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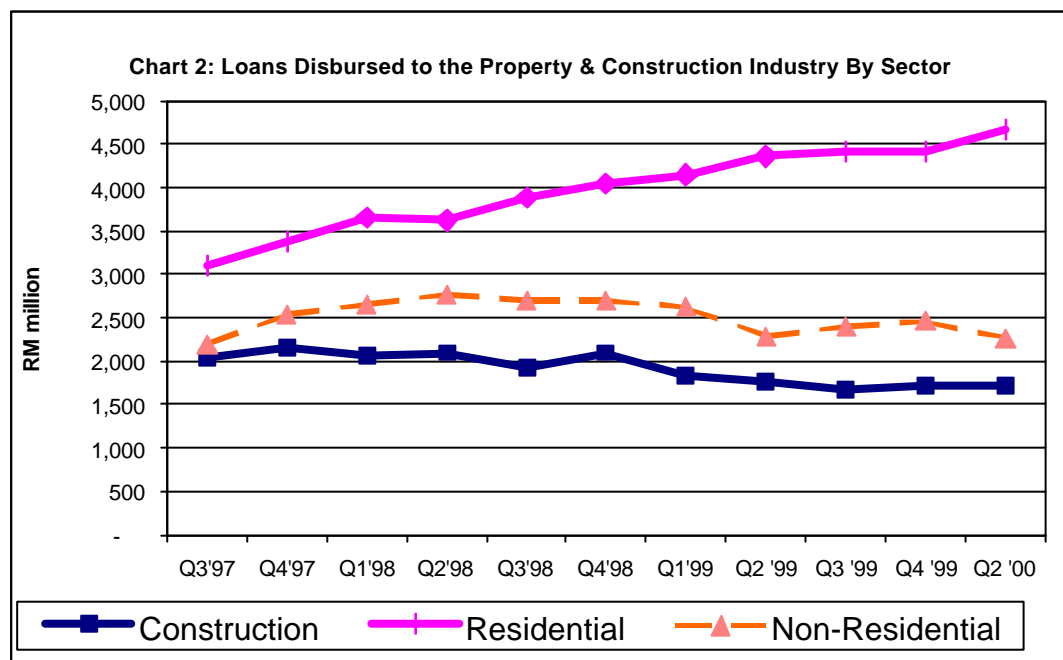
year. This shows that the construction industry remains depressed in Penang. See Table 1 and Chart 2.

On a quarter-to-quarter basis, loans disbursed for the manufacturing sector in Penang for Q2'00 was higher by 5.81% when compared to the previous quarter

Table 1: Changes in Loan Disbursements for the Property and Construction Sub-Sectors

Sub-Sector	Previous Quarter	Same Quarter Previous Year
Residential	5.7%	13%
Non-Residential	-0.8%	-1%
Construction	-3.1%	-6%

