BRETTON WOODS INSTITUTIONS, GLOBAL RECESSIONS AND THE MALAYSIAN ECONOMY

Dayita Priya Rajah♣
Faculty of Business and Economics, Universiti Malaya

Rajah Rasiah
Asia-Europe Institute, Universiti Malaya

ABSTRACT

The Bretton Woods Institutions of the International Monetary Fund (IMF) and the World Bank were established in 1944 to assist all countries to coordinate trade and investment towards supporting development. When Keynes orchestrated its launching, he had sought an egalitarian governance framework to support trade and investment. A fixed exchange rate mechanism was established to support trade and investment flows, and the settlement of balance of payment deficits, and debt. The early major fissure to such a system to threaten such a goal came in the form of the US withdrawing from the fixed exchange rate mechanism in 1971. It has since faced considerable contentions as many considered the US to enjoy asymmetric powers to shape the conduct of the IMF and the World Bank. The latest of such problems arose following the breakout of the Russia-Ukraine war in 2022 and the subsequent introduction of trade sanctions against Russia. This paper analyses the economic consequences of trade sanctions and their implications for the Malaysian economy.

Keywords: *Bretton Woods Institutions, Global Recessions, Financial Crises, Malaysian Economy*

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1. INTRODUCTION

Although monetary and fiscal policies need careful scrutiny to stimulate economic development while keeping inflation and unemployment rates low, it is also important to address the debilitative role finance capital sometimes play that can hinder the growth of agriculture and manufacturing. In this regard, Hilferding (1910) had earlier shown the destructive effects that finance capital generates when it is left to become dominant, which strangled the manufacturing sector in Germany in the late 19th century. In contrast to Hayek's simplistic claims of the market economy as driven by 'unregulated forces' when in reality, as pointed out by Polanyi, it has been driven by states directing resources to shelter the drivers of finance capital. Consequently, big business rather than the actual consumer reigns supreme in markets (see Rasiah, 2011). Three major crises are introduced in this section to address the importance of societal calibration to avert major economic crises.

♣ Corresponding author: Dayita Priya Rajah, Faculty of Business and Economics, Universiti Malaya, Email: dayita.rajah@gmail.com

The first is the Great Depression of 1929-39, which translated into a series of economic fluctuations with the stock market crash of 1929-31 following that was followed by attempts to introduce social reforms to check arguably the most crippling effects of the economic crisis the world had endured in history. The world has experienced both regional and global economic crises since, albeit with shorter recovery periods. It began following the stock market crash in October 1929 as panic reigned in the Wall Street when the value of investment stocks fell sharply (Keynes, 1920; Kindleberger, 1986; Feinstein, Temin & Toniolo, 2008). Consumption and investment dropped, which caused a sharp contraction in industrial output and employment. By 1933 around 15 million Americans lost their jobs while almost half of the banks in the United States had failed. The insistence of the liberal Herbert Hoover, the then Republican President to not directly intervene in the economy intensified the crisis. There was some respite when Franklin Delano Roosevelt replaced Herbert Hoover to introduce social reforms and greater protection for the banks, though it was not until 1939 and subsequently from 1941 that the American economy began to grow strongly again as the second world-war drove demand up. Feinstein, Temin and Toniolo (2008) document the distress faced by almost the whole world from the great depression.

The second is the Great Recession of 2007-08, which broke out when the United States' economy imploded as it reached several countries, including Malaysia in 2008-09 as a contracting United States economy drove an export crash among the trade-dependent economies. Other countries that had absorbed the financial derivates that emerged in the United States, (such as Ireland) faced even more serious consequences. The FED chief then, i.e., Ben Bernanke had raised FED rates from the 4.5% that Alan Greenspan had left behind to 5.25 percent contain soaring inflation. The proliferation of subprime stocks that gradually became worthless as bank failures rose from mounting non-performing loans, which resulted in the United States' government to intervene to introduce a massive fiscal stimulus, as well as Benanke lowering the FED rates to curb closures. By then the high interest rates and non-performing loans had strangled massive numbers of businesses and households (Stiglitz, 2010). The contagion hit several countries, including Ireland and Iceland. Meanwhile, Krugman (2009) explains similar developments behind several other financial crises across the world.

The third is the current global economic crisis arising from a combination of severe shortages caused by disrupted supply chains that began with the COVID19 pandemic but has since gained wind from economic sanctions on Russia that has caused severe shortages in oil and gas, wheat, sunflower and rape seed oil, and the inputs to grow crops. These developments have coincided with efforts by the Federal Reserve to raise interest rates to contain inflation, which threatens to reproduce the consequences of the 2007-08 global financial crisis. US Fed rates have again risen from 0.25% to 5.25% with dire consequences as bank closures have once again started to mount in the United States while high inflation, especially food inflation threatening a stagflation.

