

MOBILIZING DOMESTIC AND EXTERNAL RESOURCES FOR ECONOMIC DEVELOPMENT: LESSONS FROM THE MALAYSIAN EXPERIENCE

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This paper provides an overview of issues pertaining to the availability and mobilization of resources for national development in Malaysia. It discusses recent trends in public and private savings and also the need for external resources and concludes with an analysis of Malaysia's integration into the world economy during the 1990s.

The availability and mobilization of resources is a sine qua non for real capital formation and, hence, national development. Sustainable development can only be achieved if resources are efficiently mobilized and transformed into productive activities. The development of an efficient financial system in providing the vital link between savings and investment is thus important. Not only must there be coordination of different agencies within and among levels of government, there must also be coordination between the public and private sectors, and among the various components of the private sector.

Whatever the level of domestic savings and however large or small the net transfer of foreign savings, there is legitimate concern to ensure that those savings are allocated to investment in a developing country in a manner that is efficient and desirable in the social, political and developmental senses. Apart from having a well-coordinated financial system, the appropriate infrastructure, human capital and institutions all have to be in place. The Malaysian Government has basically relied on the use of five-year plans to implement its development strategy. Traditionally, a major portion of the financing for the Malaysian economy is intermediated through the banking system as reflected by the high bank credit to GDP ratio of 126 per cent as at end of 1999. This trend is changing as the landscape of the economy varies, necessitating a broader scope of financing to meet its needs.

This paper is structured as follows. Section I provides an overview of the availability and mobilization of resources for national economic development. Sections II and III discuss public and private savings as domestic sources of financing

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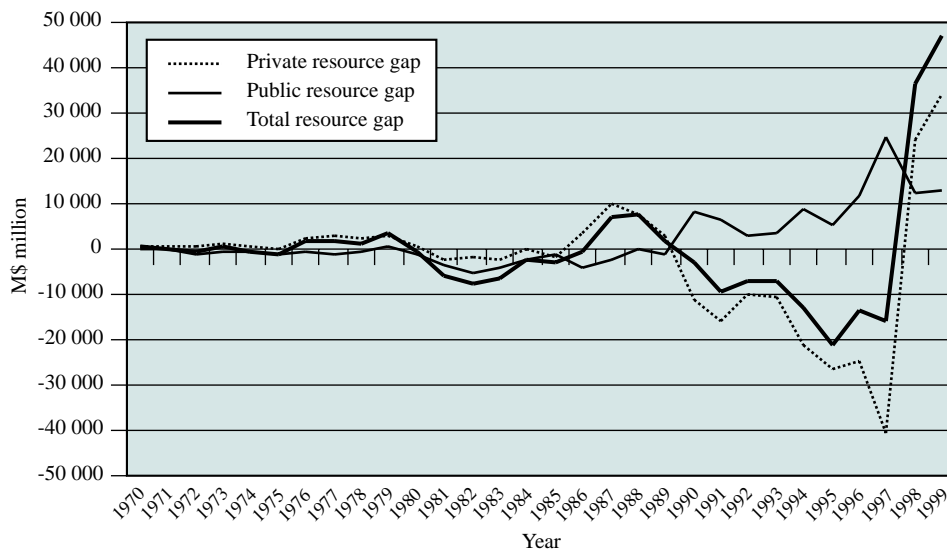
respectively. The need for external resources, consistent with the industrialization plan, is discussed in section IV. Section V looks at future developments in the capital market, dynamically with integration into the world economy. Finally, section VI sums up the paper.

I. THE SAVING-INVESTMENT GAP

Since there was substantial accumulation of foreign reserves over the period 1960-1980, Malaysia had neither a savings-investment gap nor a foreign exchange gap to bridge over these years. On the whole, Malaysia generally financed most of its investment out of domestic savings. Figure I.1 shows the relationship between public, private and total resources over the period 1970-1999. The net transfer of resources, that is, the difference between gross domestic investment and gross domestic savings, has not been more than plus or minus 1 percent of the GDP of the developing countries since 1980. The problem that arises is the accumulating domestic debt as opposed to external debt.

Essentially, the surpluses in the funds were provided by the growth in the agricultural and mining sectors, which were then mobilized by the Government and the financial system to develop the manufacturing and service sectors as well as the basic infrastructure, in an effort to avoid overdependence on one sector. In addition, the surpluses together with taxes collected enabled the economy to finance reinvestment in the respective sectors and government spending.

Figure I.1. Public, private and total resources, 1970-1999



Although the level of gross capital formation increased rapidly from around 18 per cent of GNP in the 1960s to around 25 per cent in the 1970s, the country was able to finance its investment outlays without any significant recourse to external financing. The same cannot be said of the early 1980s, with the nation entering the heavy industrialization phase. The 'big push' changed the composition of public and private investment. Public investment rose to the level of private investment in 1982 and 1983, as shown in figure I.2. Subsequent years saw a divergence between public and private investment until 1997, with private investment responding positively to the industrial policies implemented. Private savings, however, were always above public savings, with the wedge between them widening over the years, as illustrated by figure I.3.

During the period 1981-1985, the gap between GNS (gross national savings) and GDI (gross domestic investment) reached a high deficit of 8.5 per cent of GNP, which was unsustainable. In recognition of this, various policy measures were implemented to narrow the yawning gap. With continued discipline in fiscal restraint and improving commodity prices, the gap between GNS and GDI narrowed. In 1987, it turned into a surplus of about 9 per cent of GNP. However, with improving investment and consumption, the gap once again surfaced from 1989 to 1997. During this period, the financing requirement was basically met by foreign capital inflows. Nevertheless, the dawn of the East Asian crisis in the second half of 1997 led to a plunge in investment, widening the gap abruptly.

Figure I.2. Public and private investment, 1970-1999

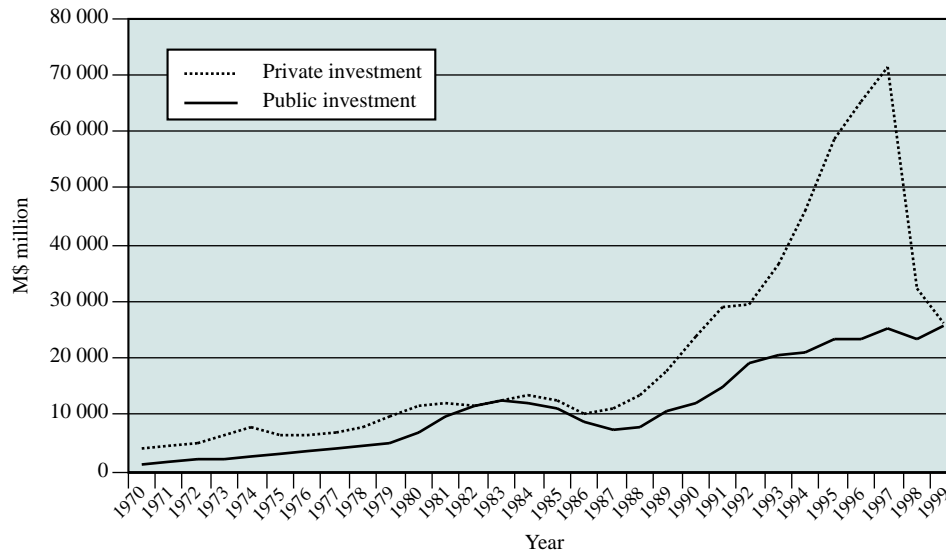
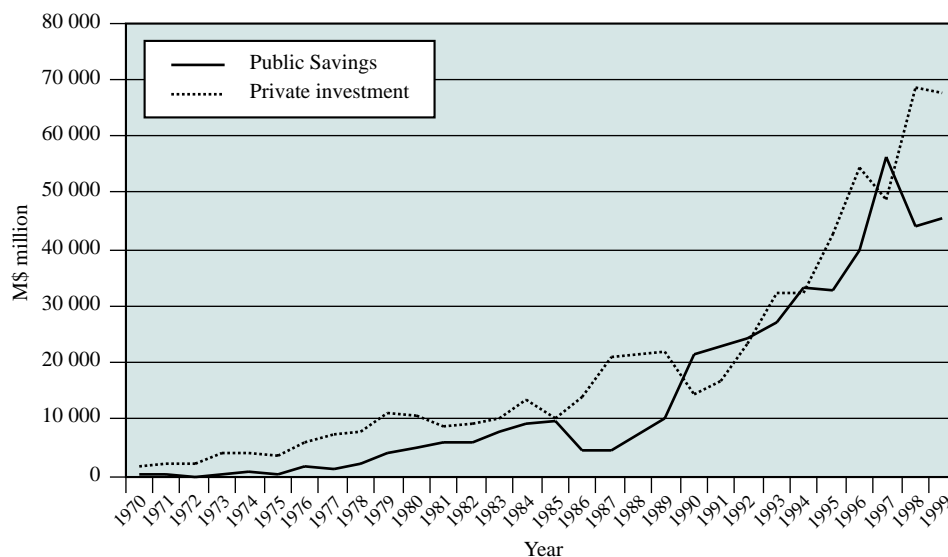


