5.0 REFORM AND RECOVERY: A COMPARATIVE STUDY OF MALAYSIA AND SOUTH KOREA

With the outbreak of the Asian financial crisis, many reform and recovery efforts were being taken by Malaysia and South Korea to confront the situation. This chapter aims to compare the economic indicators that would reflect the pace of recovery in both the countries. With that, conclusion on the competitiveness of both Malaysian and Korean firms in the international market could be drawn. This would also reflect if the economic policies undertaken by both countries so far had been fruitful in producing turbulence resilient firms.

5.1 Reform and Recovery in Malaysia

Malaysia was facing financial difficulties during the crisis. However, Malaysia did not seek assistance from the International Monetary Fund (IMF), which was ever ready to assist countries in the Asian region, as it was evident in the cases of Thailand and Indonesia.

Malaysia resorted to its own capital control measures with the hope to battle against the depreciation of ringgit against other major currencies in the world. Besides, Malaysia also directed its banking sector to increase lending to keep the economy engine moving.

As cited in Gomez (2002), on September 1, 1998, the Prime Minister introduced new capital control measures. These included making the Malaysian currency, the ringgit, an illegal tender outside Malaysia, thus necessitating the repatriation of all ringgit held abroad and curbing the trading of the currency, pegging the ringgit to the US Dollar at a fixed exchange rate of RM3.80, forbidding foreign portfolio investors from withdrawing proceeds of the sale of Malaysian securities for at least a year, and requiring regulatory approval for transfers abroad exceeding RM 10,000 (New Straits Times, 2/9/1998).

The Prime Minister also reduced interest rates and directed banks to loosen its lending policies and redefined non-performing loans to give businessmen affected by the crisis more time to settle their debts. The government went on to reduce the statutory reserve requirement from 6% to 4%, enabling banks to increase liquidity by a further RM8 billion.

These measures brought positive impact to the economy. Malaysia had recorded significant positive growth. This could be seen from the economic indicators of the country signaling the pace of recovery after the crisis, which will be discussed later.

5.2 Reform and Recovery in South Korea

Korea's problems emerged earlier in 1997 as a number of highly leveraged conglomerates or *chaebols* became bankrupt as a result of over-investment in steel and cars, and weakened profitability with the cyclical downturn. The bankruptcies weakened the financial system with non-performing loans reaching 7.5% of GDP. The decline in stock prices further reduced the value of bank equity. All these led to a sharp fall in external finance.

South Korea had to turn to IMF for assistance. On December 4, 1997, the IMF announced a package including a US$ 21 billion standby credit for South Korea. The package of measures agreed by Korea included tight monetary policy with high interest rates to stabilize markets, tight fiscal policy, strengthening the financial system through a firm exit policy, market and supervisory discipline and increased competition, further trade liberalization, easing restrictions on foreign ownership, making it easier to dismiss workers (Richardson, 1998).

In addition to the IMF funding, the World Bank had indicated that it would provide US$ 10 billion to support specific structural reform. The Asian Development Bank had promised another US$ 4 billion. Supplemental financing was on the way from various countries, should the need arise.

With these measures being adopted by the South Korean government, the Korean economy had been recovering very strongly. Despite failures of some firms being recorded, the overall picture seemed encouraging, as the failure should be part of the strategy when free market forces were playing their roles.

