Move that helped economic recovery

IN part two of his article, Prime Minister Datuk Seri Dr Mahathir Mohamad discusses the selective exchange control introduced in 1998.

THE "recalcitrance" of the Malaysian leader was also now coming under criticism by a segment of the local population, who wanted the leader to bow out and give the reins to his deputy, who was also the Finance Minister.

Supporters of the Deputy Prime Minister accused the Government and by implication the Prime Minister of cronyism, nepotism and corruption.

The message for the Prime Minister was clear. The economy would not recover unless he stepped down and handed the reins of Government to his Deputy. However the Prime Minister did not seem to get the message.

The Government was desperate, but it was not about to capitulate. It undertook certain measures to prevent further deterioration of the economy.

All salary increases were stopped; travel abroad for the Ministers and Government staff was curtailed and allowances were reduced.

There was even an attempt to reduce sugar consumption and the import of food and other products. All these measures were not at all effective.

They merely lowered the consumption level and the standard of living of the people. The importers, dealers and retailers all suffered. In the end the Government too would feel the crunch through reduced revenue.

Construction, retail sales, purchases of property and motor vehicles went down very badly. Fortunately, Malaysian workers were not laid off in a big way, as demand for Malaysians manufactured goods, mainly electronics, remained high. For many years Malaysia had become short of workers and was forced to allow almost two million foreign workers into the country.

Although a number of Malaysians lost their jobs, the brunt of the slow down was felt by the foreign workers, many of whom could not find employment and had to return to their countries.

The fact that the economies of the developed countries were not affected and were actually doing better during this time helped the Malaysian economy by enabling Malaysia to increase its exports. Exports of palm oil (sold in US dollars) earned more Ringgit because of the weaker exchange rate as well as higher demand.

In ringgit terms, and even in foreign currency terms, Malaysia very quickly achieved a current account surplus, something that it could not achieve before, because of the large deficit in the services account.

'The Prime Minister came up with a wild idea to resolve the crisis. To counter the devaluation, he toyed with the idea of raising income by increasing salaries and wages and allowing prices of goods and services to be increased proportionately'

The Prime Minister came up with a wild idea to resolve the crisis. To counter the devaluation, he toyed with the idea of raising income by increasing salaries and wages and allowing prices of goods and services to be increased proportionately.

He was aware that this would lead to an inflationary spiral, but he felt that the Government would be able to manage the inflation so as to be less than the devaluation of the ringgit.

The downside to such a move was that the cost of production in Malaysia would increase and affect exports, as well as profit from exports.

The concept was shot down by other members of the Government on grounds that it was not practical and was likely to lead to galloping inflation.

The National Economic Action Council had set up an Executive Committee consisting of the Prime Minister, Deputy Prime Minister cum Finance Minister, the Minister with Special Functions, the Deputy Governor of the Central Bank (for some reason the Governor never attended), the Director-General of the Economic Planning Unit, the head of a Malaysian think-tank and a person from the business sector.

Subsequently, the Adviser to the Central Bank and the Second Minister of Finance were also appointed to the Committee.

The Committee was charged with overseeing the economic and financial performance of the country, and to decide and act when necessary.

The Committee met every morning during the crisis to review all relevant financial, economic and trade figures.

Understanding currency trading

Briefings were made by Government agencies. The Committee was empowered to act quickly, where necessary, without waiting for Cabinet approval.

One of the measures decided upon by the Committee was to revive trade with Asean neighbours. All the Asean countries were in financial trouble and did not have enough foreign exchange to finance imports.

The mechanism of bilateral payments arrangement was to be utilised, in which the gross two way trade flows are netted off every three months and the net balance settled in the exporters' currency.

The payment was to be made between the two respective central banks. The exporter would be paid in local currency by his central bank immediately on export and the importer will pay his central bank also in his local currency.

The mechanism of bilateral payments arrangement had already been in place for many years between Malaysia and many developing countries.

The arrangement was pioneered by Malaysia and had helped to increase Malaysia's trade with its non-traditional trading partners by up to 400 per cent.

The only difference between the existing practice and the proposed arrangement for Asean countries, was that, while previously settlement of the net balance was in US dollars, now the Asean countries which were in turmoil and short of foreign exchange would settle their payments in local currencies.

The Prime Minister travelled to Bangkok, Manila and Jakarta to put this proposal to the Prime Minister and the Presidents of the countries concerned.

The proposal was accepted, subject to the laws and practices of the countries concerned. Unfortunately, the bureaucratic process took too long and the proposed bilateral payments arrangement was not implemented.

The economy continued to deteriorate and the ringgit kept getting further devalued along with the currencies of Indonesia, Thailand, the Philippines and South Korea. It seemed at times that this devaluation would go on and on and Malaysia would sink deeper into economic recession.

There appeared to be no limit to the power of the hedge funds to destroy any economy in order to make the much touted 30 per cent return for their investors.

Malaysia continued to believe that the root cause of the economic and financial turmoil was the currency trading by the hedge funds and banks.

