THE EFFECTS OF SELECTIVE CAPITAL CONTROLS ON MALAYSIA'S SUSTAINABLE ECONOMIC GROWTH

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ABSTRACT

The adoption of selective capital controls by Malaysia since September 1, 1998 remains a controversial issue. Among the opponents, selective capital controls would retard the economic growth of the country. The proponents argue that this measure is necessary to aid the government in regaining autonomy in monetary policy formulation and stabilizing the economy.

The objectives of the study are: (i) to understand the contributory role played by the selective capital controls in coping with the recent currency crisis, (ii) to examine the appropriateness and effectiveness of the selective capital controls in relation to the fixed exchange rate, government fiscal and monetary policies in recovering the economy and sustaining the economic growth in the medium or long(er) run.

The analysis on the selected economics indicators shows that the Malaysian economy has recovered from its slump. The real GDP has rebounded back from a low of –10.9% in the third quarter of 1998 to 8.1% in the third quarter of 1999 (BNM, 1999). Therefore, the selective capital controls is deemed an appropriate and effective instrument in coping with the currency crisis in the short run.

However, it is important to note that the positive achievement thus far could not be solely attributed to the effects of the imposition of selective capital controls. In conjunction with the imposition of the selective capital controls, various policies, that is, fixed exchange rate regime and expansionary macroeconomic policies have also been employed with the objectives of stabilizing and recovering the economy. Besides, the relatively favorable economic fundamentals of Malaysia at the outset, the government's efforts to disseminate information to increase the transparency of the selective capital controls, and their efforts to accelerate and strengthen the financial sector via bank

mergers and reform, the general return of confidence in the region, also seem to have played an important contributory role in this respect (IMF,1999). Overall, it is the total package that works.

The main concern, however lie on the sustainability of this positive growth in the medium and long run. From the theoretical perspective, it indicated that the measures, that is, fixed exchange rate with imperfect capital mobility and expansionary macroeconomics policies would not sustain in the long run. Over time, these measures would crowd out the exports, which would cause a trade deficit and eventually a contraction in the balance of payment.

In view of the increasing risks faced by the country, which brought mainly by globalization and financial liberalization, (selective) capital controls should be used cautiously and only be a temporary measure for managing the economy. To shield Malaysia from future economic shocks and currency attack, more preventative measures should be taken, for instances: strengthening the economic fundamentals and re-adjusting the government polices, reforming the banking and financial sectors. In addition, periodic review is necessary in enabling the government to adjust the macroeconomic policies to the market changes promptly.

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