Economics Crisis and Response:  
Case Study of Malaysia’s Responses to Asian Financial Crisis  
Fumitaka Furuoka, Beatrice Lim, Catherine Jikunan and Lo May Chiun  

The paper chooses the “Asian Financial Crisis” as a case study to examine its impact on Malaysian economy and describes how Malaysian government responded to the crisis. It also focuses on the Asian financial crisis’ impact on the employment of banking sector in Malaysia. In the finance, insurance, real estate and business service sector, a number of 6,596 workers were retrenched. Banks were forced into mergers and acquisition as well as downsizing, trim lean, organizational changes and introduction of new technologies. Excess workers were offered a “voluntary separation scheme.” These retrenched workers became the urban poor facing high cost of living and no opportunity for jobs as there is no safety net provided.

1. Introduction

The economic meltdown began in Thailand in July 1997 and spread to other countries in the region, such as Malaysia, Indonesia, the Philippines and South Korea. This phenomenon was later called the "contagion effect." To improve economic foundations, Thailand, Indonesia and South Korea decided to ask for and received rescue packages from the International Monetary Fund (IMF). However, as IMF’s conditions were very strict, some experts doubted the validity of the IMF’s policies.  

Some economists, such as Jeffrey Sachs, criticised the IMF for making a wrong diagnosis and prescribing the wrong medicine to Asian countries. They believed that the IMF’s rescue packages were suitable for the countries whose problems were caused by the public sector’s debts and government’s overspending. Asian countries’ problems, quite on the contrary, stemmed from the private sector.  

These economists believe that the IMF's measures, such as the cut of public spending and tightening of credit, were the wrong measures for Asian economies. They thought that the IMF's policies pushed Asian countries into a deeper recession. In contrast, the Malaysian government decided not to borrow money from the IMF. Instead, the government imposed capital control in order to overcome financial problems that were caused by the “contagion effect” of the Asian economic crisis.
This paper examines Asian financial crisis and Malaysia’s responses to the crisis. The paper describes in detail the Malaysian government’s economic policies to counteract the “contagion effects” of the Asian financial crisis. With regard to methodology, this paper employed the case study method. Robson (2002) defines a case study as a strategy for doing research, which involves an empirical investigation of a particular contemporary phenomenon within a real life context using multiple sources of evidence. In other words, this paper uses Malaysia as case study to examine the general characteristics of Asian financial crisis and Malaysia’s response to the crisis particularly focused on its impact toward the banking sector. It focuses particularly on the impact on workers in the banking sector in Malaysia.

2. Literature Review

There is numerous literature on the Asian financial crisis. This Asian financial crisis has had significant negative impact on the Malaysian economy. As shown in Table 1, Malaysia’s GDP at a constant number amounted to RM166,625 million in 1995 and RM183,292. In the following year, it shows the gross domestic product was at a constant number (million ringgit), which is RM193,422 million. Before the crisis, Malaysian recorded a growth rate of How much? However in 1998, the growth rate was -7.94%. Following the economic recovery in the year 1999, the growth rate was 5.78%.

Table 1: GDP at constant price in Malaysia (million ringgit)

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<tbody>
<tr>
<td>Price</td>
<td>166,625</td>
<td>183,292</td>
<td>196,714</td>
<td>182,237</td>
<td>193,422</td>
</tr>
<tr>
<td>Growth rate (%)</td>
<td>9.09</td>
<td>6.82</td>
<td>-7.94</td>
<td>5.78</td>
<td></td>
</tr>
</tbody>
</table>
Source: Department of Statistics, 2007

Table 2 shows GDP per capita at a constant number. Prior to the crisis, GDP per capita shows an increasing trend from 1996 to 1998. However, due to the financial crisis, it declined to RM 8,216 before increasing gradually to RM 8,516.

Table 2: Per capita GDP at constant price in Malaysia

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<tbody>
<tr>
<td>Per capita GDP</td>
<td>8,054</td>
<td>8,659</td>
<td>9,079</td>
<td>8,216</td>
<td>8,516</td>
</tr>
<tr>
<td>Growth rate (%)</td>
<td>6.99</td>
<td>4.63</td>
<td>-10.5</td>
<td>3.52</td>
<td></td>
</tr>
</tbody>
</table>
Source: Department of Statistics, 2007

The most fundamental question is: what were the causes of Asian financial crisis? There is still ongoing debate on the real causes that triggered it. Radelet and Sachs (1998) explained: “The Asian financial crisis is remarkable in several ways. The crisis has hit the most rapidly growing economies in the world. It has prompted the largest financial bailouts in history. It is the sharpest financial crisis to hit the developing world since the 1982 debt crisis. It is the least anticipated financial crisis in years.”

