6. FINANCIAL DEVELOPMENT IN MALAYSIA

6.1 INTRODUCTION

In tandem with the rapid economic growth since independence in 1957, the Malaysian financial system has experienced tremendous change. In the early post-independence period, the financial structure was relatively simple with a few commercial banks, basically serving trade. Most were foreign-owned, mainly by the British. The intermediary role was minimal as the main function of banking services was to facilitate trade. As Ho (1990:2) comments: 'Banks concentrated on discounting of trade bills, providing the letters of credit and checking the credit-worthiness of traders and merchants. In this sense, they were nothing more than foreign outfits to process trade papers and to act as insurers for merchants'. Only after the setting up of the Central Bank of Malaya (renamed Bank Negara Malaysia—and hereafter referred to as BNM—after the formation of Malaysia in September 1963) was there a concious effort to develop the financial system. Since then, the role of the financial system has been transformed from financing trade to mobilising and chanelling financial resources more effectively to meet the government's need for non-inflationary funds to fund economic development without crowding out private sector needs. With the downsizing of the public sector from the mid-1980s, the private sector has taken over as the main engine of growth. The financial system is already being restructured, reorganised and reshaped to meet the growing investment needs of the private sector, with large investments projected in sectors such as manufacturing, construction and services. The evidence is shown in Table 10. Total loans and advances directed to the private sector rose from RM89.8 billion or 96.5 per cent of total loans and advances at the end of 1988 to RM185.1 billion or 97.9 per cent at the end of 1992. In contrast, the share of general commerce declined sharply over the same period.

Table 10 Malaysia: Direction of loans and advances of the financial system

	as at end of							
	1980		1988		1990		1992	
	RM million	%	RM million	%	RM million	%	RM million	%
Public Sector	796	2.8	2,242	2.4	4,007	2.8	2,934	1.6
Loans to private sector	27,951	96.6	89,826	96.5	136,543	96.5	185,133	97.9
Agriculture	2,436	8.4	5,402	5.8	6,898	4.9	7,761	4.1
Mining and quarrying	288	1.0	1,077	1.2	1,138	0.8	1,161	0.6
Manufacturing	5,738	19.9	15,388	16.5	26,915	19.0	34,863	18.4
Building & construction (including real estate)	4,115	14.2	18,630	20.0	21,717	15.4	17,939	14.8
Housing	3,884	13.4	13,513	14.5	17,657	12.5	25,579	13.5
General commerce	5,197	18.0	11,669	12.5	14,300	10.1	15,431	8.2
Transport, storage & Communication	671	2.3	1,343	1.5	2,551	1.8	3,428	1.8
Consumption credit	961	3.3	4,078	4.4	11,789	8.3	17,097	9.0
Miscellaneous[1]	4,661	16.1	18,726	20.1	33,578	23.7	51,892	27.5
Domestic loans	28,747	99.4	92,068	98.9	140,550	99.3	188,067	99.5
Foreign loans[2]	174	0.6	1,016	1.1	1,010	0.7	934	0.5
Total loans	28,921	100.0	93,084	100.0	141,560	100.0	189,001	100.0

[1] Include loans for business services, lending to other financial institution and other miscellaneous loans.
[2] Comprise loans of commercial banks and financial companies to outside Malaysia; include foreign trade bills.
Source: Bank Negara Malaysia (1994: 71)

This section is not intended to provide a comprehensive survey of the Malaysian financial system,[60] but offers a brief overview of financial development in Malaysia with respect to its contribution as a source of finance for industrial and other economic activity in the economy.

