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Abstract: Every country leaders would have probably face the economic crisis but have we ever wondered why some leaders seem to remain calm in the face of economic disaster such as Tun Dr Mahathir Mohammad during the 1997 Asian Financial Crisis, while others seem to fall apart. Leaders who are able to remain calm and patient have what psychologists call resilience, or more known as an ability to cope with problems and setbacks. Resilient leaders are able to utilize their skills and strengths to cope and recover from problems and challenges, which may include job loss, financial problems, high rate of unemployment, and currency depreciation. This study focuses on how the Asian Financial Crisis 1997 initiated when Thailand first began to float its national currency, Baht (฿). This leads to an economy crisis that includes the neighboring country such as South Korea, the Philippines, Malaysia and Indonesia. Our research also focuses on how Malaysia was affected by the Asian Financial Crisis 1997 and steps taken by the leader especially Tun Dr Mahathir in fighting back the financial crisis which lasts for about two years.

Key words: financial crisis, resilient, Mahathir, currency, floating

INTRODUCTION

Between June 1997 and January 1998 a financial crisis swept like a brush fire through the "tiger economies" of South East Asian. Over the previous decade the South East Asian countries, Thailand, Malaysia, Singapore, Indonesia, Hong Kong, and South Korea, had registered some of the most impressive economic growth rates in the world. These economies had expanded by 6 percent to 9 percent per annum compounded, as measured by Gross Domestic Product. This impressive economic growth among the Asian countries was known as Asian Miracle, however, it appeared to come to an abrupt end in late 1997 when the local stock markets and currency markets imploded in one country after another. The following figure shows comparative economic growth of the US and the financial crisis effected Asian countries (combine) between 1995 and 2000.

Fig. 1: Comparison of economic growth between Asian Countries and United States.

The crisis started in Thailand with the collapse of Thai baht and subsequently the Thai government was forced to float the baht (due to lack of foreign currency to support its fixed exchange rate). At the time, Thailand had acquired a burden of foreign debt that made the country effectively bankrupt even before the collapse of its currency.
Since the early 1990s, the economy of Thailand had been a center of attraction for massive volumes of capital inflow from other countries due to its accommodating economic policies and healthy-looking conditions. The rapid economic progress of Thailand is also supported by external factors such as the stagflation in the Japanese economy and the recession in European countries during the 1990s. In Thailand, there had been a long period of strict financial regulations that limited credit expansion of commercial banks. However, this policy started to change during the beginning of the 1990s when the Thai government decided to accommodate a policy of financial market deregulation and capital account liberalization. Moreover, with an exchange rate fixed to a basket of world dominant currencies especially US dollars, Thailand enjoyed a long period of stability in terms of exchange rate (the baht fluctuated very narrowly between 24.91 and 25.59 per US dollar) with more or less stable price level (3.3 - 5.9 percent), and high rate of interest (at around 13.25 percent) before the crisis. Figure 2 shows that Thai baht was stable till 1996 and then it was increasing sharply when the crisis began in 1997.

![Figure 2: Nominal Exchange Rate (to the US Dollar).](image)

The government of Thailand could manage to maintain the inflation rate reasonably low between 3.36 percent and 5.7 percent. The fiscal balances was in surpluses level. Besides, the economy possessed a characteristic of high saving rates (around 33.5 percent of GDP) and its GDP growth rate was highly impressive (8.08 - 8.94) during 1991-95. As a result, Thai economy had become a center of attraction to international speculators, many of whom had channeled their large sum of capital out of Japan (which had undergone a lengthy period of stagflation and low interest rate). By 1995, Thailand had a net capital inflow of US$ 14.239 billion, which was more than one hundred percent increase from its net capital inflow three years ago.

However, the golden years of Thailand did not last any longer. From 1996, Thailand's economic progress became slower due to a number of factors such as the contraction in the real estate sector, the emergence of China as an intimidating competitor in international trade, the fall of world demand of semiconductor which was one of the Thai major exports in 1996. A large part of the capital inflow had been put into non-productive sectors especially real estate. Those sectors were non-productive because they produced non-tradable goods which were sold only domestically, resulting in less national volume of exports and thus weaken the economy’s balance of trade as well as the capital account. Real estates were non-tradable; thus, there was a constraint in market demand of them. Too many houses and business buildings were built; by 1997, the commercial vacancy rate had gone up to 15 percent. The real estate business had become unprofitable and the business owners thus, had no capacity to pay back their debts to financial institutions when the maturity came.

