic stabilization in the short run; a direct challenge to Keynesianism, the monetarists also proposed that the economy is essentially self-stabilizing; settling on a long run output path with a natural rate of unemployment (Wykoff:1976:299-300). These propositions were, in fact, a restatement of the ‘laissez-faire’ philosophy of Adam Smith, the father of classical economics.

It is also interesting to note, with the privilige of hindsight, that these criticisms of Keynesianism preceded the period of stagflation and hyperinflation of the 1970s with saw the demise, as the dominant economic thinking, of
Keynesian economics. Keynesians failed, both, to explain stagflation using their income-expenditure models and prescribe effective remedial policies. Thus they were described as 'defunct', the same adjective used by Keynes himself to describe the classicals in concluding his *General Theory of Employment, Interest and Money* (1935).

In the midst of the debate on policy effectiveness that followed the stagnation, while some stabilization occurring in the world market economies, a new policy 'catchword', supply-side economics, emerged in the late 1970s. This coincided with the advent of political conservatism that swept across the US and UK, namely the elections of Reagen and Thatcher into office. The pro-market orientation of supply-side economics had considerable impact in influencing the rise of political conservatism. It is noted that the present Malaysian administration came into being in 1981, not too long afterwards. The circumstances that led to the change in Malaysia are however different and it is postulated that, initially, this change in Administration did not entail a change in economic policies in place then, basically based on the Keynesian model. They may have been a change in emphasis but not approach. Budget proposals in the early 1980s and the Fourth Malaysia Plan (1980-85) did not show any dramatic policy realignment. As stated earlier, it was only in 1983/84, the beginning of the real recession, that economic policies took a turn away from the traditional Keynesian model, some characteristics of which may be similar to what is called supply-side economics.

What is supply-side economics and in what ways are the assumptions and policies different from Keynesian economics? This paper intends to give a brief theoretical answer to the above questions. Comparisons with Keynesianism is relevant because 1) Malaysian economics policies have been largely Keynesian especially since 1970, and 2) despite the 'defunct' label given to it, "even defunct economists can have powerful influence on practical people." (Bartlett & Roth:1984:1) If there is one thing economists should agree upon, it is that old economists and their policies never die, they keep coming back.

A Hesitation

One of commonest fallacy in economics, especially when dealing with policies, is the tendency to treat each term associated with a particular set of policy, supply-side for example, as unique and independent; as if an economic doctrine to the exclusion of others. An economy and its economics are far too complex in its interactions to be accorded such luxury. Iironically, it is the laymens' understanding of economics as simply "supply and demand" that best captures the essence of economic problems. Each term, classical, Keynesian
or supply-side economics, are complex terms referring to many different interrelated economics concepts. Each term can only, in the broadest sense, "refers to a methodology, a subject matter and a political position." (Wykoff:1976:299) They are not mutually exclusive.

Realizing these problems, the aim of this paper is perhaps more modest than an attempt to exclusively evaluate Malaysia's economics policies vis-a-vis supply-side economics, merely throwing some light on the different approaches adopted by the supply-siders and Keynesians in achieving the same macroeconomic objectives in the Malaysian context.

Towards this end, part III present an incomplete perspective on the so called supply-side economics. Comparisons with Keynesianism will be made. Part IV discusses policy implications related to government expenditures, investment/saving, productivity and the role of government. Empirical evidence of shifts in Malaysian economic policies during the 1980-88 period will be presented, and part V offers a brief summary and conclusion.

III. SUPPLY-SIDE ECONOMICS

Basic Assumption

There is general consensus that the principles expounded by the supply-siders today is not novel in economic analysis. Indeed, it has been the core of economic analysis of free market exponents since Adam Smith (1776). Neoclassicals, led by Friedman has always preached the vices of demand management in stimulating the economy. Supply-side economics, to put it simply is an explicit repudiation of the Keynesian assumption that demand is the lever that controls the economy.

