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Responding to the Asian Financial Crisis: Malaysian Capital Controls and Their Implications for Tourism

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ABSTRACT

The Asian financial crisis has had an impact on both the Malaysian economy and its tourism industry. This paper summarizes recent developments and critically examines the capital controls imposed as part of the government's response strategy and their consequences. Issues addressed relate to the relationship between economic movements and tourism with a conclusion that recovery of the tourism sector is likely to be hindered by current economic policy unless sound strategies are put in place in the process.

Introduction

Malaysia experienced an economic boom between 1980 and 1996, with the growth rate rising from 6 to 9 percent. The average per capita income rose from US$890 in 1980 to US$4,000 in 1996. Although this was well below that of Singapore which stood at US$27,800 in 1996, it was still higher than that of many of its neighbors and Malaysia launched the 'Vision 2020' program with the goal of becoming a fully industrialized country by the year 2020.

Since 1997 and the onset of the Asian financial crisis, the prospects have changed and realizing the objective of becoming an industrialized nation within the next twenty years is increasingly uncertain. The Malaysian economy has been seriously damaged by the turmoil in the financial markets. The gross domestic product (GDP) contracted by 6.7 percent in 1998 and poised to register a growth of 1 percent in 1999 with a significant withdrawal of capital from Malaysia.[1] However, Malaysian government has recently claimed that the recovery path is set in and the economy might grow better than 1 percent in 1999.[2]

In an attempt to keep the country's economy from degenerating further, the Malaysian government announced capital controls in September 1998. These controls cover mainly two aspects of the country's financial system, the currency exchange and stock exchange. Officials hope to curb the flight of capital out of Malaysia. Once that is achieved, they believe that a stable exchange rate will follow, regenerating the economy from within, wooing back investment and stimulating tourism which has been especially adversely affected.

The hospitality and tourism sector in Malaysia was growing so rapidly for a period of over ten years that observers said it would surpass the success of the manufacturing

[1] Bank Negara Annual Report, 1999

[2] The National Economic Action Council of which Finance Minister Diam Zainuddin is executive director released a text of an interview on April 29, 1999.

sector. However, the 1997 economic crisis and downward spiral that followed have led to revisions of these expectations. Revenue from the tourism sector fell by one billion ringgit (US$342 million) in 1997, a 14 percent drop from 1996. Malaysia went from earning RM$9.3 billion (US$2.44 billion) in 1996 to only RM$6.2 billion (US$1.63 billion) in 1997 (Malaysian Tourist Board, 1997).

The 1999 Malaysian Budget anticipates that tourism earnings will increase to RM$14.4 billion (US$3.78 billion) compared with RM$12.8 billion (US$3.36 billion) in 1998 (Ministry of Commerce, Kuala Lumpur; 1999). However, these projections did not materialize because of the extent of the crisis and operation of other factors such as political disturbances, environmental pollution, and adverse publicity associated with an outbreak of a pig virus linked to Japanese encephalitis disease.

This article explores the policy of capital control, which has been adopted as a key element in the strategy designed to respond to the economic crisis in general, concentrating on currency exchange measures, and considers its consequences for tourism. It attempts to assess whether measures taken will aid or impede recovery and opens with an account of Malaysia's economic problems, moving on to examine the controls imposed by government. Implications for the tourism sector are then discussed and recommendations offered for future action. Financial figures are given in both Malaysian ringitt, the national currency, and U.S. dollars using the exchange rate of RM$3.80 to US$1 which was applicable in late September 1998 and continues till writing of this article.

Capital Controls

At the beginning of September 1998, Malaysia legally imposed capital controls in the country and pegged the ringitt at a fixed exchange rate of RM$3.80 to US$1 and recognized the Central Depository (CDP) as an authorized nominee for Central Limit Order Book (CLOB) shares. As a result, all conversion of Malaysian currency in external accounts or bank accounts of non-residents was made subject to the approval of Bank Negara, the central bank of Malaysia (Peraira, B, 1998) and the temporary nominee status was extended to CDP to resolve CLOB investors' issues most expeditiously. The CLOB investor issue will be discussed at a later stage in this article.

Approval was also required in the case of transfer of currencies between external accounts as a measure effective from September 30, 1998. The sellers of currencies such as banks and money exchangers were required to maintain their proceeds in ringgit for a year if they had owned the securities for less this. The aim was to protect the economy from global turbulence by making it impossible for speculators to have access to funds, to create a stable currency exchange rate and insulate the domestic economy from adverse global developments. According to Bank Negara (Press Release, 1998) once monetary independence has been achieved the controls, which are detailed in the following list, will be removed.

