

## Capital Control and Stock Market Interdependencies : The Malaysian Experience

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### Introduction

Financial liberalisation policies in Malaysia started in the early 1970s when interest rate restriction was removed from the banking system. The policy was further enhanced when exchange controls for capital transactions were loosened in 1973 and capital and profits were allowed to be freely repatriated abroad in 1978. Furthermore, controls were imposed on the remittance of funds by domestic firms and individuals if they served for the purpose of direct and portfolio investment. Similarly, there were no restrictions in the inflows of foreign funds for the purpose of direct or portfolio investment in Malaysia. Thus, Malaysia deregulated its financial sector through increasing competition among financial institutions, dismantling interest rate controls, opening foreign exchanges to respond to market forces, and permitting financial institutions and corporations to introduce a variety of securities to increase the depth of the market.

The 1997 Asian crisis saw the return of government intervention in the financial system. In September 1998, the Malaysian government fixed the exchange rate and imposed capital control as an attempt to contain short-term capital outflows and ringgit speculation, particularly in the offshore markets.<sup>1</sup> Measures to control capital flows were, however, selective. Long-term flows and foreign direct investment were not regulated, and the ringgit continued to be fully convertible for commercial transactions as long as the currency was undertaken through Malaysian banks in the country. The selective measures introduced in September 1998 have now been progressively liberalised since February 1999 following the rapid recovery of the economy.

Economic theory posits that the removal of exchange and capital controls should make foreign investments more attractive and thus, increase trading of non-residents. This has

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1. Selective exchange controls have been previously introduced by the Malaysian government in 1994 when the country experienced a surge of destabilizing capital inflows, but were lifted six months later.

the effect of increasing the serial co-movement between equity markets. As a result, transmission of shocks is more speedily from one market to another. This process, however, is hampered if such restrictions exist because investors will be deterred from carrying out transactions, as they are unable to invest or transfer their investment out of the country. Moreover, international arbitrageurs would reduce both the incentive and capability of exploiting profitable arbitrage opportunities. Akdogan (1995) believes that barriers to international investment are the real sources of segmentation or integration in equity markets. Hence, the greater a country's restrictions or barriers on international capital flows, the lesser is the degree of integration between that country's equity market and the world equity markets.

The objective of this paper is twofold. Firstly, to investigate whether stock markets of Malaysia, the US, Japan and Singapore are integrated. Since Malaysia is heavily dependent on foreign trade with these three countries, it is worthwhile to determine whether the stock market movements in Malaysia are reflective of economic linkage. Secondly, to examine if there is any change in the degree of integration between these countries after the imposition of capital control.

This paper is organised into 6 sections. Section 2 discusses the literature on capital control and market integration. Section 3 reviews the Malaysian experience with capital control. Section 4 describes the data and methodology used. Section 5 presents the results. Finally, Section 6 concludes the paper.

### Literature Review

Dwyer and Hafer (1988) argued that stock market become more integrated with others when controls on capital movements and exchange of a particular country are relaxed. However, empirical studies that examine the effect of capital control on market integration are limited. In particular, no research has investigated the Malaysian case. Gultekin et al. (1989) examined the impact of the elimination of capital control in Japan in 1980 on the integration of the Japanese and the US stock markets. Using multifactor asset pricing model, they concluded that the Japanese stock market was integrated after the elimination of capital controls. Before 1980, integration was rejected most of the time. Taylor and Tonks (1989) examined the impact of the abolition of exchange control on the degree of integration of the UK and foreign stock markets. They used cointegration techniques to show that the UK stock market only became integrated with major stock markets after the UK abolished its exchange control in 1979. Ma (1993), however, provided conflicting result. He reported that the UK stock market was cointegrated with major stock markets both before and after the abolition of the exchange control.

Expanding upon earlier work by Taylor and Tonks (1989), Chelley-Steeley et. al. (1998) examined the effects that the removal of exchange controls in major European countries has had on the co-movement of their stock market indices. They found that, with the exception of the UK, the countries, which have abolished exchange controls, experienced a reduction in the degree of co-integration of their stock market price index, following the removal of exchange controls. For the UK, they found no evidence of co-integration before or after the removal of exchange controls. Possible reasons given by them are that investors

were able to circumvent exchange controls and the financial or political instability has reduced the willingness of foreign investors to invest in that country, thus ensuring that liberalisation has a weak impact.

### Malaysian Experience With Capital Controls : A Brief Account

Malaysia embarked on the liberalisation process of its financial markets through the removal of exchange and capital controls in 1978. Hence, all forms of exchange controls except in the form of a basket pegging management of the currency were removed. In addition, capital controls were no longer applied to both domestic firms and individuals. This openness of the capital market to foreign transactions made Malaysia the main attraction in Asia for international short-term money.

