Positive results from Malaysia's selective capital controls

Tun Daim Zainuddin is First Finance Minister, Special Functions Minister, and Chairman of the National Economic Action Council of Malaysia. On Jan. 23, 1999, Gail G. Billington of *EIR*'s Asia Desk and Dino de Paoli of the international Schiller Institute interviewed the Finance Minister at his office in Kuala Lumpur. Since the interview, two developments worth noting have occurred, the first a Feb. 4 announcement of a change in the policy with respect to repatriation of portfolio capital and profits, and the second, a dramatic shift in perception of the success of Malaysia's selective capital controls internationally.

On Feb. 4, the Finance Ministry released a statement from Tun Daim announcing a new policy, replacing the 12-month holding rule on portfolio investments imposed on Sept. 1, 1998, with a graduated levy, ranging from 10-30%, depending on how long the investment remains in Malaysia, and whether capital is brought in before or after Feb. 15, 1999. The new measures, which were based on discussions with fund managers, are, according to Tun Daim's release, "aimed to encourage existing portfolio investors to take a longer-term view of their investments in Malaysia and to attract new funds into the country, while at the same time discourage destabilizing short-term flows."

Worth noting, too, are examples of the positive support Malaysia's policy is garnering worldwide, exemplified by what numerous press have called "the thunderous applause" Malaysian Prime Minister Dr. Mahathir bin Mohamad received following his address to the assembled heads of state and representatives of the Group of 15, meeting in Montego Bay, Jamaica on Feb. 10, and by two other endorsements of some significance. In a Feb. 2 interview with Malaysia's *Business Times,* Cristovam Buarque, Governor of the Federal District of Brasilia, Brazil, reported that "in Brazil, there is free flow of foreign money and I do not agree with that. I prefer the Malaysian way." He added that when he returned to Brazil, he would speak to the relevant authorities to propose emulating Malaysia's controls. "We need to bring this to a higher level," he said, "and if possible give it a global perspective. . . . We do not need an agreement. Just maybe 10 countries to support the idea to start the ball rolling."

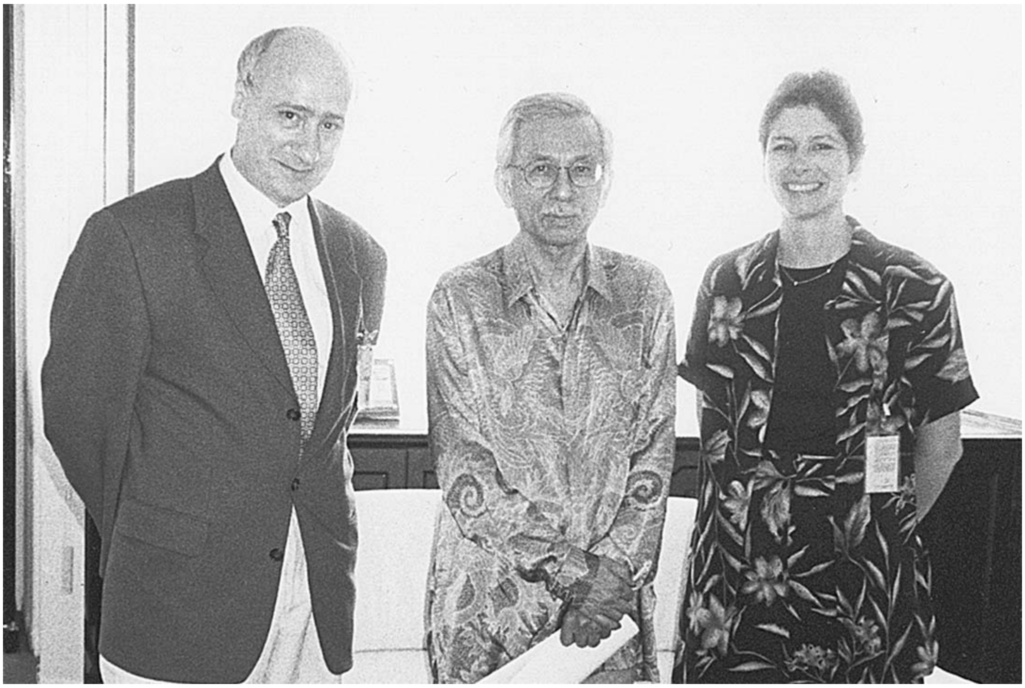
Finally, state wire services and leading newspapers in Southeast Asia, including the Singapore *Straits Times* and Malaysia's *New Straits Times* and *The Star,* have reported on a three-page article published in the Indonesia weekly *Panji Masyarakat,* titled "Good News From the Neighbor," which declared Dr. Mahathir "the hero of Davos," referring to his Jan. 29 luncheon address to the World Economic Forum in Switzerland, where he called on governments to resign if they are incapable of penalizing currency speculators. The article also commends Malaysia's selective capital control measures, noting that they are enabling people to lead a normal life. *Panji Masyarakat* reportedly has a circulation of 60,000, and was founded in the 1960s by the reknowned Islamic scholar, the late Haji Abdul Malik Kari Amrullah, or Pak Hamka. Subsequently, the Indonesian Parliament broached discussion on Feb. 12 of limited measures to monitor foreign exchange flows, especially short-term speculative flows, to prevent capital flight and speculation in the capital and money markets.—*Gail G. Billington*