The banking system in Malaysia, which has always been the core of the financial system, consists of monetary institutions[61] (comprising BNM and commercial banks including Bank Islam) and non-monetary institutions[62] (including finance companies, merchant banks and discount houses). Despite the recent developments in the securitites markets, the banking system remain the main source of funds raised by the private sector. It is obvious from Table 11 and Table 12 that in both absolute and relative terms, the most funds have been raised in the banking system. During the period 1980-86, an average of RM7.2 billion was extended by the banking system, eight times more than the amount raised in the securities market. Average new loans extended by the banking system was twice the amount raised in the securities market during the period 1987-92. Except in 1987, the securities market has never surpassed the banking system in terms of the amount or percentage of funds raised each year. This may be partly attributed to the early stage of maturity of the private debt securities market and the greater familiarity of businesses with financing by banking institutions (Jaafar, 1994: 153).

Table 11 Malaysia: Funds raised from the banking system and securities markets for the private sector

	(RM million)				
	Loans disbursed by banking system to the private sector[1]			Funds raised by the securities market for the private sector[2]	
Year	Amount outstanding	Annual change	% change	Amount	% change
1979	18,939.8			210.9	
1980	25,978.5	7,038.7	37.2	157.1	-25.5
1981	32,147.3	6,168.8	23.7	901.8	474.0
1982	37,712.0	5,564.7	17.3	678.8	-24.7
1983	46,627.7	8,915.7	23.6	1,399.2	106.1
1984	56,633.4	10,005.7	21.5	2,364.3	69.0
1985	64,866.5	8,233.1	14.5	644.5	-72.7
1986	68,774.0	3,907.5	6.0	188.6	-70.7
1987	68,929.7	155.7	0.2	1,779.8	843.7
1988	76,643.7	7,714.0	11.2	2,826.5	58.8
1989	91,567.1	14,923.4	19.5	4,650.8	64.5
1990	112,921.7	21,354.6	23.3	11,142.4	139.6
1991	137,536.5	24,614.8	21.8	6,834.2	-38.7
1992	151,383.1	13,846.6	10.1	13,718.2	100.7

Notes:
1. Includes NFPEs, other government controlled corporations, Bumiputera individuals and Bumiputera controlled firms, other individuals, firm and corporations, and foreign customers.
2. Securities markets refers to equities and private debt scurities, including short term commercial papers.

Sources: Bank Negara Malaysia and the Kuala lumpur Stock Exchange, cited by Jaafar (1994: 154).

Table 12 Malaysia: Funds raised by the banking system and securities market by the private sector (% share)

	Total (RM million)	Banking system	Securities market
1980	7,195.8	97.8	2.2
1981	7,070.6	87.2	12.8
1982	6,243.5	89.1	10.9
1983	10,314.9	86.4	13.6
1984	12,370.0	80.9	19.1
1985	8,877.6	92.7	7.3
1986	4,096.1	95.4	4.6
1687	1,935.5	8.0	92.0
1988	10,540.5	73.2	26.8
1989	19,574.2	76.2	23.8
1990	32,497.0	65.7	34.3
1991	31,449.0	78.3	21.7
1992	27,564.8	50.2	49.8

Sources: Bank Negara Malaysia and the Kuala Lumpur Stock Exchange, cited by Jaafar (1994: 155).

In 1992, the funds generated from the securitites markets (including issuance of commercial papers) came close to surpassing the amount raised from the banking system. As a percentage of total funds raised from both the securities market and banking system, the securities market accounted for 49.8 per cent, only slightly less than the banking system. The figure for 1992 was exceptional and cannot be taken as part of a trend because: 'The substantially high net funds raised in the securities market in 1992 was attributed particularly to the mammoth public issues of Tenaga Nasional (RM3.2 billion) and Proton (RM0.8 billion) and a large rights issue by Malaysian Airlines System (RM1.7 billion). Without these privatisation exercises, funds raised were still lower than the net loans extended by the banking system.' (Jaafar, 1994: 153)

6.2 REGULATION OF FINANCE IN MALAYSIA.

Since 1959, the commercial banks were brought under the BNM's supervision through the Banking Act 1973 (formerly Banking Ordinance 1958). Today, Bank Negara is vested with comprehensive legal powers under various acts and ordinances[63] to regulate and supervise the financial system. The introduction of the Banking and Financial Institutions Act (BAFIA) 1989 marked a special milestone in the legislation governing financial institutions as BAFIA gives extensive powers to BNM to regulate and supervise financial institutions, which range from those involved only in deposit-taking to institutions also engaged in the provision of finance. The BNM is responsible to ensure that the availability and cost of money and credit in the economy are consonant with national macroeconomic objectives.

