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Malaysian economy facing 'jobless recovery' situation

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EARLY this month, some 400 top economists in the United States, including 10 Nobel laureates, slammed President George W. Bush for his US\$674 billion (RM2.56 trillion) proposal to cut taxes.

Bush was also slammed for proposing the largest budget deficit (US\$2.23 trillion for fiscal years 2004-2008) in the history of US Government funding.

The group - including such eminent names as Lawrence Klein of University of Pennsylvania, Paul Samuelson and Franco Modigliani both of Massachusetts of Technology, and Kenneth Arrow of Stanford University - took out full-page advertisements in American newspapers to launch their campaign against the Bush economic stimulus package.

Their arguments are essentially this:

That the Bush package to cut taxes to stimulate economic growth "is not the answer" to creating jobs and growth - two serious problems that need to be overcome urgently and within the shortest possible time at this stage of the US economic recovery cycle.

Although statistics showed that the US economy had been growing in the three quarters to September 2002 (reported to be 0.1 per cent, 1.4 per cent and 2.1 per cent), the growth had been so slow that very few jobs had been created.

This situation gave rise to what economists around the world have now come to coin the term "jobless recovery", which basically means an economy is recovering but the number of jobs created is so small, that the unemployment rate continued to remain high as in a recession, or even rising.

Doesn't this sound quite familiar with the Malaysian economy?

The Malaysian economy has slowed down considerably in the last few years from high growth of earlier years. Two to three years ago, there were retrenchments, with factories closing down or shifting operations overseas, mainly to China and Thailand.

The present recession in the US has characteristics that are significantly similar to Malaysia's current slowdown, as far as the labour market is concerned.

As Larry Mishel, president of Economic Policy Institute, a Washington-based think-tank, told a US Senate Committee hearing in September last year:

"The decline in private sector employment - 1.7 per cent or 1.83 million jobs - is larger at this point in the cycle than in the recessions of early 1980s and 1990s.

"The increase in unemployment has been more uniform in this recession, affecting a broader spectrum of the work-force - by gender and by education.

"In contrast, unemployment in prior recessions rose much more among the less educated. College graduate unemployment this time around had also risen.

"In this recession, those who became unemployed tend to stay unemployed longer, suggesting a greater mismatch between the types of jobs available and the types of workers that are unemployed."

In Malaysia, the situation is almost similar. More people are today out of a job than the last slowdown.

Unemployment is more broad-based, with some having years of experiences,

some highly qualified, and some still young in their working life. More fresh graduates and college leavers are known to be without a job for as long as six months to a year.

In one instance, a business friend of the writer advertised for a clerk, and he received more than 600 applicants, some of whom even had degrees and were willing to work for less.

This brings to a very pressing issue, which is also occurring in the US, that rising unemployment would have the negative impact of reducing the level of income of those who are still employed, and eventually the working family's income.

As Mishel explained, incomes in the US are growing faster than inflation, but at only half the pace of a few years ago, at roughly one per cent rather than two per cent real growth.

At the same time, statistics showed a widening of the income gap between the low- and middle-income workers, and between the high-wage and middle-wage groups.

This wage inequality is now across the board in the US, and higher unemployment has cut family incomes in general by as much as US\$1,800 for 2002 for the middle-income family.

"In short, high unemployment rates relative to a few years ago are beginning to lower the living standards of many working families," Michel concluded.

In Malaysia, the stark economic reality is only beginning to exert its consequences, as more retrenched workers fail to find employment and as their retrenchment benefits begin to run out.

In many ways, the arguments of the group of 400 economists could be sound advice for Malaysian planners to take note of when drawing up the stimulus package that Prime Minister Datuk Seri Dr Mahathir Mohamad is scheduled to announce end of next month.

Generally, what the group of 400 economists is saying is that economic growth, though positive, has not been sufficient to generate jobs and prevent unemployment from rising further.

They argued that, "to be effective, a stimulus plan should rely on immediate but temporary spending and tax measures to expand demand, and that it should also rely on immediate but temporary incentives for investments".

What they are saying is that, first government planners should know the meaning of "stimulus", and should be clear about the characteristics that a stimulus package should have.

As Mishel argued in a policy paper in December last year: "Many policies are purported to stimulate the economy, but it is important to distinguish between those that will have their effects in the following year, and those that take effect only much later."