- Approval is required for the transfer of funds between external accounts. Transfers from resident accounts were permitted only until September 30, 1998. Thereafter,

approval is required. The withdrawal of ringgit from external accounts requires approval, unless it is for the purchase of ringgit assets.

- All purchases and sales of ringgit financial assets are only to be transacted through authorized institutions of deposit.
- With effect from October 1, 1998, travelers are allowed to import or export ringgit currency of no more than RM$1,000 (US$263.16) per person. There are no limits on the import of foreign currencies by resident and non-resident travelers. The export of foreign currencies by resident travelers is permitted, up to a maximum of RM$10,000 (US$2,631.58) equivalent. The export of foreign currencies by non-resident travelers is permitted, up to the amount of foreign exchange brought into Malaysia.
- Citizens and foreigners residing in Malaysia who have ringgit accounts elsewhere in the world had to bring them back within one month. According to Malaysian government estimates, there was an estimated RM$100 million (US$26.30 million) cash held overseas and RM$25 billion (US$6.58 billion) in offshore accounts.
- Foreign tourists will not be allowed to take more foreign currency out of Malaysia than they have brought into the country.
- Currency notes with RM$500 and RM$1,000 denominations are to be taken out of circulation to stop the smuggling of large sums of money out of Malaysia.

Other controls include restrictions on how quickly short-term equity investments held by non-resident or external account holders can be removed from the system. Inside Malaysia, the ringgit has been kept fully convertible with some restrictions. For example, Malaysian residents carrying more foreign currency than allowed will have the funds removed at the country's immigration checkpoints where they will be kept until their return.

The Malaysian authorities are anxious to contain speculation on the ringgit and minimize short-term capital exodus from the country. The Malaysian ringgit was declared non-convertible outside of Malaysia and all funds held offshore in ringgit denomination had to be repatriated to Malaysia in order to redeem their legal value. By restricting transfers between external accounts, and with offshore ringgit funds brought onshore, the Malaysian government has created a situation in which nearly all trade in the ringgit will be conducted solely in Malaysia.

Malaysian citizens or foreign nationals with permanent residence status traveling abroad do not have to make declarations if they carry less than RM$1,000 (US$263) each, or less than the equivalent of RM$10,000 (US$2,632) in foreign currencies. Nevertheless, like other travelers, they are subject to random checks by customs officials. Immigration officials abroad consider Malaysian citizens with permanent residence non-residents under the rules, which means they must file the new Travelers Declaration Forms for review. Travelers who breach these rules face a RM$10,000 (US$2,632) fine, or a three-year jail sentence or both. Under certain documented conditions, approval can be

obtained from Bank Negara to carry out more than RM$1,000 (US$263) in Malaysian ringgit or RM$10,000 (US$2,632) in foreign currency.

All of these technicalities may sound daunting to foreign investors and visitors, but Bank Negara says the capital controls are not designed to be an obstacle to business in general or to foreign direct investment in the tourism sector and tourists. The investors will be allowed to remit funds abroad. The tourists can also continue to use their credit cards for payment when making purchases. The stipulation is that all funds for purchases or remittances must be converted first at local commercial banks, which are authorized depository institutions. These banks will record transactions exceeding RM$10,000 (US$2,632). Prior to this, Bank Negara's surveillance threshold was RM$100,000 (US$26,316).

Since all transactions in the area of imports and exports have to be settled with foreign currency, these businesses will bear the greatest effects of this new rule. They will have to go through authorized commercial banks to convert ringgit into foreign currency for external transactions at an exchange rate that is determined by the market. Bank Negara, however, has stressed that this is not an indication that the government has imposed restrictions on foreign exchange contracts and non-residents. The rules are only for external account holders.

Malaysia's financial approach has been compared to a chess player declaring checkmate before achieving check, suggesting that it may have taken on too much too soon. It might have been less disruptive if its capital account had been liberalized and opened up to multilateral groups and industrialized nations more gradually. This would have meant that capital growth was synchronized with the increasing strength of its financial systems and institutional capability.

Malaysia, like many other Southeast Asian financial markets, opened up its capital account when its banking supervisory system was not developed sufficiently. Also, the liberalization process was not sequenced carefully to check the capital flow. The consequence was that before it could develop sound policies, Malaysia exposed its currency to speculators' attacks. Speculators in general respond to perceived inconsistencies in the economic policies or the basic economic principal of arbitrage, meaning capital markets respond to economic fundamental (Copeland, 1994).