Source: Derived from Bank Negara Malaysia Data



Source: Derived from Bank Negara Malaysia Data

### Manufacturing Sector

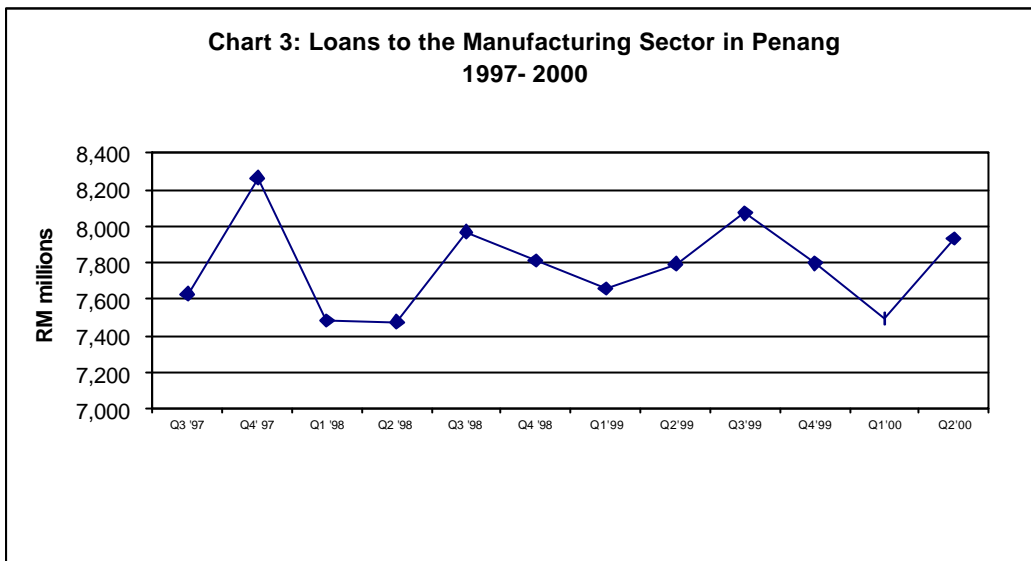
On a quarter-to-quarter basis, loans disbursed for the manufacturing sector in Penang for Q2'00 was higher by 5.81% when compared to the previous quarter (Q1'00). It was however, only 1.78% higher when compared to the same quarter in 1999. See Chart 3. These statistics are very much in tandem with upward trend for manufacturing sales for the first half of this year. Along with this rise, employment, salaries and wages in this sector also went up. The upward trend for the manufacturing sector was expected due to increased exports in this quarter. Exports of electrical and electronic products, which accounted for 58.6% of all national exports (state figures unavailable but the electrical & electronic sector contributed 52% of GDP in 1996), also rose. The improvement in productivity was not surprising since output generally increased faster than employment costs as the economy came out of recession.

### Wholesale, Retail, Restaurants and Hotels (WRRH)

Loan disbursement to the Wholesale, Retail, Restaurants and Hotels sectors was up by 6.7% on a quarter to quarter basis (Q2'00 compared to Q1'00). There was, however, a sharp surge in loans of 11.0% when compared to the same quarter the previous year (Q2'99). See Chart 4. This is also an indication that domestic spending has picked up as the Malaysian economy slips out of recession.

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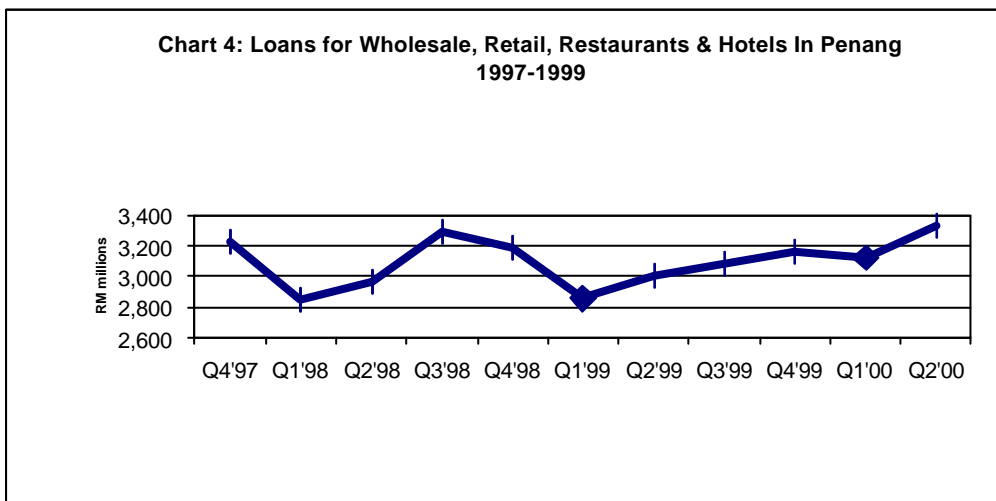
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Loan disbursement to the Wholesale, Retail, Restaurants and Hotels sectors was up by 6.7% on a quarter to quarter basis

Source: Derived from Bank Negara Malaysia Data

The Retail industry is expected to garner a significant growth of 12.5% this year, according to the Malaysian Retailers Association. This is a significant rise compared to the same quarter last year.



