"EFFECTIVENESS OF SELECTIVE CONTROL MEASURES TO REMEDY MALAYSIA'S FINANCIAL TURMOIL DURING 1997-2000"

by

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Abstract

This thesis is a research on the effectiveness of Selective Control Measures to remedy the Malaysia's Financial Turmoil during 1997-2000. Many argue that the Control Measures were obsolete and Malaysia was going backwards. However, the critics began to change its viewpoint after one year of implementation of the Control Measures. There were many signs of recovery which have been observed and collected as evidences. Primary Research was done by using the questionnaire instrument and many people from different walks of life ranging from the entrepreneur, executives to ordinary people have given positive comments on the effectiveness of the Control Measures. In addition, Secondary Research was also carried out with the collection of local and foreign comments. These comments show favor for the Control Measures. In addition, many economic and financial indicators were collected and analyzed as evidences of supporting the effectiveness of the Selective Control Measures.

The thesis was not prepared to favor any politician or any party of the Government. It is prepared with the objectives to see the Effectiveness of the Selective Control Measures in Malaysia. The Findings reveal that there were many signs of recovery after the implementation of the Control Measures. The objectives of the Control Measures were met and been fulfilled. The degree of effectiveness could be seen throughout the tables, graphs and comments (locally and abroad) collected and presented here.

My conclusion is the Selective Control Measures are working in Malaysia. It was indeed a daring move taken by the Malaysian Government. It was also a right step to stop the speculators from further damaging the economy. The thesis here was confined to the data collected from 1997 to 2000(as stated in the title of the research). Nevertheless, one should not overlook other measures too (e.g. monetary or fiscal policies) that have played vital role in bringing Malaysia out of the crisis. Perhaps, the Selective Control Measures have played the role of the catalyst of speeding up economic recovery in Malaysia.

Acknowledgments

Firstly, I wish to acknowledge the patience and endurance of my parents and family who have been patiently supporting me directly and indirectly as I prepare this thesis. Without their continuous support, I may not be able to complete this doctorial thesis.

I would like to thank Professor Dr. Ralph Thomas for all his mentoring help as my supervisor and not forgetting the co-operation and support from the IPFM center. I would like to thank all the respondents who have been very co-operative and candid in their views during the interviews and administration of questionnaires.
There may be others who have given their contribution and I may have unintentionally left them out and therefore I would like to thank them too as well for their commitment and support throughout this period of writing the thesis.

Declaration

I hereby certify that the work embodied in this thesis is the result of original research and has not been submitted for a higher degree to any other University or Institution.

(KUAN SOON LYE)

LIST OF TABLE

LIST OF GRAPHS

Table of Contents

List of Acronyms

A/C	Account
BNM	Bank Negara Malaysia or Central Bank of Malaysia
Berhad	Limited
BT	Business Times
CLOB	Cental Limit Order Book
CPI	Consumer Price Index
FDI	Foreign Direct Investment
Danaharta	Asset Fund
Danamodal	Capital Fund
GDP	Gross Domestic Product
KLSE	Kuala Lumpur Stocks Exchange
KLSE CI	Kuala Lumpur Stocks Exchange Composite Index
IMF	International Monetary Fund
NPL's	Non-Profit Loans
NEAC	National Economic Action Council
NERP	National Economic Recovery Plan
NST	New Strait Times
RM	Ringgit Malaysia
WDR	World Development Report
WTO	World Trade Organization

CHAPTER 1
INTRODUCTION

1.1 Introduction

Malaysia, as well as the other Asian countries was badly hit during the Financial Turmoil in 1997. Since the Crisis, the Malaysian Government has been continuously combating it on numerous ways to recover from the turmoil. Many measures were taken initially but they did not work. The situation worsened and the economic recession went down even further. It was at this juncture, the Malaysian Government implemented the Selective Control Measures on 1 September 1998.

The thesis here is meant to study the effectiveness of the Selective Control Measures taken by the Malaysian Government during 1998-2000. This is an independent study without any directive and financial support from any government agency or institution. It is not meant to support anyone or any political party.

Personally, I selected the topic with the intention to have a better understanding of the financial turmoil and to see the strength and weaknesses of the Selective Control Measures taken to remedy the crisis. “Are the Selective Control Measures working?” is the question to be answered. Hopefully, with the presentation of data and its analysis, this thesis may enlighten all of us on its effectiveness of the Control Measures taken.

1.2 Statement of the Problem

When Malaysia imposed selective controls the World Press reacted adversely, labelling Malaysia a ‘Renegade Economy’ (Business Week) and suggesting Malaysia was suffering from an IQ crisis (Herald Tribune). Time magazine quoted a Bangkok-based expert saying that capital controls `will create a black market for the currency and there will be a panic in the country to buy US Dollars’. Milton Friedman told the world that Malaysia’s move was the ‘worst possible choice’ These were the words of critics that were said when Malaysia launched the Selective Control Measures on 1 September, 1998.

I am interested to find out the effectiveness of the Capital Control Measures taken to help Malaysia recover from the financial turmoil.

Here are some statements of problems to be answered in the thesis here.

1. Did the Selective Control Measures help Malaysia to be back on the road of recovery?
2. Without these measures, will Malaysia recover from the crisis?

Besides myself, many other governments, economists and observers are also keen to know the effectiveness of these Measures to rescue Malaysia from the turmoil.

1.3 Purpose of the Study

The purpose of this study is to examine the effectiveness of Currency and Capital Control measures to remedy Financial Turmoil during 1997-2000.

The Research looks into the effectiveness of the Selective Control Measures in helping Malaysia out of the crisis.

Can Malaysia recover without the Selective Control Measures?

1.4 Research Questions
The following are some questions to be answered in the thesis here
1. **Is Malaysia on the road of recovery?**
 - Is our recovery real?
 - Do ordinary people also feel the impact of recovery in Malaysia?
 - Are there signs of recovery in many aspects of the Malaysian economy?

2. **Is there a positive relationship between Selective Control Measures and the Signs of Recovery?**
 Is the Recovery of Malaysia largely due to the Selective Control Measures?

1.5 Significance of the Study
This study is meant to benefit people from all walks of life, investors locally as well as abroad, undergraduate and postgraduate students who are studying this crisis as their case studies. It hopes to provide an in-depth understanding on its effectiveness of the Selective Control Measures. Perhaps the Control Measures taken by Malaysia could be seriously considered by other governments in similar crisis later.

1.6 Limitations of the Study
There are certain quarters of limitation to be highlighted.
Firstly, this study is restricted to the period 1997-2000
The Crisis began in July 1997 and it should be noted here that Selective Control Measures were only implemented on September 1,1998. Data collected was confined only within the period of 1997-2000. Data after the year 2000 is **not** studied here and is not within the scope of this research. Any comment or criticism should be confined only within the study period as stated in the title of the thesis.

CHAPTER 2
LITERATURE REVIEW

2.1 Pre-Crisis Days before July 1997
There were many favourable features of the Malaysian economy prior to the crisis in July 1997. During the five years leading up to 1996, it's real GDP growth averaged 8.7% per annum, inflation was low around 3.8 % and the unemployment rate for 1996 was only 2.5%. Unlike some other East Asian economies with high external debt, Malaysia had a relatively low external debt of US$45.2 billion or 42% of GDP as at June 1997. The external debt service ratio was only 6.1% of exports as at the end of 1996. The banking sector was healthy with non-performing loans (NPLs) at only 3.6% of total loans as at June 1997. The nation's saving rate at 38.5% in 1996 was one of the highest in the world.

2.2 Origin of Crisis
It is important that I clarify here that my research is not to study the root cause of the crisis but more on the effectiveness of the Selective Control measures to remedy Malaysia during the financial turmoil. Therefore, I would only briefly explain how the crisis began.

It is not easy to point out exactly the root cause of the problem. There were already many symptoms of the illness and at the right time with deliberate attack of certain quarters of investors, the crisis exploded into a financial turmoil

The first manifestation of the crisis was the sharp devaluation of the Thai baht, which created strong contagion effect on the currencies of Indonesia and Philippines. Funds began to flow out of the region, starting a highly damaging chain reaction. The exchange rates depreciated and domestic borrowers with unhedged foreign exchange positions rushed to buy dollars. While this was occurring, foreign leaders became worried that their customers would not be able to repay their loans, which led them to call in their loans. This prompted further fall in the currencies. The withdrawal of funds also started a liquidity crunch. Many firms had found difficulties to obtain Working Capital. Consequently, even profitable firms had become insolvent which resulted in further pressures on the banking system and depositors' confidence. The crisis triggered large fall in the stock markets in this region. By October the crisis had spread to Korea. The primary factor behind this currency and stock market collapse was the massive foreign capital outflow.

Malaysia was among the affected countries and one of the reasons given was that its past investments had not been in productive areas. This meant that the past investments did not contribute to the productivity and performance of the Malaysian economy. The investments were in the building of bridges, roads and high rise buildings, which might not add on to the productivity of the economy. The banks had also been continuously granting loans to facilitate these development projects. These loans had resulted in more bad debts.

2.3 Economic Situation during the crisis (July 1997- August 1998)

With reference to the appendices, all the economic indicators such as Consumption, Investment, Production and External indicators were showing declining rate since January 1998 to August 1998.There was no improvement at all despite the measures taken by the government.

From the perspective of Consumption Indicators,

1.Kuala Lumpur Stock Exchange – the Composite Index was 569.5 and went down to 200 by August 1998.

2. The Number of Retrenchment workers was 1,774 in January and it went up to 7,125 by August 1998.

From the perspective of Investment Indicators,

1.The sale of 21,294 new commercial vehicles in January went down to 1,681 in August.

2. The Non-Performing Loans of banking system (6 months since September 1998) which was 5% in January went up to 11.4% by August

3. The Money Supply (% p.a.) of M3 which was 16.1 in January went down to 4.4 by August 1998.

From the perspective of Production Indicators

1. The Industrial Production index (p.a.) which was 1.3% in January went down to 11.6% by August.

2. The manufacturing sector (Sales – p.a.) which was 18.7% went down to 24.5% by August

From the perspective of External Sector
The Growth rate of total exports which was 33.9% in January went down to 25.6% by August

2.4 Early Measures of the Government
Malaysia introduced a series of policy packages to address the crisis. The policy measures evolved according to the changing environment during the course of the crisis. The initial approach adopted contained some features of the IMF prescription although Malaysia was not under an IMF programme. Initially Malaysia had adopted an approach that was recommended by IMF.
a)The central Bank i.e. Bank Negara had increased interest rate on loans and curtailed credit. The period for classifying NPLs was reduced from six to three months on 18 October 1997. Overall credit growth was limited to 25% in 1997. There were also suggestions that banks facing difficulties should be immediately closed. At first Malaysian Central Bank intervened aggressively to defend the ringgit against the crisis but it was not strong enough to neutralise the huge outflow of funds and so had to abandon the defence and allow the Ringgit to depreciate itself.
b) A belt-tightening budget was presented to stop Malaysian economy from sliding into recession. The budget included the following measures:
1.The Federal Government expenditure was reduced by 2%, mega projects were to be deferred and public agencies purchases of foreign goods were to be reviewed.
2.Classification of non-performing loans in arrears from 3 to 6 months.
3.The Credit Plan was introduced to limit overall credit growth. Banking institutions were told to give priority to productive and export orientated activities when providing loans.

Other policies measures included were as follows:
1.To reduce the current account deficit to 3% of GMP in 1998
2.Cut the Federal Government expenditure by 18% in 1998
3.Approval of new reverse investment to be stricter and to defer the implementation of non strategic and non-essential projects
4.Good corporate governance to be emphasized
5.Enhanced disclosure of information of corporation and closer scrutiny for corporate restructuring.

New measures were announced in February 1998:
1.Bank Negara three-month intervention rate was raised from 10 to 11%
2.The statutory reserve requirement (SRR) cut down eligible liabilities to 10%

National Economic Action Council (NEAC) was established in January 1998 to act as a consultative body to the Cabinet to deal with the economic problems.
As one of its primary tasks, the NEAC has taken upon itself to prepare the National Economic Recovery plan (NERP), which presents a comprehensive framework of action for national economic recovery.

The six objectives of the Recovery Plan were
1. Stabilising the ringgit
2. Restoring market confidence

3. Maintaining financial market stability
4. Strengthening economic fundamentals
5. Continuing the equity and socio-economic agenda
6. Restoring adversely affected sectors

Their purpose was to make recommendations to the government on how to restore the economy. In March 1998, Government made it necessary for banks to shore up their capital adequacy positions at the first sign of trouble. Malaysia accepted a RM1 billion loan from the World Bank for social and poverty related projects. Measures included were:

1. Minimum risk weighted capital ratio of financial companies was increased from 8% to 10% with an interim compliance of 9%
2. Minimum capital funds of financial companies was increased from RM5 million to RM300 million and subsequently to RM600 million
3. Single customer limit was cut down from 30% to 25% of capital funds

The Government consequently decided to change its course of action by relaxing the fiscal and monetary policies in mid-1998. It also continued to fine-tune its policies in order to strengthen economic and financial sector fundamentals and restore domestic and external stability. The initial strong conditions in both the real economy and financial sector had allowed Malaysia to exercise greater flexibility and provided greater scope for designing pragmatic policy measures.

Unsuccessful Results of the Earlier Measures

Despite the measures above, the financial markets showed no sign of stability. While these measures were able to address certain concerns such as price pressures and the current account deficit in the balance of payments, they caused severe liquidity problems, reduced accessibility to credit and thus adversely affected the performance of the private sector and in turn contributed to strains on the economy. Coupled with week external demand and prolonged uncertainty in the regional economies, it resulted in a rapid contraction of the economy.

Malaysian authorities at first implemented an orthodox adjustment policy. Interest rates were raised to stem the decline of the ringgit and in December 1997 a drastic cut (18%) in government spending was announced. This policy package mimicked IMF programs. The Malaysia economy failed to respond to the orthodox policies. Consumption and investment demand plunged as a result of capital outflows, high interest rates and a pessimistic outlook. The attempt to reduce domestic interest rates was undercut by growing speculation against the ringgit in offshore markets. Offshore institutions (mainly in Singapore) borrowed ringgit at premium rates (double or triple the prevailing interest rates in Malaysia) to purchase dollars and bet in favour of the ringgit collapse. The economy decline continued. This was the background against which the controls were instituted on 1 September, 1998.

2.5 Capital Control – Its Initial Move

Plan B of Krugman to advocate Capital Control

According to a report in the New Strait Times, Krugman in a seminar address in Singapore in August 1998 said that Asian economies were reaching the end of the road and it was time to “do something radical” including implementing foreign exchange control since pressures on the Asian economies were too high. Krugman added that after having gone to IMF and finding that its policies (which he called Plan A) did not work it was time now for Asian countries to adopt what he termed “Plan B” which comprised foreign exchange control.”

He also said,” Plan B was a solution so unfashionable, so stigmatised that hardly anyone had dared to suggest it. The unsay- able words were the Exchange Control.”

We tried plan A (the IMF prescription of austerity) but it didn’t work. Krugman was certainly not the first person to advocate capital control as a part of the solution to the Asian financial crisis. Indeed he was, as he admitted, a new convert. But he was such a prominent part of economics establishment that his proposal could carry weight to break the taboo against considering foreign exchange controls as a serious policy option.

Exchange Controls he added used to be the standard response of countries with balance of payment crisis. “Exporters were required to sell their foreign-currency earnings to the government at a fixed exchange rate; that currency would in turn be sold at the same rate for approved payments to foreigners, basically for imports and debt service.

Different meaning of Capital Controls

Capital Controls mean different things to different people.

To the ***textbook of economists,*** Capital controls mean cutting the country off from every kind of financial link with the rest of the world.

In a broad sense “ capital controls” are measures that discourage capital flows (into or out of a country) or seek to influence their character. Capital controls encompass a wide range of and often country-specific measures although they all attempt to restrict the movement of capital across national boundaries or between residents and non-residents.

A capital control is any policy designed to limit or redirect capital account transactions. This broad definition suggests that it will be difficult to generalise capital accounts because they can take many forms and may be applied for various purposes (Baker, 1996)

Forms of Controls

Capital controls have mainly taken two general forms

1. Direct controls and
2. Market–based (or indirect controls)

1. Direct controls restrict capital movement through outright prohibitions, quantitative limits or requiring administrative approval (which may or may not be rule-based) these controls typically affect the volume of capital flows.

Examples of direct capital controls are:

-Prohibitions on residents borrowing from abroad

-Limits on the transfer of capital to non-residents and

-The need to obtain approval for non-resident foreign direct investment

2. Market-based controls discourage capital movements by making them costlier to undertake and typically affect the price or both the price and the volume, of a given transaction.

Examples of market-based control are:

- explicit taxation of cross-border flows such as taxes and levies on External Financial transactions,
- Indirect taxation of cross-border flows such as non-interest bearing reserve or deposit requirement (under such scheme, residents are required to deposit at zero interest rates a proportion of capital inflows at the central bank) and
- a multiple exchange rate system where different exchange rates apply to different types of transactions

Controls may take in the form of taxes, price or quantity controls or outright prohibitions on international trade in assets.

2.6 "Economic Theory of the Second Best"

Recently, economists have considered other circumstances other than balance-of-payments needs or real appreciation under which **capital controls might be a useful policy**. As a rule, economists emphasize that restrictions on trade and investment impose costs on the economy. There are exceptions to that rule. Taxes and quantitative restrictions may be good for the economy-welfare if they are used to correct some other pre-existing distortion to free markets that cannot be corrected otherwise. This idea that a tax or quantitative restriction can improve economic welfare in this way is called a **"Theory of the Second Best".**

2.7 Malaysia Selective Control Measures

Malaysia currency controls were crafted well so that they would prevent the currency from being manipulated by foreign currency traders while allowing the normal business transactions to be carried out without hindrances.

2.71 On **<u>September 1-2, 1998,</u>** the controls on Capital and Exchange were introduced and they were as follows: -

1. Fix the exchange rate
2. Monitor the inflow and outflow of ringgit

At the working level, the exchange control measures can be summarised into **4 primary focuses:**

1. Strengthening the regulations on external ringgit account
2. A ban on the use of ringgit to settle trade
3. Strengthening of the restrictions on short-term trading of Malaysia securities by non-residents
4. Introduction of a fixed exchange rate of RM3.80 to the dollar

Features of the Malaysian Selective Control Measures on September 1-2, 1998.

The features of Malaysian Selective Control Measures are as follows:

1.Malaysia fixed the exchange rate at RM3.80 per $US

2.Prior approval was required for non-residents to be able to buy or sell ringgit forward

3.All sales of ringgit assets were required to be transacted through the approved domestic intermediaries. This effectively shut down the operation of the offshore ringgit market

4. Non-residents were required to obtain BNM approval to convert ringgit held in external accounts into foreign currency, except for the purchase of ringgit assets in Malaysia or for the purposes of conversion and repatriation of the sale proceeds of investment made by foreign direct investors
5. Settlements of imports and exports became required to be settled in foreign currency. However, free exchange was maintained for all current account transactions in addition to supply of trade credit to non-resident exporters of Malaysian goods.
6. Credits to External Accounts were limited to sale of foreign currency, ringgit instruments, securities or other assets in Malaysia, salaries, wages, rentals, commissions, interest, profits or dividends.
7. Debits to External Accounts were restricted to settlement for purchase of ringgit assets and placement of deposits; payment of administrative and statutory expenses in Malaysia; payment of goods and services for use in Malaysia and granting loans and advances to staff in Malaysia.
8. Domestic nationals were forbidden to export more than RM10000 during any travels abroad. Foreign nationals were forbidden to export more than RM1000 upon leaving Malaysia.
9. After September 1,1998, non-resident sellers of Malaysia securities were required to hold on to their ringgit proceeds for at least 12 months before expiration was to be allowed.
10. Ban on the provision of domestic credit to non-resident correspondent banks and stock broking companies.

Further clarification of the Selective Control Measures

1. The offshore ringgit market was eliminated and currency speculators could not 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 resident but could invest their funds freely in Malaysia. Therefore the currency traders were unable to “short-sell” the ringgit and change its exchange rate. Only the Government could determine the exchange rate.
2. A “twelve-month rule” was imposed prohibiting the repatriation of Portfolio funds for twelve months. This `twelve-month rule was necessary given the prevailing instability of the financial market. The same was true with the “twelve–month rule” imposed on the non-resident investors in KLSE, which prohibited them from repatriating their capital for twelve months. If the ‘twelve-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 twelve –month rule” most foreign investors could not sell shares and today they are able to enjoy the greatly appreciated prices of the shares. The “twelve-month rule” therefore created a win-win situation for both the non-resident investors and the Malaysian government. When the situation stabilised six months later, this “twelve-month rule” was replaced with a levy and subsequently even this levy was diluted further to apply only to dividends repatriated. Interestingly, when the twelve-month rule expired in September 1999 there was no massive outflow.
3. The government fixed the ringgit exchange rate at 3.80 to the US dollar,

the rate that prevailed at the time the controls were imposed. This would have enriched Malaysia and Malaysians. In television interview, Prime Minister Dr.Mahathir Bin Mohamad announced that the government fixed the ringgit's exchange rate and that in future, the ringgit would only be tradable within Malaysia. The rate of exchange has been fixed at 3.80 to the U.S.Dollars.
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.

4.Government regulation requires exporters (including FDIs) to repatriate their export proceeds back to Malaysia immediately when the export proceeds are received. Exporters are allowed to give credit to their importers for a maximum of 6 months. This means that within 6 months after the date of export, at the latest all export proceeds are repatriated back 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 a strong external reserve position.

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

There were no controls on the following:

1. Current account transactions amendment in rules only require trade transactions both in goods and services, to be settled in foreign currencies and no longer in domestic currencies
2. Repatriation of interest, dividends, fees, commissions and rental income from portfolio investment and other forms of ringgit assets and foreign direct investment inflows and outflows, including income and capital gains are not subject to any restriction

2.72 February 15, 1999 (Changes in the Selective Controls)
As of February 15, 1999 the year-long moratorium on repatriation of investments was replaced with a graduated tax. All capital having entered Malaysia before February 15,1999 were subject to the following levies on the capital being removed:

(a) 30% if repatriated within the first 7 months after entering Malaysia
(b) 20% if repatriated between 7 and 9 months after entry
(c) 10% if repatriated between 9 and 12 months entering and
(d) No levy if repatriated after 1-year entry.

2.73 For Funds entering Malaysia after February 15, 1999
was free to enter without taxation; however profits were taxed at the rate of 30% if repatriated within one year of the entry and 10% if repatriated after one year

of entry.

2.74 February 18,1999 and April 15, 1999
Property investments and investors in MESDAQ (where growth and technology shares are listed) were exempted from the exit levy.

2.75 21 September, 1999
Further relaxation was introduced on the date above on the exit levy where the two-tier system was reduced to a flat rate of 10% on profits repatriated.

Implementation and Immediate effect of the Selective Controls Measures
The Government had adopted a flexible and pragmatic approach in the implementation of the new exchange control rules. Efforts have been directed to ensure that the administrative machinery was in place for prompt approvals so that disruptions and inefficiencies were minimised. Emphasis had been placed on the efficiency of the implementation process as well as the dissemination of information on the changes to the exchange control rules to allay the fears of long-term investors. In the short term there might be some concerns especially among portfolio fund managers on the need to retain funds in Malaysia for twelve months. Assurance was given for flexibility in the management of these funds during the twelve-month period and for the convertibility at the end of the twelve-month period.

Dr. Mahathir said the ringgit either as cash or in ringgit bank accounts abroad would be allowed a period of one month to be brought back to Malaysia. After that ringgit held abroad would be considered `invalid' and would not be allowed into the country.

From October 1, 1998 one couldn't carry more than RM1000 when he is travelling in and out of Malaysia. One has to declare to Customs in money whether ringgit or foreign currency you are carrying. But there is no limit how much foreign currencies you take into Malaysia. Non-residents could take out as much foreign currency as they brought in.

Malaysians couldn't take out more than RM10000 out of the country. They have to apply for approval and show evidence if they need more money for example for foreign studies.

One can't leave his ringgit outside Malaysia after October 1 or it will become worthless. If you have ringgit accounts elsewhere you have one month to take it back to Malaysia.