The exchange control was further liberalised in 1987 with the liberalisation of the capital account. This freed portfolio inflows and outflows and promoted cross-border activities in ringgit, which included the use of ringgit in trade, financial transactions with non-residents and offshore trading in securities listed on local exchanges. As a result, an active offshore ringgit market developed. This liberal regime was, however, partly abandoned in 1994 due to a surge in speculative inflows. In response to these short-term inflows of funds and the speculation of the appreciation of the ringgit, BNM opted to introduce selective exchange control measures in January and February of 1994. The measures introduced were restrictions on the sale of short-term securities to foreigners, imposition of limits on the absolute amount of foreign funds banking institutions can receive from foreigners and forbidding commercial banks to undertake non-trade related swaps and outright forward transactions on the bid side with foreigners (Bank Negara Malaysia, 1999). These restrictions were lifted in August of the same year and capital account was fully liberalised again.

In mid-1997, Malaysia experienced a precipitous fall in its exchange rate, following the devaluation of the Thai baht on July 2. Initially, the central bank, Bank Negara Malaysia (BNM), defended the exchange rate but the rapid loss of reserves and the significant increase in interest rates associated with the defence ultimately forced BNM to give up its effort. Thus, on 1 September 1998, the Malaysian government imposed a number of administrative exchanges and capital control measures with the primary objective of containing ringgit speculation and the outflow of capital. Malaysian authorities fixed the exchange at RM3.80 per US dollar, a rate that represented a 10 percent appreciation of the ringgit, in September 2, 1998.

Most of the speculation in ringgit was coming from short-selling of the currency in offshore markets, mostly in the Singaporean markets. These markets were offering high interest rates of 20 to 40 percent compared with domestic rates of around 11 percent. Since the government could not directly regulate or control these markets, the only alternative was to bring it onshore. The government mandated that all sales of ringgit assets had to go through authorised domestic intermediaries. Thus, offshore trading of ringgit was made illegal. Furthermore, all ringgit assets held abroad had to be repatriated. In order to prevent an outflow of capital and further depreciation of the currency, a 12-month holding period was also imposed for foreign portfolio investments. Measures to control capital flows were, however, selective. Long term flows and foreign direct investment activities

were not regulated and the ringgit is fully convertible for commercial transactions purposes as long as they are undertaken through Malaysian bank. Foreign currency transactions for current-account purposes, including the provision of up to six months of trade credit for foreigners buying Malaysian goods were also not restricted.

These selective capital controls have, however, been amended on several occasions since its implementation. During 1999, some of the capital control measures that had been introduced to support economic recovery were significantly relaxed. Following improvement in the domestic economy, the 12-month holding restriction was replaced with a graduated levy in February 1999. The levy on capital was also replaced with a profit levy for future inflows. This allowed foreign investors to repatriate the principal and profits upon payments of a graduated levy that varied from 10 to 30 percent, depending on the duration of investment in Malaysia. In September 1999, a uniform level of 10 percent on capital gains replaced the graduated levy.

The selective controls used to manage short-term flows during the Asian crisis have now been liberalised. There are no restrictions on inflows and outflows of non-resident funds. All that remains are measures focussed on preventing international trading in the ringgit, and in particular in hedging against it. These include restrictions on borrowing in ringgit and in transfers between ringgit and foreign exchange accounts, and amounts of foreign currency that people can bring into the country. By 2003, BNM liberalised the payments for ringgit assets between residents and non-residents as well as between non-residents where such payments can either be made in ringgit or foreign currency. Furthermore, rules on hedging and the overnight limits on foreign currency accounts have been liberalised. Nevertheless, the ringgit remains pegged to the US dollar at RM3.80. Refer to Appendix 1 for further details on the exchange control rules and its subsequent liberalisation.

### Data and Methodology

This study employed the log transformation of the ringgit-denominated weekly stock price indexes for Malaysia (KLSE Composite), Japan (Nikkei 225), Singapore (Straits Times) and the US (NYSE Composite). All data were obtained from Hydra database. The study covers the period from January 1995 to July 2002. In order to examine whether the recent imposition of exchange and capital control by the Malaysian government has had any impact on the degree of integration between stock markets, the sample was divided into two sub-periods: pre-control period (January 1995 to June 1997) and post-control period (September 1998 to July 2002). So as to avoid any distortion, data during the Asian crisis are excluded in the computation.

In examining the issue of equity market interdependence and the effect of capital control on market integration, this paper uses cointegration, error correction model and impulse response analyses which are all conducted within a vector autoregression (VAR) framework. These techniques represent recent advances in time series econometric. When using the VAR model to analyse economic relationships, all variables are required to be stationary. Hence, it is necessary to first test for the stationarity of each stock price series by conducting unit root tests. To do this, the paper employed the Augmented Dickey-Fuller

(ADF) test on both the original price level data and the first differenced price level data. In this test, the null hypothesis that the stock indices have a unit root is tested against the alternative hypothesis that they do not.