Since the paper is based on historical evidence of macroeconomic events, the methodology used is interpretative deploying critical scrutiny of evidence amassed. Hence, the novelty offered by this paper is a refreshing analysis of the global macroeconomic governance arising from the role of the International Monetary Fund (IMF) and the World Bank, and the impact of economic governance by powerful economies in general, and the United States in particular on the Malaysian economy.

Theoretical Considerations: The Waning Role of the Bretton Woods Institutions

The Bretton Woods System was created on July 1944 from 44 nations as they founded the International Monetary Fund (IMF) and the World Bank (originally the International Bank for Reconstruction and Development (IBRD) to start an efficient foreign exchange system (Panic, 2003; IMF, 1971). It was founded under the fixed exchange rate mechanism in which the US dollar was pegged against gold with other currencies fluctuating around the US dollar with the purpose of preventing competitive devaluations so that stable exchange rates could play an important role in economic growth.

Coming after the traumatic experience of the Great Depression of 1929-33, which remained threatening when the Second World War broke out in 1939, efforts to align currencies to support trade attracted a number of friendly trading countries to chart the Bretton Woods System in 1944 (Panic, 2003). The Bretton Woods System played an important role until the 1960s when reconstruction aid from the United States in general and to Europe and Japan in particular stimulated recovery in these countries and these growing economies were able to service their debts from rapid recovery and growth.

The US dollar became the obvious choice for the role of international reserve currency as the Sterling was gradually falling in significance since the First World War owing to its own mounting budget and trade deficits (Panic, 2003). Despite the emergence of the Cold War, there were less expensive encounters with the Soviet Bloc and China before increasing attempts by the United States at regime change raised the budget deficits faced by the United States (Panic, 2003).

China effectively joined the freer (not totally free) trade area since economic reforms introduced in 1978 (Garnaut et al., 2018). The fixed exchange rates mechanism along with the dominance of the United States in world production, exports, and ownership of gold offered little problems to the management of the system until the 1960s when the United States began to face severe budget and trade deficits (Panic, 2003).

Neo-classical economists, such as Friedman (1977), began to attack the fixed exchange rate preferring instead the free float under the flexible exchange rate mechanism, which was exacerbated by the unprecedented transnational enterprises, and industrial and corporate banks (Dellas & Tavlas, 2018; Panic & Manmohan, 2003). The Bretton Woods System became untenable from the 1970s as collaboration among the key members gradually broke down while the vested interest of the United States in pursuing its own political and military goals undermined the US dollar, which came under speculative attack (Panic, 2003). Consequently, the United States withdrew the peg against gold before subsequently devaluing the US dollar.

Stagflation broke out in the United States by the early 1970s whereby the country faced both high inflation and economic stagnation (with high unemployment levels), which was exacerbated by inflationary pressures from the first oil crisis of 1973-75. Consequently, President Nixon's actions to withdraw the US dollar peg against gold and subsequent devaluation of the US dollar is believed to have helped lower its budget and trade deficits but at

the expense of other countries experiencing a contraction in the value of their international reserves (Panic, 2003).

As petroleum became a major economic weapon, the Organization of Petroleum Exporting Countries (OPEC) became powerful as the countries formed a cartel to raise oil prices, which went up by about 4 times in 1973-75 and 2.5 times in 1979-80 (Yergin, 1991). While net oil exporting countries began to appropriate trade surpluses, net oil importing countries began to face severe trade imbalances.

The inflationary effect of the oil crisis, especially on the net oil importers was severe as these countries began to borrow heavily from transnational banks to settle their balance of payments deficits (Panic & Manmohan, 2003). These banks enjoyed heavy inflow of cash as the rich oil exporting countries deposited their cash in them (Panic, 2003). The fact that oil has had both a direct and indirect effect on inflation made the situation worse as the Federal Reserve in the United States and Central banks in other countries raised interest rates to contain inflation (Panic, 2003).

The critical functions that the Bretton Woods institutions have handled include financial crises after the collapse of the fixed exchange rate mechanism when countries were forced to accept structural adjustment packages as the IMF key function is to act as the lender of last resort when they are unable to settle their balance of payments deficits and pay their external debt. We discuss two examples here. Dooley (1994) argues that reforms in Mexico, Argentina and Chile resulted in budget surpluses along with the amortization of internal and external debt, which was complimented by privatization of financial and non-financial enterprises and the opening of these enterprises to foreign competition. Also, the high interest rates of the 1980s were reversed as interest rates fell from 1989.

