Good Governance Is Necessary But Not Sufficient

The policy option adopted by the Malaysian Government for economic recovery is quite controversial and different from that of other crisis-hit countries. The Malaysian Government did not have to seek assistance from the IMF, as the country's saving rate is high and short-term external debts are low, but on its own accord sought to improve liquidity, strengthen its banking institutions and carry out financial re-structuring.

For policy-makers, the only measure of effectiveness for a chosen economic recovery policy is how well it keeps the economy on the tracks of strong economic growth. For free-market orthodox economists, however, the choice of a recovery policy also reflects the ideological preference of the government. Malaysia’s approach to overcome the economic slowdown has been regarded by many as a deviation from a pure capitalistic approach, premised on the perceived ability of the market mechanism in establishing long-run economic stability without any external corrective actions.

The Malaysian capital controls were seen by some as a clear impediment to liberalisation and globalisation. However, there is overwhelming evidence to suggest that capital controls in Malaysia have successfully stabilised speculation and re-established market confidence. Although there is insufficient evidence to suggest that capital controls represent a better policy relative to conventional policies adopted by the other crisis-hit countries, the Malaysian experience has shown that the capital controls are capable of generating a sufficiently conducive environment for economic recovery.

One interesting feature of an extreme version of capitalism is its uncompromising stand on efficiency objective. Notwithstanding the importance of this feature, strict market rules would make it impractical, and amendments and modifications are necessary to suit domestic economic environments.

Indeed, the Malaysian approach, which has been regarded by many scholars as unorthodox, has triggered widespread policy debates, and has split further the general consensus among economists, analysts, and policy makers regarding some crucial issues pertaining to the role of government in the market economy. Nevertheless, the success of Malaysia’s recovery programme, with strong government interventions in the economy, indicates that alternative economic models also have the potential to perform at least as well as the IMF model for economic recovery implemented in other crisis-hit countries including South Korea, Thailand and Indonesia. The free-market orthodox economists worry that the effectiveness of capital controls, if not carefully analysed and explained, could have the ultimate effect of tarnishing the conventional approach, and may even go so far as to disrupt the policy transformation process in the newly emerging markets.

One must view Malaysia's so-called unorthodox capital controls as a stop-gap emergency measure to manage extreme volatility in economic variables during crisis times. Such volatilities coupled with increasing political uncertainties and market rumours tend to weaken the link between economic decisions and economic fundamentals. Such was the case with the Malaysian economy during the recent crisis, particularly in the financial sector. There was much uncertainty and unpredictability about the direction and relationship of economic variables, which eroded the efficacy of monetary and fiscal instruments in achieving policy targets.

In a situation where economic, social and political factors are intertwined, market forces need a longer time for adjustment and correction, which can be very costly to the economy. Adoption of the capital control mechanism was, therefore, necessary to curb speculations, to create a viable environment for the full functioning of market forces, and to increase the predictability and relationship of economic variables.

It is appropriate to draw a clear demarcation line between the capitalist model practiced in western countries and the East Asian Model with strong state interventions in the economy. Arguably, if this line had been drawn earlier, if the deficiencies and risk of the East Asian macroeconomic management style had been highlighted earlier, the depth and scale of the regional economic crisis could have been lessened or if not avoided altogether. Instead, prior to the crisis, Asian economies had been praised for their ‘good and prudent’ macroeconomic management and development strategies. Ironically, the successful Asian economies, including Malaysia, Indonesia and Thailand were described as "miracle economies" before the outbreak of the crisis.

While various and valid explanations and views on the causes of the economic crisis have been given by different economists, the explanations and views, particularly those of free-marketers, display an analytical bias. For instance, instead of accepting and trying to eliminate the various weaknesses associated with an open balance of payments system as factors causing the crisis, the defacto pegged exchange rate system in place in the crisis-hit countries has been blamed as the main culprit behind the outbreak of the crisis. It is well known that there is no general agreement amongst economists on what constitutes an ideal exchange rate regime. Additionally, while downplaying the negative consequences of the free flow of short-term capital on an economy, a series of other causational factors have been highlighted. These include over-investment in the property sector leading to asset bubbles, a low level of development and insufficient level of regulation and liberalisation in the financial sector. It is interesting to note that when the good times rolled, such serious defects were never brought to light.

In arguing for a more balanced and nuanced analysis of the economic crisis, there is no intention to revert to an autarkic existence. That would be a foolish and futile thing to do. After all, Malaysia's economic success prior to the crisis has always been associated directly with the push for economic liberalisation and openness. While accepting the view that having sound good governance and transparent economic environment in both public and private sectors is desirable, important and necessary, there is also the parallel and urgent need to restructure and improve the international financial architecture so as to control currency transactions and stabilise the global financial system. So far, no serious attention has been paid to this issue by the international community.

One such arena where a compromise between global and domestic imperatives is particularly apparent is that of corporate governance. Laudable initiatives have already been made by the Malaysian Government to enhance corporate governance in all sectors of the economy. Significant progress continues to be achieved in implementing the recommendations of the Finance Committee on Corporate Governance.

Malaysia has already implemented a comprehensive set of reforms across various economic sectors. These cover not only corporate governance and transparency issues but also the economy as a whole, including the financial sector. Nevertheless, domestic reforms in a small open economy like Malaysia on their own will be powerless to counter the effect of any instability in the international financial market. Thus, the delay in reforming the international financial architecture will leave this region vulnerable to yet another financial crisis.