

# ‘The Duel of Fates’

for  
‘The Malaysia Approach to Economic Recovery’ Seminar  
Present at  
The Faculty of Commerce and Accountancy,  
Chulalongkorn University, Bangkok, Thailand  
on 16<sup>th</sup> December 1999.

Dean Dr. Virach,  
Chulalongkorn associates, friends and students,  
ladies and gentlemen.

1. I have been reluctant to come here before you all today. I have hesitated to accept an invitation extended by Dean Dr. Virach to be a panelist on such an auspicious day. Today is the day which the opposition is launching a full scale ‘censure debate’ against the current government in the Parliament.

I even broke my right ankle and tendon. My name was not on the original list of the panelists. Like everything else in life, it is perhaps my *fate* that I have to share my views at this seminar. The *subject* itself is very timely, but *objectively* I shall try my utmost effort to present my own personal opinion in scholarly manner.

One primary reason why I should NOT speak on this topic is because my belief may be *biased*. As mentioned by the moderator earlier, I have briefly been in the governmental and parlimental ‘circle’. Through time, what I learn is that it is very easy to lecture on this ongoing crisis, especially to the students. However, It is very difficult to advise policy maker(s) on financial economic issues when **political and social consequence** are taken into our consideration nationally as well as internationally. It is even much harder for the policy maker(s), themselves to carry on the ‘implementation’ or ‘execution’ of a policy – if you have one. What we should judge the political economic decision making by policy maker is perhaps *not* by his/her outcome which is one of the hundred of possibilities, particularly during the crisis time. But our judgement should rest on the decision making *process* by itself as stated once by one time lecturer in 1998 at Sasin-GIBA, named Mr. Rubin, the famous former US Secretary of Treasury.

2. So, let’s me begin by calling your attention to the onset during 1997 to 1998 in order for the audience to appreciate more on my passage. This setting is a period of uncertainties as depicted by these Figures. Both the South East Asia Crisis Trio [Indonesia, Thailand and Malaysia] and South Korea were experiencing plunges in real domestic credit growth GDP and real GDP as indicated in Figures 1 to 4. Total debt and debt service to % GDP ratios are very high asper Figures 5 and 6. Some of these countries have high short term debt to foreign exchange reserve ratios. This is an elementary sort of financial vulnerability.

3. The root cause of Asian crisis was being debated then as it is being debated now. Generally, the root causes are divided into two types – one as *fundamental flaws*

and another as a *financial mishap*.<sup>1</sup> The former is widely advocated by popular media and economists like MIT Prof. Krugman and NYU Prof. Roubini. They often cite micro and macro economic causes such as crony capitalism, large current account deficit, no total productivity improvement, etc. as the origin of Asian debacle. The latter is believed by a few selective liberal economists like Harvard Prof. Jeff Sachs that to a large extent the Asian crisis is a ‘international bank run’ or ‘financial panic’ phenomenon. We did not know the answer then. And we surely do not know about this now. For me, the real truth could be in between or the combination of both.

4. Now, let get back to **how Malaysians manage their crisis**. Please, kindly take a quick look at the Appendix V from the back of this National Economic Recovery Plan book.<sup>2</sup> Before this national plan is derived, my impression is there must be at least a hundred meetings among the committee of 28 different interest groups with 260 individual associations and over 1,000 participants during Jan. 8 to July 2, 1998. These working groups consisted of wide ranges of associations, for example, :

from Malaysian - Farmers’ Organization Authority to Automotive Federation  
from JP Morgan, Singapore to Bank Bumiputra,  
from Islamic Republic News to Bloomberg Business News,  
from Employee Provident Fund to Statistics Department of Malaysia,  
from Siemens to Bar Council Malaysia, and  
from IMF/World Bank to Bank to NGOs.

This is just to name a few.