With immediate effect you can't change your ringgit in external account or bank accounts of non-residents unless you get approval from the Central Bank.

One must hold on to his ringgit proceeds for one year when one sells Malaysian securities. This rule effective immediately applies to those who held securities for less than 1 year. One can't use the ringgit for settling bills for exports and imports. All such deals must be settled in foreign currencies.

One won't be able to use the RM1000 and RM500 notes, as these big notes will be taken out of circulation. The ringgit will be held at a fixed rate of RM3.80 to US$1.00

Early Reactions Towards the Selective Controls Measures

On 2 September 1998 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.
Early reactions to the controls ranged from cautious to hostile.

The IMF did not openly condemn Malaysian policies, but it did not hide its views about their inappropriateness either. An IMF spokesperson quoted that "any restrictions imposed on the movement of capital are not conducive to build investor confidence"(quoted in "IMF Suggests Malaysian Move is a Discentive," Asian Wall Street Journal, 9.2.98 p.2). Other observers declared "Exchange Controls will undermine Malaysian growth" (head line of September 15,1998 report) An Article in Forbes International predicted "Foreign investors in Malaysia have been expropriated and the Malaysians will bear the cost of their distrust for years" (Rouche 1998). Moody's downgraded Malaysian securities. Morgan Stanley dropped Malaysia from its international index, stating that Malaysia would permanently be excluded and its previous inclusion had been a mistake in the first place.

2.8 Conclusion

Here, I have explained the origin of crisis, the earlier measures taken by the Government, Selective Control Measures and its implementation.
There were many books, articles or Journals written on the issue of Asia Crisis or Financial Turmoil. There were also books written on Capital Control Measures. However, there were none at the time of my writing to discuss the effectiveness of Malaysians Selective Control Measures.
Perhaps there were articles on the Capital Control Measures being practised in other parts of the world but there were none been written on the effectiveness of the Capital Control Measures in Malaysia.
It is my hope that the next few chapters will be of great help to reveal a better understanding on the Selective Control Measures and its effectiveness in assisting Malaysia to recover from the financial turmoil. Hopefully, the findings and analysis of data would provide enough evidences to show the effectiveness of the Selective Control Measures practised in Malaysia.

CHAPTER 3

METHODOLOGY

3.1 Research Methods

In my research here, both Primary and Secondary Research methods were applied to collect, analyse the data and thus producing different types of outcomes .
The Survey Instrument was used in the Primary Research while the Secondary Research was very much dependent upon the reports from newspaper, Journals, magazines and other written books.

The Survey Instrument (Primary Research Methods)

The survey was carried out using standard questionnaire specifically designed to contain questions, which help to determine the relationship (if any) between Selective Control Measures and the Sign of Recovery in the economy of Malaysia.
The survey was carried over a period of 18 months

The Method applied here was the Survey instrument specifically using the Questionnaire technique. Data was collected from different groups of people randomly of different occupations, races, sexes and positions held in the company. Random Sampling technique was used

A set of questionnaire was prepared and was given to individuals to answer them. Based on the results obtained by the respondents, the analysis was carried out.

The questionnaire used for data collection in this study is presented in Appendix 1

Examples of the questions contained in the questionnaire are as follows:

"Has your business or job been affected adversely?"

The responses to the above questions are expected to be a simple, "Yes" or "No"

Another set of questions that was put forward was

"The Control Measures helped to protect the economy of Malaysia from any further speculative activities or any adverse external influences."

For this question a single tick to one of the following is required. The different response will be rated with a simple tick at the respective column in terms of "Strongly disagree", "Disagree"; "Agree"; and "Strongly Agree"

General Personal Details of each respondent were also collected:

Examples are the Types of occupation and Position of job.

The Following would be the examples of questions for personal details

Kindly circle the corresponding option, which you are employed.

1. Type of organisation or employment.
1. Business 2. Education 3. Government sector 4. Industry

2. Job position in the organisation or industry

1 Entrepreneur 2. Executive 3. Academician 4. Technician

3.2 Population and Sampling

In the selection of the Sample, the public was used irrespective of age, race, income, marital status and education that possess any of the following criteria

3.21 different occupation in the market

3.22 different position or status held by the respondents

The Primary Data was obtained from people of different walks of life.

The respondents are taken from different types of organisation e.g. industry, Government Sector, business and education sector.

There were 100 respondents who participated in the questionnaire.

The Sample has diverse occupations consisting of undergraduate students, business executives, technicians, Government officers, entrepreneurs and high learning institution academicians.

Frequencies

Frequency Table

3.3 Data Collection
-Primary Data
For the fieldwork, the data was collected personally.
Questionnaires were distributed to sample undergraduates of the business faculty, different types of occupations of different sectors of industry. Each respondent was expected to answer 30 types of questionnaires.

- Secondary Data
The data was obtained from newspapers, magazines, reports, journals locally as well as abroad. Based upon the given data, graphs and other Graphs were drawn to show or to highlight the result clearly

3.4 Statistical technique
Data was analysed using descriptive statistics. Descriptive statistical analysis included the computation of the totals and percentages of data related to the effectiveness of the Selective Control measures. SPSS software (ver.10) was used to generate the different outcomes. The results of the different outcomes would appear in Chapter 4.

3.5 Conclusion
Here both Primary and Secondary data were collected to provide evidence of the control measures. Quantitative Methods were applied. The SPSS software (version 10) was used to further generate statistical outcomes. The results of the outcomes from SPSS software would be seen in the following chapter. Both Primary and Secondary findings support the Selective Control Measures taken to help Malaysia recover during 1997-2000.

CHAPTER 4

PRESENTATION AND ANALYSIS OF DATA

This chapter reports the result of study and evaluates them according to the stated purposes.
4.1 Findings of Primary Data (Questionnaire Results)
A set of Questionnaire is available in Appendix 1
Below is the result of the Primary Data
(Questionnaire-Section 1)

Frequency Table

Based on the result of the Primary data, the following is the analysis.

Analysis of Questionnaire [Section 1]

No	Questions	Effective	Not	Total	Conclusion
1	Are you in favour of the Fixed Exchange rate i.e. 1$US=RM3.80?	81	19	100	Effective
2	Has your business or job been affected adversely?	81	19	100	Effective
3	Did Capital Control Measures work during 1997-1999?	89	11	100	Effective
4	Are the Control Measures a solution to our Financial Turmoil?	82	18	100	Effective
5	Has our financial stability been worsened after the Control Measures?	87	13	100	Effective
6	Has your income been affected adversely by the Control Measures?	90	10	100	Highly Effective
7	Would you like the Control Measures to be lifted immediately?	84	16	100	Effective
8	Do the Control Measures do more harm than good?	86	14	100	Effective
9	The Selective Control Methods have helped Malaysia to recover	93	7	100	Highly effective
10	I am happy with the Control measures	88	12	100	Effective
	Total (86.1%)	861	139	1000	Effective

Analysis of Data
From the table above,
1) There are positive responses to all the 10 questions.
2) Based on the 100 respondents, the minimum percentage of positive response was 81% and the maximum percentage of positive response was 93%.
3) Out of 1000 answers from 100 respondents, only 861 answers are in favour of the effectiveness of the Selective Control Measures.
(i.e. 86.1% supporting the Selective Control Measures)

Conclusion
1. The Selective Control Measures are effective with 86% supporting the Measures taken during the crisis.
2. Based on the results gathered, the percentage obtained was less than 90% and may be concluded as effective but not on the upper limit of effectiveness.

Below is the result of the Primary Data
(Questionnaire-Section II)

Frequency Table

Item5

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Highly Effective	4	4.0	4.0	4.0
	Effective	72	72.0	72.0	76.0
	Ineffective	23	23.0	23.0	99.0
	Highly Ineffective	1	1.0	1.0	100.0
	Total	100	100.0	100.0	

Results of Primary Data- Questionnaire – Section II

	Analysis of Results	Highly			Highly	
		Effective	Effective	Ineffective	Ineffective	(%)
No.	Questions	1	2	3	4	Effective
1	Measures protect economy from speculative actv.	17	78	3	2	95
2	Great sums of RM brought back to Malaysia	9	82	8	1	91
3	Control measures ease liquidity shortage in Banking	13	75	11	1	88
4	It revives economy & greater demand in car sale	6	79	13	2	85
5	Capital control has not made people poorer	4	72	23	1	76
6	Unemployment rate has not been worsened	12	60	27	1	72
7	Surplus in our Current A/c Balance of Payment	4	81	15	0	85
8	Less Non-performing loans	4	80	16	0	84
9	Foreign investors have been drawn away	6	70	22	2	76
10	Recovery has also been felt by ordinary people	10	74	16	0	84
11	Control stopped speculators from manipulating RM.	10	78	11	1	88
12	Isn't wrong move to use the measures in this crisis	9	80	10	1	89
13	Greater increase in KLSE CI form Sept.98 to Dec 99	6	82	10	2	88
14	Fixing of ringgit provides a greater certainty to trade.	11	81	7	1	94
15	Individuals borrow with greater ease….	7	87	6	0	94
16	Provides predictability & stability	8	85	7	0	93
17	There is no shortage of food…	20	74	5	1	94
18	Recovery achieved without bloodshed & riots	19	74	5	2	93
19	Currency control measures are working	13	86	1	0	99
20	Our economic Recovery is real	7	81	10	2	88
	Total Respondents for each level	195	1559	226	20	2000
	(%) of each level of effectiveness	9.8	77.9	11.3	1.0	

Analysis of Data

1. All the 100 respondents responded positively to all the 20 questions.
2. Out of 2000 answers, 1754 show positive responses i.e.87.7% supporting the Selective Control Measures.
3. Based on the 2000 answers, only 195 answers show the upper limit of High effectiveness. i.e. only 9.8% show higher level of effectiveness.

Conclusion

1. The Selective Control Measures are working with 87.7% supporting it.
2. There was also some degree of upper level of effectiveness as there were 9.8% supporting the upper level of high effectiveness. One may conclude that the Selective Control Measures are working and effective and have a 9.8% degree of upper level of effectiveness.

Summary and Conclusion of the Results of Primary Data

Results of Primary Data

Section	No. of Respondents	Supporting Control Measures (Effective)	Conclusion
I	100	86%	Control Measures are working
II	100	87.7%	The Malaysian economy has recovered

With reference to the title of the thesis, the following conclusions are made. Based on the findings of Primary Data, the Malaysian Selective Control Measures are working. The Control Measures are effective in helping the economy to recover from the financial turmoil during 1997-2000.

4.2 Presentation of Secondary Data
(Collection of Local & Foreign Comments)

Based on the collection of the Secondary data, here are the collections of Local and Foreign comments in relation to the effectiveness of Malaysian Selective Control Measures.

Collection of Comments

Local Comments collected (by Malaysians) = 10
Foreign Comments collected (by Foreigners) = 40
Total comments collected = 50

I. LOCAL COMMENTS

There are 10 comments collected from Malaysians.

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1. “Recovery is real” says Prime Minister

He said the opposition was emulating Western sceptics who continued to insist the recovery was imaginary.

Dr. Mahathir said the problem with opposition parties was that even if a piece of paper was white and “you tell them it is white, they will say no, no it is black”

Dr. Mahathir also cited the 50% increase in Malaysian foreign exchange reserves from US $20 billion to $US31 billion. “Such a sharp rise has never happened before and these reserves are sufficient for seven months of retained imports,” he said to loud applause from 300 delegates who attended the three-day dialogue.

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2 “ Ordinary people feeling impact of nation’s recovery”

The Prime Minister said that men in the streets have felt the impact of the economic recovery and alluded to the happy faces of shoppers comforted by the improved situation. Datuk Seri Dr.Mahathir Mohamad also spoke of indicators like growing number of shoppers and sales of cars and motorcycles.

“They know they can spend because they have the means,” he said.

He said company performance too had an impact. Because when a company makes a profit, their workers don't feel threatened.

"If the company is not doing well, the workers feel that they may be sacrificed," Dr. Mahathir said. He said that a few businesses felt that the pace of recovery had been much faster than expected, citing the RM1 billion profits each registered by May bank and Sime Darby. Dr. Mahathir also referred to Arab-Malaysia Group's RM250 million profits in six months.

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3. "Currency Controls are working!" by Deputy Prime Minister

Currency control measures taken by the Government are showing positive indications that the economy is on the right road to recovery, Deputy Prime Minister Datuk Seri Abdullah Ahmad Badawi said.

He said the measures were not aimed at stopping direct foreign investment coming into the country, as some critics had claimed but "stops foreign currency speculators and the short- term flow of capital into the local currency market, which affects the stability of the country 's economy."

He said the measures had shown positive signs that the economy was on its way to recovery. "Now, many critics have started to understand the steps taken by the Government to revive the economy".

He also said that local traders were now accustomed to trading with the ringgit pegged at RM3.80 to the US dollar.

"The Government has never stopped investment but has encouraged direct investment into the country," he said adding that when the country was facing the economic crisis, it was evident the FDI had dropped.

"But now the rate of foreign investment approved has actually increased," he said adding that the International Trade and Industry Ministry approved a total of RM13.1 bil. Worth of foreign investment for the manufacturing sector in 1998.

This was 14% more than investments approved in 1997, he said

Although the country was competing with other countries in terms of attracting foreign investors, Abdullah said, Malaysia was still the main attraction.

"Survey conducted by Unctad (United Nations Conference of Trade and Development) last year on 500 multinational corporations showed Malaysia was still the main destination for investors in view of the facilities as well as cheap land and low cost of production," he said.

Facts also showed that FDI was more for the second half of 1998 than the first and the second half of 1997.

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4. Tan Sri Francis Yeoh,

"Furthermore, Malaysia is the most stable and competitive economy in South-East Asia in terms of the stock market and foreign direct investment," Tan Sri Francis Yeoh, in an excerpt from "Foreign fund managers to come charging back: Yeoh", The Star, January 27, 1999

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5. Mustapa Mohamed, Second Minister of Finance, Malaysia:

There are a number of positive developments, which indicate that the economy reached the bottom of the down cycle by last August and is now moving out of the trough. The output of the manufacturing sector picked up in

September, and the preliminary data for October reaffirmed this upward trend. If the Kuala Lumpur Stock Exchange Composite Indexes the barometer of the health of the economy, then the recent run-up in prices traded on the local bourse does confirm the upward trend of the economy. The improvement in investor confidence is not confined to the stock market but also among long-term investors. Proposed investments submitted by foreign investors increased sharply in September when compared to preceding months. We do not envisage any issue within the country posing a major hindrance to economic recovery. We are happy with the progress we have made so far in resolving the issue of non-performing loans and the recapitalization of the banks. Our greatest concern is external developments, especially the economic performance of our major trading partners. Nevertheless, the latest developments on the international front, especially the effort by the G7 to reflate their economies, augurs well for Malaysia's exports.

Excerpt from "A Better View From The Top", Asia week, January 8, 1999

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6. Tan Sri Ramon Navaratnam, corporate adviser of the Sungei Way Group and former Deputy Secretary General in the Treasury Ministry and former Permanent Secretary in the Ministry of Transport:

The response [to capital controls] has been very favourable, because businessmen and, especially, exporters can now have more certainty with the fixed exchange rate... interest rates have gone down and the balance of payments foreign reserves have improved considerably. There is a new confidence in the economic and business prospects.

Excerpt from "Prospects for a New Breton Woods are closer than ever", Executive Intelligence Review, November 20, 1998

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7. YB Tun Daim Zainuddin, Minister of Special Functions:

"The Government can revive the economy faster if Japan expedites the release of its promised loan to Malaysia. Signs are already there that our economy is recovering. It is difficult for a sick person to recover if medicine is given only in small doses." New Straits Times, November 14, 1998.

8.Bank Negara's Deputy governor Datuk Dr.Zeti Akhtar Aziz

said that the selective controls have stopped Malaysia from spiralling downwards.

New Strait Times- 12 August 1999

9.According to the **Malaysia Institute of Economic Research (MIER)** business sentiments in the manufacturing sector improved slightly in the first quarter of 1999, encouraged by improved sales performance.

The Star- April 26, 1999

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10. **Johan Tazrin Ngo, executive director and senior fund manager of Kenanga Investment Management Sdn Bhd:**

"There are actually strong fundamentals to this recovery,"

"It's important to know that this economic recovery that we are seeing is very, very real, it's not superficial,"

Excerpt from "KLSE'S Recent Rally Justifiable, Says Fund Manager" (Bernama) - 20 January 2000

Summary (Analysis of Local Comments)

No	Names	Position	Dates	Comments	Implications
1	Dr. Mahathir	PM	Sept,1999	Recovery is real	Effective
2	Dr. Mahathir	PM	Sept,1999	Recovery is felt by Laymen	Effective
3	Abdullah Badawi	Deputy PM	April,1999	Currency Controls are working	Effective
4	Mr. Yeoh	The Star	Jan,1999	Foreign Fund managers are returning	It worked
5	Mustapha Mohamad	Finance minister	Jan,1999	Improvement in Investors confidence	It worked
6	Ramon Navaratnam	Corporate adviser	Nov,1998	responses very favourable-	Effective
7	Daim Zainuddin	Minister	Nov,1998	Signs that our economy is recovering	It worked
8	Dr.Zeti Aziz	C.Bank. Governor	Aug,1999	Stopped from.spiralling downwards	Effective
9	Economic research	MIER	Apr,1999	Manufacturing sector improved	It worked
10	Johan Tazrin Ngo	Investment mgmt	Jan,2000	Recovery is very real	It worked

II. FOREIGN COMMENTS

There are 40 comments collected from the Foreigners. They are as follows: -

1 "Capital Controls stopped tyranny!" by **Singapore Senior Minister, Lee Kuan Yew.**

The Senior Minister said that the Capital Controls were one way of stopping the giant `tyranny' of giant hedge funds like those headed by American investor George Soros. But it was possible to shut out such funds by stopping foreign exchange transactions, which Malaysian Prime Minister Datuk Seri Dr. Mahathir and Mohamed did to prevent those funds from intervening with the Malaysian ringgit

2 Malaysia made the right move," said by **Taiwan's Finance Minister.**

Taiwan's Finance Minister, Paul Chiu said that Malaysia made the right move to implement the capital control policy to restore stability in the country's economy. Chiu said that the policy managed to curb volatility in foreign exchange, which in turn reduced the upward pressure on interest rates.

Chiu said the Taiwan Government was really impressed with Malaysia's foreign exchange reserves, which was stronger than many of its neighbouring countries.

The minister pointed out that there was a crucial need to maintain a high level of foreign exchange reserves in order to remain immune to adverse short-term capital flows and contractions in credit experienced throughout the region during the recent financial crisis.

3 Zimbabwe may adopt Malaysian measures

Zimbabwe may adopt some of the Malaysian measures in dealing with its currency crisis so that it can better withstand pressures from currency speculators. Its president Dr.Robert G. Mugabe said the 4th Lankawi International Dialogue (LID'99) was of a tremendous interest to Zimbabwe as it was being held at a time when Malaysia was emerging from its economic crisis.

Mugabe told a press conference during a break at LID99 that Zimbabwe was interested to learn from Malaysia 's experience in handling attacks by currency speculators. He said Zimbabwe had a similar problem whereby there had been speculation by its own commercial banks on Zimbabwe dollar, which had resulted in its currency being depreciated by some 50%.

"These commercial banks are not really owned by Zimbabwe as they are actually foreign banks set up in our country. They started speculating on our currency and withholding foreign currency instead of releasing it to importers and this has created a tremendous impact on our currency," he said.

Mugabe said that the speculation had resulted in reduced export earnings for Zimbabwe and the country was now working towards putting in place the necessary measures to emerge from the crisis.

"Therefore Malaysia 's experience is very apt and very relevant to us. We have been studying how Malaysian institutions are being organised to withstand the ringgit depreciation," Mugabe said. "We want to seek a solution and to put in place measures that we feel in the future can put us in more prepared situation should the problem recur".

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4. **Japanese l**aud Malaysian capital control measures

A high–level of Japanese delegation to Malaysia said the country's capital controls have proven effective in generating economic recovery.

Toyota Motor Corporation Chairman, Hiroshi Okuda said that Japanese investments in Malaysia had slowed down due to the crisis that was not due to Malaysia's capital controls. He said that Malaysia's capital controls would not affect investment decision pertaining to the country.

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5. Recovery impressed **World Bank**

The World Bank had described Malaysia's quick recovery from recession as impressive and Credited the Government for its good administrative capacity in pulling the country out of the Financial crisis, which hit not only Malaysia but also other countries in the region When presenting the Bank's annual World Development Report (WDR) 2000 here on 15 September 1999, its chief economist Joseph Stiglitz said the adverse effects "predicted or wished upon Malaysia" following its imposition of capital and currency controls had not occurred.

"Foreign Direct Investments in Malaysia is not adversely affected at all by the control measures," said Stiglitz who also noted that there was no disturbance to the market when Capital controls were lifted in September.

He said the exit tax allowed a smooth exit for foreign investors.

According the WDR, recent cross-country studies had little effect on economic growth. Malaysia's GDP which contracted by 7.5% in 1998, was officially projected to grow by 1.0% in 1999. Private sector estimated for Malaysia's 1999 GDP growth had gone up to 5%. Stiglitz said that there had been a very fundamental change in mindset on short-term Capital Flows.

6**. IMF** may push others to emulate Malaysia

Malaysia surprised many particularly the International Monetary Fund by imposing selective controls. But with its success, the IMF may be convinced to push neighbouring countries to follow a similar path in insulating their economies, consumerist Martin Khor said. If capital controls proved successful in the long run, then Malaysia would be free to further expand its fiscal policy by way of an expansionary budget with lower interest rates without fear of any in the exchange rates, he added. Malaysia pegged its ringgit at RM3.80 to the US dollar as part of the selective exchange controls imposed a few years ago to prevent itself from the destructive short-term capital flows. Soon after introduction of the selective exchange controls, he said there had been great improvement in the Malaysian economy and this appeared to spill over to other economies.

The IMF has now admitted that it had made a slight mistake in dealing with the Asian economies. It may be slight for the IMF but the cost to the countries of Asia is horrendous. Trillions of dollars of hard-earned assets and economic capacities have been destroyed and lost forever. In fact lives have been lost, Governments have fallen and racial animosities intensified. The partnership between neighbouring countries has been undermined and regions destabilised. Clearly the result of the small mistake by the IMF is anything but small. It has destroyed the work of decades of a huge chunk of the world.

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7. Adopting fixed exchange rate to build prosperous Southeast Asia

Yohshira Kunio in his book entitled “Building a prosperous Southeast Asia” came out with a number of proposals to build those affected nations in the crisis.

One of the proposals is “Adopting a fixed exchange rate”

The great advantages here are

i)to prevent the government from messing up the economy by mismanaging monetary affairs

ii)to promote foreign trade and capital transaction by eliminating foreign exchange risk.

In particular, domestic entrepreneurs can have access to the cheaper sources of funds due to the elimination of foreign exchange risks. The cost of hedging which is required under the present system makes it more expensive to borrow from abroad.

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8 Rudolf Staud, **Swiss Ambassador to Malaysia:**

"We will continue to be one of Malaysia's major investors. Now, we are fifth after Taiwan and Germany. Since 1993, our investments have increased by RM2.5 billion.

Last year, our firms invested close to RM63 million, ...Our firms are here to stay. We will continue to remain active with our investments. This is because we are confident the Malaysian Government can deal with the crisis, like what it has proven so far." January 30, 1999

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9. "I think the Malaysian economy is stabilising. There is a marked difference in the situation now compared to last year. We can expect some growth this year." **Director at Kleinwort Benson, Choong Kuat Hock.**

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10. "Foreign funds are getting more interested [in the Malaysian stock market]. They are dramatically underweight [in Malaysia] at the moment..."