Although Dooley (1994) is quixotic about the future, but as Stiglitz (2022) has argued, global crises caused by both economic and non-economic reasons, is beyond the powers of the World Bank and the IMF to address them – e.g., the COVID-19 pandemic and the economic sanctions imposed by the United States and its allies on Russia following the outbreak of the Russia-Ukraine war in 2022. The Bretton Woods system's survival and success depended on collaboration among all trading countries, but especially the powerful members. While the first serious breakdown of the Bretton Woods system took place when the US withdrew the US dollar from the fixed exchange rate system and subsequently depreciated it, despite the space given by the World Trade Organization (WTO) to resolve the major issues that were threatening trade between nations, little has emerged to suggest that the World Bank and the IMF have chosen to act free from interventions by the United States and her allies.

As Panic (2003) observed, this was not possible as neither was it realistic for individual members to show equal support in a world of regional groupings with one member clearly most powerful among them then, i.e., the United States, which was unwilling to forego its vested interests. This gave rise to an American hegemony. Hence, while some elements of such cooperation have emerged now and then, the world continues to face serious economic crises because of, among other things, these shortcomings.

The introduction of economic sanctions on Russia in 2022 and trade friction between the United States and China since 2014 has complicated matters further to undermine the role of what is left of the Bretton Woods Institutions of the IMF and the IBRD (World Bank). As Stiglitz (2022) has argued the continued reliance on markets using liberal theory leaves the global economy vulnerable to crises that shall continue to raise problems for countries to seek unorthodox strategies to solve both internal and external crises, which includes the interest rates hikes by the United States Treasury to cap inflation and economic sanctions on Russia, that are now threatening the Western economies with stagflation.

This development has led to the search for an alternative currency bloc by the Brazilian, Russian, Indian, Chinese, and South African (BRICS) governments (Prange, 2023), which has reduced further the reach of the IMF and the World Bank. What Keynes had feared when the Bretton Woods institutions were located at Washington DC in 1994 continues to return to haunt economists who observe disdain in the biased reactions by these institutions when dealing with global trade and investment matters. The introduction of economic sanctions against Russia have only underlined this point. Through its vast reserve currency capacity and its unilateral monetary interventions to regulate interest rates and dollar supply, the United States has enjoyed massive advantage in the world economy leaving smaller economies to work around its economic actions to organize their own monetary and fiscal policies.

The 2008-2009 Global Recession

The 2007-2008 global economic recession, which had threatened to explode into a depression initially is worth revisiting to extract lessons for the economic slowdown facing the developed countries since the COVID-19 pandemic struck since 2020. More than the contraction that was experienced across the world owing to closedowns caused by the spread of the deadly infectious virus, the recovery since 2022 has been hampered by the unnecessary Russia-Ukraine war and the subsequent imposition of economic sanctions against Russia. The actions of the United States Fed to raise interest rates to cap inflation from 2006 accentuated bankruptcies and a contraction in GDP in the country, which triggered a domino effect across the world.

Just when Lucas (2004) and Bernanke (2008) had claimed that the world has learnt enough to avoid global economic crises the United States economy imploded in 2007 to send a devastating contagion across the world. The problem was not so much caused by their claims as the world has indeed become firmer to handle depressions. The problem inherent in the capitalist system is the inability of governments to either foresee the emergence of self-interested economic agents seeking to take advantage of murky markets or to rally their main organizations to seek recalibration. Yet, such a deleterious effect on the United States economy was not altogether a consequence of following the neo-liberal ideology of leaving economic governance to market transactions. The neo-liberal dictum of allowing markets to govern the allocation of resources was led by Hayek (1944) and Friedman (1977). Although interventions to raise interest rates to cap inflation so as not to break the Phillips curve relationship is neo-Keynesian, such an alternative approach has often been taken only when inflation starts soaring to affect capital markets. The alternative, i.e., the non-accelerating rate inflation of unemployment (NAIRU) or the natural rate of unemployment is the market clearing rate expounded by Friedman. Instead, fearing the occurrence of two quarters of consecutive recessions, the Fed chair often intervened

with interest rate hikes in the United States to cap inflation.

Therein lies the problem as during the great recession of 2007-08 interest rates began rising towards the end of Alan Greenspan's tenure as the Fed chair and the early period of Ben Bernanke's reign as Fed chair, which largely arose from the continuing attempt to cap a rise in inflation that stretched through Ben Bernanke's early reign as the Fed chair from February 2006 as interest rates rose to 5.25 percent by June 2006, caused largely by market failures, that included the bursting of subprime mortgage bubble and the stark failure of the rating system led by Fanny Mae and Freddy Mac. Alan Greenspan had left the Fed chair in January 31, 2006 with the interest rate at 4.5 percent. Under Ben Bernanke the Fed rate rose to 5.25 percent on June 29, 2006 before gradually falling to 0.00-0.25 percent on December 16, 2008 (Tepper & Curry, 2023). While Bernanke's (2015) efforts were influential in leading the United States back to recovery through massive bailouts of banks and fiscal stimuluses to stimulate growth, the recovery was largely driven through interventionist monetary and fiscal policies. Hence, governments should accept monetary and fiscal policies as instruments that they can be deployed to re-steer the economy of countries back to steady economic growth.