5. The National Economic Action Council (NEAC), as shown in Appendix I, is chaired by H.E. Dato’ Seri Dr. Mahathir bin Mohamad, the Malaysian Prime Minister himself along with 11 economic ministers, while Dr. Sulaiman, our designated, but absent speaker today is as the secretary-general. Apart from gathering all the **information and grievance**, the process itself lent vast public support to the plan before the recovery plan was actually implemented. In the words of Prof. Perrakis, the six objectives of the recovery plan for actions are like **a wish list** for all constituency. Prof. Perrakis is rightfully to question some of actions which may not be able to materialize. Nevertheless, to me, the **process** in itself can not be overemphasized as a recognition to the need for a compatible balance between the **Trilemma** : **Democracy**– belief in equity, **Capitalism** – belief in self interest and **Social Welfare**– belief in helping hand.<sup>3</sup> Here, **public participation**, not government

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<sup>1</sup> Corsetti, G, N. Roubini and P. Pessenti [1998a] ‘What caused the asian currency and financial crisis ? Part I : A Macroeconomic overview,’ [1998b] ‘What caused the asian currency and financial crisis ? Part I : A Policy Debate,’ NBER 6833 to 4, [www.nber.org/papers/w6833](http://www.nber.org/papers/w6833) , Krugman, P. [1998], ‘What happened to Asia ?’, <http://web.mit.edu/krugman/www/disinter.htm> and Radelet and Sach [1998] ‘The East Asian Financial Crisis : Diagnosis, Remedies, Prospect,’ Brooking Papers on Economic Activity

<sup>2</sup> ‘National Economic Recovery Plan – Agenda for Action’ by National economic Action Council, Economic Planning Unit, Prime Minister’s Department, Malaysia, August 1998

<sup>3</sup> See more discussion by Pongsak Hoontrakul [1999] ‘Globalization and Trilemma’, forthcoming the Review of Pacific Basin Financial Markets and Policies.

public relation, in my opinion, generates public acceptance, as one of the keys to the Malaysian success story. Public participation, as a *two ways* communication between the government and the people, generates less resistance from all political groups since they may perceive this national plan contains part of their ideas. The process further provides a **political contract for public accountability**. Hence, the national plan sets **a clear direction** on the actions to be taken and clear requirements for **effective co-operation** between agencies in implementation.

6. **The first three objectives** as in Table 1 : 1) Stabilising the Ringgit, 2) Restoring Market Confidence and 3) Maintaining Financial Market Stability, are largely short term stabilisation issues. These short term measures (e.g. foreign exchange control, foreign exchange regime, asset resolution company, etc.) are somewhat controversial, but at least these measures as in Table 2 promptly address the **financial mishap belief**. If one believes in 'free market' principle, then one must follow **laissez-faire approach**. Let's the market works or clears itself out of the mess. Then, the Malaysian approach is really out of touch. Those Malaysians do not know what they are doing. However, if you believe that a small and open economy market like Malaysia is far from complete (in Arrow and Debreu sense) and perfect (in Modigliani and Miller sense), the government intervention is often necessary when the market fails.<sup>4</sup>

7. One can spend an extensive time to debate on these two philosophies. But once again I like to point out the **process** of Malaysian leader(s) decision making in these measures, from the words of senior central banker from Bank of Negara, is **very objective**. For instance, before the foreign exchange control is going to be imposed, the decision maker knows exactly how big their problems are. If executed, the short term capital may flee overnight by about \$ 7 billion; the stock and property market will plummet by approximately 30%; and the non-performing loan (NPL) of the banking system will shoot up by 10 to 15% by simple stress testing. One Prof. from MIT named Paul Krugman who is coming to Thailand next week may like to think that because of his open letter to Prime Minister Dr. Mahathir in Fortune magazine in September 1999 does the trick for the Malaysian to adopt on foreign exchange control and odd notches.<sup>5</sup> But I incline to believe that the NEAC plan has been long drafted before Prof. Krugman's open advocacy. To tell you the truth, I am very intrigued on some objective criteria on the policy decision making and limited moratorium on capital flows with market-based, exist tax policy<sup>6</sup> to stop the panic.

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<sup>4</sup> See more discussion by Pongsak Hoontrakul [1996] 'Should Thailand have a bank-based or stock market-based financial system?', Journal of Business Administration, Thammasat University and Olarn Chaipravat [Nov. 1999] 'Great Economic Recovery in Asian Countries of 1999 – Sustainable or Not ?', discussion paper (in Thai), SCB Research Institute, presented for CEO Forum members of Thailand on November 19, 1999 at Siam Commercial Bank Pcl, Head Office, Thailand and translated into English by the Nation daily newspaper on December 4, 1999.

<sup>5</sup> See more details of the open letter by <http://www.pathfinder.com/fortune/investor/1998/980907/malaysia.html>

<sup>6</sup> Malaysian exist tax is a tax system on the point of capital exist. This is not the same as Chilean, often dubbed as Tobin, tax system which is taxed based on the capital volume at the entry point. Hence, Malaysian exist tax system clearly discourage short term 'hot money' type investment.