Figure I.3. Public and private savings, 1970-1999

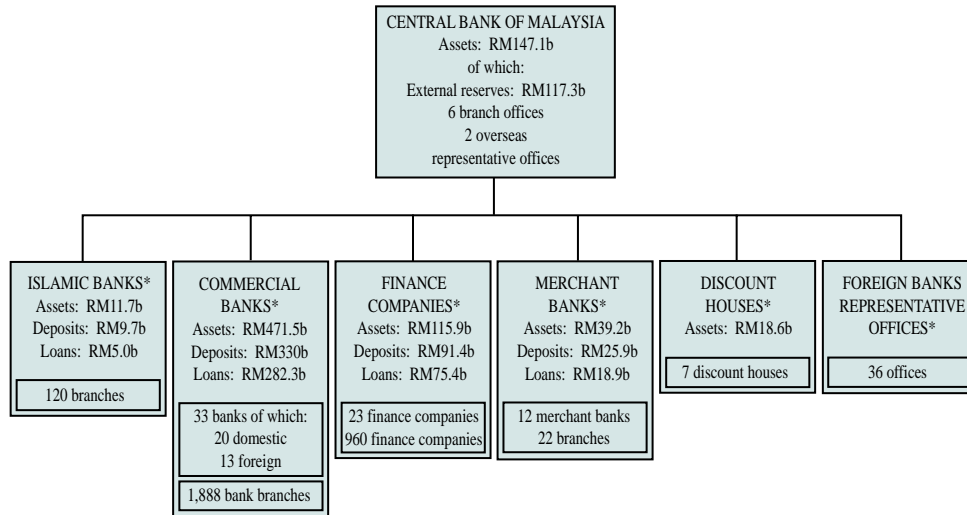
II. PRIVATE SAVINGS

Private savings have increased over the years driven by rising per capita income, higher age dependency ratio, lower share of agriculture in the economy and continued efforts to deepen the financial system. It is anticipated that private savings will have to provide the bulk of the additional investment-financing requirement, especially through the increasing role of the capital market (to be discussed in section V). The data on private savings in Malaysia at the subsectoral level are scarce and, at times, not readily accessible.

Unlike the public sector, the private sector was consistently a net saver in the 1960s and 1970s. Nevertheless, this surplus turned negative in the first half of the 1980s, reflecting lower private savings (in particular, corporate savings) and poor commodity and manufacturing (especially electronic products) prices. The transfer of assets, as a result of privatization, indicates a swell in private sector investment, which contributed to the private sector resource gap. After 1986, the situation reverted to a surplus before turning into a deficit again in the 1990s owing to a sharp rise in both private consumption and investment.

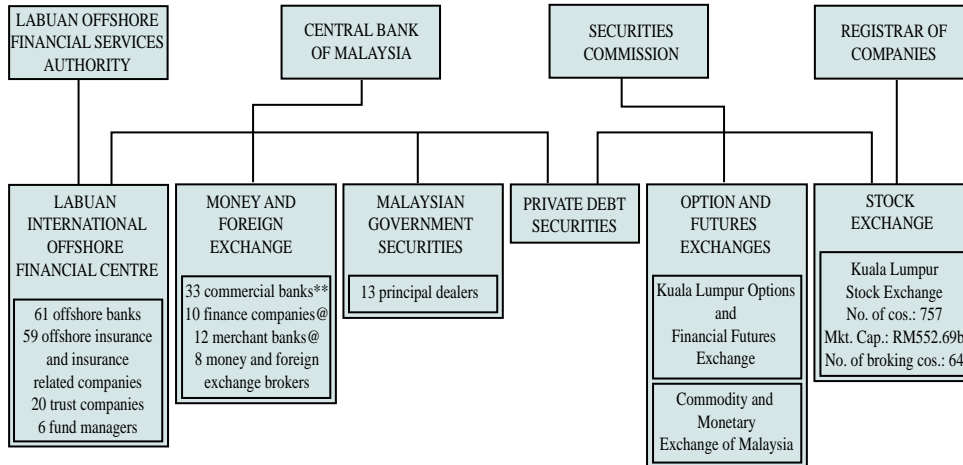
The changing structure of the Malaysian economy over the past four decades has transformed the role of financial institutions from one of financing trade to mobilizing and channelling financial resources to various growing sectors of the economy. The financial system can be divided into three parts: banking institutions, non-bank financial intermediaries and financial markets as shown in figures II.1-II.3.

Figure II.1. The structure of banking institutions as at 31 December 1999



Source: Central Bank of Malaysia.
 * Supervised by the Central Bank.

Figure II.2. The financial market as at 31 December 1999



Source: Central Bank of Malaysia.
 ** Including Bank Islam.
 @ Money market only (interbank).

Figure II.3. Non-bank financial intermediaries as at 31 December 1999

LEASING COs Assets: RM6.3b No. of companies: 45 FACTORING COs# Assets: RM1.0b No. of companies: 13 VENTURE CAPITAL COs# Size of funds: RM1.7b No. of companies: 30 CREDIT TOKEN COs# ◇18 issuing institutions	DEVELOPMENT FINANCE INSTITUTIONS# Assets: RM22.4b Malaysia Industrial Development Finance Development Bank of Malaysia Industrial Bank of Malaysia Berhad Sabah Development Bank Agriculture Bank of Malaysia Sabah Credit Corporation Borneo Development Corporation Export-Import Bank Malaysia	PROVIDENT AND PENSION Employees Provident Fund Assets: RM168.6b No. of contributors: 9.5m Social Security Organisation Assets: RM7.9b No. of contributors: 8.6m Pension Trust Fund Assets: RM14.2b Other statutory and private provident funds Assets: RM6.4b No. of contributors: 138,655	SAVINGS INSTITUTIONS Assets: RM20.9b National Savings Bank Assets: RM8.8b 426 branches including mini and sub-branches 641 post offices with savings bank facilities Urban credit co-operatives Assets: RM3.7b Rural credit co-operatives Assets: RM8.4b Of which: Bank Rakyat Assets: RM7.2b	UNIT TRUSTS 33 unit trust companies 101 unit trust funds Net asset value: RM30.1b ASN, ASB and ASW Net asset value: RM30.1b	INSURANCE COs* Assets: RM46.5b Of which: Life insurance: RM32.3b General insurance: RM14.2b 67 insurance companies of which: 56 domestic 11 foreign 38 general insurance companies 7 life insurance companies 11 composite life and general insurance companies 11 reinsurance companies Islamic insurance 2 companies (TAKAFUL)	PROPERTY TRUSTS* 4 property trust funds HOUSING CREDIT INSTITUTIONS# Assets: RM6.5b Malaysia Building Society Borneo Housing Mortgage GOVERNMENT HOUSING LOAN DIVISION Outstanding loans: RM16.8b CAGAMAS BERHAD Assets: RM20.4b PILGRIMS FUND BOARD Assets: RM8.6b CREDIT GUARANTEE CORPORATION Assets: RM2.6b MALAYSIA EXPORT CREDIT INSURANCE BHD Assets: RM29.8m MALAYSIA RATING CORPORATION BHD RATING AGENCY MALAYSIA BHD
* Supervised by the Central Bank. # Registered with the Central Bank. ◇ As at 31 December 1998.						
OFFSHORE INSURANCE AND INSURANCE-RELATED COMPANIES* No. of companies: 59						

The financial sector of Malaysia up until the 1980s consisted broadly of a formal and an informal segment. The banking system dominated the formal sector, where there was heavy reliance on direct government control in the pricing and allocation of loans. Obtaining finance from non-bank institutions (such as pension funds, insurance companies and merchant banks) and capital markets was rather limited. Since the latter half of the 1970s, the Central Bank of Malaysia has undertaken wide-ranging reform measures that are aimed at reducing the direct intervention of government and increasing reliance on the market. They include the liberalization of interest rates, relaxation of lending guidelines, reduction of subsidized credit directed to the promotion of specific sectors or enterprises, development of domestic capital markets and easing of restrictions on foreign investment in the domestic banking system and capital market. The role of government is thus becoming more indirect but is still important for providing financial legislation and a system of prudential regulation and supervision of the decentralized financial system. Nevertheless, there seems to be a transformation of intervention by the Government from one that is explicit to one that is implicit.