If something was to be done by the country on its own to counter the hedge funds, the mechanism of currency trading had to be fully understood, and a plan devised to beat the currency speculators at their own game.

Unfortunately, the person in the Central bank (with the rank of Adviser) who had international experience in foreign exchange trading had left the Central Bank in 1994. Perhaps, at this stage, the story of the foray of Bank Negara into the foreign exchange market between 1985 and 1993 needs to be told.

'The economy continued to deteriorate and the ringgit kept getting further devalued along with the currencies of Indonesia, Thailand, the Philippines and South Korea. It seemed at times that this devaluation would go on and on and Malaysia would sink deeper into economic recession'

Up to 1985, Bank Negara did not actively manage its external reserves. However, this situation changed after the Plaza Accord of 1985 when the G-7 countries decided to strengthen the Yen in order to make Japan less competitive.

Malaysia, which had significant borrowings denominated in Yen, suffered heavy losses.

In order to offset losses arising from the decisions of the G-7 countries, Bank Negara started to manage its external reserves actively, including taking foreign exchange positions.

Bank Negara's senior advisor was put in charge. The foreign exchange activities were limited to the currencies of the G-7 countries. It did not deal in the currencies of the developing countries.

Given the large liquidity available in the currencies of the G-7 countries, Bank Negara's transactions did not have any material effect on the exchange rates of the G-7 currencies.

Bank Negara did very well in its foreign exchange trading activities and made large profits.

It became very well known in the international foreign exchange market as a savvy foreign exchange trader.

Its trading activity was, however, condemned by some financial experts who later supported the currency trading activities which damaged the economies of the Asian tigers.

Clearly it is not what is done which is wrong but who is doing it.

Unfortunately, during the international currency turmoil following the non-ratification of the Maastricht Treaty by Denmark in 1992, Bank Negara suffered losses.

The Adviser resigned from Bank Negara Malaysia. The Government instructed Bank Negara to discontinue foreign exchange trading.

It is indeed a strange twist of history that this costly experience in the foreign exchange market provided Malaysia with the knowledge and skill required to implement the selective exchange control regime in order to frustrate the currency traders and help the country's economic recovery.

The former Adviser of the Central Bank was summoned by the Prime Minister for a briefing.

Following a series of meetings between the Prime Minister and the Adviser, the Prime Minister understood, for the first time since the crisis, the complex and complicated workings of the foreign exchange market, including the way the prices were quoted, the psychological

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Economic plan that succeeded

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factors that motivate the currency traders (greed and fear) and the concept of offshore currency.

The Prime Minister's understanding of the foreign exchange market was essential in devising a plan to save Malaysia from the currency speculators and the IMF.

It now became obvious that some of the information that was presented by the Minister of Finance to the Government, including figures on large outflows of ringgit in the form of cash to Singapore, was misleading.

The Minister of Finance did not fully understand the concept of off-shore ringgit.

He thought that the term "off-shore ringgit" referred to the physical ringgit overseas, mainly in Singapore. The Central Bank either did not enlighten him or it too did not understand.

In any case, the Central Bank did not stop the Minister and the Government from instructing Customs officials to [illegible]ch travellers crossing the border for [illegible] on their persons. This silly action did [illegible] stop the ringgit from going abroad and being traded.

The difference between off-shore ringgit and domestic ringgit is not whether the ringgit is physically in Malaysia or outside Malaysia.

Except for small amounts of cash held by money changers and banks, the ringgit will always be in Malaysia physically.

When the ringgit is sold by a non-resident to another non-resident all that happens is the ownership changed from the seller to the buyer in the accounts of the Malaysian bank and the foreign bank.

No cash changed hands, only book entries in the banks of the buyer and seller changed.

A matter of urgency

When the currency trader borrows the ringgit, the same thing happens. The lender, usually a foreign international bank merely transfers the ownership of the ringgit to the borrower in the books of the bank and the Malaysian bank holding the ringgit.

The trader can then short the ringgit, delivering only after the ringgit has devalued, again through transfer to the accounts of the buyer.

Being able to leverage by 20 times their capital explains the strength of the hedge funds, i.e. they use a geared position to fight the central banks which use only their cash position.

The hedge funds also tend to act together, buying and selling to each other and appreciating or depreciating the ringgit as they wished in order to maximise profits.

[illegible]hey do not buy the ringgit or any other [illegible]ency in order to pay for goods or ser[illegible]s. They really have no use for the money except to speculate and manipulate it.

For them, money is a commodity like any other traded on commodity exchanges.

As in commodity futures, the physical existence of the currency is not important.

It became a matter of urgency for Malaysia to do something drastic to protect itself from the currency speculators. Borrowing from the IMF was not an option.

The money would largely be used to repay debts to foreign banks. It was just transferring the debt to the IMF, and Malaysia would still have to find money to pay off the IMF later.

"Graduating" from this would take decades, and during that time the country would have to take orders from the IMF, losing its financial independence.

The first serious attempt made by Malaysia to combat the greedy currency speculators, who were having a one-way bet, was to make them aware that selling the ringgit need not be a one-way bet all the time.