8. There are many more short term measures in which I would like to talk more than just foreign exchange control. Due to the time limitation, I shall focus next on two corner stones- exchange rate regime and bank recap. The former is discussed on pages 50 to 53 and the latter on pages 74 to 77. On the foreign exchange issue, the NEAC recommended for the ringgit to move within **an exchange-rate band** against an old trade-weighted basket of currencies.<sup>7</sup> However, on the actual implementation, I do not know why the Malaysian government had adopted instead **a fix exchange rate regime** at the rate of 3.8 ringgit per dollar on October 1, 1998 and last up until now. Why did the Malaysian change their plan? Why did the rate peg to the USD at 3.8 ringgit, not other rates? Conceivably, this magic number 3.8 is just the moving average from the last week of trading in free floated regime as a 'fair' value.

9. I would like to *call* upon HE Dr. Mahathir via Mr. Rubbi, my peer panelist that an exchange-rate band system is more preferable than the fix system, particularly after you use a fix exchange rate for awhile. One should recognize that Malaysian ringgit or Thai baht is **an 'exotic' and thinly trade currency** in an *asymmetric* market which is prone to speculation and manipulation.<sup>8</sup> To maintain exchange rate fix, it is like to keep a *standstill target* as an open invitation for speculative attack apart from no monetary policy independence. If Malaysia does adopt an exchange rate band system as I suggest, to manage exchange rate becomes a critical issue. One may have an ultimate desire of floating exchange rate in perfectly competitive market. But one must understand first the danger of speculative exploitation in the thinly traded market where only a handful of players matter. Under such *oligopolistic market* condition, government has a role to manage the market when the volatility is too wild. It appears that after the 1997 debacle, to adopt proactive or preventive management in foreign exchange market is necessary. One way is to create more transparency in the marketplace by disseminating **'timely and quality' information disclosure** on international capital flows. Another way is to use **institutional constraints**, like prohibiting local banks to lend in local currency to non-residents who do not have the underlying transaction requirement such as exports and imports and long term investment. This effectively makes short selling a local currency very difficult. I guess after Malaysia paying the price for its mistakes during this turmoil and in 1994, at least some important lessons have been learned. Please, do not worry about us-Thai. It seems that we, Thai administrators, have learned this valuable lesson too. At least, there were some evidences in recent months.

10. One last issue for the short term measure is the **bank recapitalization**. Bailout with *public money* have been the primary method in Malaysia [, without denying,] of solving banking crisis. **Danaharta** was set up around mid 1998 to be asset resolution company, while **Danamodal** was established to deal with bank recapitalization as

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<sup>7</sup> The committee also recommends a study on the feasibility and prerequisites of adopting an ASEAN currency at a future date on page 53. See more discussion by Pongsak Hoontrakul [1998] 'Triangular peg: a strategic anchor for Thai and Asean currency,' the Review of Pacific Basin Financial Markets and Policies, pp 511-527

<sup>8</sup> See more discussion by Hoontrakul [1998, 1999]; Chaipravat [1999]; Devereux and Engel [1998], 'Fixed vs Floating Exchange Rates: How Price Setting Affects the Optimal Choice of Exchange-Rate Regime', NBER 6867; and Frenkel, J. [1999] 'No single currency regime is right for all countries or at all times,' NBER no. 7338, [www.nber.org/papers/w7338](http://www.nber.org/papers/w7338)

shown in Table 3. Danaharta or Asset Management Corporation (AMC) is acting like **a hospital** to nurture 'sick' NPLs by buying NPLs away from surviving banks to reduce their NPLs to be below its max 10% allowance. The purchase price is market price or independent outside auditor's consensus. Any upside gains after rehabilitation or work out will be *split* equally between Danaharta and the bank. There are specific time frame and performance based reward for the AMC management teams to create **incentive compatible** to all stakeholders. This greatly avoids a mass *destruction* of productive capacity unlike 'warehousing first and fire sale later' approach.<sup>9</sup> Indeed, the concept of 'good bank, bad bank' is alive and well in Malaysia. What Malaysia may fail, is to consolidate [or forced marriage] their banking system into six 'universal (anchor) banking groups' as the original plan eventhough future attempt can not be ruled out under its determined leadership. It remains to be seen that the banking recap and consolidation process by the Malaysian approach may work well in the future. Possibly, without proper handling, like Bank of Bumiputera case of 3 bailouts in 30 years history, serious moral hazard problems will easily resurface again.