The regulation of the financial system in Malaysia is maimed at the attainment of national goals. The BNM is empowered by the Central Bank of Malaysia 1958 to regulate interest rates on deposits and loans of commercial banks, finance companies and merchant banks.[64] Armed with these powers, the BNM directly set minimum lending rates for commercial bank loans and maximum deposit rates for commercial bank deposits in consultation with the Association of Banks until 1978. The objectives of the 'administered' interest rate regime during the period 1959-78 were to encourage savings, promote the growth of Malaysian banks by limiting interest rate competition with foreign banks, and protect the balance of payments from being significantly affected by capital flows due to interest rate differentials between Malaysia and the rest of the world (BNM, 1994a: 131).

Besides the price controls imposed by the BNM, a specific set of guidelines on the direction of lending, was introduced from October 1976, aimed at promoting a 'fair distribution' of bank credit among various sectors and ethnic groups in line with the emphasis of the New Economic Policy (NEP) on achieving inter-ethnic parity. Since then, allocative requirements have been imposed on banks to channel a certain proportion of credits to Bumiputras,[65] small-scale enterprises[66] and residential housing. The 1994 Lending Guidelines continue to emphasize these three as priority sectors (BNM, 1994b: 34).

Since its establishment, the BNM has promoted the development of Malaysian banks as the financial system was then dominated by foreign banks. Until 1973, the BNM continued to issue licences to new foreign banks except for banks whose ownership, control and management were dominated by foreign governments or their agents (see Lee, 1992: 167). From 1974 onwards, no more new banking licences were granted to foreign banks. Since then, only one foreign bank has been allowed to open a branch in 1994, i.e. the Bank of China in return for Malayan Banking getting a licence to operate in China (*Asiamoney*, 1995, vol. 6, no. 4: 84).

One of the new provisions in the BAFIA is concerned with the local incorporation of foreign commerical banks operating in Malaysia. They have been given a grace period of five years (or such further extension of time as the Minister of Finance may approve) to locally incorporate and upon local incorporation, will be allowed to retain 100% per cent foreign ownership.[67] To become a public company incorporated in Malaysia means that they become separately capitalised banking entities, legally separate entities from the parent banks abroad and thus, more closely and uniformly regulated (Lee, 1992: 160). Moreover, with a board of directors based in Malaysia, their policies and priorities should be more oriented to the domestic needs of the nation (BNM, 1989: 50).

A recent development is the introduction of a new two-tier regulatory system in December 1994. The two-tier system is aimed at providing incentives for smaller banks to recapitalise and merge (Montagu-Pollock and Lim, 1995:23). To qualify for tier one status, banks must have an equity base of at least RM500 million. Tier one banks have the privilege to do transactions previously denied to all banks, such as opening foreign currency accounts. Further privileges have yet to be revealed by the BNM.

6.3 LIBERALISATION

In Malaysia, a conscious policy measure by the BNM to promote a more liberal and competitive financial system commenced when the commercial banks were allowed to determine deposit and lending rates in October 1978. Notwithstanding several steps to liberalise interest rates since 1971,[68] these measures were mainly taken in response to the inflationary environment prevailing then in order to to encourage deposits and discourage consumption (Awang Adek, *et al.*, 1993: 3). The freeing of interest rates in 1978 (except for interest rates on loans to priority sectors) was but one in a package of four measures introduced by the BNM during 1978-79 to modernise and deepen the market. The other measures included reforming the liquidity requirements of financial institutions, bringing the merchant banks under the BNM's supervisory framework and the introduction of two new money market instruments—banker's acceptances and negotiable certificates of deposit. Unlike earlier developments, taken as a whole, the liberalisation of interest rates in 1978 and these measures, were concrete steps towards a more liberal and competitive financial system (Awang Adek, *et al.*, 1992: 4).