There was a need to identify some sources of supply of US dollars which could be sold for ringgit to off-set the purchase of US dollars against ringgit by the currency speculators.

A decision had already been made that the Central Bank should not use its external reserves to intervene.

Fortunately, Malaysia has a number of companies with large export proceeds and

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these companies are natural sellers of US dollars.

Trying something else

All that was required was to coordinate their sales of US dollars in such a way as to catch the short-sellers off-guard, and trigger the element of fear in them, so that they would buy back the ringgit that they had short-sold, fearing that it would appreciate and cause them to lose money.

Of course when they buy the ringgit it would appreciate further.

When this strategy was put into effect, it worked initially. The slide of the ringgit stopped and subsequently the ringgit began to appreciate towards the rate of three to one US dollar.

It looked as if the ringgit could go back to its original level of 2.50. At this point, the hedge funds, realising what was afoot, came back with a vengeance.

They sold larger and larger amounts of the ringgit. The Malaysian companies could not sustain their defence of the ringgit against the multi-billion dollar hedge funds and the large foreign banks which allowed them to leverage up to 20 times their capital.

Considering that the Quantum Fund and the Long Term Credit Management Fund were capitalised at around US$10 billion, (RM38 billion) leveraging by 20 times really means that they have virtually unlimited capital resources to counter any attempt by locals to roll back the devaluation. Very quickly the companies gave up the attempt to defend the ringgit.

Since the first strategy did not work, something else had to be tried. The Government considered a proposal to peg the ringgit against the Yen, but pegging was not possible as long as the ringgit was freely available to the currency traders to manipulate.

Finally, it was decided that the only remaining option was to impose selective exchange controls. Early in 1998, a proposal was made for a broad framework of exchange control measures.

The most crucial element in ensuring that currency control would work was to prevent the ringgit from getting into the hands of the currency traders.

The ringgit, as had been explained, never leaves the country. This is because the ringgit is not valid tender in other countries.

The physical ringgit outside the country is only useful for exchanging with other currencies by people who want to take it back into Malaysia, where it can be used to purchase things.

Money changers and foreign banks may keep small amounts of cash for changing with travellers wishing to visit Malaysia.

Larger amounts to be taken into Malaysia may be by a bank order which can be drawn on a Malaysian bank.

The foreign bank would receive from the buyer the equivalent amount in foreign currency before issuing a bank order to transfer the ringgit to the buyers account in the Malaysian Bank.

The manner with which the currency traders buy and sell ringgit have already been explained. Such transactions are anything but transparent.

They are also very fast now as they are done on the computers of the banks. Literally hundreds of millions of dollars can change hands within a few seconds across numerous borders.

If we have to prevent the currency traders from getting their hands on the ringgit, we can only do so through the Malaysian banks which are subject to directives by the Malaysian Central Bank.

After studying the *modus operandi* of the currency traders, it was decided that since any ringgit transaction abroad must be reflected in the books of Malaysian banks where the physical ringgit is held, these Malaysian banks and foreign banks operating in Malaysia should be instructed not to transfer the ringgit from one account to another.

'The first serious attempt made by Malaysia to combat the greedy currency speculators, who were having a one-way bet, was to make them aware that selling the ringgit need not be a one-way bet all the time'

Ringgit appreciates

The legal ownership of the ringgit would remain with the owner of the ringgit at the time the controls were imposed, regardless of his sale of his ringgit.

The buyer will not be entitled to the ringgit he has bought. Effectively this meant no offshore transaction in ringgits was possible. The sale of ringgit outside Malaysia stopped abruptly.

There were some last minute purchases of the ringgit by the currency traders in expectation of the Government revaluing the currency.

As a result the ringgit appreciated slightly. The other Asian currencies also appreciated as there was general fear that other countries would follow Malaysia's example. But of course these countries were under IMF control and could not take independent action.

When the ringgit was traded at 3.80 to the US Dollar, the Government announced that that would be the rate of exchange between the ringgit and the US dollar.

But all was not smooth sailing in developing this strategy to fix the ringgit exchange rate by depriving the currency traders of access to the currency.

The proposal was debated at length in the NEAC Committee. Initially most of the members were against it. The Deputy Gov-

the world's banks. It would not be able to borrow should it need money for whatever reason. Interest rates on such loans would be raised to prohibitive levels. It was hinted that sanctions might be applied against Malaysia.

Additionally, Malaysia had to pay for imports. Would there be sufficient foreign exchange to pay for these. Dependent as it is for capital and intermediate goods in order to manufacture for exports, inability to pay for imports would reduce Malaysia's exports and inflow of foreign exchange.

What if all the investors, both short and long-term, were to pull out. Malaysia's economy would collapse. There was the possibility of legal action being taken against Malaysia by a host of people adversely affected by the controls. Malaysia would not be able to defend itself.

One member of the Committee came up with 32 reasons why Malaysia should not attempt to control the exchange rate in the way that was proposed.