11. It goes without saying that the Malaysian approach on the short term measures is relatively a success. Prof. Stiglitz, Chief Economist at the World Bank confirmed this success during the World Economic Forum in Singapore in October 1999. Beginning in the third quarter of 1998, Malaysia has sought to fix its collapsing economy with reflation carried out behind temporary capital control. Expansionary fiscal and monetary policy are pursued to coincide with the change of hearts around the region. This creates **a virtuous cycle** of a region-wide pump priming at least until the end of year 2001.

12. Nevertheless, this does not ensure a long term sustainable recovery. To hedge their bets and to address the popular critic on Asian fundamental weakness, from Tables 1 and 2 the NEAC has the last three objectives – Strengthening Economic Fundamentals, Continuing the Equity and Socio-Economic agenda, and revitalising Affected Sectors. The race-based policy of increasing the Malay community's share of prosperity is quite controversial in term of 'pure' economic consideration, but it might be a 'must' for a racial divided country like Malaysia. I will leave this to other to judge since it involves political and social issues. It is also too early to tell on Malaysian long term approach since this is a **time-tested model**, especially on sectoral assistance and strategic industry in globalized world. It remains to be seen some of the recommendations, for example, to promote KLIA as a 'hub' airport for this region (p.182), to enable the Multimedia Super Corridor in boarderless world (p. 160) and to *strategically* keep its national car Proton world class competitive as the WTO and ASEAN Industrial Corporation rules being effective (p. 165).

13. Therefore, I would like to conclude that in short run I believe the Malaysian approach seems to work out very well given all the constrains which they have. What we should learn most from the Malaysian is **not a 'secret' formula** which may and may not be true in *different* circumstances. **As a matter of fact, many Malaysian measures are consistent to H.M. the King's self-sufficient economy concept stated in Dec. 1997.** What we should learn is on how and the process they bring

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<sup>9</sup> See more discussion by Chaipravat and Hoontrakul [1999] 'Thai Credit Market Failure : the 1997 aftermath,' dicussion paper, Sasin-GIBA, Chulalongkorn University.

together all **the unity for the duel of fates** of one country with such a divided ethics in time of crisis.

Comments are welcome.

May I wish you all, in advance, happy holidays.

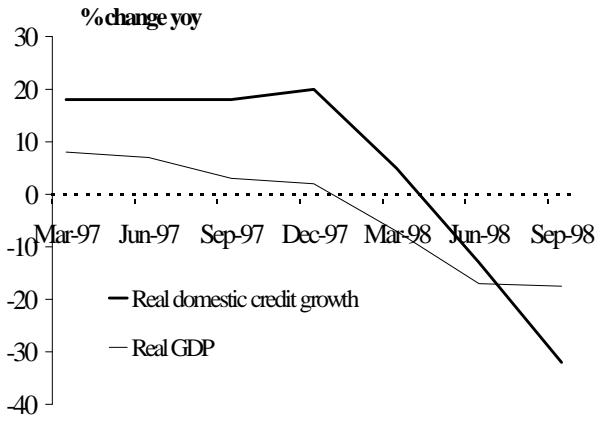
May Lord Buddha bless you all with courage, health and prosperity into the next millenium.

Thank you for your kind attention.

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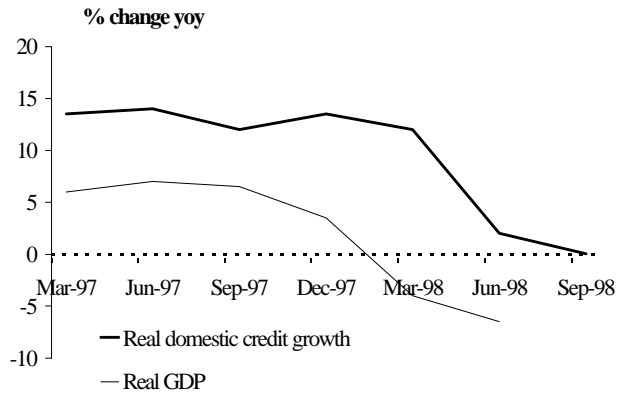
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**Figure 1: Indonesia**