The concept of cointegration was introduced by Granger (1986) and further developed by Engle and Granger (1987). Cointegration analyses indicate whether there exists long-run equilibrium relationship between the Malaysian, Japanese, Singapore and the US equity market indices. A multivariate test for cointegration developed by Johansen (1988) and Johansen and Juselius (1990) was employed to examine this relationship. The Johansen-Juselius (JJ) procedure of cointegration test is based on the maximum likelihood estimation of the following VAR model:

$$P_t = \beta_1 P_{t-1} + \beta_2 P_{t-2} + \dots + \beta_k P_{t-k} + \alpha + v_t, t = 1, \dots, T \quad (1)$$

where  $P_t = (MAL, SING, JAP, US)^2$  is a  $(4 \times 1)$  vector of  $I(1)$  variables;  $\beta_i$  are  $(4 \times 4)$  matrices of parameters;  $\alpha$  is a  $(4 \times 1)$  vector of constant;  $v_t$  is a vector of normal distributed error with zero mean and constant variance; and  $k$  is the maximum number of lag length processing the white noise.

If there is no long run relationship among the stock markets, equation (1) would be reduced to a VAR model of the first difference. However, if stock markets are found to be cointegrated, a vector error correction model (VECM) is conducted to investigate the dynamic interactions among the variables in the system. The system was further subjected to an impulse response analysis in order to examine the speed in which stock price movements in one market are transmitted to other markets. This approach, proposed by Lütkepohl (1991), essentially maps out the dynamic response of each variable in the VAR model to a shock in itself and in another variable.

## Empirical Findings

### Unit Root Test Results

The null hypothesis of non-stationarity (unit root) and alternative hypothesis of stationarity (no unit root) are tested for each data series, in original and first-differenced form using the Augmented Dickey Fuller (ADF) test as described in Dickey and Fuller (1979). The results of the ADF unit root tests are presented in Table 1.

As can be seen in Table 1, the natural logarithms of stock prices in all markets are non-stationary for the whole sample period. The findings are not sensitive to the inclusion of a deterministic trend variable in the ADF regression equations. For the pre-control period, the null hypothesis cannot be rejected for any stock price series without or with a trend variable in the model. For the post-control period, all but the Malaysian stock price series exhibit the presence of a unit root which indicates that the exchange rate control policy imposed by the Malaysian government had a stabilising impact on the country's equity market. Even though the Malaysian stock price series is stationary in its level form, the first difference of this series is used in further empirical analysis for the sake of

2. MAL-Malaysia, SING-Singapore, JAP-Japan, US-the United States.

Table 1  
ADF Test For Unit Root

| Variables             | Whole period <sup>a</sup> |            | Pre-control <sup>b</sup> |            | Post-control <sup>c</sup> |            |
|-----------------------|---------------------------|------------|--------------------------|------------|---------------------------|------------|
|                       | Jan 1995 - July 2002      |            | Jan 1995-Jun 1997        |            | Sept 1998-July 2002       |            |
|                       | No trend                  | With trend | No trend                 | With trend | No trend                  | With trend |
| $\ln P_{MAL}$         | 1.7587                    | -1.8907    | -1.7615                  | -2.0949    | -4.2396                   | -3.7354    |
| $\ln P_{JAP}$         | -1.2799                   | -1.4719    | -1.8929                  | -1.8870    | -0.4093                   | -2.0202    |
| $\ln P_{SING}$        | -2.4779                   | -2.4749    | -1.6652                  | -1.6601    | -2.7746                   | -2.9052    |
| $\ln P_{US}$          | -2.1469                   | -0.0052    | -0.3054                  | -2.8642    | -1.6887                   | -1.9571    |
| $\Delta \ln P_{MAL}$  | -9.2116                   | -9.2041    | -8.6883                  | -8.6974    | -9.5369                   | -9.8505    |
| $\Delta \ln P_{JAP}$  | -11.395                   | -11.4203   | -7.9225                  | -7.9090    | -10.1597                  | -10.3641   |
| $\Delta \ln P_{SING}$ | -9.6175                   | -9.6074    | -9.3069                  | -9.3016    | -10.1418                  | -10.4586   |
| $\Delta \ln P_{US}$   | -9.6237                   | -10.0284   | -10.0356                 | -10.0047   | -10.8995                  | -11.0988   |

(a) For the period January 1995 to July 2002, the 95% critical value for the ADF test statistic is -2.8690 (-3.4229) for the ADF regression equation with no trend (with trend).

(b) For the period January 1995 to June 1997, the 95% critical value for the ADF test statistic is -2.8837 (-3.4447) for the ADF regression equation with no trend (with trend).