Nevertheless, this did not mean a completely laissez-faire environment as the BNM did not hesitate to intervene in the open market to ensure that there was an adequate supply of liquidity and that interest rates did not rise excessively so as to hamper business and investment activities. The experience after 1978 showed that bank lending rates tended to be downwardly sticky with a prolonged lag (BNM, 1994a: 43). To cope with this problem, the BNM introduced the base lending rate (BLR) in 1, November 1983. Every bank's or finance company's lending rates (except for those in the priority sectors) would have to be tied to its declared BLR, to be determined by the cost of funds, after providing for the cost of statutory reserves, liquidity asset requirements and overheads.

When liquidity was tight due to the severe recession, putting upward pressure on interest rates, the BNM formally suspended market determination of interest rates from October 1985 to January 1987. The BNM directed the commercial banks and finance companies to align their interest rates for deposits of up to twelve month maturity to the deposit rates of the two lead domestic banks from 21, October 1985. This effectively lasted until February 1987. Again, the sticky response of lending rates to the decline in deposit rates led the BNM to reimpose control on interest rates until February 1991 when the BLR was freed from the administrative control of the BNM. Except for interest rates in certain priority sectors, all interest rates are now supposed to be freely determined by market forces.

It was not until the economy recovered from the recession in 1987 that most of the major financial reform measures were taken. As noted by Awang Adek *et al.* (1992: 9):

> . . . reform of the financial system was not pursued concurrently in the early stages of the real sector liberalisation.[69] On the contrary, greater control and supervision of the financial system was exercised as the system was beset with difficulties. Consequently, the policy concern in the first half of the 1980s was to maintain a tight control over the financial system to prevent it from collapsing in the face of possible bnak failures and erosion of public confidence. It was during this period that financial liberalisation took a step backward when in 1985, the system of 'lead bank' was introduced.

Efforts have been made by the state to put in place the necessary institutions, legal and administrative frame work and incentives to develop the capital market. Among the significant institutional development were the establishment of Rating Agency Malaysia Bhd. (RAM), the country's first credit rating agency, in 1990 and the Securities Commission (SC) in 1, March 1993.

Despite the entry restriction imposed on foreign banks, incentives have been provided to entice foreign banks to open in Labuan, which the state set up as an international offshore financial centre (IOFC) in 1, October 1990. Various measures have been taken to make Labuan comparable to some of the 'best' IOFCs around the world, enhancing the attractiveness of Malaysia as an investment centre. To this end, a relatively liberal regulatory environment has been established on the island: exchange rate control regulation pertaining to offshore business activities have been made very liberal; preferential tax treatment for income, profits, dividends and interest earned from offshore business activities has been offered (for details, see BNM, 1994a: 46-47). Since the launching of the IOFC, 21 banks were granted licences by the Minister of Finance to conduct offshore banking activities at the end of December 1993 (BNM, 1994a: 46).

6.4 INDUSTRIAL FINANCING IN MALAYSIA: AN OVERVIEW

Historically, as mentioned earlier, the country's credit activities were initially concentrated in the financing of trade. During the British colonial era, banks mainly provided funds for major agency houses, which dominated the export of the country's primary commodities (tin and rubber) as well as the import of consumer goods. Loans advanced to the industrial sector were negligible during the period or even in the immediate post-independence era. As the pace of diversification and industrialisation accelerated, the financial system had to meet the growing demand for loanable funds. To take a closer look at industrial finance in Malaysia, we nned to analyse various institutional developments and other changes that affected finance-industry relations in the country.

