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BACKING FOR MALAYSIA

WESTERN COMMENTATORS INCREASINGLY BACKING MALAYSIA'S ECONOMIC STAND

By: Yong Soo Heong

KUALA LUMPUR, Aug 21 (Bernama) -- When the International Monetary Fund (IMF) recommended a heavy dose of structural reforms to tackle the Asian financial crisis, Malaysia argued that its proposals would not be appropriate.

But Malaysia's arguments against the so-called reforms, which included having a tight monetary policy, high interest rates, budget cuts, abrupt closure of banks, rapid enforcement of bank capital adequacy standards, were lambasted by Western critics who said Malaysians were still denying that the country was in trouble.

Malaysians were also described as not being in touch with reality and were stubbornly against accepting the IMF's prescription.

Now, after more than a year into the country's worst economic crisis, Western commentators are changing their tune. They are now increasingly saying that what Prime Minister Datuk Seri Dr Mahathir Mohamad had repeatedly articulated was right after all, especially about the inappropriateness of the recommendations.

In other words, what has been expounded by Dr Mahathir is gaining currency.

The latest of such support came from two American academicians -- Steven Radelet and Jeffrey Sachs.

Radelet is an associate at the Harvard Institute for International Development (HIID) and lecturer of economics at Harvard University while Sachs is the director of the HIID and professor of international trade at Harvard University. Their article "Why not let banks own the debtor firms?" appeared in a recent issue of a regional newspaper.

"The IMF's approach, far from reviving confidence, has inadvertently made a bad situation worse," they said in their contributed article.

After one year, they said the combination of sustained high interest rates and illiquidity had, in fact, led to severe economic contraction and a vast overhang of bad debt throughout Asia.

Another Western academician, Robert Wade, professor of political economy at Brown University, also wrote in The Financial Times sometime back that the IMF failed to grasp the implications of imposing high interest charges on Asian companies.

Asian firms are typically far more indebted than their Western and Latin American counterparts and high rates would push them quickly from illiquidity towards insolvency, forcing them to cut back purchases, sell inventories, delay debt repayment and fire workers, he said.

Banks then accumulate a rising proportion of bad loans, their solvency comes into question, they call in loans and refuse to make new ones.

The IMF's insistence that banks meet strict Basle capital adequacy standards only compounds the collapse of credit.

Wade said the combination of high interest and Basle standards is the immediate cause of the wave of insolvency, unemployment and contraction that continues to ricochet around the region and beyond.

The uncertainty, instability and risk of further devaluations keep capital from returning despite high real interest rates.

Wade also finds it puzzling why the IMF has taken this contractionary approach in Asia because it was well aware of the US experience.

Recalling the aftermath of the 1987 U.S. stock market crash, in which assets that were collateralising bank loans fell sharply in value, he said

the US authorities acted to keep the markets highly liquid no matter what the cost.

"Yet in Asia, the Fund has acted to contract liquidity. Is this because it only knows only one recipe? Or because it is more interested in safeguarding the interests of foreign bank creditors than in avoiding collapse in Asia?"

Tun Daim Zainuddin, before he was appointed Special Functions Minister, said in May that an extremely tight monetary policy would bring about unexpected adverse affects on businesses.

Since his appointment as minister, he had recommended through the National Economic Action Council (NEAC), of which he is also executive director, that interest rates be lowered.

Bank Negara Malaysia has moved swiftly to ease its tight monetary stance and has come out with a new framework to reflate the sagging Malaysian economy.

This relaxed stance has caused lending rates to slide to more realistic levels at about 13 percent presently from about 16 to 17 percent a few months ago and from as high as 21 percent last December. The base lending rates of some major banks have also dipped to below 11 percent.

Radelet and Sachs said that for the Asian crisis to begin to move forward, a different approach is needed.

And it should be based on a new macro-economic strategy and an aggressive restructuring of corporate and bank balance sheets. Only such a change in direction will restore confidence and growth in the Asian economies.

They said the IMF had provided each government with several billion dollars upfront to help shore up reserves, with the promise of larger sums in the future if reforms were implemented.

The objectives of this approach were to arrest the slide in regional currencies, reduce the scale of non-performing loans on balance sheets, and to convince foreign investors to stop their withdrawals by showing them that the Asian governments were serious about reforms.

But Radelet and Sachs said the IMF's plan largely backfired. This is because the immense economic contraction that was already under way as a result of the capital withdrawals was amplified by the IMF's contractionary policies.

And foreign creditors became worried that debtor firms would be much less able to repay their loans in such an environment.

In addition, the actual official foreign financing turned out to be substantially less than the headline amounts that were announced, so the liquidity squeeze in foreign exchange markets remained.

Banks also came under extreme stress and basically stopped making fresh loans. Capital withdrawals accelerated after some IMF programmes, and currencies in all of the crisis-ridden countries continued to slide.

Radelet and Sachs also pointed to the fact that the illiquidity crisis evolved into a widespread insolvency crisis as crushing debt burdens translated into negative net worth and despite the recent stability in currency markets, real economic recovery is far off.

"Under these circumstances, continued high interest rates and the gradual work out of foreign and domestic debts will not solve the problem," they stressed.

As time goes on, more firms will become insolvent and close down, thus leading towards a deepening downward spiral.

Given these circumstances, a different approach is needed to move much more quickly to eliminate the overhang of bad debt and get firms back on their feet.

Radelet and Sachs have suggested ideas which had been advocated by the

National Economic Action Council -- expand liquidity, restructure debts, recapitalise banks and re-adjust macro-economic policies.

Expanding liquidity would ensure that there is sufficient liquidity in the banking system and enable firms, especially exporting firms, to continue production even before these firms are able to restructure their debts.

As for debt restructuring, they said this strategy is not aimed at rescuing non-viable firms. If after the debt conversion, firms cannot generate a positive cash flow, then they should probably be liquidated.

Radelet and Sachs stressed that firms should not be saved at any cost, but the better ones should be given the opportunity to re-establish their operations without the debt overhang.

They also recommended that corporate debt restructuring and bank recapitalisation should proceed in tandem. Neither step can await the completion of the other. Bank re-capitalisation needs to begin urgently so that lending can resume quickly for exporters and firms without a large debt burden.

But the process of bank recapitalisation cannot be completed until corporate debts are restructured and the banks convert some corporate debt into equity.

Radelet and Sachs said the key to re-adjusting macro-economic policies is to reduce interest rates and expand domestic credit. But this would probably entail some further depreciation in the region's currencies, at least in the short run.

But that would be a relatively small price to pay for re-starting economic activity, they said. -- BERNAMA

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