(c) For the period September 1998 to July 2002, the 95% critical value for the ADF test statistic is -2.8756 (-3.4326) for the ADF regression equation with no trend (with trend).

comparability with other variables in the system. Overall, the ADF test shows that all data series are stationary in their first difference at the 5 percent level.

### **Multivariate Cointegration Tests Results**

Since all data series are integrated of order 1 or  $I(1)$ , the cointegration test based on the JJ procedure is conducted. The results are given in Table 2. As shown, both the trace and maximum eigenvalue statistics in the pre-control period show that stock indices are not cointegrated. This indicates that there is no significant long-term price linkage among the Malaysian, Japanese, Singapore and the US equity markets. For the post-control period, the trace and maximum eigenvalue statistics suggests that there is at most one co-integrating vector, i.e.  $r = 0$  is rejected by the 95 percent critical values. This means that Malaysia and its trading partners are cointegrated and are therefore significantly linked in the long run. Given the presence of one co-integrating vector, we may conclude that there is  $(n - r) = 3$  common stochastic trends among this system of national stock market prices.

### **Multivariate Time Series Models**

Results from the JJ multivariate cointegration tests revealed that the stock price indices of the Malaysian, Japanese, Singapore and the US markets are not cointegrated in the pre-control period, but exhibit cointegrating relationships in the post-control period. Hence, a VAR model was used in the former sub-period and a VEC model in the latter period. The appropriate lag structure of the models is determined using the Akaike information criterion (AIC) and the likelihood ratio test. Results for both sub-periods are presented in Table 3.

#### **Pre-Control Period**

No long run relationship was found among the Malaysian, Japanese, Singapore and the US stock markets. The VAR results reveal that, all the stock markets under investigation are not influenced by their own past return or the returns of others. This implies that these markets are semi-strong efficient.

#### **Post-Control Period**

In light of cointegrating relationship in this post-control period, a VEC framework was estimated to model the short-term dynamics that characterise the system. The results demonstrated that the error correction term is significant in all stock return equations, except for the US. Furthermore, the coefficients of the error correction term were negative and statistically significant. This implies that the Malaysian, Japanese and Singapore stock markets adjust to any deviation of actual returns. However, the error correction coefficient for Japan and Singapore suggest that it would take a long time for their equation to return to their equilibrium once they have been shocked. For the Malaysian case, the coefficient suggests a moderate speed of convergence to equilibrium.

The past return of its own stock and other stock markets was not statistically significant in explaining the Malaysian and Japanese stock returns, which suggests that both markets are semi-strong efficient. The Singapore stock market reacted positively and significantly

Table 3  
Multivariate Time Series Models\*

| Dependent Variable : $\Delta \ln P_{MAL}$                   | Pre-control Period   |         | Post-control Period   |         |
|-------------------------------------------------------------|----------------------|---------|-----------------------|---------|
|                                                             | Jan 1995 - June 1997 |         | Sept 1998 - July 2002 |         |
|                                                             | Coefficient          | P-value | Coefficient           | P-value |
| $\Delta \ln P_{MAL}(-1)$                                    | -0.00338             | 0.975   | 0.02971               | 0.666   |
| $\Delta \ln P_{JAP}(-1)$                                    | -0.00197             | 0.979   | -0.0938               | 0.279   |
| $\Delta \ln P_{SING}(-1)$                                   | 0.00201              | 0.987   | 0.05291               | 0.509   |
| $\Delta \ln P_{US}(-1)$                                     | 0.13892              | 0.298   | -0.0631               | 0.585   |
| ECT(-1)                                                     |                      |         | -0.12263              | 0.000   |
| F-statistic                                                 | 0.2975               | 0.879   | 7.8257                | 0.000   |
| <b>Dependent Variable : <math>\Delta \ln P_{JAP}</math></b> |                      |         |                       |         |
| $\Delta \ln P_{MAL}(-1)$                                    | -0.18108             | 0.198   | -0.09357              | 0.143   |
| $\Delta \ln P_{JAP}(-1)$                                    | -0.04356             | 0.653   | -0.03109              | 0.698   |
| $\Delta \ln P_{SING}(-1)$                                   | -0.01573             | 0.919   | 0.01545               | 0.835   |
| $\Delta \ln P_{US}(-1)$                                     | 0.00322              | 0.985   | 0.05996               | 0.575   |
| ECT(-1)                                                     |                      |         | -0.0434               | 0.047   |
| F-statistic                                                 | 0.8352               | 0.505   | 1.5602                | 0.186   |

Contd...