Table 5.1: Malaysia: Overall Economic Performance

	1995	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change, year over year, except for noted)							
Nominal GDP (level in billion US$)	88.7	100.9	100.2	72.5	79	89.7	87.5
Real GDP	9.8	10.0	7.3	-7.4	6.1	8.3	0.4
Consumption	10.5	5.6	4.6	-10	6.3	9.9	4.7
Private Consumption	11.7	6.8	4.3	-10.2	3.3	12.2	2.8
Government Consumption	6.1	0.7	5.7	-8.9	18.5	1.7	11.9
Investment	22.8	8.2	9.2	-43	-5.9	24.1	-2.1
Private Investment	28.1	11.3	9.4	-55.2	-21.8	28.7	-19.7
Government Investment	11.3	0.5	8.4	-8.4	15.9	19.9	15.5
Export of Goods and Services	19.0	9.2	5.5	0.5	13.4	16.1	-7.6
Import of Goods and Services	23.7	4.9	5.8	-18.8	10.8	24.2	-8.6
Fiscal and External Balances (percent of GDP)							
Budget Balance	0.8	0.7	2.4	-1.8	-3.2	-5.8	5.5
Merchandise Trade Balance	0.04	4.0	3.7	24.4	28.7	23.3	21.0
Current Account Balance	-9.7	-4.4	-5.9	13.2	16	9.4	8.3
Financial Account Balance	0.0	0.0	0.0	0.0	-8.4	-7.0	-4.5
Economic Indicators (percent change, year over year, except as noted)							
GDP Deflator	3.6	3.7	3.5	8.5	0.0	4.7	-2.7
CPI	3.4	3.5	2.7	5.3	2.8	1.6	1.4
M2	24.0	19.8	22.7	1.5	13.7	5.2	2.1
Three-Month Interbank Rate (percent p.a., end-period)	6.76	7.39	8.7	6.46	3.18	3.25	3.27
Real Effective Exchange Rate (level, 1997=100)							
Unemployment Rate (percent)	3.1	2.5	2.4	3.2	3.4	3.1	3.7
Population (millions)	20.8	21.3	21.8	22.1	22.7	23.3	23.8

Source: Country Report – Malaysia (APEC), 2002 Economic Outlook.

Table 5.2: Korea: Overall Economic Performance

	1995	1996	1997	1998	1999	2000	2001
GDP and Major Components (percent change from previous year, except as noted)							
Nominal GDP (level in billion US$)	489.4	520.0	476.6	317.7	405.8	461.7	422.2 1
Real GDP	8.90	6.80	5.00	-6.70	10.90	9.30	3.00
Consumption							
Private Consumption	9.60	7.10	3.50	-11.70	11.00	7.90	4.20
Government Consumption	0.80	8.20	1.50	-0.40	-1.30	0.10	0.20
Investment							
Private Investment	29.70	9.1	-5.9	-57.6	51.7	23.8	3.10
Government Investment	14.20	44.70	7.60	-21.40	-30.90	-8.80	40.10
Exports of Goods and Services	24.60	11.20	21.40	14.10	15.80	20.50	1.00
Imports of Goods and Services	22.40	14.20	3.20	-22.10	28.80	20.00	-2.80
Fiscal and External Balances (percent of GDP)							
Budget Balance (financial year)	0.4	0.0	-1.5	-4.2	-2.7	1.3	1.3
Merchandise Trade Balance	-0.90	-2.88	-0.67	13.10	6.99	3.65	3.17
Current Account Balance	-1.74	-4.42	-1.71	12.70	6.03	2.41	2.04
Capital Account Balance	3.4	4.5	0.3	-1.0	0.5	2.6	-0.8
Economic Indicators (percent change from previous year, except as noted)							
GDP Deflator	7.20	3.90	3.20	5.00	-2.00	-1.10	1.30
CPI	4.50	4.90	4.40	7.50	0.80	2.30	4.10
M2	15.50	16.20	19.20	19.00	27.90	30.20	15.70
Short-term Interest Rate	11.73	13.53	18.55	7.70	7.16	7.08	5.32
Exchange Rate (Ann. Ave. W/US$)	771	805	951	1,398.9	1,189.5	1,130.6	1,290
Unemployment Rate (percent)	2.00	2.00	2.60	6.80	6.30	4.10	3.70
Population (millions)	45.09	45.52	45.95	46.29	46.62	47.01	47.34

Note: 1 Korean economy recorded 3.0 percent growth in 2001, but nominal GDP in US$ was 422.2 billion dollar, which was smaller than that for 2000, due to changes in exchange rates.

Source: Bank of Korea, Ministry of Finance and Economy, Korea National Statistical Office, Wharton Econometric Forecasting Associates, cited in Country Report – Korea (APEC), 2002 Economic Outlook.

5.3 Real Gross Domestic Product (GDP)

Before the crisis, real GDPs recorded in Malaysia from 1995 to 1997 were higher than South Korea, which were 9.8%, 10.0%, and 7.3% respectively, as compared to 8.9%, 6.8%, and 5.0% in South Korea for the same period of time. The plunge in both countries had an impact on 1998's real GDP, where negative growth was recorded, which was -7.4% for Malaysia and -6.7% for South Korea.