That means any useful stimulus package should strengthen the recovery immediately, and create more jobs within the next six to 12 months.

He added: "Any stimulus designed to increase productive capacity - the supply side of the economy - will be ineffective because at this time, there is already substantially unused capacity."

In Malaysia, there are already unused capacities in the form of plants and factories, many of which are currently running at way below 100 per cent capacity.

Then, there is also an oversupply of labour which means a large pool of unemployed.

But what is missing, as Mishel argued, are the "customers" for the firms to increase their sales.

Businesses need more sales to survive. At this stage of the recovery, they do not have the customers to buy their products.

With more sales, profits will also rise, and so will more firms employ more workers. Investments in plant and factories will follow next to produce more to meet the higher demand.

In economic terminology, what we have is excess supply but insufficient demand. Thus, this mismatch is not able to produce an equilibrium on the market.

It would be a sheer waste if economic planners were to introduce measures just to spur more business investments at this stage. It would be ineffective, as business investments will continue to remain sluggish until consumers pick up their spending.

Indeed, as in the US, many businesses in Malaysia already have sufficient cash resources in hand to invest more, and the present low interest rate regime should also provide them with additional capital for investments. They would only do so if consumer spending increases.

It has been proven that government spending would be a more effective tool to stimulate consumer spending than tax cuts or rebates. The latter measure may result in leakage when consumers save rather than spend.

To the higher-income earners, the tax cuts or rebates may not even matter much to their pattern of spending.

This comes to the next issue: That a "stimulus" package should also have fiscal discipline - a point on which Federal Reserve chairman Alan Greenspan parted ways with his boss, President Bush.

About a week ago, Greenspan emphasised at a congressional hearing the importance of long-term fiscal discipline.

He said: "There is an aggregate amount of fiscal capacity in any economy, and we are very clearly straining capacity of this system owing to the inexorable retirement of a very significant part of our population starting at the end of this decade."

Bush's US\$2.23-trillion budget deficit is to last till 2008 - which is about the end of the decade that Greenspan is talking about. The burden of carrying the costs of financing that huge deficit would also have to fall on the shoulders of the population existing then, which Greenspan referred to.

The purpose of a good "stimulus" package is only to get the economy rolling again, so that the private sector would come in to play its role in restoring the economy's health.

So, as Mishel said, for this "one-time short-run objective, permanent ongoing measures are inappropriate", meaning a permanent "stimulus" package is unnecessary. Such a package could also adversely affect the Government's fiscal position in the next five to 10 years.

Dr Mahathir had said last month that there would not be any fiscal stimulus, adding that "if we do not have the money, we will not pump-prime".

National Economic Action Council executive director Datuk Mustapa Mohamed was more direct when he said last week that the Prime Minister would be announcing a "growth package" that aims to make Malaysia more competitive.

"We are not talking about expenditure, about money. We are talking about systems, about procedures, about improving the government delivery system."

Could then the growth package that the Prime Minister plans to announce be a long-term economic plan with more permanent measures? Which could mean it is not a stimulus package.

If on the other hand it is a stimulus package, and if it involves tax cuts and pump-priming spending, then it should be designed with components that are "one-off and temporary".

In essence, for a stimulus package to be effective in giving the economy

a nudge, the measures proposed should comprise those that will have an immediate impact and those that will take effect six to 12 months down the road.

A stimulus package should also target the "unfulfilled" social needs, such as repairs needed on existing, or construction needed for new, educational facilities, as well as improvements needed for sanitation and sewerage facilities.

Temporary spending by the Government on these "unfulfilled" social needs would not only stimulate consumer demand but also meet the social needs, which eventually will raise the overall standards of living.

One final note: In Malaysia, there is a rather misleading yet pervasive view that since the stock market is a barometer of the economy, pushing share prices up would help revive a sluggish economy.

Many economists have today argued that economic policies should not be targeted at getting the stock market up, so as to help those suffering painfully from their losses.

They said that governments in general should not be in the business of providing safety nets for shareholders. There are many reasons why this is so.

There is no basis of establishing what the correct level of the market should be. No one really understands what moves the market. The connection between rising share prices and improvement in the well-being of a majority of the people has not been established conclusively.