The Asian meltdown (the end of Asian Miracle) began on February 5th, 1997 in Thailand. That was the memorable date that Somprasong Land, a Thai property developer, announced that it had failed to make a scheduled $3.1 million interest payment on an $80 billion eurobond loan, effectively entering into defaulting. Somprasong Land was the first victim of speculative overbuilding in the Bangkok property market. The Thai stock market had already declined by 45% since its high in early 1996, primarily on concerns that several property companies might be forced into bankruptcy. Now one had been.

After the Somprasong’s default, it became clear that not only were several other property developers teetering on the brink on default, so where many of the country’s financial institutions including Finance One, the country’s largest financial institution. Finance One had initiated a practice that had become widespread among Thai banking institutions --- issuing eurobonds denominated in US dollars and using the proceeds to finance lending to the country’s booming property developers. In practical, this practice made sense because Finance One was able to exploit the interest rate differential between dollar denominated debt and Thai debt (i.e.
Finance One borrowed in US dollars at a low interest rate due to US financial crisis, and lent in Thai Baht at high interest rates.

The only problem with this financing strategy was that when the Thai property market began to unravel in 1996 and 1997, the property developers could no longer payback the cash that they had borrowed from Finance One. In turn, this made it difficult for Finance One to pay back its creditors. As the effects of over-building became evident in 1996, Finance One’s non-performing loans was doubled, and then doubled again in the first quarter of 1997. In February 1997, trading in the shares of Finance One was suspended while the government tried to arrange for the troubled company to be acquired by a small Thai bank, in a deal sponsored by the Thai central bank. It didn’t work, and when trading resumed in Finance One shares in May, they fell 70% in a single day. By this time it was clear that bad loans in the Thai property market were swelling daily, and had risen to over $30 billion. Finance One was bankrupt and it was feared that others would follow.

The percentage of non-performing loans had shown a tremendous rise up to 13 percent in 1996. This soar of the non-performing loans began the era of banking crisis as banks’ balance sheet had been deteriorated. In international trade, Thailand had become less competitive in the existence of an emerging trader like China together with a constantly increasing trend of dollar currency (i.e. an appreciation of dollar) which had worsened Thailand’s terms of trade since Spring 1995. (The exchange rate of yen for dollar went from 80 in Spring 1995 to over 125 yen per dollar in Summer 1997). Thailand’s terms of trade had been worsened because the Thai baht was needed to appreciate along with the dollar which was the major currency in the currencies basket Thailand had fixed its exchange rate to. Moreover, as the world demand of semiconductor was fallen in 1996 (Figure 3), Thailand’s volume of exports was decreased, contributing to a balance of trade deficit.

Fig. 3: Decline In Semiconductor Prices.

Furthermore, a series of external shocks began to change the economic environment - the devaluation of the Chinese Renminbi and the Japanese Yen, raising of U.S. interest rates which led to a strong U.S. dollar adversely affected their growth. As the U.S. economy recovered from a recession in the early 1990s, the U.S. Federal Reserve Bank under Alan Greenspan began to raise U.S. interest rates to head off inflation. This made the U.S. a more attractive investment destination relative to Southeast Asia, which had been attracting hot money flows through high short-term interest rates, and raised the value of the U.S. dollar. For the Southeast Asian nations which had currencies pegged to the U.S. dollar, the higher U.S. dollar caused their own exports to become more expensive and less competitive in the global markets. At the same time, Southeast Asia’s export growth slowed dramatically in the spring of 1996, deteriorating their current account position.

**Literature Review:**

In the history of Asian economics, the worst ever crisis went through by the Asian countries was the 1997 Asian Financial Crisis. The primary cause of the financial crisis was the fluctuation of Thailand Baht (฿). The economic crisis that happened in Thailand was due to several reasons. There was large deficits in the current account. Current account was defined as the net transfer of a country’s goods, services, and assets with the rest of the world. Thailand’s deficit was as 8 percent of GDP in 1995; 7.9 percent in 1996 and 1997 (Far Eastern Economic Review, 1998). The export growth rate showed a decrease by 23.5 percent between 1995 and 1996. The deficits caused the country to rely heavily on external borrowing (Thammavit, 1998).