That the United States' economy recovered through interventionist fiscal and monetary policies - which Bernanke turned to - is both a reflection of the incisiveness of neo-Keynesian instruments and the understanding that markets are inherently rife of imperfections. It also suggests that economic planning requires a profound understanding of the economic developments, including micro-forces against macro-variables, (such as interest rates, inflation, exchange rates, and unemployment) that can derail any economy. It is also a call to avoid a fixation towards standard neoclassical rules of governing economies. Neither governments nor markets on their own can guarantee successful economic and financial governance. Consequently, a small open economy, such as Malaysia, have to be vigilant primarily over the actions of the dominant economic power, i.e., the United States, but to a less extent other strong economies, such as the European Union, Japan, China, and India.

Economic Sanctions and Inflation Capping

While the collapse of the global economy following the COVID-19 pandemic that struck in 2020 came about when the world economic growth had already started to slow down prior to that, the spread of the virus and deaths proved that there was no correlation between them and the per capita incomes of countries (Rasiah, 2023), with arguably the exception of the World Health Organization (WHO) and many individual countries the world witnessed the lack of cooperation from the United States. Instead of uniting with the rest of the world, the United States political leadership targeted China to blame the country for creating the corona virus, which is believed to be an extension of the China containment policy that arguably started under the Barack Obama administration but became more punitive under the Donald Trump administration.

As the world transited from a pandemic to an endemic, the United States and its allies had imposed trade sanctions on Russia as reaction to Russia's attack on Ukraine in February 2022. While the devastating war should never have been allowed, the sanctions has also caused widespread economic consequences as the shutdown in oil and gas exports to Europe in

particular and also shortages caused by the supply chain disruptions has driven up inflation. This has been made worse as the wheat, and edible oils from Ukraine and Russia, and the fertilizers to grow them has fallen sharply.

The energy crisis arising from economic sanctions has impacted negatively on several European economies with Germany arguably suffering the most. With inflation at nearly 8 percent and energy prices rising at almost 40 percent, people living in Germany are expecting a cold winter. In addition, the slowdown in several importing markets, including China and Russia, Germany's trade surplus has dwindled to hit negative figures in May 2022 for the first time in 30 years (Ahmed, 2022). The inflation rate in Germany soared from 5.1 percent in when the Russia-Ukraine war broke out in February 2022 to its peak of 10.4 percent in October 2022. Although that rate has since fallen to 8.1 percent in December 2022 before rising again to 8.7 percent in January and February 2023, it was still far higher than the 2 percent medium-term target set by the European Central Bank (Statista, 2023; ECB, 2023).

The Fed appears to have repeated the mistakes made in 2006 as monetary policy once again has focused too long on inflation capping. The neo-Keynesian argument on the Phillips curve should have been taken as a short-term phenomenon, which should never have been stretched beyond its timeline, especially when information was rife on business and banking closures, and rising non-payment loans from households. A stagflation was already imminent before efforts were taken to bring interest rates down. Importantly, it makes no sense to focus an aggregate instrument, such as inflation capping when the economic casualties of such a strategy was producing mounting business bankruptcies and bank closures. Ben Bernanke's intervention to lower interest rates, and to bail out businesses and banks very much saved the United States economy then. The United States Fed announced a hike in the Fed interest rate from 5.25 percent to 5.5 percent in July 2023, but that the dollar declined in the aftermath of this announcement, which suggests that the markets did not resonate well with such an action.

Also, the US economy contracted over the first two consecutive quarters in 2022 by 1.6 percent in the first quarter and 0.9 percent in the second quarter, before growing by 3.2 percent in the 3rd quarter and 2.6 percent in the last quarter (BEA, 2022). The steady improvement in GDP growth in the United States over the first (2.0%) and second (1.8%) quarters of 2023 suggest that the country has shown relatively strong recovery despite the announcement to hike interest rates to cap inflation further that could have discouraged growth in consumption and investment. However, fears that there will be continued interest in the dollar and savings with rising interest rates appears to have receded as the dollar exchange rate has also shown a trend fall since July 2023 thereby allaying fears that it will cause an exchange rate depreciation of currencies of trading partners. Consequently, Malaysia's trade surplus declined by 3.6 percent in the first half of 2023 (New Straits Times Press, 2023) but is expected to rise again in the second half of 2023.