Although all the arguments were demolished, the fear was real and the possible problems which the country would be faced with were frightening.

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Imposing controls

At that time the political situation in Malaysia was still stable. The Deputy Prime Minister and Finance Minister was still with the Government. Nevertheless, if the proposed controls failed, then the Government's credibility would be shattered and the Government party might lose in the next election.

Throughout the discussions, the Deputy Governor of the Central Bank was unconvinced and opposed the controls.

When it was pointed out that China has such restriction on trading of its currency he argued that whereas China had never freed its currency, the ringgit had been floated a long time and controlling it would be a backward step.

Eventually with various degree of reluctance it was decided that the controls should be imposed.

The Central Bank was naturally given the task of implementing the various measures, the principal of which was to instruct banks in Malaysia not to transfer ringgit to any account when instructed to do so by their client's banks abroad.

Bank Negara was to supervise the management of ringgit owned by foreigners very strictly to prevent any leakage.

The ringgit owned by foreigners could, however, be used to buy anything within the country and to export the goods purchased.

This simply meant releasing the ringgit into the market and increasing liquidity. In this way, much of the money which was being used to speculate would be returned to Malaysia, enabling Malaysian banks to lend to locals.

The ringgit could not be taken out of the country in any form. However, dividends or proceeds from the sale of assets in the country was allowed to be taken out in foreign currency at 3.80 to one US dollar to be obtained from the banking system or Central Bank.

The sale of assets during such times would not be easy, as there were few local buyers and the prices would not be good.

Sales to foreigners would involve inflow of funds and would not affect the reserves when the foreign exchange is taken out.

a very serious reduction in market capitalisation. At the time the currency turmoil began, the market was worth more than RM800 billion or about US$320 billion, at 2.50 ringgit per US dollar.

As soon as the ringgit was subjected to attacks and was devalued, share prices on the Kuala Lumpur Stock Exchange started to fall. The Composite Index was at about 1,000 points in early 1997. By the end of 1997 it had dipped to around 600.

CLOB mechanism

The Government tried to stop the slide by making short-selling illegal. But still, the share prices went down. It was apparent that there was a leakage.

And that leakage could only be due to shares being sold on the Singapore over the counter market called CLOB (Central Limit Order Book), set up by the Singapore authorities to market Malaysian shares when the Singapore Stock Exchange was separated from the Kuala Lumpur Stock Exchange in 1989.

Sales of shares on the Kuala Lumpur Stock Exchange have to be registered with the Central Depository System accounts in Malaysia.

Such sales are subjected to conditions imposed by Malaysian authorities. Malaysian brokers and the Kuala Lumpur Stock Exchange benefit from commissions charged. Sales in Singapore would not of course benefit Malaysians or the Government.

Although the Malaysian Government objected to the setting up and the operation of CLOB, no serious attempt was made to stop the activities of this over the counter trading in Malaysian shares in Singapore.

Even when frequent rumours were started in Singapore which caused share prices to dip, and then to recover when the rumours were found to be unfounded, the Malaysian authorities did nothing.

Obviously, speculators in Singapore were making a lot of money from these rumours and the subsequent fluctuation of the share prices.

But when the currency turmoil started, the drop in share prices became more acute despite the ban on short-selling.

Suspecting the CLOB for the failure of the ban, the former Central Bank Adviser was requested to study in detail the mechanism through which Malaysian shares were traded on the CLOB.

It was discovered that CLOB was owned by the Central Depository (Pte) Limited in Singapore (CDPL).

All shares purchased through CLOB goes into the CPDL, which had CDS accounts with Malaysian brokers, but the bulk of the custody was with Huang-DBS Bhd in Penang.

The beneficial owners of CLOB shares in Singapore did not have legal ownership of the shares, as far as the Malaysian CDS is concerned.

What they had was a statement from the CDPL, which confirmed to them on a monthly basis their stock holdings, including the Malaysian shares purchased at CLOB.

Since the trustees of the share owners remained the same, transactions on the CLOB would not be reflected on the CDS.

The CDPL of Singapore could also lend the shares for short selling in the CLOB and the Malaysian CDS would not be any wiser.

How trading in ringgit was stopped

(3) New Straits Times 25/8/2000

IN this final of his three-part article, Prime Minister Datuk Seri Dr Mahathir Mohamad explains the Government's policies and measures that made economic recovery possible within a short time.

'On Sept 2, the controls came into effect. The world was shocked and practically everyone, including of course the great economic and financial experts, predicted the total collapse of the Malaysian economy. It was madness for Malaysia, a small developing country to go against the rest of the world, almost.'

IN order to stop CLOB, registration of ownership through trustees was disallowed. Owners of shares must all register in their own name. Shares acquired through CLOB were not allowed to be traded until the owners register with the CDS.

This meant that registration in the name of trustees could not be made and the buyer of shares would not be entitled to the shares bought until they were registered in the owners name with the CDS.

Effectively this stopped the operations of the CLOB. Having decided what to do to stop the trading in Malaysian currency and the activities of CLOB, there remained the need to implement these measures.

