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Misunderstood Malaysia

By DAIM ZAINUDDIN

DAIM ZAINUDDIN Dealing with the Asian economic crisis is no easy task. One would like to believe that standard prescriptions exist, but after trying various cures, the crisis-hit countries are still not out of the woods. Malaysia initially adopted a textbook response for dealing with its problems. Public expenditure was slashed and monetary policy tightened to contain the exchange-rate depreciation. As a result, the high cost of capital and the credit squeeze choked businesses. Cutting public expenditure only intensified the contraction of an economy caught in a regional contagion. So we tried a new approach. In July 1998 we adopted the National Economic Recovery Plan, which relaxed monetary policy and increased fiscal spending. Selective capital-control measures were imposed on Sept. 1, not on ideological grounds but to tame capital flows and stop the internationalization of the ringgit. The changes aim to contain ringgit speculation and minimize the impact of the kinds of short-term capital outflows that precipitated the problems we now face. As a small country, Malaysia can ill-afford the costs associated with internationalizing the ringgit. The high offshore interest rate for the currency at the height of the crisis was 30% to 40%, compared with 11% at home, prompting the outflow of funds. The offshore ringgit was used to short the domestic ringgit. This prolonged the exchange-rate volatility and nullified our attempts at recovery. Some observers concluded that Malaysia had decided to use capital controls to isolate itself. Why would we want to do that? Our international trade is more than twice the size of our GNP, and exports have long driven our economic growth. The new controls continue to guarantee the general convertibility of current-account transactions and the free flow of direct foreign investment. They should not affect the normal conduct of business or long-term investment. Malaysia is not under any illusion that capital controls are the cure for its troubles or a substitute for appropriate policies. To provide any benefit, they must be accompanied by the right mix of macroeconomic policies, and restructuring efforts must continue. Contrary to what critics say, Malaysia did not resort to capital-control measures to rev up the economy to an imprudent level. Moreover, we did not print money to fund the budget deficit so as to avoid the pains of financial and corporate restructuring.

The government has not resorted to printing money for such purposes at any time in the past 40 years. Only on three occasions has federal government operating expenditure exceeded revenue. Development expenditures are funded from non-inflationary sources, such as provident funds. The federal budget had chalked up overall surpluses for some years before the crisis. Under the fiscal-stimulus program, the overall deficit of the federal government this year isn't expected to exceed 6% of GNP. After the adoption of controls, Malaysia's foreign reserves grew $6 billion to reach $26.2 billion in December. Every ringgit in circulation is backed 4.8 times by gold and foreign reserves. Malaysia's short-term external debt is less than 30% of international reserves, while total foreign-debt servicing is only 5.4% of exports. Programs to restructure and recapitalize banks are on the fast track, with expert assistance provided by U.S. investment firms. Though Malaysia faces the worst economic crisis since World War II, social cohesion and ethnic harmony are still maintained. Even the International Monetary Fund agrees that there is no evidence these control measures are doing much harm to the economy. Since interest rates have come down in Thailand and Korea, some still question the need for Malaysia's controls. The current sense of economic stability is largely due to the weakening U.S. dollar and the reduction of risk exposures by financial traders following last year's near-collapse of U.S. hedge fund Long-Term Capital Management. Who can say that this lull will not be disrupted by a dramatic change in circumstances, given the uncertainties in the global financial system? The adoption of capital controls has helped heal our wounds. It has reduced foreign-exchange uncertainty, stabilized the business environment and allowed companies to plan ahead. Confidence is returning. The Kuala Lumpur Composite Index has more than doubled since September. Sales of passenger cars have increased sharply, while the value of foreign direct-investment applications in September rose markedly from levels recorded between May and August. Since the start of the crisis, pundits have attacked Malaysia to no end. They have based their analysis on unsubstantiated guesswork rather than hard facts. Those who really know Malaysia are convinced that the country does not belong in the same basket as its afflicted neighbours. Malaysia has thought seriously and worked hard on its recovery program. Some of our strategies to overcome the crisis may seem unorthodox, but they should not be summarily dismissed. Nobody can vouch that a textbook approach will outperform a nonconventional one. Let's wait for the results to speak for themselves.