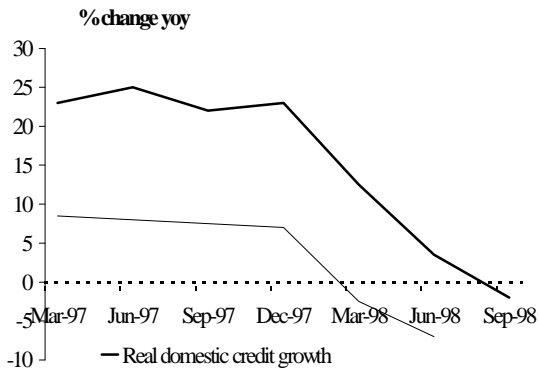
Source: ICEIC, GS estimates

**Figure 2: Korea**



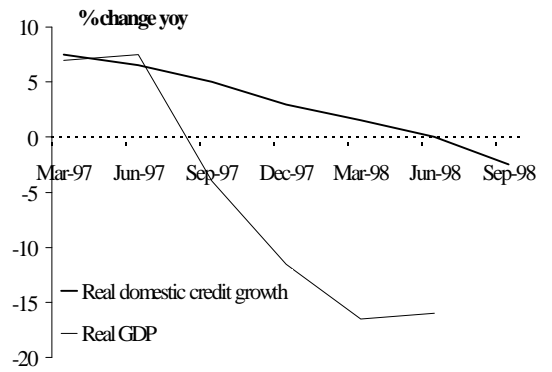
Source: ICEIC, GS estimates

**Figure 3: Malaysia**



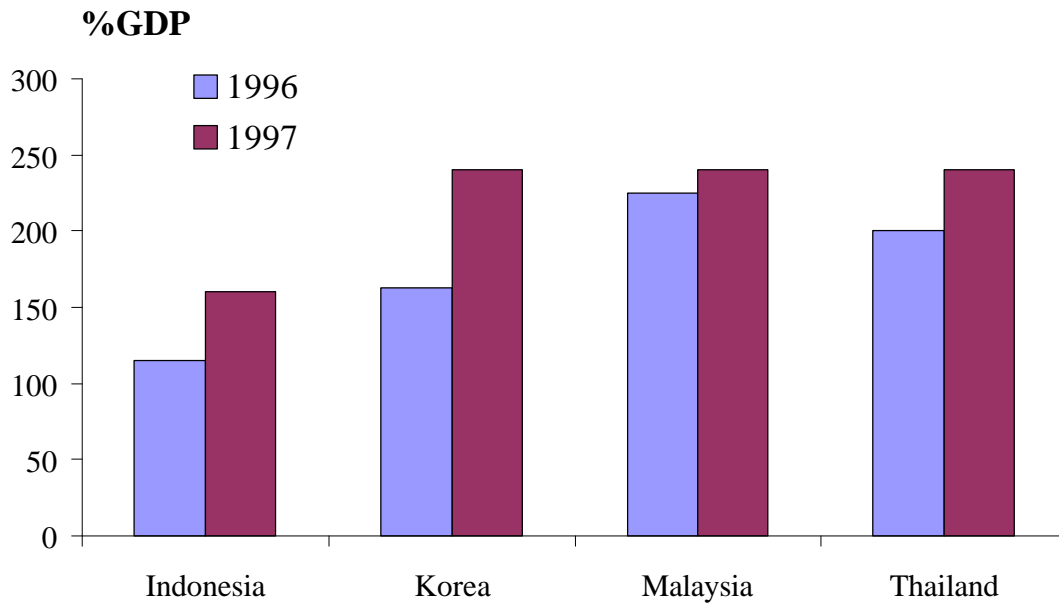
Source: ICEIC, GS estimates

**Figure 4: Thailand**



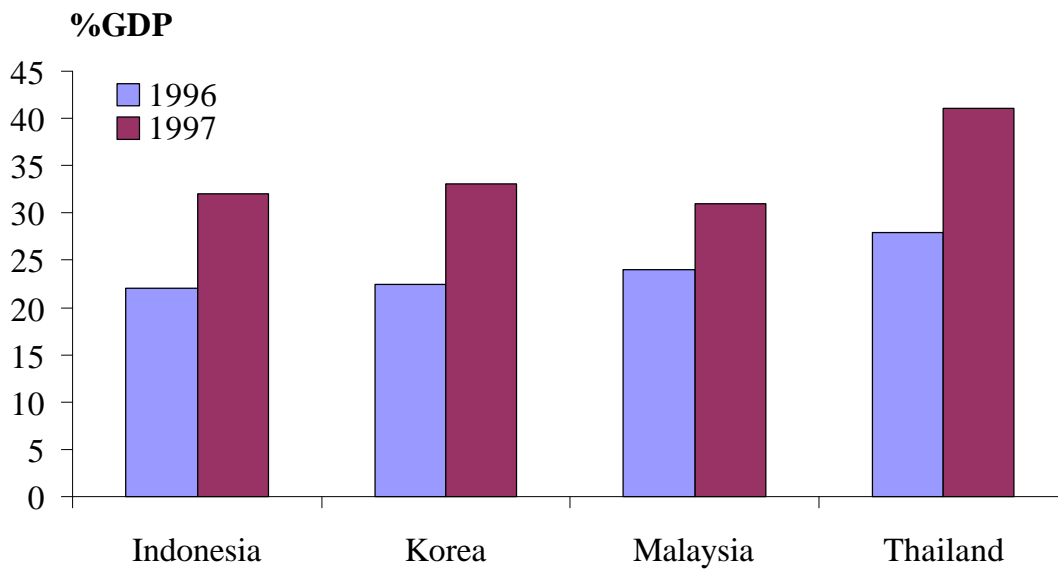
Source: ICEIC, GS estimates

**Figure 5: Total debt**



Source: GS estimates

**Figure 6: Debt service ratios**



Source: GS estimates

## **Six Objectives of the Recovery Plan**

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

### **Objective 1: Stabilising the Ringgit**

- Appropriate Choice of Exchange Rate Regime
- Reduce Over-Dependence on the US Dollar
- Increase External Reserve
- Adopt a Balanced Interest Rate Policy

### **Objective 2: Restoring Market Confidence**

- Improve Transparency and Regulatory Environment
- Establish Rules for Assisting Industries and Companies in Trouble
- Increase Consistency of Policies
- Adopt Liberal and Market-Based Policies
- Improve Public Relations
- Improve the Dissemination of Economic Information

### **Objective 3: Maintaining Financial Market Stability**

- Preserve the Integrity of the Banking System
- Establish Agencies Along the Lines of FDIC/RTC
- Recapitalise the Banking Sector
- Monitor Closely Overall Credit Expansion
- Improve the Capital Market
- Develop the PDS Market

### **Objective 4: Strengthening Economic Fundamentals**

- Increase the Quality of Investments
- Improve the Balance of Payments
- Maintain a Balanced Public Sector Financial Position