Governments of both countries immediately undertook the necessary measures to prevent their economies from collapsing and remarkable results were seen in the following years.

South Korea's real GDPs were 10.9% (1999), 9.3% (2000), and 3.0% (2001), whereas Malaysia's were 6.1% (1999), 8.3% (2000), and 0.4% (2001). It was evident that South Korea, which had agreed to take in IMF's assistance, had a stronger rebound in terms of its GDP. Growth in Korea was due to an increase in exports and investment, while consumption grew steadily. The major industries such as electronics, semi-conductors, and automobiles showed a robust rebound.

As for Malaysia, although the fiscal measures and an accommodative monetary policy, coupled with the ongoing financial and corporate sector restructuring initiatives, which enabled the country to weather the more challenging external environment, the GDPs recorded were not as significant as those in South Korea. Private investment expenditure declined sharply by 19.7% (2000: 28.7%), reflecting the negative impact of lower external demand and excess capacity in certain sectors of the economy, particularly in the export-oriented manufacturing industries.

In South Korea, IMF measures required them to allow incapable firms to fail and the market operates based on the "survival of the fittest" philosophy. The strong background that some firms acquired allowed them to have survived the battle. Corporate governance and transparency had been given much attention. However, in Malaysia, the government had been trying very hard to bail out companies with financial difficulties. Without the government's assistance, these companies would have to declare bankruptcy. In other words, these firms were not allowed to fail as some of them belong to close associates of influential politicians, or the trusted acting figure of the politicians themselves.

5.4 Inflation

In terms of inflation, figures in the Consumers' Price Index (CPI) are given attention. For the case of Malaysia, CPI remained low, which was below 4.0%, throughout the years (1995 to 2001), except the year of 1998, when it was recorded to be 5.3%. This was believed to be an effect from the financial crisis. In fact, after the crisis, the government managed to keep the inflation rate at 2.8% (1999), 1.6% (2000) and 1.4% (2001), which were remarkably low.

The low figure in 2001 was due to the stability of the exchange rate, the low rate of inflation abroad, lower prices for many commodities, and excess capacity in several sectors of the economy. The moderate appreciation of the ringgit against non-US dollar currencies, as well as lower prices paid by the producers also contributed to lower inflation.

In South Korea, inflation rate had been at 4.5%, 4.9% and 4.4% respectively from 1995 to 1997. The crisis had brought the rate up to 7.5% in 1998, which was very drastic for the Koreans. However, IMF measures undertaken by South Korea witnessed significant results for the following years, with 0.8% (1999), 2.3%(2000) and 4.1%(2001). The high increment in 2001 was due to the rise of food prices as a result of flood damage. The prices were expected to normalize after some time as the economic effects from flood damage usually vanish in a short time.

Inflation rate in both countries were considerably low and this would then encourage consumption among the public at large. This is important in generating liquidity in the economy. In general, both countries had done a good job in maintaining a low inflation rate to prevent any unnecessary disputes in the public at large, as this would create chaos in the society. For the case of South Korea, the figure rose considerably in the year 2001 due to unforeseen circumstances. Therefore, it was difficult to compare as situations were different in both countries.

5.5 Employment

From the aspect of employment and unemployment, Malaysia had a stronger unemployment rate, as compared to South Korea. In Malaysia, unemployment rate remained below the 4.0% deemed to be the full employment level. However, the impact of the slowdown in economic activity was felt in 2001 by the labour market, particularly in terms of retrenched workers in the manufacturing sector. Given the flexibility accorded by the labour market, alternative measures that were adopted by the employers helped contain the number of workers retrenched.

In South Korea, however, due to the contraction of the economy and nationwide structural reform after the financial crisis, the unemployment rate reached a peak rate of 6.8%, after 2.0% (1995; 1996) and 2.6% (1997) being recorded. However, the unemployment rate had continued to decrease for the years after 1998. Strong growth in private consumption, concentrated in cars and other durable goods, helped to improve labour market conditions. Furthermore, an increase in service sector hiring had caused the unemployment rate to fall to 2.7% since June 2002, which was the lowest since the onset of the crisis.