Asian Wall Street Journal, 25 January 1999

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11. "Malaysia has raised much of the $16 billion it needs to reflate its economy, despite negative outlooks by international rating agencies. And capital controls have not given rise to a black-market. Since September, reserves have risen by almost $6 billion, to $27 billion, while the benchmark composite index of the stock exchange has doubled. Manu Bhaskaran of SG Securities thinks that the economy could grow at more than 2% this year, way up from the 7% contraction it is expected to report for 1998."
Far Eastern Economic Review, 21 January

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12. **Andrew Crocker, general manager of the Bank for International Settlements**, at a meeting of 17 central bankers from the US, Europe and Asia:

"The discussion implied that the crisis was now on the mend... I sensed a degree of optimism that the worst had now happened and the financial situation had now improved." This would pave the way for economic recovery.
Excerpt from "Bankers hopeful Asia crisis has bottomed out", Financial Times, January 12, 1999

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13. **Lim Beng Leong**, Banking Analyst at Kay Hian, a Singaporean stock broking firm: said that the worst is over for Malaysian banks and it has lifted its grading on the Malaysian financial sector from underweight to overweight...[Malaysia] had made a lot of progress since the imposition of capital controls in September.

Malaysia was undertaking reforms in its own manner and had made more progress than Thailand and Indonesia in recapitalising the banking system so far.

Excerpt from "The Worst is over for Malaysian Banks, says major Singapore brokerage",
The Star, 12 December 1998

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14. Warburg Dillon Read: Malaysia:
Financial Sector Restructuring Proposals – best seen in the region to date...
We are going to swallow hard and type some words we have not used for a number of years now: "We could be getting more optimistic about Malaysia." There, we said it. The latest proposals to restructure Malaysia's financial sector seem pretty good - indeed a lot better than anything else we have seen elsewhere in the region... The reasons would be
1) Malaysia has significantly lower levels of foreign debt;
2) its domestic debt is far more concentrated in the hands of a few private sector (and often well connected) players - corporate indebtedness is far more endemic elsewhere; and
3) the regulatory authorities at BNM have always had a better handle on what was going on and have been fighting a rearguard action against the system's problems for at least half a decade. December 9, 1998

15**. Graham Fry, British High Commissioner,** when speaking on four British conglomerates' intention to make bigger investments in power generation and cement production in Malaysia:

"Interest by British companies in Malaysia has not deteriorated despite the country being caught up in the regional economic crisis. These companies are taking a long term view of the future prospects for Malaysia."
The Sun, November 21, 1998

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16. **Paul Krugman (1998)** has argued that countries facing major crisis might benefit from temporary imposition of controls on outflow, by giving the country the time to lower their domestic interest rates and put into place a pro-growth package.

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17. **Prof. Thomas DeGregori,** an economist at the University of Houston, said Malaysia's success "speaks for itself". He said Prime Minister of Malaysia has made his case and the short-term controls have worked.
New Strait Times-September 3, 1999.

18.**Zhao Jianping, China's deputy director-general state administrator of foreign** exchange, said history would judge the courageous efforts of the Malaysian government"

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19. **Special Advisor to the Japanese Minister of Finance Dr.Eisuke Sakakihara** led a number of international speakers who endorsed the selective capital control regime adopted by the Government to encounter the effect of the Asian crisis.
New Strait Times- September 3, 1999

20**. Joseph Stiglitz, World Bank senior vice-president**:
"It [the introduction of capital controls] was not an anti-foreign capital move, it was an anti-speculative hot money capital move. In a world in which it was very clear that those kinds of money moving in and out of a country could give rise to enormous economic cost to the society, it seems to me, not an unreasonable experiment.
Excerpt from "World Bank To Study Malaysia's Capital Controls"
(Bernama) - 19 Oct 1999

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21. **Michael Hague, Chief Executive Officer Standard Chartered Bank Malaysia:**
"We remain positive about the prospects of the Malaysian economy. There is still potential for long term growth, especially in the banking sector."
Excerpt from "Exciting times for financial sector" (The Star) - 28 December 1999

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22. **J. M. Clegg, Vice-Chair and CEO, US Export-Import Bank:**
"The Malaysian economy is starting to pick up and we are very optimistic, especially if the numbers of the third-quarter continue for the next two quarters,"
"..We see some healthy growth and that is one of the reasons why we are here to do more,"
Excerpt from "US bank offers US$1.5b finance for local firms" (The Star) - 10 December 1999

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23 Clyde Prestowitz, president of the Economic Strategy Institute in Washington, DC.:

"Not only is Malaysia recovering nicely, it is arguably doing better than any other Asian country,
what sets Malaysia apart is the greater speed and extent of its reforms, and the strength of its economic structure."

Excerpt from "A lesson in home remedies" (Financial Times) - 17 Nov 1999

24**. David Emery, Dun & Bradstreet vice-president and managing director for Asean and South Asia:**
"The whole of 1999 is a masterpiece of a turnaround. The government deserves credit but I must compliment the Malaysian business community which made full use of the government's measures such as the ringgit's peg especially for manufacturers to drive exports and seize the market share from surrounding countries such as Taiwan and Singapore.
"It was really a piece of teamwork between the business community and the government,"
Excerpt from "Survey: Confidence in Msia still strong"
(Bernama) - 4 November 1999

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25. **Chris Durbin, Chief Investment Strategist, JP Morgan:**
"We have moved to increase our investments in Malaysian equities based, not necessarily on valuations, but the dynamics of putting it back in the [MSCI] index and its realistic recapitalisation plan,"
Excerpt from "JP Morgan putting more money into KL equities", Singapore Business Times - 7 September 1999

26**. Tan Min Lan, Economist, Merrill Lynch:**
"The rebound in Malaysia is stronger relative to the region,..
"It's not just exports but imports are also turning around. Capital goods import is up for the first time in two years and statements from big companies like Komag and Western Digital show that Malaysia is attracting some high quality foreign direct investments,"
Excerpt from "Malaysia's strong surplus sustainable: Analysts",
The Star - 3 September 1999

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27. **Goldman Sachs Quarterly Report**:
"While January economic indicators might raise doubts about economic recovery, we are more reassured by the aggressive pace at which financial and corporate restructuring are being tackled with little political interference,"
"We continue to favour Malaysian credits despite the sharp tightening already seen. The equity market should also exhibit a pick-up this year given the prospects of better economic performance, lower interest rates and the recent inclusion of Malaysia's equity market in major benchmark indices,"
Excerpt from "Goldman Sachs gives the thumbs-up to Malaysia reforms"
(The Star) - 14 July 1999

28**. Mark Carawan, managing partner of Arthur Andersen's emerging markets and financial sector restructuring:**
"Asian economies need to look like Malaysia, who without international intervention, has taken care of reviewing its financial sector through locally adapted structures,..
"Malaysia, to a point, anticipated challenges facing the economy and set out contingency plans unlike countries like Thailand and Indonesia,"
Excerpt from "Asian govts urged to emulate Malaysia" (BT) - 1 July 1999

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29. **A.T. Kearney, US Management Consultancy survey of foreign direct investment by multinationals**, published in June: "Malaysia, Hong Kong and the Philippines have all regained a place in the top 25 investment destinations."
Excerpt from "Investment in Asia returns to favour", Financial Times, 28 June 1999

30**. Datuk Jorgen Bornhoft, President, MICCI:**
"The last two months have been very encouraging. It showed that Malaysia is bouncing back from the economic crisis"
Extract from "MICCI: Malaysia is bouncing back" (NST) - 16 June 1999

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31. **Mr Song Seng Wun, regional economist** with Singapore brokerage house G.K. Goh Holdings:
"Strong manufacturing growth for March and April means that Malaysia's economic recovery is solidifying much more quickly than anticipated,"
Excerpt from "Economists bullish about economy" (BT) - 11 June 1999

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32. **Chris Palmer, Gartmore Asset Management**:
"In certain aspects, Malaysia appeared to have sailed through the crisis. Our assessment is positive and we are hanging on to our Malaysian shares."
Excerpt from "UK firm won't reduce investment in KLSE" (NST) - 20 May 1999

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33. **James D. Wolfensohn, President, World Bank:**
He said he was able to congratulate the Minister for the economic recovery that had been made in Malaysia.
"I am delighted to see that so many of the statistics have improved, and they have moved so much better,"
Excerpt from "Thumbs up from World Bank" (NST) - 15 May 1999

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34 **Simon Davies, Regional Director for Asian-Pacific Region, Scott Wilson (M) Sdn, Bhd. :**
"The government's balanced package of measures has proved to be effective in pushing Malaysia out of the economic crisis,"
Excerpt from "Infrastructure firm bullish on Malaysia" (The Star) - 30 April 1999

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35. "**The United Nations Development Programme (UNDP)** sees confidence returning to Malaysia and the other countries in the region as indicated by the gradual increase in the inflow of foreign direct investments (FDIs)."
Excerpt from "UNDP sees investors' confidence returning to Malaysia", (BT) 9 April 1999

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36. "Indeed while some in the market have real GDP forecasts as high as 3%, the [**Bank Negara Annual**] report has a more modest view of 1%. HSBC Economics forecasts 1.5%. The credit positive view is that given the conservative estimate, there's likely to be more upside surprises than downside ones. Hence the bullish view for Malaysia."
HSBC Markets Asian Credit Investment Daily 1 April 1999

37**. BG Lee Hsien Loong, Deputy Prime Minister, Singapore:**
"Malaysia's economy looks as if it is stabilising and is gradually on the mend."
Business Times Singapore, 31 March 1999

38**. Margaret Chin-Wolf, senior fund manager at Pauli Investment Management, Singapore:**
"This would be seen as positive because sentiment has turned around 180 degrees in recent months.
Fewer people dispute that Malaysia is doing something right. They are tackling their problems."
Reuters reporting of analysts' reaction to Bank Negara's annual report, 1 April 1999

39. **Don Hanna, Goldman Sachs executive director of South-East Asia Economic Research:**
"We continue to favour Malaysian credits, despite the sharp tightening already seen. The prospect of better economic performances, lower interest rates, and inclusion in major benchmark equity indices should also help the equity market,"
Excerpt from "Conditions favour economic recovery"(BT) 27 March 1999"

40. "In reassessing the sovereign's fundamentals, we find the case for an upward adjustment to Malaysia's credit rating compelling.
"A rating in the range of BBB flat to BBB plus is a more accurate reflection of Malaysia's current default risk."
Excerpt from "Malaysia poised for credit rating upgrade by year-end (BT) 26 March 1999"

4.3 Summary and Analysis of Foreign Comments

No	Names	Position/ Company	Dates	Comments	Implications
1	Lee Kuan Yew	Singapore Senior Minister	July, 1999	Stopped tyranny of hedge funds	Capital controls were working
2	Paul Chiu	Taiwan's Finance Minister.	July, 1999	Taiwan government was impressed	Capital controls were effective
3	Dr. Robert G. .Mugabe	Zimbabwe	July, 1999	Zimbabwe adopted Malaysia measures	Good Model
4	Hiroshi Okuda	Toyota Motor Corporation Chairman	Sept, 1999	Controls had proven effective	Capital controls were effective
5	Joseph Stiglitz	World Bank	Sept, 1999	Quick recovery-impressive	Recovery was real
6	Martin Khor	Director, World Network	Sept, 1999	IMF pushed others to follow Malaysia	It was working
7	Yohshira Kunio			Fixed. Exch. Rate built Southeast Asia	It worked
8	Rudolf Staud	Swiss Ambassador to Malaysia:	Jan. 1999	Confidence in Malaysia	Capital Controls worked
9	Choong Kuat Hock	Director at Kleinwort Benson		Malaysian economy was stabilising	It was working
10		Asian Wall Street Journal	Jan. 1999	Foreigners interested in Malaysia	Capital controls were effective
11		Far Eastern Economic Review	Jan. 1999	Reserves had risen	It worked
12	Andrew Crocker	General manager of the Bank for International Settlements	Jan. 1999	Sitiuation improved	Capital controls were effective
13	Lim Beng Leong	Banking Analyst at Kay Hian, a Singaporean stock broking firm:	Dec. 1998	Had made a lot of progress	It worked
14	Warburg Dillon		Dec. 1998	Best measure seen in the region	It worked
15	Graham Fry	British High Commissioner	Nov, 1998	British were not deterred away	Capital controls were effective

16	Paul Krugman	Economist at the University of Houston,	1998	Countries benefit from the controls	It Worked
17	Prof. Thomas	Univ. of Houston	Sept. 1999	He said Prime Minister of Malaysia had made his case and the short-term controls had worked.	It worked
18	Zhao Jianping	State administration Foreign		History would judge the courageous efforts of the Malaysian government	It was Effective
19	Dr.Eisuke	Advisor of Japan Ministry of Finance.	Sept. 1999	Led a number of international speakers who endorsed the selective capital control regime adopted by the Government to encounter the effect of the Asian crisis.	It worked
20	Joseph Stiglitz	World Bank senior vice-president:	Oct 1999	Not an unreasonable experiment.	It was effective
21	Michael Hague	Chief executive officer Standard Chartered Bank Malaysia	Dec. 1999	We remain positive about the prospects of the Malaysian economy	It worked
22	J. M. Clegg	Vice-Chair and CEO, US Export-Import Bank:	Dec. 1999	We see some healthy growth.	Good Sign
23	Clyde Prestowitz	President of the Economic Strategy Institute in Washington, DC.:	Nov 1999	Not only is Malaysia recovering nicely, it is arguably doing better than any other Asian country.	It was Effective
24	David Emery	Vice-president and managing director for Asean and	Nov. 1999	The whole of 1999 is a masterpiece of a turnaround. The government	It worked

		South Asia:		deserves credit. I must compliment the Malaysian business community which made full use of the government's measures such as the ringgit's peg especially for manufacturers to drive exports	
25	Chris Durbin	Chief Investment Strategist, JP Morgan:	Sept. 1999	We have moved to increase our investments in Malaysian equities	Capital controls worked
26	Tan Min Lan	Economist, Merrill Lynch	Sept. 1999	The rebound in Malaysia is stronger relative to the region,..	A good Sign
27	Goldman Sachs	The Star	July 1999	We continue to favour Malaysian credits despite the sharp tightening already seen.	It worked
28	Mark Carawan	Managing partner of Arthur Andersen's emerging markets & financial sector restructuring:	July 1999	Asian economies needed to look like Malaysia, who without international intervention had taken care of reviewing its financial sector through locally adapted structures	It worked
29	A.T. Kearney	US Management Consultancy survey of foreign direct investment by multinationals	June 1999	Malaysia, Hong Kong and the Philippines had all regained a place in the top 25 investment destinations	Capital controls were effective
30	Jorgen Bornhoft	President, MICCI:	June 1999	The last two months have been very encouraging. It showed that Malaysia is bouncing back from the economic crisis	It worked
31	Song Seng	Regional	May	Strong	It worked

	Wun	economist with Singapore brokerage house G.K. Goh Holdings:	1999	manufacturing growth for March and April means that Malaysia's economic recovery is solidifying much more quickly than anticipated	
32	Chris Palmer	Asset Management.	May 1999	Malaysia appeared to have sailed through the crisis. Our assessment is positive and we are hanging on to our Malaysian shares	Effective
33	James Wolfensohn,	World Bank	May 1999	Congratulate the Minister for the economic recovery that had been made in Malaysia. I am delighted to see that so many of the statistics have improved, and they have moved so much better	The Recovery was real
34	Simon Davies	Scott Wilson	April 1999	Balanced package of measures has proved to be effective in pushing Malaysia out of the economic crisis,"	It worked
35	"The United Nations Development Programme	Business Times	April 1999	UNDP saw confidence returning to Malaysia and the other countries in the region as indicated by the gradual increase in the inflow of foreign direct investments (FDIs)	Capital controls were effective
36		HSBC	April 1999	There's likely to be more upside surprises than downside ones.	Capital controls were effective
37	Lee Hsien Loong	Deputy PM Singapore	Mar. 1999	Malaysia's economy looks as if it is stabilising	Capital controls were effective

				and is gradually on the mend.	
38	Margaret Chin-Wolf	Investment Management	April 1999	This would be seen as positive because sentiment has turned around 180 degrees in recent months.	Capital controls were effective
39	Don Hanna	Economics Research	Mar. 1999	We continue to favour Malaysian credits	Capital controls were effective
40	Business Times	Business Times	Mar. 1999	"A rating in the range of BBB flat to BBB plus is a more accurate reflection of Malaysia's current default risk."	Capital controls were effective

4.4 Principal Findings

Findings of Primary Data

With reference to the outcomes and analysis of the survey result, it clearly showed that the Selective Control Measures had worked. The conclusion here is the Selective Control Measures were effective in helping Malaysia to recover from the financial crisis.

Findings of Secondary Data

Based on the collection of Local as well as Foreign comments given from different walks of life from laymen to Prime Minister, one can say there are many positive comments indicating the success of Selective Control Measures in helping Malaysia out of the Financial Turmoil. The Comments given here are one type of evidence to support the effectiveness of the Control Measures. If there is no success of Control Measures, then economists, bankers, businessmen, politicians and International Organization Officers would not be able to give such positive comments especially by the Foreigners. There must be some truth in such reports especially these comments given by professionals as well as high administrative personnel.

In short, the Selective Control Measures had worked and were effective too.

Summary and Conclusion

All the 20 Local and 40 Foreign comments from laymen to minister, locally as well as abroad fully supported the Selective Control Measures. The Control measures have worked and the economy of the country has recovered.

One simply could not ignore or deny 60 quotations made by prominent people from different walks of life on the effectiveness of the Control Measures.

Rational of such Positive Comments

The recovery was largely the result of a series of measures including the adoption of an expansionary fiscal policy, an easing of monetary policy as well as the adoption of selective controls since Sept 1, 1998. All these were done to insulate the Malaysian economy from externally generated risks and vulnerabilities. It was implemented to restore stability, revive economic activities and strengthen the resilience of the economy. Real Gross Domestic Product had recovered with an annual growth 4.1% in the second quarter of 1999 and registered even higher growth in the second half of the year. For the whole of 1999, a real GDP growth of 4.4% was recorded. The Balance of Payments recorded a significantly large surplus and had contributed to the significant increase in the nation's external reserves. Investor confidence had also been restored as stability returned to the financial markets, following the imposition of selective controls, improvement of economic fundamentals and the introduction of measures to strengthen the banking system. The benchmark index of the Kuala Lumpur stock exchange and market capitalisation had more than doubled since Sept 1, 1998 resulting in a positive wealth effect for the economy. This coupled with higher disposable income and a prevailing regime of low interest rates, which had led to recovery in private consumption.

All these positive developments have broadened the base of the economic recovery and provided a stronger foundation for the economy to return to the path of strong and sustainable growth in the millennium.

Strengths of Selective Control Measures

Introduction

There was gradual change or outlook towards the Selective Control Measures.

Early prognostications of impending doom was gradually replaced by more upbeat projections as it became clear that Malaysia was recovering rather than sinking deeper into crisis.

"…..a strong economy recovery is also now underway in response to fiscal and monetary stimulus.." (WEO, October 1999,p 19)

Strengths of Capital Control Measures

To understand the sign of success of Selective control, one must first look at the strength of the Capital Control measures

There are many positive things one can say about ringgit controls.

1. It protects the economy from the adverse external influences emanating from the forex markets by stabilizing the ringgit.

2. It forces the ringgit parked abroad to be brought home before the end of September.

3. It eases liquidity shortage in the banking system and keep interest rates low

4 It defuses inflationary pressures by keeping imported inflation at bay

5 It makes more domestic resources available for implementing the National Economic Recovery Plan, especially Danaharta and Danamodal which have been established to buy non-performing bank loans and recapitalise the banking system.

6 It revives up the economy by removing the credit crunch that had had a debilitating effect.

7.It induces redundant foreign workers to return home, thereby creating jobs for retrenched Malaysian workers.

Strengths of the Currency Peg

The currency peg has been a major help in the recovery process

It brought the following benefits

- It allowed the Government to break the line between interest rates and exchanges rates, thus allowing us to lower interest rate without sending ringgit into another downward spiral

- It made our exports more competitive. Merchandise exports became cheaper in terms of US dollar. Imports became more expensive in terms of ringgit. This reduction in imports and increase in exports turned the current account of the balance of payments a surplus
- A cheaper ringgit brought in more foreign tourists. Malaysians found it expensive to holiday abroad and opted for local holiday sites
- Labour costs in terms of US dollar were cheaper, making the country more attractive for investment in export-orientated industries.

4.5 Signs of Recovery

The measures implemented are showing positive results and contributing towards the restoration of public and investor confidence. There are **17** signs of recovery which have been collected and analysed as supporting evidences.

1. Recovery in the Real Economy

Initial signs of recovery in domestic demand particularly private consumption are becoming evident in the increase of car sales.

Evidences (Sales of Vehicles)

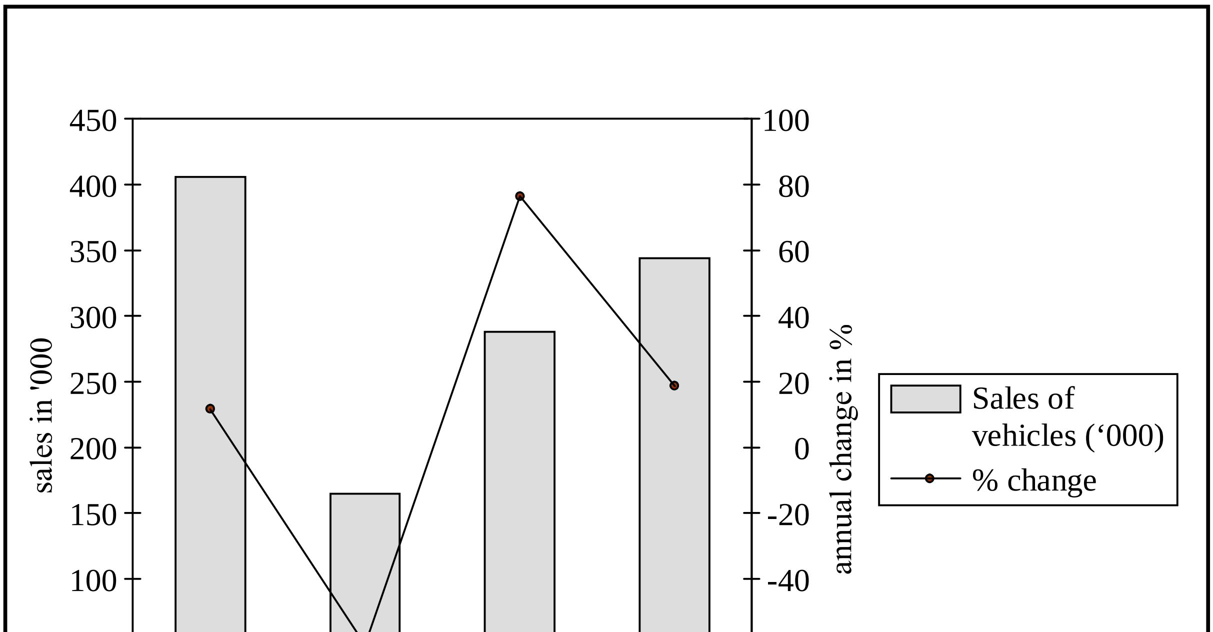
One of the corresponding effects of a growing economy is that it can spur consumption and promote investment. With this in mind, one can look at the sales of vehicles. The number of new vehicles sold had increased from
12,883 units in September 1998, 14,232 units in October 1998
19,081 units in November 1998, and finally to 20,694 units in March 1999.
With reference to Graph 1,the percentage change of sales were as follows:
Table 1: Sales of Vehicles and their percentage change:

Year	Sales of Vehicles	% Of change
1997	404,000	11.3
1998	163,000	-59.6
1999	228,000	76.7
2000	343,000	19.1

Source: The Star – December 2001

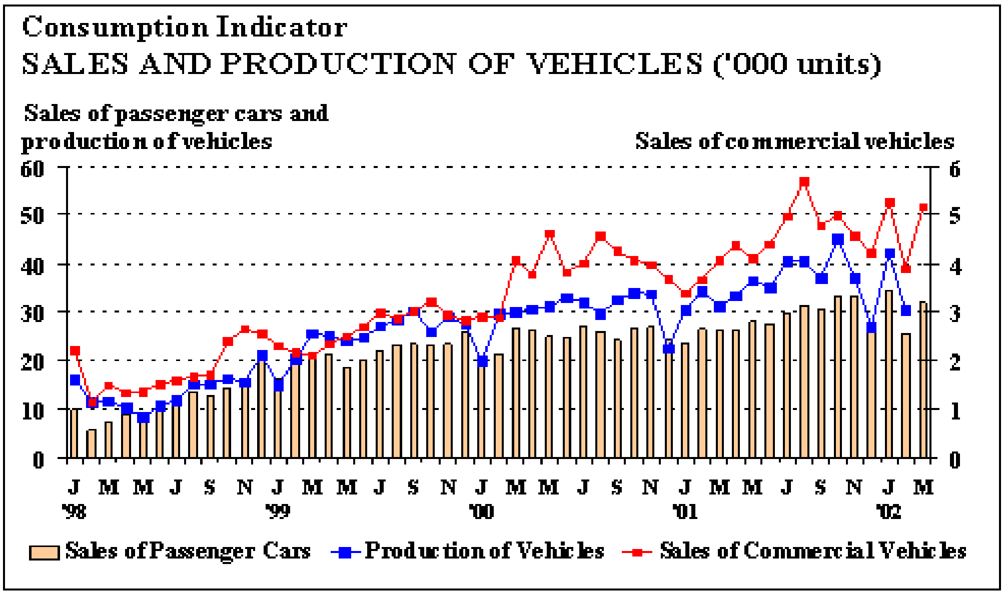
This reflects improved consumer confidence in an environment of higher disposable income, low interest rates as well as favourable employment prospects which point to a much improved economy.

