

## **Malaysia's Strategies To Deal With The Financial Crisis As Related To The Impact Of Globalisation On Developing Countries**

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Malaysia's approach to globalisation in general and the financial crisis in particular has been guided by the basic principle that the pace of globalisation in Malaysia at least must be on Malaysia's terms, based on its circumstances and priorities. It may not always be possible of course but it is crucial to ensure that everybody benefits - both the foreign investors and Malaysians. A step by step approach is also important to avoid the excesses and problems associated with all new ideas, principles or processes including globalisation. We need as always to be pragmatic and flexible, not dogmatic in pursuing globalisation. It cannot be viewed as an end in itself, but as a means to an end, which is a better life for our people and our continued freedom from foreign domination.

2. Just as absolute freedom leads to anarchy, so too, "absolute globalisation " could lead to chaos, as demonstrated by the recent financial crisis. We must avoid the tyranny of "free markets ", where power comes not from the barrel of a gun, but from the checkbook. We do not subscribe to the view that market discipline is infallible, because markets have never been perfect and have a strong tendency to over-react and to be subjected to manipulations.
3. The industrial countries took more than 100 years to reach the present stage of their development before they propose to adopt globalisation and liberalisation. It is unfair to expect developing countries to liberalise and do away with the protection of their borders at the same instant the developed countries do.
4. The Asian Financial crisis has brought to the forefront the risks and challenges that globalisation poses to developing countries, particularly small open economies such as Malaysia. Initial denial has now been replaced by a reluctant acceptance of the need to address the problems of destabilising capital flows often associated with the activities of currency speculators, hedge funds and short-term investors. The crisis has also heightened the call for reforms in the international financial architecture. The so-called caretaker of the international financial system, the International Monetary Fund (IMF) has been widely criticised for its mismanagement of the crisis. Questions have also been raised about the role of the World Trade Organisation (WTO) in contributing to global instability by `encouraging' developing countries to liberalise too rapidly.
5. After more than two years of painful policy adjustments and social upheavals, erosion of incomes and loss of dignity or `face', the crisis-affected Asian economies of Indonesia, Thailand, Korea and Malaysia have turned around, a few with growth rates now exceeding pre-crisis levels. Despite the initial scepticism, Malaysia's rejection of the IMF formula and loans and its decision to regain exchange rate control and regulate the flows of short term capital have now been reluctantly accepted as a viable alternative in crisis management.

6. The initial international reaction when on September 1, 1998 we introduced selective capital and exchange control was to condemn Malaysia. It was said:

That Malaysia was turning its back on the free market system;

That capital controls were regressive and will lead to all sorts of inefficiencies;

That the controls were a case of closing the barn door after the horse has bolted;

That Malaysia' s resort to controls was to avoid economic and financial restructuring;

That the Malaysian Government feared being overthrown like the Indonesian Government; and

That Malaysia was inherently against the IMF for no very good reason.

7. The truth of the matter is that at the beginning of the crisis, we did adopt policies similar to the IMF approach. We were told that the IMF policies of tight fiscal and monetary policies would restore market confidence and stability. Unfortunately, these policies not only did not restore confidence, but actually aggravated the crisis, as the reduction in Government expenditure reinforced the contraction in domestic demand, while higher interest rates and a credit squeeze took their toll on the balance sheets of the corporate and banking sectors. When we saw that tight fiscal and monetary policy was deepening the recession in the IMF-programme countries and in Malaysia as well, we decided to look for alternative solutions to restore stability and ensure economic recovery.

8. The reasons why the IMF policy recipe failed in Asia are now well-known. The basic problem, of course, was that the IMF misdiagnosed the problems in Asia and applied the same remedies that were used in Latin America before. Because of its background and expertise, the IMF tends to look at macroeconomic variables, and missed out the crucial details in the crisis countries. This led to policies that were not suitable for the problem at hand. From the beginning, the IMF viewed the crisis as a small and temporary problem. It did not believe the information on the ground of the size of the hedge funds, their staying power and their unlimited greed. Consequently, the IMF underestimated the duration and depth of the currency depreciation.

9. The crisis also worsened because the IMF is principally concerned with repayments of debts imprudently made by commercial banks to the countries concerned. The IMF programmes also did not take into consideration the specific conditions in individual crisis countries, such as the degree of foreign borrowings of both the Governments and the private sectors. Consequently, the IMF' s recommendations of higher interest rates simply weakened the capacity to repay loans by and the viability of the indebted businesses and the Government. The IMF also underestimated the impact of its recommendations on the financial system. Forced closure of banks led to loss of confidence in surviving banks and the breakdown of the intermediation system. Similarly, policies that arbitrarily removed monopolies and subsidies in the existing economic system led to higher

costs and the breakdown of the distribution system. As a result, inflation soared to levels beyond what was warranted by the currency depreciation. Another error in judgement by the IMF was the lack of understanding of the close links between the foreign exchange market and stock market, which can reinforce each other in depreciating the exchange rate and depressing the value of stock prices. The decline in stock prices made debtors of previously healthy companies and investors. Non-performing loans increased and the surviving banks began to fail. Market capitalisation shrank to a fraction of its original value resulting in real loss as margin calls on loans could not be met, further increasing the percentage of NPLs. The IMF also shortened from six months to three months the period for declaring loans as non-performing. The effect on business and banks was disastrous.

