Board Meeting of March 30, 1999
Statement by Jan Piercy

Malaysia: Country Assistance Strategy

1. The U.S. welcomes the opportunity to discuss the Bank’s lending strategy for Malaysia. As a consequence of Malaysia’s decision five years ago to terminate an active relationship with the Bank, we found ourselves at the onset of the crisis with a substantial information deficit on Malaysia’s macroeconomic situation, financial/corporate sector strategies, and social development policies. In this light, the Bank’s active response to Malaysia’s request for a renewed relationship has been swift and well targeted. Given the range of serious policy concerns that the Board has expressed on Malaysia ad hoc, as Bank, IFC, and MIGA projects have been approved over the last year, this strategic discussion on the Bank Group’s engagement with Malaysia is timely.

2. Annex 1 in the CAS highlights the fact that Malaysia began the crisis in better condition than many of its Asian neighbors. Malaysia is categorized as upper-middle income, and is much wealthier per capita than surrounding countries. Importantly, Malaysia’s highly educated population allowed it to concentrate more heavily on skills-intensive high value added manufacturing.

3. The country has largely responded well to the crisis without the large adjustment packages provided by the IFIs. On paper, at least, Malaysia’s plans for banking recapitalization and the disposition of bad assets are of high quality. In fact, Malaysia has the potential to emerge from the crisis faster than many of its neighbors because of its standing legal infrastructure (e.g., facilitating corporate restructuring) and the fact that it began the crisis with much lower levels of external indebtedness. In the financial sector, the government has moved aggressively toward recapitalizing banks and purchasing non performing loans (NPLs) in an effort to strengthen the financial system.

4. Unfortunately, despite the many positives that Malaysia exhibits, there are also core weaknesses that undermine confidence. The successive policy reversals of last fall and the imposition of capital controls have created uncertainties and
greatly tarnished Malaysia’s image in the international financial community. Regulatory forebearance and efforts to ease credit conditions (e.g., weakening the definition of NPLs, mandating 8% credit growth) have not accomplished their objectives of strengthening the banking and corporate sectors. Non-transparent government rescue packages for politically-favored banks and corporates remain a genuine concern. Going forward, increased transparency and greater burden sharing in the banking and corporate restructuring process will be critical to restore the confidence of the market. Finally, a willingness to relax restrictions on foreign equity in the financial sector could improve investors’ perception and help to strengthen the capital structure, credit culture and risk management techniques of the financial sector in ways that could greatly benefit Malaysia. Such a relaxation would also be consistent with the rest of Malaysia’s economy, which is generally quite open.

5. Clearly, the authorities’ actual performance has on the greatest influence on the Bank’s relationship with Malaysia. I believe that staff have arrived at the correct stance concerning the base case and the triggers for moving to a high case option that would qualify for structural adjustment assistance. With that said, it is our understanding that trigger (vi) requires IMF Board endorsement of the macroeconomic framework. This could be achieved either through an IMF upper credit tranche program or, as was done in the past with Malaysia, through written certification of the framework.

6. Regarding the investment projects in the base case and the three projects that the Board is considering today: Year 2000 Technical Assistance ($100 million), Education Sector Support ($244 million), and Social Sector Support ($60 million): we support these investment projects and welcome their predominantly social sector emphasis. However, we would note that these projects are large and unusually fast disbursing, and that they finance an unusually high share of the total project costs. We question whether some or all of the operations should have been assessed on SSAL terms. Future investment loans should focus more explicitly on poverty reduction. In this regard, we request that management reconsider the Road Asset Management Project scheduled for FY 00. The focus of the Bank’s program should be on investment, not support for recurrent expenditures.

7. We think the Bank’s extensive program of non-lending services and analytic work directed toward Malaysia has very high value. We would like to highlight the planned Public Expenditure Review and the Participatory Poverty Assessment as excellent examples of high value-added Bank service that no other source can provide as effectively.

8. Finally, I would like to commend staff on the preparation of a generally high quality document that focuses in appropriate detail on the main issues for discussion.