Another mistake was that the Malaysian government tried simultaneously to control two incompatible economic targets: exchange rates and interest rates. Many domestic and multinational companies operating in the Association of Southeast Asian Nations (ASEAN) region realized there was no currency exchange risk in borrowing overseas since interest rates were low. As a result, many of them borrowed short-term in foreign currencies and invested in long term projects without hedging their currency exposure.

Some of the other principal reasons for the financial turmoil in Malaysia are summarized below.

- The capital account was not calibrated according to the level of soundness and sophistication of the country's financial systems.

- The circuit breakers to avert financial risks were not installed fully into the system to warn when a sudden inflow or outflow of funds had occurred.

- There was no sound system to monitor, check, and control the flow of short-term speculative funds

- The system lacked the mechanism to ensure that investments were properly matched with each other. In reality, large sums of short-term funds flowed into Malaysia to finance long-term investments. The short-term funds were invested in stocks and real estate, which were in turn used as collateral for borrowing for long-term assets.

- Malaysia did not fend off and control the massive inflow of foreign capital, when its own domestic savings were high enough to finance most of its investment needs. The domestic savings would have been good enough to supplement foreign direct investment for technology transfers, management expertise and access to export markets. Malaysia, being already at or near full capacity in the mid-1990s, did not need large flows of short-term capital funds.

- While building up its productive capacity, Malaysia did not slow down and cool off its economy and strengthens its institutional framework. By doing this, it could have eased integration into global financial markets.

- Malaysia rushed its advance towards globalization, open financial markets, trade liberalization and free capital movement. However, there are inherent dangers in today's globalized financial market. Speculators equipped with high technology can take advantage of a country when they realize massive amounts have flown into and out of it. Today's technology can move huge amounts of money almost instantaneously. Thus the value of currencies can change significantly overnight (Peraira, 1998), (Tan, 1998) and (Anon, 1998).

Had Malaysia financed its projects using its own savings, it may have averted such large-scale turmoil. However, dire conditions left the country with only two ways out of the crisis: follow the International Monetary Fund prescription, as Thailand and South Korea did, or limit the flow of capital accounts and put restrictions on currency exchange in and out of the country. Malaysia did the latter and imposed a series of capital controls including those discussed below. Nevertheless, many questions have been raised about the efficacy of these measures, such as: Can Malaysia afford to maintain its capital controls even if there is no global consensus to check the excesses of currency speculation? By cutting itself off from global financial markets, will Malaysia ruin its economy, especially the tourism sector. More importantly, what are the implications and consequences of a prolonged system of capital control, especially for tourism sector?

The Central Limit Order Book Issue

As a measure of capital control, Malaysian government temporarily halted the trading of Central Limit Order Book (CLOB) shares on the Kuala Lumpur Stock Exchange (KLSE). The CLOB is an over-the-counter market based in Singapore where Malaysian

shares were traded until September 1998. These shares were mostly related to tourism ventures such as hotels, real estate business, tourism resorts and casinos, and held by Singaporean investors. Singapore's over-the-counter market trading of Malaysian shares through CLOB reportedly totaled about 144 billion shares valued at S$229 billion (US$134.70 billion) since it started trading on January 2, 1999 (Toh, 1999).

According to the Stock Exchange of Singapore journal, CLOB shares as of September 15, 1998, were valued at RM$29.2 billion or US$7.68 billion with an account of 172,419 CLOB investors. The KLSE announced on December 31, 1998, that Singapore's Central Depository (CDP) will be recognized as an authorized nominee for CLOB shares until the end of 1999. The Malaysian government claimed that the trading of CLOB shares was used for speculative attacks on the Malaysian stock exchange and if such trading would have continued it could have triggered a massive sell down in Malaysian shares. The tying of the Malaysian shares held by Singaporean investors and to make it a matter of government-to-government issue would boost the stability of the stock markets of both Malaysia and Singapore. However, restricting the shareholders that held stocks in the developmental projects of hotels, real estate, tourism resorts, and casinos from trading on the KLSE the whole of year 1999 thus dampened tourism development in Malaysia.

