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Malaysia's Past and Present Economic Priorities

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1. Introduction

Today, Malaysia is one of the most open economies in the world with total trade amounting to almost 220% of our nominal GDP of US$87.5 billion (RM332.5 billion). According to the World Trade Organisation (WTO), in 2001 Malaysia ranked 12^{th} and 26^{th} in terms of trade in merchandise and commercial services respectively. Manufactured exports today comprise almost 90% of total exports with technology-intensive electrical goods and electronics accounting for some 60% of our export value while crude petroleum and liquefied natural gas have supplanted tin, rubber, timber and palm oil as the primary export commodities.

The output structure of the Malaysian economy has been radically transformed. Today, the manufacturing sector contributes one third of GDP while the services sector (including government services) contributes more than 55% of output. The agriculture sector contributes less than 10% of total output and only accounts for 15% of the labour force. This is a far cry from the 1970s when agriculture contributed more than one third of domestic output and absorbed more than half of the national labour resources.

This structural transformation of the economy is a result of Malaysia's changing priorities to meet the needs and circumstances of each of its development phases. Malaysia's economic management has evolved from one of laissez faire in the 1960s to one where the state has actively intervened to restructure the economy and to develop domestic capacity, especially in the early 1980s. This was followed by a drive towards greater privatisation, liberalisation and deregulation in the mid 1980s. This strategy produced Malaysia's most successful period of economic growth. More recently, towards the end of the last decade, with the Asian crisis leaving many corporations bruised, the Government has, in the national interest, stepped forward again to assume a larger role in the economy.

This paper discusses Malaysia's economic priorities in three periods: during its boom years (from 1986 to 1997), during the Asian crisis (1998 to 2000) and the future (after 2000). In this discussion, the paper will examine the factors that shaped these priorities, the strategies and measures that were used to achieve them and make an assessment of the impact of these goals on Malaysia. The analysis will show that the priorities are decided after taking into account the challenges at hand, the prevailing domestic and international conditions including advantages and constraints and the resources available. These changing priorities are glued together by one underlying theme, namely for Malaysia to attain good socio-economic development.

2. 1986-97: Economic Restructuring Through Growth

The 1986-97 period was eulogized as Malaysia's golden age: from 1990 to 1996 the economy grew at an average annual rate of 8.5%, the longest period of sustained high growth in Malaysian history. Other economic statistics are equally impressive:

- Export grew by double digits annually, reaching a high of 26.5% in 1995.
- Unemployment was substantially reduced from 8.3% in 1986 to 2.5% in 1997. In fact, from 1993 to 1997 Malaysia enjoyed full employment.
- Inflation remained below 3.7%, except in 1992 when it rose to 4.7%.
- Foreign Direct Investment (FDI) in manufacturing grew almost fourfold, from US$1,778 million in 1986 to US$6,561 million in 1995.

This high growth performance was accompanied by economic restructuring. The share of agriculture sector has shrunk from 22.2 % in 1980 to 13.6% in 1995. Conversely, the manufacturing sector's share has jumped from

19.6% to 33.1% during the same period (Table 1). Similarly, manufacturing products have replaced those of agriculture as the country's main export earners: Manufacturing exports share in total exports had increased from 33 % in 1985 to about 80% by the middle of 1990s. In the league of developing countries, Malaysia was the world's sixth largest exporter of manufactures, after the four East Asian newly industrialised countries and China. Table 3 gives a concise picture of Malaysia's economic performance.

One of the most admired features of the Malaysian economic transformation was the socio-economic restructuring, namely reduction of poverty and income inequality (Table 3). The incidence of poverty declined significantly from 49% in 1970 to 8.7% in 1995. Between 1970 and 1995, income inequality as measured by the Gini coefficient fell from 0.537 to 0.446, which meant that the improvement in income that came from economic growth was enjoyed by all. The reengineering of society in the form of corporate equity distribution had also shown some success, with the Bumiputera share of capital ownership increasing to 20.6% in 1995 from 2.4% in 1970.

This transformation was not accidental but planned. The following priorities were set and the appropriate strategies were formulated to turn them into reality:

- Generate a sustained high growth after the recession in 1985;
- Make Malaysia an industrialised economy by the year 2020, as embodied in Vision 2020, an initiative launched in 1990;
- Continue with the New Economic Policy goals of poverty eradication and restructuring of society where ultimately economic functions cannot be identified with ethnic groups;
- Further integrate Malaysia with the global economy;
- The private sector would play a lead role in generating economic activities; and
- Modernise and diversify the agriculture sector.

Why these priorities?

In the 1970s Malaysia was faced with high unemployment: the unemployment rate in 1970 was 7.5%. This problem was caused by the high rate of population growth and to exacerbate the situation, the agriculture–based economy was unable to grow fast enough to absorb the new entrants into the labour market. Thus, industrialisation was identified as the solution. However, since Malaysia had a negligible domestic industrial base, export-oriented industrialisation was the most natural solution: it was the fastest way to accumulate capital as well as penetrate the global market. A successful export-oriented industrialisation required liberalisation and deregulation of the domestic economy so that it could be competitive and participate well in the international trading system.

The government also recognised that export-oriented industrialisation might not develop in a way that is closely linked with the fledging domestic industries. But, a fully developed industrial sector must have both these components (export and domestic-oriented industries). To create a strong domestic industrial base, the public sector had to intervene by participating directly because the domestic private sector did not have the necessary resources. The early 1980s saw the direct participation of government in heavy industries. The twin crises caused by current and budgetary deficits highlighted the economic vulnerability in the mid 1980s, partly due to the large size of the public sector[1].

Therefore, in order to overcome the crisis and build a stronger foundation for the economy, it was decided that Malaysia needed more economic liberalisation and deregulation and that the private sector should be the engine of growth. Liberalisation would introduce more competition, attract foreign capital and increase efficiency. Public sector participation in business had produced mixed results and therefore, it should in future focus on its core activity, namely administering the country.

While economic growth was important, it was insufficient to meet the broader socio-economic development goals. The twin New Economic Policy (NEP) goals of poverty reduction and restructuring society had to continue because some of the targets such as share of corporate equity had not been met. And since a large proportion of the poor are in rural areas, the income level of this sector had to be increased through modernisation and diversification of the agriculture sector.

Strategies to operationalise these priorities

A number of the priorities were interlinked and common policies were used to achieve them. Export-oriented industrialisation strategy was the method employed for the three priorities - generating high economic growth, making Malaysia an industrial economy and integrating better with the global economy. This strategy began in the early 1970s when Malaysia opened its doors to foreign multinationals, especially in electronic and textiles industries, which were seeking a cheaper investment location. It established free trade zones and licensed manufacturing warehouses that offered tax-free facilities for imported inputs, which enabled these companies to operate at world prices. In addition, Malaysia also introduced a variety of tax incentives such as pioneer status that gave exemption from income tax for qualified companies, (contained in the Promotion of Investment Act 1986). These measures had attracted a large inflow of Foreign Direct Investment (FDI) particularly from Japan, which had an additional push factor when the Yen appreciated as a result of the Plaza Accord to push for a stronger Yen (as a measure to reduce the large Japanese trade surplus).