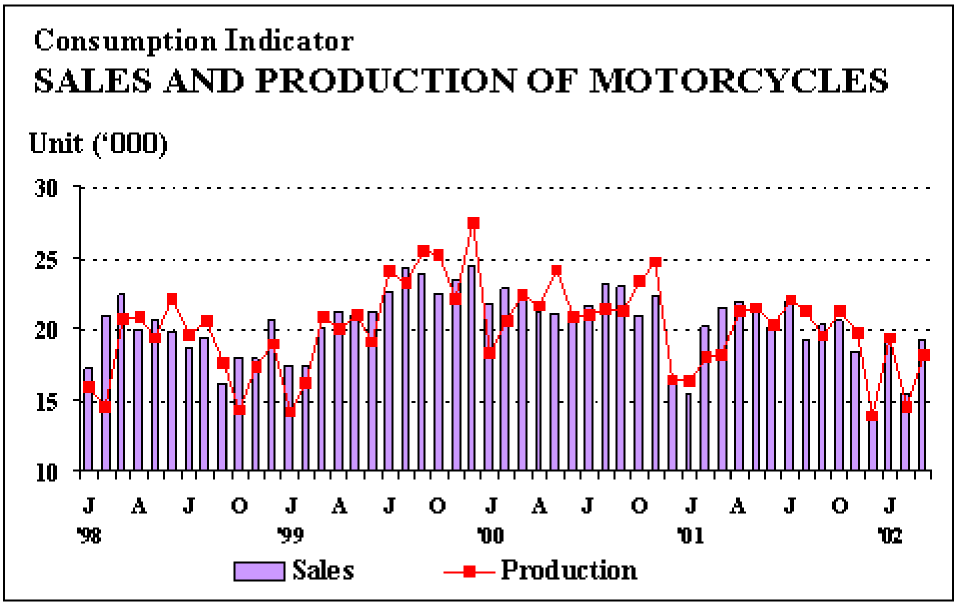
Graph 1
Sales of Vehicles
1997-2000



Source: The Star- December 24, 2001

Graph 2

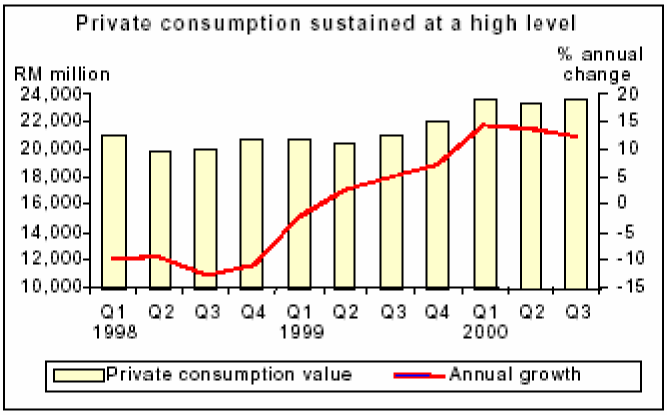




Source: Economic Planning Unit of Prime Minister's Department

Private consumption grew by 12.1%. Growth in private consumption was largely due to the Selective Control Measures that had resulted in higher disposable income, lower interest rate and better employment prospects.

Graph 3

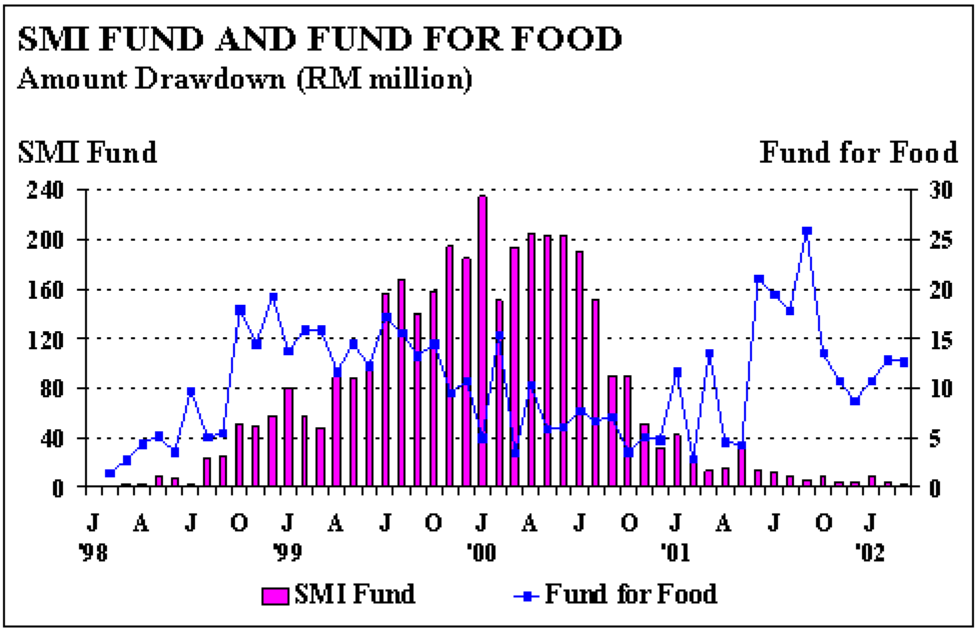


Source: Bank Negara Malaysia (29 November 2000)

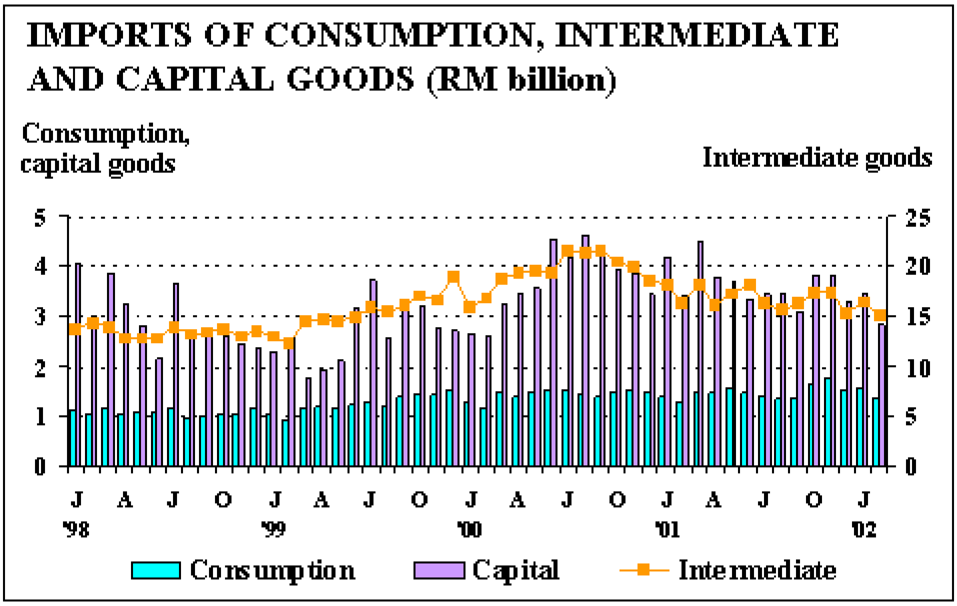
The strong retail sales performance was seen in a number of survey data. The Consumer Sentiment Index compiled by the Malaysian Institute of Economic Research rose by 5 points from the 2nd quarter to 126 points in the 3rd quarter of 1998. Consumers' indicators such as sales and loan disbursements for consumption credit continued to show a favourable trend. The findings of Malaysian Retailers' Association also indicated that the one-month nation-sales by 19.4% which helped to spur the growth of the retail industry to by 8-11% for the quarter.

There is a great disbursement of loans for purchase of residential properties. It was also reflected by the RM3.5 billion worth of property sales which was achieved during the Home Ownership Campaign between 12 December 1998 and 12 January 1999. The increase in stock prices since September 1998 had a positive wealth effect. Total outstanding loans issued by the banking system for the purchase of residential property had increased at an average of 0.7 % per month between January and December 1998. The recovery in private investment is reflected by the increase in the utilization of funds supervised by Bank Negara Malaysia as well as the increase in total loan approvals by the banking system, particularly for manufacturing and construction. The number of disbursements for the SMI Fund and Fund for Food had increased at an average of RM52.8 million and RM17.2 million per month respectively between October and December 1998. Measures introduced to increase liquidity and lower interest rates provided the enabling environment for the gradual improvements in investor sentiment. The fall in the NPL ratio in September 1998, the first time since the onset of the crisis is expected to further promote lending by the banking system.

Graph 4: a) SMI Fund and Fund for food



b) Imports for Consumption, Intermediate and capital goods



Source: Economic Planning Unit of Prime Minister's Department

Table 2 -: Sources: - Bank Negara, official sources, IMF & DataStream

Economic and Financial Indicators				
Economic Indicators	Malaysia	Thailand	Indonesia	S.Korea
Real GDP growth (2nd Qtr 1999)	4.1	3.5	1.8	9.8
Inflation (Sept)	2.1	-0.8	1.3	0.8
Export Growth (US$ Sept)	12.6	11.4	12	11.8
Import Growth (US$ Sept)	17.1	31.6	-9.3	40
Trade Balance (US$bn Jan-Sept)	13.8	7.2	17.6	17.4
Industrial Production	17.4 (Aug)	15.4(Sept)	n.a	18.1(Sept)
Capacity Utilization	81(2nd qtr)	61.5(Aug)	n.a	79.1(Sept)
Unemployment (% of total labour)	3.3(2nd qtr)	5.3 (May)	24.0 (1999f)	5.2(Sept)
Financial Indicators	Malaysia	Thailand	Indonesia	S.Korea
NPLs (% of total loans)	7.9*	45.8(Aug)	n.a	11.3(June)
3-month interest rate (end October)	31.5	4.25	15.66	7
Foreign Exchange Reserves (US$bn)	30	32.4	16.01	66.2
(As months of imports)	6.2(Oct)	8.9(Sept)	7.9 (Sept)	7.1(Oct)
Cost on Bank Restructuring	Malaysia	Thailand	Indonesia	S.Korea
In US$bn	15.8	40.4	65.8	53.7
As % of 1998's GDP	21.1	31.1	87.9	15.2
Cost on Financing Recovery	Malaysia	Thailand	Indonesia	S.Korea
In US$bn	4.9	5.5	10.8	32.1
As % of GDP	3.2	6.4	3.9	4.5
* Refers to 6-month classification				

3-month classification=12.4%

Analysis of Table 2

Based on data obtained by November 1999,not only had Malaysia recovered, the economy was expected to register a stronger growth of 7.2% in the second half of 1999.

This was a dramatic turnaround of 11.8% points in a short period from 7.5% last year. What was even more significant was that the recovery was broad-based, achieved in an environment of low inflation and domestic economic activities. Per capita purchasing power parity had improved by 4.4% to US$8,604; the highest increase when compared with the other crisis-hit the countries in the region. As Rouches's forecast had been proven, with Malaysia clearly on the road to recovery, his argument now was that other countries in the region had also recovered.

According to the World Bank Poverty Update released in June, there was a significant increase in poverty in urban South Korea, which was increased by 10,6% points of the population, In Indonesia it increased by 8.9% points and in Thailand it increased by 1.5% points. In Malaysia the financial sector was in a much stronger position even before the crisis. At present (November 1999) the level is much lower in Malaysia, even when the three-month classification is used.

In Thailand the NPLs at the end of August stood at 45.8% of total loans against Malaysia 's 12.4%, (7.9% if the six-month classification is used and in South Korea the figure is 11.3%

Analysts said Malaysia's announcement of 4.1% gross domestic product growth for the second quarter confirmed their assessment that Malaysia is finally out of a recession and that recovery will gain momentum. JM Sasson & co (Pte

Ltd) group chief economist Liew Yin Tze said that Malaysia's recovery is robust especially when compared with others in the region. The domestic and external sectors are both growing strongly. "From the current mix of external and domestic factors, it is unlikely that anything big will derail the economy. The whole region is recovering and Malaysia is not going to miss out on the action", he added.

Since September 1998, industrial production has increased more than 8% despite dropping significantly after controls were initially applied.

All other indicators show that the economy is now improving rapidly and it is expected that the target of 1% growth in the gross domestic product for 1999 will be achieved easily. The controls have apparently succeeded in bringing about the recovery of the Malaysian economy.

Key Sectors Growth

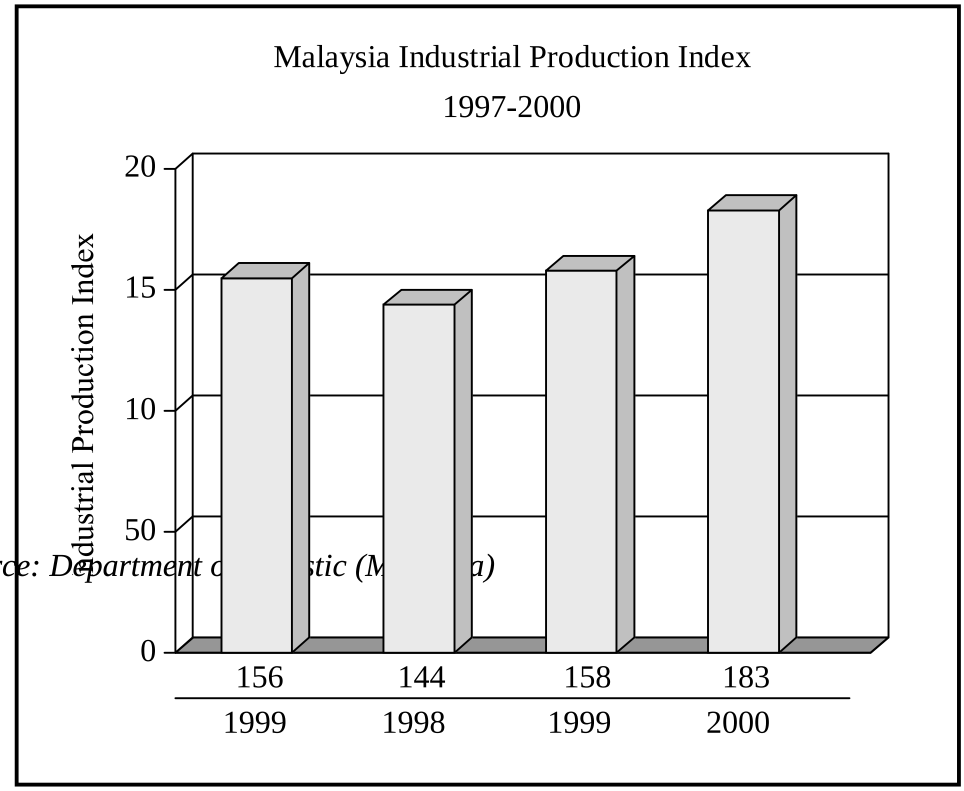
As much of the economic performance of a trade-orientated economy like Malaysia is tied to the performance of its key sectors output as they contribute to the overall GDP, a look at their performance would help us to see whether the economy has improved or otherwise

Reflecting a significant increase in external demand for electronic components and semiconductors as well as sustained strong domestic demand, the production volume as measured by the industrial production index grew significantly to close at 183.9 in 2000 (Graph 2) after declining to 144.9 during the crisis in 1998. Manufacturing output expanded significantly thus contributing to higher value-added growth of 13.5% in 1999 and 21% in 2000 (Graph 2) The strong expansion in manufacturing output enabled the sector to strengthen its position as the leading contributor to GDP increasing from 30% in 1999 to 33.4% in 2000.

In tandem with the significant improvement in economic activities in the major sectors of the economy the services sectors also recorded a stronger growth of 3.3% in 1999 and 4.7% in 2000 as compared to 0.7% in 1998 (Graph3) This has been due to higher external trade, increased momentum of manufacturing activities, increased consumer spending and higher tourist arrivals (796,900 in 1999 and 1,042,600 in 2000 against 593,600 in 1998)

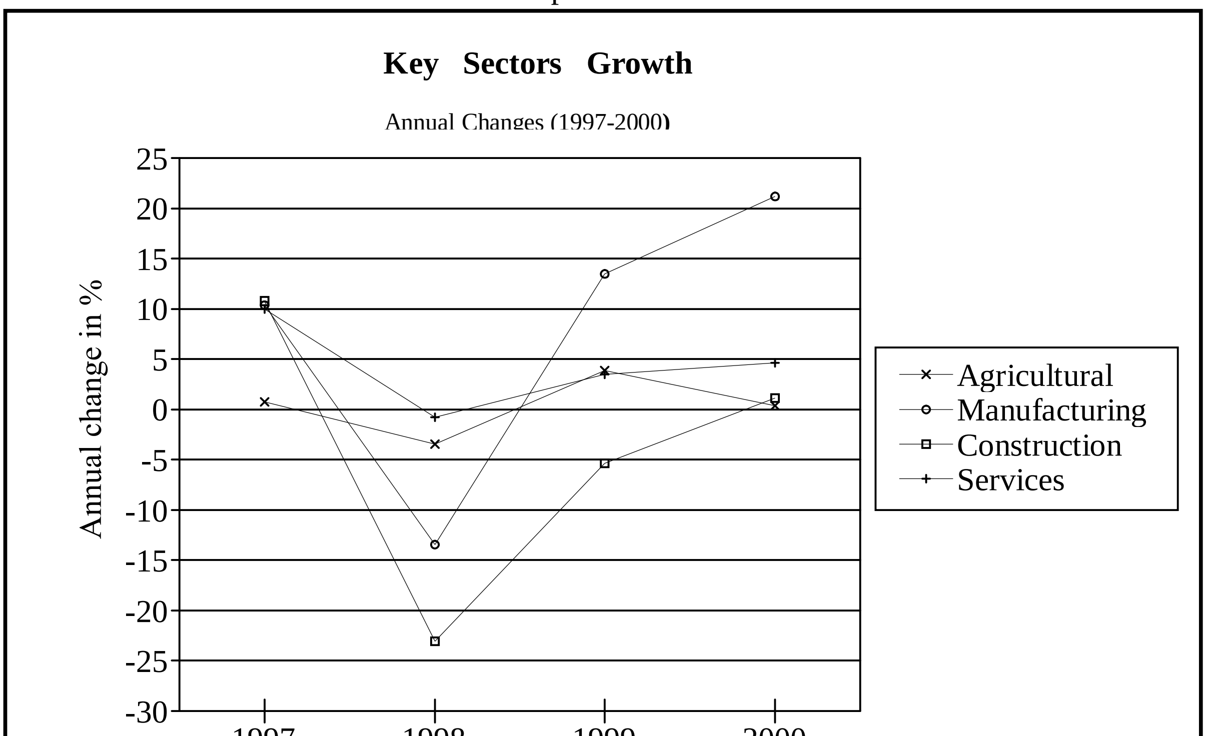
The agriculture sector too expanded to 3.8% in 1999 and 4% in 2000 (Graph3) from 3.3% in 1998. The worst hit sector of all, the construction sector which contracted 23% in 1998 and 5.6% in 1999 due to oversupply and low occupancy rates made a slow recovery in 2000 where it recorded a growth of 1.1% (Graph 3) which was mainly due to the implementation of several large public and privatised infrastructure projects and new investment in the residential sector in particular low and medium-cost houses to meet underlying demand.

Graph 5



Source: Department o stic (M a)

Graph 6



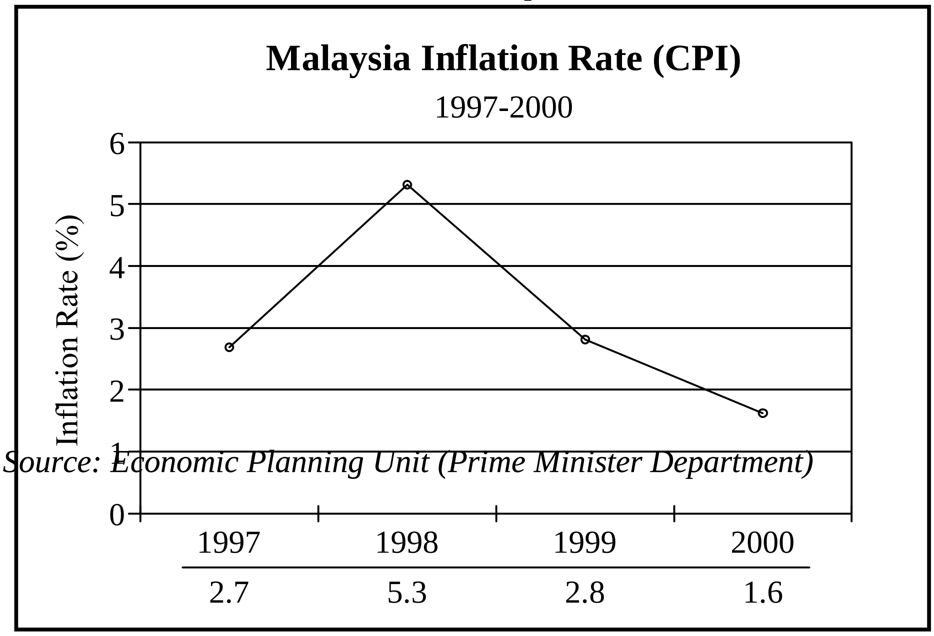
Source: Department of Statistic (Malaysia)

Inflation Rate

The annual rate of inflation has decelerated from a high 5.3% in 1998 during the crisis to 2.8% for 1999 and slid down further to 1.6% in 2000 (Graph below) Factors that contributed to the lower rate of inflation was the relative stability of the ringgit exchange rate, low inflation abroad mainly among Malaysia's trading partners, excess capacity in certain sectors of the domestic economy, expansion programmes undertaken by the sectors that were operating at close to full capacity as well as the lower prices for many commodities.

Minimal increases in the price of petroleum and the staggered implementation of bus fare increases as well as abundant food supplies throughout the year helped to contain the inflation rate at 1.6% by the end 2000 thus improving the purchasing power of the general public who in 1997 and 1998 had to live with higher prices of goods and services during the crisis.

Graph 7



Source: Economic Planning Unit (Prime Minister Department)

2. The Exports had resulted Malaysia to its 21st month of trade surplus

The Country's 21st consecutive month of trade surplus, including the RM5.8bil surplus for July is a clear reflection of the export boom it is currently experiencing.

Evidences

The trade surplus for January-July (1999) shot up to RM39.4 bil from RM13.1bil in the previous corresponding period (1998). The lower exchange against greenback made exports cheaper and attractive in the global market particularly in the Western part of the world. Exports grew in value as well as in volume. This resulted in a ballooning trade surplus for Malaysia. Apparently, the robust export performance also helped build up the foreign reserves, which were considerably low prior to the economy and financial crisis.

