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## Capital controls a good recipe

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THE campaigns for the 10th general elections have begun with considerable intent, and are expected to be more absorbing and charged than the last general elections in 1995.

The train the Barisan Nasional (BN) is on is excellent, it should pick up lots of passengers come Monday, November 29. The Prime Minister, Datuk Seri Dr Mahathir Mohamad, is an experienced veteran driver; well-tested after having driven the same train for 18 years. No one can derail the Mahathir Express!

I told that to the 1999-2000 Hubert Humphrey Fellows at Boston University (BU) in Boston last Thursday when I spoke to them about "The Malaysian Way of Managing An Economic Crisis". Here are excerpts from my 30-minute remarks:

"On May 13 1969 race riots broke out in Kuala Lumpur following a long and an acrimonious and rancorous general elections campaign. As a result the Government, in the following year, introduced the New Economic Policy (NEP), and we have been engaged since then in an effort of which I believe many of you will approve, which is the affirmative action. The NEP was a bold and successful social engineering initiative which enlarged the Malaysian middle class and provided enhanced economic and social opportunities for all Malaysians, the indigenous or the disadvantaged community in particular.

"Since then Malaysia has not only experienced rapid economic growth, it has also distributed the fruits of that growth relatively fairly across the board through the New Economic Policy. The fact that the Bumiputras did not achieve the 30 per cent promised them or the aggregate target of the NEP, is another story. The pragmatism of the Malaysian leadership brought about a remarkable economic performance during 1988 through 1996 when the Malaysian economy expanded between 8 to 9 per cent per annum. Our economic development is not only a dynamic process it is also country-specific. The privatization policy which allows for the implementation of projects which otherwise could not be undertaken with normal public sector budgetary allocation, given the limited resources of the Government, is part of the current National Development Plan (NDP), the successor of the NEP.

"Then in the summer of 1997 we were caught in the devastating Asian economic crisis. The Thai baht slumped; and the Indonesian rupiah followed suit and this "tom-yam effect" developed into a regional crisis, first caused by the East Asian contagion. In the mid-eighties, Malaysia experienced negative growth of about 1 per cent. We thought the recession then was unprecedented. Still, we were shocked, devastated by what happened because it was much worse; we suffered a negative growth of 7 per cent in that year and over 6.7 per cent in 1998.

The reasons are many but I shall not go into them because what is relevant now is how Malaysia has managed to come out of the "bubble" economy.

"In response to the crisis, the Government established the National Economic Action Council or the NEAC in January 1998 to stop the economic malaise and speed up economic recovery. The Government felt that the economy must be saved fast, given the rapid pace of the economic slowdown and erosion of business confidence. Then the NEAC started the National Economic Recovery Plan (NERP) in July 1998 with the objectives of

stabilising the ringgit (that is our currency), restoring market confidence, maintaining financial market stability, strengthening economic fundamentals, continuing the equity and socio-economic agenda and restoring adversely affected economic sectors. All these are now being actively and vigorously implemented.

"While not amounting to micro-managing the economy, the NEAC does go into detail on issues and problems which are barriers to speedy economic recovery, initiated campaigns to help clear stock of unsold properties, waived major administrative requirements such as stamp duties, stopped further development of over supplied sectors like building of big hotels, mega offices, expensive and exclusive condominiums and instead the Government encouraged construction of low-cost housing for the ordinary people whilst the local governments were told to stop approving new housing projects unless they are of benefit to the people.

"However, I would like to think that the establishment of Danamodal, Danaharta and the Corporate Debt Restructuring Committee (CDRC) was the most effective in tackling our pressing economic problems. Danamodal was created to recapitalise financial institutions as many of them experienced reductions in their capital adequacy ratios (CAR) as a result of rising non-performing loans (NPLs). Danaharta was launched as a special purpose vehicle (SPV) to acquire NPLs from financial institutions in order to assist banks to concentrate on banking activities and operations. The CDRC was formed to help solve corporate debt problems via negotiations with creditors and debtors in order to come out with market-based-solutions. Simply, one institution recapitalises banks and the other disposes of bad loans.

"The institutional set-up attempts to solve the problems in a manner, in a Malaysian way, that fits the socio-economic priorities of our people and to maintain business confidence in the nation. The Malaysian experiences have shown that we have done better in adjusting ourselves compared to those nations which adopted the IMF prescriptions. We rejected IMF intervention because the Fund applies the same prescriptions for all nations even though each country has different economic problems, social safety valves and different political structures. It also has a very serious even fundamental flaw: the IMF solution, consciously or undeliberately, failed to recognise the great risk of the potential for social disintegration and racial unrest. We were proven right with what happened in Indonesia where financial crisis eventually led to civil unrest, political instability and eventually a change of government. Michel Camdessus, the long-time French managing director, of the IMF announced last week he was leaving the Fund two years before his third term finishes because of a personal reason. I wish him well in his retirement or in whatever he does. He will, I think, not be missed much, at least, in Indonesia even in Thailand. He deserves a good rest (laughter).

"Despite criticisms and reservations the Malaysian Government introduced selective capital controls in September 1998 which made international non-convertibility of the ringgit via pegging of the ringgit at 3.80 per US dollar, that short-term capital should stay on-shore for a minimum of one year which has now lapsed. These measures in essence killed the off-shore market for the Malaysian currency, discouraged the inflow of speculative short-term capital and brought home off-shore ringgit (mainly in Singapore) which had left the country in 1997 and early 1998 attracted by higher interests, and enticed by foreigners. The controls did what was desired: prevented external attacks on the ringgit by rogue currency speculators and traders and insulated the Malaysian economy from the vulnerable impact of short-term capital flows and future manipulation of

the Malaysian currency.