- Maintain an Appropriate Monetary Policy
- Maintain Price Stability
- Increase Labour Competitiveness

### **Objective 5: Continuing the Equity and Socio-Economic Agenda**

- Ameliorate the Hardship from Poverty
- Address the Issues on Bumiputera Equity Ownership
- Expand Employment Opportunities
- Meet the Challenge of Expanding Tertiary Education
- Address the Problem of Graduate Unemployment
- Control the Influx of Foreign Workers
- Gear Up State Corporations to Face the Crisis
- Revamp Cooperatives and Cooperative Banks
- Protect Environment for Sustainable Development

### **Objective 6: Revitalising Affected Sectors**

- Primary Commodities and Resource-Based Industries
- Mining and Petroleum
- Manufacturing
- Information Technology and the Multimedia Super Corridor
- Motor Industry
- Construction
- Property
- Infrastructure
- Transportation
- Freight Forwarding
- Tourism
- Industrial Development Finance Institutions
- Insurance and Reinsurance

## Institutional Arrangements For Corporate And Financial Restructuring

	Voluntary corporate workout	Asset resolution company	Agency for bank recapitalization
Indonesia	Jakarta Initiative Task Force	Indonesian Bank Restructuring Authority	[Bank Indonesia]
Korea	Corporate Restructuring Coordination Committee	[Korea Asset Management Corporation]	[Korea Deposit Insurance Corporation]
Malaysia	Corporate Debt Restructuring Committee	Danaharta	Danamodal
Thailand	Corporate Debt Restructuring Advisory Committee	Financial Restructuring Authority (for non-bank finance companies)	[Financial Institutions Development Fund]