EIR: The financial control measures adopted on Sept. 1, 1998 have been very closely watched throughout the world. What was the purpose of these policies and what have been the results?

Tun Daim: The main objective is to stop the internationalization of the ringgit [Malaysia's currency], and to manage capital flows in order to contain ringgit speculation and minimize the impact of short-term capital outflows that caused the economic crisis. The result of the capital controls is the stabilization of the ringgit, which brought about business environment stability and reduced foreign exchange uncertainties. As a result, confidence in the economy has returned. The Kuala Lumpur Composite Index has doubled, and sales of passenger cars have increased sharply. Foreign direct investment rose to $1.2 billion in September, compared to less than $40 million in July and August combined.

EIR: Malaysia has stated that these controls will remain in place until something is done about the anarchistic state of international currency markets. What do you think is required?

Tun Daim: The G-7 countries, being the major players in the international monetary system, must be determined to deliberate and act to reform the global financial system. There



Malaysian Finance Minister Tun Daim Zainuddin (center), with Gail Billington of EIR *and Dino de Paoli of the Schiller Institute. "Malaysia is in favor of a revamp of the current global financial system," says Finance Minister Tun Daim. "The international community should consider various proposals, such as those suggested by LaRouche, so as to come up with a workable system that will benefit all parties."*

should be increased transparency in currency trading and clearer rules of the game. The IMF [International Monetary Fund] should not drag its feet in promoting reforms in the financial system. Further, the IMF itself should be more transparent in its operations. The IMF should put in place a mechanism that will be more effective in providing financing to help countries pursuing sound policies to maintain stability.

EIR: Could you explain how some of the speculation had worked prior to your imposition of controls? Specifically, the role of hedge funds, and their ability to move money in and out of the country? What role did offshore holdings of ringgit play in this?
Tun Daim: There was panic in the region with the flotation of the Thai bhat. The foreign media inflamed the fear of widespread failure of the banking and corporate sectors. This led to panic, and investors moved funds out of the region in a herd-like fashion. The highly leveraged hedge funds started the panic, and took advantage of the panic to reap high profits. The offshore interest rate for the ringgit was around 30-40%, while commercial bank three-month fixed-deposit rates were around 11%. This led to the outflow of ringgit that was used to short the currency.

EIR: What is different about the situation you addressed in the mid-1980s to get Malaysia out of recession, and the situation that struck in 1997-98?
Tun Daim: The crisis of the mid-1980s was fundamentally one involving the public sector. The expansionary role of the public sector during the 1970s and early 1980s had led to high government expenditure, and also meant high imports. This situation led to twin deficits, on the fiscal account as well as the current account of the balance of payments. In addition, the economy was over-regulated, and the investment climate was not liberal.