Although most of the governments of Asia had seemingly sound fiscal policies, the International Monetary Fund (IMF) stepped in to initiate a $40 billion program to stabilize the currencies of South Korea, Thailand, and Indonesia, economies particularly hard hit by the crisis. In the year of 1997 the International Monetary Fund (IMF) estimated that Thailand’s external debt was about $U.S.99 billion. According to Bernard (1994), the external debt of Thailand was about 55 percent of its gross domestic product (GDP). The majority of this debt
was privately incurred and this large external debt sharply lifted the country’s debt service ratio from 11.4 percent in 1994 to 15.5 percent in 1997 (Suehiro, 1992).

### Table 1: Monthly Statistics of Thailand (May 1997 – September 1997).

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<tbody>
<tr>
<td>Exports</td>
<td>124.0</td>
<td>119.3</td>
<td>137.6</td>
<td>147.7</td>
<td>171.1</td>
</tr>
<tr>
<td>Percentage Of Change</td>
<td>0.8</td>
<td>9.3</td>
<td>24.2</td>
<td>25.1</td>
<td>52.0</td>
</tr>
<tr>
<td>Imports</td>
<td>140.8</td>
<td>143.8</td>
<td>159.6</td>
<td>170.6</td>
<td>170.0</td>
</tr>
<tr>
<td>Percentage Of Change</td>
<td>-10.2</td>
<td>-1.9</td>
<td>9.1</td>
<td>9.4</td>
<td>23.7</td>
</tr>
<tr>
<td>Trade Balance</td>
<td>-16.7</td>
<td>-24.5</td>
<td>-22.0</td>
<td>-22.9</td>
<td>1.1</td>
</tr>
<tr>
<td>Current Account Balance</td>
<td>-22.7</td>
<td>-23.2</td>
<td>-17.7</td>
<td>-18.6</td>
<td>-3.9</td>
</tr>
<tr>
<td>Balance Of Payments</td>
<td>-112.3</td>
<td>-24.6</td>
<td>-51.5</td>
<td>-146.1</td>
<td>133.0</td>
</tr>
<tr>
<td>Official Foreign Reserve (U.S.$ billions)</td>
<td>33.3</td>
<td>32.4</td>
<td>30.4</td>
<td>25.9</td>
<td>29.6</td>
</tr>
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Source: Bank Of Thailand (cfThammavit, 1998)

The collapse of the property sector that began to boom in the late 1980’s. With the liberalization of international capital flows in 1993, this sector grew rapidly. This is where Thailand became the world center of attraction for investment. By 1995, an oversupply of housing emerged, expanding into a major problem. With loans increasingly becoming more expensive and hard to get under the Bank of Thailand’s squeeze on lending, the property sector began to collapse in 1996 (Corsetti, Pesenti, and Roubini, 2001). The property sector’s debts totaled around 1,000 billion baht (approximately $39 billion) in 1996. The slump in the property sales market and lending squeeze worsened developers cash flow troubles and defaults on interest payments (Glick and Rose, 1999). As a consequence many finance companies and small banks faced liquidity problems, with 16 finance companies suspended in June 1997, and another 42 in August 1997. By December 1997, 56 finance companies were closed permanently.

According to Gregorio and Valdès (2001), the exchange rate mismanagement seen as a factor of the financial crisis. With a fixed exchange rate and the liberalization of international capital flows, foreign money poured into Thailand between 1993 and 1996 because of its strong and potential economic progress. Due to this inflow of foreign currencies (Das, 1999), the Thai baht became overvalued against other currencies, partly slowing down growth in exports in 1996 because imports looks very cheaper compared to domestic products. However, the Bank of Thailand continued to peg the baht to a basket of currencies in which the U.S. dollar had a significant influence. Speculators attacked the baht in February and May 1997 and in order to defend the currency the Bank of Thailand used official foreign reserves. (Woo, 2000)

Table 2 shows the deterioration on the exports and current accounts of some of the South East Asian countries. The table displays that while the current accounts deficits remains high and worsen, the exporting countries at the same time period faces a downturn in its amount of export. Using South Korea and Thailand as an example, their exports grew the least with only 3.7 and 0.5 percent respectively. This compared to 30.3 and 23.1 percent respectively a year earlier. Therefore, this reflects a fiscal imbalance of reducing exports with consistently high current account deficits. In simpler words, eventually export amount will not be enough to pay for its current account deficits.