10. It should be remembered that fixed exchange rates were not incompatible with the free market. The Bretton Woods agreements to revive world trade was actually based on the fixed exchange rate. In deciding to fix the exchange rate of the Malaysian Ringgit with the U.S. Dollar, Malaysia was therefore not renouncing the free market. We have always subscribed to and will continue to believe in the free market. We cannot do otherwise as we are a trading nation, in fact the 17th biggest trading nation in the world. Far from being incompatible with the free market, the fixed exchange rate actually facilitated trade and contributed towards recovery and rapid growth. The only thing that the exchange rate control did was to keep the currency out of the hands of speculators, who are after all not necessary for trade or the economy. With the fixed exchanged rate it was possible to take various measures to revive the economy without fear of the speculators deliberately devaluing the currency.

11. Some commentators have suggested that Malaysia need not have imposed the exchange controls. They pointed out that the regional currencies were all beginning to recover in the last quarter of 1998, suggesting that Malaysia had shut the door after the horse had bolted. It is easy to say that now, but at that point in time everyone including the great economic experts were predicting continued depression of the Asian economy. They said that we had not struck bottom yet. What could have caused the Asian economy to recover was the fear on the part of currency traders that many Asian countries would have adopted Malaysia's exchange rate control. This would have resulted in huge losses for the currency speculators. And so they reduced their speculations. But a contributory cause to their reduced activities could be that at about this time the Long Term Credit Management Fund lost its bet on the Russian Rouble and threatened to destabilise the U.S. financial institutions completely. Suddenly currency speculations became a dangerous game for the rich countries and it was stopped.

12. In Malaysia's case, instability in the Ringgit exchange rate was aggravated by outflows of the Ringgit to offshore markets. The situation in Malaysia was peculiar in that we had a very liberal foreign exchange regime, which led to the build up of a large offshore Ringgit market. While Malaysia had curtailed Ringgit borrowings to finance currency trading, Ringgit funds were available from banks

in Singapore, which offered rates as high as 20 to 30 per cent. Although the cost of borrowing foreign Ringgits was high, the need to borrow for short selling was only for a brief period and the profits were very high. Malaysia could not compete by raising interest rates because this would adversely affect business in Malaysia. To prevent this haemorrhage we stopped the movements of the Ringgits across our border. If the Ringgits held outside the country was not returned within one month then they will not be allowed to return at all. Effectively this meant they will have no value at all after one month. Foreign holders of the currency had to return it to Malaysia. This measure stopped the flow of the Ringgit to Singapore and deprived the currency traders from access to the Ringgit to speculate with. With the banks flushed with repatriated money it was possible to lower interest rates, thus reducing the cost of doing business. Fortunately Malaysia achieved a huge trade surplus during the turmoil, earning Malaysia sufficient foreign exchange to pay for imports.

13. Control over short-term capital was in the form of a moratorium on expatriation of short-term investment funds for a period of one year. Profits could be taken out of the country and so could the receipts from the sale of assets of Foreign Direct Investments. As a result of this control on short-term speculative money, the share market recovered rapidly. By the end of the moratorium period the market had gained by about 200 per cent and when the moratorium was lifted one year after the predicted massive outflow of capital did not take place. The Stock market Index remained high.

14. Malaysia was very conscious that its decision to control the exchange rate was a move fraught with danger. In the first place it was going against accepted current wisdom and it would be faced with a very hostile reaction by the international financial community including the IMF, the World Bank and the most powerful country in the world. Clearly it was going to frustrate the rich investors who had invested huge sums of money in the hedge funds and were getting as much as 30 per cent return on them. If they could they would try to ensure that Malaysian control failed. When Malaysia tried to borrow from abroad to finance local projects the rates shot up so that the loan had to be aborted. Other actions were also taken to prevent Malaysia's economic recovery, including reporting that Malaysia is dangerous for tourism.

15. Malaysia knew there were dangers but to submit would bring about a fate that would be worse. We would lose our independence and our honour. On the other hand if we succeeded we would remain independent, even if our economy might not do so well.

16. Still we needed to ensure that there would be a reasonable chance of success. Despite charges that Malaysia had been profligate and had expanded too much on the so-called mega projects, financially Malaysia was and is very sound. Neither the Government nor the private sector had borrowed much from foreign sources. The need for foreign exchange to repay loans was insignificant. But the greatest strength lie in Malaysia's high savings rate of almost 40 per cent of GDP. We had sufficient internal financial resources to support our recovery. Even when the foreign rating agencies downgraded us, it did not hurt.