Goldstein (2001) believes that the multiple factors resulted in this financial crisis. He argued the reasons were financial sector weakness, external sector problems and contagion. Goldstein went further to explain that the some ASEAN countries were experiencing an economic...
boom in the 1990s, in terms of how the growth of bank and non-bank credit to the private sector exceeded the already rapid growth of real GDP by a wide margin. This credit boom has encouraged private capital inflows, real estate and also equities investment. At least a third of the total banks loans were from Thailand, Indonesia, Malaysia and Singapore, and more in Hong Kong. This evidence shows that there was a large extent of exposure to a property sector. Goldstein further emphasized that the overextension and concentration of credit left the some ASEAN economies vulnerable to a shift in cyclical and/or credit conditions.

On the external sector problems, Goldstein (1998) emphasized that there was an element of poor quality of investment. Although, a third of investments were in place, this was not attractive if the corporate governance was poor. A high proportion of the investment directed toward the speculative investment, such as real estate. Overambitious infrastructure projects also contributed to this problem as there was an element of monopolies from the government, lack of transparency and cronyism.

Goldstein (1998) further argued that there were several more plausible channels of contagion. One is called the “wake up call” hypothesis, where Thailand acted as a wake up call for international investors. These international investors re-assessed the creditworthiness of Asian borrowers and when they managed to do so, they found out that quite a few of these Asian economies had weaknesses which were similar to Thailand. Such weakness were weak financial sectors with poor prudential supervision, large external deficits, appreciating real exchange rate, declining quality of investment, export slow down during 1996, and overexpansion in certain key industries.

Wang (2005) examined the popular explanation about how the East Asian countries fell into the crisis: 1) cronyism, 2) exchange rate policy 3) weak macroeconomic fundamentals, 4) open capital accounts, 5) poor regulation and supervision of financial institutions , 6) lack of transparency and 7) weak banks.

A renowned economist and Nobel laureate, Joseph Stiglitz (2002) commented, "I believe that capital account liberalization was the single most important factor leading to the Asian Financial crisis. I have come to this conclusion not just by carefully looking at what happened in the region, but by looking at what happened in the almost one hundred other economies crisis of the last quarter century.....it has also become increasingly clear that all too often capital account liberalization represents risk without reward. Even when countries have strong banks, a mature stock market, and other institutions that many of the Asian countries did not have, it can impose enormous risk.”

Noland et al. (1998) explained that what causes panic is the herd behaviour of investors. They argued that as global investment opportunities increases, investors’ direct knowledge of local situations decreases. As a consequence, investors are forced to rely more on their observations of other investors, rather then their own observations of local fundamentals. Lack of credibility and lack of transparency are amongst those connected to moral hazard.

Some researchers believe that rapid financial liberalization caused the Asian financial crisis. Bird and Rajan (1999) explained that “During the early 1990s, and partly as a consequence of their own growth, East Asian economies experienced persistent current account deficits, which balance of payments accounting tells us have to be financed either by inflows of foreign capital or by running down international reserves. It was also during this period that many East Asian countries took steps to liberalize both the domestic financial sector and the capital account of the balance of payment.” This period was referred to as the boom period (1990-1996).
Research conducted by Kaminsky and Schmukler (2008) confirmed the arguments that “liberalization is followed by substantially more pronounced booms and crashes in the short run, which supports the models in which financial liberalization triggers risky behaviour and excesses in financial markets.” Asian countries such as Hong Kong, Korea, Malaysia, Indonesia, Thailand, Philippines and Taiwan have undertaken to liberalize their financial sector, as indicated in table 8.

This empirical evidence by Kaminsky and Schmukler (2008) show that during the early 1990s, up until before the crisis, most Asian countries had liberalized their financial sector i.e. the capital account and the stock market. Korea prior to the crisis fully liberalized their financial sector, while Malaysia liberalized the capital account and stock market, but only partially liberalized the domestic financial sector. Thailand prior to the crisis had fully liberalized the financial sectors. However, in the case of Indonesia, they had fully liberalized their financial sector up to the January 1991, and from February 1991, it was indicated the Indonesia was under financial repression.