Table 3 Contd...

|                                            | Pre-control Period   |       | Post-control Period   |       |
|--------------------------------------------|----------------------|-------|-----------------------|-------|
|                                            | Jan 1995 - June 1997 |       | Sept 1998 - July 2002 |       |
|                                            |                      |       |                       |       |
| Dependent Variable : $\Delta \ln P_{SING}$ |                      |       |                       |       |
| $\Delta \ln P_{MAL}(-1)$                   | -0.05279             | 0.615 | 0.08388               | 0.251 |
| $\Delta \ln P_{JAP}(-1)$                   | -0.01711             | 0.813 | -0.04951              | 0.589 |
| $\Delta \ln P_{SING}(-1)$                  | -0.08489             | 0.464 | -0.03793              | 0.655 |
| $? \ln P_{US}(-1)$                         | -0.07366             | 0.569 | 0.25013               | 0.042 |
| ECT(-1)                                    |                      |       | -0.0487               | 0.052 |
| F-statistic                                | 0.787                | 0.536 | 2.1635                | 0.074 |
| Dependent Variable : $\Delta \ln P_{US}$   |                      |       |                       |       |
| $\Delta \ln P_{MAL}(-1)$                   | -0.08855             | 0.24  | 0.06571               | 0.158 |
| $\Delta \ln P_{JAP}(-1)$                   | -0.01919             | 0.712 | 0.10717               | 0.067 |
| $\Delta \ln P_{SING}(-1)$                  | 0.11726              | 0.159 | -0.01769              | 0.743 |
| $\Delta \ln P_{US}(-1)$                    | -0.11442             | 0.218 | -0.17225              | 0.028 |
| ECT(-1)                                    |                      |       | -0.01936              | 0.222 |
| F-statistic                                | 0.8774               | 0.48  | 2.9603                | 0.021 |

\* All models are estimated with an intercept but no trend component.

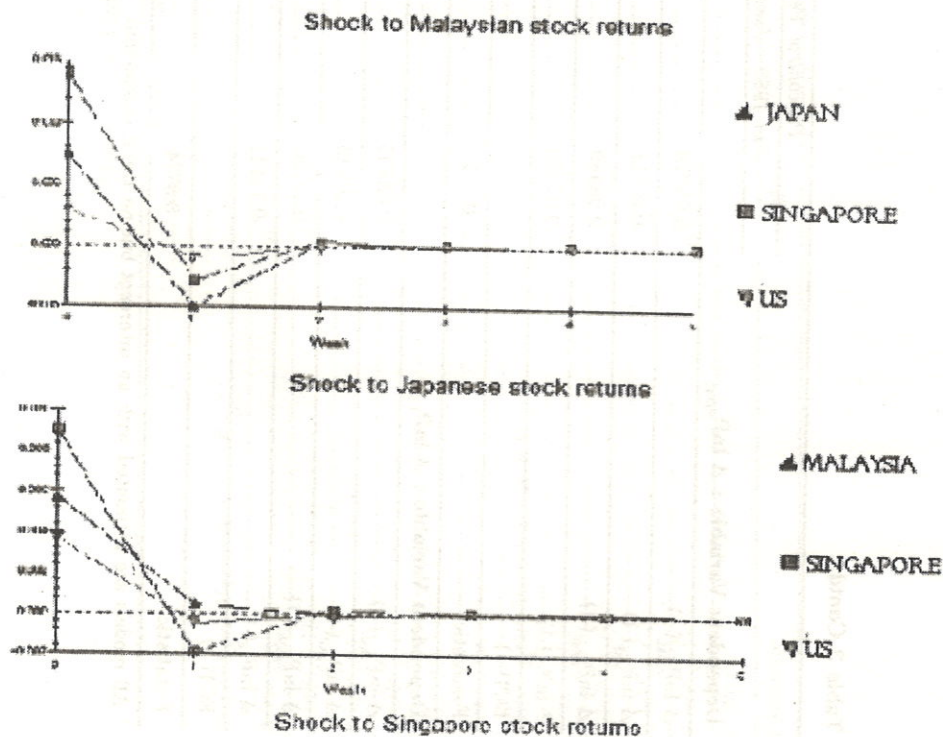
to the past US return. The US market was influenced by its own past return and the past return of the Japanese market.

### Impulse Response Analysis

This section further investigates the relationship of all four stock markets by analysing the speed and length of time of the interaction between them. Figure 1 presents the impulse response results of the pre-control period. It can be seen that Japan, Singapore and the US responds immediately to a Malaysian shock within the first week and generally completes its response within two weeks' time. A shock to the Japanese stock return led to a small impact on the Malaysian, Singapore and the US markets. However, the Malaysia's response to the Japanese shock had been positive. When the Singapore market was shocked, there was a large impact on the Japanese market. However, it resulted in a small impact on the Malaysian and US market. A shock to the US market gave rise to a negative impact on the Japanese and Singapore stock returns, but a positive impact to Malaysia. Overall, all markets responded within the first week and the response dies out in week two.