Essentially, the basic supply-side proposition is that it is aggregate supply that determines national income, what is better summarized as Say's Law: supply creates its own demand, "that goods will eventually be paid for by goods" (Bartlett & Roth:1984:1); in effect rendering Keynesian demand management policies ineffective and insignificant. Consumption, a component of demand, therefore is an effect, not a cause of the supply of goods and services (production). Implicit in this assertion is the underlying assumption that market forces, if left unperturbed, will eventually determine economic equilibrium (supply = demand). This equilibrium, however, is determined by supply forces.
Having decided that supply factors are the determinants of national income, supply siders therefore concentrate on the management of the factors that will influence the supply of goods and services namely savings and capital stock formation instead of consumption and investment. Government policies should aim at providing incentives towards this end. Thus the apt description of supply side economies as “policies using microeconomic incentives to achieve macroeconomic goals such as increasing aggregate output and reducing unemployment.” (Shackleton:1986:24). The cost of borrowing to finance investment, wages earned from employment and tax rates on income are financial incentives that will affect the behavior of both individuals and firms. This parallels classical microeconomics as focussed by Walrasian general equilibrium where consumers and producers interact in the marketplace to determine production on the basis of relative market prices. The belief here is that in capitalistic economies, the ‘natural’ equilibrium level of output, thus employment and price levels, are determined by a pattern of incentives such as real wages, profits and interest levels, taxation, regulation and social obligations faced by the individuals and firms in the economy. Thus the determination and analysis of macroeconomic objectives include the determination of consumer and firm behavior patterns.

Supply-side believe that growth as represented by an economy’s production possibility curve can only be increased, apart from technological change, by the increase in capital stock accumulation;¹

The general industry of a society never can exceed what the capital of the society can employ. . . . . . No regulation of commerce can increase the quantity of industry in any society beyond what its capital can maintain (Smith:1776:193).

The production possibilities of any two good, x and y, if existing resources are fully employed, are given by the curve AB. The exact combination, point C for example, will be determined, based on relative prices, by interactions between owners of resources, producers and consumers, a Walrasian equilibrium.

¹The Harrod-Domar growth model with its emphasis on capital accumulation and its effects on productive potential, concurs with this. The famous Harrod-Domar condition for steady state growth

\[ s = n/a \]

mps equals the ratio of rate of growth of labor force and capital productivity involves parameters emphasized by supply-siders.
'Fiscal' Policy

Since increases in supply of resources, capital stock and labor, can shift the curve outwards, $AB \rightarrow A'B'$, policies should concentrate on increasing or providing incentives for these resources to increase. This contrasts with the Keynesian approach of using tax and government spending to affect household and business demands for goods and services (Ture 1980).

The 'natural rate of unemployment' thesis of supply-siders parallels Friedman's assertion that the economy will gravitate towards some fixed rate; the 'full' employment. Thus the inflation-unemployment tradeoff in the Phillip's curve, combinations of inflation and unemployment, is altered as in Figure 2 instead of Figure 3 (without the natural rate of unemployment).

Policy implications are significant. Stabilization possibility frontier (choices of combinations of inflation and unemployment) is a vertical line at the natural unemployment rate. The best policy is to ignore unemployment and target for price stability. Obviously, social welfare (SW) can be increased by moving up the stabilization possibility line.
Figure 2: Social Welfare Curves and Stabilization Policy Possibility (w natural unemployment)

Figure 3: Social Welfare Curves and Stabilization Policy Possibility Frontier (w/o natural unemployment)
If Figure 3 is instead correct, as generally assumed in the Keynesian framework, expansionary fiscal and monetary policies can be used to move from point A, for example, to point B which is on a higher social welfare curve. However, under the natural rate of unemployment hypothesis, such policy choices do not exist since unemployment is fixed as in Figure 2. Expansionary policies will increase money income and may result in temporary reduction in unemployment, but the lower unemployment is unnatural and eventually the excess demand will drive prices up and unemployment will fall back to \(u_n\), the natural rate. Under these conditions, if unemployment is to be maintained below \(u_n\), increasingly higher rates of inflation will have to be sustained. In terms of the classical model, output in the long run is fixed at some level \(Q^*(u_n)\) so that the equation of exchange becomes

\[
MV = PQ^*(u_n).
\]

Expansionary fiscal (\(\Delta V\)) or monetary (\(\Delta M\)) policies will only serve to increase inflation. Thus policies intending to increase spending power, which do not directly affect microeconomic considerations mentioned earlier, serves only to increase price without any effect on output as illustrated by Fig. 4.

Demand management policies fail to increase output as the aggregate supply is vertical at the natural rate. Supply-siders argue that only through the offering of microeconomic incentives can output be raised to a higher 'natural' level. Only when consumers and producers are provided with new or different sets of incentives will they alter their behavior.

