

Chapter 2: Literature Review

2.1 The Asian Contagion

The crisis came about on July 2, 1997 as speculators attacked the baht, believing it to be overvalued and vulnerable due to poor economic fundamental in the country (British Broadcasting Center - BBC, 1998). The collapse in the Thai currency spread to Malaysia, Indonesia and later South Korea.

Robert McKee of Independent Strategy in London analyzed the Thailand economy and found that there was a huge flow of capital through the banking sector in Thailand. The investments were directed more towards real estate and speculation on the stock market. BBC (1998) had also reported that Thailand's current account deficit was increasing and it had a poorly regulated financial sector. Thailand had to approach the International Monetary Fund (IMF) for financial assistance. The IMF approved a \$17.2 billion rescue deal to Thailand in 1997. Asiaweek (1998) reported that in December 1997, 56 Thai finance companies were closed and wiped out nearly \$20 billion in assets. With the closures and the tough IMF stance on reforming the economy had resulted in rising unemployment. In January 1998, the Thai currency hit record low against the US dollar. The deputy Prime Minister, Supachai Panitchpakdi, called for a review of the IMF package. He said the effect of implementing the IMF's requirements had been more severe than expected (BBC, 1998).

Robert Garran in his book titled 'Tigers Tamed: The end of the Asian miracle' stated that by early 1998, Indonesia had become the worst affected country in East- Asia. He mentioned that in the start of the crisis, in August 1997 Indonesia had been quick to float the rupiah and on September announced a reform package

aimed at restoring market confidence. The outlook turned sour due to the problem in the banking sector. The next month Indonesia sought help from IMF. Indonesia former President Suharto first adopted the IMF program but later had rejected it because he preferred the idea of currency board. Indonesia's corporations and banks have seriously defaulted on foreign debt. The government also did not have the capital to restore growth and improve the economy. Asiaweek (1998) reported that the Indonesian Chamber of Commerce had estimated job losses in the property at 40,000 and textiles at 300,000. Manpower ministry disclosed that bankrupt companies retrenched almost half a million. Indonesia's social and political problems were also increasing. Robert McKee of Independent Strategy in London stated that Indonesia had to stick to its IMF program that is to keep control of their monetary base, not to expand their fiscal spending to greatly and to steadily reduce subsidies to stop money pouring into sectors of the economy which are not productive.

As for South Korea, Asiaweek (1998) reported that the country owed \$156.9 billion to foreign creditors by early December 1997. \$92 billion was due in a year and \$32 billion by March 1998. South Korea's large industrial conglomerates had build up the debt, amounting three to four times their capital base. South Korea had sought for an emergency loan of \$2 billion from IMF. South Korea also implemented stringent IMF reforms.

2.2 Malaysia

2.2.1 The mid-1980s recession

The 1988/89 Economic Report stated that the Malaysian suffered low level of economic growth, sluggish private investment, strained government finances and increasing unemployment. Unemployment was expected to rise as the supply for the labour continues to exceed demand. The report also mentioned on the emerging feature of the problem is the increasing number of graduates entering the labour market.

Jomo K.S. (1990) analysis on the labour market trends showed that in the 1960s the rate of employment expansion was behind the labour force growth, before overtaking it in it in the 1970s. Hence the unemployment rate had declined throughout the 1970s until 1982, after which the unemployment rate had been rising exceeding 9% in 1987.

The reason for unemployment to decline in the 1970s was largely due to the growth of labour intensive export oriented industrialization. However Jomo K.S. (1990) mentioned that the recession in the 1980s have exacerbated the unemployment problem. With the recessionary trends in the 1980s, the rate of employment expansion declined from 4.2% in 1981 to 1.4% in 1985. The growing unemployment problem was compounded by workers retrenchments. Jomo K.S. (1990) state officially reported retrenchments was 16,668 workers in 1983 and increased to 43,844 workers in 1986.

Bank Negara (2000) analysis on the economy background perspective stated that the unemployment rate during the recession period of 1984-86 reached a peak of about 8%. However with the rapid expansion in economic activity in the 1990s there was a marked improvement in the labour market situation and employment growth had exceeded the rate of expansion in the labour force. In 1992, the unemployment rate was 3.7% and declined further to 2.4% in 1997. There was approximately 1.2 million registered foreign workers here. However in 1998-99, unemployment averaged at 3.1% while the number of foreign workers declined significantly.