Source: Derived from Bank Negara Malaysia Data

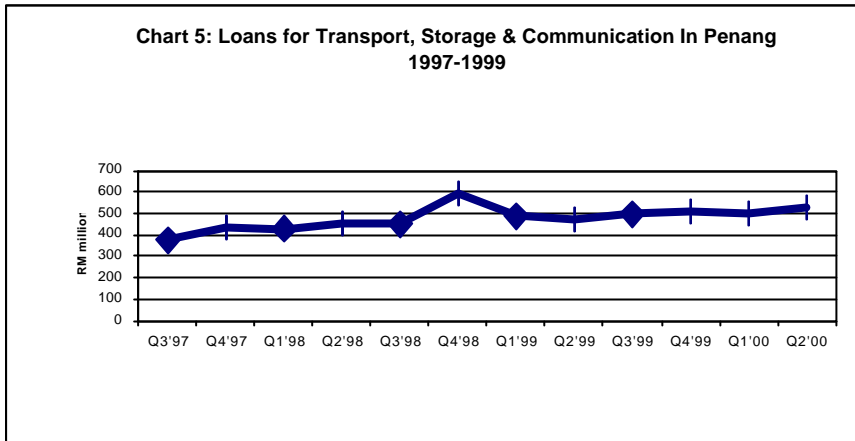
*Transport, Storage and Communication*

Spurred by the upward swing of the economy and the revitalisation of related sectors such as the manufacturing; the transport, storage and communication sector loans disbursement was up by 5.5% on a quarter-to-quarter basis. When compared to the same quarter the previous year, growth was even more outstanding at 11.9%. Penang's strong export manufacturing sector has definitely played an important role in the dynamic recovery of the transport, storage and communication sub-sectors. See Chart 5.

*Implications*

The general public in Penang is beginning to regain their confidence in response to the

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Source: Derived from Bank Negara Malaysia Data

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economic measures taken by the Government, albeit, slowly. This is reflected in the willingness to make long term commitments and purchases of residential property. Of course, this too has been given a boost by 2 house ownership campaigns.

The construction sector is yet to recover as major infrastructure projects in Penang have still not been fully implemented (Butterworth Outer Ring Road and Penang Outer Ring Road/Jelutong Expressway) or have just taken off, such projects include road widening at the Bagan Jermal/ Hill-side.

The Wholesale, Retail, Restaurant and Hotel sub-sectors are also recovering and this is evidenced by an increased domestic demand for them. The Malaysia Shopping Carnival has given a great boost to stimulate domestic spending in these sub-sectors. A recent survey of all beach hotels from Gurney Drive to Batu Ferringi during the Merdeka weekend showed full occupancy with no cancellation of bookings.

Strong support in the manufacturing sector powered by booming exports of electrical and electronic products, gave much stimulus to the local economy and this is observed in the willingness to take out loans for the expansion of operations in the last quarter. The manufacturing sector continues to spearhead the recovery process for Penang's economy. Supported by the good infrastructure, port, airport and communication facilities, Penang can expect to see a more buoyant economy due to increased manufacturing activities in the later part of this year and early next year. **§ Khor Hung Teik**

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to the 1997 crisis. If currencies had been allowed to float freely there will be little price distortion and hence little opportunities to speculate. However, Bank Negara like most central banks typically buy and sell their reserves to keep the exchange rate around a certain peg, in this case around RM2.50 to the U.S. dollar. Thus when the ringgit softens speculators buy cheap ringgit along its down trend and then sell what they bought to Bank Negara as prices are pulled up.