Wang (2005) says that premature capital account liberalization was the direct cause of various financial crises, including the 1997-1998 Asian Crisis. Montes (2001) argued that most Asian country has encouraged the inflow of foreign investment and the economy of the countries has been open to incoming capital for a long time. Further he argues that “liberalizing the capital account effectively consisted of (1) providing guarantees to non-residents that they could withdraw their investment effortlessly, and (2) easing outward investment restriction on and limitations to foreign assets holding by nationals, given that a significant proportion of non-residents could actually be nationals of the country”. For example, the opening of capital accounts in Thailand gave the financial sector and corporation access to offshore funds.

For Indonesia, domestic investment becomes heavily dependent on external finances. Montes (2001) highlighted that the demand for bonds and securities in Indonesia companies increased, and this has made the corporate sector became vulnerable when the rupiah began to devalue in late 1997. The opening of capital accounts also provide foreign fund managers access to the domestic stock market and bond markets, and has given the domestic financial system access to lower cost funds from abroad.

Wang (2005) further emphasizes that it is advisable to delay capital account liberalization or maintain capital control before countries put an effective domestic regulatory framework and financial infrastructure in place. He further forward his argument that in comparing with China and Southeast Asian countries, China is unlikely to experience a crisis. China controls and monitors the pace and sequence of its financial liberalization and domestic financial regulations. China’s capital account is strictly controlled; the currency, the Renminbi, is not convertible for capital account transaction. Therefore, possibility of moving the currency out of the country during a possible crisis is limited. The restriction of China’s domestic stock to foreign investors means they were not able to trade Renmimbi-denominated shares on China’s stock exchanges. Foreign investors are only able to trade or purchase shares that are classified as B shares and traded in the small value of the B share market. This type of share only can be sold or disposed if the foreign investors are able to find another foreign investor buyer. Wang further elaborates that in contrast with the other Asian countries during the crisis, “foreign portfolio managers all rushed for the exits simultaneously, contributing to a sharp decline in local shares”. They also contributed to devaluation of the currency value by dumping the local currency in order to avoid incurring losses.
Some economists think that massive inflow and outflow of capital was the real cause of the Asian financial crisis. Radelet and Sachs (2000) stress that the massive capital flows poured into Asian region was at the main core of the Asian financial crisis. Table 9, shows the net private capital inflows, particularly in a country such as Thailand indicate the net private capital inflows received in 1996 was 14.5% of GDP, the Philippines 12.7% of GDP, Malaysia 8.4% of GDP, Korea 4.9% of GDP and Indonesia 6.1% of GDP. Most of these countries received doubled net private capitals inflows in 1996 compared to 1994. Radelet and Sachs (2000) noted that in the case of Thailand, the bulk of the capital inflows were from offshore borrowing by banks and the private sector. Malaysia received considerable amount of the private capital inflows through the foreign direct investment (FDI).

Grenville (2000) says that there is presumption that market outcome will be beneficial, i.e. international capitals flows are a good thing. His argument was that the financial flows supplement domestic saving; allowing more investment in those countries where returns are highest, foreign direct investment brings the advantages of technological transfer and diversification of risk. While D’Arista and Griffith-Jones (2001) argued that this pattern of inflow of foreign portfolio investment became possible when many developing countries began to relax their exchange controls and opening up their capital account, which happened at the end of the 1980s and beginning of the 1990s. The action increased opportunities for cross-border investment by other countries. Radelet and Sachs(2000) agree that investors are looking for more profitable investments that give them high returns. Low interest rates in the United Stated and Japan at that time encourage them to increase their investments in Southeast Asia and other emerging markets.

Furthermore, Radelet and Sachs (2000) mentioned that “domestically, there are four factors that contributed to the capital flows such as: 1) continuing, and in some cases increasing high economic growth gave confidence to foreign investors, 2) financial sector deregulation was not accompanied by adequate supervision, especially in Thailand. Lax supervision created an environment conducive to high interest rate for foreign borrowing, since it allowed banks to take on substantial foreign currency and maturity risks, 3) the nominal exchange rate was effectively pegged to the US dollar, with either limited variation (Thailand, Malaysia, Korea and the Philippines) or very predictable change (Indonesia). Predictable exchange rates reduce perceived risk for investors, further encouraging capital inflows, 4) governments gave special incentives that encouraged foreign borrowing, even after concern arose about “hot money” flows in the early 1990s”.