2.2.2 The July 1997 crisis

S.Mahbob and K.Govindan (2000) stated there were several initial signs of overheating in the economy in 1996. There was a rise in the consumer price index, a growing balance of payment and current account deficit. There was also some weakness in the financial side. Malaysia had initially adopted the IMF type of fiscal and monetary restraint in late 1997, to stabilize the financial market and contain inflationary. Interest rate were raised, public spending was cut and large investment project deferred. The measures only served to depress confidence and increased uncertainty in the economy. Malaysia unlike Indonesia, Thailand and South Korea did not use to the IMF program but resorted to find a remedy on it's own.

The National Economic Recovery Council of the Economic Planning Unit published the national economic recovery plan in 1998 as a guide for Malaysia towards economic recovery after the July 1997 economic crisis. This plan highlighted that the unemployment rate was expected to increase from 2.7% in 1997 to 6.4% in 1998. The number of unemployed workers was expected to rise

from 229,700 person in 1997 to 564,200 people in 1998. The sectors that will face rising retrenchments were manufacturing and construction.

The overall plan will focus on six objectives towards recovery:

- i) Stabilizing the Ringgit
- ii) Restoring the Ringgit
- iii) Maintaining Financial Market Stability
- iv) Strengthening Economic Fundamentals
- v) Continuing the Equity and Socio-economic agenda
- vi) Restoring adversely affected

Objective 4 of this plan provided six actions plan to strengthen the economic fundamentals, one of the action plan recommended under this objective was to increase labour competitiveness. In order to increase labour competitiveness and enhance Malaysia's international competitiveness, the plan recommended that wage increases should reflect productivity gains. The current employment laws and wage system, restrict the adjustment of wages in relation to operating costs and productivity.

Objective 5, which is continuing the equity and socio-economic agenda, highlights the need to expand tertiary education to satisfy the surge of local demand. Nine lines of actions were proposed under this objective in which three of them were related to employment:

- i) Expand employment opportunities

To expand employment opportunities the plan recommended that there should be more investment in export-oriented industries that require highly skilled labour and encourage self-employment. Employment Act should also be reviewed to encourage flexibility in employment practices

ii) Address graduate unemployment

The plan recommended that the Ministry of Education should coordinate the registration and placement of unemployed graduates. New graduates and their employers could be exempted from contributing to EPF. Graduates should be encouraged to participate in small business and apprenticeship schemes. Unemployed graduate should be allowed to get jobs overseas

iii) Control the influx of foreign workers

The policies and strategies on foreign workers should be reviewed, as there is an increasing amount of foreign labour coming into the country. Foreign workers who cannot be re-deployed should be repatriated. There should be strict enforcement of the Immigration Act. Foreign labour should be charged market rates for using local education and health facilities.

The Manpower Department of Ministry of Human Resources provides reports on the labour market trends on a quarterly basis. This report shows the statistics and charts of the overall economic growth, employment growth, job vacancies, and registered job seekers. This report gives an outlook of the trend of demand and supply of labour on a quarterly basis.

The Ministry of Human Resources of Malaysia had published a summary of labour and human resource statistics. According to the statistics the real impact of the crisis was felt in 1998. Real GDP growth declined to -7.5% in 1998 from 7.7% in 1997. The total labour force decline from 9,038,000 in 1997 to 8,881,000 in 1998. The labour force growth declined from 4.6% in 1997 to -1.7% in 1998.

Employment growth also declined from 1997 to 1998, an unemployment rate increased to 3.2% in 1998 from 2.6% in 1997.

The Ministry's annual labour market report of 1998 had anticipated a reduction in employment growth, rising retrenchment and high unemployment rate beginning the first quarter of 1998. In 1998 a total of 83,865 workers were retrenched compared with 18,863 workers in 1997. The manufacturing sector recorded the highest number of retrenchment.

The labour market report also showed the alternatives measures taken instead of retrenchment. These measures were done through pay cuts, voluntary lay-off and voluntary separation schemes. Several measures were undertaken by the ministry to help to improve the labour market in 1998. The labour market report in 1999 showed positive signs of recovery. A total of 37,357 workers were retrenched in 1999 compared to 83,865 workers in 1998. The report also highlighted on some measures taken by the ministry to help the labour force by emplacement of local retrenched workers, training and retraining activities and industrial relations.

The Economic Report 1998/99 published by the Ministry of Finance of Malaysia provides statistics of the real Gross Domestic Product (GDP) growth, Labour Force growth, Employment growth and Unemployment rate.