Abstract

The government of Malaysia has decided with effect from 1 September 1998 to implement a series of capital control measures to insulate the Malaysian economy from the risks and vulnerabilities of external developments. This has been viewed by some as a bold and unconventional step to weather the economic storm following the outbreak of the Asian financial crisis.

This study seeks to analyze the capital control policy measures a macroeconomic policy perspective and to evaluate its appropriateness and impact on the real economy.

The study covers, inter-alia, a review of the relevant literature on capital controls and capital flows; a brief history of relevant Malaysia's financial openness from the mid 1980s to the present; an analysis of the effectiveness of the expansionary monetary and fiscal policies following the adoption of capital control measures using the framework of the basic Mundell-Fleming Model; and an examination of the economic indicators for an empirical analysis of the policy impact.

It is found that from a theoretical perspective, the policy measures would not be sustainable in the long term as it may have its adverse repercussions on the balance of payments. The trade balance may turn into deficit when imports rise as a result of expansionary fiscal and monetary policies. It should, however, be pointed out that the available economic indicators are not sufficient to make definitive statements on the effectiveness of such policy measures. However, it is highlighted that capital controls cannot be an effective substitute for necessary fundamental adjustment policies.