Malaysia, being able to provide labour at a lower cost as compared to South Korea, was able to maintain its unemployment rate at a low level. The government had also decided to lay off foreign workers, especially those from Indonesia to provide more opportunities for the locals. This had certainly helped to bring down the unemployment rate. Besides, Malaysia had also been constantly upgrading its workforce to a higher level, thus becoming skilled workers by providing technical training to retrenched workers and unemployed graduates.

5.6 Gross External Debt

Malaysia's total external debt increased by 7.6% to RM169.8 billion (US$44.7 billion) in 2001. The increase was also reflected in the ratio of external debt to GDP. This was largely due to the increase in the private sector's short-term and the federal government debt. The increase in private sector's debt was largely on the account of the increase in short-term borrowings by commercial banks mainly to provide for their trade financing activities, revolving credits and inter-company loans. The private sector's short-term external debt increased significantly by 33.7% to RM23.3 billion (US$6.1 billion), equivalent to 13.7% of total external debt and 19.9% of international reserves. In other words, Malaysia's total external debt was RM170.1 billion (US$44.8 billion) and international reserves were RM117.1 billion (US$30.8 billion).

Although the federal government external debt increased significantly to RM24.3 billion (US$6.4 billion), it accounted for only a small share (14.3%) of total external debt. The increase was due to additional borrowings to finance the deficit, arising from the implementation of fiscal stimulus measures. The government had also tapped the international capital markets to maintain a market presence as well as to take advantage of the favourable market conditions.

For South Korea's case, after the early completion of repayments to the IMF in August 2001, foreign reserves were at a level that provided substantial insulation against shocks. Moreover, due to Korea's outstanding restructuring efforts and macro-economic performance, its sovereign credit rating was returned to pre-crisis 'A'-levels by the three major credit rating agencies, namely Moody's, Fitch Ratings and Standard & Poor's.

Korea's total external liabilities stood at US$125.8 billion at the end of June 2002. Korea has maintained its position as a less-indebted country according to World Bank standards. Its international reserves were recorded at US$1,105 billion in June 2002, thus making it the fifth in the world.

In general, South Korea managed to climb up from the plunge, as it is evident from its ability to clear its debts and maintain its international reserves at a high level, despite the country was in huge debts and needed to repay IMF's financial assistance.

For the case of Malaysia, the country had undertaken capital control measures in the country and battled against the crisis on its own without asking for help from international financial institutions. The outcome was positive but not remarkably strong as compared to South Korea, which was also severely affected by the regional contagion crisis.

5.7 Exchange Rate

The ringgit exchange rate remained pegged to the US Dollar at the rate of RM3.80 per US dollar, an arrangement that has been effective since 2 September 1998. Throughout the year of 2001, the ringgit appreciated against all major currencies, including regional currencies in tandem with the strong US dollar. The pegged exchange rate regime continues to be supported by the strong fundamentals of the economy as reflected by the strong current account surplus, the low rate of inflation and the high level of reserves.

As for South Korea, the weakness of the yen and falling demand for Korean exports downgraded the won to the 1,362 per US dollar at the end of 2001. The won-dollar exchange rate has continued to decline since April due to the weakening of the dollar and the continuing Korean export upturn in the year of 2002. The dollar had then stabilized around 1200 since the month of August.

In terms of exchange rate, following the depreciation of US dollar due to a slowdown in world economy and also the September 11 incident, ringgit and won had both undergone an appreciation. It was unable to compare ringgit with US dollar as the currency was pegged at a fixed exchange rate since September 1998.

5.8 Malaysia vs. South Korea

Malaysia and South Korea have demonstrated different paces of recovery since the outbreak of the Financial Crisis. The differences in terms of the interplay of business-government relations in the two countries have caused these outcomes.

South Korea, with authoritarian political system, made government assistance conditional to good export performance, especially during the Presidency of Park Chung Hee. In order to secure government assistance, Korean companies had to perform and excel in industries favoured by the government, or the President himself. Governing by dictatorship, President Park did not require the occurrence of vote-buying or money politics to secure his political position. As a result, many world-class manufacturers that are competitive and resilient are created. Coupled with strong background and foundation, many could weather the crisis gracefully, with injection of capital from the IMF. The difficulties faced by them during the crisis were only temperamental.