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*Figure 4 : Aggregate Supply and Demand under Natural Unemployment*

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\(^3\)see Wykoff(1976), pp. 285-291 for further theoretical explanation
The assumption of 'natural' rate of unemployment (thus a 'natural' level of output) has further implications on the labor markets. In contrast to the Keynesian view that unemployment is involuntary, supply-siders believe, as did classical economists, that unemployment are actually voluntary; that at a given wage rate, some workers 'choose' not to take employment. This may be because they are frictionally or structurally unemployed. They may be because they are frictionally or structurally unemployed. They may also be looking for better paid jobs for which they are qualified which is expected in the near future (search unemployment). The point that supply-siders make is that all these levels of unemployment; frictional, structural or search, are due to the 'rigidities' that exist in the market that discourage workers from actively seeking jobs and employers from offering them.

Shackleton (1986) depicts supply-side labor market by Figure 4. Here D is the demand curve for labor, the AS curve stands for 'actual supply': number of workers who will actually accept a job at a given wage rate, W and LF, by contrast, shows the number of workers who wish to be in the labor force at a particular wage. The difference between AS and LF are those 'voluntarily' unemployed in the sense defined earlier. \((N_2 - N_1)/N_2\) is therefore the 'natural' unemployment rate. Since the market is actually at equilibrium, demand expansion is not the correct prescription. Policy should

![Figure 5: 'Voluntary' Unemployment](image)

*The diagram is also used in Begg et al (1984)*
concentrate on moving AS closer to LF by providing incentives for firms to create new employment and for individuals to seek employment more diligently (Shackleton, 1986:25). Unemployment benefits, not quite relevant in Malaysia, is often quoted as a disincentive for the unemployed to reverse their status. Institutional wage ‘stickiness’, labor and trade unions, and inadequate training and retraining facilities are some of the other disincentives.

Apart from the negative effects of expansionary fiscal policies on prices, supply-siders also assert that increased public expenditure will result in inefficiency in the market which can shift the production possibility frontier (Figure 1) inwards. The decision to provide more of a certain good through government provision involves attracting away resources from the production of other goods, a movement along the p-p frontier. “Supply-siders, however, emphasize that the increased taxes levied to pay for the new goods can reduce the total available resource, shifting the curve inwards.” (Tatom, 1981) Here, it is not so much that government expenditure is bad per se, but the new taxation necessary will create inefficiency and be a disincentive for private sector growth. Resource owners will still supply the resources to the marketplace but divert them to lower-taxed, less efficient uses thus lowering productivity. This may actually reduce the ‘natural’ level of output or increase the ‘natural’ level of unemployment. As a consequence, supply-siders stresses the need for tax reform with the intention of providing incentives both to individuals and firms; to increase savings on the part of individuals (resulting in higher supply of loanable funds which leads to lower costs of investment) and encourage firms to expand production. Tax reform should reduce the relative price of savings with respect to consumption. If tax levied on both current income saved and future income acquired with savings, the relative cost of savings increases. Here again supply-siders disagree with Keynesians that the motivation for tax cuts is to increase consumption and therefore aggregate demand.

The policy implications of supply-side economics can therefore be summarized as:

i) reduction in the role of government
ii) deregulation of markets and privatization
iii) tax cuts and incentives for private sector
iv) savings and investments incentives.

*Why must price be sticky and not fall to clear the market is a highly debatable question. Keynesians like to reason that employers are deliberately keeping wages above market clearing levels in order to have a bigger pool of worker to choose from. The recent recession has however shown that private employers, if they are hiring, are taking advantage of the high unemployment rate by offering much lower wages especially for the semi-skilled and skilled positions.*
The following section will briefly discuss Malaysia's economic policies in the 1980s in this context. The purpose, to reiterate, is not an attempt to label the policies as supply-side or otherwise, but to identify any shifts and whether the shifts can actually be characterized as in alignment with those proposed by supply-side economics discussed above.

IV. THE MALAYSIAN EXPERIENCE : 1980-88

If one were to tabulate the official strategy stated in the Budget Speeches for the years 1980-88, a clear pattern indicating a shift will be evident (see Table 1). The nine year period can be divided into two distinct periods with dividing point being the 1983/84 years.