This export-oriented industrialisation also provided a vital route to expand the industrial sector and as means to penetrate international export markets. Malaysia’s labour-intensive export products were competitive globally, thus producing double-digit export growth. As a broad strategy to create a more attractive investment environment, infrastructure was expanded and on the financial front, a market-based interest rate setting mechanism was introduced.

In addition, a focused development of the capital market was undertaken with the establishment of the Securities Commission, the promotion of a debt securities market and the increased role of the Kuala Lumpur Stock Exchange as a channel for companies to raise capital. The government also took steps to forge a closer relation with the private sector through initiatives such as Malaysia Inc. and Malaysian Business Council.

The modernisation and diversification of the agriculture sector involved both the public and private sector. Rubber was replaced by palm oil and the commercialisation of the palm oil industry has made it an important export earner for Malaysia. The government had, through its budgetary allocation, created jobs and improved infrastructure, increased the yield of agriculture production and commercialised small-farmers activities. Efforts to increase the rural sector income and skills were also significantly assisted by the labour-intensive export-oriented industries that employed mostly unskilled rural female workers.

To restructure the economic functions so that they would not be divided along ethnic lines, the government participated directly in business activities by holding in trust the equity on behalf of the Bumiputeras. Moreover, capital and training were made available to encourage the Bumiputeras to join industrial, services and financial activities.

For example, one of the benefits in promoting the automotive industry was the creation of small and medium-scale Bumiputera vendors producing components for the two national cars. Specialised institutions were formed to provide financing facilities and technical advice to potential Bumiputera entrepreneurs. Similarly, encouragement was also given for Bumiputera players in the banking sector and related financial services industries such as stockbroking.

In 1986, Malaysia underwent another dramatic shift in its economic management strategy in response to the recession of 1985. The public sector was downsized while public finances were consolidated through budgetary control. The private sector was allowed to become the primary engine of growth. The government adopted active programmes to promote the privatisation of non-financial public enterprises. Guidelines on privatisation were introduced in 1985, and the Privatisation Master Plan was adopted in 1991. The programme began with the privatisation of government owned enterprises such as airlines and telecom. Subsequently, it was extended to include new projects proposed by the private sector such as toll roads, ports, utilities (water supply) and energy (power generating plants)

The fundamental achievement of this period was the transformation of Malaysia into an emerging economy by the 1990s with strong macroeconomic fundamentals, a vibrant private sector and the emergence of a sizeable middle-class, which gave rise to social cohesion and stability. This in turn encouraged the influx of foreign direct investment, which further fuelled economic growth. In short, Malaysia entered a virtuous cycle in economic development that has, sadly eluded many impoverished third world countries.

3 The 1997-98 Crisis

a) The unfolding of the crisis and its impact on the Malaysian economy

In the 1990s Malaysia joined the rank of “the Asian Miracle Economies” or “Tiger Economies” and thus, when Malaysia was drawn into the 1997-98 economic and financial crisis, it surprised many. The crisis began with the floating of the Baht on 2 July 1997, which created immediate and severe pressure on other regional currencies. On July 11, the Philippines gave up defending the Peso, Malaysia floated the Ringgit two weeks later and Indonesia abolished its exchange rate band, thus leaving the Rupiah to float on August 14. Thailand called in the IMF on July 28 and Indonesia did the same about two months later.

While the Malaysian economy was in a relatively strong position[2] when it entered the East Asian crisis, it could not avert an economic and financial implosion. As a result, the Malaysian economy experienced its deepest recession and the gross domestic product (GDP) contracted by 7.5% in 1998. The economy was still buoyant in 1997 with GDP growth of 7.7% and the impact of the crisis only began to be felt in the first quarter of 1998 when the GDP declined by 3.1%. The severest contraction occurred in the third quarter of 1998 when GDP fell by 10.9%.

This severe contraction was due to a combination of several factors: the deflationary force of the regional crisis, massive capital outflow, public sector expenditure reduction and tight monetary policy. The massive outflow of short-term foreign capital (Table 4), particularly from the equity market and the withdrawal of loans by foreign banks had drastically reduced the funds available to companies, thus forcing many to trim down their business activities.

The sharp contraction of the Malaysia economy in 1998 was caused by the collapse of aggregate demand by 20.3%. This fall came from three components: public consumption and private consumption and investment. Public consumption fell by 7.2% while private consumption fell by 7.5%. However, the single most important cause for the contraction in aggregate demand was the 50.5% fall in private investment, which was triggered by the complete lack or higher cost of funds, excess capacity and the expectation of decreasing consumption. Public investment did not help very much as it grew only by 0.4%.

Sectoral performance

In terms of sectoral performance, it was not a surprise that the construction sector suffered the worst: the sector had over-invested during the period of high growth (1987 to 1997), which resulted in a massive excess capacity. GDP in this sector shrank by 28% and 29% in the third and fourth quarters of 1998 respectively. The manufacturing sector also recorded a severe decline: the contraction in the second half of 1998 was 18.7%. The agriculture sector experienced a relatively mild contraction (- 4.5%) when compared to the other two sectors. Even the services sector was not spared – in the second half of 1998 its output dropped by 3.5%.

Exchange rate

At the onset of the crisis, when regional currencies were under pressure to devalue, Malaysia tried to defend the Ringgit but it found this strategy unsustainable and costly. On July 14, the Ringgit was floated and subsequently the Ringgit exchange rate slipped from RM2.50 to US$1 prior to the crisis to its lowest level of RM4.88 on January 7, 1998.

Equity market

The equity market, not surprisingly, was among the worst hit when the Kuala Lumpur Stock Market lost 80% of its market valuation. From a high of RM917 billion in February 1997 the market valuation sank to RM182 billion on 1 September 1998 when the selective capital controls were imposed. This drop was reflected in the movement of the KLSE composite index, which fell from 1271 points to 262 points during this period.

External sector

During the initial phase of the crisis, exports had decreased as the troubled East Asian economies (50% of Malaysia's export market) had seriously cut their demand for imports. When the Ringgit was pegged (at RM3.80 for one US dollar) other regional currencies appreciated, which increased Malaysia's relative price competitiveness. This allowed Malaysian exporters to take advantage of the robust US export demand. In nominal Ringgit terms, total exports grew by 29.8%, with palm oil registering the highest increase of 64.4%, followed by manufactured goods (32.2%) and crude petroleum (6.2%). The sharp Ringgit depreciation had also increased Ringgit export revenue, which had contributed to higher domestic liquidity.