On the other hand, Radelet and Sachs (2000) further agrees that capital flows is important as an engine for growth if only they are channelled to productive investment activities. Nevertheless, Radelet and Sachs (2000) and D’Arista & Griffith-Jones (2001) caution that capital flows pose an important policy dilemma for the macroeconomic management, especially when they are large, volatile, unsustainable or poorly utilized.

Some researchers think that change in investors’ expectations caused Asia financial crisis. Radelet and Sachs (2000) noted that panic can change the investors’ expectation, with each of whom trying to flee ahead of the others.

However, according to Grenville (2000), there is element of “herd behaviour” that creates the atmosphere of expectation. Grenville argued that information played an important role. Explanation on the reversal investors’ information about the emerging market is superficial, so it could be overwhelmed by a small amount of new information. Investors without their own knowledge base simply followed the herd. In this case, it is rational for individual players to shift
with the herd when new perceptions arrive. Whatever the fundamental is, when the herd is running, you run with it.

3. Asian Financial Crisis and Malaysia’s Responses

a) Asian Financial Crisis

The Asian economic crisis had been preceded by a series of crises dating back to the stock market crash in 1929 and the Great Depression in the 1930s. The signs of the impending economic doom surfaced in the mid-1990s, but most people regarded the Latin American crisis and the earlier economic slowdown in Japan as isolated events. The crisis rapidly spread throughout Southeast Asian countries, affecting South Korea especially seriously.

The value of local Asian currencies in the region collapsed with the Thai baht, the Indonesian rupiah and the Malaysian ringgit going into a freefall. As it was reported, three quarters of the value of Indonesian and Thai financial assets had been devalued due to the plummeting of the combination of stock prices and currencies (Miller, 1998). In Thailand, more than two million workers were jobless in 1998. In Indonesia, “stagflation” had threatened to double the prices of goods and merchandises and pushed nearly one half of the population into poverty.

One of the reasons why the Southeast Asian “miracle” economies collapsed had been an export boom halt that occurred at the time when short-term loans were due. This was mainly caused by a heavy borrowing from abroad. Most of the afflicted countries had run budget surpluses or minimal budget deficits in recent years; at the same time, private sector borrowing increased heavily. For instance, loans to Thai corporations from the international banks had doubled from 1988 to 1994, with half of the debt being short-term loans falling due within a year.

Southeast Asian countries export a large variety of manufactured goods from autos, computer chips and steel to textiles. When the economic crisis hit, foreign investors fled with their capital. This lead to a tightening of domestic spending, falling bank rates, and rising unemployment. Thus, the Southeast Asian miracle has become a story of tremendous human suffering.

The cause of the economic crisis in Southeast Asia was not due to misaligned exchange rates, or mistaken domestic policy, or lack of transparency in the banking sector. It was attributed to a combination of an excessively rapid rise of capital inflows and the falling global demand for the exports from the region that arose from a global economy changing the market rules.

In 1996, a net US $78 billion has flowed into the region from foreign countries in the form of foreign bank loans and short-term portfolio investments, such as stocks. However, in 1997, that has turned into a US $38 billion outflow, particularly from the countries most hit by the crisis, such as Indonesia, Malaysia, South Korea, Thailand and the Philippines. According to Jan Kregel, an economist, by the end of 1997, the Southeast Asian economies suffered “the equivalent of a massive bank run on the region without any lender of last resort” (Miller, 1998). This sudden fall of the Southeast Asian economies has caused many companies in Thailand and Indonesia to be put on the receiving end. Besides, both countries had to undergo austerity measures administered by the IMF in return for emergency loans to help to repay some foreign debts. Malaysia chose to independently administer similar austerity measures.