"The selective capital controls had been proven effective yet at the early stage of its implementation the critics and detractors of the Prime Minister of Malaysia, Dr Mahathir Mohamad, said he was crazy.

Mr George Soros, the global currency speculator, then even called Dr Mahathir "a threat to his own country". Soros repeated this baseless remark in New York in September during a luncheon speech by Dr Mahathir at the Council on Foreign Relations which I was present.

"Despite Soros and the likes of him and other critics, thank God my country thus far is on the road to recovery, better than any other affected Asian country, with the possible exceptions of Singapore and Taiwan. So much so we are going to have our 10th general elections later this month. If the Mahathir Government is not confident, and unpopular as his opponents and detractors insist, Dr Mahathir would not have dared to call the election which is not due until June next year, and I predict the Barisan Nasional, a coalition of 14 parties, will win again as it has always had since Independence. This is because the worst appears to be over, and the economic mood is up beat (up to a point). The debate on the "feel-good" Budget 2000 was taking place when Parliament was dissolved to pave the way for the polls. The new government, which I am certain, will be the same one will either approve the Budget 2000 as tabled or introduce and even better one! Malaysia is heading for sustainable recovery, underpinned by the recent and on-going impressive performance of the merchandise export sector, and growth forecasts for the year have been pushed above 4 per cent, and the stock market is up 180 per cent since September last year. Sustained growth in the economies of our major trading partners such as the US would have a positive impact on Malaysia's exports and this would accelerate further growth in our economy.

"Unemployment is falling (we have nearly two million foreign workers), trade surplus had boosted the nation's reserve to US\$32 billion (US\$1 = RM3.80) - the equivalent of more than seven months of imports. According to the latest statistics released last week the surplus during the first three quarters of this year jumped to RM52,3 billion or US\$13.7 billion, or 35.4 per cent increase against the same period last year. Exports grew by 9.4 per cent and imports by 3.6 per cents. I predict, a trade surplus for 1999 could well be RM74.1 billion or US\$19.5 billion against RM69 billion in 1998. We have now recorded trade surpluses for 23 consecutive months!

"We have to concentrate on the domestic economy because we have to sustain and enhance the relatively high standards of living and good quality of life all Malaysians have always enjoyed and are enjoying. This is crucial in the context of preserving political stability in the country. The measures have given us independence to manage our own monetary policy, the independence which has been eroded with the internalisation of the ringgit. While I am at this, I would like to say this: Malaysia never discourages capital; we welcome long-term foreign capital, American capital especially. We are only determined to discourage the disruptive short-term and halt the speculative capital. Besides capital controls are not really new: China, India, Republic of Korea, Taiwan and others such as Chile, Spain and Portugal had some forms of capital controls too. So why are the criticisms against us? In any event, we are recovering despite what the prophets of doom have said that Malaysia might never recover. Dr Mahathir is not quite having the last laugh yet but he is not displeased with what we have attained (applause).

"I will grant you there may be higher growth rates and bigger trade surpluses but what sets us apart is the greater speed and extent of Malaysian reforms, the strength of our economic structure and more

importantly the durable and well-tested Malaysian political system which remain intact throughout the economic crisis. We have overcome the economic down-turn principally because we are politically stable, our civil or public service is relatively clean and competent by any standards, and we used the experience (i.e. the crisis) as an opportunity to introduce even greater transparency and market discipline. We appraised and will continue to do so of our strengths and weaknesses, and will vary or modify any areas where changes and improvements are needed in planning, budgeting and implementation. We will review and modernise governmental system, and if necessary, even reconstruct it.

"We also are very careful to scrupulously maintain key elements of an economic safety net and more importantly the social, political and racial safety nets that were and are lacking in other economic-crisis hit nations even in open economies.

"Had we taken up the IMF prescriptions instead of the traditional fiscal and monetary stimulous policies to resuscitate our ailing economy we would have been in deep economic and political trouble. I am happy our economic remedies have won support; even the IMF has reluctantly acknowledged the usefulness of controls in this particular Malaysian circumstance, that the Malaysian home-made remedies had succeeded (applause).

"The affirmative action has enabled us to achieve a degree of social harmony which was absent in Indonesia and not evident in many parts of Asia and Africa. Consequently the Malaysian Economic Crisis while posing a threat to growth does not imperil racial harmony nor threaten national integrity and independence though the danger of us being controlled by outsiders through an unrestricted (or open) economy is ever present. The economic downturn caused us to lose 5 years in economic terms and to catch up again is a gigantic task.

"Still, we have to continue to work hard indeed even harder. As a result of the economic crisis our target to become a fully developed nation by the year 2020 has been delayed quite a bit. As before despite the odds we succeeded. I am convinced that if the races in Malaysia remain united, work and play hard as a team and give their best and with accompanying goodwill from all nations, the US in particular, Malaysia can achieve whatever it desires. And there is a popular slogan in Malaysia, which says "Malaysia Boleh" (or Malaysia Can) and all Malaysians are out to prove just that".

With the economy thriving and everyone feeling good it is a long shot to bust BN because it has everything that the Opposition lacks. And the timing is excellent given the prevailing political circumstances including PAS's obsession to win over the Chinese voters via offering them a Chinese Prime Minister!

All being well, BN's victory is a certainty. What is not is the extent of its two-thirds majority (rounds of applause).

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