**TABLE 1**

**Stated Budget Strategy 1980 - 1988**

<table>
<thead>
<tr>
<th>Strategy</th>
<th>80</th>
<th>81</th>
<th>82</th>
<th>83</th>
<th>year</th>
<th>84</th>
<th>85</th>
<th>86</th>
<th>87</th>
<th>88</th>
</tr>
</thead>
<tbody>
<tr>
<td>Restrain inflation</td>
<td>*</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Counter-cyclical (Expansionay)</td>
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<td>*</td>
<td>*</td>
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<td></td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>Eradicate poverty</td>
<td></td>
<td>*</td>
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<td></td>
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<td></td>
<td></td>
<td></td>
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<tr>
<td>Strengthen bal. of payments</td>
<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Strengthen public sector finances</td>
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<td></td>
<td></td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Private sector growth</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td>*</td>
<td></td>
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<td></td>
<td></td>
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<td></td>
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<tr>
<td>Reduce govt role</td>
<td></td>
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<td></td>
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<td></td>
<td></td>
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<td>*</td>
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<tr>
<td>Promote export</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>*</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employment creation</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>*</td>
</tr>
</tbody>
</table>

Source: Budget Reports, 1980-88

Before proceeding to discuss the types of shifts that occurred, it is wise to recall that the earlier period, 1980-83, represents a prelude to the recession. Signs were not encouraging and optimism was not the mood then even though actual economic performance was commendable. The economy grew by about 8 percent in real terms in 1980, exceeding the 6.5 percent target, and private
investment grew by 18 percent. International economic slowdown and inflation, at 7 percent in 1980, were however worrisome to the extent the then Finance Minister concluded rather cautiously, that “... undoubtedly, we have and are going through a difficult time.” (Budget, 1980:6). For the purposes of comparison, this period can be classified as ‘anticipatory’; that is policies implemented can be interpreted as preparations for the impending recession.

The latter period, 1984-87, can be termed the recession period; low growth, high unemployment and low price levels. The policies of this period can be regarded as ‘getting out of the recession’. 1988 is omitted because indicators have so far been very positive that this year may be the beginning of the recovery period, if growth is sustainable.

![Chart](https://via.placeholder.com/150)

Source : Economic Report, Min. of Finance

**Figure 6** : Annual Growth of GNP, and Consumer Prices (%). 1977 - 1988

Classifying the two periods this way enable a more succinct policy comparison.

**The 1980 - 83 period**

It is noted that 1980 marked the completion of one of the longest cyclical upswings in the Malaysian economy, sustained within an environment of generally weak economic growth and rapid inflation in the major industrial
economies. Economic indicators for the preceding five years have been robust.\(^6\) Confidence, derived from the resiliency exhibited by the economy throughout the upswing, was high. This optimism, however, was guarded because the international recession did not show signs of recovery. The primary concerns of policy makers during this period were, therefore:

- continuing international recession, and
- inflation.

Given this scenario the government, as indicated by the Budgets of 1980-83, concluded that expansion of domestic demand would be the basis of growth for the Malaysian economy. As such, “budgetary considerations were conceived with the principal objective of stimulating private sector expenditure in the face of weakening external demand as well as slackening consumer spending” (Bank Negara Annual Report, 1980:14). Public sector expenditure would assume a countercyclical role - a classic Keynesian prescription!

Direct development expenditure was increased by a whopping 87% and operating expenditure by some 25% in 1980.\(^4\) It is worth noting that “Operasi Isi Penuh” was launched in 1979, and contributed significantly to the increase in operating expenditure. The government also revised salary for the public sector in 1981. Consequently, public sector finance incurred an overall deficit of $7.1 billion, or an increase of 92% from the previous year.\(^7\) This trend of increasing public expenditure as a countercyclical measure continued until 1982. As a direct result, foreign borrowings in 1981 increased by over ten times the amount in 1980, and contributed to the increase in overall foreign debt from a total of $4.5 billion at the end of 1979 to $17.73 billion by the end of 1983. (Bank Negara Quarterly, June 1986:58) The decision to go into deficit spending is again a Keynesian measure, but to finance this through external borrowings may have been initially influenced by the over-confidence in the strength of the ringgit at the beginning of 1980. The then Finance Minister implicitly imply this when he said “This (the appreciation of the ringgit by 7.5% against major currencies and the doubling of external reserves) strenghten Malaysia’s credit

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\(^6\)The Malaysian economy recorded an average growth rate of 8% in real terms during the 1976-79 period and inflation was maintained at about 4%. Trade surplus amounted to more than $18 bil. throughout the four years and contributed to the doubling of external reserves, some $9 bil. at the end of 1979. Unemployment was slightly over 5% was not a concern.