The IMF’s short-term economic prescriptions have, regretfully, failed to deliver in Asia. The higher interest rates imposed under the IMF plans have choked businesses, while budgets cuts have deflated economies. The plan, which seemed virtuous and good in the long run, hardly helped the countries recover from the crisis (Spaeth and Colmey, 1998). Karl derimis (2004) ar-
gued, although the Asian Financial crisis had given the IMF a legitimate interest in their opera-
tion related to the international monetary system, the legitimate interest however does not equate to a power to regulate. He argued that the reform failed because the IMF had fractured the incipi-
ent democracy of the developing countries and plunged the countries into chaos.

b) Malaysia’s Response to the Asian Financial Crisis

In September 1998, the Malaysian Prime Minister Tun. Dr. Mahathir Mohamad announced a new economic program meant to stop the outside world from controlling the movement of the national currency, the ringgit. Subsequently, the Malaysian Government announced that all ring-
gits held outside of Malaysia had to be returned, which meant that ringgit trading would be done entirely within the country’s own borders. Foreigners were no longer allowed to sell stocks and repatriate funds, unless a year has passed since the time of purchase. Thus, the ringgit was officially fixed at an exchange rate of RM 3.8 to the U.S. dollar. According to Dr. Mahathir, this plan was meant to isolate Malaysia’s economy from the international currency speculators and traders whom he blamed for causing the country’s economic crisis. After the announcement, Ma-
laya’s stock prices fell steeply, but the value of the ringgit remained steady.

Dr. Mahathir’s strategy was supported by well-known economist and Nobel laureate, Paul Krugman, who endorsed the concept of capital controls, as it allowed Malaysian authorities to lower interest rates to counteract the recession without causing the ringgit to collapse. A strong reason to formalize the controls was that the international community had continued to be very reluctant in declaring currency trading as an illegal activity. Although the experts at interna-
tional financial institutions were aware that currency speculation might cause potential harm to the economy of a weaker country, they had chosen to allow the speculation of currency, claiming that it was part and parcel of free market economy.

Malaysia imposed currency controls because it felt that adopting the IMF formula of rais-
ing interest rates and shutting off lending would only worsen and prolong the impact of the cri-
ysis. The strategy of currency controls was aimed essentially at eliminating offshore trading of the Malaysian ringgit, especially in the Singapore foreign exchange market.

According to Prime Minister Mahathir, implementation of the monetary policy control was done to ensure the safety of the Malaysian economy and to help Malaysia recover from the economic crisis. The measure discouraged short-term capital flows by obliging investors to keep their capital in the country for at least one year to allow Malaysia to better adjust to the global financial system.

Dani Rodrik and Ethan Kaplan of Harvard University in the paper entitled “Did the Ma-
laya’s Capital Controls Work?” had done a comparison between Malaysia’s capital controls with that of South Korea and Thailand, when these two countries were undergoing their IMF programs, with assumptions that changes in the external environment were allowed. They con-
cluded that the Malaysian capital controls lead to a faster economic recovery with smaller de-
clines in employment and wages, and a better turnaround in the stock market. In their analysis, Rodrik and Kaplan pointed out that some of the more pessimistic predictions about the conse-
quences of capital controls were not correct, as it became clear that Malaysia was recovering from the economic crisis, unlike South Korea and Thailand where interest rates had fallen to single digit, while offshore ringgit deposits were paying rates in the range of 20 per cent to 40 per cent (Business Times, February 21, 2001). In addition to that, South Korea and Thailand -- both of whom received financial assistances from the IMF and other multilateral institutions -- were subjected to very strict structural reforms. Interest rates in these two countries had to be raised,
and their fiscal policies tightened. Financial markets in South Korea and Thailand had to be opened to foreigners and local banks and financial institutions, while those in deep financial trouble had to be closed.

In response to the crisis, Tun Mahathir had to cancel a few “mega” projects, among which had been a plan for a bridge linking Malaysia and Indonesia, as well as the massive and controversial Bakun dam project in Sarawak. In the meantime, a group of Malaysian companies launched a global public relations campaign to win back foreign investors’ confidence and push up the Kuala Lumpur Stock Exchanged composite index.

As part of the recovery package, Malaysia has incorporated an asset management company known as Danaharta to purchase loans from financial institutions with the purpose of re-capitalising its banking sector, and a Corporate Debt Restructuring Committee to help companies resolve their debts without intervention from the courts.

Some of the less informed investors were concerned about the Malaysian Government’s unorthodox policies, as they had an impression that currency controls would limit the movement of their capital and profits. However, this was not the case, as explained by the United Nations Conference on Trade and Development (UNCTAD) expert, Jan Kregel, who maintained that Malaysia’s move was aimed essentially at eliminating offshore trading of the ringgit, especially in the Singapore foreign exchange market, and, in actual fact, formalizing the controls will help alleviate investors’ concerns (Business Times, September 21, 2000).

c) Economic Recover without IMF loans

Kregel agreed with Malaysia’s selective capital controls programs, as the model has proved successful in protecting the Malaysian economy. He has further elaborated that the measure has allowed Malaysia to incur much lower costs than did many of its neighbours in adjusting to the new environment. A firm confirmation of the measures’ validity came in September 1999, when capital controls were lifted with only RM5.2 billion of funds leaving the country (Business Times, September 20, 2000).