2. IMPLICATIONS FOR THE MALAYSIAN ECONOMY

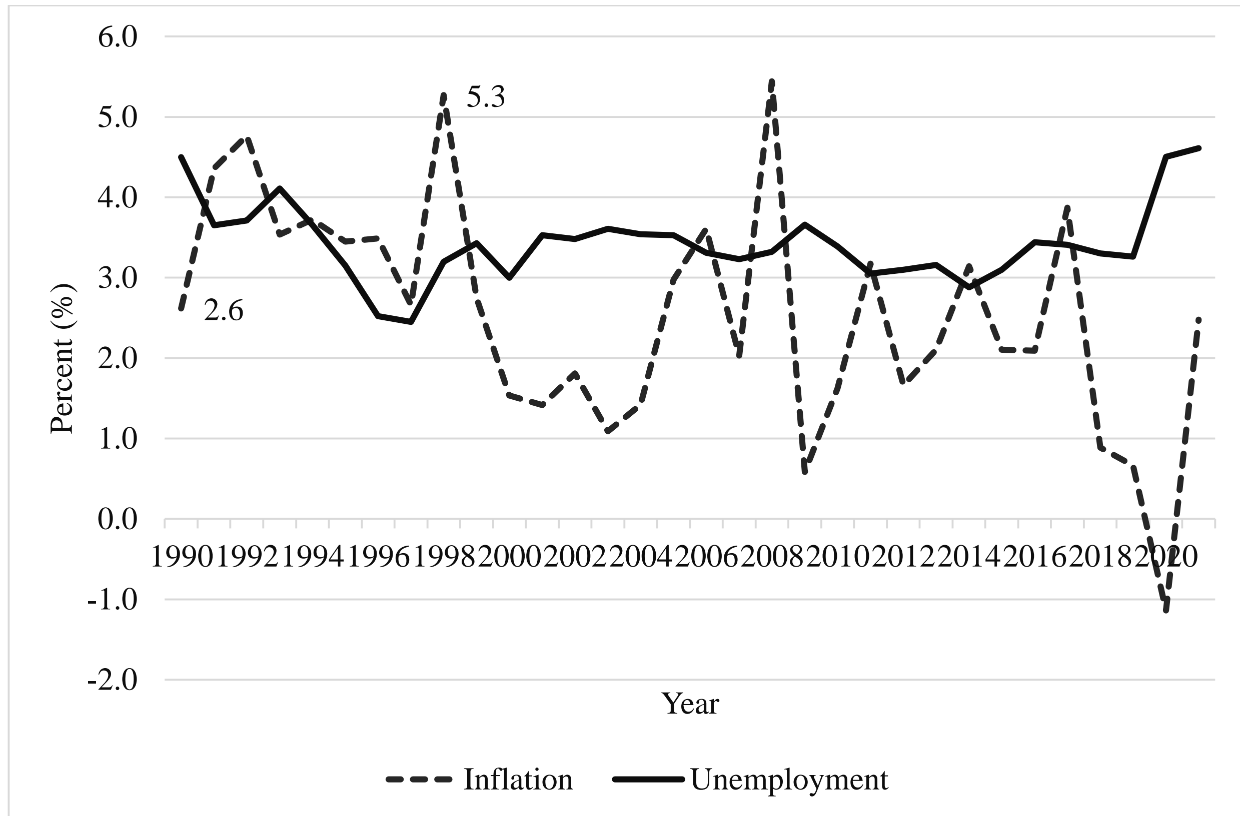
Having explained how the Bretton Woods institutions have evolved over the years and how the United States' macroeconomic policies have imposed constraints on other economies, this section focuses on their implications for the Malaysian economy. The emphasis on the former shall

address how the United States' have dominated global macroeconomic governance to the point of usurping that role from the IMF and the World Bank. This section deals with its implications for inflation and unemployment, trade, monetary and fiscal policies, exchange rates, and sectoral development policies in Malaysia. Because the Phillips curve denotes the relationship between inflation and unemployment these two macroeconomic variables are examined jointly.

Inflation and Unemployment

Two major macroeconomic variables, i.e. inflation and unemployment showed fairly stable movement, though inflation rose to 5.3 percent in 1997 when the Asian financial crisis broke out and 5.5 percent in 2008 as the global financial recession emanating from the United States that caused a major contraction in exports (Figure 1). Unemployment too has largely remained below 4 percent, except for the years in 1993 and 2020-21 when it exceeded 4 percent, the latter being a consequence of the calamitous impact of THE COVID-19 pandemic. The world has largely averted a stagflation as inflation in the United States has fallen gradually from 9.1 percent in June 2022 to 3.0 percent in June 2023. Meanwhile Malaysia's monthly inflation fell from 4.7 percent in August 2022 to 2.0 percent in August 2023.