\(^4\)Direct development expenditure increased from $2.83 bil. in 1979 to $8.86 bil. in 1980 and operating expenditure from $10.05 bil. to $13.7 bil.

\(^7\)Overall deficit was $3.7 bil. in 1979 and $7.1 in 1980.
standing in the international monetary market thus enabling us to undertake external borrowing at very favorable rates. “(Budget, 1980:5). This heavy borrowings resulted in debt services charges to increase from 13% of operating expenditure in 1979 to some 19% in 1983, a bigger share than for economic services - a legacy that still haunts policy makers today.

Despite this heavy increase in public expenditure, “the biggest tax cut in the nation history was carried out in 1980, amounting to some $482 million.” (Budget, 1980) This combined strategy of increasing public expenditure and implementing tax cut are meant to increase domestic demand to make up for the slack due to the impending recession. Further evidence again that Keynesian demand management policies were the guidelines throughout the period. Average growth rates of more than 5%, though low by previous standards and progressively decreasing, throughout the period provided some measure of consolation for policy effectiveness, at least in terms of growth.

As usual, the private sector was encouraged to play a more dominant role in leading the economy. Some incentives; accelerated depreciation and reinvestment allowances and reduction in surtax, excise and duty of selected raw materials were provided between 1980-1982. At the individual level, increases in tax exemptions and reduction of marginal rates for the top three brackets were proposed in 1980. A supply-side feature for the period is the introduction of incentives for private savings. Total EPF contribution was increased from 13 to 20% in 1981 and interest gained from fixed deposits of more than 12 months are exempted from tax beginning in 1982.

It was not until 1983 before government finances and its effects on future growth became a real concern. In fact the 1982 Budget was revised, decreasing both the operating and development allocations by about 8%. Expansionary fiscal policy was stopped in 1983 and government finances and balance of payments became the primary concerns from that year onwards. Privatization Policy was introduced in 1983, among other reasons, to reduce public sector finances.

1984-87 Period

1984 was sort of a transitory year in terms of policy. The government for the first time admitted that “these countercyclical measures cannot continue indefinitely without causing undue strains on Government finances, balance of payments and on our future growth. “(Budget, 1984) The fact was that these measures had already caused the strains mentioned. Two other changes occurred in the Finance Ministry : changes of the Finance Minister and the governor
of Bank Negara. To what extent these changes affected ensuing policies is debatable but the pro-private sector profile in subsequent policies must have been influenced, to some extent, by the ‘non-politician’ businessman Minister and a ‘banker’ Bank Negara Governor.

TABLE 6
($bill)

<table>
<thead>
<tr>
<th>Year</th>
<th>Revenue</th>
<th>Current Exp.</th>
<th>Develop. Exp.</th>
<th>Overall Balance</th>
<th>Net Foreign Borrowings</th>
</tr>
</thead>
<tbody>
<tr>
<td>1977</td>
<td>7.76</td>
<td>7.4</td>
<td>3.2</td>
<td>-2.8</td>
<td>.269</td>
</tr>
<tr>
<td>1978</td>
<td>8.84</td>
<td>8.1</td>
<td>3.6</td>
<td>-2.9</td>
<td>.541</td>
</tr>
<tr>
<td>1979</td>
<td>10.51</td>
<td>10.1</td>
<td>4.2</td>
<td>-3.7</td>
<td>.679</td>
</tr>
<tr>
<td>1980</td>
<td>13.93</td>
<td>13.7</td>
<td>7.3</td>
<td>-7.1</td>
<td>.310</td>
</tr>
<tr>
<td>1981</td>
<td>15.81</td>
<td>15.7</td>
<td>11.1</td>
<td>-11.0</td>
<td>3.42</td>
</tr>
<tr>
<td>1982</td>
<td>16.69</td>
<td>16.7</td>
<td>11.2</td>
<td>-11.2</td>
<td>4.9</td>
</tr>
<tr>
<td>1983</td>
<td>18.61</td>
<td>18.6</td>
<td>9.4</td>
<td>-9.2</td>
<td>4.6</td>
</tr>
<tr>
<td>1984</td>
<td>20.81</td>
<td>19.8</td>
<td>8.1</td>
<td>-7.1</td>
<td>3.1</td>
</tr>
<tr>
<td>1985</td>
<td>21.12</td>
<td>20.1</td>
<td>11.3</td>
<td>-5.7</td>
<td>.96</td>
</tr>
<tr>
<td>1986</td>
<td>19.52</td>
<td>20.1</td>
<td>11.3</td>
<td>-7.5</td>
<td>1.4</td>
</tr>
<tr>
<td>1987</td>
<td>17.28</td>
<td>20.8</td>
<td>10.6</td>
<td>-9.7</td>
<td>-2.0*</td>
</tr>
</tbody>
</table>

Source: Bank Negara Quarterly Bulletins

*Prepayment of foreign debt was complemented by drawdown of assets and increased domestic borrowing.