The crisis is a story of a market failure. Stanley Fischer, the economic director of the IMF, admitted at a regional meeting in Hong Kong that markets are not always right, as sometimes the inflows are excessive and sometimes they may not be sustained too long, and markets sometimes tend to react too late (Miller, 1998).

Southeast Asian capital markets failed in three critical ways. Firstly, there was too much capital inflow due to the prospect of continued double-digit growth. In search for new places to invest, financial capital continued to flow into the real estate sectors, even when financial instability was widespread and obvious. Secondly, the capital markets and the banking system failed to convert the funds into a more productive usage. Too little money had been spent in productive investments that could be able to sustain the export boom. Instead, a lot of money had been pumped into the real estate sector. Thirdly, too much capital rushed out due to the excessive inflow of capital earlier on.

Malaysia’s unconventional methods of tackling the financial crisis have by now been accepted by a number of experts. Besides, the measures proved that different countries might require different policies. Kalderimis (2004) supported that, IMF conditionality is a flawed regulatory measurement where it should not be permitted to entrench itself as a part of a new investment framework.
4. Asian Financial Crisis’s Impacts on Workers in the Banking Sector

One of the main implications from the Asian financial crisis is the increasing of unemployment in all countries that were affected by this crisis. The crisis inevitably caused contraction in the GDP, which resulted in retardation of employment growth in Malaysia. Employment growth was steady at 4.9 and 4.6 percent in 1996 and 1997 respectively. However, it contracted by 3 percent in 1998 (Mohamed and Syarisa Yanti, 1999).

Table 1: Retrenchment of workers according to sector, 1996-1998

<table>
<thead>
<tr>
<th>Year</th>
<th>Total</th>
<th>% Change</th>
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<tbody>
<tr>
<td>1996</td>
<td>7,773</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>18,863</td>
<td>143</td>
</tr>
<tr>
<td>1998</td>
<td>83,865</td>
<td>345</td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Agriculture</td>
<td>5,108</td>
<td>6.1</td>
</tr>
<tr>
<td>Mining</td>
<td>877</td>
<td>1.1</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>45,151</td>
<td>53.8</td>
</tr>
<tr>
<td>Construction</td>
<td>9,334</td>
<td>11.1</td>
</tr>
<tr>
<td>Electricity, gas and water</td>
<td>1</td>
<td>0.0</td>
</tr>
<tr>
<td>Transportation and communication</td>
<td>2,007</td>
<td>2.4</td>
</tr>
<tr>
<td>Wholesale and retail, hotel and restaurants</td>
<td>10,434</td>
<td>12.4</td>
</tr>
<tr>
<td>Finance, insurance, real estate and business services</td>
<td>6,596</td>
<td>7.9</td>
</tr>
<tr>
<td>Social services</td>
<td>4,242</td>
<td>5.1</td>
</tr>
<tr>
<td>Others</td>
<td>115</td>
<td>0.1</td>
</tr>
</tbody>
</table>


The unemployment rate in the country increased from 2.6% in 1997 to over 5% in 1998 (Cheng and Hossain, 2001). From Table 1, a total of 83,865 workers were retrenched. This number is a sharp increase from the 19,000 retrenched in 1997. At the same time, the inflation rate reached a high of 6.2 percent in June 1998 before moderating (Mohamed and Syarisa Yanti, 1999). It is important to note that some 11% or 8,966 workers were foreign workers (Norinah, 2004). The highest number of retrenchment recorded was in the manufacturing sector, 45,151. This figure shows a change of 53.8%, as compared to previous year. This is followed by the wholesale and retail, hotel and restaurants sector, with 10,343 workers retrenched.

The construction sector recorded 9,334 workers, followed by the finance, insurance, real estate and business services with 6,596 workers retrenched. This is about a 7.9% change from the previous year. The decline in the construction sector was mainly due to the government’s postponement of the implementation of several projects to reduce pressure on government deficits (Cheng and Hossain, 2001).