Naturally the Central Bank had to be the principal implementing authority. A last minute bid was made by the Governor of the Central Bank and his deputy to stop the control measures.

Both of them resigned. The Government had to quickly authorise the Assistant Governor to act as head of the Central Bank and to implement the measures.

On Sept 2, the controls came into effect. The world was shocked and practically everyone, including of course the great economic and financial experts, predicted the total collapse of the Malaysian economy. It was madness for Malaysia, a small developing country to go against the rest of the world, almost.

What exactly were the selective exchange control measures? Actually, the measures were minimal. There were only three measures, namely:

- The off-shore ringgit market was eliminated and currency speculators no longer had access to ringgit funds.

This was done by "freezing" the external ringgit accounts of the non-residents in Malaysia.

They were not allowed to sell or lend the ringgit to another non-resident but could invest their funds freely in Malaysia.

Thus the currency traders were unable to short-sell the ringgit and change its exchange rate. Only the Government could determine the exchange rate.

- The Government fixed the exchange rate at RM3.80 to the US dollar.
- A "12-month rule" was imposed prohibiting the repatriation of portfolio funds for 12 months.

This "12-month rule" was necessary, given the prevailing instability of the financial market.

There was the possibility that the bad publicity following Malaysia's "unorthodox" measures could result in massive short-term capital outflows.

A 12-month restriction was therefore considered necessary. However, when the situation stabilised six months down the road, this "12-month rule" was replaced (for new funds) with a levy and subsequently even this levy was diluted further to apply only to dividends repatriated.

Interestingly, when the 12-month rule expired in September 1999, there was no massive outflow.

The market perception had obviously changed dramatically between September 1998 and September 1999.

Foreign investors were happy with the appreciation of their shares in the KLSE and the general performance of the Malaysian economy.

The primary objective of Malaysia's selective exchange control regime implemented in September 1998, was for Malaysia to regain control of its economy from the currency speculators and manipulators, so that Malaysians can decide the destiny of Malaysia.

The measures implemented were very carefully crafted so as to optimise the positive aspects of globalisation, and remove the negative aspects of globalisation.

The positive aspects of globalisation that were retained were the complete freedom in matters of international trade and foreign direct investments.

The liberal regime that governed trade transactions and foreign direct investment were left unchanged.

Exchange rate

The negative aspects of globalisation that were eliminated, were the off-shore market for the trading of ringgit and the free flow of short-term funds that destabilises the economy.

The Government fixed the ringgit exchange rate at RM3.80 to the US dollar, the rate which prevailed at the time the controls were imposed.

The Government could have fixed the ringgit at the old rate of RM2.50 against the US dollar.

This would have enriched Malaysia and the Malaysians. However, such a strong level for the ringgit would have made Malaysia less competitive, relative to its neighbours.

The ringgit's exchange rate of RM3.80 against the US dollar restored the previous rate of 1:10 against the Baht and the Peso.

True, imported goods priced in US dollars would be more expensive at RM3.80 compared to RM2.50, but this is actually good for the Malaysian economy.

While imports would be reduced, exports would increase, and, therefore, a trade surplus would be easier to achieve.

Indeed Malaysia's trade surplus has never been bigger than now.

Once CLOB was put out of action by the new rules in September 1998, the prices on the KLSE rallied strongly.

The KLCI rose quickly from 262 to above 800 and market capitalisation increased substantially.

Malaysian investors of listed companies saw the value of their shares appreciate significantly, and the margin calls became a thing of the past.

Those who needed to raise cash had no problem in selling their shares at very much higher prices then before.

The holders of shares bought through the CLOB were not able to sell their shares immediately after the closure of CLOB in September 1998, as logistical arrangements had to be worked out to migrate the shares to the CDS in Kuala Lumpur on an individual basis.

The migration was completed in the middle of the year 2000. During the period, the value of the shares had increased by more then 300 per cent.

'If the "12-month rule" was not imposed, the non-residents would have sold their shares at very much lower prices and repatriated their funds. As a result of the "12-month rule", most foreign investors could not sell their shares and today, they are able to enjoy the greatly appreciated prices of the shares they hold.'

The holders of CLOB shares should really be grateful to the Government of Malaysia for delaying the sale of their shares.

The same is true with the "12-month rule" imposed on the non-resident investors in KLSE, which prohibited them from repatriating their capital for 12 months.

If the "12-month rule" was not imposed, the non-residents would have sold their shares at very much lower prices and repatriated their funds. As a result of the "12-month rule", most foreign investors could not sell their shares and today, they are able to enjoy the greatly appreciated prices of the shares they hold.

Given that their holdings accounted for 30 per cent of the KLSE's capitalisation, had they sold their shares in 1998, this would have resulted in a sharp downturn of the KLSE and a depletion of Malaysia's external reserves.

This would have destabilised the Malaysian economy and would have made the subsequent recovery that much more difficult.

The "12-month rule" therefore created a win-win situation for both the non-resident investors and the Malaysian Government.