Malaysia's large merchandise balance of RM 69 billion (or US$18.2 billion) in 1998 was achieved not only from high export growth but also from the collapse of imports. Sharply dampened consumer demand and low investment reduced the demand for imports - total imports only grew by 3%. Due to the strong performance of the merchandise account balance, the balance on goods and services has reversed its deficit trend that was prevalent during the 1990-1997 period into a surplus of RM 46.7 billion in 1998. The merchandise account surplus of RM 69 billion was more than sufficient to offset the RM 22.3 billion deficit from the services account.

Capital flows

In 1998, RM10.6 billion worth of long-term capital flowed into Malaysia, a reduction of about RM9 billion over the 1997 inflow. Not unexpectedly, the short-term capital account showed a substantial net outflow of RM21.7 billion due to the decline in net external liabilities of the commercial banks and the liquidation of portfolio investments by foreign investors. The lower net external liabilities by commercial banks followed from the stagnation in domestic demand and the unwinding of trade-related hedging activities.

Financial sector

The crisis had created stress on the banking system. High interest rate and the collapse of the stock market have raised non-performing loans (NPLs) of financial institutions to a level that was considered threatening. Prior to the crisis, financial institutions' NPLs were 4% in 1997 but they had jumped to 15.8% in August 1998. Higher cost of financing and tighter liquidity has discouraged private investment. The cost of funds for investment increased substantially when the base lending rate rose from 10.3 % in June 1997 to 12.3% in July 1998: in some cases the effective interest rate was as high as 20%.

Inflation and unemployment

Unlike in some other crisis-hit economies, the severe economic contraction did not translate into hyperinflation and widespread unemployment. In 1998, inflation rose to 5.3%, double that of 1997, and unemployment climbed to 3.2% from 2.5% during the same period. The presence of a large group of immigrant workers absorbed the severe impact of economic recession and many of them left Malaysia for their home countries and thus mitigated the problem of high unemployment.

b) The facts about the 1997-98 crisis

As with the other affected countries, Malaysia's early response was to adopt the standard IMF-style measures, namely tightened fiscal and monetary policies, introduced measures to redress balance of payment deficits and floated the exchange rate. The government had announced a 3% surplus for the 1998 Budget. Among the budgetary measures introduced were a 20% reduction of government's expenditure, deferral of mega projects and cutbacks on government purchase of foreign goods. In the financial sector, a comprehensive set of measures was implemented such as reclassifying the NPLs in arrears from six to three months and greater financial disclosure by financial institutions. A credit plan was also introduced to limit overall credit growth to 25% by end-1997 and 15% by end-1998, where priority was given to productive and export-oriented activities. The Bank Negara Malaysia (the central bank) had also raised the three-month intervention rate from 10% to 11%, increased the minimum risk-weighted capital adequacy ratio from 8% to 10% and reduced the single customer limit from 30% to 25%. The level of provisions against uncollateralised loans was also increased to 20%.

The outlook for the economy in January 1998 as it entered its most dire phase was as follows:

- These initial policies did not produce the expected results. The fiscal reduction of 20% and infrastructure projects deferment had severely contracted domestic demand. In addition, higher interest rate and credit tightening had starved domestic firms of funds at a reasonable cost. As a result the domestic economy continued to deteriorate and the exchange rate remained volatile.

- The private sector was in serious trouble and it could not lead the recovery as it did in the 1985 crisis. In addition to decreasing demand, companies were faced with a liquidity crunch and rising debts. Many companies found it difficult to continue with their businesses. Moreover, the private sector's rising debts could threaten the stability of banking institutions due to the inadequacy of capital to meet the rising NPLs.
- The external environment was very volatile and uncertain and recovery from the crisis would need much more than an export-driven recovery strategy.

c) The priorities to revive the economy were:

- The domestic economy to lead the recovery process.

  In view of the external volatility and uncertainty, expansion of the domestic economy was to compensate for the adverse impact of contracting externally linked economic activities.
- Stabilisation of the Ringgit.

  The floatation of the Ringgit did not produce the desired result because, instead of stabilising, the Ringgit became volatile. With a stable Ringgit, domestic production could resume because exchange rate uncertainty would have been removed. Most businesses could operate at any exchange rate level, after making adjustments, as long as there was some degree of stability. Multinational companies, which imported most of their inputs and exported all their products, faced no foreign exchange risk.
- Regaining monetary policy independence.

  Malaysia must regain the control of its monetary policy and this could be done only if the link between interest and exchange rates was severed.

Monetary independence would allow a substantial reduction of the interest rate without putting pressure on the currency. Malaysia needed to lower interest rate to revive domestic demand and investment, which were key components of the fiscal stimulus policy. A regime of high interest rate could be perilous to the private and banking sector because of the high level of borrowings in the economy: the ratio of domestic debt to GDP was 160%.

- Restoring Market Confidence

  Up until the crisis, Malaysia had a reputation as a good investment location and it enjoyed a positive and good relationship with the investing community. The outbreak of the crisis was, in part, attributed to the loss of confidence among international investors. The loss of domestic confidence followed a little later when the economy deteriorated and the exchange rate plunged. The restoration of market confidence, particularly domestic, was crucial to bringing back a favourable environment for investment.

- Maintaining Financial Market Stability

  The crisis that began in the equity market had affected the real economy and could have threatened the stability of the banking sector. The economic slowdown and higher costs of funds had increased the level of NPLs (the level of NPLs has risen from 3.5% in March 1997 to 10.6% in April 1998). Financial institutions without adequate capital to meet this contingency would not be able to perform their intermediary functions of funding business activities and this could throttle the economy.

- Ensuring adequate liquidity to finance economic activities.

  The earlier tight monetary policy has resulted in a liquidity crunch, with high interest rate and reduced availability of credit. For the economy to stabilise and grow there must be sufficient liquidity and a reasonable level of interest rate, which will allow companies to borrow again and resume their activities.

- Preserving socio-economic stability

  In an ethnically diverse society, socio-economic considerations are vital for continued stability and harmony. Experience has shown that economic hardship could feed racial tension, if one ethnic group perceived that it was suffering more than other groups or if one group was less distressed. The economic decline is particularly important if seen in the light of Malaysia's effort to restructure corporate equity to reflect the nation's ethnic composition. In designing the recovery measures, it was essential to ensure that policies were not only economically efficient and market consistent but also supported socio-economic and strategic objectives.