Using the Granger causality test, the authors have found that there is no clear evidence in favour of the supply-leading or demand-following hypotheses. The supply-leading hypothesis stresses the importance and usefulness of financial development that leads to national economic development while the demand-leading hypothesis views the causal relationship as the reverse. When the monetization variable MV3 (i.e., M3/real GDP) is employed as a measurement of financial development, it is apparent from the empirical results in table II.1 that neither the supply-leading phenomenon nor the demand-leading hypothesis dominates. However, the use of monetary aggregates M2 and M3 as financial development measures seems to suggest a supply-leading hypothesis, though not a substantial one.

**Table II.1. Financial and economic development in Malaysia:
a causal relation**

<i>Pairwise Granger causality tests</i>			
<i>Sample: 1973 1999</i>			
<i>Lags: 4</i>			
<i>Null hypothesis:</i>	<i>Obs</i>	<i>F-Statistic</i>	<i>Probability</i>
M3 does not Granger Cause GDP	23	3.58114	0.03272
GDP does not Granger Cause M3		2.13370	0.13042
M2 does not Granger Cause GDP		5.19311	0.00889
GDP does not Granger Cause M2		2.19350	0.12265
MV3 does not Granger Cause GDP		2.60374	0.08125
GDP does not Granger Cause MV3		6.15719	0.00449

The monetization variable MV3 shows the real size of the financial sector in a growing economy and registers a rise over time (see table II.2), indicating the faster development of the financial sector than the real sector. It also indicates the extent of the informal sector financing of the economy, which declines over time. However, the reverse is true for currency ratios, which fall as real growth rises. Financial innovations lead to more diversification of financial assets and liabilities and more transactions being carried out in a non-currency form. As a consequence, the use of notes and coins to monetary aggregates tends to decline over time, which is illustrated by the decreasing currency-deposit ratios in table II.2.

Consequently, efforts to raise private savings should focus on structural reform involving gradual financial liberalization, particularly on the mobilization of long-term saving instruments, such as the Employees Provident Fund¹ (EPF), pensions,

¹ The Employees Provident Fund (EPF) was first established on 1 October 1951 under the EPF Ordinance 1951, which was subsequently replaced by the EPF Act 1991. The statutory rates of contribution for employers and employees are currently 12 per cent and 11 per cent of the employee's wages respectively.

Table II.2. Monetization ratio for the Malaysian economy (1970-1999)

	<i>Currency ratios</i>	<i>M2</i>	<i>M3</i>	<i>RGDP87</i>	<i>M3/GDP</i>
1970	0.968904	4 122.3		29 070	
1971	1.000944	4 668.2		32 090	
1972	0.877809	5 762.4		31 680	
1973	0.851767	7 551.9	8 313.4	35 386	0.234935
1974	1.002024	8 713.9	9 791.0	38 323	0.255486
1975	1.061238	9 981.5	11 322.7	38 630	0.293106
1976	0.999391	12 748.2	14 496.3	43 111	0.336255
1977	1.032238	14 819.0	16 894.4	46 474	0.363524
1978	0.976531	17 466.5	20 270.9	49 587	0.408795
1979	0.932465	21 706.4	25 457.5	54 199	0.469704
1980	0.950914	27 991.8	32 687.6	58 234	0.561315
1981	0.862193	32 772.7	38 051.6	62 276	0.611015
1982	0.848482	37 899.9	44 357.8	65 976	0.672332
1983	0.81346	42 264.1	51 705.7	70 100	0.737599
1984	0.809287	47 733.2	59 772.6	75 541	0.79126
1985	0.845285	50 412.2	65 607.7	74 693	0.878365
1986	0.89209	56 096.8	71 399.9	75 554	0.945018
1987	0.874979	59 771.7	74 891.7	81 085	0.92362
1988	0.885196	64 072.1	80 987.4	89 143	0.908511
1989	0.759785	74 392.8	97 668.3	97 219	1.004622
1990	0.709328	83 902.9	115 435.7	105 976	1.089263
1991	0.69644	96 092.5	133 120.8	116 094	1.146664
1992	0.665211	114 480.9	159 177.9	126 408	1.259239
1993	0.478928	139 800.0	196 611.1	138 917	1.415313
1994	0.521192	160 365.6	222 329.8	151 713	1.465463
1995	0.507453	198 873.3	271 948.4	166 626	1.632089
1996	0.45799	238 208.6	329 707.6	183 292	1.798811
1997	0.511161	292 217.1	390 809.3	196 714	1.986688
1998	0.508409	296 472.0	401 459.2	182 222	2.203132
1999	0.52424	330 908.2	434 593.3	192 506	2.257557

Source: Calculated from data provided by Bank Negara Malaysia.

insurance companies, mutual funds and, to a lesser extent, the separately constituted private pension and provident funds. The EPF has been the nation's largest provident and pension fund, with resources of M\$158 billion (85.8 per cent of total resources of provident and pension funds). The EPF (as well as SOCSO²) faces restrictions in terms of investment avenues. Specifically, the Trustee Act restricts EPF from purchasing corporate bonds without a bank guarantee or acceptable collateral. Thus, the EPF is confined to mobilizing funds in the stock market and investing in Malaysian Government Securities (MGS). In this context, there is a need for the above restrictions to be relaxed by allowing the purchase of unsecured private debt securities with good credit rating, and derivatives. Of late, there has been greater mobilization of EPF funds through permitting withdrawals by employees for purchases of houses.

Insurance companies, however, mobilize total funds of M\$26.6 billion (from M\$1.7 billion in 1980) by providing attractive insurance products. The unit trust industry has expanded over the years, with a net asset value of M\$39.8 billion as at end-August 1999, which is largely contributed by Government-supported funds like Amanah Saham Nasional. To have a sustained increase in long-term savings, the Government would need to reduce its recourse to captive financing from the EPF, SOCSO and pension funds, in order to give market participants more flexibility in their portfolio allocation, while encouraging greater private-sector involvement in the creation of more innovative financial products and enhancing competition. With more remunerative saving instruments installed, investors would certainly be enticed.

Since the 1970s, Islamic banking has emerged as an alternative source of finance in the international financial scene. In Malaysia, Islamic legal provisions and banking regulations coexist with those of the conventional banking system. The Islamic Banking Act 1983, which came into effect on 7 April 1983, marked the introduction of Islamic banking products. In principle, many Muslims are reluctant to resort to conventional banking institutions, since their Islamic beliefs prevent them from dealings that involve usury or interest (*riba*). The emergence of Islamic banking, which prohibits interest payments, caters for their banking needs. In this context, their funds will not be kept idle.

As at end-1999, Islamic banking assets contributed 5.4 per cent of the total assets of the banking system, amounting to M\$35.8 billion. Deposits placed with the banking institutions continued to form the bulk of the funds in the Islamic banking sector, which accounts for 69.2 per cent of the total resources of the sector. The Islamic funds mobilized were mainly used to finance economic activities (37.3 per cent of total uses of Islamic funds), while the remaining funds were deposited with other banking institutions, with investment and dealing securities accounting for

² The Social Security Organisation (SOCSO) was established to provide security benefits to workers. It mobilized total resources of M\$7,034 million as at end-June 1999. The rate of employer-employee contribution varies according to the employees' wages.

19.1 per cent and 12.3 per cent respectively. Total financing extended by the Islamic banking sector stood at M\$14.0 billion as at the end of 1999. The sector's exposure to the broad property sector remained significant at 42.9 per cent, while 9 per cent of total financing goes to the manufacturing sector. Although the Islamic banking sector is still small relative to the conventional banking sector, efforts are being made to expand its presence and create an Islamic banking system to function on a parallel basis with the conventional system.

Another source of finance comes from the Pilgrim Fund Board. It was set up by statute in August 1969 to promote and coordinate activities connected with Muslims going on pilgrimage. The funds mobilized by the Board were invested mainly in quoted and unquoted corporate securities as well as short-term investments, which together accounted for 71.7 per cent of total assets. Investments in corporate securities and short-term instruments have over the years increased significantly from M\$349 million and M\$548 million as at the end of 1987 to M\$3.9 billion and M\$2.3 billion in 1999 respectively.