The monetary approach worked for Britain in the eighties and the fiscal route worked for Malaysia during the recent crisis. Could the opposite have worked? Unlikely. It is not a question of whether the right approach should always be monetary or always fiscal but the right judgment of the prevailing circumstance. In Britain it was competition over the same funds between the private and public sectors. The lower deficit freed investment funds for the private sector use. Government will power was the crucial element because it was unwavering certainty over what the British government wanted to do that brought recovery. In Malaysia such an approach is less likely to be successful because policies often get revised midstream creating uncertainties. Having said this, however, Bank Negara has not wavered from its RM3.80 to the dollar conversion. Nonetheless there remain much talk that the government will revise this rate of conversion. The fiscal approach has been necessary for Malaysia. Unlike Britain, there really isn't a huge private sector leading industry. The government has a

lot of control over the big private corporations. Thus even if government spending were to shrink, there is no guarantee that investments funds will be readily tapped by the private sector. Loan growth by banks although targeted as one of the vehicles for economic recovery were slow in keeping pace.

What could we learn from Sir Alan's public lecture as we ponder over strategies that Malaysia has adopted for economic recovery? Put it another way, should Bank Negara look more closely at monetary targets? The answer lies in whether there is a relationship between money and income. Dividing Malaysia's M2 (cash, current accounts, savings and time deposits) by the GNP we see this ratio to have about doubled at a fairly steady rate from less than four-tenths between 1971 and 1995. The relationship does exist with an upward trend. However, over the same period, the monetary base sometimes grows in excess of 30 percent in a year, sometimes well below 10 percent. Bank Negara could have done better with its monetary policy. There may have been reasons for having held the reins less tightly, such as the wish to keep interest rate steady as part of its overall strategy for a stable exchange rate to make Malaysia's industrial exporters happy. Now that the ringgit's exchange rate is no longer an issue the time should be ripe for Bank Negara to put on its monetary cap and steer Malaysia's economic growth more exactly along the tracks. **§ Chan Huan Chiang**



## Technological and Managerial Upgrading of SMI/Es Through Linkages with MNCs/LSIs (Part 1)

It is widely known that many MNCs/LSIs are developing supplier networks of competitive SMI/Es to complement their core activities. However, it is also an acknowledge fact that many of the local SMI/Es remain de-linked from the MNCs/LSIs, and thus are at a disadvantage in terms of technological spillovers, access to markets, information technology as well as finance. The main reason for this de-linkage is that the local SMI/Es have not been able to comply with the corporate standards of the MNCs/LSIs as well as the international standards on price, quality, delivery, health, labour and environment.

There are many traditional obstacles to forging linkages: requirements for SMEs to be partnership ready; best practices in terms of programmes; new challenges; what the private sector needs from the public sector; what the private sector can do and the blueprint for growing competitive SMEs.

This paper attempts to discuss the implications of these issues for the development of local SMI/Es.

### Issues & Challenges

#### Issues

##### *Limited Financing for SMI/Es*

Most SMI/Es, especially new start-ups face financing problems. This is mainly because the banking and financial institutions are reluctant to disburse funds to the local SMI/Es that lack collateral and track records. Limited financing will impede the growth of the SMI/Es in increasing the capacity, technological capabilities, as well as growth in other resources such as human resources.

##### *Lack of Skilled Labour Force*

The SMI/Es have to compete with the MNCs/LSIs in the recruitment of skilled and qualified engineers and technicians. Most SMI/Es, particularly the smaller ones and the new start-ups are unable to match the remuneration package given by the MNCs/LSIs. As such, they lack a skilled labour force that is capable of operating high-tech equipments and processes.

##### *Low Technological Level/Outdated System*

Low technological level and utilisation of an outdated system of production is very much related to limited financing. The lack of capital and assets to invest in the state-of-the-art machinery and equipment as well as to increase the skills capability of the labour force results in low technological level of the SMI/Es. The low technological level of the local SMI/Es is also attributed to the lack of skilled labour force and the mindset of the owners/proprietors of the SMI/Es. Local SMI/Es are commonly family-owned or are established by personnel with only technical expertise. As such, the owners/proprietors of these SMI/Es lack management expertise that would enable them to understand the importance of training and retraining of their labour force as well as the importance of providing a favourable working environment for their workers.

##### *No Business Code*

As many of the SMI/Es are family-owned and lack management expertise, most of them also do not have a proper business code. Without a proper system for conducting business, the SMI/Es experience slower progress in the adoption, absorption and implementation of newer technologies as well as management skills.