- Assisting affected sectors

  Some sectors were more affected than others during the crisis, and thus required more attention. These sectors were affected by increasing costs, falling demand, financing difficulties and mounting debt. For example, the construction sector had the largest rate of contraction (23% in 1998), while sales in the automotive industry plummeted by as much as 70% in early 1998. On the other hand, there were some opportunities that could be exploited, such as tourism. As the impact of the crisis differed between sectors and industries, it was imperative to formulate specific measures to assist them to either minimise the damage or maximise the available advantages.

In formulating the recovery measures, above priorities were translated into five major thrusts:

- ✓ Boosting the domestic economy through fiscal stimulus programmes;
- ✓ Easing the monetary stance;
- ✓ Stabilisation of the Ringgit
- ✓ Strengthening and restructuring of the financial and corporate sectors;
- ✓ Corporate governance

Fiscal stimulus programmes

The budget stance was reversed from a surplus of 3.2% of the GNP in 1998 to a deficit of 6% in 1999. Additional development expenditure of US$1.8

billion was allocated for agriculture, low and medium-cost housing, education, health, infrastructure, rural development and technology upgrading. The fiscal stimulus programmes concentrated on infrastructure projects and an Infrastructure Development Fund (US$1.6 billion) was established to finance essential projects.

Easing the monetary stance

The measures to increase liquidity and reduce the costs of funding included:

- *Statutory reserves requirement (SRR)* was gradually reduced from 13.5% in February 1998 to 8% in July, 6% in September 1, and 4% in September 16, 1998. The reduction of the SRR meant that an additional RM38.3 billion had been injected into the banking system and this increased liquidity.
- The base lending rate (BLR) was reduced from a high of 12.3% in June 1998 to 6.79% in October 1999. Lending rates were consequently reduced from a high 24% in February 1998 to 7.91% in October 1999. The lending spread was capped to 2.5% of the BLR.
- The period of classification of loans into NPLs was changed back to 6 months in September 1998 after being set at 3 months in March 1998.
- An annual loan growth target of 8% was set for 1998 and 1999.

Stabilisation of the Ringgit

Malaysia created a widespread controversy when it implemented the selective capital controls measures on 1 September 1998 as a response to the Asian crisis. The selective capital controls have two inter-related parts: first the stabilisation of the Ringgit and second the restriction on the outflow of short-term capital. Stability of the currency is guaranteed by pegging the Ringgit to the US dollar at a rate of RM 3.80 to USD 1.00. The capital control measures affect the transfer of funds among non-residents via non-resident external accounts, import and export of Ringgit by travellers (both resident and non-resident) and investment abroad by Malaysian residents. Similarly, non-residents are restricted from raising credit domestically for purchase of shares. Non-resident portfolio investors are required to hold their investment for at least twelve months in Malaysia[3].

However, capital controls do not impede current account transactions (trade in goods and services), repatriation of interest, dividend, fees, commissions and rental income from portfolio investments and other forms of Ringgit assets and FDI inflows and outflows (including income and capital gains).

Another measure that significantly affects portfolio investors requires all dealings in securities listed on the KLSE to be affected only through the KLSE or through a stock exchange recognised by the Malaysian authority. Consequently, trading of 112 Malaysian companies on the Central Limit Order Book (CLOB), an over-the-counter market in Singapore was discontinued by the Singapore Stock Exchange.

The selective capital controls were modified effective February 15, 1999 when the quantitative control (the requirement that proceeds from the sales of Ringgit assets be kept in the country for one year) was replaced by a price-based regulation, the exit levy. The maximum rate was 30% and it decreased the longer the capital was retained in Malaysia. Further relaxation was introduced on 21 September 1999, when it was reduced to a flat rate of 10% on profits repatriated. It was withdrawn totally in 1 May 2001.

Strengthening and restructuring of the financial and corporate sectors

Asset Management Company (Danaharta) was set up to manage NPLs of financial institutions. Its main objective is to remove the NPLs from the balance sheets of financial institutions, at fair market value and to maximise their recovery value. This will free the banks from the burden of debts that had prevented them from providing loans to their customers.

As the capital base of banks has been affected by the decline in share prices and NPLs, these banks needed to be recapitalised. For this purpose the Special

Purpose Vehicle (Danamodal) was set up to capitalise the banking sector, i.e., to inject capital into banks facing difficulties and especially to top-up their capital, which was reduced when the NPLs were taken out by Danaharta. The injection of capital would enhance the resilience of banks, increase their capacity to grant new loans and consequently speed up the economic recovery process.

To complement the restructuring of the financial system by Danaharta and Danamodal, the Corporate Debt Restructuring Committee (CDRC) was set up in August 1998 to facilitate debt restructuring of viable companies. The aim is to minimise losses to creditors, shareholders and other stockholders; avoid placing viable companies into liquidation or receivership and to enable banking institutions to play a greater role in rehabilitating the corporate sector. The CDRC devises a market-approach debt restructuring plan to enable creditors and debtors to solve their debt without resorting to legal procedures. It also brings together all interested parties to assist the progress of all corporate debts restructuring.

Corporate governance

Although Malaysia had implemented measures for good corporate governance practice, the crisis highlighted some of the shortfalls of the existing regime. Additional measures were introduced to further strengthen the governance environment and there were calls for more effective execution. The additional measures were:

- Improve transparency and disclosure standards.
- Establish a committee on corporate governance. It has produced a comprehensive report on measures to enhance governance.
- Enhance monitoring and surveillance
- Enhance accountability of company's directors
- Protect rights of minority shareholders
- Review Codes and Acts such as the Securities Industry Act to minimise any weaknesses that can lead to breaches of the Act.

- Changes in the rules of the KLSE and its clearing and depository system to ensure orderly and transparent trading of securities.

4. Recovery of the Malaysian Economy

The Malaysian economy began to grow strongly in the second quarter 1999, when it expanded by 4.1% and the third quarter growth of 8.1% marked the end of the recession. Other indicators of recovery included:

- Industrial production recovered strongly after a continuous decline for 12 months. February 1999 marked the turnaround of industrial production when it grew by 3.9%. By June 1999, the industrial production index had expanded by 8.3%. Industrial revival continued and the index reached 27.5% in October. Within the industrial sector, manufacturing was the driving force with growth of 19.5% in the third quarter of 1999. The construction sector recovery was slower than that of other sectors.
- The external sector was the engine of recovery. The Malaysian trade surplus in 1998 was RM58.4 billion and in 1999 it rose to an unprecedented excess of RM 72 billion. The strong trade balance helped improve significantly the current account position, where in 1998 the current account surplus was RM34 billion or 13% of the GNP. The strong external sector was also reflected in the improved international reserves position. In August 1998 Malaysia had reserves of US20.2 billion, and these had increased to US31.7 billion in July 1999.
- The level of interest rate decreased significantly. In October 1999, the base-lending rate was 6.79% as compared to a high of 12.27% in June 1998.
- Inflation had remained mild throughout the crisis. The rise in the consumer price index peaked at 6.2% in June 1998 and then declined to only 2.1% in October 1999.