From 1984 onwards, the Budget strategies thus policy choices were rather straightforward, that is

- reduce government’s involvement in the economy, and
- promote private sector growth.

The first strategy does not merely involve contractionary fiscal policy aimed at improving government finance and the balance of payments, but also involves market deregulation and provision of a wide range of incentives to promote private sector growth. The motivation was that the burgeoning public sector is inefficient and becoming a stumbling block to the realization of the economy’s potential; a hindrance to growth. This change in policy is not a transitory measure in combating the recession but represents a belief that the path towards future development must be spearheaded by the private sector.
Public sector expenditure, specifically development expenditure, showed a contractionary pattern from 1983 until 1986 when it went up by some 14% before declining again until the tabling of 1988 Budget. As a result overall government financial deficit declined accordingly and balance of payments position showed some improvement. The Federal Government overall deficit of $9.7 billion in 1987; some 18% of GNP, is, however, an indication that the effort at controlling public expenditure is far from over. Only through increased revenue, resulting from a higher growth rate can the deficit be reduced. The government is however fortunate that external reserves showed healthy gains enabling pre-payment of foreign debt thereby reducing somewhat debt services charges. There is also an apparent move towards domestic borrowing thus protecting the government from loan appreciation through foreign exchange movements.

A contractionary fiscal policy during a down cycle is definitely not Keynesian, but one may also argue that the reduction in public expenditure may have been out of fiscal necessity, the need to control government finances. Reports of high deficits and increasing external borrowings, apart from having the obvious economics effects, have a dampening effect on private sector investment. This aspect, the reduction of public expenditure, of reducing the role of government in the economy may not be able to be labelled as supply-side for certain. The government may have just been prudent in their finances.

It is privatization and deregulation together with the provision of incentives to the private sector that can be more aptly described as being supply-side in orientation.

Though various incentives have been offered before to the private sector, the years following 1983 showed a more earnest effort. Incentives and tax reductions are not limited to items such as increasing estate death duty exemptions and reducing road tax for public transportation. Equity requirements vis-a-vis NEP have also been relaxed. Foreigners can own up to 100% equity in companies that export 50% or more or employ 350 or more Malaysian workers. A glance at the Industrial Master Plan, launched in 1986, showed a wide range of incentives from exemption of duties on industrial inputs to further accelerated depreciation and reinvestment allowances to abolition of excess profit tax. Real property gains tax were revised downwards, double deductions given for training and research expenditures, and as further measure to encourage savings, tax exemption on interest derived from deposits was extended to include all banks and finance companies. Initially, only those with LUTH, Bank Simpanan Nasional, Bank Pertanian and MBSB are exempted. Individual income tax schedules were also revised. Marginal rates were reduced as well as raising the franking limit of excess profit from $100,000 to $300,000.
Privatization is yet another tool of supply-side that has gained popularity since 1983. Without having to go into details in this much debated policy, one must realize the underlying philosophy of privatization. Quite simply, privatization means government need not be involved in the production of goods, hopefully private goods. Public expenditure should not go into the production of private goods. Apart from the financial burden, government are simply not efficient. Privatization also means the loss of government's significance in controlling the economy. Indeed, privatization and the other aspects of supply-side policies do not just structurally alter the economy but necessitate a change of attitudes, both of the public and private sector.

It is true that Malaysia's seemingly remarkable economic recovery as indicated by estimates for 1988 cannot be wholly attributed to external factors. Government policies especially since 1982 has a role in that recovery. The maintainance of low inflation rate, a healthy level of reserves and the ability to attract investments are results of policies. It does not hurt that commodity prices have recovered tremendously.

It is also clear that if business confidence can be maintained through sound government fiscal and monetary policies, high growth can be attained. If there really are elements of supply-side, thus a growth-oriented policy, and it being a permanent feature, the question that remains is whether this growth can also be equitably distributed? On the other hand, there is no sense in talking about equitable distribution if there is no growth.

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