

SPEECH BY: DATO' SERI DR. MAHATHIR BIN MOHAMAD
(PRIME MINISTER)

EVENT: NATIONAL SUMMIT ON ACHIEVING ZERO INFLATION

VENUE: PUTRA WORLD TRADE CENTRE, KUALA LUMPUR

DATE: 12 SEP 1995

TIME:

I would like to thank the organiser, Asian Strategy and Leadership Institute (ASLI), for inviting me to officiate this conference 'Towards Zero Inflation: A New National Agenda'. The Government appreciates very much the organisation of the conference as it will help the Government's efforts to achieve zero inflation. It is hoped that this conference will contribute towards innovative approaches in combating inflation and reducing it to zero.

2. Malaysia continues to record impressive rates of growth averaging more than 8 percent per annum over the last eight years. This high growth is also forecast to continue over the next few years. Like all countries, Malaysia faces inflationary pressures, with inflation around four percent per annum. It is assumed of course that since we have growth there must be inflation, the higher the growth the higher the inflation. But countries not experiencing growth also suffer from inflation, in some cases very much higher, running into more than 1,000 percent per annum. One may therefore be permitted to question whether growth and inflation must always go together.

3. Inflation has been variously defined but it is generally accepted to mean an increase in the price of goods and services over time. However the Consumer Price Index (CPI) recognises that the increase in prices per se does not concern us as much as the increase in the prices of certain essentials. Thus in the CPI, food, ordinary food, is given high weightage. Obviously the increase in the price of caviar or smoked salmon or a Martini will mean little to the average consumer. Other than food, clothing, shelter and travel receive high weightage in the CPI.

4. Clearly when we talk of inflation we are concerned with the rise in prices of the essential needs of the average citizen. We are not really concerned with luxuries although as the standard of living rises, more and more items become essential to the life of the people and must be included in the determination of the CPI.

5. The fault of the CPI arises from the need to make worldwide comparisons. Obviously this is quite meaningless because the essentials in a developed country may be regarded as luxuries in a developing country. The items in the CPI basket cannot be the same for all countries. But as Malaysia is a member of the world community it must accept world standards, however irrelevant it may be. Still, for the purpose of our campaign for zero inflation it would be better if we determine what should be in our CPI baskets. These items must reflect the real needs of the average Malaysian. If the prices of these necessities remain stable then we can say we have achieved zero inflation. This is more relevant to our people although the rest of the world may not agree. They will still say our inflation is up because the prices of items in the CPI basket have gone up in Malaysia.

6. We are now familiar with the MacDonalD Hamburger Index, renamed the Purchasing Power Parity. Finally economists have accepted that it is not how many US Dollar equivalent you earn that counts, but the purchasing power locally of what you earn. Again purchasing power has nothing to do with the number of units of the local currency which you earn. Big numbers mean little if the purchasing power or value of each unit is small. On the other hand if the Purchasing Power value is high, small amounts of the currency is much more meaningful. Thus three years ago the Serbian Government issued a note of 50 billion dinars. The actual value at the time of issue in exchange rate terms was 12 US cents or 30 Malaysian sen. It does not need an economist to tell us that dinar billionaires are poverty stricken. Yet such is the glamour of big figures that most people still believe that higher incomes in terms of figures can enrich them. That such incomes can only be had if the cost of living goes up, and therefore the purchasing power of the income goes down, is still not appreciated. And so when the cost of living goes up more income is demanded, giving rise to the now less often quoted wage/price spiral, which really refers to the income/price spiral, for prices also go up when profit margins or executives' pays go up.

7. All that I have said is known to everyone of us. But we still persist in ignoring these facts when we think about wages, salaries and profits. If we are to aim for zero inflation, we can only do so if we can overcome our obsession with incomes in figures or exchange rates, but instead focus on purchasing power. It is just not worthwhile to have more money only to be able to buy less goods and services.

8. If prices remain static, who gains and who loses? Obviously the consumer gains. And it must always be remembered that we are all consumers, even though we

may be the suppliers or sellers. Any increase in the consumers income will enable him to consume more, not necessarily of the same thing of course. If he does not have an increase in income he will not be worse off. If his income shrinks he will not be as badly off as when the prices go up i.e. inflation. Of course if prices go down he would be better off. Even the supplier would eventually be better off, for although his profit may decrease, the cost of replenishing his stock would also go down and his cost of living too would go down. Clearly static prices or zero inflation benefits all of us, for we are all consumers. Even when we function as suppliers we can still benefit from zero inflation.