- The stock market also rebounded strongly. The key indicator of broadly established confidence, the Kuala Lumpur Composite Index, went from its low of 262 points on 2nd September 2 1998 to 991 points on 10th February 2000.
- Another important recovery indicator is consumer aggregate demand. This has improved, albeit not strongly. Indicators of consumer demand came from increased sales of consumer durable, such as vehicles, and houses and higher collection of sales tax.
- Financial and Corporate Sector Restructuring

  i) As at 31 December 2001, Danaharta has successfully carved out a total of RM48.03 billion of NPLs. The level of NPLs in the banking sector has been significantly reduced to 11.4%. The first phase of NPLs purchase was completed in 6 months, much faster than the original time target of one year. Financial institutions have had to take losses from the sales. The average discount rate for NPLs was 55%. The second stage of Danaharta operation is asset management. Danaharta has conducted five property tenders, offering to the market 614 properties. Of these, 498 properties (approximately 81%) had been sold, with a vale of RM843.52 million.

  ii) Danamodal has injected RM7.6 billion into 10 financial institutions, pre-empting any potential systemic risks to the financial sector. As a result, the capital adequacy ratio of the recapitalised financial institutions rose to 11.7%, almost at par with the industry level (12.6%).

  The capital injection was accompanied by absorption of losses by shareholders through reduced shareholding in the institutions, change in the composition of the boards of directors and/or changes in management. Danamodal has also appointed their representatives at the recapitalized institutions to ensure that these institutions are managed prudently and efficiently as well as to institute changes that will strengthen these institutions. Most of the recapitalised institutions have repaid Danamodal's capital injection.

iii) By the middle of 2001, CDRC had taken on 75 cases, representing RM47.3 billion debts, and had resolved 33 of them, representing RM27.6 billion. Most of the rejected cases (21) involved unviable businesses. Working on a voluntary framework, the CDRC seeks to assist the companies to restructure without government support. Negotiations have proven to be difficult because agreement must be reached between creditors (usually many parties) and the debtors. Notwithstanding these difficulties, CDRC has progressed well and is expected to terminate its existence by the middle of 2002 when it has resolved most of the outstanding cases.

5. Post-crisis Priorities

The V-shaped recovery from the crisis, especially the 8.5% growth recorded in 2000 had at first reassured Malaysia that it was back on the high growth path and on track to achieve the Vision 2020 target[4]. But the US economic slowdown and the September 11 incident trimmed Malaysia's economic growth substantially to 0.4% in 2001. As a very open economy, Malaysia is heavily dependent on the global economic situation. In fact, this influence is now even stronger with the expanding scope and channels of globalisation. Malaysia's links have progressed beyond trade in goods and foreign direct investment - now its international links include trade in services, financial flows, technology, movement of people and information technology. Certainly, the nascence of new economies that compete in the same markets and with the same products as Malaysia are making the global challenges ever stiffer. For example, China's growing economic presence and its accession to the WTO have made many countries, including Malaysia reassess their global competitive advantage.

The impact of the crisis and the global developments have redefined the new economic priorities for Malaysia, as follows:

- Achieve a sustained high growth path
- Increase economic competitiveness
- Continue with the objectives of restructuring the society to achieve a more balanced socio-economic composition
- Minimise the nation's vulnerability to externally induced crises
- Maximise the benefit of integration with the global economy

a) To achieve a sustained high growth path

Prior to the 1997-98 crisis, Malaysia was at a crossroads in its development path – it had exhausted its comparative advantage in labour-intensive activities and was planning to move up to a productivity-based economy. The 7th Malaysia Plan set the strategies for this transformation. The 1997-98 turmoil highlighted the pitfall of a growth strategy based on accumulation of inputs, in this case high capital investment. Yet, Malaysia's economic goals – to be an industrialised nation and to restructure its society – require sustained high growth, now based on productivity, technology and knowledge. This would mean a growth that does not create imbalances such as saving-investment gap, current account deficits and asset-price inflation. The following policy initiatives are critical if we are to remain on such a growth path.

- K-economy: In response to the changing nature of the global economic activity driven by rapid advancements in information and communication technologies, Malaysia has embarked on a strategy to transform itself from a Production- to a Knowledge based-economy (K-economy). In this type of economy, knowledge, creativity and innovation have important roles in generating and sustaining growth. Malaysia started to lay the foundation for a K-economy in the mid 1990s with the establishment of the Multimedia

Super Corridor (MSC). A key ingredient for a successful K-economy is the availability of the right human capital. In this regard, Malaysia needs to create a pool of educated, flexible, well-trained and highly skilled manpower.

- Human Capital: This vision of the future economic and competitive landscape naturally requires that the quality of our human capital evolves in a way that meets the skills demand of that system. Malaysia is fortunate to have a patrimony of a well-educated labour force, which is English-speaking. However, that is no longer sufficient to compete in a digital and knowledge-based economy. Malaysia's education infrastructure has to make the quantum leap: to nurture a labour force that is not only proficient in employing today's technology but also able to contribute to and shape the technology and ideas of tomorrow. This must remain the most urgent task on the Malaysian economic agenda.
- New sources of growth: the services sector. The manufacturing sector has almost reached its maximum share of the economy, about 33% of GDP and therefore the next growth cycle would have to come from the services sector. Besides the need to increase productivity, growth for this sector also, following the example of the manufacturing sector, would have to come from exports. The immediate priority is to enhance the capability of exportable services industries. Tourism, educational and health services are all potential major export earners and efforts to make these industries more competitive are already underway. It is import both to improve productivity and quality and also to bring down the costs of all services activities that are input to the general economy, such as transportation and telecommunication. By lowering the costs of these services, other components of the economy can increase their export competitiveness.
- Revisiting the privatisation policy: the public sector is back in the driving seat. The 1997-98 crisis also marked a major shift in the Malaysian development philosophy; namely the public sector reassumed the role of leading economic growth. The public sector through its fiscal stimulus programmes and the

take over of troubled privatised entities such as MAS, Renong and the light rapid transportation system have echoes of the development philosophy of the early 1980s. Although this action was at the time the best option, it is perhaps useful to later revisit the privatisation policy to ensure the role of the public sector as the promoter of growth should continuously be reviewed so as not to create a "crowding out" effect to the private sector. This review is useful to ensure that balance between efficiency and benefit of privatisation is maximised, based on the crisis experience.