Besides that, due to the boom in the exports, there is immediate need of funds to finance its exports industry and other increasing economic activity. At that instance, the liberalization of the Global Financial market provided the best platform for external funds. (Diamond and Dybvig, 1983) Eventually such borrowing will widen the current account deficits and worsen the situation more. When a country’s current account deficits
widened more with the decline in exports and an overvaluation of the currency due to the inflow of foreign funds into the country, it will attract the attention of currency speculators. (Frankel and Rose, 1996) Currency speculators will eventually attack the domestic currency and the end result will be currency depreciation which finally worsen the economic progress of a country.

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<tbody>
<tr>
<td>Thailand</td>
<td>-7.9</td>
<td>-7.9</td>
<td>23.1</td>
<td>0.5</td>
</tr>
<tr>
<td>Indonesia</td>
<td>-3.3</td>
<td>-3.3</td>
<td>13.4</td>
<td>9.7</td>
</tr>
<tr>
<td>Malaysia</td>
<td>-10.0</td>
<td>-4.9</td>
<td>20.1</td>
<td>6.5</td>
</tr>
</tbody>
</table>

The net result being that official foreign reserves fell from $U.S.39 billion in January 1997 to $U.S.32.4 billion in June 1997. (Granger et. al., 2000) Additionally, the Bank of Thailand sold $U.S.23.4 billion of the reserves on the forward market. In July 1997, the Bank of Thailand had to replace the fixed exchange rate with a “managed float”, as it could no longer tap the reserves. The exchange rate for the baht has fallen steadily since then from 25.8 baht to the $U.S. to around 40 Baht to the $U.S. currently, with the Baht reaching 50 Baht to the $U.S. before settling at its current level. The mismanagement of the exchange rate system has been cited as evidence of central bank incompetence (Radelet and Sachs, 2000).

In the knowledge of Hoet al. (2000), the governments of the affected economies will try to stabilize its currency from continuous collapsing either by increasing the interest rates or using its foreign exchange reserves to increase the currency. When higher interest rates are introduced, it will eventually bring down the banking sector due to the massive increase cost of borrowing abroad. Eventually there will be a ‘reverse flow of funds’ from an inflow to outflow of foreign funds (Kaminsky and Reinhart, 1998). With such outflow of funds, it will result in a credit crunch and coupled with the high interest rate it will eventually bring down the real estate and banking sector.

Finally, the political instability played the role in Thailand financial crisis. Chavalit Yongchaiyudh’s administration, which lost government in November 1997, performed very poorly in economic management (Far Eastern Economic Review, May 21 1998). Its economic teams lacked unity and common goals, and failed to deal with the mismanagement by the technocrats. Confidence of foreign and domestic investors slipped away, and the economy continued to worsen after the 1996 elections. (Bello, 1998).

**Findings of Study:**

**The Impact of 1997 Asian Financial Crisis on Malaysian Economy:**

In mid-May 1997 marking the end of Asia Miracle and the beginning of Asian Financial Crisis, the Thai baht came under severe pressure from speculative attacks. The ringgit (RM) also felt the impact due to the depreciation of Thailand Baht in world market. The ringgit was also not spared, and came under severe selling pressure. The Prime Minister of Malaysia, Tun Dr Mahathir ordered Bank Negara Malaysia’s (the central bank of Malaysia) to intervene in the foreign exchange market (FOREX) to uphold the value of the ringgit. Bank Negara valiantly upheld the value of the ringgit for about a week before it finally was forced to float the ringgit on July 14. Unfortunately, the bank had already lost approximately to U.S.$1.5 billion in the effort to prop up the ringgit. At its minimum point, the ringgit depreciated against the dollar by almost 50 per cent, hitting a high of RM 4.88 to the U.S. dollar on January 7, 1998.
After a short period of stability between the months of February and March, the exchange rate continued to deteriorate with wide fluctuations in the upcoming months. (Lopez, 1999) Even more drastic than the plunge in the exchange rate, was the collapse of the stock market of Kuala Lumpur Stock Exchange (KLCE). Between July and December 1997, the composite index of the Kuala Lumpur Stock Exchange (KLSE CI) fell by 44.9 per cent. After a slight recovery in the first quarter of 1999, unfortunately the index again fell, this time to an eleven-year low of 262.70 points on September 1, 1998. On the whole, between May 1, 1997 and September 1, 1998, market capitalization in the KLSE fell by about 78.7 per cent to RM 181.5 billion. In fact, although it enjoyed the best precrisis economic fundamentals among countries that were hit by the crisis, Malaysia experienced the biggest stock market plunge in the South East Asia Region (Athukorala, 1998).