Implications for the Tourism Sector

While other factors have been at work, such as political uncertainty, environmental pollution, health risks and competitive pressures, there is a strong link between economic movements and the state of the tourism sector. Before the implementation of the capital controls in September 1998, the industry was already experiencing a serious decline in growth rates compared to earlier years of the decade. In 1994, tourism made up 4.6% of Malaysia's domestic product and tourist earnings that year had shot up to RM$9 billion (US$3.56 billion) compared with RM$4.5 billion (US$1.78 billion) in 1990, creating some 98,000 jobs. Revenue expanded further in 1995 with a record 7.5 million arrival and 120,000 new jobs created so that tourism became the second largest foreign exchange earner. By 1998, however, receipts had fallen to reflect an 11% drop in arrivals to 5.5 million (Kwan, 1999).

While efforts are being made to halt this decline and pursue recovery, the capital controls represent an added complication. Malaysia's 1999 budget allocates RM$170 million (US$44.7 million) for tourism in anticipation of 7.2 million visitors in 1999 compared with 6.8 million in 1998. The tourists spent RM$2.5 billion (US$667 million) shopping in Malaysia in 1998, contributing 26.8% to the country's foreign exchange from tourism. Hotel sector in Malaysia contributed RM$2.96 billion (US$779 million) or 31.8% of the RM$9.34 (US$2.45 billion) earnings from the tourism industry. Although there was a 167.9% increase in tourist arrivals from Singapore, China (137.2%), the Netherlands (108.8%), Germany (91.6%), UK (91.1%) and Japan (73.4%) for 1998, that is no guarantee that tourists will come back automatically and already there is some evidence of the new restrictions affecting visitors.

The rules require travelers to declare the amount of money in their possession when entering or leaving Malaysia. Under the ruling introduced, all travelers including

Malaysians have to obtain clearance for specific amounts noted above from state customs officers. The Tourism Authority of Thailand claims Malaysian visitor arrivals have dropped 70% due to these rulings. At the Singapore-Malaysian Causeway, the travelers complain that customs officials enforcing the currency exchange regulations exacerbate existing congestion of foot passengers and traffic.

Within the context of tourism, there are two main objectives of imposing capital controls and currency exchange regulations. Malaysia is mired in its first recession in over a decade and is under pressure to fend off the exodus of capital by maintaining a stable exchange rate to insure against speculative hedging of funds. By lowering the interest rate, the Malaysian government hopes to jump-start the ailing economy via the tourism sector. The measures, if strictly carried out, could have a short-term, positive impact on tourism. Lowering the interest rate will allow tourism investors to borrow cheaply for their projects. Government officials hope that the incentives will rejuvenate many potentially prosperous projects that have been set aside due to the gloomy economic outlook. The controls also provide the government with a chance to implement structural reforms in the tourism sector. However, the long-term effects of capital controls on tourism remain a matter of some debate with a series of causes for concern.

The boost to tourism investments may turn out to be an illusion if capital controls limit the amount of ringgits that investors can bring in and take out and if they require earning from stocks and shares to be kept in Malaysia for a year. CLOB, the Singapore market for Malaysian shares, was effectively killed when Malaysia introduced capital controls. According to the Stock Exchange of Singapore journal, CLOB shares as of September 15, 1998, were valued at RM$29.2 billion (US$7.68 billion). Malaysia had claimed that CLOB was being used for speculative attacks against its stock market, but the effects of it on tourism related investment have not been determined as yet.

Also, the ultimatum to make RM$25 billion (US$6.57) in offshore ringgit valueless unless repatriated into Malaysia by September 30, 1998, is tantamount to blocking foreign direct investment (FDI) in tourism. In case the offshore funds return to Malaysia, tight capital controls designed to stem the outflow of funds will prevent existing foreign establishments and investments from taking cash out of the country.

If the FDI for tourism projects declines, raising funds overseas will become difficult which will create the danger of the government being forced to print local money to finance the projects. Printing a moderate amount of local money is acceptable so long as it does not pose the risk of causing inflation, but it could actually encourage this because tourism related projects are often extensive in scale and require substantial amounts of capital expenditure. Another danger of creating excess money is that it may flow into real estate and the stock market, causing the prices of properties and shares to go up artificially. The bubble in unproductive sectors may thus start building up all over again.

The FDI total into Malaysia for 1996 and 1997 was US$4.7 billion and US$3.8 billion respectively (UNCTAD, 1998). Most of the FDI is hospitality, tourism, and infrastructure related and without foreign direct investment, business will contract and unemployment in the tourism sector will rise. Unemployment can have an impact on the real estate

market and the retail traders, creating additional economic problems that might lead to tighter credit controls and lower returns on investments. Even if there are no restrictions placed on repatriating earnings and dividends for FDI investors, a host country cannot afford to inconvenience foreign investors given the competitive race to attract FDI in tourism, infrastructure, and transportation projects.