- Deepening the capital market: One of the main reasons for the 1997-98 crisis was the over-dependence of companies on the banking sector and the equity market in raising funds to finance their activities. The third source of capital, that is the bond market, should be developed further to reduce the reliance on the two other sources and to better match funding risks and returns. In particular, infrastructure projects are often better financed through the bond market, because of their long gestation period. The national Bond Market Committee has been established to accelerate the development of this market.

b) To enhance economic competitiveness

- Manufacturing competitiveness: In view of the emerging new economies such as China, India and the Eastern European countries plus developments in global manufacturing activities, Malaysia needs to increase its manufacturing competitiveness (Yusof and Mahani, 2001). Malaysia can no longer compete on cost alone: the sales pitch must point to world class quality and service. A key consideration is for Malaysia to reposition itself in the global supply chain by becoming a base for R&D, production of critical components and design and procurement centres. Malaysia is planning to move up the value chain and this effort is closely linked with the human resources development and increasing the efficiency of the domestic economy.

- Regional logistics infrastructure hubs: Over the years, Malaysia has invested and developed a potential advantage in modern logistics infrastructure such as airports, ports and roads. At the same time, emerging regional economies such as the Indo Chinese countries, which have good growth prospects will needs transportation facilities to service their import and exports. Thus, Malaysia should take advantage of this opportunity and redouble its existing efforts to be the regional hub for air transportation (passenger and cargo) and shipping.
- Restructuring of the corporate sector: more professional managers. The restructuring of key companies recently may signal a shift in the thrust of the Malaysian business model. The question that was put forward in the aftermath of the crisis was whether there is a need to remake Malaysia Inc. because of over-reliance on a number of owner-entrepreneurs has not produced a robust corporate Malaysia. While this model benefits from their risk-taking dynamism, there is concern that this trait would lead to insufficient emphasis on controls, good governance and risk management and asset-liability management (Nor Mohamed, 2002). The previous policy is also to a significant degree linked to the privatisation policy. The recent corporate ownership and boardroom changes have seen the shift from entrepreneur-owners to institutionalisation of ownership and professional management. This new approach is to provide greater controls, check and balances and to improve risk management. However, the desired optimum business model has yet to be identified: even in advanced economies, the separation of owner from managers and many pervasive controls and prudential regulations do not always ensure a fool-proof business model.
- Corporate governance: new factor of investment and competitiveness. The importance of good corporate governance is increasingly recognised worldwide, particularly in the context of enhancing investor confidence. Increasingly, investors are drawn to countries with credible corporate governance practices because in the long run such locations will give higher

investment returns. More importantly, such practices will also boost the confidence of domestic investors and ultimately induce a more stable source of financing for investors.

The additional measures are aimed at improving transparency and disclosure standards, enhancing monitoring and surveillance, increasing the accountability of a company's directors and protecting rights of minority shareholders. These include:

- Malaysian code on corporate governance – this Code was released in March 2000 and essentially aims at setting out best practices in corporate governance.
- Legal and regulatory reforms – effective 1 July 2000, amendments to the securities legislation were made to enhance primary market disclosure. The amendments have effectively delineated and streamlined the responsibilities of the Securities Commission and the Registrar of Companies with regards to prospectuses, thus resulting in greater legal and regulatory certainty in the area of public offering of securities. In addition, the revamped KLSE Listing Requirements, released on 22 January 2001 introduces new provisions to strengthen disclosure, internal controls, continuing listing obligations, financial reporting and protection of minority shareholders.
- The Securities Industry Act 1993 was also amended to remedy weaknesses in insider trading rules and to strengthen the ability of regulators to take action against directors.
- To increase transparency, the Securities Industry Central Depositories Act has been amended to prohibit persons from hiding behind their nominees, by introducing the concept of authorised nominees and prohibiting global accounts.
- A comprehensive corporate governance reform exercise was undertaken with the establishment of the Finance Committee on Corporate Governance to recommend the best practices to be adopted. The

committee has published their recommendations and they are under consideration.

- The Minority Shareholder Group was formed to protect the interests of this group of shareholders. The Group has representatives from public sector agencies, which often have substantial, albeit minority shareholdings in large companies. The remit of the Group is to watch out for proposed business developments that may jeopardise their interests and to disseminate their findings to interested parties.

However, strengthening corporate governance will be a much more difficult, complex and lengthy process than the other restructuring measures to date. Most importantly, it requires the political will and commitment to guarantee that any corporate governance framework that is developed will be fully and effectively implemented.

c) Continue with the objectives of restructuring the society

The new Malay dilemma: where are the Malay billionaires? The recently published list of billionaires by Forbes magazine listed 5 non-Bumiputera tycoons from Malaysia. The fact that there were no Bumiputeras in this list had stirred some debate, particularly in the Bumiputera community. Although the NEP has reduced poverty, it has not been very successful in its task of raising the Bumiputera corporate equity to the targeted 30% share. Equally headline grabbing is the issue of meritocracy among the Bumiputeras, particularly in tertiary education. This issue was linked to the attitude and performance of Bumiputera students, which in some areas trail the other communities. There are calls for the introduction of a merit system in public university enrolments.

The issue of the restructuring of society has now an added dimension: while the numerical targets are still important and are being pursued, of equal importance is the question of quality of these achievements. For example, on the issue of corporate equity, the challenge is for the Bumiputera group to maintain its holding of the equity share already gained. Similarly, on the issue on human resources, graduates produced must not only reach the targeted quantity but also meet a quality standard. In this regard, the effort to restructure society must continue but now a new dimension has been added.

d) To minimise the nation's vulnerability to externally induced crisis

Although the Malaysian economy has benefited tremendously overall from its openness, the 1997-98 and 2001 experience has shown the vulnerability of such a structure. Thus, while Malaysia continues with its outward-oriented policy, it must also build a more resilient domestic economy because it cannot let its economic performance be purely dictated by external factors. This point is best illustrated by the comparison of the Malaysian economic performance during the two recent incidences of external volatility. In 1997-98 adverse external conditions including an export decrease of 2% (in US dollar terms)[5] had caused the economy to contract severely (7.5%). Although some argued that the 2001 global slowdown was less damaging then the earlier crisis, the Malaysian exports fell by a massive 14%. But the recovery measures for the 1997-98 crisis have expanded the domestic economy sufficiently so that it was able to cushion the impact of the export collapse. In 2001, Malaysia managed to avoid recession and the economy grew by 0.4%. In contrast, Singapore, which has a higher proportion of exports to GDP (145%), suffered a contraction of 2%. To this end, increasing the resilience of the domestic economy must include fostering strong consumer demand, which comes from attaining a higher income level and having a high propensity to buying domestic goods. A stronger economy also needs a diversified export markets and product range. In this context, Malaysia should tap new large emerging markets such as China and India as well as to have more balance export product structure.

e) To maximise the benefit of integration with the global economy

Malaysia is preparing to meet the challenges of a more integrated global economy. The next stage of integration will be in services sector, with the financial services likely to face the fastest and deepest liberalisation. In this regard, preparation will include the consolidation of financial institutions to produce sufficiently strong entities that can compete with established global players. Financial institutions must be able to offer an extensive range of products and services efficiently and at competitive costs. For this, institutions will have to invest in new technology and increase their workers' productivity. Only financially strong financial institutions can do this. The financial sector consolidation plan has merged 58 financial institutions in Malaysia into ten banking groups. Each of the ten new banking groups may offer a complete range of financial services, and may also operate non-commercial banking services such as merchant banking, fund management and stock-broking services. Therefore, the structuring of the financial sector is necessary to prepare it for future liberalisation, in which domestic financial institutions will have to compete freely with larger and more efficient foreign financial institutions.