From table II.3, we can conclude that changes in the real interest rates as measured by the Real Base Lending Rate (RBLR) have no effect on the private rate of savings (PRS), as indicated by insignificant t-ratios, holding other things constant. This implies that monetary policy is ineffective in mobilizing private savings. As the role of banking institutions (with respect to bank loans) diminishes, the monetary transmission mechanism would alter by moving towards other channels of financing. This would make it increasingly difficult for the monetary authority to evaluate the

Table II.3. Effects of RBLR on private savings (PRS)

<i>Dependent variable: PRS</i>				
<i>Method: Least squares</i>				
<i>Sample: 1970 1999</i>				
<i>Included observations: 30</i>				
<i>Variable</i>	<i>Coefficient</i>	<i>Std. Error</i>	<i>t-Statistic</i>	<i>Prob.</i>
C	-1 456.051	1 672.037	-0.870825	0.3915
RBLR	-87.83493	273.9169	-0.320663	0.7509
NOMGNP	0.219170	0.011012	19.90214	0.0000
R-squared	0.938673	Mean dependent var		19 718.87
Adjusted R-squared	0.934131	S.D. dependent var		18 967.30
S.E. of regression	4 867.966	Akaike info criterion		19.91338
Sum squared resid	6.40E+08	Schwarz criterion		20.05350
Log likelihood	-295.7007	F-statistic		206.6323
Durbin-Watson stat	1.221424	Prob(F-statistic)		0.000000

Source: Data on real interest rates and private savings are provided by the Central Bank.

efficacy of monetary policy, thus making monetary policy less potent. Fiscal incentives to savings mainly through tax incentives are unlikely to be effective as well. Using a simple two-period intertemporal model, we would find that a fall in endowments leads to a decrease in savings, which is further enhanced by the existence of Ricardian equivalence and consumers having rational expectations.

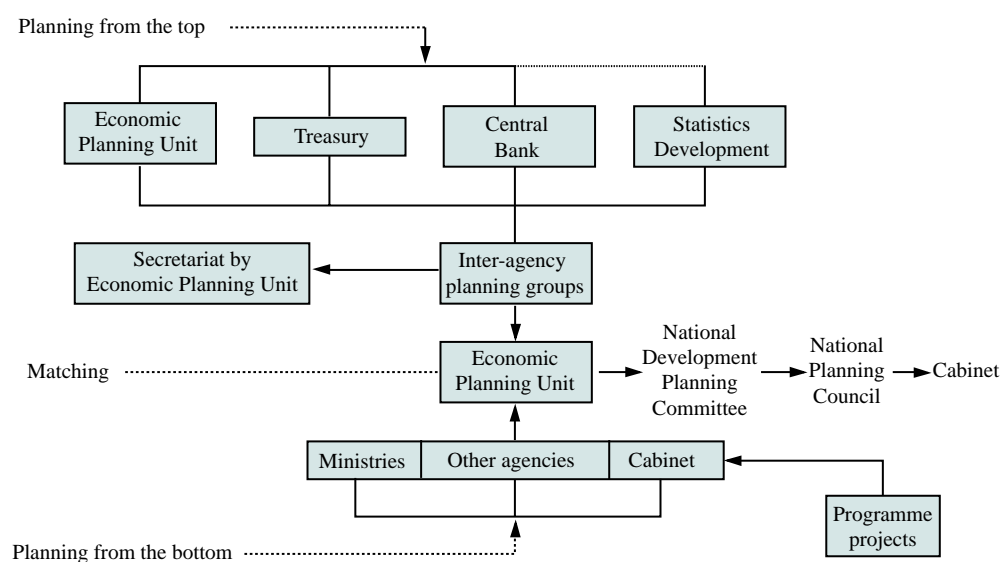
III. PUBLIC SAVING

The theory of economic policy as described by Brainard (1967) or Theil (1971) suggests that public policy alone should be used to influence the national savings level. It would seem that the most direct way to raise national savings is through higher public savings since it is subjected to direct control by the authorities. The Malaysian Government consists of the federal Government, state governments, local and statutory authorities and non-financial public enterprises³ (NFPEs). Figure III.1 shows the planning process involved. As in any other federation, fiscal imbalance, defined as the inability of state and local governments and statutory bodies, to raise sufficient revenue on their own to undertake the functions and responsibilities assigned to them, would appear to exist in Malaysia (Ariff, 1991). Table III.1 indicates such imbalances for the period 1995-1999.

Two types of fiscal imbalance are referred to in this context, namely, vertical and horizontal imbalances. Vertical imbalances involve the lopsided nature of resource distribution between the federal and the state governments. These imbalances are rectified through grants and reimbursements from the federal Government, in view of its central role in the economy, as an economic stabilizer, as a redistributor of the nation's wealth, as a resource allocator and as a provider of public goods and services like education and defence. Horizontal imbalances pertain to interstate disparity in revenue-raising capacity and consequently to differences in the ability of states to fulfil their constitutional obligations. The allocation of grants to various states is important to narrow the gap between states. Several criteria can be used for distribution to address the needs of the states, i.e., the revenue-expenditure gap, reserves, income per capita, private-sector involvement and stage of economic development.

Nevertheless, tax sources need not be divided between federal and state governments in a manner that ensures that the latter balance their budgets on their own. Revenue assignments are demarcated accordingly as shown in figure III.2. Federal government revenue constituted a large portion of public-sector finance, that is, approximately 80 per cent, on average, over the period 1990-1999, as shown in table III.3. The residual of 20 per cent goes to the state government, local government

³ The criteria for determining an enterprise as an NFPE included annual sales turnover of at least M\$100 million (before 1998, M\$50 million) with large borrowing requirements and high capital expenditures as well as at least 51 per cent equity share by government, including public sector agencies.

Figure III.1. The Planning Process

Source: Economic Planning Unit.

Table III.1. Consolidated state governments, local governments and statutory bodies' own resources for financing expenditure (1995-1999^a)

		1995	1996	1997	1998	1999 ^a
State government	State sources	6 799	8 006	8 389	6 838	6 421
	Expenditure ^b	7 640	8 598	9 156	8 938	8 641
	Balance	-841	-592	-767	-2 100	-2 220
Local government	Own resources	2 294	2 364	2 509	2 586	2 769
	Expenditure ^b	2 865	2 922	2 854	3 684	3 835
	Balance	-571	-558	-345	-1 098	-1 066
Statutory bodies	Own resources	2 225	2 743	3 210	3 235	2 720
	Expenditure ^b	5 538	6 188	5 916	6 049	7 290
	Balance	-3 313	-3 445	-2 706	-2 814	-4 570

Source: Economic Report, 1999/2000.

^a Latest estimates.

^b Equals the sum of operating and net development expenditures.

Table III.2. Federal government revenue as a proportion of general government revenue

	<i>Federal government revenue (M\$ million)</i>	<i>State government revenue (M\$ million)</i>	<i>General government revenue (M\$ million)</i>	<i>Federal revenue as a percentage of general revenue</i>	<i>State revenue as a percentage of federal revenue</i>
1990	29 521	6 718	38 472	76.73	22.76
1991	34 053	6 429	42 671	79.80	18.88
1992	39 250	6 911	49 516	79.27	17.61
1993	41 691	7 361	52 376	79.60	17.66
1994	49 446	7 964	61 136	80.88	16.11
1995	50 954	8 261	62 271	81.83	16.21
1996	58 280	9 526	70 912	82.19	16.35
1997	65 736	9 967	79 783	82.39	15.16
1998	56 710	8 591	69 369	81.75	15.15
1999 ^a	56 690	8 228	68 600	82.64	14.51

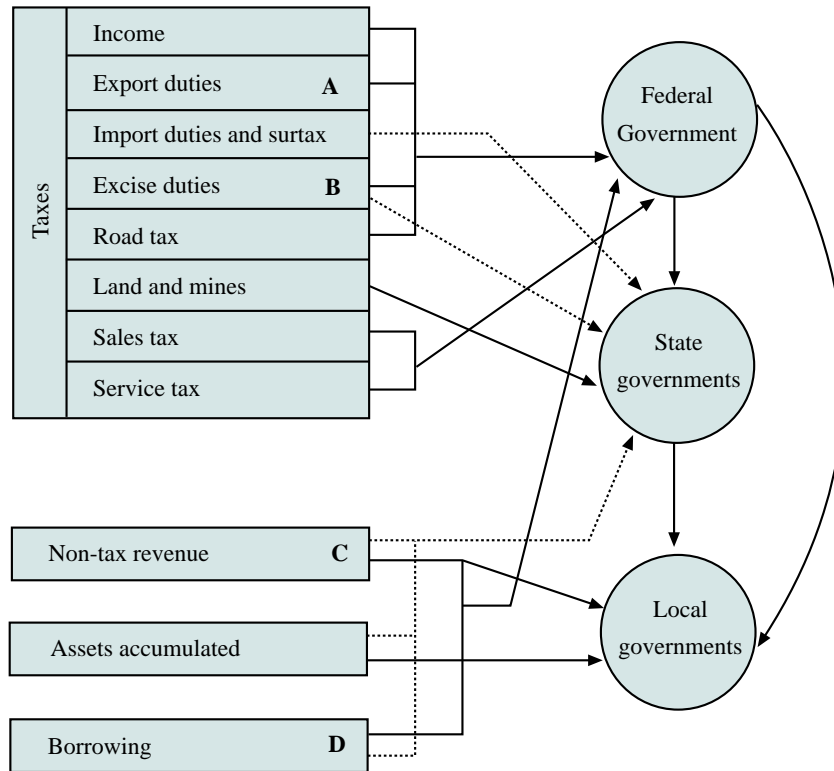
Source: *Economic Report*, various years.