An important point that needs emphasising is that FDIs were not subject to the selective exchange control measures in any way.

They were allowed not only to repatriate their profits but were also allowed to repatriate the proceeds from the sale of their assets, if they chose to do so.

It must be noted that the rules for FDIs in Malaysia do not require the FDIs to bring in 100 per cent of the capital to meet all their financing needs.

For every one ringgit they bring in, they are allowed to borrow three ringgit from the banks in Malaysia.

The selective exchange control measures did not change this policy.

Malaysia is able to be liberal in this respect because it has large external reserves, as well as ample liquidity in the domestic financial system.

The most important consideration in Malaysia's policy towards the FDIs is job creation and technology transfer.

The foreign exchange inflow aspect of the FDIs was never an important consideration in Malaysia's policy towards FDIs.

In order to ensure that the local borrow-

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Policy promoted win-win situation

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ing of the FDIs is not entirely with the subsidiaries of foreign banks operating in Malaysia, a 60:40 rule was imposed which requires the FDIs to meet at least 60 per cent of their domestic borrowings from Malaysian-owned banks in Malaysia.

This liberal policy of allowing the FDIs to borrow from banks in Malaysia has also brought about a win-win situation. They are good paymasters, and banks in Malaysia are good paymasters, and banks in Malaysia, including Malaysian-owned banks, make good profit by lending to them.

Given that Malaysia has a high savings rate of 38 per cent of GDP, the banks have a need to lend a significant portion of the national savings.

However, an interesting phenomenon of FDIs in Malaysia is that they invariably add on to their investments in Malaysia either through new capital or through the retention and plough back of their profits.

Even during the bad patch of the 1997-1998 financial crisis, the FDIs in Malaysia continued to increase their investments.

Repatriating proceeds

Malaysia's policy on the repatriation of export proceeds need to be explained, as this was an important factor in Malaysia's ability to implement the selective exchange control regime in September 1998.

Government regulation requires exporters (including FDIs) to repatriate their export proceeds to Malaysia immediately when the export proceeds are received.

There are some exceptions given to this repatriation requirement, but these exceptions are very minor.

Exporters are allowed to give credit to their importers for a maximum of six months.

This means that, within six months after the date of export, at the latest, all export proceeds are repatriated to Malaysia and sold to banks in Malaysia.

The banks in Malaysia, after meeting the demands from the importers, will sell the net balance to the Central Bank daily.

This policy has resulted in a convincing build-up of Malaysia's external reserves over the years, and gave Malaysia the confidence to implement the selective exchange control regime in September 1998, on the basis of its strong external reserves position.

It should be noted that the combination of a liberal attitude of allowing the FDIs to borrow from the domestic financial system and strictly forbidding them from retaining their export proceeds overseas, has resulted in Malaysian banks being able to recycle the high level of Malaysian savings and the Central Bank to build up its external reserves.

'A total of RM6.4 billion worth of properties were sold during the two property ownership campaigns. This result was gratifying for everyone, including the Government which knows very well the adverse side effect of a big property overhang'

Having stabilised the currency market through the selective exchange control measures and having stabilised the KLSE through the closure of CLOB, the Government had the opportunity, from September 1998 onwards, to focus more directly on reviving the economy.

The non-performing loans (NPL) of the banking system by that time had risen from 4.7 per cent at the end of 1997 to 13.2 per cent.

The capital strength of banking institutions had been severely tested with 11 of them requiring new capital injection.

The performance of the banking system was badly affected with 46 banking institutions registering losses.

The total loss registered by the banking system amounted to RM2.3 billion.

Fast gear

The following chronology of events reflect the fast gear that was engaged by the Executive Committee of the NEAC to revive the economy:

- Sept 1, 1998: The statutory reserves requirement was reduced from eight per cent to six per cent, injecting RM8 billion into the financial system.
- Sept 3, 1998: The BNM intervention rate was reduced from 9.5 per cent to eight per cent per annum to bring about an equivalent lowering of interest rates across the board in the financial system.

The liquid asset ratio requirement was also reduced from 17 per cent to 15 per cent, freeing RM8 billion of liquid assets that could be sold by the financial institutions to fund their operations.

The requirement for commercial banks to maintain their vostro balances with the Central Bank was uplifted and this provided extra liquidity to the banks of more than RM1 billion.