Malaysia is progressing well with its AFTA commitments, with already 97% of its products having less than 5% import tariff. Notwithstanding this progress, there are some strategic industries that need longer before joining the AFTA liberalisation scheme. But measures taken must ensure that these industries can increase their productivity and competitiveness and be on track for AFTA. It is imperative that Malaysia enhances its economic integration and co-operation because it is the only way in which we can continue to attract FDI. The FDI share into ASEAN is declining and therefore the task ahead for Malaysia and for ASEAN generally is to reenergize the attractions of the region.

Malaysia supports the multilateral approach to global trade but at the same time the bilateral free trade initiatives adopted by increasing number of countries may require Malaysia to review its global and regional integration approach. A multilateral approach may be too slow: those taking this route may be left behind compared to those who have chosen to leverage their advantages through selective but deeper liberalisation.

6. Conclusion

Malaysia's evolving economic priorities can be categorised into three broad groups: economic philosophy, economic composition and the society's economic interests. There were clear and distinct changes in these groups of priorities during the three periods discussed. From the point of view of economic strategy, the emphasis changed from a private sector led-growth economy to managing a crisis and afterwards to putting the public sector back in the driving seat. Following closely the strategy was the external economic dimension – the open and liberalised economy had to selectively insulate itself in order to minimise the externally induced volatility and to the recover. Even during this period of instability, the major part of the economy continued to be open and had benefited from the expansion in global demand. However, going forward, economic openness had to be balanced with a resilient domestic economy. An increasing challenge is how to remain (and hopefully increase) competitiveness in light of stiffer international competition.

With respect to the composition of the economy, there is likely to be a major shift in the sources of Malaysian economic growth: in the middle of 1980s we saw the manufacturing sector overtaking the agriculture sector in as the most important contributor to the GDP. In future, the services sector, which is already contributing about 52% of the GDP, will increase its share at the expense of the manufacturing and agriculture sector. However, during the seventeen years (from 1986 to 2002), the economic priority for the society has not changed significantly. We still aim for the improvement of our standard of living, increase our welfare and maintain social stability.

The evolving priorities confirm the economy's flexibility in meeting challenges and the demand of its population. In realising these priorities, many policies and initiatives were introduced and implemented. For examples, to answer the future needs, Malaysia has launched a set of interrelated policies: the Third Outline Perspective Plan (OPP3), The 8th Malaysia Plan, the Financial Sector and Capital Market Master Plans and the New Agriculture Policy. The OPP3 covers the period from 2001 to 2010 and embodies the National Vision Policy (NVP). The NVP is a continuation of the NEP, which advocates poverty eradication, restructuring of society and balanced development as well as putting the economy on a higher growth path. Thus, the NVP sets the roadmap for the country to address the priorities in the first decade of the 21st century. The 8th Plan, which covers the first half of the OPP3 period, contains the strategies, programmes and projects to implement the broad thrusts of the OPP3. Likewise, the Financial Sector and the Capital Market Master Plans and the New Agriculture Policy set the detailed measures to complement and operationalise the vision set in OPP3, which is to make Malaysia a resilient and competitive economy.

In summary, Malaysia's priorities and programmes are continuously revised, with the ultimate goal of making Malaysia a progressive and developed country.

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Table 1

Malaysia: Changing Sectoral Share of GDP (%)

Sector	1961	1980	1995	2000
Agriculture	38.5	22.9	13.6	8.7
Mining	6.1	10.1	7.4	6.6
Manufacturing	8.5	19.6	33.1	33.4
Construction	4.6	6.0	6.7	3.3
Services	42.5	41.4	39.2	52.4

Table 2: Malaysia: Selected Economic Indicators, 1980 and 1985-97

	1980	1985	1986	1987	1988	1989	1990
Real GDP Growth	7.44	-0.96	1.05	5.39	8.94	9.21	9.74
Per capita income ($)	1723	1850	1607	1793	1933	2053	2037
Real per capita income growth	4.07	-3.55	-1.65	2.71	6.3	6.63	7.21
Unemployment rate	5.6	6.9	8.3	8.2	8.1	6.3	5.1
Inflation rate (CPI-based)	6.7	0.3	0.8	0.2	2.5	2.7	2.8
Money supply (M2) growth (%)	28.4	9.8	11.0	3.8	6.7	15.2	10.6
Average commercial bank deposit rate (%)	6.0	7.5	7.0	4.3	4.3	5.4	7.2
Gross domestic investment (% of GDP)	30.4	27.6	26.0	23.2	25.9	28.4	31.3
Gross domestic saving (% of GDP)	29.3	25.6	25.6	31.3	31.3	29.2	29.2
Fiscal balance (% of GDP)	-6.9	-5.7	-10.5	-7.7	-3.6	-3.3	-3.0
Public debt (% of GDP)	44.0	82.4	103.4	103.5	98.0	87.8	81.4
Foreign debt (% of GDP)	20.7	36.1	38.3	33.5	29.1	26.9	25.7
Export/GDP ratio (%)	51.47	54.85	56.31	63.85	67.61	73.26	76.28
Growth of export value ($)(%)	17.1	-7.7	-10.5	30.9	17.4	18.1	16.6
Growth of import value ($)(%)	33.6	14.1	10.6	15.8	28.6	31.7	28.4
Current account balance (% of GDP)	-1.1	-1.9	-0.4	8.1	5.4	0.8	-2.1
Total external debt (% of GDP)	28.8	54.8	70.5	63.2	51.7	44.3	39.7
Short-term debt (% of total)	-	-	-	-	5.2	7.4	9.6
Debt service ratio, total (%)	4.3	15.8	18.9	16.4	13.1	9.6	8.3
Debt service ratio, federal government (%)	1.8	6.7	7.2	5.9	6.2	4.4	1.2
Foreign reserves, end of year ($bn)	4.4	4.9	6.0	7.4	6.5	7.8	9.8

Note: - data not available

Source: Compiled from IMF, International Financial Statistics Yearbook 1988 and BNM, Monthly Statistical Bulletin, March 1999.