^a Latest estimates.

and statutory bodies. The federal Government collects direct taxes such as income taxes and taxes on property and capital gains as well as indirect taxes, like taxes on production and consumption, and import and export duties. Import duties account for only a small proportion, roughly 9-10 per cent of the total tax revenue. Malaysia has a low-tariff regime and this has made it easy for Malaysia to further liberalize, unlike countries that are heavily dependent on import duties. Corporate and individual income tax account for 26.0 and 11.1 per cent of the total tax revenue respectively. As argued by Musgrave (1983), taxes on production and consumption are cyclically stable and should be assigned to the state governments since they have no monetary and debt devices for manoeuvre.

Traditionally, public savings were insufficient to finance public investment. In the 1960s and 1970s, this was readily bridged by non-inflationary sources and without crowding out the private sector. Such non-inflationary sources would include the Employees Provident Fund, pension, insurance and the ample liquidity in the banking sector. The first half of 1980s saw the doubling of the absolute size of this gap, a factor behind the economic crisis of the mid-1980s. However, the implementation of the privatization programme in the second half of the decade, together with higher revenues attributed to better economic performances, reduced this deficit considerably. From 1993 onwards, the consolidated public sector registered budget surpluses, in tandem with the South-East Asian miracle economies.

Figure III.2. General sources of finance of various levels of government in peninsular Malaysia



- Notes:*
- A: Tin-producing states are entitled to a share of the proceeds from the export duty imposed upon tin with the federal Government.
 - B: Excise duty levied upon toddy accrues directly to the state governments.
 - C: Non-tax revenue of the federal Government includes such items as government commercial undertakings, interest and returns of investment, licences, service fees, fines and rental revenue from Federal Territory, contributions from foreign Governments and international agencies, and petroleum royalties/gas cash payment. Non-tax revenue of state governments may include fees and receipts for specific services rendered by them, returns from their commercial undertakings, revenue from forestry, petroleum and gas royalties, and entertainment duties and municipal revenue unless accrued directly to the municipalities concerned. With respect to local government, their main sources of funds are the collection of house assessments in their localities and fees for services rendered to the public and even from the issuance of trading permits.
 - D: State governments have to seek the approval of the federal Government to borrow either domestically or externally.

Table III.3. Federal government revenue

M\$ million

Period	Tax revenue																			
	Direct taxes						Indirect taxes						Non-tax revenue							
	Sub- total	Com- pany income tax	Petro- leum income tax	Indi- vidual income tax	Stamp duties	Other	Sub- total	Export duties	Import duties	Excise duties	Sales tax	Service tax	Other	Sub- total	Licences and permits	Petro- leum royalty	Interest and returns on investment	Other revenue receipts		
1970	2 400	685	489	0	168	17	11	1 155	259	558	249	0	0	89	529	181	0	115	233	31
1971	2 418	725	517	4	168	19	17	1 192	231	582	307	0	0	72	471	192	0	143	136	30
1972	2 920	803	559	0	182	26	36	1 387	232	589	366	115	0	85	692	215	22	310	145	38
1973	3 399	907	585	27	218	48	29	1 900	437	746	407	220	0	90	548	249	25	95	179	45
1974	4 791	1 383	800	144	355	45	39	2 671	943	893	443	297	0	95	679	289	46	139	205	58
1975	5 117	1 990	1 164	322	438	47	19	2 266	625	800	450	272	8	111	792	290	78	159	265	69
1976	6 157	2 139	1 163	322	574	56	24	3 006	1 010	978	550	323	12	133	900	351	84	256	209	112
1977	7 760	2 900	1 336	776	679	65	44	3 761	1 391	1 140	695	383	16	136	990	409	111	243	227	109
1978	8 841	3 300	1 624	771	771	93	41	4 267	1 463	1 325	849	458	18	154	1 118	447	116	307	248	156
1979	10 505	3 835	1 804	829	1 041	119	42	5 162	1 939	1 513	957	544	22	187	1 326	481	166	419	260	182
1980	13 926	5 495	2 530	1 736	983	182	64	6 565	2 567	2 060	973	696	26	243	1 675	551	345	473	306	191
1981	15 806	6 112	2 754	1 978	1 087	207	86	6 482	2 225	2 246	967	730	34	280	2 855	592	417	1 499	347	357
1982	16 690	6 398	2 619	2 075	1 360	248	96	6 192	1 720	2 315	1 024	788	42	303	3 529	669	425	2 050	385	571
1983	18 608	7 712	3 451	1 998	1 814	338	111	7 551	1 892	2 591	1 361	1 284	108	315	3 012	781	491	1 286	454	333
1984	20 805	8 445	3 432	2 570	1 975	372	96	8 029	2 090	2 697	1 459	1 320	114	349	3 791	875	581	1 795	540	540
1985	21 115	9 259	3 920	3 130	1 749	340	120	7 441	1 839	2 518	1 376	1 234	107	367	3 975	914	619	1 996	446	440
1986	19 518	8 653	3 446	3 072	1 761	246	128	6 029	1 141	2 066	1 410	992	60	360	4 356	911	549	2 499	397	480
1987	18 143	6 468	2 783	1 533	1 812	257	83	6 006	1 267	1 934	1 310	1 090	63	342	5 134	929	410	3 450	345	535
1988	21 967	7 508	3 146	2 208	1 779	278	97	7 200	1 395	2 406	1 536	1 456	73	334	6 623	1 028	499	4 696	400	636
1989	25 273	7 793	3 402	1 847	2 043	421	80	8 881	1 588	2 899	1 932	1 913	91	455	7 496	1 143	509	5 405	439	1 103

Table III.3. (continued)

M\$ million

Period	Tax revenue											Non-tax revenue								
	Direct taxes						Indirect taxes					Sub- total	Licences and permits	Petro- leum royalty	Interest and returns on investment	Other revenue receipts				
	Sub- total	Com- pany income tax	Petro- leum income tax	Indi- vidual income tax	Stamp duties	Other	Sub- total	Export duties	Import duties	Excise duties	Sales tax						Service tax	Other		
1990	29 521	10 402	4 497	2 644	2 506	645	110	10 842	1 970	3 420	2 266	2 442	121	623	6 946	1 255	627	4 613	451	1 331
1991	34 053	13 251	5 352	4 052	2 989	720	138	12 579	2 029	4 107	2 849	2 763	134	697	7 456	1 443	875	4 648	490	767
1992	39 250	15 403	7 524	3 417	3 441	770	251	13 369	1 689	4 384	3 062	3 082	322	830	9 603	1 592	774	6 672	565	875
1993	41 691	17 070	8 551	2 859	4 248	1 215	197	14 830	1 464	4 566	3 713	3 468	613	1 006	9 274	1 947	741	5 940	646	517
1994	49 446	20 160	10 562	2 211	4 567	2 515	305	17 327	1 158	5 615	4 297	4 131	825	1 301	11 338	2 855	626	7 133	724	621
1995	50 954	22 699	11 707	2 185	6 203	2 192	412	18 972	853	5 622	5 280	4 869	1 016	1 332	8 469	2 516	710	4 381	862	814
1996	58 280	25 851	14 166	2 203	6 172	2 708	602	21 421	1 041	6 132	5 790	5 473	1 231	1 754	10 330	3 536	848	4 761	1 185	678
1997	65 736	30 432	16 688	3 861	6 429	2 714	740	23 195	1 053	6 524	6 054	6 167	1 475	1 922	11 421	4 483	991	4 789	1 158	688
1998	56 710	30 015	17 294	4 046	6 900	1 190	585	15 321	623	3 868	3 586	3 845	1 447	1 952	10 883	3 756	1 102	4 883	1 142	491
1999p	58 675	27 246	15 742	2 856	6 419	1 566	663	18 100	670	4 720	4 723	4 488	1 459	2 040	12 674	3 638	974	7 007	1 055	655

Source: Accountant General Department.