Being a former British colony, the Malaysian financial system exhibited much of the Anglo-Saxon model which restricts banking activities to accepting deposits, granting loans and other specified activities. In contrast to the German and Japanese models, banks in Malaysia are kept at arm's length from involvement in corporate governance and management. Under the Banking (Control of Acquisition and Holding of Shares) Regulations 1968[70], a bank could only invest in trustee shares and only up to a limit of 10 per cent of the bank's paid-up capital and reserves (or 10 per cent of its net working funds for a foreign bank). In aggregate, a domestic bank is not permitted to hold shares of companies exceeding 25 per cent of their paid-up capital and reserves and a foreign bank is not permitted to invest in such shares exceeding 25 per cent of its net working funds (BNM, 1989: 101).

With effect from 1, September 1989, however, the scope of permitted investments by commercial banks was broadened to allow them to invest in Malaysia Airline System Berhad (MAS), the Malaysia International Shipping Corporation (MISC) approved 'blue chip' shares, as well as the shares of manufacturing companies and units of property trusts subject to prescribed limits (for details, see BNM, 1989: 101; Lee, 1992: 281). As for investments in the shares of manufacturing companies, the limit for a commercial bank should not exceed 10 per cent of the paid-up capital and reserves (or 5 per cent of a foreign bank's net working funds), whichever is the lower. The aggregate of these shares is subject to a limit of 25 per cent of a domestic bank's paid-up capital and reserves or 25 per cent of a foreign bank's net working funds. As the Japanese and Germany experiences now, allowing banks to own non-controlling shares in companies, even in limited amounts is desirable, since this will help to develop and maintain close bank-firm relations and banks would have the incentive to engage in monitoring the firms.

In the early days, most domestic banks were generally small, family-owned entities.[71] There were no restrictions in the laws governing banks and finance companies on the size of share holdings in these institutions, on transactions in these shares and on who could be shareholders of these institutions until 1985 (Lee, 1992: 243). The family-owned shareholding structure of domestic banks gradually changed, especially when the banking law was amended in 1985 to prohibit an individual from owning more than a 10 per cent interest in a bank, while the limit for an entity other than an individual was set at 20 per cent. It was claimed that the rationale of the BNM policy was to prevent the banking system from becoming the captive of a small number of owners who might unduly influence the banks to provide credit to companies belonging to them (Lin, 1994: 219). The provision was also to ensure that bank ownership is deversified as 'a rapidly growing economy necessitates a rapidly expanding banking sector, which is not possible if the banks are constrained by the limited funds available to a single family' (Lin, 1994: 220). Since then, the BNM has actively encouraged banking institutions to seek public listing and to offer at least 25 per cent of their shares to the public (BNM, 1985: 40).

To ensure no circumvention of the limits imposed on shareholdings, Section 45 of the BAFIA has a provision that requires prior written approval of the Minister of Finance before any person can enter into an agreement or arrangement to acquire or dispose of any interest in the shares of a locally incorporated banking institution if the interest in the shares is 5 per cent or more. The Minister of Finance, on the advice of the BNM, is empowered to prevent acquisition of shares of locally incorporated banking institutions by irresponsible and undesirable persons. Besides regulating entry into the finance industry, this provision provides protection to domestic banks from encroachment of foreign banks in their ownership and control (Lee, 1992: 246). Cross-holdings of shares among financial institutions are also prohibited, but the Minister of Finance, on the recommendation of the BNM, can grant exemptions when he sees fit.

Banks in this country tend to be very conservative when it comes to lending criteria. As noted by Hing (1987: 422):

> For instance, they will finance companies based on their past record, current solvency and liquidation value rather than their long-term prospective profitability. They also demand greater security for loans. These policies separately and conjointly restrict the availability of funds and increase the cost of capital to industry. What is worse is that they in turn impose on industry a similarly cautious and short-term view of investment, profitability and profit allocation and inhibit long-term or high-risk industrial investment.