Table 2 (cont.) Malaysia: Selected Economic Indicators, 1980 and 1985-97

	1991	1992	1993	1994	1995	1996	1997
Real GDP Growth	8.66	7.79	8.34	8.75	8.94	9.21	9.74
Per capita income ($)	2491	2925	3174	3505	4133	4449	4315
Real per capita income growth	6.15	5.3	4.74	4.41	6.7	5.7	5.5
Unemployment rate	4.3	3.7	3.0	2.9	2.8	2.5	2.5
Inflation rate (CPI-based)	2.6	4.7	3.5	3.7	3.4	3.5	2.7
Money supply (M2) growth (%)	16.9	29.2	26.6	12.7	20.0	23.8	18.9
Average commercial bank deposit rate (%)	8.2	7.8	6.3	6.2	6.9	7.3	8.2
Gross domestic investment (% of GDP)	37.2	33.5	37.8	40.4	43.5	41.5	42.8
Gross domestic saving (% of GDP)	28.4	29.7	33.0	32.6	33.8	37.1	37.2
Fiscal balance (% of GDP)	-2.0	-0.8	0.2	2.3	0.9	0.7	2.4
Public debt (% of GDP)	74.6	65.6	58.0	48.9	41.8	35.9	32.5
Foreign debt (% of GDP)	25.5	21.6	20.2	15.9	14.6	11.7	14.4
Export/GDP ratio (%)	80.84	77.65	81.45	89.82	95.5	92.01	89.76
Growth of export value ($)(%)	17.1	18.1	16.1	23.1	26.5	7.4	0.7
Growth of import value ($)(%)	26.9	10.1	17.8	28.1	30.3	1.9	1.2
Current account balance (% of GDP)	-8.8	-3.8	-4.8	-7.8	-9.7	-4.4	-5.6
Total external debt (% of GDP)	38.5	37.9	41.9	38.7	38.9	39.2	61.6
Short-term debt (% of total)	14.1	23.5	25.0	19.3	19.1	25.7	25.3
Debt service ratio, total (%)	6.9	9.3	6.4	5.5	6.6	6.9	5.5
Debt service ratio, federal government (%)	2.7	4.2	2.8	1.4	1.4	1.1	0.7
Foreign reserves, end of year ($bn)	10.9	17.2	27.2	25.4	23.8	27.0	20.8

Note: - data not available

Source: Compiled from IMF, International Financial Statistics Yearbook 1988 and BNM, Monthly Statistical Bulletin, March 1999.

Table 3
Malaysia: Incidence of Poverty, 1970 – 95

Strata	**Total Poor Household (thousand)** 1970	1976	1984	1989	1995
Pen. Malaysia	791.8	764.4	483.3	448.9	365.6
Rural	705.9	669.6	402.0	371.4	281.8
Urban	85.9	94.9	81.3	77.5	83.8
	Incidence of poverty (%) 1970	1976	1984	1989	1995
Pen. Malaysia	49.3	39.6	18.4	15.0	8.7
Rural	58.7	47.8	24.7	19.3	14.9
Urban	21.3	17.9	8.2	7.3	3.6

Source: Ishak, S. and M.Z. Ragayah (1995)

Table 4

Malaysia: Net Capital Inflow[1] (US$million), 1990-97

	1980-89[2]	1990-62[2]	1990	1991	1992	1993	1994	1995	1996	1997
Total capital flows	1449	8592	1790	5935	8551	10291	1242	7532	9432	1590
GDP	4.9	12.8	4.2	11.7	15.0	16.8	1.8	8.8	9.6	2.2
Composition of total capital flows (%)	100	100	100	100	100	100	100	100	100	100
Official long-term capital	37.9	1.7	-69.8	-6.0	-11.9	2.2	4.7	25.7	2.4	53.0
Federal government	31.7	-10.0	-19.4	0.9	-13.1	-7.2	-26.2	-6.8	-7.0	-19.2
Non-financial public enterprises	6.8	11.8	-50.8	-6.6	1.6	9.8	31.6	32.5	9.1	72.6
Private capital flows	62.1	98.3	169.8	106.0	111.9	97.8	95.3	74.3	97.6	47.0
Corporate investment [3]	61.7	49.5	155.3	98.5	54.5	29.5	59.3	43.7	40.9	164.8
Private short-term capital	0.4	48.8	14.5	7.4	57.3	68.3	36.0	30.6	56.7	-117.8
Portfolio investment	-1.8	37.7	-11.9	-17.3	32.6	58.7	75.2	22.4	28.1	-324.3
Banking sector borrowing[4]	2.2	8.7	26.4	24.7	24.7	9.5	-41.1	6.1	18.4	173.6
Non-bank private borrowing [4,5]	-	2.4	-	-	-	-	1.8	2.1	10.2	32.9

[1] Net capital flows comprise net direct foreign investment, net portfolio investment (equity and bond flows) and official and private bank borrowings. Changes in national foreign exchange reserves are not included

[2] Annual average.

[3] Equity investment, long-terms loans by parent companies and undistributed earnings of foreign-affiliated companies.

[4] Borrowing for a period of one year and below.

[5] Mostly trade related.

- data not available.

Source: Athukorala, P, 2001, Crisis and Recovery in Malaysia: The Role of Capital Controls, Edward Elgar Publishing, Cheltenham.

[1] To accommodate the public sector driven growth strategy, its size has increased significantly as reflected by its expenditure. In 1970, the public sector expenditure as a share of the gross national production was 22.1% and it expanded to 38.3% by 1982.

[2] Like most of the affected countries, prior to the crisis, Malaysia has a strong fiscal position as it recorded a surplus or balance budget since 1995. As such, Malaysia was in an advantageous position compared to some regional economies because it has relatively smaller short-term foreign debts, low rate of non-performing loans, it has a well-supervise financial system and an established legal system. Malaysia's short-term external debt was 69% of its international reserves while for South Korea it was 314% and for Indonesia 177%. Furthermore, the non-performing loans of commercial banks in 1997 was only 4.9%. The Banking and Financial Institutions Act (1989) gives extensive power to the Bank Negara Malaysia to supervise the financial system and it provides for a more integrated approach toward maintaining a strong and prudent system. The Malaysian legal system was established under the colonial period, with well-defined laws and procedures including for bankruptcy.

[3] For the detailed measures see Mahani (2000).

[4] For Malaysia to be an industrialised country in 2020, it needs to grow at an average rate of 7% per annum, as envisaged in the Second Outline Perspective Plan.

[5] Although in 1998 exports decreased in US dollar terms, the currency's sharp devaluation had increased exports in Ringgit terms by 30%.