The current economic crisis, on the other hand, involves private-sector excesses, with the private sector having borrowed short-term funds largely to finance investments in the property and share markets. The crisis did not originate in Malaysia, but in Thailand, with the contagion spreading to Malaysia through the currency market. Currency speculators exploited weaknesses in the global financial system to undermine the ringgit, thereby causing severe instability to the financial sector and subsequently the real economy.

EIR: What are the similarities and differences between the approach Malaysia has taken to dealing with the non-performing loans, or NPLs, from that of Thailand and Indonesia?
Tun Daim: Malaysia, Thailand, and Indonesia have all taken steps to resolve NPLs. In the case of Malaysia, it has set up Special Purpose Vehicles, namely, Danaharta, to acquire NPLs from banks, and Danamodal, to recapitalize banks. The programs to resolve NPLs have been on a fast track, with 42% of NPLs removed from the banks. Thailand also has a similar program of addressing NPLs, and has made some progress in this regard. From independent reports, the progress achieved by Indonesia is more limited.

EIR: In 1997 and 1998, Malaysia voluntarily implemented several policies recommended by the IMF, but ended them with the Sept. 1 controls? Why were those "virtual" IMF policies implemented and what were the results that led you

to abandon them?
Tun Daim: As a matter of clarification, the change in the direction of Malaysia's fiscal and monetary policy came with the adoption of the National Economic Recovery Plan in July 1998, and not Sept. 1. The initial policy package had anticipated a less severe economic contraction and the tightening of monetary policy was to address rapid expansion of credit before the crisis. However, when the economic contraction turned out to be worse than anticipated, the continuation of these policies will only deepen Malaysia's economic troubles and cause more business failures. In addition, the volatility in the exchange rates, which was linked to the regional contagion, had frustrated whatever attempts by the government to bring about economic stabilization. In order to bring about a more conducive economic environment, the government adopted selective capital controls so that the fiscal stimulus and easing of monetary policy could help the domestic economy.

EIR: The Sept. 1 measures have prevented the trade in derivatives on the Malaysian ringgit in Singapore and elsewhere. How are you keeping speculation on the domestic derivatives markets under control?
Tun Daim: The Securities Commission (SC), which also oversees the equity market, oversees the regulation of the derivatives market in Malaysia. With the imposition of capital and currency controls, SC will continue to monitor developments in the derivatives market, a role that it had undertaken even before Sept. 1, 1998.

I believe that some form of speculation in the derivatives market is quite natural to ensure a healthy development of this market. Nevertheless, if and when necessary, SC will introduce regulations to ensure that the derivatives markets do not spin out of control.

EIR: How is Malaysia dealing with foreign debt restructuring of the major firms, such as Renong?
Tun Daim: In our efforts to address the problems of the corporate sector, the Malaysian government has set up the Corporate Debt Restructuring Committee (CDRC) to provide an avenue for financially distressed companies to arrive at an amicable solution with their lenders. In carrying out this work, the CDRC will seek to address problems of not only local debts, but also foreign debts of the particular company. The CDRC has also been entrusted with the task of working out a solution for Renong's local and foreign debt problems.

EIR: The government has appealed to the banks to increase lending. Is this purely voluntary? And how has this request been met?
Tun Daim: Credit plans are submitted by banks to Bank Negara every year. The loan growth target for 1997 was 30%, which Bank Negara at end of 1997 suddenly reduced to 25%, because domestic lending had exceeded 30%. For 1998, it was 15%, but in view of the cautious lending policy, the government asked the banks to reduce the target for loan growth to 8% for 1998.

EIR: It has recently been pointed out that since the controls were applied, the level of investment and of foreign reserves have risen since the low point earlier this year. Can you comment on this?
Tun Daim: Contrary to what critics say, capital control measures have been positive to Malaysia. Malaysia has been recording positive trade balances for the last 13 months, leading to a trade surplus of $13.6 billion (51.5 billion ringgit) at end of November 1998. Malaysia's foreign reserves had gone up to $26.2 billion, or RM 99.4 billion as of the end of December 1998. Total investment in projects approved by MIDA [Malaysian Industrial Development Authority] for September and October amounted to $1.7 billion, several times larger than the $194 million in July-August 1998.