- Sept 8, 1998: Loans for the purchase and construction of houses costing RM250,000 and below were exempted from the 20 per cent limit on lending to the broad property sector to further stimulate the construction sector.
- Sept 15, 1998: The maximum margin over the quoted Base Lending Rate was reduced from four percentage points to 2.5 percentage points to lower the lending rate for companies and individuals so as to facilitate viable projects and encourage consumption as well as reduce the interest servicing burden of companies.
- Sept 16, 1998: The SRR was reduced from six per cent to four per cent, releasing another RM8 billion into the economy.
- Sept 23, 1998: The limit for financial institutions on lending for the purchase of shares and unit trust funds was increased from 15 per cent to 20 per cent of total outstanding loans so as to encourage investment in the KLSE.
- Sept 25, 1998: The non-performing loan classification was lengthened from three months to six months to provide borrowers with some breathing space to regularise their accounts.
- Oct 5, 1998: The BNM intervention rate was reduced from eight per cent to 7.5 per cent per annum, to lower further the general interest rate level in the system.
- The maximum margin of financing of 60 per cent imposed on loans for the purchase of residential properties and land was abolished, so as to give a boost to the property sector which had a serious overhang as a result of the crisis.
- Oct 13, 1998: The Loan Complaints and Monitoring Unit (LCMU) was established in Bank Negara Malaysia to assist borrowers facing difficulties in securing financing.
- Nov 10, 1998: The BNM intervention rate was reduced from 7.5 per cent to seven per cent per annum to reduce further the interest rate level in the financial system.
- Nov 19, 1998: The Government established a RM750 million "Rehabilitation Fund for Small and Medium Industries", to provide financial assistance to viable small and medium industries (SMIs) which were facing temporary cash flow problems.
- Nov 20, 1998: The minimum monthly repayment of credit cards was reduced from 10 per cent to five per cent to promote consumer spending.
- Nov 21, 1998: Every banking Institution was required to set up a "Special Loans Rehabilitation Unit" to assist borrowers who had problems repaying their loans.

The maximum margin of financing of 85 per cent for passenger cars costing RM40,000 and below was abolished.

- Dec 5, 1998: BNM reduced the maximum lending rate under the Small and Medium Industries Fund and the Special Scheme for Low and Medium Cost Houses from 10 per cent to 8.5 per cent.

Crisis management

The Executive Committee of the NEAC gave particular attention to the operations of Danaharta (Assets Management Company), Danamodal (Bank Refinancing Company) and the Corporate Debt Restructuring Committee (CDRC) which had all been set up during the crisis, to address the problems of non-performing loans and bank recapitalisation.

The role of Danaharta was to carve out the NPLs from the banking system so that the banks could refocus on their function of lending to revive the economy.

The role of Danamodal was to recaptilise the financial institutions and thereby restore the capital strength of the banking system to a much healthier level.

The role of CDRC was to provide a platform for companies and banks to come together and work out a debt restructuring programme in an informal manner.

Once the selective exchange control measures were implemented, the three organisations went into high gear.

By March 31, 1999, Danaharta had acquired NPLs amounting to RM16 billion, Danamodal had recapitalised 10 banking institutions amounting to RN6.2 billion, and the CDRC was fully focused on the restructuring of a number of large companies.

The Executive Committee of the NEAC scrutinised every aspect of the economy daily.

Figures on trade performance, external reserves, interest rates, lending by banks, sales of property and motor vehicles, retail sales, tonnage and containers handled by the ports, passengers and freight at the airports, details of goods manufactured and exported, details on imports, new businesses registered and bankruptcies, unemployment and job vacancies, wages, Government projects and contracts, electricity consumed etc were all laid out daily before the Committee for discussion.

Quite often specific actions were immediately taken. When motor vehicles were not selling well the Committee decided on special hire-purchase terms and ensured that the prices were right.

Gratifying results

Two property ownership campaigns were held to reduce the large overhang in the property sector.

The first campaign was held in December 1998 and the second in October 1999.

The developers participated enthusiastically in the property fairs bringing in their models and brochures, and equipping their booths with many sales people.

Banks, insurance companies, lawyers and Government officers concerned with registration of property sales and other legal procedures were all brought under one roof.

A total of RM6.4 billion worth of properties were sold during the two property ownership campaigns. This result was gratifying for everyone, including the Government, which knows very well the adverse side effect of a big property overhang.

When retail sales were low, the Government gave a temporary allowance of RM600 to all its employees.

The allowance was disbursed at RM100 per month to ensure that it is spent in the country for the purchase of daily necessities.

The local retailers benefited from this extra purchasing power of the Government employees.

Complaints of the business community were heard by the Executive Committee and frequent briefings were given by various Government agencies and by the private sector.

Very often immediate actions were taken, always with the objective of ensuring that nothing stood in the way of a quick turn around towards a path of rapid growth.

It is now two years since Malaysia imposed selective capital controls, and the signs are clear that the controls have successfully stopped the currency traders and the short-term investors from doing any more damage to the economy of the country.

The exchange rate of the ringgit has remained fixed at RM3.80 to the US dollar, and

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'Confidence has returned and people have money to spend once again'

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the composite index of the KLSE has risen from 262 points in September 1998 to around 800 now.

The companies and the banks have nearly all recovered. Confidence has returned and people have money to spend once again.

All the economic activities have revived, and the construction cranes are moving again.

Motor vehicle sales have returned to pre-turmoil levels. Indeed all signs indicate a robust economic recovery.

In 1997, when the recession began, growth of the GDP was still high at 7.5 per cent as the downturn affected only the second half of the year.

1998 was the most serious year when the GDP shrank by 7.2 per cent. But 1999 showed distinct recovery with the GDP returning to 5.6 per cent.