The dynamics of the property in Malaysia also subsequently burst, and the tragedy was accompanied by massive capital outflows as confidence in the Malaysian economy by the investors became increasingly shaky. As a result of the actions taken by the investors, the banking system began to experience increasing nonperforming loans (NPLs) which, according to Bank Negara data, rose from about a modest 2.18 per cent in June 1997 to 4.08 per cent in December 1997, and then to a high of 11.45 per cent in July 1998 (Malaysia, EPU 1999). Nonperforming loans here are defined as a sum of borrowed money upon which the debtor has not made his or her scheduled payments for at least 90 days. A nonperforming loan is either in default or close to being in default. Once a loan is nonperforming, the odds that it will be repaid in full are considered to be substantially lower. If the debtor starts making payments again on a nonperforming loan, it becomes a performing loan, even if the debtor has not caught up on all the missed payments (Brennan and Aranda, 1999)

Private sector estimates for NPL ratios at the time were much higher than the earlier official figures suggested, as many companies had begun to roll over debt as part of their survival strategy. On other hand, the
increase in NPLs in the banking and financial sector slapped in a sharp downturn in borrowing and financing, bringing about tight liquidity conditions. After a short time lag, the real sector of the economy also began to feel the pain of the crisis. General contraction in domestic demand was resulted by the weak stock prices, the property market slump, and the net contractionary impact of the ringgit depreciation together led to a negative wealth effect. The domestic-oriented industries, such as the construction and services sectors, were severely hit by the financial crisis.

Meanwhile, private investment generally contracted due to uncertainties and dim economics progress arising from unstable exchange rates, the decline in local and external demand, as well as excess capacity and tight liquidity position in the economy causes the contraction of the private investment in the country. (Jomo, 2001) Foreign direct investment (FDI) levels, as measured by the value of applications received in the manufacturing sector and applications for investment incentives from the hotel, tourism, and agriculture sectors by the Malaysian Industrial Authority (MIDA), shows a negative trend over the period January–December 1998 due to shaky economics conditions. (Sachs and Velasco, 1996) In the public sector, a decrease in both expenditure and investment was expected earlier following the government’s announcement that it was slashing the budget for operating expenses by 18 per cent, not to mention the cancellation and/or postponement of several infrastructure mega-projects. The government action is believed to reduce the government spending thus producing a fiscal surplus in the economy.

With the major decrease in consumption, investment, and government expenditure, the only source of growth was expected to rise from the country’s net exports. In addition, the initial impact of the crisis led to declining imports of luxury goods as domestic demand slowed due to the depreciation of the ringgit in the world market. Meanwhile, imports in general though, did record an increase (52.7 per cent year-on-year in February 1998). The high import of Malaysian manufactured exports, especially of capital and intermediate goods, goes a long way in explaining the subsequent rise in imports at the time. (Obstfeld, 1984) Meanwhile, exports rose as well, especially in the resource-based sector, and displayed a continued uptrend in ringgit terms. Unfortunately, when converted into U.S. dollar terms, most of the major export categories displayed a downward trend.