EIR: Representatives of China and Japan have made favorable comments about the controls. How would you gauge the support of these countries? Of the Association of Southeast Asian Nations (ASEAN) countries? And outside of Asia?
Tun Daim: We have come across mixed reviews on capital controls ever since Malaysia imposed selective exchange controls on Sept. 1, 1998. Within Asia, there have been favorable comments from China and Hong Kong, particularly because China itself has its own capital controls, while Hong Kong saw the merits of controls when currency raiders were attacking the Hong Kong currency. Japan was generally neutral, although recently there have been some favorable statements.

Countries that are currently being assisted by the IMF under the structural adjustment program will certainly not be supportive of Malaysia's currency controls, because it would be considered heresy to subscribe to such unorthodox measures.

To be frank, it is not important to Malaysia whether other countries see our actions favorably. The government felt that in overcoming the crisis, it had to begin with currency stability so that business could plan and function without having to fear what will happen to the ringgit the following day. Selective capital controls are expected to insulate the economy from the instability of the currency turmoil so that we can address the larger problems of the banking sector and the real economy.

EIR: In Dr. Mahathir's speech to the ASEAN heads of state meeting, he spoke of the risk of globalization being used to weaken, even destroy the economies of developing nations. How has globalization worked against the interests of these nations?
Tun Daim: We are not against globalization but we have to point out its weaknesses, too. Very briefly, globalization has resulted in the movement of money across borders quickly and easily, very often through a stroke of the computer keyboard. Much of the movement of capital is from industrial

countries to the developing world that needs capital to develop their economies. As the quantum of capital flows increase, so does its volatility, since the sudden withdrawal of short-term capital from a country can destroy the country's economy, its businesses, its jobs, and its standard of living overnight.

This is why the global financial market needs to be regulated and a new global financial architecture put in place.

EIR: *EIR*'s Founding Editor Lyndon LaRouche has proposed an overhaul of the global monetary system, literally, creating a New Bretton Woods system, which would channel credit for production, putting an end to speculative flows. It would build rail corridors across the Eurasian continent, and in these corridors build industry, power generation, and water management projects. Within this geometry of growth, relations among nations would be changed. How do you see Malaysia fitting into such a new global economic geometry?

Tun Daim: Malaysia is in favor of a revamp of the current global financial system. The details of the new financial architecture must be thought through and developed with the cooperation from both the developed and developing nations. In this context, the international community should consider various proposals, such as those suggested by LaRouche, so as to come up with a workable system that will benefit all parties. In all these attempts, the interests of the developing countries should be taken into consideration.

EIR: Do you see this idea as compatible with discussions of the so-called "new global financial architecture"?

Tun Daim: We need to look into the details of the proposal.

EIR: Before the crisis, Malaysia and its neighbors had launched a series of "growth triangles." What is the status of the intra-regional development zones with Thailand, Indonesia, and the Philippines?

Tun Daim: Yes, there were altogether three growth triangles in which Malaysia was involved with its neighbors. Although the respective governments were involved in the initial planning and coordination of these growth triangles, the growth triangles were primarily to be vehicles for private sector collaboration.

The three growth triangles are very much alive, particularly with respect to certain projects and activities that have not been severely affected by the crisis, for instance, agricultural activities. The economic crisis has, however, slowed down the scope and scale or growth of triangle activities, particularly because some of our participating countries have been badly affected by the crisis.

EIR: Malaysia headed a committee of Asian nations on developing the Asian Railroad and its connection to the Eurasian Land-Bridge. What is the status of that?

Tun Daim: The plan is to build a rail connection between Singapore and Kunming in China. There are some missing links, and a new line has to be built through either Cambodia, Laos, or Myanmar to China. A Special Working Group under the Malaysian Minister of Transport is conducting a feasibility study. The final report is expected in March 1999. Once the Asian rail connection is completed, Asia will be linked to Europe through the Trans-Siberian Railway. At the first Asian-Europe Meeting in Bangkok, this project will be endorsed by the Europeans.