It is expected that this year the GDP will achieve at least 5.8 per cent as projected by the Government. Malaysia has recovered and recovered very fast and very strongly.

Grudging admission

The experts who had predicted disaster for Malaysia when it imposed selective capital controls are now either silent or have grudgingly admitted that the controls work and enabled Malaysia to recover strongly.

Lately the IMF commended Malaysia for solving its economic problem through the selective capital controls devised by itself.

Even George Soros who had condemned Malaysia and its leadership for singling out the currency traders as the culprits responsible for devaluing currencies and damaging the economies of countries, now admit that Malaysia had done the right thing in not submitting to the IMF and the standard formula that it prescribed for all economic ailments.

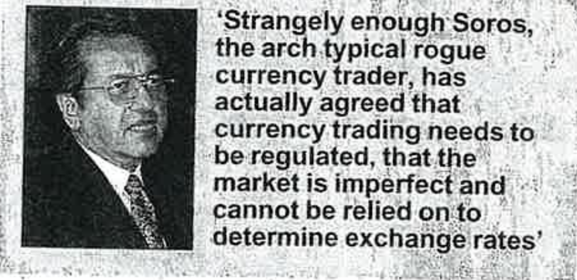
Strangely enough Soros, the arch typical rogue currency trader, has actually agreed that currency trading needs to be regulated, that the market is imperfect and cannot be relied on to determine exchange rates.

But the IMF and the economically and financially powerful countries of the West are still adamant that the freedom to trade in currencies must be maintained.

Freedom is sacred and must in no way be curbed. It is an article of faith that must never be questioned. There can be no doubt that currency trading had caused terrible damage to the economies of the countries whose currencies were devalued by the traders.

In several instances, the financial and economic turmoil due to devaluation was accompanied by massive unemployment, shortages of food and fuel, demonstrations, riots, the burning of business premises, looting, rape and murder.

Governments were overthrown to be replaced by shaky Governments which not only submitted to the IMF and Western control, but were unable to restore law and order or to bring about a turn around of the economy.



'Strangely enough Soros, the arch typical rogue currency trader, has actually agreed that currency trading needs to be regulated, that the market is imperfect and cannot be relied on to determine exchange rates'

And these are countries whose Governments previously demonstrated their ability to develop their countries until they became known as economic tigers.

Still the currency traders are not blamed for the damage done to these economic tigers.

The blame is put squarely on the shoulders of the Governments. They are accused of corruption, of cronyism and nepotism, of lack of transparency and generally of bad governance.

For as long as there is this refusal to admit that it was currency trading and the greed of the currency traders which caused the unnecessary destruction of the economies of many countries, for so long will the damage continue to be done to even healthy economies by currency trading.

Even the powerful countries will not be free from the threat as the failure of the Long Term Credit Management Fund demonstrated.

The genie is out

There is no hope that currency trading will be banned or even curbed any time soon.

Too many influential people are making too much money from it.

That the currency is coming from the misery of poor people in poor countries is just unfortunate.

As one Frenchman said, the genie has been let out of the bottle and no one "in the world" can put it back in.

This is a remarkable admission, considering that the people who let out the genie are the same people who have appointed themselves as the policemen of the world, the champions of human rights and justice for the oppressed people in the world.

The poor and the weak should take note. They are less important than the currency traders, whose freedom must be upheld at all cost.

Malaysia's experience in handling the economic and financial turmoil will stand it in good stead for future turmoils and crisis.

The most important lesson learnt from the experience is the need to know the true causes of the downturn, how they work and the interrelationship between different factors.

Once the details become known, it will be possible to design a strategy to combat the forces causing the problem.

Several solutions may present themselves for any one problem, and these solutions need to be debated and tried out.

Back-up solutions must be ready should the chosen method fail.

The implementation of a strategy or solution requires hands-on monitoring by the decision makers, at least in overseeing the implementation process and in taking corrective action.

Complete and continuous information on what is happening on the ground is absolutely essential.

Figures, graphs and charts tell a better story than wordy reports.

Explanations must be made orally by those reporting. Of course, those getting the reports must be sufficiently knowledgeable on the subjects to be able to make assessments and to decide on what actions need to be taken.

The system is important, but the people working the system are more important. In fact, a good system by itself will only deliver partial solutions at best. The people manning the system are the ones who make the system work.

Keeping vigilant

An important lesson is that Malaysia must always be careful in the management of its economy.

It must never allow itself to be weakened by carelessness in the maintenance of its financial and economic strength.

Only with absolute vigilance can we ensure that Malaysia's rate of growth will be sufficient to achieve developed country status as envisaged in Vision 2020.

The currency crisis is an unnecessary crisis and need not have happened if the objective of the international financial system is really to facilitate trade and other economic interactions between nations, including foreign direct investments.

But the big capitalist powers want more than that. They want to promote their political agenda as well, and it is because of this political agenda that the international financial system not only permitted but at times even encouraged currency trading, a totally unnecessary activity, which destroys more wealth than it creates.