Malaysia was believed to have recorded the highest growth in exports among the crisis-hit nations. The record-breaking figures on container throughout and

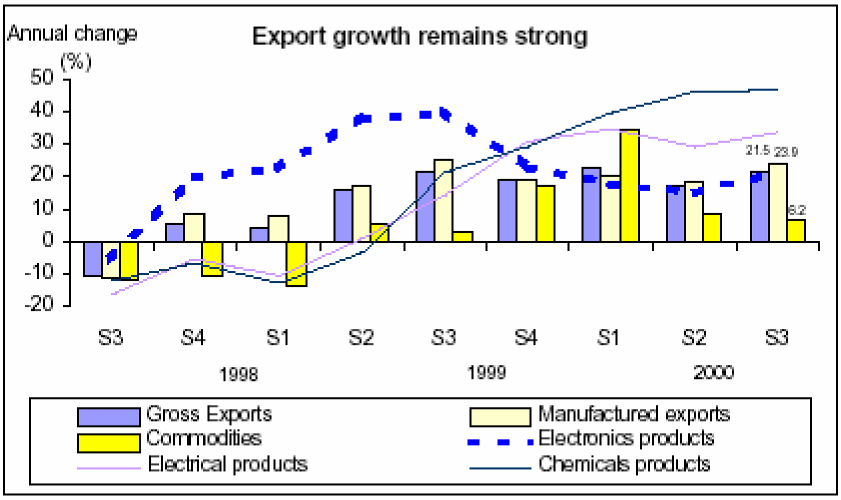
transhipment volume in Port Klang may also be an indicator of the expanding exports.
In the first 8 months of the year 1999, Port Klang's total container throughout increased by 43% to 1.61 billion TEU's from 1.13 billion TEU's in the previous corresponding period. Meanwhile, transhipment volume rose by 129% to 606,124 TEU's in January-August in 1999. The survival factor was considered as a contributing factor to the export boom. During the crisis, export-orientated activities had to be shielded from the negative impact that brought many others to their knees. This soon made the other companies realise that they had to export in order to survive.
Idec (M) Sdn. Bhd executive director "Chan Luck Seh" agreed that companies were paying more attention to export markets now than before since exports generated higher profit margin. "Export is much more active now than before the crisis. The industrial sector such as furniture and textiles were performing well and their order books were filled up," said Chan.
The weaker ringgit and the quality of goods produced had helped made-in Malaysia products find their way into the global market.
Federation of Malaysian Manufacturers (FMM) vice –president Yong Poh Kon said at a recent conference entitled Currency Stability: After 12 months that the majority of manufacturers welcomed the pegging of the ringgit to 3.80 to the US dollar because it helped to boost export earnings.
According to the Statistics Department, the country's growing trade surplus was mainly due to higher exports of electrical and electronic products particularly in the semiconductor which is experiencing a boom.
National Semiconductor Sdn.Bhd (NS) managing director Liu Chue Siak said that the company's export volume had been at its highest ever in the past 6 months of 1999.
"In the past 6 months, our quarterly export volume grew to about 10% which was considerably strong," Liu told Star Business in a phone interview.
NS produces semiconductor products for its US parent company.
Liu said the semiconductors sector started recovery in December 1998. "It is now entering into its boom period"
It is believed that the boom in this sector could be a long lasting one due to the growing demand in computer equipment and wider usage of semiconductor products in more electronic products.
Electronic and electrical products are the major income contributors to the country's exports earnings, accounting for about 60% of total exports earnings in July 1999.
The country's export had benefited from the weak ringgit but exporters should not solely rely on the currency factor.

Table 3

	Trade Performance	1999	
(RM billion)	Exports	Imports	Surplus
January	21.90	17.50	4.3
February	21.93	16.99	4.9
March	25.70	19.20	6.5
April	25.90	19.70	6.2
May	25.60	19.20	6.4
June	26.30	20.90	5.4
July	28.20	22.50	5.8

Note: Conceptually, the export and import figures in the external trade statistics are different from that in the merchandise accounts the balance of payments compilation. The July 1999 data are not fully validated; the validated data would be updated in the cumulative data in the August 1999 publication.
Source: Statistics Department

Graph 8: Export Growth remains strong



Source: Bank Negara Malaysia (29 November 2000)

Strong Export Demand
The performance of the external sector continued to remain strong as there is a strong external demand. The demand for Malaysian exports continued to be at a high level. Gross exports recorded a strong growth of 21.5% in the 3rd quarter. Exports of manufactured goods increased by 23.9% that was greatly due to both higher export volume and export prices (20.4% and 2.1% respectively)
The strength of manufactured exports was caused by the strong demand for electronics and electrical products (24.5%) and the great expansion in oil-based exports such as petroleum and chemical products. Exports also increased by 6.2% in the primary commodity sector.

3. Increase in Imports
Increase in imports was another sure sign of economic recovery, as it showed a pick-up in domestic demand. Imports are very sensitive to economic ups and downs. Imports in terms of US dollar picked up for the first time in December 1998 after many months of continuous fall.
Evidences
After September 1998, Imports have risen slowly which was certainly an encouraging sign. There was a gradual increase in imports of Consumption, capital and Intermediate goods. In August 1998, the imports of consumption goods were worth RM965 million and by December 2000, the imports of consumption goods were worth RM1461 million. The total imports were RM18,812 million in August 1998 and it went up to RM24,609 million in November,2000. The growth rate (% p.a.) of total imports was –1.0 in August 1998 and it was 43.1 by August,2000.

4. Capital Controls support the balance of payments by protecting the foreign exchange reserves by preventing outflows of domestic saving and capital flight. Capital Controls help limit volatile short-term capital flows (avoiding balance of payment crisis, and exchange rate volatility)

Evidences (BOP)

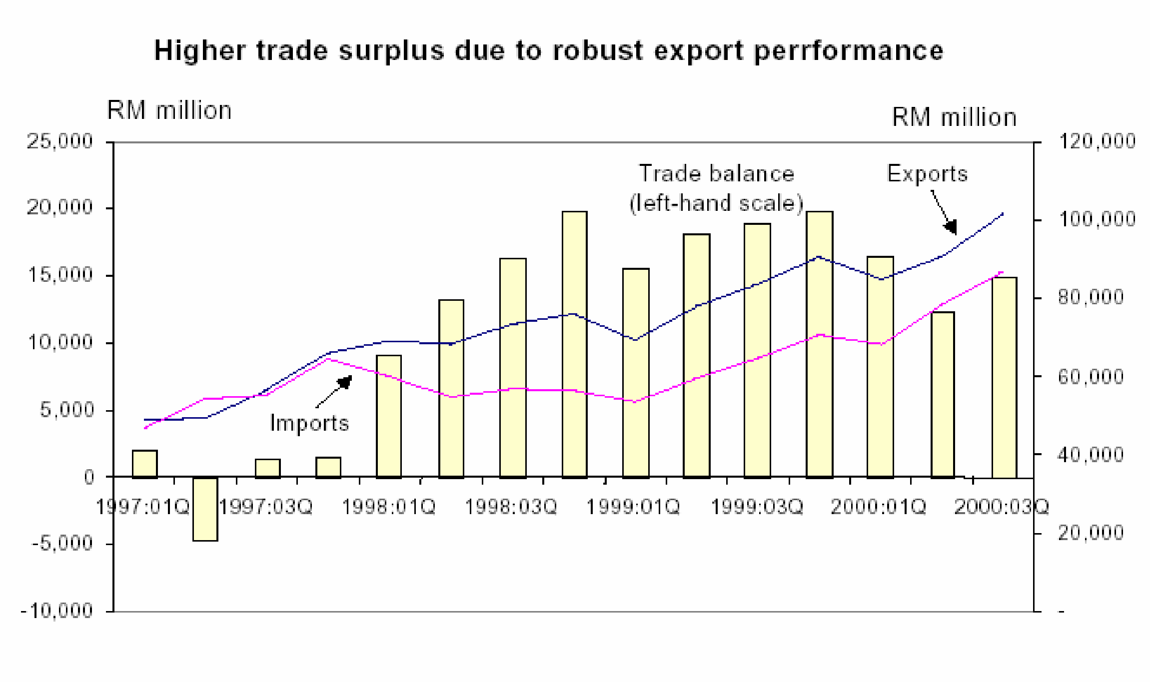
There is a greater Surplus in the Current A/C of the Balance of Payments

Controls help retain domestic savings by reducing the return on foreign assets through interest equalization tax or by raising the cost of moving funds abroad and by limiting access to foreign funds.

The current account of the balance of payments registered a surplus equivalent to 13.7% of GNP in 1998. Therefore it would allay concerns with regard to the external balances of the country and its ability to finance external commitments. The strong current account was largely due to the large surplus in merchandise trade. In terms of ringgit, the growth rate in the value of exports for 1998 registered 28.9% reflecting some extent of valuation gains associated with the depreciated ringgit. Since October 1998, there were indications of strengthening in export volume, given that growth of exports in terms of USD is positive after registering negative rates since March 1998. The fixing of the ringgit exchange rate to the USD provided a greater certainty to trade.

A trade surplus of about RM51.5 billion has been registered and this has surpassed the earlier budget of 1999-estimated surplus of RM35 billion. By the second half of 1998, a current account of surplus of about RM15 billion has been booked. The Balance of Payments, which had been in deficit for many years, was reversed into huge surpluses achieved in trade balance.

Graph 9



Source: Bank Negara Malaysia (29 November 2000)

The external sector continued to remain favourable in the third quarter. Although imports grew strongly (33.8%) reflecting improved domestic demand and investment activity, export growth strengthened further (21.5%) resulting in a large trade surplus of RM14.9 billion (second quarter: RM12.3 billion)

The Balance of payments position remained favourable with a continued large surplus in the trade balance and sustained inflows of long-term capital. In contrast to developments in 1998 when the trade surplus reflected a significant reduction (-18.8%) in imports, a fundamental strength in the trade account in 1999 and 2000 continued buoyant expansion in exports. The stable exchange trade enabled industries to respond positively to the increased export demand. The current account too remained fundamentally strong and recorded a large surplus for the third consecutive year.

The level of reserves remains high increasing to RM117.2 billion in 1999 and RM113.5 billion in 2000 from RM99.4 billion in 1998 and RM59.1 billion in 1997 (table 3) during the crisis.

The strength of Malaysia's reserves is also reflected in the adequacy of reserves to finance 4.5 months of retained imports in 2000 and 5.9 months of retained imports in 1999 as compared to only 3.4 months during the crisis.
The movement in the level of reserves for part of 1999 and in 2000 reflected underlying trade transactions and capital flows due to a stronger economy. In addition some export earnings were maintained in foreign currency accounts with banks in Malaysia. While reserves had declined marginally, Malaysia's external liquidity position had strengthened because of the decline in short term external debt.

Table 4- External Sector Indicators

	1997	**1998**	**1999**	**2000**
	RM million	**RM million**	**RM million**	**RM million**
Export of goods & services	186,449	187,415	212,484	247,037
Import of goods & services	199,655	162,212	179,778	222,137
Current account balance	-16,697	37,394	47,902	31,163
Central Bank reserves	59,123	99,424	117,244	114,541
Months of retained imports	3.4	5.7	5.9	4.5

Source: Bank Negara Malaysia

Increases in External Reserves

Proponents of capital controls argue that controls support the balance of payments by protecting the foreign exchange reserves by preventing outflows of domestic savings and capital flight. Controls help retain domestic savings by reducing the return on foreign assets through interest equalisation tax or by raising the costs of moving funds abroad and by limiting access to foreign funds.

Evidences

The external reserves of BNM increased by US$8.4 billion (RM29.4 billion) from the end of August 1998,and by end-December 1998 Bank Negara had reached about RM99.4 billion and later to a level of US$ 28.6 billion on 15 March 1999 which were adequate to finance 6.2 months of retained imports.

For almost a decade there had been a deficit in the balance of payment, but now there is a huge Surplus. Reserves have gone up from US$20 billion to US$27 billion, sufficient to sustain over five months of retained imports. The controls also improved Malaysia external accounts and the Government had managed to secure most of the US $16 billion (RM60.8 Billion) needed to spur recovery.

The Reserves of the Central Bank shot up 50% as the trade surpluses increased. The Reserves stood at US$20 billion when the controls were imposed. There was hardly any foreign debt. The huge surpluses in balance of payments have resulted the reserves to increase from US$20 bil. to US$36 bil in the space of six months.

Table 5

External Reserves as % of Gross Domestic product 1997 – 2000*

Year	Malaysia	China	Indonesia	Japan	S.Korea	Philippines	Singapore	Taiwan	Thailand
1997	30.0	15.6	15.9	5.6	6.4	11.0	84.8	32.7	26.0
1998	35.0	15.3	19.1	5.0	14.1	11.7	89.9	32.6	23.2
1999	39.0	15.6	15.4	5.9	17.5	15.8	89.3	35.9	28.3
2000	43.0	16.0	21.5	7.0	20.8	17.4	93.4	37.7	26.8

*End of June 2000

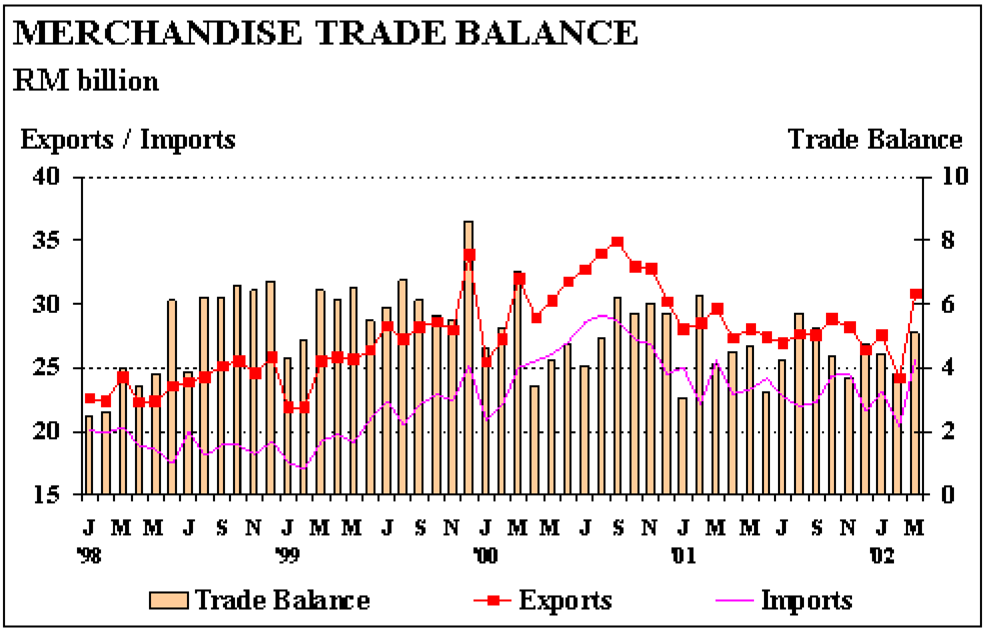
External Reserves, 1997 – 2000* (US$ billion)

Year	Malaysia	China	Indonesia	Japan	S.Korea	Philippines	Singapore	Taiwan	Thailand
1997	21.7	139.9	21.4	220.8	20.4	6.7	71.4	83.5	27.0
1998	26.2	145.0	23.6	216.0	52.0	8.0	75.0	90.3	29.5
1999	30.9	154.7	24.4	288.1	74.1	11.8	77.2	106.2	34.8
2000	34.0	158.6	27.5	330.0	90.2	12.0	77.7	113.8	32.1
Rise in reserves (US $ bill)	**12.3**	**18.7**	**6.1**	**109.2**	**69.8**	**5.3**	**6.3**	**30.3**	**5.1**
Growth rate, 1997-2000(%)	**11.9%**	**3.2%**	**6.5%**	**10.6%**	**45.0%**	**15.7%**	**2.1%**	**8.0%**	**4.4%**

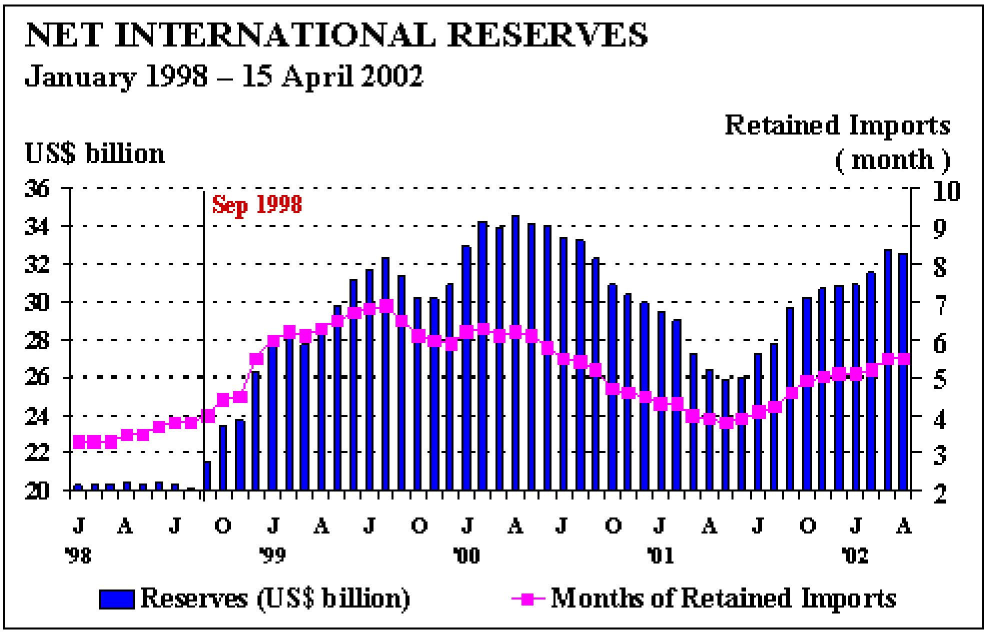
* End of June 2000

Source: NEAC, Treasury Economic Report

Graph 10 a) Merchandise Trade Balance



b) External Reserves



Source: Economic Planning Unit of Prime Minister's Department

5. Increase in Foreign Investment

There was an increase in the value of proposed investment through the acquisition of shares and joint ventures by foreign interests to the FIC, reflecting confidence of long term investors in the economy, as shown in Table 11.

Evidences

The value of investment in 1998 was 3.7 times higher compared with 1997. The investment in the manufacturing and services sector were the highest accounting for 81% of the total, and this would contribute significantly towards the recovery of the corporate sector.

Controls drawing investors in

Foreign investors have not been driven away by Malaysia's selective capital controls and the fixed exchange rate regime. On the contrary they are increasing, moving their operations from other regions and countries to Malaysia in addition to expand their facilities

Evidences

These decisions have been prompted by the stable and predictable conditions following the imposition of the controls and fixed exchange rate of the ringgit to US dollar. Business decision is difficult to make even under normal conditions and when the currency fluctuates violently as in the case of many Asian currencies during the financial crisis it becomes even more difficult.

But Malaysia's control provided the stability needed by businesses. This has prompted Komag Inc., for example, to move two plants from San Jose, California to Malaysia.

The reason: Malaysia ‘s currency peg of RM3.80 to US$1.00, which provides predictability, stability and gives the country a competitive edge.

The move to Malaysia will save the computer disc drive maker an estimated US$ 80 million or 67% in payroll costs annually. In addition as a result of the peg, the cost of infrastructure- including the land and property – to foreign investors is lower, making the country more attractive as an investment centre compared with its neighbours.

Western Digital Corporation, the world’s third largest disc drive maker, is increasing its production capacity in Malaysia by shifting its operations from Singapore. It means an additional 1700 odd jobs will be created. The reason for the move is said to be the peg.

Other companies that have increased their operations and facilities in Malaysia are from a wide range of industries. In addition to the electronic sector, those in the food industry have also moved or are in the process of expanding their operations.

One of them Yeo Hiap Seng is moving its bottling facilities from Singapore to Malaysia. Others that have increased their investments in Malaysia include British Telecom, which has raised its stake in Binariang.

The inflow of foreign investments has kept pace. While the flow of FDI into developing countries moderated due to the financial crisis. Malaysia continues to attract a sizeable amount of funds. According to the United Nations 1999 World Investment Report, the country is among the top five recipients of FDI, receiving 55% of all developing countries inflow in 1998.

Malaysia’s Industrial Development Authority figures show that in the first five months of 1999, it approved RM6.359 billion worth of FDI compared with RM13.06 billion for the whole 1998.

FDI flows, which are more stable and are long term investments bring along numerous benefits to the recipient countries in contrast to the speculative hot money, which can cause untold changes. The Selective capital controls were designed to insulate the country from the unpredictable and volatile external environment. This had been achieved and the vote of confidence by the many long-term investors who are setting up new operations, moving their existing operations from other places or expanding their facilities from other places to Malaysia is a testimonial to this.

6. Increased Certainty in Foreign Exchange Market

Control program may help government buy time to move the fundamentals to a region where self-fulfilling speculative attacks are less likely.

Evidences

The fixed exchange rate provided a degree of certainty in the foreign exchange market and benefits both traders and investors. With the new rate, both traders and investors no longer need to hedge their investment against risks. That would lower operation costs and enhance their competitiveness.

7.Capital Controls help to reduce interest rates without allowing capital outflows so that investment could be encouraged.

Evidences:

It is true here in Malaysia that market interest rates have been reduced the last few years since the implementation of Selective Control Measures in

September,1,1998. The base-lending rate was 11.7% in August,1998 and by December,2000, it was only 6.78%. There has been a great reduction in the market interest rates following the reduction in the base-lending rates. Consequently, many investors and entrepreneurs can afford to borrow money from banks and other financial institutions for investment purposes or expansion of their business. Previously, the market interest rates were rather high and the returns would not be enough to recover the cost of borrowing.
Investment has been greatly encouraged.
For Example, the sales of new commercial vehicles were 1681 units in August 1998 and by August 2000, the sales accelerated to 4,557 units.
1618 new companies were registered in August 1998 and by August 2000, the number increased to 2818 new companies.

8.Greater Scope to introduce Appropriate Policies
Capital Controls help in stabilisation and structural reform programs.
Evidences:

The imposition of exchange control regulations enabled Central Bank of Malaysia (BNM) to pursue policies more aggressively such as lowering interest rates, injecting greater liquidity into the banking system and enhanced the intermediation process to support economic recovery. The average BLR of commercial banks was reduced from a peak 12.27% at the end of June 1998 to 8.04 % in November 1998, lower than the pre-crisis rate. The SRR was reduced in stages from 13.5% to 4%.

The reduction in SRR and interest rate resulted in greater liquidity in the banking system, making available more funds to borrowers at a reasonable rate. With the reduction of interest rates, the debt service burden of the corporate sector as well as households was reduced significantly. Total loans approved in October and December 1998, compared with an average of RM4.3 billion per month between January and September 1998. For January 1999, a total of RM7.8 billion was approved.

9. Reduction in NPLs (Non-Profit Loans)

Following the crisis the banking system continued to rise and peaked in August 1998 as shown in Table 1 above. The adverse impact of the overall slowdown of the economy in the corporate sector, the rising interest rates as well as the reclassification of NPLs to 3 months from 6 months contributed to the increase in NPLs. Measures introduced to increase liquidity and reduced interest rates subsequently contributed towards the improvement in the overall business environment and the risk profile of borrowers, thereby lowering the incidence of loan defaults and reducing NPLs from banking institutions. Danaharta would continue to purchase the NPLs from Banking institutions to ensure their levels of NPLs remain manageable at all times. By removing the NPLs banking institutions would be able to refocus on their lending activities, which was crucial for accelerating economic recovery.

Evidences

Since September 1998, net NPLs in the banking system generally declined and as at the end of December 1998, net NPLs (based on 6-month classification) stood at RM29.2 billion or 7.5% of net total loans.

Since the imposed controls, the results have been very gratifying. Business has been revived and are doing fairly well. As the prices have gone up, the Non Performing Loans (NPLs) are reduced; companies and banks are healthy again. The repatriation of the Malaysian ringgit has resulted in recapitalising the banks and purchase of NPLs without foreign loans

10. Repatriation of Ringgit

By making the Ringgit an acceptable currency only in Malaysia and preventing the re-entry of offshore ringgit, our currency was no longer accessible to currency traders. They have therefore been forced to bring back Ringgit immediately to Malaysia and that in turn enhanced our banking liquidity. They are also unable to appreciate and depreciate the value of the Ringgit as they please. The power to determine the value of the Ringgit against foreign currencies once again reverted to the Government. As anticipated, offshore Ringgit was brought home.