According to Cheng and Hossain (2001), a total number of 43,838 workers were retrenched from the start of the crisis in 1997 to mid May 1998. A number of 30,152 workers lost their jobs in the first five months of 1998. Retrenchment during this period was mainly the result of sharp slowdown and reduction in production activity, and from the bankruptcies of some firms.

In the subsequent section, this paper will discuss Asian financial crisis in the banking sector. With regard to the evolution of Malaysian banking sector, Malaysia witnessed the develop-
ment of strong domestic commercial banks and the widespread branching of banking services in the 1960’s. In the 1970s, despite the breakdown of the financial system, Malaysia’s banking sector grew stronger. However, in 1980s, the financial system faced great challenges due to the severe global recession in 1985 and 1986.

With regards to banking legislation, commercial banks were governed by Banking Ordinance 1958, later known as the Banking Act of 1973, and then the Banking and Financial Institution Acts (1989) which were enacted on 1 October 1989. (Poon, 2005).

Before the crisis, there were 55 banking institutions; consisting of 20 commercial banks, 23 finance companies and 12 merchant banks. After the crises, the government proposed the mergers of these institutions into 10 big banking groups. For example, Maybank merged with medium sized Phileo Allied Bank Bhd, Mayban Finance Bhd, Aseambankers Malaysia Bhd, Pacific Bank Bhd, Kewangan Bersatu Bhd and Sime Finance Bhd (Poon, 2005).

After restructuring and consolidation, the banking sector continues to contribute to the nation’s economic growth.

**Table 4: Employment in financial intermediaries, 2002-2006**

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<th>2002</th>
<th>2004</th>
<th>2006</th>
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<tr>
<td></td>
<td>240.5</td>
<td>236.1</td>
<td>242.3</td>
</tr>
<tr>
<td></td>
<td>0.025</td>
<td>0.023</td>
<td>0.024</td>
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</table>

Source: Department of Statistics, 2007

In terms of employment, the banking sector created job opportunities to 240.5 thousand in the year 2002. It decreased 2004, with 236.1 thousand jobs. Then it increased gradually to 242.3 thousand in 2006.

In terms of share of total employment, the data shows that the share of banking sector employment was 0.025% in 2002 to 0.023% in 2004, and slightly increased to 0.024% in 2006.

There is little doubt that trade unions have played important role in the banking sector. According to McConnell et al., (2009), the role of trade union is to represent, protect and enhance the interests of workers. Trade union collectively bargains with employer to seek better employment terms.

Particularly, trade unions play an important role in mitigating the negative impact of economic crises towards employment. For example, trade unions may oppose massive layoffs on behalf of workers, or trade unions may voice concerns regarding pay cuts during economic crises. In other words, trade union make efforts to set wages above the market clearance wages. Although this benefits the employees, it causes negative effects on employers, especially in terms of reduced profits for employers. A higher wage rate also creates wait unemployment. At a higher wage, individual will remain unemployed with the hope of being recalled to higher paying jobs (McConnell et al., 2009).

There is numerous various employment protection legislation (EPL) in Malaysia. According Garibaldi (2006), EPL is one of the most important institutions of the labour market. It refers to set of norms and procedures to be followed in cases of dismissal of redundant workers. EPL forces employers to transfer to the worker a monetary compensation in the case of early termination of a permanent contract worker.

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1 For more detailed discussion about role of union in Malaysia context, see Todd and Peetz (2004).
This EPL is aimed to protect workers’ rights and promoting procedural justice in the workplace. During an economic crises, EPL can essentially play an important role to prevent necessary layoffs or excessive job losses and employee pay cuts. There are two types of job destruction; consensual and non-consensual separation (Garibaldi, 2006). During economic crises, EPL prevents non-consensual separation.

On the other hand, EPL can cause some economic problems in the labour market. If EPL is stringent, there could be job hoarding. Labour hoarding is defined as a situation in which a firm hires a given quantity of labour, even though the current marginal profit associated with such labour is negative. In an imperfect labour market, labour hoarding is a common phenomenon (Garibaldi, 2006).

During economic crises, there are intensified conflicts between employer and employees. In order to mitigate conflict of interest, companies need to implement proper industrial relations practices. In other words, employers should hear the voices of the employees.