The crisis-induced slowdown in economic growth has had an undeniable impact on Malaysia’s social dynamic as well. The contraction in domestic product resulted in the expansion of unemployment growth and retrenchment levels. While employment growth had been growing steadily at 4.9 and 4.6 per cent in 1996 and 1997, respectively, it contracted by 3 per cent in 1998. For the whole of 1998, the number of workers retrenched was 83,865, a sharp increase from the 19,000 retrenched in 1997 (Central Bank of Malaysia) Inflation levels increases as well, reaching a high of 6.2 percent in June 1998 before moderating. (Chang and Velasco, 1998) The inflation rate was 5.3 per cent in 1998. The rise in unemployment and inflation are the main channels through which the social impact of the crisis has been transmitted because it is through these channels that real household income declined. Urban families experienced the worst of the impact due to increased cost of living, including the cost of food, household necessities, health care, tertiary education, and transportation.

**Fig. 7:** The Inflation Rate In Malaysia between 1996 – 2000.

**How Tun Dr. Mahathir Fight Back the Financial Crisis of Asian 1997:**

One of the main reasons of Malaysian economy stability today is from a leader who fights back the financial crisis with much patience and reliance known as Tun Dr Mahathir. In September 1997, Mahathir declared that “trading of national currency is unnecessary, unproductive and immoral,” and argued that it should be “stopped” and “made illegal.” Mahathir threatened to impose an unilateral ban on foreign exchange purchases unrelated to imports but it never happened in Malaysia. All these actions took by Tun Mahathir
seemed to exacerbate the situation until he was finally reined in by regional government leaders and his cabinet colleagues. His reputation by the Western leaders worsened day by day due to his action to ban the foreign exchange purchases, until Tun Mahathir came to be demonized as the regional bad boy. (Edward, 1997)

Table 3: Timeline of Malaysia in response to 1997 Asian Financial Crisis

<table>
<thead>
<tr>
<th>Event</th>
<th>Date</th>
</tr>
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<tbody>
<tr>
<td>After exhausted of funds defending the baht, Thailand decides to float its currency</td>
<td>1 September 1998</td>
</tr>
<tr>
<td>Bank Negara Malaysia intervenes in the Forex market to defend the Ringgit</td>
<td></td>
</tr>
<tr>
<td>Mahathir attack rogue speculators and point finger at Soros</td>
<td></td>
</tr>
<tr>
<td>Malaysia designate the 100 index linked counters and banned short selling</td>
<td></td>
</tr>
<tr>
<td>Malaysian Ringgit continue to plunge</td>
<td></td>
</tr>
<tr>
<td>Mahathir called for currency trading moratorium, and be banned in Hong Kong</td>
<td></td>
</tr>
<tr>
<td>Soros calling Mahathir ‘a menace to his country’</td>
<td></td>
</tr>
<tr>
<td>Meeting in Argentina, Mahathir and Nor Yekop finalized the Capital Control</td>
<td></td>
</tr>
<tr>
<td>Malaysia impose tough market measures by Anwar Ibrahim</td>
<td></td>
</tr>
<tr>
<td>BNM reduce SRR from 13.5% to 10% in banks, boosting liquidity in banks</td>
<td></td>
</tr>
<tr>
<td>Asian currencies continue to plunge</td>
<td></td>
</tr>
<tr>
<td>KLCI plunge to the lowest at 260 points</td>
<td></td>
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<tr>
<td>Imposition of Capital Control</td>
<td></td>
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</table>

On 1 September 1998, the Malaysian authorities lead by Tun Dr. Mahathir introduced strong control over the capital and other currency controls. The move taken by Mahathir is to fix the ringgit exchange rate at RM3.8 to the US dollar, compared to the pre-crisis rate of around RM2.50. At that time, due to political misunderstandings between Anwar and Mahathir, the prime minister then dismissed the deputy prime minister and finance minister, Anwar Ibrahim. The imposition of capital controls on outflows was clearly an important challenge to the prevailing orthodoxy, especially as promoted by the IMF. Capital controls did not slow down the Malaysia’s recovery due to the financial crisis. The 1998 collapse was less pronounced in Malaysia than in Thailand and Indonesia, while the recovery in Malaysia was faster in 1999 and 2000. Absolutely, the pre-crisis problems in Malaysia were less serious, due to strengthened prudential regulations after the banking crisis of the late 1980s.

