Board Meeting of March 30, 1999
Statement by Pieter Stek

Malaysia - CAS; Education Sector Support Project; Social Sector Support Project

When the Bank renews its involvement with a country it is crucial to have a clear framework for engagement based on a thorough analysis of the situation of and the needs in a country. In this respect the Malaysia CAS is a very useful document. It justifies resumption of lending to Malaysia. World Bank assistance to the social sectors could provide the leverage needed to prevent the erosion of past achievements in the present situation. I would like to commend the staff with the work done and thank them for their answers on our questions about the CAS as well as the Education and Social Sector Support Projects.

This being said, some very important questions remain about the future of Bank involvement in Malaysia and indeed future developments in Malaysia itself. The Bank should proceed prudently.

Paragraph 32 notes that the Government needs “…to deal with the poor perceptions of governance, transparency and the rule of law…” Even if Malaysia has a good track record on economic governance “poor perceptions” have an obvious source in unpredictable and sweeping changes in economic policies. As long as investors cannot be sure that the rules will not be changed during the game, poor perceptions reflect an all too real governance problem. In this respect, it should be noted that even after the modification of the capital controls, a part of the portfolio investments locked in as a result of the September 1998 announcement can still not be repatriated without paying a levy (paragraph 36). In addition, the risk of unrest due to growing discontent over the economic situation cannot be excluded.

The issue of transparency of (economic) policy making should be highlighted. Indeed, there are important downside risks for Malaysia, but the country also seems to have more upside potential than neighbouring countries (Merrill Lynch expects two percent GDP growth in 1999). However, this upside potential can only be realised if the Malaysian Government makes a credible start with the implementation of the necessary long-term reforms instead of focusing on short-term measures. The redefinition of Non Performing Loans, which is also at odds with commitments
made under the Economic Restructuring Support Loan, is an example of how not to do it (paragraph 55).

The CAS lays out a three-year program with USD 1 to 1.5 billion of investment lending in the base case. I attach great value to the base case assumptions in table 4 as necessary circumstances to go forward with the proposed program. Should the Government not maintain public expenditure on social services, the proposed projects would become gap filling instead of providing additional protection to the poor and vulnerable groups. In the same vein, failure to improve transparency would reveal disinterest in the proposed Public Expenditure and Structural Policy Reviews. With regard to the high case, I take it that “IMF endorsement” implies endorsement of the macro-economic framework by the Fund’s Board.

The CAS notes that it is possible that Malaysia may wish to scale down borrowing if recovery goes faster than expected (paragraph 76). In this case, staff intends to maintain the country relationship through policy dialogue and Economic and Sector Work. To what extent will the Government be responsive to the Bank’s advice if it does not borrow anymore? Given the significant probability that lending will come to a halt again in the near future, the Bank should make sure that it does not spread itself too thinly (paragraph 62). The ADB, UNDP and bilateral donors are active in the areas of the environment and agriculture. The Bank should not get involved in these areas.

With respect to co-ordination with the ADB we heard through our office in Manila that an ADB mission recently suspended negotiations with Malaysia after it had been told that the World Bank would give the country USD 400 million in fast-disbursing loans. After consulting with staff we have informed our office that the ADB was apparently ill informed. Could the staff comment on this information gap?

According to paragraph 57 the preparation of the CAS has been a participatory process. According to our Embassy in Kuala Lumpur, the local NGO network does not seem very strong. Moreover, the departure of foreign NGOs might further weaken local NGOs, which sometimes rely heavily on funding from foreign NGOs. Could this affect the possibility to manage the proposed poverty assessment (paragraph 61) in a participatory way?