##### *Low Reliability*

Lack of business code, skilled labour force, finance and technological know-how contribute to low reliability in quality and delivery by the SMI/Es. Low reliability further de-links the SMI/Es from the MNCs/LSIs, as the SMI/Es are unable to comply with the require-

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ments of the MNCs/LSIs.

#### *No Vision, No Strategy for the Future*

As in the case of business code, the local SMI/Es also lack vision and a strategy for the future. Without a vision and strategy, the local SMI/Es are unable to chart their direction of growth and they do not have a target to benchmark their growth. This resulted in haphazard growth among the SMI/Es.

#### *Small Scale/Volume of Production*

The SMI/Es, especially the smaller ones do not have economies of scale. Their volume of production is relatively small, making profit margin rather insignificant. This impedes their efforts to expand. The other impediments like lack of skilled labour force, financing and technology competency further aggravate this situation.

### Challenges

#### *Intensification of Limiting Factors*

The limiting factors include time, rapid technological development, and lack of capacity for continuous innovation. Due to the rapid changes in technology, in the electronics industry in particular, product life cycles are getting shorter. This indicates shorter time to market and in order to be suppliers to the MNCs/LSIs that are competing in the global market, local SMI/Es have to upgrade their technological capability and capacity to meet the requirements of the MNCs/LSIs. The lack of volume of production may hamper the efforts of the SMI/Es to develop their technological capabilities. As the volume is too small to justify automation, SMI/Es will most likely maintain their original mode of production rather than adopting and implementing newer and more advanced ones. The lack of volume also discourages the SMI/Es from increasing their production capacity. This prevents them from receiving large orders when opportunities arise.

#### *Speedy & Paperless B2B*

The trend of today's business-to-business (B2B) transactions are towards paperlessness and at a very high speed. Local SMI/Es will be required to adopt the ERP (enterprise resource planning) and eventually CRM (customer relationship management) systems and communicate via Internet if they want to be successful and competitive globally. Progress and advancement in communications and transactions will be based on speed and also paperlessness. As such, the local SMI/Es have to keep themselves abreast with the latest developments in ICT (information and communication technology), failing which they would be left behind in global competition.

#### *WTO*

WTO's commitment, which prohibits traditional strategies based on restrictions such as local content and partnership/joint venture rules, will pose a great challenge for local SMI/Es. The abolishment of local content and partnership/joint venture rules will result in greater competition for the local SMI/Es. SMI/Es that fail to meet the corporate requirements of the MNCs/LSIs will lose out as competitors from within the country as well as elsewhere will be competing for the same customers.

#### *Implications*

SMI/Es, especially new start-ups will encounter the issues discussed above. Sometimes the larger firms also face financing issues during an economic downturn. Skilled labour shortage is also a generic problem among the larger firms, especially when there is a mismatch between the supply of and the demand for workers. This is especially so when the countries are facing a full employment situation. As for technology, not all industries are high-tech in nature and thus, some large firms could also utilise technologies that have been in existence for sometime. Only firms that are involved in the electronics components, computer & peripherals as well as information and communication sectors need to continuously upgrade their technology capabilities and capacities.

It is rather common that SMI/Es, especially new start-ups and the smaller ones do not have a proper system for conducting business, lack vision and strategy and do not have economies of scale. All these characteristics, thus contribute to low reliability.

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As such, all countries, whether developed, developing or underdeveloped would have this category of firms, no matter how advanced their large companies are. On the other hand, to become competitive in the global markets, these firms must be able to face the challenges mentioned earlier. The local SMI/Es must have the initiative to continuously upgrade their technological level in accordance with the requirements of their customers. These technologies may not be the latest in the market but must be able to comply with their customers' demands.