Figure 1: Inflation and Unemployment, Malaysia, 1990-2021



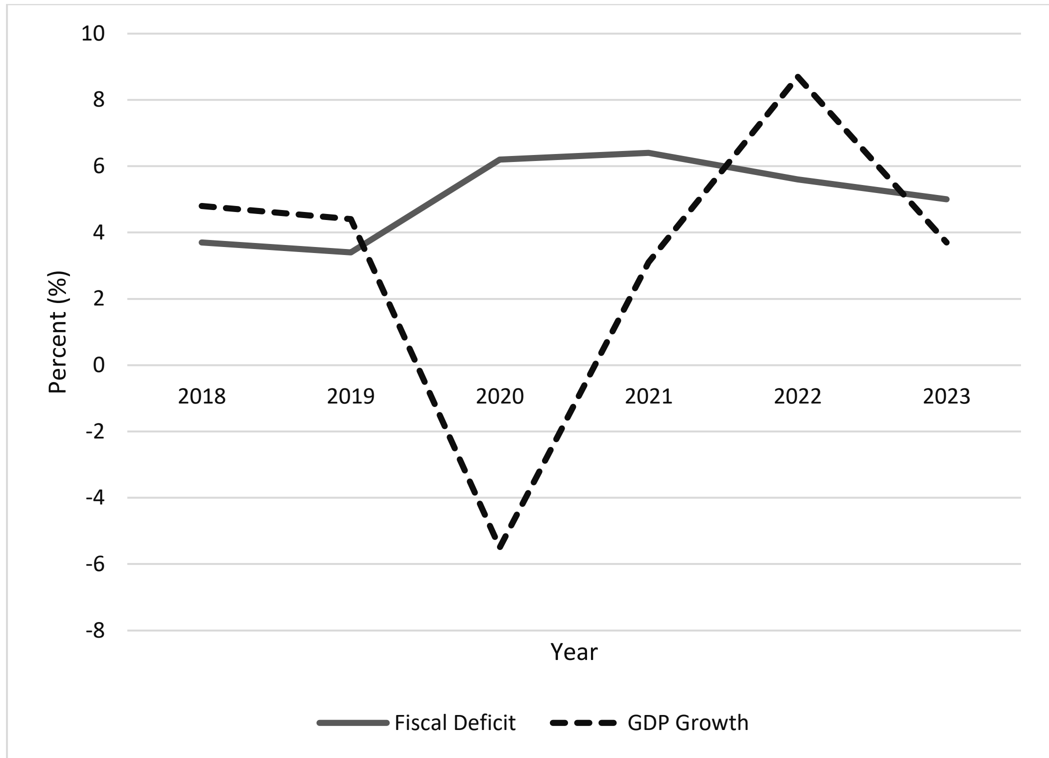
Note: Unemployment figure for 1990 is from national estimate while the rest is from ILO estimate.
Source: Plotted from World Bank (2022) data

Fiscal and Monetary Policies

As noted earlier, the dominant governance role the United States has led also culminated in the imposition of trade sanctions by the North Atlantic Treaty Organization (NATO) and its allies on Russia following Russia's attack on Ukraine in February 2022. While the COVID-19 outbreak had already caused a contraction in the GDP of Malaysia with falling exports and imports, as well as supply chain disruptions, the trade sanctions on Russia aggravated them further.

These implications will have to be drawn in light of growing deficit in Malaysia's fiscal account as well as rising debt to GDP ratio, which exceeded 6 percent and 60 percent respectively by the end of 2022. While Malaysia recorded a GDP growth rate of 8.7 percent in 2022, (which was largely inevitable given the contraction in 2020 and the low growth rate in 2021, GDP only grew by 3.7 percent in 2023 (Figure 2). The relatively low growth threatens to derail Malaysia's efforts to achieve a 6.5 percent per annum annual average GDP growth over the period 2023-2030 to support a wage rise from a median figure of RM2,600 per household in 2023 to RM4,510 in 2030 (Malaysia, 2023). Importantly, if the projected GDP growth cannot be met, and given the lack of tax buoyancy from the use of the sales and services tax (SST) compared to the Goods and Services Tax (GST), there should be concerns over whether the government can meet the fiscal deficit down to 3.5 percent of GDP by 2025 following the passing of the Fiscal Responsibility Act in Parliament on October 10, 2023 (Vethasalam,et al., 2023). Concerns should also be targeted at whether the debt to GDP ratio, (which exceeding 60 percent in 2023) can be reduced to 50 percent by 2027. Hard decisions must be made but efforts to reintroduce the Value Added Tax without making the poor bear the brunt of its regressive effects. The government should convince the bottom 60 percent of the citizens that all consumption taxes collected from them shall be returned to them quickly through the use of e-invoicing and improved delivery instruments. Meanwhile, the government's announcement that the bottom 60 percent shall continue to enjoy subsidies but through targeted transmission is good as it shall remove free riding and cross-border leakage through smuggling.