Imports of supplies for hotels and restaurants must be paid for in foreign currencies and offshore importers of Malaysian food products, especially palm oil and coconuts, will require ringgit for trade according to capital control rulings. On the other hand, food processing and export-based companies will have ringgit costs and foreign currency revenues. They will have to remit their foreign exchange revenue back to Malaysia. Most of these companies as well as their employees will probably prefer to maintain foreign currency accounts overseas. Malaysian-based travel businesses earning foreign currencies may want to protect their interests by maintaining overseas foreign currency accounts and making their transactions in foreign currencies in Malaysia, even though they are officially not allowed to do so by capital control rulings. Realizing the situation, many foreign travelers holding ringgit will decide to exchange them for foreign currencies, causing the ringgit to fall in real terms. Malaysians working overseas also will keep as much in foreign currencies in overseas accounts as is possible. The demand for foreign currencies may escalate in the market causing the ringgit to deteriorate further or to be converted into basic exportable commodities in Malaysia and shipped out of the country for foreign exchange. This may lead to shortage of foreign currencies, difficulties in conversion, and the emergence of a black market.

In another scenario, Malaysian firms exporting merchandise for retail and tourism businesses could under-declare the value of their goods. Suppose the value of a palm oil shipment to foreign countries is US$200 million on paper and the vendor is required to bring back the same amount to Malaysia. In reality, the merchandise may fetch US$100 million, with the difference of US$100 million kept by the retail-exporting firms in banks abroad. The same is true for the resort developers who may have to import goods and services from abroad. These firms could over-declare the value in their documented invoices, so that authorities would approve them, opening the way for businesses to build profits through the system. For example, a real estate firm working on a resort complex may buy goods and services from abroad that cost US$800 million. The firm could claim in its requisitions that it is paying US$1 billion. Since the U.S. dollar is pegged at RM$3.80 in Malaysia, but worth RM$4.20 or so abroad, these firms would be able to obtain US$200 million from the Malaysian Exchequer at the lower rate. The difference is a drain on cash-strapped Malaysia.

Another potential consequence is that the controls will give Malaysian authorities the power to decide which countries to approve currency transfers with. These approvals may not be in harmony with the trends in tourism, causing inappropriate allocation of funds. For instance, if the currency transfer decisions are made independent of trends in tourism industry, that might create problems amongst some important revenue generating destinations. The result could be a corresponding fall in visitor numbers from those

destinations. Table 1 provides details of hotel guest nights by origin in 1997 compared to 1996 and provides an indication of recent arrival patterns.

Table 1
Malaysia: Hotel Guest Nights by Origin of Guests [1996 versus 1997]

Country	**1996**	**1997**
Singapore	2,354,600	2,663,500
Japan	1,736,300	2,003,900
Taiwan	978,500	1,103,700
UK	936,700	1,103,100
Australia	772,900	837,600
Hong Kong	640,100	713,400
USA	501,400	567,000
China	486,600	713,400
Germany	472,700	513,300
Indonesia	373,200	511,900
Others	3,209,900	3,947,000

Source: Annual Report on Tourism 1997, Malaysian Tourism Board Kuala Lumpur

The present currency transfer approval system may cause a domino effect on neighboring countries. Malaysia is Singapore's first tourism destination and second largest trading partner. Singapore is also Malaysia's top tourism and real estate investment destination, with more than $10 billion invested there. About 50 million people pass through Malaysia's entry and exit points every year. Restricting money that can be carried out to no more than RM$1,000 (US$263) in ringget or RM$10,000 (US$2,632) in foreign currency per person can breed smuggling and racketeering as reported in *The Straits Times* (1998). When capital controls are imposed, parallel or black markets in foreign exchange are likely to develop. Among the more common factors in the development of an underground is the under-invoicing of exports and over-invoicing of imports.

Capital controls do represent a temporary measure to stop the flight of capital. The long- term implications for the tourism sector, however, are still unclear. In the meantime, Malaysia has to implement an economic policy that does not give an opportunity to speculators to respond to perceived weaknesses in the economic system. The large amount of capital flight out of the country is often the symptom, and not the cause of speculation (Taylor, 1997). Malaysia can correct the cause of currency speculation as well as put its tourism business back on track by removing the perceived inconsistencies in its economic policies.