1. Include real property gains tax and cooperative income tax.
2. Include betting and sweepstakes and gaming tax.
3. Include profits from PETRONAS and Bank Negara Malaysia.
4. Include services less fines and penalty.

p = Figures for 1999 are preliminary.

Table III.4. Tax revenue/GNP ratio for the period 1981-1999

<i>Year</i>	<i>Tax revenue/GNP ratio</i>	<i>Tax buoyancy</i>
1981	30.33	Đ
1982	31.31	1.34
1983	32.97	1.50
1984	34.45	1.48
1985	35.07	-0.46
1986	31.48	-6.95
1987	32.02	1.29
1988	33.91	1.80
1989	35.64	1.57
1990	37.85	1.91
1991	38.64	1.14
1992	41.88	1.81
1993	40.25	0.58
1994	43.09	1.82
1995	40.12	0.19
1996	41.69	1.39
1997	43.77	1.71
1998	40.15	1.77
1999 ^a	38.13	-0.20

Source: *Economic Report*, various years.

^a Latest estimates.

Malaysia's ability to tax, given by the tax revenue/GNP ratio, is on average 37.0 per cent of GNP for the period 1981-1999, as obtained from table III.4. This is among the highest for developing countries and exceeds that of neighbouring countries, which reflects the buoyancy of direct taxes, which contribute 43.0 per cent of total federal revenue, with corporate taxes taking a major share. With a high taxable capacity, there is no need for Malaysia to increase taxation in general to finance spending.⁴ In fact, the tax administration system. Measures to be undertaken include expanding the smart partnership concept with related licensing agencies, increasing the education programme, strengthening enforcement activities and surveillance to minimize tax evasion or avoidance, so as to expand the tax base. Another step would

⁴ Increasing taxes may lead to the following adverse implications, namely, excess burden involving additional distortion of economic behaviour that imposes costs on the private sector as well as political problems of different sorts. Then, there is the Ricardian equivalence issue where the Government can finance spending through debt instruments but it is through tax revenue that this spending is ultimately financed.

be the introduction of a value-added tax in place of the relatively inefficient sales tax. Although value-added tax boasts the virtues of simplicity, efficiency and neutrality, it has not yet been implemented in Malaysia. The stumbling block is arguably the fear of inflation.

IV. EXTERNAL FINANCE

The sources of external finance for development in Malaysia have undergone major changes over the years. In Malaysia, these sources are essentially categorized as official long-term capital, private long-term capital and private short-term capital.

Malaysia has experienced a change in the observed pattern of external financing since the 1960s. Such a change in composition can be seen in the relative importance of official versus private long-term capital and long-term versus short-term capital. During the early stages of Malaysia's development, domestic resources up until the late 1970s met most of the economy's financing requirements. Official net long-term capital constituted the major portion of external financing for those years. However, greater government participation in national economic development generated a rising trend in external borrowing. This became pronounced in the first half of the 1980s owing to the extensive borrowing by the Government and non-financial public enterprises (NFPEs) in the midst of the heavy industrialization phase. However, soft loans, multi- and bilateral loans and overseas development assistance (ODA) have declined since the mid-1980s. As official long-term capital moderated, private long-term capital became increasingly important, mainly attributed to industrialization plans. While private long-term capital remains large, there seems to be, a priori, an increase in merger and acquisition activities, albeit small. Both greenfield investments and reinvestment, driven by the incentive structure, have moderated somewhat. The early 1990s marked a surge in short-term capital inflows (see figure IV.1 for a graphical exposition).

Capital flows bridged the domestic resource gap by providing the requisite foreign exchange for the import of capital and intermediary goods as well as domestic investments. Official long-term capital inflow consists mainly of borrowing by the federal Government in the form of market loans, project loans and suppliers' credit, and borrowing by NFPEs, which generally require a federal government guarantee. Figure IV.2 shows that external borrowing by the federal Government tapered off after 1987, together with NFPEs' borrowing. However, during the period 1993-1997, external loans taken by NFPEs (comprising the major portion of the official long-term capital) rose to finance expansion and new investments, with more than three quarters of the loans taken by Tenaga Nasional, Telekom and Malaysian Airline System (MAS), a factor contributing to the 1997-1998 currency/financial/economic crisis. Federal government market loans and NFPEs' borrowing made up a large portion of official long-term capital.

Figure IV.1. Capital financing, 1985-1999

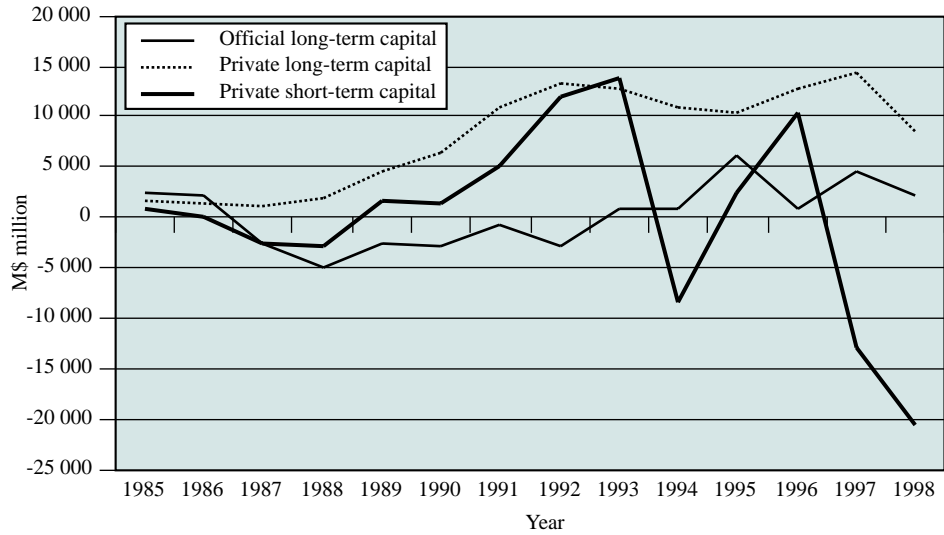
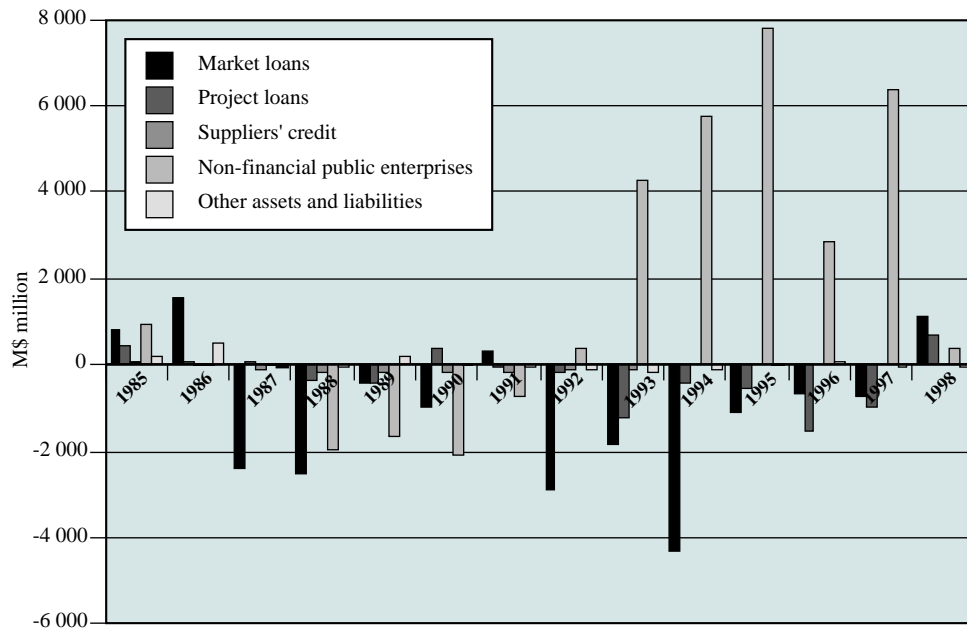


Figure IV.2. Components of official long-term capital, 1985-1998



Specifically, the official borrowing is mainly through the issuance of bonds (Eurobonds, Yankee bonds and Samurai bonds) via commercial banks' borrowing and suppliers' credits. Malaysia also obtains soft loans from multilateral agencies like the World Bank and Asian Development Bank (long-maturity loans) as well as ODA, mainly from Japan (long-maturity loans with concessionary interest rates), and bilateral loans. These inflows provide funding for direct investments in industries, such as steel, cement and national car projects, and infrastructure development to support the industrialization process.