Malaysia, on the other hand, with a democracy political system, has nurtured many companies that are politically well-connected but lack the competitiveness in the international arena. Unlike Korean companies, these companies need not to perform excellently to secure government assistance. Forming a close relationship with the government or influential politicians is probably more important in the seeking patronage from the government. As the companies were focusing more on maintaining the business-government ties rather than building a strong foundation, many of these companies have not been performing significantly well.

At the onset of the financial crisis, Malaysia did not seek IMF's assistance and resorted to its own capital control measures. Not only was the Prime Minister confident that the country could survive on its own, it was also because the administration of the country did not want to lose its financial sovereignty. With IMF coming into the picture, the country would have to agree to IMF's restrictions and give up on capital sovereignty.

If the market were to function on its own based on market forces, then many of the Malaysian firms would be at the verge of bankruptcy. This includes many of the known to be politically well-connected companies, such as Renong, Johor Corporation, Berjaya Group, etc. These companies have not been performing well even in the economic booming years. The outbreak of the crisis has accelerated their plunge. Furthermore, they also captured attention from the public at large due to increase in awareness towards corporate governance and transparency.

This was a phenomenon that would not want to be seen by the Prime Minister and his administration. The close business-government relations existed in the country would have a huge implication on the bankruptcies of these firms. Many of the firms belong to the new rich *Bumiputeras* in the country, either nurtured by the government itself, or the family members or close associates of some influential politicians.

Furthermore, the companies were so used to the idea of "subsidy" and would not be able to compete and survive the competition brought in by IMF should Malaysia agreed to receive aid from the institution. Part of the financial aid package was to enable foreign firms to set up their companies in the local environment.

Therefore, Malaysia resorted to its own capital control measures as discussed earlier, and instead of tightening the market, the government had increased consumption and liquidity in the economy. Banking sector was directed to be more flexible in its lending measures and loans were given longer time to be repaid. All these effort was meant to keep the economy moving, instead of being stagnant.

In South Korea's case, under the leadership of President Kim Dae Jung, a series of structural reform has taken place in South Korea. The country realized the imparity in the market and had taken measures in making a revolutionary change in the financial, corporate, labour and public services. Firms that were not competitive in the market were allowed to fail.

Besides, the country had also been ensuring that market-driven principles take root in the corporate and financial sectors and that improvement in public sector efficiency and labour-management relations continue. The government had also been putting in effort in developing logistical, business, and financial infrastructures, thus increasing South Korea's industrial competitiveness and transform the country into a Northeast Asian Hub.

According to the Korean ambassador in Malaysia, Lee Ying Min, foreign investments in South Korea peaked in June 2002, amounting to US$645 billion, which was three times the total foreign investments for the past 40 years (Nan Yang Siang Pau, 2/12/2003). It was also part of Korea's effort of reform and restructuring to attract more foreign investments so that there would be an inflow of capital into the country.

The political leadership and the South Korean's mindset was particularly important in weathering the storm and enabling the country to be one of the most outstanding ones in the region. They were receptive to changes and worked together as one nation towards development, to create another Asian miracle, after the crisis.

The nature of the long existed business-government relationship has also changed. As the government adopted an open market competition policy, the relationship no longer played a vital role in ensuring companies' survival in the economy. However, it is inevitable to conclude that the relationship no longer exists.

In general, South Korea had recorded a much stronger growth as compared to Malaysia. The outstanding growth in the industry sector, such as electronic, petro-chemical and automobile manufacturing was remarkable. Malaysia's Prime Minister, Dr. Mahathir Mohamed had also acknowledged the achievement by South Korea and urged the Malaysians to learn from the latter. South Korea has become the model for the country's Look East Policy.

From the perspective of business-government relations, it is evident that the nature of the relationship in Malaysia was not able to produce companies that were more resilient, especially in times of crisis, as compared to those in South Korea. Malaysian companies were used to the subsidized and protected environment and could not handle the thunderstorms, should there be any. They needed the government's aid in order to avoid themselves from bankruptcy.

However, Korean firms were more competitive and were able to survive the external uncertainties in the international market. Therefore, even though there were many corruption and fraud cases, the nature of Korea's business-government relations was considerably better than the one in Malaysia. The implications were obvious, especially when times were vulnerable for the economy.