Impulse response results for the post-control period are reported in Figure 2. Overall, the results of the impulse response analyses for the post-control period show that the interaction among these markets occurs immediately. However, in contrast to Figure 1, the functions do not converge to zero when the system is shocked. This means that a shock has a persistent impact on stock returns. The result has an implication that markets have long memory.

Figure 1 Impulse Response Analysis for Pre-Control Period



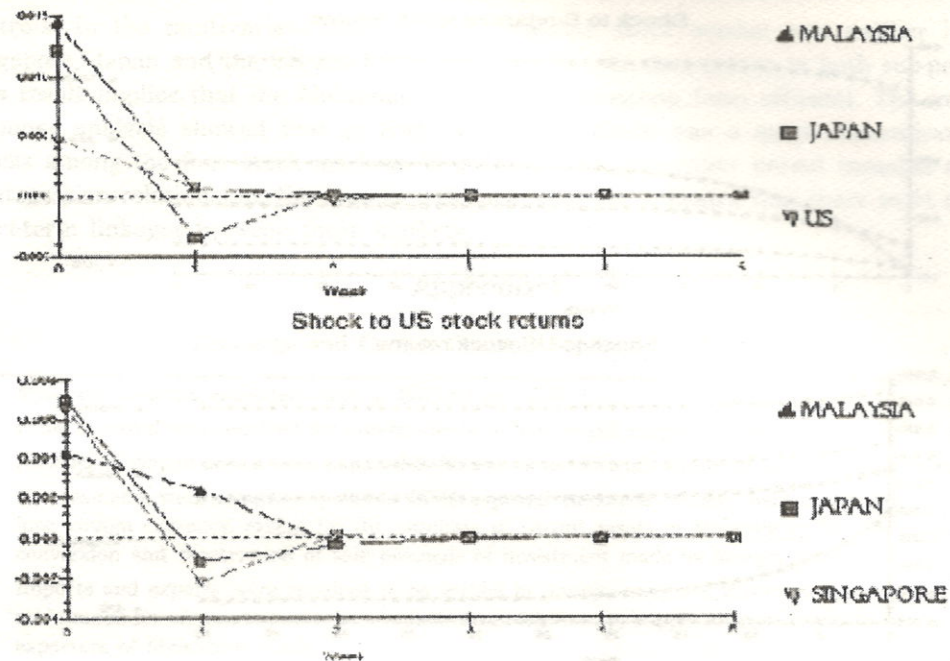
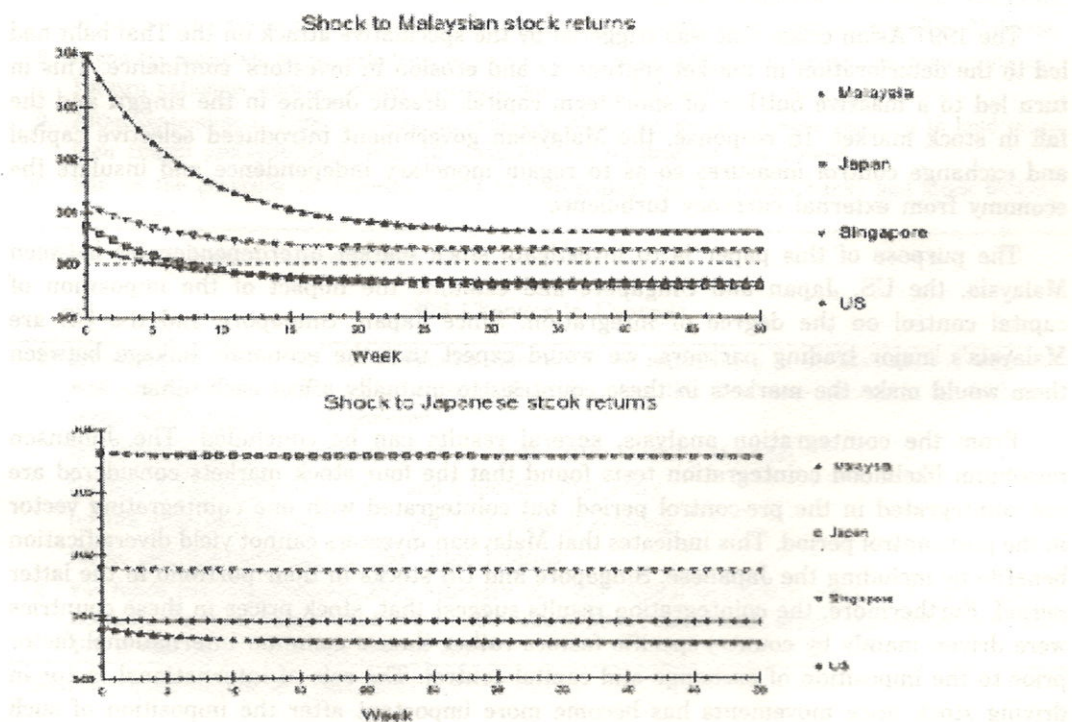
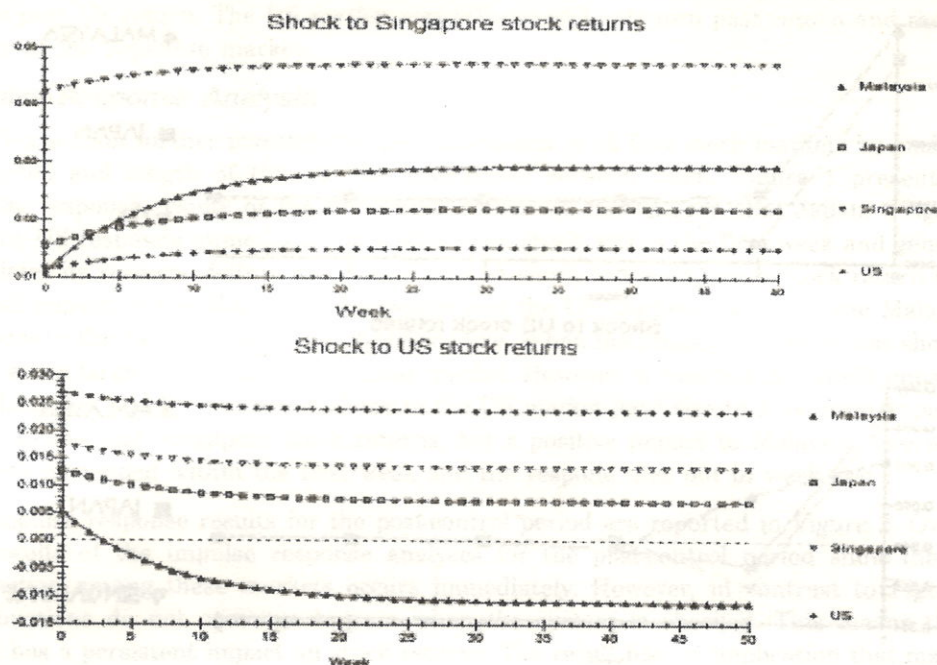