The short-termist view of the banks was clearly reflected by the increase in the share of credit to the property sector[72] from 21.6 per cent in 1977 to 35.9 per cent in 1988 following the liberalisation of interest rate, which coincided with a property boom. The soaring of property loans was in contrast to the low increase in the relative importance of building and construction sector in total GDP and reflected the improved profitability of the sector, through capital appreciation:[73] 'The liberalisation of interest rates allowed banks to charge higher interest rates for the property loans, yet the real interest rates were low relative to gains from capital appreciation and perhaps included some speculative element as well. This has made property projects profitable, at least *ex ante* and hence bankable' (Zainal *et al.*, 1994: 307). As a result, the share of credit to the manufacturing sector declined during this period (see Table 13) despite a sharp increase in its shares in total GDP.[74]

Table 13 Malaysian banking system: classification of loans and advances outstanding by sectors (% share)

Sectors	1977	1978	1980	1982	1984	1986	1988	1990	Jun 1991
Agriculture	7.1	7.2	8.1	7.3	6.1	5.7	5.4	5.0	4.5
Mining	1.0	1.0	1.1	1.6	1.2	0.9	1.3	0.9	0.9
Manufacturing	14.4	15.6	20.7	19.1	16.0	14.9	16.9	18.9	19.5
General Commerce	22.7	22.6	19.8	18.1	16.1	14.9	14.2	11.9	11.1
Broad Propety Sector	21.6	22.4	26.4	31.0	33.5	35.9	35.9	29.9	29.3
Construction	6.0	6.3	6.9	6.4	6.9	6.8	7.4	7.1	6.9
Housing	9.8	10.5	10.8	12.0	11.5	13.0	13.0	11.4	11.5
Real Estate	5.7	5.6	8.7	12.6	15.0	16.1	15.5	11.3	10.9
Transport and Storage	2.0	1.9	2.5	2.9	2.1	1.7	1.6	2.1	2.1
Electricity	0.0	0.0	1.1	0.4	0.1	0.1	0.1	0.2	0.2
Finance, Insurance	7.4	6.2	5.4	7.8	10.2	10.5	10.6	10.6	10.6
Consumption Credit	2.8	2.9	3.7	3.9	4.5	4.0	4.9	10.3	11.1
Others	21.0	20.0	11.2	7.8	10.1	11.5	9.2	10.3	10.7

Source: Bank Negara Malaysia., as cited by Zainal (1992: 40)

A study by Central Information Collection Unit (CICU) of Permodalan Nasional Berhad (PNB) database, as cited by Zainal *et al.* (1994: 313) shows that company size ia an important determinant to accessibility to credit, and the larger companies enjoy lower average cost of credit. This could be due to the less stringent requirements imposed by financial institutions on them as bigger compaines have better track records and reputation (see Zainal *et al.*, 1994: 313). Table 13 shows that this 'discrimination' was more pronounced during the recessionary years of 1985-86, when the average cost of credit for the large companies was almost 11 per cent lower than the small and medium-sized enterprises.

Table 14 Malaysian listed companies: Average cost of credit, 1983-90
(measured by the ration of interest payments to total debt)

Company Size	Period	BL/BT	F/BT
Small and Medium	1983-84	0.996	0.142
	1985-86	0.963	0.216
	1987-90	0.991	0.153
Large	1983-84	0.964	0.112
	1985-86	0.973	0.108
	1987-90	0.662	0.088

Note: BT = Total Debt
BL = Loans from financial institutions
F = Interest payments
Small and Medium = Shareholders' funds < RM2.5 million
Large = Shareholders' funds ≥ RM2.5 million

Source: Adapted from Zainal *et al.*, 1994: 314.

