

17/04/1998

Short-term capital flows should be limited

Din Merican

TRILLIONS of US dollars in the hands of currency traders and hedge fund managers have today wreaked havoc in East Asia, particularly in Southeast Asia.

Regional economic prosperity earned through hard work, thrift and painstaking planning has in a matter of months given way to gloom and doom. Investor confidence has been undermined, while the national psyche is badly shaken.

A worldwide recession is now a distinct possibility, if nation states fail to take collective action on the basis of mutual interest to deal with this currency-induced phenomenon. It is not correct to attribute this crisis entirely to the policy weaknesses of East Asian governments.

The actions of these market operators whose only aim is making money through the creation of paper wealth have been lauded in the name of free markets. They have the privilege of delivering rough "economic justice" with impunity.

The very mention of regulation or even the immorality of their actions can create additional turmoil in the financial and capital markets and bring about more hardship. The Asian financial crisis underscores the need for some temporary mechanism to limit the short-term volatile and pernicious capital flows, to quote Joseph Stiglitz, chief economist of the World Bank.

Malaysia has been in the forefront in drawing international attention to the impact of these massive global short-term capital flows on emerging nation states. Prime Minister Datuk Seri Dr Mahathir Mohamad has proposed collective action at both regional and global levels. Unfortunately, the Western powers seem to be in a state of paralysis, mesmerised by the tenets of free markets, and are unwilling to take corrective action.

Malaysia is a good example of a mixed economy where the state co-exists with the market. The role of the state in an emerging market is crucial to ensure that economic growth is balanced with equity.

The New Economic Policy which was initiated in the early 1970s has a two-pronged strategy of poverty eradication and economic restructuring to create a viable indigenous business community. It was designed to promote political stability and national unity.

The NEP benefited all communities including long-term direct foreign investors because it was carried out in an expanding pro-business environment. When it was in full swing, Malaysia enjoyed almost uninterrupted strong economic growth, and political and social stability. There is, therefore, no reason to apologise for this affirmative action policy. It is today widely accepted as a pragmatic and realistic programme.

When Malaysia was hit by a severe recession in the mid-1980s Tun Daim Zainuddin who was then the Finance Minister drastically reduced the role of government in business and the economy, and tapped the dynamism of the private sector. He also implemented the unpopular political decision to scale down the NEP programmes. Daim was, therefore, willing to accept unorthodox approaches and solutions in resolving the country's economic problems.

In the current economic circumstances, Malaysia has again demonstrated its willingness to act decisively. The creation of The National Economic Action Council outside the existing political and bureaucratic structure

of government signals Malaysia's willingness to put all national economic policies under critical review. Daim, the architect of Malaysia's spectacular recovery from the 1986-1987 recession, is its executive director.

Away from the glare of publicity, Daim and his small NEAC staff have been meeting business and trade union leaders, industry and professional groups, academics, community leaders, individuals and also foreign groups. These meetings are intended to establish a broad consensus on the issues and problems confronting Malaysia today.

At this juncture, it is inappropriate to speculate what the NEAC's actual recommendations will be. But one can be reasonably clear - based on his past actions - that Daim will not shy away from making firm recommendations and policy prescriptions that best serve the national interest. As he pointed out in the Feb 19 issue of the Far Eastern Economic Review, "... the primary task of the NEAC is to restore confidence".

The 5th Column in the April 2 issue of the Review, advocates unrestricted foreign ownership of financial institutions. Arguments in support of this proposal are that foreign investors can bring in fresh capital, new technology, international linkages, strong management expertise and better service to customers. I disagree. Malaysia has historically had and continues to have a strong foreign presence in its financial services sector.

The financial services sector is strategic in nature. For this reason, none of the Organisation of Economic Cooperation and Development countries have allowed foreign ownership and control of their domestic financial institutions and insurance companies.

Financial institutions are custodians and mobilisers of domestic savings. Malaysia must continue to ensure that domestic savings are utilised to finance domestic long-term and productive investments. This makes sense since over-reliance on foreign savings, especially short-term capital inflows, is a risky proposition for long-term investments. Malaysia should not give its financial house away in the name of free markets.

It remains an open question whether the present fascination with free markets and disenchantment with government intervention will endure. The way unfettered markets have been behaving in recent times may trigger a reversal in thinking and call for a redefinition of the future frontier between the state and the market. There are strong grounds for a more prominent role for the state in emerging and less developed countries.

Political stability is of paramount importance since no one will invest in a country that is chaotic. For Malaysia, given the state of its political development and socio-economic profile, the continuing challenge will be to find a healthy balance between economic efficiency and social justice. This balance will ensure continued political stability.