Evidences

Repatriation of Ringgit from abroad contributed mainly to the increase of deposits of RM 1.5 billion currency notes by Malaysians at the end of September and in addition as at 8 October 1998, RM 4.9 billion were deposits in external account held by non-residents in the Malaysian banking system. As a result, our banking system had sufficient funds to provide loans.

It has been reported that about RM11 billion of Malaysian deposits parked abroad have returned home and that international reserves had gone up by some US1 billion (RM3.8 billion) in just three weeks of the implementation of the control measures.

11 Positive Response to Capital Markets and Increase in Stock Prices

The overall response to the measures introduced by the SC, KLSE and the Government since 1 September 1998 may be partly gauged by the performance of the local stock market. Stock prices on the KLSE stabilised from sharp decline registered since the onset of the financial crisis.

Evidences (Equity Market)

1. Since 1 September 1998, KLSE CI increased from 262.7 points to 518.5 points on 15 March 1999, a gain of 97.4 %. The benchmark Kuala Lumpur Composite Index (KLCI) rose by 23% to 721.18 points as at 15 October 1999 from 586.13 points at the end of 1998. By August 1999, the stock market had reached about 700 points.

Driven by low domestic interest rates and greatly improved liquidity, the Kuala Lumpur Stock Exchange Composite Index (KLCI) had almost quadrupled by February 2000 to 1013.27 from its low-point (262.7) reached in early September 1998. The KLCI retreated in line with declines in US and Asian bourses to 679.6 by the end of 2000

2. The total volume traded on the Kuala Lumpur Stock Exchange rose by 83.2% to 72.9 billion units during the first nine months of 1999 against 39.8 billion units during the corresponding period of 1998.

Since the imposition of Selective Controls on September 1, 1998 market capitalization has increased over one and a half times to RM553 billion (US 145.5 billion) as of end–1999 (Table below). In the first half of 2000 itself, the market remained bullish with KLCI staying at the 800-point mark.

The continued recovery in the KLCI reflected increased investor confidence, indications of a broader based economic recovery strengthening of economic fundamentals and expectations of better corporate results. Although the KLSE began the first quarter on a weaker note, the KLCI turned around in the second quarter to close at 811.10 points at end of June 1999. The upward trend in the KLCI was further boosted by growing confidence in sustainability of the country's economic recovery, large monthly external trade surpluses, net inflows of funds following the introduction of a graduated exit levy since 15 February 1999.

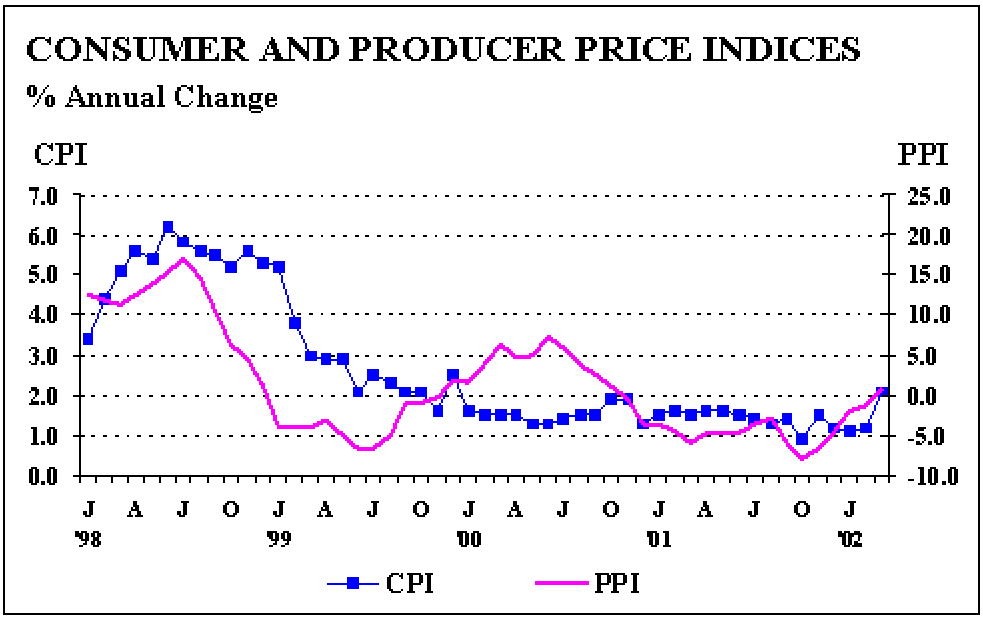
This was due to largely improved economies as well as corporate performance coupled with the return of stability and growing business and business confidence with the Malaysian economy.

Table 6: Stock Market Indicators

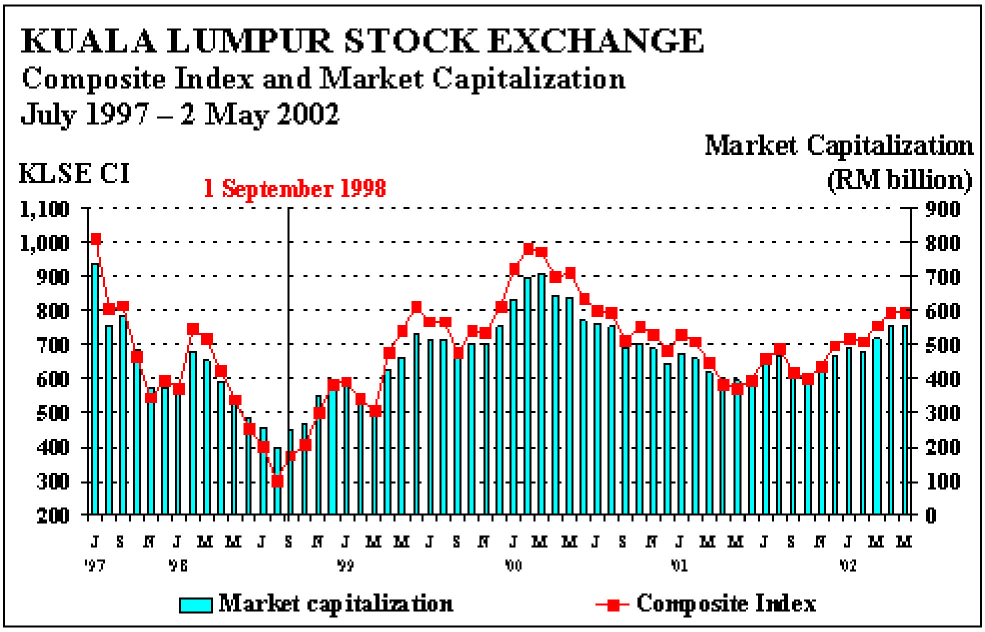
	1997	1998	1999	2000
KLSE Composite Index	594.4	586.1	812.3	679.6
Market Capitalization (end period) RM billion	375.8	374.5	552.7	444.4
Turnover (RM billion)	408.6	115.2	185.3	244.1

Source: Kuala Lumpur Stock Exchange

Graph 11 a) Consumer and Producer Prices Indices



b) Kuala Lumpur Stock Exchange



Source: Economic Planning Unit of Prime Minister's Department

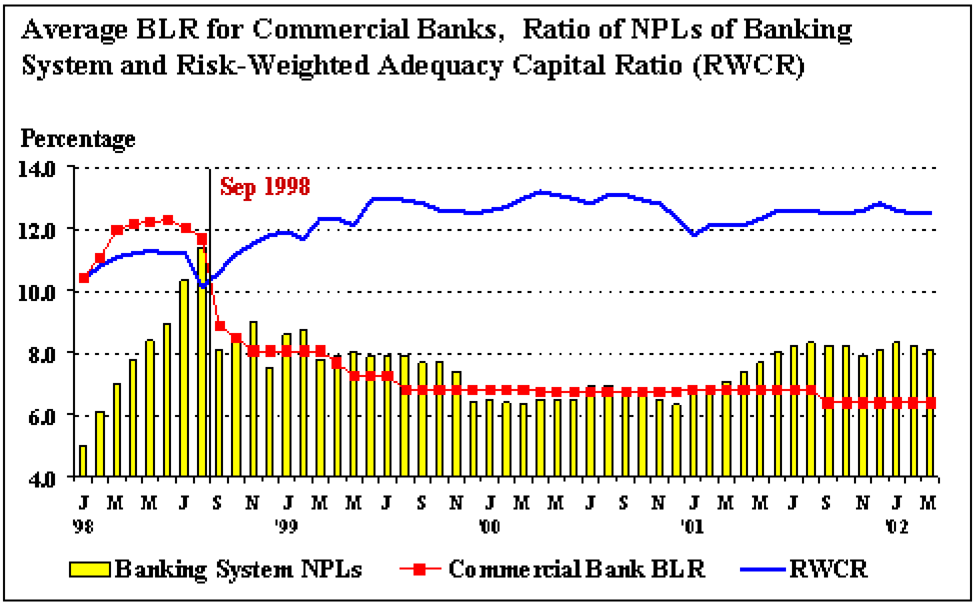
Graph 12: Performance of Main International Stock Exchange

(% change in Local Currency)

PERFORMANCE OF MAIN INTERNATIONAL STOCK EXCHANGES (% Change in Local Currency)

Stock Exchange	1 Sep '98 - 22 Dec '00
KLSE Composite Index	165
Singapore Strait Times Index	131
Hang Seng	109
Korea Composite Index	62
Dow Jones Industrial Average	36
Jakarta Composite Index	28
Thailand SET	27
Philippines Composite Index	20
FTSE 100	18
Nikkei 225	-7

Source : Bloomberg



Source: Economic Planning Unit of Prime Minister's Department

When compared with other major bourses in the United States, Europe and Asia, the KLSE has been one of the best performers between 1 September 1998 and 15 March 1999.

The KLSE CI futures markets maintained its trading activity despite a sharp decline in foreign participation.

Measures aimed at strengthening the role and function of the capital markets received broad approval and drew favourable response from the stock market. Steps taken to facilitate the stocks in the KLSE saw renewed activity. The announcement in November 1998 of comprehensive package of measures to resolve problems faced by stock brokers while warrants and selected warrants-related stocks also enjoyed a higher turnover after measures introduced by the SC allowed an extension of the term maturity of warrants
With regard to the securities and future industry, measures, which came into effect in November 1998, were seen as having important implications across a broad range of areas. Changes to Securities Industry (Central Depositories) Act 1991 and to the KLSE rules regarding the trading of listed securities were generally welcomed. Similarly measures to improve transparency, corporate governance and investor protection in the stock market and enhance regulatory supervision were well received.
The recovery in the stock market will enhance household wealth, which may induce consumption.

Increased confidence

Recent improvements in the KLSE have helped to improve sentiments and the investing public has again been presented with an opportunity to invest in the stock market. The gains in the KLSE also have a positive wealth effect. The investing public who are enjoying higher earnings can now expend on items, which they had previously postponed. Improvements in KLSE will also improve the ability of the corporate sector to raise investible funds from the capital market through the issuance of shares

12. External Debt

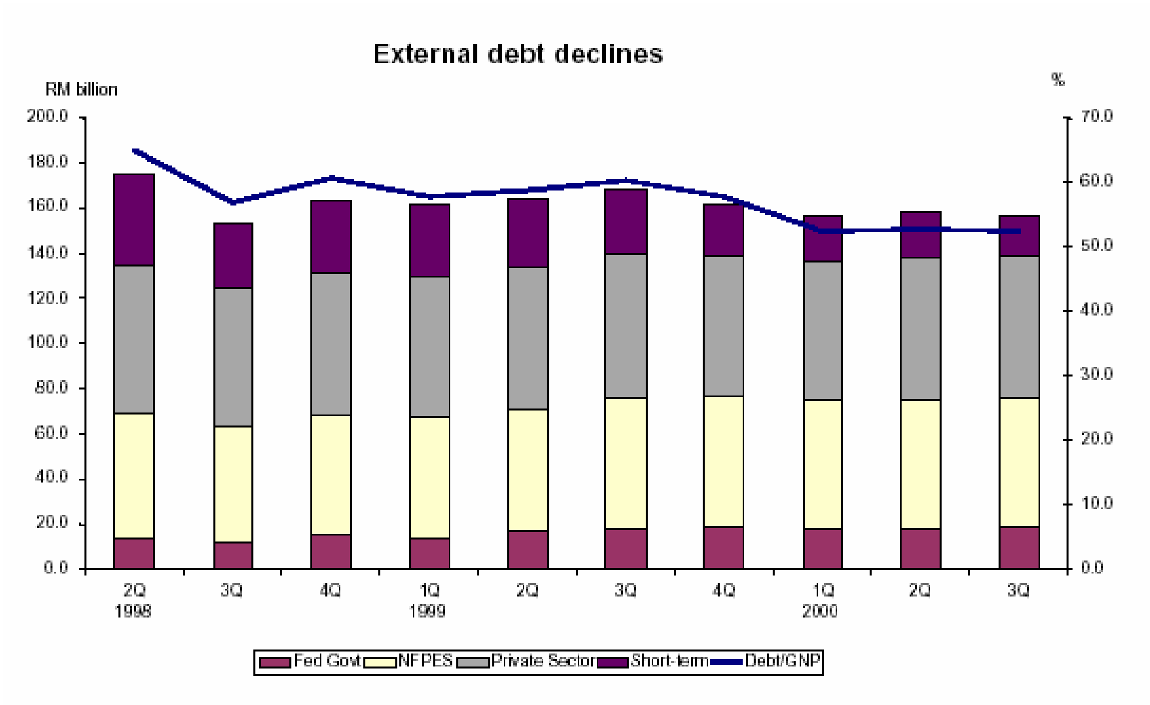
Two years after the Asian Crisis, Malaysia's external debt position continued to improve and remain low relative to other emerging economies. Prudent external debt management policy is clearly reflected in the continued improvement in the external debt position of the nation. The nation's external debt declined by 3% (US$41.3 billion) by the end of 2000 (Table2) mainly due to the significant drop in the short term and to the revaluation gains arising from the stronger ringgit. The improvement in the debt situation is also reflected in the debt service ratio as in % of exchange of goods and services where the debt service ratio dropped from 6.7% to 6.0% during the crisis in 1999 and 5.0 % in 2000. Prudent debt management has improved the external liquidity position thereby reducing Malaysia's vulnerability to external shocks.

Table 7 – External Debt Indicators

	1997	1998	1999	2000
Total external debt (US$ billion)	43.9	42.9	42.9	41.3
In % of GDP	43.8	59.4	54.3	46.6
Short term external debt (US billion)	11.4	8.4	6.0	4.6
% Of gross Internal Reserves	28.8	19.7	14.0	11.1
Debt Service Ratio	53.5	33.1	19.7	15.7
(% Of exports of goods & services)	5.5	6.7	6.0	5.0

Source: Bank Negara Malaysia

Graph 13: External debt declines



Source: Bank Negara Malaysia (29 November 2000)

Total external debt declined by 0.6% to RM157 billion (US$41.3 billion) at the end of September 2000, equivalent to 52.4 % of GNP. The medium and long-term external debt increased by 0.4% to RM139.1 billion (US$36.6 billion). Short-term external debt declined by 7.5% to RM17.9 billion (US$4.7 billion) as at end of September 2000, equivalent to 11% of total external debt and 14.6% of foreign reserves.

13. Cheaper loans or easier access to credit

All sections of Malaysian society benefited from recent measures. The lowering of interest rates to the pre-crisis level was beneficial for businesses as well as individuals in terms of lower repayments on loans and improved cash flow positions. With lower interest rates, the cost of loanable funds is now cheaper and this will enable businesses to undertake investments which were previously not viable thus expanding the scope for investment returns to savers. Furthermore the lower interest rates will potentially accelerate economic recovery and will open up alternative investment opportunities with higher returns to savers such as in the stock market and in trust funds.

With improvements in liquidity in the banking system arising from the lowering of SRR, the repatriation of offshore ringgit and increase in external reserves, both businesses and individuals now have greater access to credit. Credit lines, which were previously withdrawn from businesses, are being reviewed and reinstated and fresh loans are being made available. Individuals are also able to borrow with greater ease for the purchase of property, motor vehicles and other consumer durables. The removal of NPLs from and the recapitalization of the banking system have also improved the willingness of banks to lend, benefiting both individuals and businesses.

Evidences
Interest rates had been reduced significantly. Interbank rates had fallen from an average of 10.2 % in August to 7.7% last month. Loans are growing at a faster pace. The stock market had started to tick again. Car Sales had picked up significantly from 5000 units a month to 12,000 units.

14. General economy of the country is under control.
Retrenchment is minimal.
Evidences (Labour Market)
7,125 people were retrenched in August, 1998 and by December 2000 the number decreased to 2,061. The number of vacancies was 6,005 in August and by December the number came down to 5,799.
The employment situation has improved in tandem with the recovery of the economy . Indicative of this is the expansion of the labour force which grew 3.7% (9.2 million persons) in 1999 and 4.3% in 2000 (9.6 million persons) in table .
Total employment also shot up to 3.5% in 1999 and 4.6% in 2000 after a decrease of 2.9% in 1998. Given the pick up in demand for labour, the unemployment rate declined to 3.1% in 2000 even though it had increased slightly to 3.4% in 1999 as compared to 3.2 % during the crisis. Overall labour productivity improved significantly in 1999 and in 2000 as capacity utilization rose to higher levels to cater to an increase in demand for products and services. Job vacancies recorded a positive growth both in 1999 (45.2%) and 2000 (14%).
Retrenchment continued to slide downwards from 83,865 in 1998
to 25,244 in 2000.

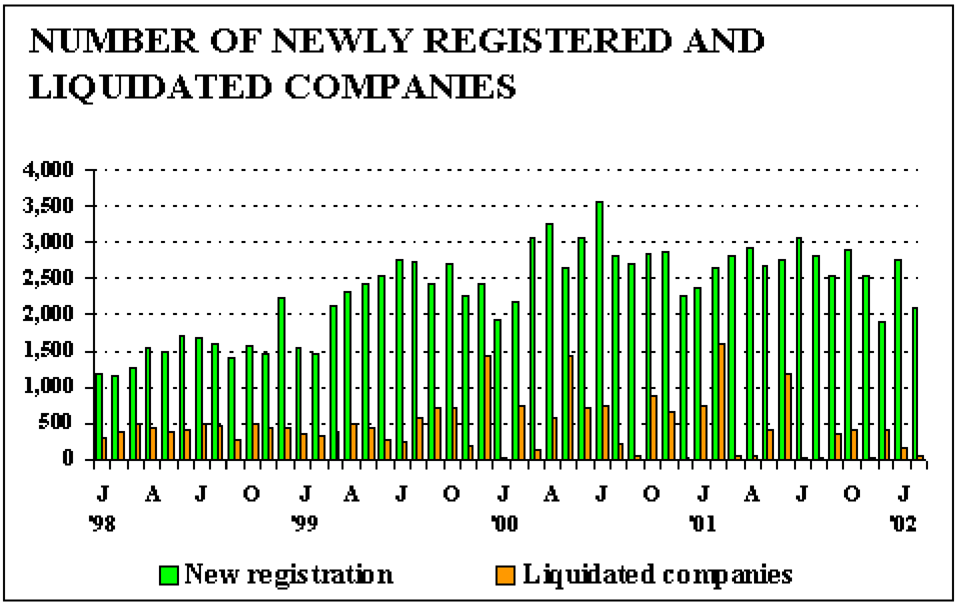
Table 8 - Labour Market Indicators

	1997	**1998**	**1999**	**2000**
Labour force ('000)	9,039	8,849	9,178	9,573
(Annual change in %)	4.6	-2.1	3.7	4.3
Employment (annual change in %)	4.7	-2.9	3.5	4.6
Unemployment rate (%)	2.7	3.2	3.4	3.1
Labour productivity (GDP/employment) (annual change in %)	2.5	-4.6	2.2	3.8
No. of Job vacancies	96,452	74,610	108,318	123,484
No. of workers retrenched	18,863	83,865	37,357	25,244

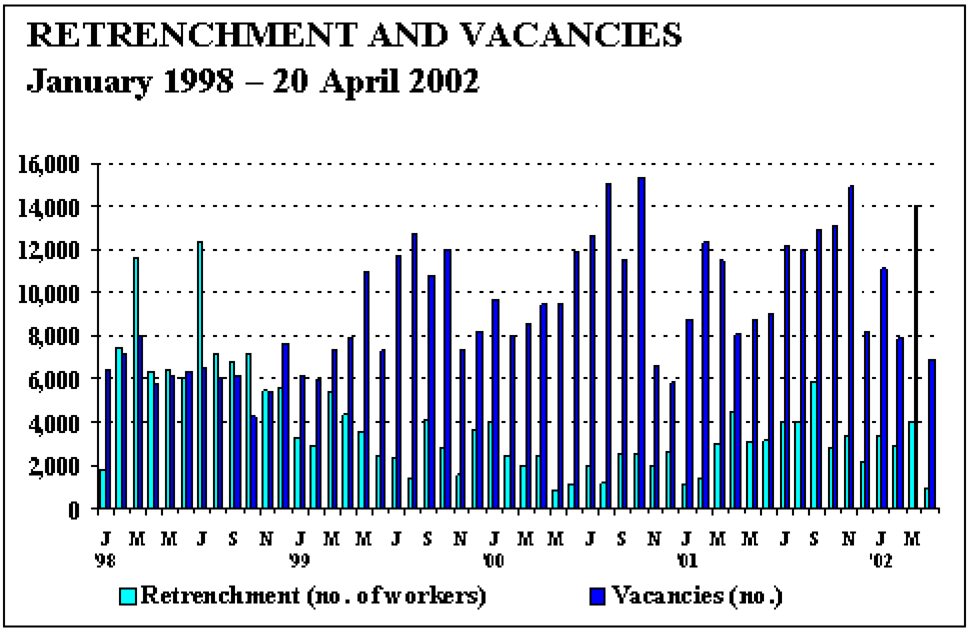
Source: Manpower Department, Human Resource Ministry

Inflation is only 1.5% above the average yearly inflation rate. There is no shortage of food or medicine or fuel. The supermarkets are well stocked with everything including imported foods.
There are no riots and one can travel safely anywhere in Malaysia.

Graph 14: a) Number of Newly Registered and Liquidated Companies



b) Retrenchment and Vacancies

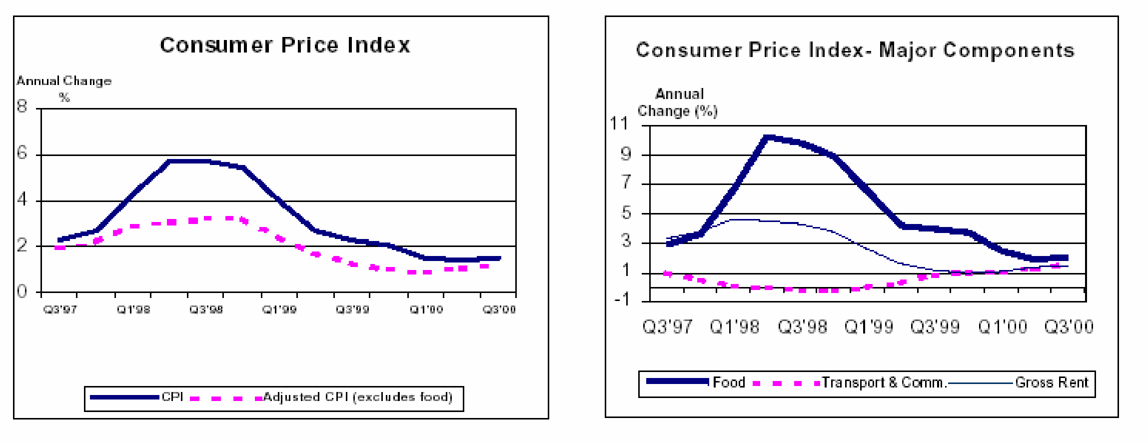


Source: Economic Planning Unit of Prime Minister's Department

15. Business Condition Index and Consumer Sentiments Index

MIER's Business Condition Index and Consumer Sentiments Index have shown an upturn for the last two consecutive quarters of 1999, which suggests that Malaysian economy, is beginning to look brighter.

