ABSTRACT

This thesis has two objectives. The first objective pertains to the impact of financial liberalization on allocative efficiency of the Malaysian banking system. The second objective pertains to the impact of financial liberalization on the stability and performance of the Malaysian banks.

Financial liberalization, the seminal work of McKinnon and Shaw advocates the removal of virtually all controls over financial activities in order to enhance competition and efficiency within the financial system. The centre-piece of their policies is the removal of interest rate ceilings which were identified as the primary if not sole culprit of repression.

The impact of financial liberalization on the allocative efficiency of the financial system is assessed with three approaches. The first approach uses Social Cost Benefit Analysis (SCBA) to evaluate on an ex-post basis, the utilization of loans. The application of SCBA to evaluate public listed companies has been unprecedented in Malaysia. The second approach employs Rank Correlation Analysis to detect whether correlation exists between the more productive manufacturing subsectors and the subsectors that received more credit. While the third approach makes use of statistical measures such as variance and coefficient of variation to determine whether the average borrowing costs between the subsectors of the manufacturing industry has narrowed.

The results for the first objective indicate that

(i) Utilization of loans by the public-listed companies are more efficient in the pre-liberalization period.
(ii) There is no correlation between the more productive manufacturing sub sectors and the sub sectors that received more credit in the post-liberalization period.
(iii) The average borrowing costs between the manufacturing sub sectors have become more varied in the post-liberalization period.

Thus, the allocative efficiency hypothesis put forward by financial liberalization theory is found to be untrue here.

To achieve the second objective, two exercises are carried out. First, Cost-Ratio Analysis is used to examine the bank's performance in terms of the bank's cost of intermediation. Second, Logistic Regression Analysis, is employed to assess the probability of a banking crisis in a liberalized environment when other factors [bank specific and macroeconomic factors] are controlled for.

Cost-ratio analysis showed that majority of the banks analyzed have a larger intermediation spread while the Logistic Regression showed that a liberalized environment contributed to instability in the banking sector.