Figure 2 Impulse Response Analysis for Post-Control Period





### Conclusion

The 1997 Asian crisis that was triggered by the speculative attack on the Thai baht had led to the deterioration in market sentiments and erosion in investors' confidence. This in turn led to a massive outflow of short-term capital, drastic decline in the ringgit and the fall in stock market. In response, the Malaysian government introduced selective capital and exchange control measures so as to regain monetary independence and insulate the economy from external currency turbulence.

The purpose of this paper is to investigate stock market interdependencies between Malaysia, the US, Japan and Singapore and examine the impact of the imposition of capital control on the degree of integration. Since Japan, Singapore and the US are Malaysia's major trading partners, we would expect that the economic linkage between them would make the markets in these countries to mutually affect each other.

From the cointegration analysis, several results can be concluded. The Johansen maximum likelihood cointegration tests found that the four stock markets considered are not cointegrated in the pre-control period, but cointegrated with one cointegrating vector in the post-control period. This indicates that Malaysian investors cannot yield diversification benefits by including the Japanese, Singapore and US stocks in their portfolio in the latter period. Furthermore, the cointegration results suggest that, stock prices in these countries were driven mainly by country-specific factors rather than a common international factor prior to the imposition of exchange and capital control. The role of international factor in driving stock price movements has become more important after the imposition of such

controls. In the multivariate context, the Malaysian stock market was neither led by Singapore, Japan and the US markets return nor its own past return in both sub-periods. This result implies that the Malaysian market is semi-strong form efficient. The impulse response analysis showed that in both sub-periods, there was a quick transmission of shocks among the four stock markets. Even though the pre-control period revealed a non-cointegration relationship; the impulse response analysis indicates that there exist strong short-term linkages between these markets.

