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Malaysia can sustain recovery: Krugman (HL)

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MALAYSIA should be able to sustain its recovery given the minimal threat of external factors adversely affecting the economy, US economist Paul Krugman says.

Krugman, who supports Malaysia's selective capital control measures but warned the country against clinging too long to them, believes developments like deflationary pressures in China and Japan would not colour economics this side of the world.

"The only way you can be hurt is currency movement, which could happen if China devalues its currency, for example," he told a seminar in Kuala Lumpur yesterday. "But I still cannot see a scenario where that would disrupt Malaysia's economic recovery."

Krugman also said any outflow of funds after September 1, when the one-year moratorium on repatriation of portfolio capital expires, would be "irrelevant" to Malaysia in view of its vast reserves.

The professor of economics at Massachusetts Institute of Technology and visiting professor at the London School of Economics was speaking during a panel discussion on "Malaysian Business Forecast".

Well before the 1997 regionwide financial crisis, Krugman had suggested that Asia's rapid growth was unsustainable because it depended on massive input of capital and labour.

For this reason, Malaysia is unlikely to see its gross domestic product (GDP) growth returning to pre-crisis levels of more than 8 per cent. Malaysia's days of allocating a high percentage of the GDP to capitalise growth are over and there is no longer the large pool of cheap labour, he said.

In congratulating the country on its success with the selective capital controls, Krugman said: "The easy thing to do would be to share in Malaysia's triumph in taking steps the rest of the world think outrageous and proved those warnings inappropriate.

"You have great reasons to pat yourself on the back for a clear recovery, but it is very important to use the newfound freedom with discipline and not abuse it."

The similarly speedy recovery of countries which adopted the International Monetary Fund's prescription had made deciding who was right or wrong difficult, he added.

In the interest of attracting foreign investment, Malaysia should explain that the action taken was necessary to recover from the crisis, and nothing more, Krugman said.

"If people realise and believe that the capital controls were placed only to curb the inflow of hot money and that Malaysia is favourable to open market and globalisation, it (Malaysia) will still be viewed as an attractive place for foreign direct investments."

Rather than intended to curb the activities of currency speculators per se, he believed Malaysia's measures were introduced to create a conducive environment for the effective pursuit of monetary policies.

Should Malaysia now decide to ease the controls, a more market-friendly mechanism to limit hot money inflows, like the one Chile has adopted where investors are required to deposit a sum of money in non-interest accounts for a year, could be considered, he added.

Krugman said the unorthodox policies introduced by Prime Minister Datuk Seri Dr Mahathir Mohamad, whom he met yesterday, were right both in

practice and principle, "although his timing was a bit off and so was mine."

He was referring to suggestions that when the controls were imposed the financial crisis was already abating.

The panel discussion was chaired by Second Finance Minister Datuk Mustapa Mohamed and included Bank Negara Governor Tan Sri Ali Abul Hassan Sulaiman, Institute of Strategic and International Studies representative Datuk Dr Zainal Azman Yusof, and managing director of Oracle Systems Malaysia Sdn Bhd William Hounq-Lee.

Mustapa, in response to Krugman's views, said he believes Malaysia is fully capable of returning to pre-crisis growth levels of between 7 and 8 per cent as it is taking advantage of the window of opportunity provided by capital controls to emerge from the turbulence stronger.

"Malaysia can achieve it... with electronic commerce, information technology and development of skilled manpower... We in Malaysia, with all the right policies in place, will go back to our good old days.

"The restructuring of financial institutions and merger of banks will help us not only to recover lost glory, but also prove to the rest of the world that they are wrong about Malaysia," he said.

Ali meanwhile noted that capital controls have not impeded trade and that Malaysia still has one of the lowest tariff regimes in the world. While the economy may have been previously driven by capital and labour inputs, now all it needs to do is to maximise the use of resources.

"We can go back to our original growth path, hopefully by next year," the central banker said.

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