Figure 2: GDP Growth Rates and Fiscal Deficits, Malaysia, 1990-2023



Source: Plotted from unpublished data obtained from Bank Negara Malaysia

Exchange Rates

The impact of the United States' Fed chief's efforts to raise interest is arguably the prime reason for relative depreciation in the Malaysian Ringgit till early 2024. Its deleterious impact is expected to fall as the Fed Chief, Jerome Powell, did not raise it since raising it to 5.25-5.50 percent in July 2023. Nevertheless, the Fed rate has remained at 5.25-5.50 range till March 2024 (Cox, 2023). A parallel development occurred in Malaysia where Bank Negara Malaysia (BNM) raised overnight policy rates (OPR) to cap inflation and support exchange rates but has since the end of 2023 refrained from raising the OPR. Since the CPI inflation rate has trended downwards to 1.5 percent in January 2024 and the Ringgit recovering in trend terms from RM4.80 on February 20, 2024 to US1.00 to RM4.73 to a US1.00 on March 27, 2024. Indeed, the BNM has refrained from raising the OPR while expecting the Fed Rate to fall soon.

Being a small open economy that is highly integrated globally through trade and investment flows, Malaysia is highly susceptible to global economic swings. The export crash from the 2008-2009 global economic recession caused a severe contraction in exports, which resulted in

the country's GDP shrinking (Mahani & Rasiah, 2009). Malaysia's GDP growth hit a negative 1.5 percent in 2009 (World Bank, 2022). Malaysia responded by first lowering interest rates and collateral to expand domestic consumption,[1] and subsequently attempting to diversify its export markets away from the United States economy. Whereas Malaysia exported most to the United States in 2005, which accounted for 19.5 percent of total exports, that share fell to 9.5 percent in 2015. Meanwhile, Malaysia's exports to China rose from 6.6 percent in 2005 to 13.0 percent in 2015. While Malaysia's export surplus showed a tangible fall in the first two quarters of 2023 the relocation out of manufacturing from China, (which is largely driven by the United States' China containment policy), needs to be studied carefully. While the initial responses included the relocation of manufacturing back to the major markets, as well as to some friendly Southeast countries, such gains made by the Southeast Asian countries are gradually disappearing, which is visible from a gradual fall in investment from the Northeast Asian countries.

The US dollar remains the dominant foreign exchange reserve currency, which accounted for 59 percent of foreign exchange reserves in the first quarter on 2023 (Siripurapu & Berman, 2023). The Euro came second at 19.8 percent. While the dominance of the US dollar cannot be denied, it will help for Malaysia not to put all the eggs in the US basket. Malaysia should strategically work towards keeping sufficient reserves in the Euro, as well as in the Renminbi as the Brazil, Russia, India, China, and South Africa (BRICS) countries are increasingly using the latter as their international currency for trade (Jennings, 2023). Also, such a position also reinforces Malaysia stance since the 1960s in support of the Zone of Peace, Friendship and Neutrality (ZOPFAN), which Tun Abdul Razak, Malaysia's second Prime Minister, mooted and supported for ASEAN. It gives further support for the middle power role Malaysian had pursued internationally since the 1960s.

Food Security and Sectorial Development

A critical observation that the Malaysian government must address is how exchange rates and viewed in relation to essential goods, especially inferior goods, such as rice. Exchange rates had a Dutch Disease effect on food trade, including rice from 1990 until the fall in the Ringgit following the Asian financial crisis. Despite Malaysia facing a chronic balance of payments deficit in 1990-1996 the Ringgit had appreciated from RM2.8 in 1991 to RM2.5 a US dollar in 1995 and 1996 because of strong inflows of foreign direct investment and portfolio equity investment in that period. That had a deleterious effect on the food trade balance, which has remained negative since until 2022 – something that is likely to continue unless the government galvanizes food production through allocation of land, proliferation of industry 4.0 technologies, and shielding the food sector from crippling flexible exchange rates downswings (Rasiah, 2018).