Graph 15: Consumer Price Index



Source: Bank Negara Malaysia (29 November 2000)

The expansion of the economy continued to be achieved in an environment of relative price stability. The annual rate of inflation as measured by the Consumer Price Index (CPI 1994 =100) remained low at 1.5% in the third quarter (second quarter 1.4%). The 0.1% percentage point rise in the CPI during the quarter was due to the higher fares in transport and communication sectors. During the stated quarter, import inflation remained low in major industrial and regional economies.

16. Economic Prospects

The economic outlook for the Malaysian economy is bright due to a combination of factors.

Evidences

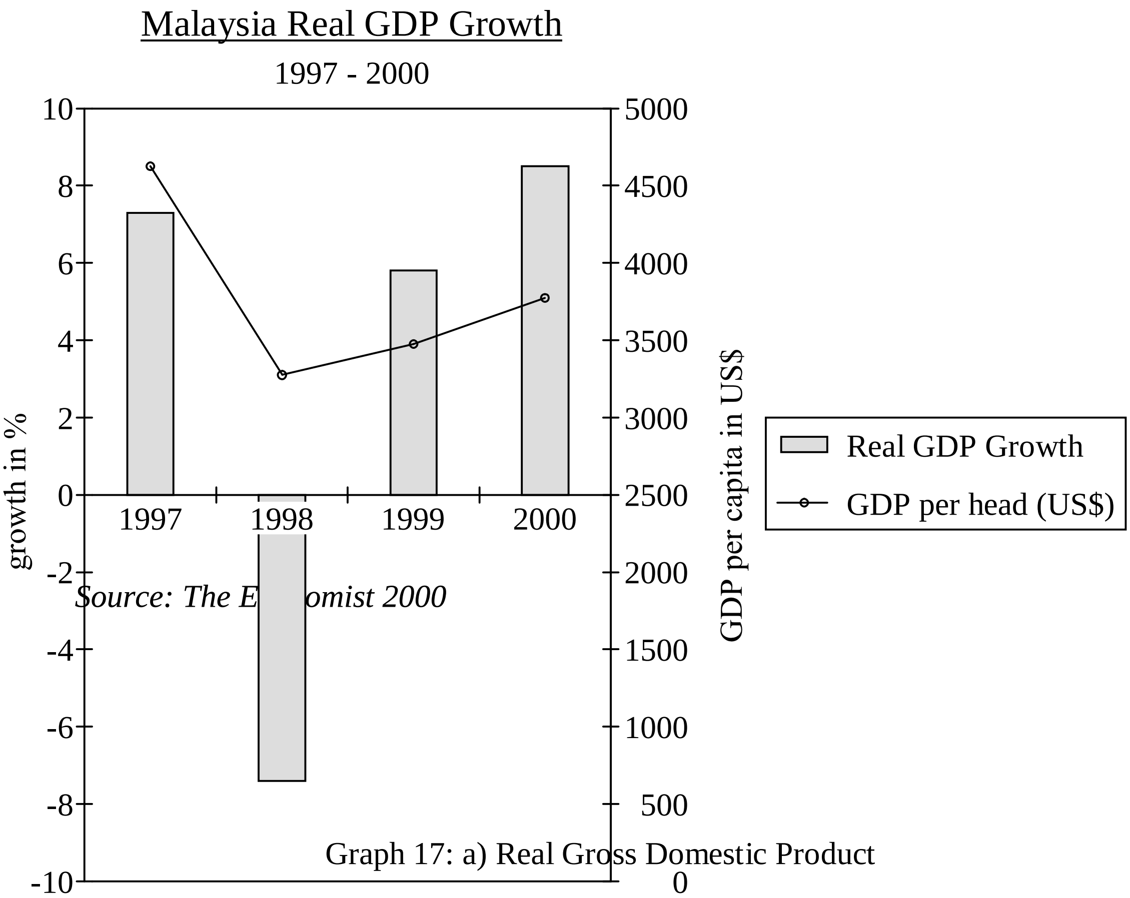
Gross Domestic Product (GDP)

One of the main indicators of a growing economy is the GDP. Anchored by the expansion in output in the manufacturing sector which increased 13.5% in 1999 and 23.1% in 2000, the Malaysian economy made a strong recovery from the severe deflationary impact of the regional financial crisis earlier.

GDP recorded a positive growth of 5.8% in 1999 and 8.5% in 2000 (Graph 16) indicating the selective exchange controls implemented in September 1998 has indeed helped Malaysia to emerge from the recession with strengthened macroeconomic fundamentals. Strong growth for the second half of 1999 due to strong signs of growth in the real and monetary sectors

Per capita gross domestic product too turned around the decline in 1998 to record US$3467 in 1999 and jumped further to US$3780 in 2000.

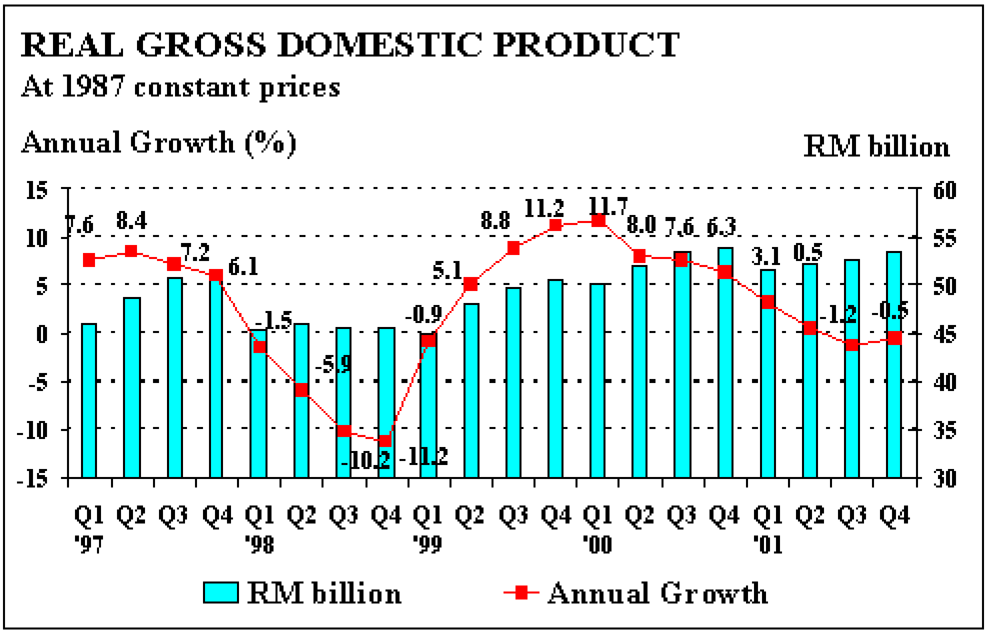
Graph 16



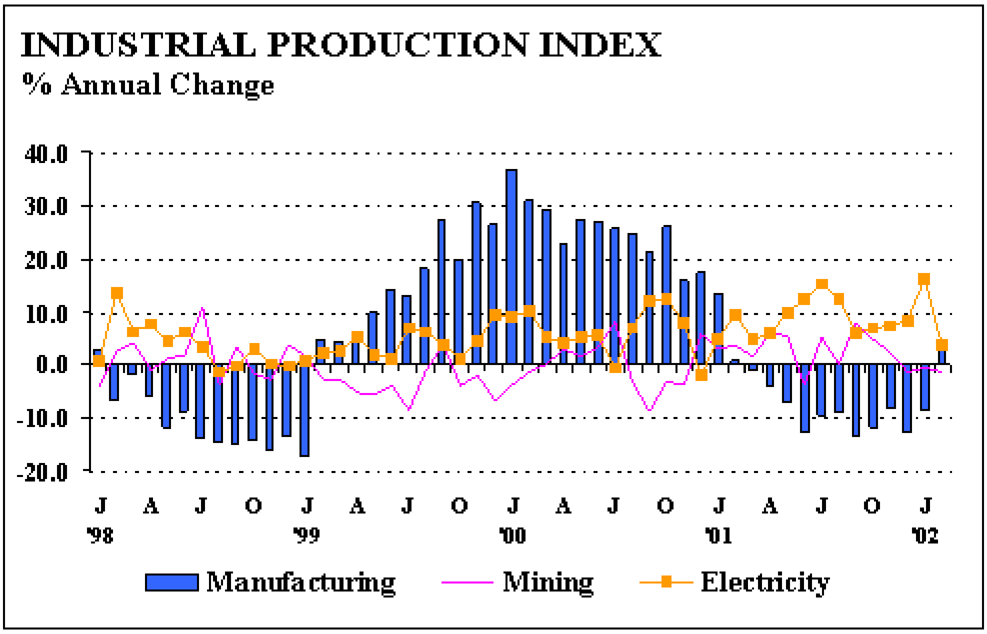
7.3	-7.4	5.8	8.5
4626	3268	3467	3780

Source: The Economist 2000

Graph 17: a) Real Gross Domestic Product



b) Industrial Production Index



Source: Economic Planning Unit of Prime Minister's Department

Continued low interest rates, higher fiscal spending and strong economic growth were to boost investor and consumer confidence. Inflation remains low and this has helped the ringgit peg.
The positive outlook is based on a combination factors:

- Strong growth in exports especially of electronics.
- Rising demand for Asian exports from Japan which will reinforce the upward economic spiral now underway in the region. Japan accounts for 11% of Malaysia’s exports and 10% of its FDI inflows
- On the domestic front, the measures under 2000 and 2001 budget had stimulated growth. These include the increase in disposable incomes from income tax cuts and rise in salaries of civil servants, reduction in tariffs and the fiscal boost that have strong multiplier effects on the economy

4.7 Reasons Why Currency Trader stopped their manipulation

Today, Malaysian economy is growing again. It is believed that it is due to the controls that have been imposed. The recovery of Malaysia is due to the fact that currency traders have stopped their manipulation of the currencies.

There are some reasons why they have stopped

1.When Malaysia imposed controls, there was a fear that other countries might do the same if the attacks continued

2.At about this time the Long Term Capital Management Fund collapsed threatening to destabilise the financial system of the rich countries.

As a result, the banks stopped lending to the hedge funds thus stopping them from attacking and devaluing the currencies of East Asia.

The business community both the local and the foreign had been convinced that the controls have benefited them.

Malaysia has made serious efforts and registered good progress in restructuring its financial and corporate sectors. NPLs were taken from the banking system and troubled financial institutions were recapitalised. In fact Malaysia’s effort in these two areas had been regarded as a critical part of the recovery because they were executed efficiently in a transparent manner and at a cost much lower than that incurred by the other crisis-hit countries. Moreover the banking sector consolidation exercise shows Malaysia’s commitment to further strengthen its financial sector and to increase efficiency. Rules governing the equity market have also been tightened to ensure a more orderly market.

One may argue that it is not clear whether these capital controls contributed to improve Malaysia’s performance. At least, the findings above suggest that the Capital Control did not harm Malaysia, as some critics of the measures feared.

4.8 Why the Selective Control Measures have worked?

Without the restrictions on the repatriation of short-term capital and the banning of securities trading outside the KLSE, the liquidity injected in the domestic economy by fiscal stimulus programme and lowering of the statutory reserve requirement would have flown out of the country and made the recovery policy ineffective. The Selective capital controls also had an important implicit objective namely to renew domestic confidence that has been battered by the crisis. Revival of domestic confidence is vital for the resumption of domestic economic and business activities and foster social stability. With the pegging of the ringgit, domestic producers were able to restart production because exchange rate uncertainties have been removed. After making necessary adjustments, most business communities welcomed the fixing of the ringgit exchange rate. In an ethnically diverse society such as Malaysia, social and economic stability is critical to growth and development and thus the threat of a conflict among the various ethnic groups arising from an economic slowdown must be avoided. By insulating the economy from further deterioration and stabilising the ringgit, the government has managed to revive domestic confidence, thus averting any serious social discontent. The prevailing excess liquidity and the low interest rate have attracted investment in the equity market and large gains were recorded in the KLSE. A large foreign capital inflow will exert an upward pressure on the pegged ringgit as foreign investors are expecting to make a double gain from a rising stock market and an appreciated ringgit.

Consequences anticipated by the Critics did not materialise and could be attributed to the following reasons:
First, the ringgit was pegged at a level where it was undervalued
Second, the measures made a clear distinction between short and long-term capital
Third, they were skilfully implemented.

Presently, there are no signs that the pegging of the ringgit has caused misallocation of resources.

The inflow of international capital into Asia from the end of 1998 had allowed the pegged ringgit to remain competitive as other regional currencies appreciated. The undervalued ringgit gave Malaysian export a price edge, resulting in a double-digit export growth in 1999. Consequently Malaysia recorded large trade surpluses. As the selective capital control require export proceeds to be brought back into the country, it had increased liquidity in the economy and revived domestic consumption. Strong export performance had attracted resources to this sector because it had the best growth prospect. The ‘undervalued” ringgit had acted as a deterrent to a high import growth during the recovery period, thus further strengthening the balance payment and international reserves position. As a result, the improvement in the current account position and the accumulation of the reserves were considered among the biggest achievement of the capital controls.

The Malaysian capital control measures restrict only short-term capital, which is normally invested in the equity market, but it continues to encourage the inflow of FDI. Investment in equity market can easily leave the country if current sentiment changes but FDI are investments in the manufacturing sector, with longer gestation period and closer linkages to the domestic economy. The separation between short and long-term capital is essential for the recovery of the Malaysian economy because the selective capital controls have not deterred the inflow of long-term foreign capital.

The “soft management” of the capital controls had prevented the creation of a black market for the ringgit. At the early stage of the introduction of the selective capital controls, the Bank Negara Malaysia had ensured that there was adequate supply of foreign currencies to meet any increase in demand and this move had calmed the market and has created confidence among the general public. The procedures for approval for remittance of funds are transparent and Malaysia has the institutional capability and capacity to implement the measures effectively. Another aspect of the skilled management of the measures was the flexibility showed in responding to feedback from the market. For example the replacement of the rule of twelve-month holding period for proceeds from sales of Malaysian securities with the exit levy was made after consultation with market players.

4.9 Conclusion

The Selective Capital Controls could be viewed as measures to calm the market and allow the country to put a brake on economic deterioration. Malaysia's recovery approach shows that there is an alternative way to deal with an economic and financial crisis.

Is Malaysia abandoning the free market mechanism and isolating itself from the global financial system?

The answer of course is that Malaysia is not withdrawing from the international financial community or abandoning the free market mechanism. In fact, the controls are administrative in nature and imposed mainly on the trading of ringgit in offshore markets. There are no restrictions on most inflows and outflows of foreign exchange.

The Malaysian Control is not a simple turning your back from the world.
Malaysia is a trading nation. Its economic growth and well being depends largely on its commercial and financial links, including the direct foreign investments with the rest of the world. With only 22 million people and a relatively low per capita income, there is no way for Malaysia to be totally independent economically and certainly no way for Malaysia to prosper. Malaysia must maintain strong economic links with the rest of the world.

4.91 Specific Reasons for the Bold Move

1. No sign of Stability in financial market despite various measures by the affected countries. Since July 2 1997, ringgit had dropped 40%, stock price tumbled some 50% and the economy had slipped into recession, and the worsening of the regional contagion might swap Malaysia further backward.
2. Failure of "Self-imposed IMF package"
   The Prime Minister was disgruntled about the self imposed IMF package that the austerity measures and high interest rate had neither restored confidence nor revived the country's financial turmoil.
3. It is part of macroeconomic management to reinforce or substitute for monetary and fiscal measures
4. It may be due to Paul Krugman's suggestion
   Partly supported by Professor Paul Krugman's article in Fortune Magazine that IMF had failed in the rescue package in Asia and it was time the afflicted country imposed exchange rate controls. Professor Krugman had made a strong statement that extreme situation demand extreme measure warning that if Asia did not act quickly, crisis would worsen into a depression similar to 1930s (Fortune Magazine)
5. To attain long-term national development goals such as ensuring residents capital is locally invested.

4.92 Philosophy behind this Policy

Malaysia's controls are therefore selective, designed to achieve the specific objective of containing speculative capital. The measures do not apply to foreign direct investment.

The controls are not intended to disrupt or dislocate genuine trade-related activities or direct foreign investment flows. The primary objective of Malaysia's selective 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 objective of the exchange control measures is "to regain monetary independence and insulate the Malaysian economy from the prospects of further deterioration in the world economies and financial environment.

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 FDIs. The liberal regime that governed trade transactions and FDIs were left unchanged. The negative aspects of globalisation that were eliminated were the offshore market for the trading of ringgit and free flow of short-term funds that destabilises the economy.

Press release on the exchange control measures "The current escalation in the contagion effect has not provided the sense of urgency to the world financial leaders to act decisively to contain the global financial crisis. While arguments have been put forward for emerging economies to undertake economic and financial reforms, of greater urgency is the need to reform the international financial system. Subsequently the crisis spread to Russia and Latin America giving rise to the possibility that its damage would trigger uncertainty over industrialised countries' financial systems. Only then did the view appear in earnest among world financial leaders that it would be necessary for them to act together to tackle the international liquidity crisis."

Rationale Behind the Control Measures

To understand the rationale behind the imposed administrative controls, it is important to appreciate the following consideration.

I. Malaysia was concerned that the risks of contagion from Asian crisis have increased and that pre-emptive measures are necessary to protect the domestic economy from the risk of a global financial meltdown

II. In the absence of a global solution to what is essentially a global problem, Malaysia had to undertake selective controls to safeguard the progress made to date in terms of economic and financial restructure and

III The need to regain monetary policy independence to ensure that the conduct of monetary policy is consistent with the need to promote economic recovery

I. The need to protect Malaysia's economy from the risks of contagion

The Asian crisis and its continuing contagion had heightened the financing issues faced by crisis countries because by their very nature, portfolio capital flows are subject to sharp reversals. Markets can only operate efficiently under ideal conditions, including perfect knowledge and a level playing field. In reality, this has not been the case. Recent trends in the global financial markets indicate that markets have not always behaved rationally and the international environment has continued to deteriorate.

A major concern for Malaysia was the rapid growth of an offshore market for the ringgit, which provided easy access to ringgit funds for speculative activities. At its peak, offshore ringgit deposits were attracting interest rates in excess of 30%. Such high interest rates demonstrated just how profitable ringgit speculation had become. It also revealed the constraints imposed by external developments on the conduct of monetary policy.

Malaysia considers the internationally agreed preconditions and safeguards are the preferred solutions to prevent the destabilising effects of large capital movements. The complete absence of prudential rules on currency trades highlights the negative effects of globalisation. The damage that has been inflicted on the emerging market economies has been particularly serious. While available resources of speculative currency traders may be small relative to the resources of the industrial countries and the volume of global financial transactions, their combined resources overwhelm the markets in the emerging economies as their amount exceeds external reserves and even the GDP of the emerging economies. The speculative pressures of such massive capital flows have been intensified by the herd behaviour of market players. The irrational behaviour of the market players had resulted in an over-reaction to developments, leading to harmful spill-over effects. As shown in the Asian crisis, these developments have eroded economic progress that has been achieved over the past three decades. This underscores the risks and challenges of unbridled globalisation and the need for an international framework to ensure that all countries are adequately protected from such risks. Given that prospects for an early international consensus to restore stability have not been forthcoming, it is necessary to protect the domestic economy from further external shock.

Bold new measures are needed to restore the stability in the world financial markets. Incremental and piecemeal efforts are clearly inadequate. The role and functions of the Breton Woods institutions need to be reviewed to ensure that they are keeping with the changing times. Unless this is recognised by the international community, there will never be a permanent solution to the crisis. A new wave of instability could well trigger a global financial crisis and the deepest economic slump since the Great Depression

In an effort to ensure prospects for stability, Malaysia had introduced selective administrative controls to allow for orderly capital inflows and insulate the domestic economy from such external risks. Malaysia has on previous occasions introduced such measures to restore an adjustment in the stabilisation process. An example of such selective exchange controls occurred in the 1993-94 period when Malaysia experienced a surge of destabilising capital inflows. These controls were lifted after sixth months. These measures proved effective and allowed stabilisation to be achieved at a lesser cost to the economy and due to their short-term nature.

II. The Importance of safeguard progress in economic and financial restructuring

Malaysia‘s experience indicates that for a small open economy, capital account liberalisation works best accompanied by strong prudent regulations. Overall prudent regulation (both exchange control and investment guidelines) has enabled Malaysia to strike a good balance between foreign direct investment flows and external borrowing to finance investment and growth. Policies to encourage foreign direct investment flows into the export sector have ensured that export growth increased sufficiently to finance the required outflows for profits. The country's policy on active debt management had enabled Malaysia to contain total external debt without impinging on the ability of the private sector to obtain loans from foreign sources at favourable rates. Prudent criteria on managing external loans by both the public and private sectors have helped to contain the foreign exchange risks of these loans. The bulk of external loans are approved only to firms with foreign exchange earnings, providing a natural hedge to these loans. These loans have contributed to stable flows of long-term funds in Malaysia. On the other hand, the absence of prudent rules on short-term capital flows made Malaysia vulnerable to unfounded adverse sentiments of portfolio fund managers.

It is emphasised that the new controls are not a substitute for sound macroeconomic and financial policies. The Measures will provide some breathing space to ensure that the ongoing structural adjustment measures could continue uninhibited by external developments. The government is in fact on course in its efforts to restructure the financial sector in particular the recapitalisation of the financial institution.

III. Regaining Monetary Independence

The measures to restrict ringgit trades offshore and to manage short-term capital flows would allow greater flexibility to facilitate economic recovery. With the threat of speculation on the ringgit being reduced, interest rates will reflect domestic conditions while the stability of the exchange rate will facilitate economic and business decisions. However, it should be emphasised that interest rate policy will continue to maintain the balance between the need to contain inflation and the need to create an environment that is conducive to growth. Interest rates will continue to meet the objective of containing inflation by ensuring positive real interest rates

While Malaysia had adopted this strategy, it is not suggested that this is the appropriate approach to be adopted by all countries adversely affected by this crisis. What is to highlight is this is appropriate for Malaysia at this point in time for several reasons based on conditions and circumstances in Malaysia. More specifically: -

- Malaysia needs to insulate itself from externally generated instability in view of the openness of its real economy
- It became increasingly necessary to reduce the rapid pace of internationalisation of the ringgit, which arose from special circumstances between Malaysia and the financial centres in the region.
- Malaysia had undertaken the adjustments in the external sector with a reversal of the current account deficit to a large surplus
- Financial restructuring and mechanism are already in place
- Malaysia had established a track record of implementing selective controls to achieve specific purposes while maintaining sound macroeconomic policies

- Malaysia has the administrative machinery to manage these controls to avoid inefficiencies in the economy.

4.93 Other Supporting Reasons

Given the fact that the most external ringgit accounts are located in Singapore, the regulations also amounted to a de facto ban on the trading of Malaysia currency and stock in Singapore.

The government of Malaysia decided that it could use capital regulation to split the domestic and foreign markets and then introduce a fixed exchange rate that would stabilize the currency values, thereby enabling it to enact expansionary economic policies without undermining the market. The net effect of this should be able to stimulate the economy, reduce the cost of restructuring financial institutions and ultimately bring about an early resolution to the bad-debt problem.

The measures are aimed at greatly reducing the conditions and opportunities for speculators to make profits out of fluctuation in the ringgit's value. The move to have ringgit's rate fixed by the financial authorities, rather than by the market will also restore greater financial stability by reducing the uncertain conditions under which businesses and consumers now have to operate. The great advantage of this approach is that it allows the government greater degree of freedom to determine domestic policy, particularly in influencing domestic interest rates. It can now reduce interest rates without being overly constrained by the reaction of the market and by fears of the ringgit falling. Since the introduction of the measures, interest rates have fallen by about 4 to 5 % points. This has eased the debt-servicing burden of businesses and consumers (especially house buyers) and the financial position of the banks. Controls on short-term capital would give crisis-hit countries great monetary flexibility, making banking reform easier while lower interest rates would give a boost to growth. Without controls, Malaysia might have difficulty restructuring their banks.