Perhaps due to this short-termist view of the banks, the BNM has undertaken the following measures. Following the 1985-86 recession, the commercial banks have suffered a large overhang of non-performing loans. In order to assist viable Bumiputra entrepreneurs who had been affected by the economic recession and to reduce the problem of 'non-performing loans' facing the banking system, the BNM eatablished a RM500 million Enterprise Rehabilitation Fund (ERF) in 1988 (Sheng, 1989: 25). The fund was financed by the BNM and managed by a development bank, providing soft loans or seed capital to viable Bumiputra entreprises. The viability of eligible enterprises would be evaluated by specialist 'turnaround groups', comprising of leading professionals in the fields of manufacturing, trading, agriculture and property.[75]

Another measure to facilitate the corporate restructuring to resuscitate financial distressed, but basically viable firms was the issuance of general guidelines on debt-equity swaps in December 1989. Under the guidelines, commercial banks were generally allowed to hold up to 33 per cent of the nominal paid-up capital of restructured corporations arising from debt-equity conversion, including any additional equity injection made subsequent to conversion (BNM, 1989: 58). Despite being permitted to nominate its directors or staff as non-executive directors on the board of the restructured corporation, unlike counterparts in Japan and Germany the banks were somehow required to sell down their equity stakes in the restructured corporation once they had turned around (BNM, 1989: 58).

The first half of the 1980s saw a plethora of abuses by directors and staff of banks and finance companies in lending operations. What is worse is that the financial scandals and white-collar crimes often involved politicians who had close ties with influential political leaders. Many major Bumiputra conglomerates have emerged in the post-NEP period owing to extensive patronage practised by the ruling elite, particularly in the form of soft loans from state-owned banks and the award of major construction projects and licences (Gomez, 1994: 9). Meanwhile, many major corporate groups controlled by non-Bumiputras have also grown due to political patronage arising from their close ties with prominent Malay politicians (Gomez, 1994: 21). The ownership of financial institutions as well as top corporations by the state and its associates have led to such undesirable consequences. As such, other national priorities such as industrial development have been sacrificed at the expense of 'the interests of whichever faction is holding sway at a particular time' (Hing, 1987: 423):

> When people who manage and control top corporations and financial institutions belong to the same circle—for instance, the government owns the largest corporations and banks—loans involving a few hundred millions can even be drawn down without going through proper investigations and procedures, and usually given, not for productive activities but for some speculative get-rich-quick schemes.[76]

The most celebrated case was the involvement of the state-owned Bank Bumiputra in massive fraud amounting to RM2.5 billion through its Hong Kong based subsidiary, Bumiputra Malaysia Finance Bhd. (BMF). The BMF had approved huge loans to a Hong Kong property speculator (Carrian), which in turn rechannelled the funds to certain United Malays National Organisation (UMNO) leaders (Gomez, 1994: 59). Another bank scandal involving the D&C Bank and a prominent politician was also exposed, revealing how funds are channelled into his party for election campaign purposes in the early 1980s.[77]

Unlike the Malaysian experience, the Japanese experience shows that an effective developmentalist role can be found for state-owned financial institutions. Partrick (1994 :393) attributes this success to two factors: 'they had to be profit-making institutions, and they had autonomy from government bureaucrats and politicians in loan decisions, which they based on objective credit-worthiness criteria of projected cash flow and spesific collateral.' Corruption, individual or institutional, have not been a pervasive characteristic of the Japanese financial system. The perception that Japanese banks, bankers and regulatory bureaucrats in general are honest and responsible is attributed to the insulation of spesific credit allocation decisions from political pressures or bureaucratic interference. the severe legal, economic, and sosial sanctions against various forms of morally hazardous bahaviour, strong prudential regulation and effective bank supervision (Patrick,1994:398).

The recent enactment of BAFIA has a provision to prevent abuses by the directors and senior officers of banks and finance companies in connection with the use of resources of these institutions. It prohibits these institutions from extending credits to their own directors or employees or to organisations in which they have an interest (Lee, 1992: 205). The BNM is empowered to exempt a bank from this prohibition if certain conditions are satisfied (see Lee, 1992: 206). While the BAFIA gives extensive powers to the BNM to regulate and supervise financial institutions more effectively, it does not ensure the high degree of independence from political bodies enjoyed by the Deutsche Bundesbank. Without this independence, the BNM can be prevented from carrying out its duties to ensure a sound and prudent fenancial sytem.