Private long-term capital, as recorded in the monthly statistical bulletin published by the Central Bank of Malaysia, is used as a proxy for FDI in Malaysia. This is basically the inflow of long-term foreign financial liabilities net of the outflow of long-term financial assets in the corporate sector, which could approximate the difference between net FDI and net investment abroad by domestic companies. However, the accessibility of reliable FDI data is much desired. FDI statistics can be derived from the Malaysian Industrial Development Authority (MIDA), or estimates from IMF, UNCTAD and ADB can be used.

The FDI statistics from MIDA are not comprehensive as they exclude investments outside the promoted sector (manufacturing sectors only) and reinvestments undertaken by the existing units. The data largely relate to approved investments rather than actual investments. Since some of the approved projects had a relatively long gestation period, the FDI data based on approvals grossly overstate foreign participation in the various industrial sectors. It would seem that data from the Central Bank of Malaysia provides a more realistic picture of FDI in Malaysia.

External financing through FDI has been preferred over other sources. This is especially so after the Asian economic crisis, which demystified the Malaysian growth miracle. It was argued that the inflow of foreign direct investment (FDI) assists in the expansion of indigenous industrial capability and capacity, since it typically comes in a package with management expertise, technical human capital, product and process technologies, and overseas marketing channels, which can be adopted and adapted by local industries. In this regard, FDI was preferred even compared with domestic investment. This does not imply that domestic investment is less important. The superiority of FDI over external debt, however, is obvious as noted in the recent Asian crisis, where the rapid growth of private foreign debt (especially short-term debt, which accelerated from M\$2.4 billion in 1988 to M\$43.3 billion in 1997) can bring about adverse consequences.

Private long-term capital has always been positive, indicating the strength of foreigners' confidence in the Malaysian economy and the profitability of investing in Malaysia, especially with the lucrative incentive structure⁵. It registered significant

⁵ The Promotion of Investments Act, 1986 (PIA), which supported the First Industrial Master Plan (IMP1), was formulated to develop promoted activities and products and liberalized the incentives for potential investors. Since the 1986 'liberalization', the Malaysian economy has been relatively successful in attracting FDI.

gains after 1988, with annual inflows of over M\$10 billion for the period 1991-1997. In addition to the various incentives accorded and the relaxation of the foreign ownership guidelines in 1986, this trend was also due to the Government's effort to reduce its external borrowing and prepay its external debt. Most of these private flows were channelled to the manufacturing sector, in particular, the electronic subsector.

While FDI can stimulate and generate exports, its impacts on the balance of payments are mitigated by the high import content required for production, freight and insurance payments, and repatriation of investment income, as shown in table IV.1. As a result, net factor payment from abroad has become increasingly significant. Growth-oriented policies, coupled with political and social stability, a pro-business environment, labour and capital market reforms, good infrastructure and the availability of an educated and trainable workforce have frequently been cited as the driving reasons for Malaysia's rapid economic growth and ability to attract high-level inflows of FDI. Nevertheless, it should be noted that merely relying on tax and investment incentives is unlikely to tilt investor decisions and attract international resources on a sustainable basis.

Prior to 1991, private short-term capital, which refers to short-term foreign assets net of the foreign liabilities of all industries, displayed no specific patterns. Part of the portfolio investment flows is captured under private short-term capital, while some fell under 'errors and omissions', which amounted to M\$13.5 billion in 1998. Short-term capital gained importance in the early 1990s, in particular, 1992 (M\$11,960 million) and 1993 (M\$13,930 million). The 1993 figure showed that private short-term capital actually exceeded private long-term capital by M\$1,070 million. These short-term funds are highly sensitive to interest rate differentials and movements in expected exchange rates. In the Malaysian context, the huge inflows were also encouraged by the Government's attempts to make Malaysia a financial centre through capital account liberalization. The massive increase in private short-term capital in the early to mid-1990s exhibits great volatility. One of the measures undertaken to reduce volatility was to subject all funds sourced from abroad to liquidity and statutory reserve requirements.

The Asian economic crisis, although marked by the massive flight of short-term capital and large-scale sell-offs of foreign equity holdings, was at the same time accompanied by a wave of inward direct investment as argued by Krugman (1998). As reported in the 1999 World Investment Report, cross-border mergers and acquisitions (M&A) accounted for US\$ 411 billion of all 1998 FDI and for a very high proportion of total FDI among developed countries. With the recent spate of mergers and acquisitions around the world, their presence in Malaysia is still very low, partly owing to a policy bias against cross-border M&As. A priori, there seems to be an increase in M&A activities, while both greenfield investments and reinvestment have moderated. Even though foreign firms are unlikely to have controlling stakes in

more local companies, the merger and acquisition activities are set to increase in the near future in line with the global trend and the development of the capital market.

As pointed out earlier, net factor payment abroad has consistently been in an ever-increasing deficit. The only way in which Malaysia could reduce net factor payments abroad is probably for Malaysia to undertake reverse investment abroad that would generate an inflow of factor payments. This, however, has adverse implications for the capital account of the balance of payments at the initial stage. In any case, with the selective capital control in place, such a trend is unlikely to turn around in the near future.

V. THE FUTURE OF FINANCING

The capital market covers transactions of private and public debt instruments with maturities exceeding one year, stocks and shares, as well as derivatives. It is an integral part of the financial system, providing efficient delivery mechanisms for savings mobilization and allocation, risk and liquidity management, and corporate governance. In addition, capital market transactions not only facilitate government debt management and the conduct of monetary policy but also provide a channel for privatization. Capital markets can also be the catalyst for, and benefit from, the development of institutional investors (pension funds, insurance companies and mutual funds), efforts at fiscal decentralization and the development of mortgage markets.

While the banking system and equities market are relatively developed, the capital markets for government securities and private debt securities are still underdeveloped, as indicated by a high ratio of bank loans to net funds raised in the capital market of 263.0 per cent in 1997. This implies that there is still ample room for the development and enhancement of alternative sources to meet the financing needs of the Malaysian economy. In order to diversify risks and minimize spillover effects in a more integrated international financial system, Malaysia should move towards a broader and deeper financial system.

Net funds raised in the capital market increased significantly in the 1990s, reaching a peak of M\$33.5 billion in 1997, which financed 17.1 per cent of GDP. Figure V.1 points out that net funds raised in the capital market came mainly from the public sector prior to 1980. Private-sector activities in the capital market before 1986 were quite insignificant. Ever since then, net funds raised by the private sector rose steadily to a high of M\$34.9 billion in 1997, contrasting with the declining trend experienced by the public sector. However, the onset of the Asian crisis marked a sharp reversal of net funds raised by the private sector, which plunged to M\$7,960 million, while those sourced by the public sector rose moderately. When a financial system relies heavily on its banks, systemic vulnerability increases. The Asian financial crisis provided ample evidence of this. Although net funds raised in the capital market seem to move in a pro-cyclical manner, a sound domestic capital market

Figure V.1. Funds raised in the capital market (M\$ million)

Sector	1971-1975	1976-1980	1981-1985	1986-1990	1991-1995	1996	1997	1998	1999 ^p
BY PUBLIC SECTOR									
Debt Securities									
Malaysian Government Securities (MGS)	4 875	12 250	24 030	30 975.8	13 129	6 000	3 000	14 950	10 000
MGS Advanced Subscriptions	(2)	32	64	(46.7)	270.9	£	£	£	£
Khazanah Bonds (KB)	£	£	£	£	£	£	794.4	2 731.9	2 598.2
Government Investment Issues (GII)	£	£	500	1 700.0	5 750	£	£	£	2 000
Malaysia Savings Bonds (MSB)	£	£	£	£	948	£	£	£	372.2
New Issues of Debt Securities	4 873	12 282	24 594	32 629.1	20 098	6 000	3 794.4	17 681.9	14 975.4
Less: Redemptions									
MGS	998	2 867	4 209	5 513.9	10 787	3 809	3 648	6 200	6 676
KB	£	£	£	£	£	£	£	£	£
GII	£	£	300	1 000	1 600	900.0	1 400	750.0	2 000
MSB	£	£	£	£	200.6	34	154.8	982.2	2.1
Less: Government Holdings	58	2	17.4	(107.5)	(100.6)	(74.2)	(1.2)	£	£
Net Funds Raised by the Public Sector	3 817	9 413	20 067.6	26 222.7	7 611	1 331.1	(1 407.2)	9 803.7	6 297.3
BY PRIVATE SECTOR									
Shares/Warrants									
Ordinary Shares ¹									
Initial Public Offers	101.1	77.4	929.1	5 579.4	15 187.3	4 099.2	4 781	684.6	999.5
Rights Issues	163.2	387.3	3 234.8	7 169.1	15 449.3	5 268.5	8 524.9	722.0	4 346.9
Private Placement/Restricted Offer-for-Sale	27.6	21.2	£	76.6	2 632.1	4 554.4	3 233.6	320.1	518.6
Special Issues	£	132.6	1 245.7	837.2	3 600.3	2 002.3	1 818.8	61	208.0
Preference Shares	£	£	£	£	32	£	£	£	£
Warrants	£	£	£	£	£	£	£	£	13.5
New Issues of Share/Warrants	291.9	618.5	5 409.6	13 662.3	36 901	15 924.4	18 358.3	1 787.7	6 086.5