Protection of infant markets

The infant industry argument (which was an old idea) often used to justify tariffs in goods market has been resurrected to rationalise the use of capital controls on both inflows and outflows. This idea started with the premise that small domestic firms were less efficient than larger foreign firms and would be unable to compete on an equal basis. To permit small domestic firms to grow to the efficient scale that they need to enjoy to compete in world markets, they must be protected capital markets, the argument urges that capital controls be used to protect undeveloped financial markets from foreign competition. The problem with this argument as in goods market is that protected industries often never grow up and end up seeking perpetual protection.

To Preserve Domestic Saving for Domestic Use

Capital controls preserve domestic saving for domestic use. From a national point of view, there might be benefits from greater rate of domestic investment that do not fully accrue to the investors. For example, domestic savers might invest disproportionately overseas because of political risk of expropriation or a desire to escape taxation. In either case, the nation as a whole could be made better off by limiting or taxing domestic investment abroad.

4.94 Implications

Capital Controls may affect:

1. Foreign direct investment of residents and non-residents
2. Portfolio investments by non-residents
3. borrowing and lending between residents and non-residents through financial institution
4. other capital transactions such as controls over resident holdings of foreign currency deposits or personal transfers and real estate investments.

Details of its Immediate Implications

1.Greater freedom for Malaysia to re-inflate the economy through lower interest rates. This meant lower interest repayment for Malaysian companies. In the short run, many companies that might be going into bankruptcy under the old interest rate would be able to stay afloat.

2.Confusion in international market over how the currency control measures will be implemented. Most currency traders are taking a wait-and- see attitude until the pictures become clearer on October 1

3. Speculators are effectively cut off from any speculative activities in Malaysia

4.International funds are dissuaded form entering Malaysia

5.There were to be an inflow of currency back into Malaysia that is estimated to be around RM25 billion in offshore accounts and RM100 million in cash from speculators and buoyed by a reduction of interest rates.

Strengthening of the KLSE. The main index soared 40% to close over 400 points from September 1 to September 7. This was due to frantic buying by Malaysian investors who responded to greater protection

4.95 Control Measures have worked

A cursory look at the economic figures shows that the recovery measures have worked. But such an analysis is incomplete because the impact the crisis may have had on society is not included. The Malaysian recovery can be considered a success because it maintained Malaysia's social cohesion. Compared with some other affected countries, Malaysia was able to minimise the social impact of the crisis. The unemployment level was kept a manageable level (3.2% in 1998) and there was no massive retrenchment. Similarly, Malaysia also avoided high inflation: the highest price increases were food items and the government introduced price control and food subsidies to mitigate problem. Another indicator of the social impact of the crisis is the poverty level. There was no serious increase in the poverty level in Malaysia.

As an ethnically diverse society, the success of Malaysia's recovery can also be measured by its ability to maintain social stability during the crisis. A sharp erosion of economic welfare can create tension among the various races and fuel social instability. In Malaysia, the situation was even more challenging because there was political instability during the crisis. However, the economic hardship was not too severe and the gains that had been made in narrowing the interethnic economic disparity and the existence of a significant middle class have averted social and ethnic tension.

Contrary to the dire predictions, the selective capital controls have achieved their objectives. The "undervalued" ringgit gives Malaysian exports a price edge, resulting in double-digit export growth in 1999, a large trade surplus and the strengthening of the current account and international reserves position. As the capital control measures only restrict the movement of short-term capital, which is normally invested in the equity market, FDI has continued to flow in. The selective capital controls were designed not to impede the current account transactions (trade transactions for goods and services) repatriation of interest, dividends, fees, commissions and income from portfolio investment and other forms of ringgit assets and FDI inflows and outflows (including income and capital gains). But the selective capital controls also had an important implicit objectives, namely to renew domestic confidence that had been battered by the crisis. Revival of domestic confidence was vital for the resumption of domestic economic and business activities for social stability. With the pegging of the ringgit, domestic producers were able to restart production because exchange rate uncertainties had been removed. After making the necessary adjustment, most businesses could operate at any exchange rate level so long as there was some degree of stability. Multinational companies face no foreign exchange risks when the ringgit exchange rate is fixed. As a result, the business community welcomed the various ethnic groups arising from an economic slowdown. By insulating the economy from further deterioration and stabilizing the ringgit, the government managed to revive domestic confidence, thus averting any serious social discontentment.

Chapter 5

THE EXPERIENCES OF OTHER NATIONS

5.1 Introduction

The capital control measures introduced by Malaysia are not unique.
Many countries including the industrial countries have resorted to capital controls. Countries such as Germany, Switzerland and the United States imposed capital controls when they faced difficulties in achieving domestic and external balance in post-war years. Capital controls played an important role in the defence of a number of European currencies arising from the aftermath of market disturbances within the exchange rate mechanism (ERM) of the European Union. Among the developing countries, the use of capital controls has been much more prevalent. The Latin American countries (Argentina, Chile, Mexico and Venezuela), the South Asian countries (India, Pakistan and Sri Langka) the former centrally planned economies, and closer home China and Taiwan have all used capital controls.

5.2 History of Previous Experiences in Control Measures

Contrary to the belief that capital controls are rare, taboo or practised only by a few countries that are somehow `antimarket' but the reality is that these measures have been widely used before. In the early post-war years, capital control for macroeconomic reasons were imposed on outflow of funds as part of policies dealing with the balance of payments difficulties and to avoid or reduce devaluation.

Rich and poor countries used capital inflows for longer-term development reasons. When freer capital movements were allowed from the 1960s onwards, large capital inflows posed problem for rich countries such as Germany, Holland and Switzerland. They imposed controls such as limits on non-residents, purchases of local debt securities and on bank deposits of non-residents. Recently, some developing countries facing problems due to large capital inflows also resorted to capital controls. For example, when faced with a surge of short-term capital inflows in January 1994 Malaysian banks were subject to a ceiling on their external liabilities not related to trade or investment; residents were barred from selling short-term monetary instruments to non-residents.

UNCTAD said that recent financial crisis and frequent use of capital controls by countries had the effect of swings in capital flow .It questions recent moves in the IMF to restrict the autonomy or freedom of countries to control capital flows. Ways have not yet been found at a global level to eliminate the cross-border transmission of financial shocks and crises due to global financial integration and capital movements. Thus, conclude UNCTAD for the foreseeable futures, countries must be allowed the flexibility to introduce capital control measures, instead of new obligation being imposed on these countries to further liberalize capital movements through them.

The experiences of countries in achieving the objectives of capital controls are varied. In a conference entitled "Measures for Stabilisation of Currencies in East Asia and Establishment of a Regional Monetary System," Thailand Development Research Institute Foundation research director Dr.Pakorn Vichyyanod reviewed the experiences of the following countries. Although the measures taken by the Government are viewed as radical some form of exchange control regulations are also taken by several other countries like Germany, Switzerland, France and Australia at one point or another. Until today, Australia, France and United States continue to impose conditions requiring that money brought in or taken out to be declared. Up until 1979 Britain had restricted the amount of pound sterling that could be taken out.

Controls on capital flows are imposed for two reasons:
Firstly, as part of macroeconomic management (to reinforce or substitute for monetary and fiscal measures)
Secondly, to attain long-term national development goals (such as ensuring residents' capital is locally invested or that certain types of activities are reserved for residents)
Rich and poor countries alike also used controls on capital inflow for longer-term development reasons.
When freer capital movements were allowed from 1960s onwards, large capital inflow posed problems for rich countries such as Germany, Holland and Switzerland. They imposed controls such as limits on non-residents' purchase of local debt securities and on bank deposits of non-residents.

Controls in the post World War Two were generally targeted to achieve balance of payments objectives or as a part of broader economic development strategies. The exchange controls in the UK were designed to protect sterling in the face of a weak balance of payments problem. The Controls in the US in the 1960s were aimed at improving a weak balance of payments by preventing capital transfers abroad. The controls in Japan and France ensured that savings were invested at home than abroad while those in Germany and Switzerland were aimed at restricting capital inflow to prevent the exchange rate from appreciating. These restrictions were consistent with members' obligation under the IMF's Articles of Agreement. For example, Article IV, section 3, states "Members may exercise such controls as necessary to regulate international capital movement." The rationale was to prevent short-term equilibrating capital movements rather than long-term ones.

5.3 Conclusion

Malaysia's Crisis and its own measures

Malaysia is an ethnically diverse country with delicate social and political balance. The stability of the country is very much dependent on its ability to expand the economy to meet it's restructuring and distribution objectives as set out in the New Economic Policy. Thus, the Malaysian society may not be able to absorb any severe economic deterioration. Furthermore, to be beneficial, any restructuring efforts must also take into account the national socio-political and economic dimension.

The crisis has shown that short-term capital flow, which is expected to grow even larger, can determine a country's economic performance. Short-term capital flow is determined both by a country's economic fundamentals as well as market confidence. In a situation of uncertainties, market perception over-rides economic fundamentals and as a result a country with strong fundamentals may also suffer from a flight of capital. In such situation, it is perhaps imperative to minimise the liquidity to exit until such a time that market confidence has returned. Therefore selective controls should be viewed as a measure to calm the market and allow the country to put a brake on the path of economic destruction. However, countries must strengthen their fundamentals because capital controls may only give a temporary relief. The medium and long-term growth prospects will only be determined on the basis on fundamentals.

CHAPTER 6

CONCLUSION

6.1 RECOMMENDATIONS

The UNCTAD report has clearly made out the case for capital controls. It is important to note that these controls should not be treated as a panacea for recession ills. The recent crisis in East Asia and Latin America suggested that geographic proximity was an important determinant of financial contagion and it was in the interest of neighbouring countries

1) to promote regional co-operation and co-ordination in macro-economic policy, banking standard and enforcement of bank regulation to prevent spilovers across countries, the WDR said. In considering the risks inherent in the ebbs and flows of international capital, the World Bank recommended that governments differentiate between liberalising domestic financial institutions and liberalising the capital account. "Although they involve different policy instruments and pose different risks, both types of liberalisation can result in financial instability if they are poorly managed", the WDR said.

2) At the international level, Malaysia must continue **to pressure for reforms to the international financial structure.** What has been so far done does not go far enough. Developing countries must speak up for change. **The call for transparency and accountability should not be just for national authorities**. There has to be an equal emphasis on transparency of the international financial institutions and of course the hedge funds. A modality must be established to compile and disseminate data on international exposure of investment banks, hedge funds and other institutional investors. Countries in the region including Japan should push for closer economic integration among them. This will create a formidable economic entity that can promote global trade and investment and contribute a more stable international financial system

3**) A more constructive approach towards control would be to consider when and under what circumstances such capital controls can be applied in what form they should take**, the preconditions that would ensure it would yield desired results and how it might be effectively implemented.

6.2 SUMMARY AND CONCLUSION

1.Too Much Generalizations or Ignorance of Potentials of Capital Controls
The conventional wisdom of the economies profession has been whatever the problems with destabilizing capital flow or fixed exchange rates that capital controls are ineffective and impose substantial costs on economies that outweigh any benefits. That generalization ignores distinctions among types of capital control and varied criteria for success. Capital controls have many potential purposes and thus many potential standards by which to judge their efficacy. Difficulties in separating the effects of capital controls from the balance of payments or capital flow problems they were intended to alleviate complicates the empirical study of the effects of capital controls (Johnston and Tomirisa, 1998) Also generalizing about the effectiveness of capital controls form one country or even one period –to-another is risky because the effectiveness of capital controls depends on the rigor with which they are enforced (Obstfeld and Taylor, 1998). Governments that control substantial aspects of their citizen’s lives (e.g. Cuba) find it easier to enforce controls on trade in assets (Minton, 1999). Therefore, one should not have prejudice or too much generalized concepts towards the Control Measures but be more positive of its potentials in different situations.

2. Objectives of the Control Measures are met
The primary objective behind capital controls was to end speculation against the ringgit. Most of the speculation was coming from short-selling of the ringgit in offshore (mainly Singaporean market) These markets were offering high interest to attract ringgit deposits that in turn served to find shorting of the currency. To shut down offshore trading the government mandated that all sales of ringgit assets had to go through authorised domestic intermediaries, effectively making offshore trading illegal. All ringgit assets held abroad had to be repatriated.
From the perspective of economics, the real side economic recovery was faster and employment and real wages did not suffer as much. On the financial side, the stock market did better, interest rates fell more, and reserves recovered more rapidly and net financial flows turned around faster.

3. Different Perspectives of success
Capital Controls can be an important set of policies that can protect a country facing a turbulence and hostile external situation, so that it reduces exposure to financial and economic chaos at least for some time.
By adopting selective controls on short-term capital and pegging the Ringgit to US$3.80 in September 1998, the economy was insulated from further speculative and disruptive short-term capital flows. This has allowed our economy to focus on planned and predictable business activities once more as well as to protect the living standards of ordinary Malaysians.

4. Further Signs of Recovery
The poverty level has not been worsened, unemployment remains low, inflation has moderated and the balance of payment position continues to strengthen. The financial market remains stable. The banking system has been restored to its pre-crisis strength. Malaysia’s experience has demonstrated that in an imperfect world where small open economies are adversely affected by volatile capital movements, traditional prescriptions for economics and financial management are not necessarily workable.

5. Rationale behind the Success of the Control Measures
The Malaysian Selective Controls were successful because they were carefully crafted to meet specific objectives on the backbone of strong macroeconomic fundamentals and in particular a strong external reserves position. There was no massive build up in external debt. More importantly, the recovery in Malaysia was achieved with minimum social cost. Malaysia’s multiracial society remained united. In fact, the government of Malaysia was very supportive of the measures taken to maintain economic and financial independence.

6. Other Important Measures
Developing countries need to protect themselves from the free flow of funds. Selective Controls are necessary parts of economic instruments that must be an option. In these days of financial turbulence they may even be a necessary option. This does not mean of course that Selective Controls by themselves are a panacea or “magic bullet”. They should be accompanied by an international mechanism for debt standstill to help seriously indebted countries. Selective controls should not merely be a shield for a country to protect itself. Thus the success of efforts to revive a financially turbulent economy will also depend greatly on the effectiveness, efficiency and fairness (in burden sharing) of recapitalisation, restructuring and reforms in the financial institutions and corporations. It will also depend on the right mix of monetary and fiscal policies that can spur recovery without causing greater financial or economic burden on ordinary citizens especially the poor. In other words, Selective controls are necessary but not sufficiently strong to protect a country from irremediable crisis. They have to be accompanied by other measures. On the other hand, the fact that there are weaknesses in Selective controls does not make capital controls a wrong or evil policy option, as some opponents of capital control appear to portray them.
Total freedom for capital flows is a principle championed by the big financial players and institutions that stand to gain from extreme financial liberalisation. Capital controls are needed from the scientific point of view as well as from the

viewpoint of ordinary citizens who need to be protected from predatory speculation and from economic chaos.

7. Effective during specific conditions

While capital controls cannot substitute for sound macroeconomic policies and prudent framework, they can be effective measures during specific conditions such as the financial turmoil the benefits of these controls must be carefully weighed against their costs. Comprehensive capital controls may effectively allow a country to insulate itself from external shock in the short-term but such controls can also impede the long-term development of domestic financial sector and may reduce access to international savings. Moreover as financial markets become more sophisticated, countries will find it increasingly difficult to impose controls that can limit “unwanted” capital flows without unduly restricting desirable transactions.

8. Success was not due to chance

The Malaysian success in dealing with the crisis so quickly and with minimum disruption was not by chance. It was due to strategic and flexible policy making. It also exemplifies the close understanding and cooperation between the Government, the private sector and society in addressing the crisis. Malaysia can take pride in what has been achieved. The poor have been protected from the harshness of recession. Political and social turmoil have been avoided that others in the region had to endure. There remains a lot more to be done. It is time for action and Malaysians have to move on the present recovery to a path of high-quality growth. As the crisis has proven, there is no single holy grail. Malaysia as others in the region will have to frame its own strategies to suit its own unique social and economic circumstances

9. Lessons to be learnt

I believe Malaysia’s experience in managing the recent crisis holds important lessons not only to policy makers but also for writers of economic history. There are many dimensions and permutations to traditional macroeconomic management beyond the standard fiscal, monetary and structural policies. The most important lesson in my mind is that we should not be afraid to change and try new approaches when the old ways prove to be ineffective. Our approach was unconventional but comprehensive and forward looking. Despite the initial criticism there have been encouraging results in Malaysia and even the IMF has acknowledged that Selective Controls can be useful in specific circumstances. This is Malaysia’s contribution towards revitalising the Asian economy.

At this point of writing (February 2002), the Selective Control Measures are still being implemented in Malaysia. I am sure that if such measures are not working, they would have been lifted or replaced by other measures.

Any measure that is not working would not be allowed to continue for a long time. The shortcomings or weaknesses would be identified and soon new measure would replace them. As the Control Measures are still being practised, it may imply that they are working and thus producing good results.

10. Final

Were the Selective Control Measures effective?

Yes, they were effective in helping Malaysia to recover from the turmoil during 1997 to 2000. It should be noted here that there were other measures taken by the Malaysian Government to assist in speeding up the recovery.

The National Economic Recovery Plan has done a lot to provide the stimulus or catalyst to assist in this recovery. The National Economic Recovery Plan alone without the Selective Control Measures would not work.

As stated earlier, the National Economic Recovery Plan was introduced in January 1998 and there were no signs of recovery from its implementation to September 1998. As the NERP did not work and the economy of Malaysia was worsening, a more daring and stringent policy was introduced. On the other hand, the Selective Control Measures alone without the other measures taken by the National Economic Recovery Plan may not be able to result in such quick recovery. Actually, the Selective Control Measures were not totally a different or separate measures .In fact, they were the later stages of the National Economic Recovery Plan.

Compliments for Malaysia’s Speedy Recovery

Citing an example, Clyde V Prestowitz Jr. President of the Economic Strategy Institute in Washington D.C. said that Malaysia’s growth for the year 1999 had been adjusted to above 4% and the stock market was 180% since September 1998. “What set Malaysia apart was the greater speed and extent of its reform efforts and the better health of its fundamental economic structure,” he said in his article entitled, “Lessons from Malaysia,” which was published in Fortune Magazine’s October issue. It was released by the National Economic Action Council on October 15,1999. In the wake of the crisis, Malaysia while avoiding borrowing from IMF, moved quickly on its own to dispose off bad loans and to recapitalise the banks to enable them to start lending again. Unlike Thailand, Malaysia did not have to create bankruptcy rules and procedures from scratch, he said. Prestowitz Jr pointed out that Malaysia already had perfectly serviceable regulations. “Unlike Korea, the government did not have to struggle with giant chaebol industrial and financial groups that dominated the economy and operated as entitities beyond the reach of the law,” he said. Although it did implement certain policies targeted at industries such as automobile and steel. Prestowitz Jr also quoted Prime Minister Datuk Seri Dr. Mahathir Mohamed as saying that “a great flaw of the US-IMF led austerity measures in response to the crisis was their failure to recognise the potential threat of social disintegration and ethnic unrest from such policies”. The example of Indonesia, where a financial crisis led to social unrest and political instability, confirmed Mahathir’s scepticism of IMF ‘s policies, he added. When it became clear that authority could tear apart social fabric of country, Mahathir rejected IMF’s prescriptions and turned to traditional fiscal and monetary stimulus policies to resuscitate the economy, he said.

FINAL REMARK

With reference to the **Statement of Problem** in Chapter 1,

1.Did the Selective Control Measures lead to recovery of Malaysia? YES

2. Without these measures, will Malaysia recover from the crisis? NO

With reference to the **Research Questions ,**

1. Is our recovery real? YES
2. Is there a positive relationship between Signs of Recovery and Selective Control Measures? YES

It is important to note that the issue here is NOT the effectiveness of Capital Control Measures in the affected countries of Asia but rather the effectiveness of Selective Control Measures in MALAYISA during 1997-2000.
If there were signs or evidence of recovery during this period in Malaysia, one may say the Selective Control Measures were working.

Here, it is believed that the recovery was largely due to Selective Control Measures plus the other measures of National Economic Recovery Plan. Remember, the Selective Control Measures were also part and parcel of the National Economic Recovery Plan. Together they have helped to speed up the recovery.

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8. APPENDICES

Appendix 1

Kuan Soon Lye,
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PULAU PINANG
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To whom it may concern,

This is a Research questionnaire and currently I am doing a thesis on the following topic i.e. " Effectiveness of Currency and Capital Control Measures to remedy Malaysia's financial turmoil during 1997-2000." Your cooperation in participating the following questions is greatly appreciated.

Thank you.

Yours truly,
Kuansoonlye
(KUAN SOON LYE)

SAMPLE OF QUESTIONNAIRE

Kindly circle the corresponding option, which you are employed.

1.Type of organisation or employment.

1.Business 2. Education 3. Government sector 4. Industry

2. Job position in the organisation or industry

1 Entrepreneur 2. Executive 3. Academician 4. Technician

Research Title : "Effectiveness of Selective Capital Control measures to remedy Malaysia Financial Turmoil during 1997-2000"

The Selective Control Measures were introduced in Malaysia on September 1,1998 were as follows:

1. Fix the exchange rate i.e. 1 US$ = RM3.80

2. Monitor the inflow and outflow of Ringgit Malaysia

Instruction :

Please tick **Yes** or **No** in the given box for the following questions:

Section 1

1.Are you in favour of the Fixed Exchange Rate i.e.1US$=RM3.80? Yes~ No□
2.Have you business or job been affected adversely? Yes□ No □
3.Did Capital Control measures work during 1997-2000? Yes□ No□
4. Are the Control Measures a solution to our Financial Turmoil? Yes□ No□
5. Has our financial stability been worsened after the Control measures?Yes□ No□
6. Has your income been affected adversely by the Control Measures? Yes□ No □
7. Would you like the Control Measures to be lifted immediately? Yes□ No□
8. Do the Control Measures do more harm than good? Yes□ No□
9. The Selective Controls Methods have helped Malaysian to recover. Yes□ No□
10. I am happy with the Control Measures. Yes□ No□

Instruction: Please indicate as appropriate the extent to which you agree or disagree with each statement by circling the number that corresponds to your answer using the following key:

1. Strongly disagree 2. Disagree 3 Agree 4. Strongly agree

Section 2

1.The Control Measures help to protect the economy of Malaysia from any speculative activities or any adverse external influences.

1.Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

2.Great sums of Ringgit Malaysia has been successfully brought back to Malaysia after implementing Capital Control.

1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

3 The Control measures ease liquidity shortage in the Banking system and keep interest rate low. The cost of loan able fund is now cheaper to the public.

1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

4.It revives the economy and there is greater demand of private consumption in car sales and bank loans for purchase of residential properties.

1. Strongly disagree 2. Disagree 3. Agree 4 Strongly agree

5.Capital Control has not made people poorer.

1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

6.Unemployment Rate in Malaysia has not been worsened from 1997-2000.

1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

7.There is a surplus in our Current account Balance of Payment since implementing the Control Measures.

1.Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

8.There are less Non-performing loans after the Control Measures.

1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

9.Foreign investors have been drawn away after the Control measures.

1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

10.Our nation's recovery from recession has also been felt by ordinary people.
1.Strongly disagree 2. Disagree 3.Agree 4. Strongly agree

11Capital controls have stopped speculators from manipulating Ringgit Malaysia.
1.Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

12. . It isn't a wrong move to use the Control Measures in this crisis
1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

13.There is a greater increase in KLSE Composite Index from Sept98 to Dec' 00
1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

14. The Fixing of ringgit exchange rate to US dollar provides a greater certainty to trade. Both traders and investors do not need to hedge their investment against risks.
1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

15. With improvement in liquidity in the banking system and increase in external reserves, individuals are able to borrow with greater ease for the purchase of property, motor vehicles and other consumer durables.
1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

16. Fixed exchange rate of RM3.80 to US$1.00 provides predictability, stability and gives the country a competitive edge.
1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

17. There is no shortage of food or medicine or fuel. The supermarkets are well stocked with everything including imported food. One can travel safely anywhere in Malaysia .
1. Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

18. Malaysia's recovery is achieved without bloodshed, riots and the destruction of property .
1.Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

19.The Currency Controls measures are working in Malaysia .
1.Strongly disagree 2. Disagree 3. Agree 4. Strongly agree

20. Our Economic Recovery is real
1.Strongly disagree 2. Disagree 3. Agree 4. Strongly agree