The Next Asia takes on austerity

Malaysia needs to maintain capital regulation tools

Proposed measures in the new Trans-Pacific trade pact that the Malaysian government is negotiating could re-strict Pacific nations from preventing and mitigating financial crises. Since March 1, the so-called Trans-Pacific Partnership Agreement (TPP) – a proposed treaty by the US, Australia, Brunei, Chile, Malaysia, New Zealand, Singapore and Vietnam — has been under negotiation in Australia.

US President Barack Obama has pledged that this “new century” of trade agreement that dissolves many of the harsh conditions of past trade pacts. In the wake of the global financial crisis and with the memory of the Asian crisis still so raw on our minds, any 21st-century trade deal should leave Pacific nations with all the tools necessary to prevent and mitigate financial crises.

Under the proposed deal, however, nations would not be permitted to regulate speculative capital flows to protect their economies from financial crises.

During the Asian financial crisis, Malaysia initially adopted the IMF’s policy measures such as raising interest rates and reducing public spending to counteract the economic downturn. This exacerbated the problems, raising interest rates did not contain capital flight and only constrained the economy.

In a change of course, in September 1998, the government introduced several capital control measures that included banning the trading of off-shore ringgit, which was contributing to the outflow of funds due to higher off-shore interest rates.

It also pegged the ringgit at 3.80 to US$1 and imposed a one-year moratorium on the repatriation of proceeds from share sales (from the purchase date of shares) to dis-courage short-term trading of local shares.

Other measures included halting ringgit loans to non-residents, controlling the transfer of ringgit funds and the conversion of ringgit deposits to other currencies except for the purposes of trade and long-term investments.

These measures were gradually loosened and capital now flows freely to and from Malaysia.

But we must remember that they allowed the country to have the breathing space to pursue more independent and effective monetary poli-cies. Together with other counter-cyclical fiscal policies and proactive debt restructuring measures, Malaysia recovered more quickly from the Asian financial crisis (indeed, this has been confirmed by US government-sponsored research as well).

Let us hope that the nation, or any other na-tion for that matter, does not experience such a situation again. But if the time does come, we will need all the possible tools at our disposal.

The 2010 IMF report showed that such measures not only work but “were associated with avoid-ing some of the worst growth outcomes” of the current economic crisis. The paper concludes that the “use of capital controls — in addition to both prudential and macroeconomic policy — is justified as part of the policy toolkit.”

Indeed, many of these other countries, such as Chile and Peru, that are also in TPP negotia-tions, have used regulation to stem capital in-flows to prevent crises from happening in the first place.

Citing this evidence, over 100 economists from TPP nations (including ourselves) sent a letter to their negotiators urging them to safe-guard the agreement with the flexibility of using capital account regulations to prevent and mitigate financial crises.

Malaysian treaties have been careful to main-tain the flexibility to regulate capital flows in many of its other trade treaties. It would be highly prudent to maintain that flexibility in a trade deal with the US — the source of much of the world’s volatile capital flows and the world’s largest financial crisis since the Great Depression.

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Malaysia has been careful to see that it maintains that breath-ing room in most of its other trade treaties. A recent study by the Washington-based Institute for Policy Studies shows that most free trade agreements among other TPP nations provide tem-porary safeguards on capital in-flows and outflows to prevent or mitigate financial crises, or defer that matter to the host country’s legislation. Indeed, Article 17 of the Malaysia-NEW YORK TIMES treaty and Article 88 of the Malaysia-Japan treaty have such a safeguard.

However, the TPP would disallow Malaysia these policy options. According to the US propos-als, all forms of capital — including derivatives, stocks, bonds and currency speculation — must be permitted to move “freely and without delay” among TPP countries. Moreover, rather than have the enforcement of these provisions be conducted by nation-states, the treaty would al-low private firms to directly file claims against governments who have used them.

The experience of Malaysia and that of other countries demonstrate that judicious use of cap-ital regulations is an important tool that coun-tries should have in managing their economy. Indeed, there is a new consensus on capital regulations and crises.