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Malaysia shows the world a softer, gentler solution

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EISUKE Sakakibara, Special advisor to the Japanese Minister of Finance, said that he saw no reason why Malaysia should remove its selective exchange rate controls. And neither do the Malaysian authorities. Sakakibara, describing the measures first implemented on September 1 1998 as "courageous" and argued that the exchange rate controls should in fact be "an instrument in the arsenal of policy options" available to a country.

The institutions to implement the measures must be in place and in Malaysia's case Sakakibara singled out Bank Negara, adding that "Malaysia has a very competent Central Bank and that is a must and crucial". Malaysia's experience showed that selective exchange rate controls do work. Contrary to predictions of doom that there will be a "rush to the door" and that the "move is expected to uncork a stream of capital out of Malaysia" the outflow was very much smaller.

The forecast was for a minimum of US\$3 billion (US\$1 = RM3.80) and anything up to US\$10 billion. Many critics must have been disappointed that on the first three days of September just US\$462 million in portfolio funds found their way out. The net outflow of funds works out to be even much lower taking into account the inflow in the capital account. Even following the relaxation of the controls and the imposition of a graduated levy from February 15 1999 there has been a net inflow of funds to the tune of US\$4 billion. In addition, the country's foreign reserves have risen to US\$32 billion, more than sufficient to cater to the outflow. Some argue that Malaysia's economy has improved in line with those of the region and those under the International Monetary Fund's (IMF) tutelage. But they fail to point out the "real story" of recovery in each of the countries.

Even under the close supervision of the IMF and the conditions placed on these countries there continue to be reports of even more critical problems - the Bank Bali case in Indonesia, the Daewoo issue in South Korea and the renewed attack by a hedge fund on the Thai baht by the US-based Tiger Fund.

Malaysia, as Dr Mahathir said, did it on its own terms. It did not have to go through "the misery of massive unemployment; the tragedy of children thrown out of schools; the decimation of the middle class which we have spent a generation to build; blood on the streets and political turmoil throughout the land".

In addition the institutions in Malaysia remain intact unlike in other countries where they have come under severe pressure or have been totally destroyed. In other countries much of the corporate and financial sector has been "lost" to foreigners and they continue to race and hope to pick the prizes at fire sales and basement prices. "Economic colonialism" is on the march.

In Malaysia at least the institutions, which are in much better shape and healthy, remain within its own control. Efforts are being made to strengthen the corporate and the financial sector further with enhanced corporate governance and merger and strengthening of banks.

Now that the dire consequences and the "rush to the door" to get the money out on September 1 1999 did not materialise and the economy is clearly on the road to growth, the critics now seem to be changing their tune.

Among others they now claim that "serious criticism of the restrictions has never claimed that they would lead to immediate economic disaster". Unless one suffers from memory lapses or selective memory it will be recalled that the selective controls were described as "voodoo economics", "outrageous", "worst possible choice" and that they would be a "spectacular failure".

Malaysia was described as a "maverick" moving back to the "dark ages", "shut its doors to the global economy" labelled as a "pariah and a heretic" and "What Dr Mahathir knows about economics can be written on the back of a postage stamp".

The results however, speak for themselves. Now even some members of the "Washington Consensus" admit that Malaysia's measures have worked and Dr Amar Bhattacharya, the World Bank's Senior Advisor, said that Malaysia has proven that a consistent "macro package" can play a role during times of "large capital controls" adding that they "would be studied".

The Group of Seven (G-7) at one of its recent meetings in Cologne, Germany, admitted that "under emergency conditions controls on capital outflow may be necessary".

Malaysia was condemned for its policies by the international community, fund managers, market players and many others, but the authorities were steadfast in their belief that the "orthodox" measures prescribed by the IMF would be even more damaging and disastrous.

The battery of criticism and opposition to its selective controls could well be due, as Sakakibara argued, to the fact that Malaysia and Dr Mahathir "challenged the US and the world establishment with his views and has succeeded."

The existing rules of the financial world are biased towards Wall Street and a number of people there have vested interests in maintaining the status quo. Malaysia, a small developing country, with its policies and selective capital controls was seen to be changing these rules and thus had to be "stopped". Thus the violent and ballistic reaction and opposition to the selective controls.

There is no one road that leads to Rome and thus no one option to solving the global financial crisis. The results speak for themselves and Malaysia has shown the world that there is another "softer" alternative to the painful text book solutions applied on a regular basis.

Malaysian authorities nevertheless are the first to admit that there is still a lot of work ahead. Even as recovery is clearly underway reform will take time and certainly cannot be implemented overnight. As Dr Mahathir said "we have suffered too much pain" and even as the country moves ahead "we will not forget that we need reform. But in the meantime don't grudge us our recovery".

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