We have huge amounts of Ringgits and our foreign reserves could at that time finance more than three months of retained imports. (Today it is six months). We were therefore quite confident that if our controls fail we would not be forced to beg at least not for a long time.

17. As it turned out the signs of recovery appeared almost immediately after the controls were instituted. The banking system was flushed with money, which had been brought back and low interest rates revived the ailing businesses. The stock market recovered. Trade surpluses increased and contributed towards higher reserves. The fixed exchange rate made hedging unnecessary, reducing the cost of business and increasing profits.

18. The GDP, which had contracted by seven per cent in 1998, achieved a 5.6 per cent growth in 1999. Domestic consumption shot up, creating a sense of well-being for all. Inflation was within manageable levels.

19. Malaysia had no unemployment problem and had always had to import labour. The downturn affected foreign labour largely. The few Malaysians who had been laid off found new jobs. With recovery wages improved.

20. Still as a result of the economic recession many companies and individuals had to face financial difficulties. The Non Performing loans which before the turmoil was only three per cent rose to 17 per cent plus. Government set up an asset management company, which purchased all the big NPLs at a discount. This enabled the distressed companies to borrow again and the banks to be back in business. Other less affected companies had their loans restructured with the help of the Corporate Debt Restructuring Committee (CDRC). The banks were refinanced through a Capital Fund set up by the Government.

21. All these funds helped the distressed companies to recover, to regain profitability and to contribute to the Government coffers through corporate taxes.

22. The IMF' s principal objective was to prise open the beleaguered country' s market so that foreign companies could move in to take over local businesses. The raids by foreign predators are made less costly because the pull-out of short term capital from the stock market lowered share prices to rock-bottom level. Some countries resisted but others have now lost all their good companies and banks, including the newly privatised utility companies. Privatisation was encouraged by the IMF because locals were unable to participate and foreigners could pick the choicest items.

23. Since Malaysia is not under the IMF we are able to keep off the foreign predators. But now the attack is coming from another direction. Globalisation and the I.T. are making local companies uncompetitive and their failure will result in foreign takeovers. We are trying to find out how to counter these new assaults.

24. The propaganda machine of the West is good at making everyone feel guilty if he does not accept the new ideas and ideologies created by the rich to give them ever more advantage over the poor. Democracy, the free market, a world without borders, liberalism labour rights and child labour etc, have all been

cooked up in the rich countries and then forced on the poor. They all sound great but somehow their acceptance by the poor invariably destabilise them and put them at the mercy of the rich.

25. The free market is a case in point. Malaysia subscribes to the free market but now we are told that Governments are superfluous, as the free market will determine the level and the manner of economic growth. It seems that the free market will actually discipline Governments, making them more accountable, transparent and less corrupt. But markets exist in order to enable investors to make money and maximise profits; not to cater to a nation' s need or society' s welfare. Businessmen are not elected by the people to look after their welfare. If they are elected at all, it is by the shareholders. And shareholders are interested in returns and capital gains for themselves only. It is therefore ridiculous to think that the free market will discipline Government for the good of nations or society. Governments, especially democratic Governments owe it to their constituents to ensure the well-being and development of the nations.

26. Yet today people talk of the free market as if it is a religion that everyone must accept. To question its role in shaping the economic development of the world is to commit heresy. The free market must be embraced and upheld by everyone, rich and poor.

27. However the free market is no more than a new name for Capitalism, unbridled Capitalism with a capital `C' . The size of the capital involved today is unbelievable. It is said that the trade in currency, which is what capital is about is twenty times bigger than world trade. Such a huge sum of money cannot but disrupt businesses wherever it goes. When used to buy and sell currencies economies can be totally disrupted, enriching the money movers and impoverishing whole nations, exploding into riots, violence and wars, overthrowing Governments and spreading anarchy where law and order had prevailed. Still the free market or unbridled capitalism is defended.

28. It is time that we, the poor in particular, recognise that we are being led up the garden path by the sweet words and promises of the new slogans, new systems and new ideologies. We recognise that we cannot go backwards. We cannot go back to the centrally planned economy of the Socialist and Communist. But is it necessary that the way forward should be the one shown to us by the rich and the powerful? Cannot the market be free without its domination by the rich and the powerful. Indeed is a free market free if it is dominated by the rich?

29. Malaysia has experienced the globalisation of capital and we were nearly destroyed by it. Fortunately we were able to develop our own methods to defend ourselves and rebuild our economy. We know that our success may be short-lived but we are not going to allow ourselves to be sold ideas, ideologies and slogans without carefully examining them. If we find the slightest suspicion that another agenda is being promoted we will fight tooth and nail to defend our country and the prosperity of our people.