Board Meeting of March 30, 1999
Statement by Jean-Claude Milleron

Malaysia: Country Assistance Strategy

We would like to commend staff for a high-quality and comprehensive CAS document which provides a candid assessment of Malaysia’s economic challenges at a particularly critical juncture. We also want to thank them for the very useful bilateral discussions on this strategy.

Malaysia, which has a long tradition of openness, sustained development, and success in poverty alleviation, has recently had to cope with a brutal deterioration in its external environment and to face a severe recession. In such circumstances, we very much welcome the Bank’s timely efforts to reinforce the partnership with the Malaysian government in order to help the economy reattain sustainable growth rates and to alleviate the adverse impact of the crisis on the poorest. As we indicated last year when we discussed the Economic Recovery and Social Sector Loan, we nevertheless consider that such support must accompany the implementation of the needed reforms.

FURTHER DEEPEN THE STRATEGIC DIALOGUE

We thank staff for providing as precise a picture as possible on the current economic situation. Clearly, the SAL approved last year offered the expected “monitoring vehicle” necessary to our renewed relationship with Malaysia. Nevertheless—and logically since the Bank had long been absent—we think that the Bank still needs to further deepen its understanding of Malaysia. In many areas, the Bank should ensure that it acquires the expertise that will strengthen the quality of its policy advice. We would like to briefly evoke a few of those areas.

Macroeconomic management. Confronted with a major economic shock in 1997, Malaysia has chosen a largely home-made adjustment strategy whose overall impact remains to be assessed. Nevertheless, in the present crisis context, there is no easy way out: fundamental reforms are needed to adjust to a new environment.

On the fiscal side, we need to develop a much clearer picture of the cost of such reforms, which at this stage can only be very uncertain, and on how they will be financed. On the external
front, as well pointed out by staff, Malaysia will need renewed steady access to international capital markets to meet its development objectives under the Vision 2020 plan.

On the whole, the Bank should err on the side of caution in endorsing the government’s strategy as long as we do not have enough assurance that the reforms we consider key to future sustainable growth are actually being implemented.

**Bank and corporate restructuring.** Staff recognize the risks of “inadequate information on details of structural reforms implementation”. Restoring a dynamic private sector will require significant restructuring of an economy where the total level of domestic credit amounted to more than one and a half the GDP. As indicated by staff, important reform efforts have been undertaken in the banking and corporate sectors, as well as in improving public and private transparency and governance standards. Actual progress in all these areas will be essential to bolster investor confidence, to lay sound foundations for a sustainable recovery, and for longstanding alleviation of poverty.

Risks are substantial, and we must be convinced by the quality of the reform effort. For example, loan losses must be fully acknowledged. Adequate restructuring must not rely solely on the use of public money to purchase bad assets and to recapitalize institutions. A dose of market discipline must also orient the recycling of bad assets, in accordance with clear and transparent rules, and in order to reach socially appropriate burden-sharing. In all these areas, the Bank should maintain close monitoring of progress achieved and make its core expectations clear.

In this perspective, the upcoming SPR should constitute a major building block in developing our expertise and in defining our program on Malaysia.

**Social agenda.** The present crisis has brought to the fore two parallel challenges for Malaysia on the social front: mitigate the immediate impact of the crisis through well-targeted supports, and reflect on how to build sustainable mechanisms designed to cushion the vulnerability of the poorest in the future. It seems to me that both of these approaches should play an essential part in our partnership with the Malaysian authorities.

Here again, to achieve this objective, the Bank must in our view improve its knowledge and develop its own assessment of the needs of the country. We should also build on the lessons learnt in other countries of the region, including Indonesia, on the design of the social safety nets and particularly on ways to ensure adequate targeting of the poorest.

**Bank support**

It will take time for the authorities to demonstrate they can deliver on key aspects of the reform program. In this context, the Bank should continue to cautiously and gradually increase its support.

**Base case and lending to social sectors.** We find the proposed base case lending scenario very relevant. The immediate focus on social sectors, at a time when the crisis takes its
toll on the most vulnerable, is fully warranted. Still, we have questions on both of the fast disbursement sector investment loans.

First, on the nature of the operations: is a SIL the best vehicle in a crisis environment? Both loans are unusually large, and the Bank is financing unusually large proportions of each. In this regard, in at least part of the education loan, it seems we may have missed an opportunity for additional leveraging. For example, the new institute is being constructed in the middle of an industrial park full of major industries. The location of the institute suggests that it will serve the industries situated there. Surely, they (and other private sector donors) could and should be leveraged for funding construction.

Second, on the development impact of the education operation: 54% goes for the refurbishment of six polytechnic institutes and the building of one. The new one is being built in Sabah, one of the poorest provinces with 18% poverty. However, there is little in the loan to suggest that this institute will actually help the poor in the area where it is being built. We wonder about the targeting of relatively few—and possibly more advantaged—students. Wouldn’t we have more impact if aiming at helping the real poor in grades 1-11 in the poorest provinces where private investment can never go?

Finally, we would like to know more about the indicators of development impact designed for the project. For example, how can any empirical measures be derived from one of this project’s main aims: “improve economic competitiveness and develop human capital to help restore and sustain future economic growth in Malaysia”? How does staff propose to develop ways to measure a relationship between this project’s contribution to that aim and the “key performance indicator” associated with it—“GDP and export growth resume upward trend”?

High case scenario. Switching to a high case scenario would require stronger assurances that the policy environment is credible and conducive to an enhanced Bank support. Indeed, it would not serve any lasting purpose for the Bank to lend to Malaysia without adequately taking into account the risks of deterioration in the policy environment. In this context, the issue of the degree of endorsement of Malaysia’s policies by the IMF naturally comes to mind. I thank staff for recognizing candidly that they are ready to consider that an informal Fund approval of the Malaysian government’s policies would suffice.

At this stage, we would only emphasize that we would need to be fully convinced by the two institutions of the quality and adequacy of the policies implemented (including the policy mix, the exchange rate policy, the structural reform program and its cost), be it under a formal Fund agreement or not. Whatever the final outcome, this brings us back to the urgency for the Bank to develop solid expertise on the Malaysian economy, in close cooperation with the Fund.

Bank resources

Finally, a few questions on the Bank allocation of resources to Malaysia. Given our previous comments, we very much appreciate the efforts made in the CAS document to lay out
the sector work program, the supervision issues and therefore the symmetry between the CAS objectives and selectivity and the use of the country team budget.

Nevertheless, given the emphasis already put on Malaysia (as we are reminded in the Strategic Directions Paper which mentions a "major scale-up in Malaysia" on page 17), we would appreciate staff comments on the budgetary issues put forward in paragraph 52 and 67 of the document. Is the budget under discussion for the Malaysian team in the context of FY2000 consistent with the proposed work progress? Are the staffing plans appropriate? If it is the case, what are the underlying trade-offs, particularly in terms of program and projects supervision?