9. All these may sound rather idealistic if not pure flights of fancy. But although inflation is a fact of life, deflation has occurred before. In fact deliberate and successful deflation has been achieved. In 1962 France decided to drop two zeros from the French franc and call it the Nouveau Franc. The effect was to reduce the prices and the wages by 10,000 percent. It worked. If deflation (and massive deflation at that) is actually possible, zero inflation should also be possible. However, the deflation or revaluation of the French franc caused the Nouveau Franc to be valued upwards by the same percentage in terms of exchange rate. There was no gain in competitiveness in the international market but it made the French franc less cumbersome and more credible as a currency unit.

10. Other countries devalued their currencies against gold or other currencies in order to be internationally competitive but did not achieve deflation. Indeed all that happened was to impoverish their people. The early gains in terms of competitiveness was soon lost as workers demand increases in wages and imported inputs cost more, pushing production costs up.

11. There is also a belief that economic growth, especially high growth, must cause inflation. This is said to be due to too much money chasing too few goods. If this is true than surely the answer lies in increasing the supply of goods, including the variety. The other strategy is to increase the interest rates, the effect of which is to increase cost and actually to cause inflation. If we do not want inflation induced by growth, why should we prefer inflation induced by a deliberate increase in interest rates. In any case what good is an increase in income if it cannot increase the purchasing power. It would be far better if the prices and the income remain static.

12. The management of a country's economy through fiddling with the values of the currency or interest rates have never really worked satisfactorily. If they

can work then the economies of every country should be good because it is really a simple matter to devalue money or to raise interest rates. They only need the Government to make a decision.

13. So, if one really cannot control inflation through currency devaluation or revaluation, or through manipulating the interest rates or indeed through limiting growth, what can one do, especially when the target is so ambitious as to achieve zero inflation.

14. Perhaps the most important thing is the knowledge of the people as a whole and the workers and businessmen in particular, about the meaning of inflation, the methods of containing it, and above all the roles that all must play. In the first place we must be realistic and limit zero inflation to those goods and services which are really basic necessities for a reasonable standard of living.

15. Secondly, it is necessary that everyone, in particular wage-earners and traders, to understand that more money does not mean more wealth. It is the purchasing power of what is earned that counts. In an inflationary situation purchasing power will diminish. Only when there is zero inflation will an increase in income result in an increase in purchasing power. It is therefore important that income increases should not cause inflation, whether the income is in the form of wages or profit margins, or earnings in whatever form. This is possible if income increases are accompanied by a comparable increase in productivity i.e. increase in income does not affect unit cost.

16. Growth increases wealth. Again if the increase brings about inflation, the wealth gained will be diminished or may become totally meaningless. Again growth need not cause inflation if it is due to productivity increases. Profits can increase but through higher volume of business rather than higher margins.

17. With increases in earnings all round through higher productivity and increased volume of business, consumption would go up. It is assumed that there will be more money chasing less goods. But in the present world of plenty, there should really be no shortage of goods or services. There should therefore be no increases in prices, remembering of course that we are concerned only with basic necessities, not luxuries.

18. But what about increases in the cost of imported goods. Actually the inflation rate in the country of origin, particularly for necessities included in the Malaysian CPI should cause minimum effect on our rate of inflation. If the raw sugar from Fiji goes up 10 percent, the increase in sugar price in Malaysia should

not be by 10 percent. This is because the retail price in Malaysia includes a lot of Malaysian costs which have not gone up.

19. The Government has a big role to play here. Price control of certain necessities must go on even if there is no shortage. Taxes and other instruments of the Government should be used to limit price movements in whatever direction. A strong Ministry of Domestic Trade is absolutely necessary as traders are usually not self-regulating and need supervision. The Ministry of Human Resources must ensure industrial peace by promoting fair and affordable wages based on productivity.

20. Price-tagging, particularly of necessities as listed in the Malaysian CPI must not only continue but be computerised for quick comparison in terms of locality and time.

21. Zero inflation is not only desirable but also achievable. Indeed there is no reason why there should be inflation for inflation and currency devaluation are really one and the same thing. No wage-earner or trader would deliberately demand for his earnings to be devalued in terms of purchasing power. Yet they could be willing to contribute directly towards devaluing their incomes by demanding for wage increases without productivity or profit increases without proper justification, all of which will cause inflation and the effective devaluation of their earnings.

22. When we talk about zero inflation we must understand that we are demanding for a stable currency, not so much in terms of exchange rates but in terms of domestic purchasing power. If we appreciate this then the road to zero inflation will be facilitated by good cooperation from all parties, wage-earners, traders and the Government.

23. On that note, I have the pleasure in declaring open this very significant conference on Zero Inflation.