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Falling ringgit: Why bother?

Jomo K.S.

ON Aug 15, though it barely rated mention in the Malaysian Press, the ringgit breached RM2.80 to the US dollar temporarily, falling to its lowest level ever since 1973.

A quarter of a century earlier, the system of flexible exchange rates had been introduced, inaugurating a new international monetary regime with mixed consequences.

The current regime is therefore relatively new, beginning after America's unilateral withdrawal from the Bretton Woods' regime of fixed exchange rates which had pegged the ringgit to the dollar at RM3, and the dollar to gold at US\$35 per ounce.

There is little publicly available evidence so far that the recent financial and monetary crises in Southeast Asia have been manipulated by Western powers.

While George Soros - who publicly says that he has retired from active management of the firm which bears his name, to concentrate on his philanthropic and other activities - has undoubtedly supported anti-SLORC campaigns through his Open Society Foundation, as he has supported the Bosnian cause, he would be in very serious trouble if, indeed, he deployed the funds under his firm's management for political, rather than profit-making ends.

This is partly why international observers do not believe Southeast Asian claims that the recent crises were of Soros' making.

Why the Crisis?

Very briefly, the export-led growth of Southeast Asian economies since the late 1980s was followed by a construction and property boom, fuelled by financial sectors favouring such "short-termist" investments - involving loans with collateral which bankers like - over more productive but often also more risky investments in manufacturing and agriculture.

The exaggerated expansion of investment in such non-tradeables has exacerbated current account trade deficits, which have, in turn, become more significant for financial investors due to financial liberalisation.

(Some first-generation East Asian newly industrialising countries had proportionately much bigger current account deficits in an earlier era when such indicators had not attained their current significance in financial markets.)

The property-finance nexus was much stronger in Thailand, which made it much more vulnerable to the collapse of such a bubble, comparable - in some ways - to the Japanese experience.

Believing the Southeast Asian region to be much more integrated than it really is, fund managers based outside the region generally know little about regional differences and nuances, and are prone to herd behaviour, causing a domino effect.

Perhaps more importantly, the very logic of hedge funds exacerbates this phenomenon, with disastrous snowball consequences for the region.

Regional and local currency speculators also need to be held responsible, but it should be remembered that, however disruptive the consequences, they are only reacting to perceived market trends.

The common practice of farming out hedge fund management could well mean that the Soros group may be much more involved in the region than the paltry amount they have admitted to so far.

But even then, it is difficult to prove that Soros manipulated the

recent developments.

Who's the Devil?

The devil is the unfettered market itself, which induces the behaviour causing the disastrous consequences we have seen.

In the wake of Mexico's tequila crisis some years ago, even the International Monetary Fund stepped back from its previous advocacy of virtually unfettered liberalisation.

But unfortunately, the short-termism of financial markets extends to our memories and related policy-making as well.

In 1986, management guru Peter Drucker published an influential article about what he called the changed world economy.

He noted inter alia, that the volume of international financial transactions in the mid-1980s was already worth more than ten times as much as real economic transactions (trade, direct investments, etc), and noted some dangerous implications of this trend.

More than a decade since and with the recent proliferation of new financial instruments and markets, the volume of foreign exchange trading was more than 67 times the value of international trade in 1995.

In February, Soros published an important essay entitled "The Capitalist Threat" arguing that the unregulated expansion of capitalism threatens to undermine its own future, i.e. that capitalism has to be saved from itself.

He readily admits that he himself has profited greatly from financial liberalisation (his role in the 1992 collapse of sterling is well known).

Yet, he argues that excessive liberalisation has been resulting in virtual anarchy, which is dangerous for the stability so necessary for the orderly capitalist growth and democratic development desired by his vision of a Popperian "open society".

Ever since Lord Keynes advocated "throwing sand" into the financial system to check the potentially disastrous consequences of unfettered liberalisation, Keynesians - and others - have been wary of the financial liberalisation advocated by ideological neo-liberals and their often naive allies.

Nobel laureate in economics, James Tobin has called for a tax on foreign exchange spot transactions to facilitate more independent national monetary policy, discourage speculative capital movements, and increase the relative weight of the long-term economic fundamentals against more short-termist and speculative considerations, besides more than adequately funding the United Nations system and programmes.

As many - including Prime Minister Datuk Seri Dr Mahathir Mohamad - have pointed out, the international financial system and its further liberalisation have favoured those already dominant and privileged in the world economy, largely at the expense of the real economy and development in the South.

Opportunity?

For Malaysia, the problem has been cushioned by several developments.

The Government has been privatising profitable projects and enterprises while socialising costs and unprofitable projects; thus, ironically, the private sector has been partially protected from the resurgence of public sector profligacy.

By allowing more foreign purchases of real property, the Government has also been able to sustain demand in the property market.

In response to concerns about excessive lending to the property sector (raising the spectre of a repeat of 1985-6) Bank Negara checked such lending from March.

However, despite continued rapid growth and some strong fundamentals, not all is well.

The depreciation of the ringgit is not entirely attributable to financial speculation or liberalisation, or even to subjective factors.

But while it has adversely affected the financial sector, it may not be all that bad for the real economy.

After all, Japan, Britain, and Southeast Asia's newly industrialising economies, including Malaysia, have recently grown faster after their currencies were depreciated.

The Government might also be forced to become more fiscally prudent, as it did in responding to the 1985-6 economic crises.

It would not only gain popularity, but would also be seen to be more responsive and accountable by dropping economically indefensible projects.

It could also become more determined in ensuring that growth is primarily based on the development of Malaysian human and other resources, rather than continuing to rely on the inflow of cheap foreign labour, foreign capital and technology.

The cheaper ringgit would help make exports much more competitive than they would otherwise be.

As the Chinese character for crisis reminds us, it involves both danger and opportunity.

The writer is a professor at Universiti Malaya and president of the Malaysian Social Science Association. His most recent books include *Southeast Asia's Misunderstood Miracle* (Jomo et al., Westview, 1997); *Malaysia's Political Economy* (Gomez and Jomo, Cambridge University Press, 1997).

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