What was the reason for the jobs’ lost in the banking sector? As a result of the crisis, the banking sector in Malaysia began to experience increasing non-performing loans (NPLs). This increased NPLs in the banking and financial sectors was reflected in a sharp downturn in borrowing and financing, bringing about tight liquidity conditions. This situation forced the banking sector to look for alternative solutions in order to maintain the sustainability of the banks.

The government, on the other hand, constantly encouraged the banking sector to merge and consolidate for the reason that the bigger the banks and their capitalization, the more stable they become. The fifty-eight financial institutions with a total of 2,712 branches in the whole country were to merge into six “super banks.” This was later expanded to eight, and subsequently to ten “anchor banks,” in recognition of the fact that some banks cannot merge with others. Although foreign banks and financial institutions are not bound by the move, they also opted to consolidate their banking system the same way the local financial institution opted for. Besides mergers and acquisitions, the banks also embarked on downsizing, trim lean, organizational changes and introduction of new technologies.

Fortunately, almost all of the workers in the banking sector were unionized. Their terms and conditions for their work are stated in the collective agreement, and this has made it difficult for the banks to reduce the workforce to the extent that they would like. In response to the financial crisis, other industries, such as manufacturing, companies resorted to reducing wages of their employees from 15 to 20%, claiming that this was the only way to save the company from closing down and save jobs. In extreme cases, many companies finally resorted to retrenchment.

What option then did the banking sector in Malaysia take to reduce the excess of workers due to the mergers, acquisition, outsourcing, organizational changes and introduction of new technologies? On approval from the Bank Negara Malaysia, the banks offered a scheme called a “voluntary separation scheme”. This scheme was also negotiated at the high level between the banks and the banks’ union in Malaysia. Bank employees were paid compensation according to the rate agreed.

What was the impact of the retrenched workers? In addition to the existing poor, there is a new group of urban poor. Almost all of the retrenched employees’ from the banking sector came from urban areas and proved that they became the urban poor as soon as they lost their jobs. In Malaysia, there is no social safety net to help workers who have been displaced from

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2 For more detailed discussion about EPL in Malaysia, refer to Suhanah, S.S.A. (2002).
their jobs. Urban families are experiencing the worst impact due to increased cost of living, including the cost of food, household necessities, health care, tertiary education, and transportation (Mohamed and Syarisa Yanti, 1999). Coming back to the banking employees’ who have been retrenched, it is remarkable that most of the displaced employees’ are of older age, and this has raised problems for them to get a new job. Other impacts include no opportunity for jobs, limited opportunities for training in new skills, etc.

On the other hand, those left behind and still working with the bank are not spared from the effect of the whole restructuring of the banking sector. Increasing pressure from the job, as they have to perform multitasking, results oriented on selling, overtime pay was not allowed, lack of training when new technology was introduced, re-designation of jobs, which resulting in their holding more responsibilities without further compensation, and also forced them to exit as union members.

5. Conclusion

The Asian financial crisis created a havoc to countries such as Thailand, Indonesia and Korea, where these countries no to seek assistance from the International Monetary Fund (IMF) in order to save their country’s economy. However, Malaysia has taken a different step in saving the country by refusing the IMF package and heading for a striker financial adjustment. What is important here is how the crisis affected the majority of people, which were the workers.

At this time, many workers lost their jobs because of the closures of many businesses (manufacturing, construction etc.), mergers and acquisitions and other forms of reducing the workforce in order to save costs. The unemployment rate in the country increased from 2.6% in 1997 to over 5% in 1998. In the finance, insurance, real estate and business service sector, a number of 6,596 workers were retrenched.

As a result of the crisis, the banking sector in Malaysia began to experience increasing non-performing loans (NPLs) bringing about tight liquidity conditions. This situation forced the banks into merger and consolidation exercise by the government. Besides mergers and acquisition, the banks also embarked on downsizing, trim lean, organizational changes and introduction of new technologies.

The banking sector then offered a “Voluntary separation scheme” to reduce the excess of workers due to the mergers and acquisition exercise. Banks’ employees were paid compensation according to the rate agreed. However these retrenched workers faced difficulties, as there was no safety net provided and a lack of new job opportunities. With high cost of living and no income, the group of people has created a new form of poor called urban poor beside the existing poor.

As an implication of the study, findings of the paper suggest that during economic crisis there is intense conflict of interest between employers and employees. Therefore, the management in the company should come up with better industrial relations system, and the government should take measures to prevent conflict between employers and employees. Trade union should represent workers’ interests, but not to the extent of harming the employers.
References