A strict control was imposed on Malaysian private borrowing from abroad generally whereby it required borrowers to demonstrate likely foreign exchange earnings from the proposed investments to be financed with foreign credit. Although Malaysia had the most open economy in the region after Hong Kong and Singapore, with the total value of its international trade around double its annual national income amazingly, its foreign borrowing and the share of short-term loans in total borrowing were far less than in the more closed economies of South Korea, Indonesia, and Thailand. In the measure of decreasing the foreign borrowings, the Malaysian authorities had limited exposure to foreign bank borrowing, while their neighbors in East Asia allowed, facilitated, and even encouraged such capital inflows from the late 1980s such as Thailand who emerged as a center of attraction for investment. The vulnerability of East Asian economies to such borrowing was not due merely to financial interests seeking arbitrage and other related opportunities, or to corporate interests seeking

While the effects of capital flows to stock markets undeniably differ from those of foreign bank lending, the risk was such portfolio capital flows are even more easily reversible than short-term foreign loans. Malaysian bank vulnerability during the crisis was not so significant due not so much to foreign borrowing as to extensive lending for stock market investments and property purchases and to their reliance on shares and real assets for loan collateral. Considering the high savings rates in the South East Asia region, there is no evidence that portfolio capital inflows significantly contributed to productive investments or economic growth. Unfortunately, the reversal of such flows proved to be very disruptive, exacerbating volatility and causing a certain risk to the economy. Their impact has been due largely affected to the wealth effect and its consequences for consumption and, eventually, investment. When such capital flow reversals were large and sustained, they contributed to significant disruption. To make the situation more worse, while portfolio capital inflows built up slowly, outflows were much larger and more sudden. The supply of the national currency became much more higher than the demand for Malaysian Ringgit (RM). Such outflows from late 1993 had resulted in a massive collapse of the Malaysian stock market, Kuala Lumpur Stock Exchange (KLSE). The early 1994 introduction of controls on inflows sought to discourage yet another buildup of such potentially disruptive inflows.(Chander and Patro, 2000).

The efficiency of the Malaysian controls on the capitals was due largely arguable to their appropriate and effective design when they were introduced by Tun Dr. Mahathir. At the time, many market analysts did not consider and acknowledge the Malaysian authorities capable of designing and implementing such controls, but some later conceded that they had been wrong for a lengthy period of time. The controls addressed the problem and were subsequently revised in February 1999 and lifted after a year. The Malaysian authorities reviewed their assessment of the capital controls and demonstrated their flexibility, responsiveness, and, thus, commitment to being market and investor friendly. The most important part was they emphasized from the outset that the measures were directed at currency speculation, and not at foreign direct investment (FDI) although FDI plays a major role in enhancing the progress of economic growth in a country. Although green field FDI to Malaysia declined after 1996, a global decline from 2000 also affected the Southeast Asian region as a whole (including Singapore), with China and a few others being the only exceptions. The argument that rises at that time was the Malaysian capital controls provided a “screen behind which favored firms could be supported, and if it’s true, the analysis would have to shift to the other measures introduced to provide such support, since the controls only provided a protective screen. Amazingly, the argument’s evidence points to significantly greater appreciation of the prices of shares associated with the surviving political leadership in the month right after the introduction of controls on capitals by the government of Malaysia.

The government emphasized efforts to bolster the stock market, for which many blame the government-controlled Employees Provident Fund (EPF) of over RM10 billion in 1998. The EPF and other Malaysian government-controlled institutions are believed to have bought about RM2 billions of Malaysian stock through Singapore- and Hong Kong-based brokers to give the impression of renewed foreign investor interest in the Malaysian market. Hence, the government phased out the September 1998 and subsequent capital and currency control measures in light of their ambiguous contribution to economic recovery, changing conditions, and the adverse consequences of retaining the measures. The National Economic Action Council’s later efforts to revise the 1 September 1998 measures—thus undermining their main original intent (to deter panic-driven capital flight)—reflected the pragmatism and flexibility of the Mahathir regime despite his rhetoric, and probably limited damage to foreign investor sentiment.

