Chapter Eight

POLICIES RECOMMENDATIONS FOR MALAYSIA

In the process of development, running current account deficits and obtaining external loans may not be avoided. However, the reason for running current account deficits and obtaining external loans have to be based on profitability and productivity, not for speculation and private interests. The current account deficit should not be a result of non-tradable investments. The source of deficit should always be crucial to determine whether the current account deficit is sustainable. Foreign portfolio investment should not be depended solely to finance a current account deficit. Once a country has established itself, there should be efforts to scale down gradually the current account deficits and external loans. Singapore's experience highlights how a country's current account position changes over time, from a current account deficit position to a capital exporter, depending on the particular stage in its economic development.

Capital inflows must be channeled to profitable investment for current account deficit to be sustainable. Excessive liquidity caused by capital inflows tempts excessive risk taking in lending. Loans that are loosely given out may not be justified by good investments. Funds may be spent on national monuments, unproductive projects and other non-tradeables. Cronyism, corruption and nepotism may further aggravate the situation. Awarding of tenders and credit should be based on caliber and ability of management. The growing list of public sector mega projects of which economic viability is questioned will eat into the share of financing needed for productive investments. Projects may be aimed at national pride but what is national pride when the current account deficit is dangerously unsustainable? The more appropriate concern should be how the foreign savings are used, not how much foreign saving to resist. Soundness of the financial system and productive investments are indispensable for the sustainability of economic growth, more so if countries were to be active in the international capital market.

The tell tale signs to look for in ensuring good management of the economy should be the amount of external debt, non-performing loans and share of property loans and the macroeconomic indicators analyzed in earlier chapters. All of them should be kept at sustainable levels. Banks and authorities must recognize the size of the non-performing loan problem and to address them at an early stage before the condition exacerbates.

Deregulation, technological advances, financial innovation and globalization of the financial markets imply stronger competition and exposition of financial institutions to new areas of risks, including foreign exchange risk and portfolio risk in securities trading. Local financial personnel may not be trained to deal with these sudden changes. The organization and information requirements of new financial institutions need the development of a legal framework and greater intervention in encouraging the development of embryonic institutions. Risk will increase as competition becomes more intense. Liberalization will make markets more volatile and uncertain. Therefore supervision and surveillance of the financial system should be on par with financial liberalization.

Adequate information system is important. Adequate accounting system; the availability of balance sheets and profit and loss account to creditors as well as strong supporting infrastructure provide sufficient flow of information, credit appraisal and rating. Accounting and auditing are fundamental tools not only for managerial decision-making but also for lender evaluation of credit risk. Information asymmetries reinforced by lack of regulation and monitoring will produce moral hazard and adverse selection. Consistency in implementing government policies should be adhered to. Conflicting words and actions will produce questions about the credibility of the country. Transparent government policies and creditable corporate governance are what all international investors seek for.

Externally, Malaysia can rely more on Asean currencies for trading within the Asean countries instead of the US dollar. A closer dialogue and co-operation within Asean for regional surveillance in domestic financial systems and regulatory capacities will help in dictating early signs of financial crises. The quick availability of economic and financial data that is reliable among Asean will provide information for the right decisions to be made.