### Appendix 1

#### Exchange and Capital Controls September 1-2, 1998

1. Malaysia fixed the exchanges rate at RM3.80 per US\$.
2. Prior approval was required for non-residents to buy or sell ringgit forward.
3. All sales of ringgit assets were required to be transacted through approved domestic intermediaries.
4. Non-residents were required to obtain BNM approval to convert ringgit held in external accounts into foreign currency, except for the purchase of ringgit assets in Malaysia or for the purpose of conversion and repatriation of sale proceeds of investment made by foreign direct investors.
5. Imports and exports were required to be settled in foreign currency. However, free exchange was maintained for all current account transactions in addition to supply of trade credit to non-resident exporters of Malaysian goods.
6. Credits to external accounts were limited to sales of foreign currency, ringgit instruments, securities or other assets in Malaysia, salaries, wages, rentals commissions, interest, profits or dividends.
7. Debits to external accounts were restricted to settlement for purchases of ringgit assets and placements of deposits; payments of administrative and statutory expenses in Malaysia; payments of goods and services for use in Malaysia; and granting of loans and advances to staff in Malaysia.
8. Domestic nationals were forbidden to export more than RM10,000 during any travels abroad. Foreign nationals were forbidden to export more than RM1,000 upon leaving Malaysia.
9. After September 1, 1998, non-resident sellers of Malaysian securities were required to hold on to their ringgit proceeds for at least 12 months before repatriation was allowed.
10. Ban on the provision of domestic credit to non-resident correspondent banks and stock broking companies.

Source : Bank Negara Malaysia, 1999.

#### 1999 Changes in Controls

1. As of February 15, 1999, the 12-months moratorium on repatriation of investments was replaced with a graduated tax. All capital entered Malaysia before this date were subject to the following levies on the capital being removed:
  - (a) 30% if repatriated within the first 7 months after entering Malaysia
  - (b) 20% if repatriated between 7 and 9 months after entry
  - (c) 10% if repatriated between 9 and 12 months of entering
  - (d) no levy if repatriated one year after entering
2. For funds entering Malaysia after February 15, 1999, capital was free to enter and leave without taxation. However, profits were taxed at the rate of 30% if repatriated within one year of entry and 10% if repatriated after one year of entry.

Source : Bank Negara Malaysia, 2003.

## 2003 Changes in Controls

1. To provide flexibility to Non-resident Controlled Companies (NRCCs) in obtaining domestic credit facilities, the restriction on foreign-owned banks to extend not more than 50% of all credit facilities from banking institutions **is abolished**. In addition, the amount of ringgit credit facilities that can be extended freely by residents to a NRCC **is raised** to RM50 million from RM10 million. While compliance with the 3:1 gearing ratio for domestic debt and eligible capital funds remains, the computation of domestic debt and eligible capital funds **is liberalised**. NRCCs are now given the flexibility to compute their gearing ratio either on per corporate group basis or on single entity basis. Additionally, the 3:1 gearing ratio is only applicable and computed based on the amount of domestic borrowing that is in excess of the RM50 million limit.
2. To reduce transaction cost and enhance overall operational efficiency and risk management, the overnight limits on foreign currency accounts **is liberalised**. The maximum overnight limit of foreign currency accounts (FCA) maintained by resident exporters with onshore commercial banks and Islamic banks is raised to USD50 million from USD10 million. **Additional flexibility** is also granted for resident exporters to retain in the account another 10% of subsequent export proceeds repatriated to Malaysia. Under these more flexible arrangements, exporters who are eligible to retain export proceeds up to USD50 million could retain an additional USD20 million in their accounts. The foreign currency account limit for Approved Operational Headquarters **is also raised** to USD70 million from USD10 million.

## The New and Previous Limits are Shown Below

| Monthly average export receipts<br>(RM million) | Previous limit<br>(USD million) | New limit<br>(USD million) | Limit including 10% accumulation<br>(USD million) |
|-------------------------------------------------|---------------------------------|----------------------------|---------------------------------------------------|
| Exceeding RM100 million                         | 10                              | 50                         | 70                                                |
| Exceeding RM50 million up to RM100 million      | 10                              | 30                         | 50                                                |
| Exceeding RM20 million up to RM50 million       | 10                              | 10                         | 30                                                |
| Exceeding RM10 million up to RM20 million       | 5                               | 5                          | 10                                                |
| Exceeding RM5 million up to RM10 million        | 3                               | 3                          | 5                                                 |
| Not exceeding RM5 million or new exporters      | 1                               | 1                          | 3                                                 |

3. To facilitate foreign exchange risk management, the rules on hedging **are being liberalised** in stages. In addition to current rules allowing forward sales of export proceeds, residents are also freely allowed to sell forward their foreign currency receivables for any purpose to authorised dealers provided the transaction is supported by firm underlying commitment to receive such currency receivables and the tenure of the contract does not exceed 12 months.
4. To reduce administrative costs to residents and the banking industry, the threshold for completing Form P for payments to non-residents by residents **is increased** to RM50,001 from RM10,001 in ringgit or its equivalent in foreign currency, irrespective of purpose of payment. Payments for overseas investment, including extension of loan to a non-resident, continue to require prior approval if the amount exceeds RM10,000 equivalent.
5. In addition, to ensure that statutory reporting requirements do not hinder the efficiency of resident exporters, the requirement to complete Form KPW X for exports in excess of RM100,000 f.o.b. **is now abolished**. Resident exporters only need to continue to submit quarterly and annual reports on their export related transactions.

Source : Bank Negara Malaysia, 2003.

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