Figure V.1. (continued)

Sector	1971-1975	1976-1980	1981-1985	1986-1990	1991-1995	1996	1997	1998	1999 ^P
Debt Securities ²									
Straight Bonds	₪ 57	20	₪	2 164	8 836.4	2 675.4	4 209	10 238	9 570
Bonds with Warrants	₪	₪	₪	269.4	8 160.2	5 563.7	2 950.3	150.0	555
Convertible Bonds	57	₪	579	1 020.1	4 014.6	1 794.6	2 018.9	98.8	1 269.2
Islamic Bonds	₪	₪	₪	378.5	1 475	2 350	5 249.7	345.0	1 734
Cagamas Bonds	₪	₪	₪	6 487	11 546.8	4 665	5 169	3 320	4 425
New Issues of Debt Securities	57.0	20.0	579.0	395	34 033	17 048.7	19 596.9	14 151.8	17 553.2
Less: Redemptions									
Private Debt Securities ³	₪	₪	₪	473.3	2 689.6	1 765	1 368.5	2 964.4	6 279.5
Cagamas Bonds	₪	₪	₪	50	5 135	750.0	1 640	5 012	6 470
Net Issues of Debt Securities	57	20	579.0	6 258.7	26 208.4	14 533.7	16 588.4	6 175.4	4 803.7
Net Funds Raised by the Private Sector	348.9	638.5	5 988.6	19 921	63 109.4	30 458.1	34 946.7	7 963.1	10 890.2
Net Funds Raised in the Capital Market	4 165.9	10 051.5	26 056.2	46 143.7	70 718.4	31 789.2	33 539.5	17 766.8	17 766.8

Source: Central Bank of Malaysia.

Notes: 1) Excludes funds raised by the exercise of Employee Share Options Scheme, Transferable Subscription Rights, Warrants, and Irredeemable Convertible Unsecured Loan Stocks.

2) Excludes bonds issued by the banking institutions.

3) Includes all straight bonds, bonds with warrants, convertible and Islamic bonds.

P = Preliminary.

provides market signals on current situations and future expectations, which would reduce the severity of the fluctuation. Furthermore, strong domestic capital markets help to ensure efficient and sustainable medium- and long-term funding of Governments, corporations, banks and large-scale or long-term projects.

The Malaysian Government Securities (MGS) constitute the bulk of the new issues of public debt securities over the years. In 1998, MGS contributed M\$14,950 million, while the remaining M\$2,730 million were raised through Khazanah bonds⁶. Funds raised in the capital market by the private sector were mainly through the issuance of shares prior to 1990. New issues of private debt securities surged in the 1990s, raising more than M\$100 billion for the decade as a whole.

As there is already a well-functioning and active equity market in Malaysia, efforts have been stepped up to further develop private debt securities as well as to encourage secondary trading in the government securities and private debt securities markets. Thus far, secondary trading⁷ of private debt securities is insignificant relative to the trading of shares⁸. The development of an active private debt securities market would enhance the capability of the domestic capital market to accommodate large and more complex funding arrangements and diversify financing away from the banking sector. The bond market would allow companies to obtain long-term fixed rates of financing at a lower cost relative to bank credit. This is because intermediation would be minimized and as risks are diversified among a large pool of investors and liquidity risks for investors are reduced, investors are prepared to accept a lower return. By allowing secondary trading, access to financing would be spread across the board.

The development of non-bank sources of financing bodes well for the development of a knowledge-based economy. Given the different and evolving nature of the business world, alternative sources of financing for high-risk investments are required. The Malaysian Government recognizes that venture capital companies, such as the Malaysian Technology Development Corporation (MTDC), have an important role to play in providing equity capital to finance high-risk investments to support the emergence of a knowledge-based economy and has granted tax incentives to venture capitalists. Nevertheless, venture capital in Malaysia is still very much Government-directed. Other alternative sources of finance such as Öbusiness angelÓ

⁶ Khazanah bonds are bonds issued by Khazanah Nasional Bhd, a wholly-owned subsidiary of the Ministry of Finance, primarily for benchmarking purposes.

⁷ Secondary markets are those where financial securities trade after the issuance of financial securities, while primary markets are where firms raise capital through the issuance of financial securities.

⁸ One of the main reasons is that there are selling restrictions which ensure that the bonds are traded among economic agents whose ordinary business is to buy and sell bonds as set forth in section 38 (1B)(c) of the Companies Act, 1965.

investment and specialist seed capital firms would complement venture capital financing and should also be promoted. The market has the potential to extend beyond merely catering to the needs of Malaysian technology-based companies. The wave of dot com companies will hit Malaysian shores soon. It is important for venture capitalists to take heed in the funding of these companies, so as not to be overenthusiastic about them.

The commencement of trading of the Malaysian Exchange of Securities Dealing and Automated Quotation Bhd (MESDAQ)⁹ is also a significant step in providing an alternative source of financing and serves as an exit mechanism for venture capital companies. Unfortunately, however, its launch coincided with the crisis, which has hindered the progress. To date, there are only two companies listed on MESDAQ.

Equally important is the development of instruments that enable the unbundling of risks so that risks are borne and managed by those who are best able to do so. In consequence, the risk tolerance of the economy increases and financing is available at reasonable cost. The development of the derivatives market is ideally suited to the private sector. As Robert A. Klein and Jess Lederman (1994) put it, futures, options, swaps (credit derivatives) and other derivatives are transforming every aspect of finance from investing to raising capital to managing risk. The commencement of trade in the Kuala Lumpur Options and Financial Futures Exchange (KLOFFE) and the Commodity and Monetary Exchange of Malaysia (COMMEX) is an encouraging move ahead but still relatively sluggish. With the expected boom in the use of derivatives, skilled manpower to embrace these new financial instruments is needed.

VI. CONCLUSION

No single model of development finance applies equally well in all institutional, cultural and technological situations. There is no one proper sequence of financial reforms for all countries or for all times. Market discipline is likely to be severe in the initial stages, and any backtracking on reform would result in dire consequences, such as the inability to have access to international funds or only at costlier terms. Encouraging exchanges of experiences within and across regions of developing countries also fosters the adaptation and redesign of foreign models of reform and turns them into reforms that can be utilized by the domestic establishment. Needless to say, mobilizing resources is not only a static question of how much funds to mobilize effectively but a dynamic one, where the methods of financing evolve through time.

⁹ MESDAQ is a stock exchange targeted specifically at growth and technology companies, in a similar similar vein to NASDAQ. It commenced trading on Friday, 30 April 1999.

Malaysia's rapid economic growth and development are due to both endogenous and exogenous factors. The latter are more obvious, given the country's economic openness to foreign trade and investment, as attested by the fact that the ratio of exports to gross national income exceeds 100 per cent and manufactures account for more than 80 per cent of total exports. Malaysia's export orientation and export-led growth would not have been possible had it not been for its liberal policies towards foreign direct investment. It is important to note that Malaysia's outward-looking growth strategy was reinforced by sound domestic policies and strategies, which include mobilization of domestic resources. A major factor behind Malaysia's successful development drive has been its capacity to generate and mobilize domestic savings. Foreign investment supplements, but does not replace, domestic investment. Malaysia has also been quite successful in raising tax revenues in the form of both direct and indirect taxation.

The Malaysian experience underscores the need to avoid a domestic resource gap and budgetary deficits. It was the widening private savings-investment gap and/or deficit budgets which led to increased dependence on external borrowing and foreign short-term capital flows, both of which proved to be extremely dangerous, as demonstrated by the 1985-1986 and 1997-1998 economic crises.

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