Generally, prior to the assumption of the role as the sole currency-issuing authority by Central bank in 1967, the exchange rate of the Malaysian dollar was fixed at 2s.4d sterling. On June 1967 when Central Bank commenced issuing currency, Malay dollar was exchangeable for Malaysian dollar. However with the devaluation of sterling by 14.3 % in November, the sterling-pegged Malay dollar was devalued by the same magnitude automatically. Instead of the previous 2s.4d, the exchange rate for one Malaysian dollar became equal to 2s.9d. Hence the Malay dollar was then worth 85.71 cents of Malaysian dollar. In 1997-1998 East Asian Financial Crisis, the Central bank respond to pegging the ringgit to the United States dollar at RM 3.80. The rationale for such policy action was to provide a breathing space for Malaysian economy to recover from the spill over recessionary effects by securing monetary policy autonomy for the country.

As a part of the capital control imposed by Tun Dr. Mahathir, the following measures are taken to ensure that the objectives of stabilizing the Ringgit and control the capital flows are accomplished.

**Reasons Behind Malaysia’s Success in Today’s Economy:**

Malaysia is well known for its stability of government as it is also called as authoritarian government. Emergence of Malaysia as an authoritarian government practices Asian values such as maintaining good relationships, respect the elders, upholding harmony and family closeness. Authoritarian Government is seen as the one of the main element for the rapid economic growth in Asean whereby the West Countries fail to do that.
Singapore’s government under Lee Kuan Yew is often criticized for being too authoritarian and so does Dr Mahathir Mohammad and Indonesia’s Suharto. Being an authoritarian government, it enabled Mahathir to push both state-led and private corporations into cohesion so as to achieve its objective. (Flood and Garber, 1984)

Fig. 8: The real economy growth in Malaysia (1990 – 2008) shows a large improvement from 1998 to 1999 due to capital control introduced by Tun Dr Mahathir.

The pursuit of autonomy on its economy started since the May 13th 1969 racial riots. It was agreed that the main reason for the racial riots is due to the inequality of income distribution between and Chinese and the Malays. The Chinese seems to be predominantly controlling most businesses and hence at the expense of the Malays. In order to ensure more equitable distribution of income, The New Economic Policy was born in 1971. To close the gap between the Malays and the Chinese business licenses, monetary assistance, employment in public enterprises, property purchase discount (10%), ownership quota (minimum 30%), universities intake (more than 90%) and a myriad of other discriminatory policies are enacted. The concept of resilience in Tun Dr. Mahathir was seen here playing a major role in stabilizing the political aspect in order to conserve the economic progress. It would be a unrealized dream for Western politicians to exert such autonomy on their economy and its people.
Due to the structural transformation of the Malaysian economy since the 1980s after the Crash of the tin price which was brought about Mahathir’s effort to corner the tin market. It has since more diversified from being an agrarian economy to a manufacturing economy. Import substitution and export-led industries such as electronics are the main activities and contributed much as the engine of growth therefore providing higher export for the country. In the meanwhile, the high price of agricultural commodities such as palm oil and rubber also helped cushion the impact of the crisis in the rural areas. This is because the rural economy depended much on rubber and palm oil plantations and it not only insulated it from the onslaught of the crisis but also contributed to the vibrancy of the rural economy. Hence, Malaysia had one less problem to tackle and it can now concentrate its fight on the urban economy (Krugman, 1998).

Although Malaysia enjoys the advantage due to capital control, but it also should take into account that creation of black market for currencies. Due to the increased demand for US$ since dollar was becoming strong in the world market, more people will be willing to pay more Ringgit for the dollar. Hence in the black market instead of the stipulated US$1 to RM 3.80, people are willing to pay more say RM 4.00. However, this does not happen in Malaysia because due to the authoritarian nature of the government. Bank Negara Malaysia can exert full control on the commercial bank operations. Commercial banks then are warned not to mess around with the black market and also the government through NEAC liaise the Bank Negara with the Customs Department in order to control the smuggling of the Ringgit and dollars between its border with Singapore and Thailand.

Due to Bank Negara Malaysia’s stringent control on offshore borrowing by local corporations, Malaysia’s external debt did not pose any danger to its Debt/GDP ratio. This in response to its earlier experience during the 1987-1988 crisis. Only Malaysian companies that are earning foreign receipts are only allowed to raise capital overseas. Hence this helped it to control its external debts especially the short-term ones. The following graph shows the Debt/GDP of the most affected countries during the 1997 Asian Financial Crisis.

**Fig. 10:** The Debt in terms of GDP in South East Asian Countries during the Asian Financial Crisis.

**REFERENCES**