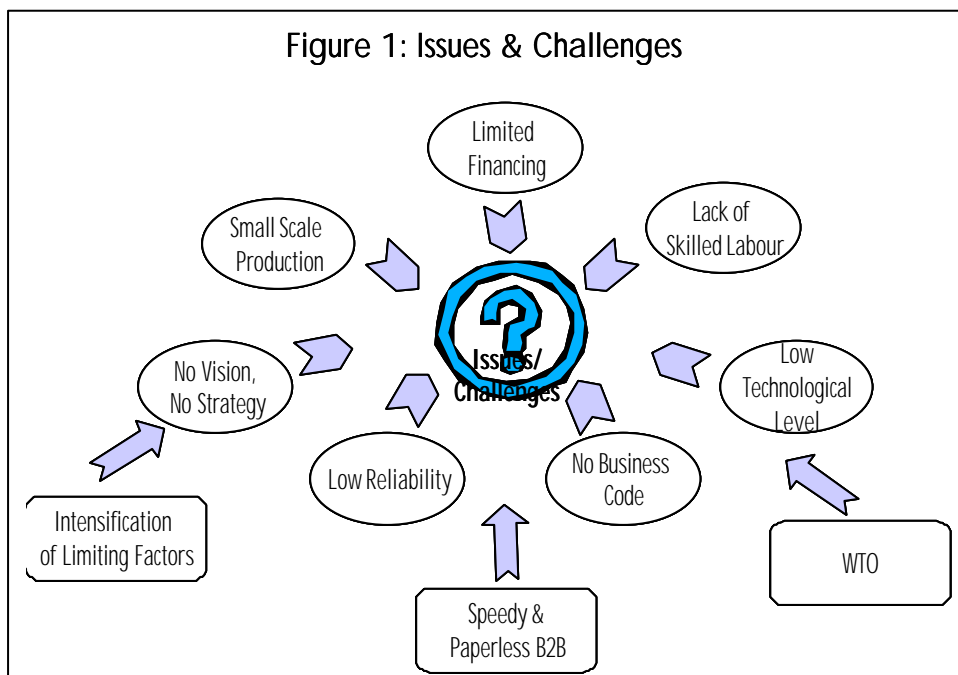
As businesses and manufacturing activities are increasingly becoming 'virtual', the local SMI/Es have to conduct their businesses via Internet or stand to lose out to other competitors. This is mainly because larger firms are beginning to source via e-business or paperless channels.

WTO and the forthcoming AFTA will lead to greater liberalisation and abolishment of protectionism. It is envisaged that the local SMI/Es that are presently supplying to the MNCs/LSIs in the electronics industry and the global markets will face little difficulty in competing with suppliers/ subcontractors from the other regions of the world.

On the other hand, other industries, which have been protected either by the government or the special trade systems would most likely be affected with the rectification of AFTA/WTO. The apparel industry, which is presently subjected to the quota-system of the Multi-Fibre Agreement (MFA) would have to compete with other regional suppliers of apparel products when AFTA/WTO is realised and the quota system abolished.

Although the local automotive industry has been given exemption from AFTA till 2005, and thus assured continuous business for its suppliers and vendors, it is just postponing the problem of facing global competition. The vendors would most likely face greater challenges when the exemption period expires. The Malaysian automotive industry, although it is the best model for developing local vendors, is also an arena of protectionism by the government. Furthermore, the 'single sourcing policy for each product' by the national car manufacturer further reduces competition among the local vendors. As such, while the other export-oriented industries may face fewer difficulties with the implementation of AFTA/WTO, the automotive industry may have to put in more efforts to enhance their capabilities to compete in the global market. **§ Anna Ong**

(Part Two — to be continued in October)



## Monetary versus Fiscal Policy: Reflections On The Public Lecture by Sir Alan Walters

There has been constant debate as to whether monetary or fiscal policies are more effective for steering an economy in crisis towards recovery. In a public lecture at SERI recently, Sir Alan Walters, Chief Economic Advisor to Margaret Thatcher during her term as Prime Minister, shared his experience. "I am a quantity theory of money man. Let me say that out front so that you know where I am coming from." By this he meant that the stock of money multiplied by the velocity of money (how fast money circulates through the economy) will be equal to price level times the total of all economic transactions (represented by the GDP). Monetarists go by this equation. To support economic expansion via GDP growth, monetarists would alternatively tighten and loosen money supply in the open market so that growth in the money stock is kept at a steady pace. This would help keep price level generally unchanged so that inflation is well under control. Money velocity in the equation is thought to be about constant because it reflects the proportion of the year's income that people will likely hold as cash. As a result, growth in money supply and economic growth will be somewhat proportional to each other.