EIR: The Thais are again looking at the Kra Canal. What does Malaysia think of this project, and how might you be involved?

Tun Daim: Feedback indicates that the Thai government is not actively pursuing the Kra Canal. It is a Thai project. If they intend to proceed with the project, some Malaysian companies would be interested to participate.

EIR: What is Malaysia's role in the new road projects in India? Are there other major projects abroad in the works? How have such overseas projects been affected by the crisis?

Tun Daim: The Indian government has appointed a consortium of Malaysian firms to participate in building toll roads in India under the BOT [build, operate, transfer] concept. Malaysian firms have acquired considerable expertise and technology in the construction of roads, ports, airports, telecommunications, water projects, and energy generation. As such, they are actively involved in projects such as road and port building in India, water supply in Vietnam, telecommunications in India and Vietnam, and inland port and airport development in Cambodia. The crisis has not affected the capacity of Malaysian firms in pursuing such projects abroad.

EIR: Domestically, several crucial infrastructure projects are on hold, such as the Bakun Dam, and the bridge to Sumatra. What is the status of these projects at this point? What major projects would you like to see constructed?

Tun Daim: The bridge to Sumatra was only a project idea before the crisis. Its current status is that of a deferred project. The Bakun Dam was deferred after the onset of the crisis. These are private sector projects. The government is currently looking at the proposals submitted by the various groups and the feasibility of implementing the Bakun project on a limited scale.

I would like to see a continuation of projects that strengthen the infrastructural foundations of the economy and contribute to the creation of value-added. Projects that come to my mind are highway projects, railway modernization, port development, and low-cost housing. These projects have strong multipliers and are also contributors to economic growth and employment.

EIR: There has been renewed discussion of the Asian Monetary Fund, originally proposed by Japan in 1997. What are the prospects?

Tun Daim: The Malaysian government had consistently supported such an idea since it was first formulated in 1997.

We have not changed our position since then.

The prospects for such a fund would depend firstly on the extent to which other Asian countries, including China, will support the idea and be prepared to join hands to ensure its realization. Secondly, it will depend on the ability of Japan to sell the idea to the United States and the international financial institutions that see the Asian Monetary Fund as a threat to their role in Asia.

EIR: Malaysia appears to have avoided the drastic increase in poverty levels which the crisis brought to Thailand and Indonesia. What have been the effects on the population, and what measures have you taken to meet emergency social needs?

Tun Daim: Although the ringgit has depreciated 30-40% in 1998, inflation is largely under control, with rates below 5%. Rural households engaged in palm oil and other resource-based products sold in U.S. dollars have benefitted. In any case, the government is concerned with the negative effects of the crisis on the poor. Accordingly, it has widened and strengthened the social safety net by introducing various programs, such as the development program for the hard-core poor, and the micro-credit program for hawkers in urban areas and rural infrastructure. Allocations for the development of education and health care facilities have in fact increased. We have stopped sending students abroad, and have instead expanded local capacity, including private sector efforts to have twinning programs with foreign universities.

EIR: Education, in particular, has been hard hit by the crisis, with millions of children dropping out of school across the region. What is the situation in Malaysia?

Tun Daim: While it is true that education has been hard hit by the crisis in many Asian countries, the situation in Malaysia has been much different. School enrollment at both the primary and secondary school level has not changed adversely from before the crisis.

This could be because the government has continued to invest in education despite the crisis. We did not cut the education budget. Instead, we increased educational expenditures as part of our commitment to the social safety net and human resource development.

EIR: What effects have the U.S.-British bombing of Iraq had on damaging or derailing discussion of solutions to the global financial crisis?

Tun Daim: In my mind, the bombing of Iraq should be seen as distinct from the discussion of solutions to the global financial crisis. Yet, even without the bombing of Iraq by the United States and Britain, it seems to me that the G-7 countries appear to be stalling the process of discussions on finding solutions to the global financial crisis.