Recommendations

Malaysia can minimize these potential problems by, firstly, being careful not to reflate its economy too rapidly, especially since offshore ringgit deposits in the order of

RM$20 billion (US$5.26 billion) to 25 billion (US$6.58 billion) are expected to flood the market. Such a move would cause the level of liquidity to expand suddenly, boosting inflation and eroding the credibility of the exchange rate.

Many non-performing real estate loans were extended during the expansion era. These non-performing loans were given a three-month recognition period through the capital controls. If the recognition period for such a loan is extended beyond the current three limit, the potential cost of rescuing the banking system will increase, adding to fiscal and inflation fears.

Under the new policy payment system, imports must be officially approved. Malaysia must not allow import procedures to become so cumbersome that they affect competitiveness and are eventually reflected in trade accounts.

Malaysia should use capital controls as a defense against hot currency movements. It should not allow capital controls to spread into a comprehensive system that restricts all trade and payments. If capital control regulations are used to determine the amount of different commodities to be imported and exported without reference to trade trends, economic warfare might ensue, inviting economic retaliation from Malaysia's trading partners (Nbiam, 1998).

The Malaysian government, in its 1998 budget, indicated that RM$4 billion (US$1.06 billion) would be allocated for roads, bridges, ports, and other tourism related infrastructure projects in 1999. Such a reflationary strategy will improve the investment climate and may attract FDI in tourism, but at this stage it is difficult to be optimistic as the reflationary strategies may sometimes encourage reckless lending to people who are politically connected. The reflationary strategy may also lead to the build-up of tourist destinations that were neither needed nor well planned. A case in point is the tourist-related projects in Kien Giang province in Vietnam where investors could not perceive the sequencing of tourist destination development with the reflationary policy in place (Gates & Truong, 1998).

Furthermore, there can be no substitute for the reforms essential for economic growth and financial stability, rather than relying on the success of the capital controls. Economic growth and financial stability in turn will attract FDI in tourism (Cheng, 1998). Possible reforms include:

- Clear-cut transparency and accountability in government and corporate affairs
- Strengthened banking systems and financial institutions through improved regulatory frameworks and substantial recapitalization.
- A level playing field for the private sector involving the dismantling of monopolies and privileges as well as the establishment of simpler, more transparent regulatory systems.
- Reductions in unproductive spending such as prestige projects and subsidies to enterprises.

- Obviously Malaysia should look beyond its borders and seek regional partners in its attempt to control the exodus of capital. In view of the different developmental stages of the countries in its neighborhood, there is room for both vertical and horizontal linkages and integration, which will increase the policy's effectiveness, although certain political barriers do exist to effective regional cooperation and coordination.

Conclusion

The Malaysian government wants to jump-start its economy by imposing capital controls to insulate the currency from speculation. As has been seen, capital controls can offer a temporary window of opportunity to stimulate and reform an economy. The government has also sharply lowered interest rates, reduced bank reserve requirements, and instructed banks to maintain their lending growth at 8 percent. It declared two main objectives of capital controls: to maintain a stable exchange rate and to enable the government to pursue an easier interest rate policy in a bid to stimulate the ailing economy.

However, these objectives cannot be achieved unless the economic inconsistencies are addressed. Capital controls are not a substitute for prudent macroeconomics policy. They do give a respite for banking reform and corporate restructuring without volatile exchange rates forcing the central bank to raise interest rates and slow down the economy. There is, however, a danger that excessive expansion in domestic demand could lead to the deterioration of the trade balance, resulting in a loss of foreign reserves and capital flight. Malaysia should not allow its public and private companies to borrow extensively all over again. Supporting non-performing loans such as that for the Multimedia-Super-Corridor, a prestige tourism and IT project, on the part of domestic banks will create the same problems that its neighbors face: asset bubbles, and over-investment in ambitious and unproductive projects.

Other questions include whether Malaysia can afford to maintain its capital controls even if there is no global consensus to check the excesses of currency speculation and is it possible for the country to cut itself off indefinitely from global markets. More importantly, what are the implications and consequences on economic sectors such as tourism if the capital controls are prolonged?

In terms of tourism, capital controls may discourage investors and tourists alike and frustrate the achievement of targets set in the 1999 Budget based on the projected increase in hospitality and tourism earnings. The authorities might be described as creating obstructions on the road to recovery, rather than lifting them. Tourism thus appears to have become the victim of both the financial crisis and strategies adopted in response to it. It will be interesting to monitor developments in Malaysia and the performance of the tourism industry as it continues to struggle to come to terms with the crisis and its aftermath.

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