Britain embraced the monetary approach under Prime Minister Thatcher. Despite public criticisms, containing revelations of the deepest recession in British history, her administration targetted reductions in the public sector borrowing requirements (PSBR) in the face of huge unemployment. The PSBR amounted to 5.5 percent of GDP in 1978. By 1982 the PSBR had been halved to 2.25 percent of GDP. Monetary policy came into its own. Not only was there no specter of recession but between 1982 and 1987, growth in Britain had surpassed all European nations, a reversal of the situation the decade before.

The strategy was simple. Like other monetarists, Sir Alan is not convinced that fiscal policies will have much effect in boosting the economy. Less government spending through the lowering of the deficit should have little or no effect on the economy. Less government spending would allow private sector investments to crowd in. Private sector confidence would increase over the government's determined effort to improve economic fundamentals thereby spinning more investments to produce the desired private sector led growth.

On the other side of the divide, Keynesian economists like Walter Heller who was economic advisor to President John F. Kennedy disagrees. Although they do not refute the validity of the above equation linking money supply to economic transactions, Keynesians are doubtful over the stability of the velocity of money. Given conditions of under-employment, they would expect the money velocity to be very unstable and will offset the effects of changing money supply. Therefore

money supply growth will not bring any significant improvement to the economy. More likely, money supply growth will result in inflation. Keynesians prefer to work directly on boosting economic transactions via promoting full employment often through government spending, i.e., using fiscal policies in addition to measures that affect money supply. Heller said in 1968, "The issue is not whether money matters - we all grant that - but whether only money matters."

Malaysia handled her crisis in precisely the same way. When private sector investments waned, the public sector stepped, in attempting to fill up the gap in true Keynesian fashion. But cautious of likely retreat in the money supply, interest rates were kept low through increased banking liquidity and loan growth targets to boost private sector expansion. The country's financial system was restructured to ensure sufficient funds. The ringgit was also taken out of the international forex market to sever the link between domestic interest rates and the ringgit's exchange rate. Exports and imports would then be done using U.S. dollars which was converted at the fixed rate of RM3.80 to the dollar. To a country like Malaysia where external trade is larger than the GDP, this rock steady exchange rate stability removes many uncertainties that exporters are concerned about.

What was Sir Alan's opinion on this? He mentioned that the present time is a good opportunity for Malaysia to consider dollarising its economy. Otherwise it has to adopt either the fixed-exchange rate or the floating exchange rate. Both suffer from likely instabilities that Bank Negara would like to avoid. With a fixed exchange rate system domestic interest rates and prices will have to move in tandem with exchanges occurring between the ringgit and say the U.S. dollar. The floating exchange rate is too unstable and is thought to be the cause of the financial crisis in the first place. Local industrialists are thus quick to defend the move by Bank Negara to take the ringgit out of the forex market that has created the stability that they felt necessary for doing business. The move ended all speculation on the ringgit, the villain in the eyes of the local industrialists.

But economic theory has it that speculators help stabilise rather than create turmoil in the market place. Prices on foreign exchange of the different currencies are ever changing following their demand and supply. Arbitrage by speculators are quick to detect price differences of the same types of currency across different forex markets. They make riskless profits by simultaneously buying cheap in one market and selling dear in another. Price inconsistencies would thus be quickly ironed out. Malaysian exporters disagree, considering that money flows in the world today are hundreds of times the value of goods that are actually traded. Sir Alan's explanation is that governments have been intervening too actively in domestic interest rates or the exchange rate of their own currencies. Such interventions produce the very price distortions that speculators act to close. For example most countries including Malaysia were on the floating exchange rate prior