In doing so, the government should avoid pursuing the McKinnon-Shaw hypothesis on using financial repression to stimulate entrepreneurship. McKinnon (1973) and Shaw (1973) had claimed that the high interest rates imposed on formal banking lending in the mid-1970s sterilized the entrepreneurial market to ensure that only competitive businessmen who could generate high returns to service the high interest rates. In contrast, the successful chaebols and

[1] Although such a knee-jerk reaction drove household debt to rise sharply (Mahani & Rasiah, 2009).

other preferred entrepreneurs had enjoyed subsidized interest rates in return for stringent quotas to export (Amsden, 1989). Just as the Malaysian government created a portfolio to lend at low interest rates to stimulate a quick recovery in 1998 from the Asian financial crisis and to restructure assets ownership, which successfully supported economic recovery over the late 1990s, caution must be taken prevent excessive interest rate hikes and the imposition of unreasonable collaterals on small and medium scale investors.

Given that planning is impossible under uncertainty circumstances, such as the outbreak of the COVID-19 pandemic, (which neither the IMF nor the expected and had no clue as to how their own repertoire of macroeconomic solutions could be deployed, the government should consider using its Natural Resource Fund created in 1988 to support financing of such destructive crises. Indeed, a portion of taxes collected from natural resource exports must be allocated to this fund

Having made the above points, it is pertinent to note that Malaysia's efforts to reinvigorate the agricultural and manufacturing sectors, and to quicken technological transformation of the services sector to knowledge-based services requires instruments to insulate the economy from external shocks. This is especially so when the ambitious 12th Malaysia Plan (2021-2015) will cost RM400 Billion and the Fourth National Industrial Plan (NIMP4) will involve RM95 Billion, though the latter includes private funding (Malaysia, 2021, 2023). The National Agricultural Plan (NAP), the NIMP4, and the blueprints to promote digitalization and climate resilience must ensure that the country is well insulated from external shocks (Malaysia, 2023; Rasiah, Salih & Cheong, 2022; Rasiah, 2023). In doing so, effective monitoring of not just the policy forays to transform Malaysia to a developed country but also to see that the country does not become a victim of external economic and financial shocks.

3. CONCLUSIONS

As with small open economies strongly integrated in the world economy, the Malaysian economy has been highly affected by the vicissitudes of volatile economic swings caused by crises in the major economies, such as the United States, which is what has happened to our national economy during the global economic recessions of 2008-09 and 2020-2023. Coming in the wake of a trend worsening of the fiscal deficit and the debt- to-GDP ratio, the capacity of the government to use fiscal policies to support the economy has declined. Not only has debt grown over the last 30 years in trend terms faster than revenue, the fiscal deficit as a share of GDP has already breached the 3-percent ceiling. While a random event, namely, the COVID-19 crisis drove the escalation of the fiscal deficit in 2020-2021, the deficit only fell to 5.6 percent in 2022 and 5.0 percent in 2023, which raises the need to trim unnecessary fiscal expenditure, especially involving operating expenditure. In addition to increasing tax revenue, other sources of revenue should be screened to ensure that the government will be able to meet the fall in the fiscal deficit as a share of GDP to 3.5 percent by 2025.

The important issues the finance ministry must look out for when handling its monetary policy in particular and macroeconomic policy (including fiscal) in general is to ensure little exposure to the external economy, which the government has done well on as its debt are largely denominated in Malaysian Ringgit. Second, there must be efforts to ensure that the country does

not fall into the trap of balance of payments deficits, which it has handled successfully since 1998. Third, monetary policy should avert excessive reliance on inflation capping instruments, such as interest rate hikes so as not to discourage investment raise the cost of debt service to the poor and small and medium enterprises, which tend to bring gloom to the real sector. Governments seeking to promote development should seek a balance between regulating credit, including using interest rates to cap inflation and stimulating entrepreneurship. In this regard, the conduct of the US Fed needs serious review, as the excessive escalation of interest rates contributed to the global financial crisis of 2007-2008 (Krugman, 2009; Stiglitz, 2010).

It is also clear that there are also several domestic issues that have led Malaysia to acute economic imbalance. For example, the abandonment of intensive farming policies since the mid-1980s has caused food shortages, though falling import prices from 1990-1996 destroyed significant small-scale farming in Malaysia. This Dutch Disease problem caused by a rising ringgit from massive inflows of foreign direct investment and portfolio equity investment opened the floodgates for food imports (Rasiah, 2018). A key issue Malaysia must address, though is the need to raise self-sufficiency levels in essential goods, (especially food) to check inflation affecting the poor. Efforts in that direction should also offer the opportunity to create jobs that can control unemployment. In that regard, the NIMP4 promises to create 3.3 million high skilled jobs over the just launched industrial policy.

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