

Facing each crisis 'our way'

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The Malaysian story, thus far, is a remarkable story, Second Minister of Finance Tan Sri Nor Mohamed Yakcop told Malaysian students at the London School of Economics in a speech yesterday

THE financial crisis hit us in July 1997. We suddenly found ourselves under attack. Our currency, which was stable around RM2.50 against the US dollar for at least 10 years (1986-1996), began to weaken significantly to almost RM5 against the US dollar.

Our stock market was one of the best performing stock markets in the region given the strong earnings of the companies and the high confidence of the investing public, both local and foreign, in the Malaysian economy. But the stock market too began to plunge.

This created a panic among corporates as they saw the value of their business fall. This also created a panic among the investing public because their investments, be it in stocks and shares or in properties, fell substantially.

To make matters worse, the financial authorities, at that time, started to increase interest rates and reduce credit, thereby creating a vicious cycle.

Towards the end of 1997, when the situation was getting worse by the day, Tun Dr Mahathir Mohamad, the then prime minister, summoned me back to rejoin the public service to assist him in overcoming the crisis.

To fight the enemy, one has to understand who the enemy is and what weapons he has. Only then can we devise the right strategy to beat the enemy — even possibly beating him at his own game.

The enemies were the currency speculators and manipulators. They had smelled blood after their success in attacking the Thai baht in June 1997. They spread the myth of "contagion" for them to attack the currencies of the other countries in the region.

Their weapon: Borrowing the currencies of the countries which they wanted to attack, selling these currencies in the market in a big way and, at the same time, spreading stories that the countries were economically weak. And when the currencies weakened, they would buy back the currencies at a lower price compared with what they sold, repay their borrowings and make a handsome profit.

How does one fight such an enemy? One may think that the easiest way to fight them would be for the central bank, in our case Bank Negara Malaysia, to buy the currencies when the currency speculators are selling them. Since the central bank's buying would neutralise the speculators' selling, the currency should not weaken.

In some circumstances, such a strategy could work, but not during the crisis of 1997/98. The currency speculators in 1997, particularly the

hedge funds, had huge amounts of capital and, in addition, they could borrow up to 20 times their capital from the international banks.

Bank Negara's foreign currency reserves in 1997 was only US\$20 billion (RM70 billion). The currency speculators' total resources were in excess of US\$500 billion.

In 1998, when we began to analyse the situation, we realised that there were essentially two elements that were in favour of the currency manipulators, namely:

(i) their ability to borrow unlimited amounts of ringgit for the purpose of short selling; and

(ii) the regime of floating exchange rate, where, if there was a larger amount of sales compared to purchase, the currency will weaken, and vice versa.

The "unorthodox" measures that we introduced on Sept 1, 1998 were essentially to remove the two elements. First, we discontinued the practice of allowing non-residents to borrow ringgit to short sell. This immediately dried up the ringgit pool available to the speculators.

And, second, we changed the currency regime from a floating rate regime to a fixed rate regime. We fixed the rate at RM3.80, which was, in fact, weaker than what most analysts thought would be a fair rate, and, as we expected, there was a large inflow of funds into the country, expecting a currency revaluation.

With these unorthodox measures, the economy improved substantially, and over the last 10 years, we have not only survived but also have prospered, and we are now well on our way to Vision 2020, a vision that will see Malaysia emerge as a developed nation.

As the spectre of currency manipulators faded over the years, we returned to the floating rate regime in 2005.

In addition to being the 10th anniversary of the financial crisis, this year, 2007, is also the 50th anniversary of our Independence.

This may, therefore, be a good opportunity to look back over the last 50 years and then look ahead to the next 50 years, beyond 2020.

The first 50 years saw Malaysia's transformation from a poor Third World country into a modern and prosperous nation.

The Malaysian story, thus far, is a remarkable story. Independent Malaya inherited a colonial economy that was dominated by two primary commodities that shaped its economic history as well as much of post-Merdeka politics, namely rubber and tin. Economic functions were racially defined and the politics that developed from such a society were also racially defined.



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The first post-Merdeka government chose to preserve the inherited economic structure and adopted a pro-business policy stance.

While this *laissez faire* attitude may seem at odds with the need to address the serious imbalances that existed then, it is important to remember that it provided the government with an economy that was quite vibrant, one which could be harnessed for the massive development agenda that lay ahead.

The British left behind an administrative structure and a legal tradition that ensured both the protection of property rights and the capability to plan and implement development plans.

In many ways, the British had already created a federal administrative structure to support a strong central government. The post-Merdeka governments benefited greatly from this strong central government structure as it endowed them with the mechanisms to plan and execute national development plans that largely ignored state boundaries, while also acknowledging state sovereignty.

Although the country gained independence during a period coloured by global ideological tensions, it had always been pragmatic.

In 1957, the young nation avoided the nationalist-socialist tendencies of newly independent countries then, preferring instead to align itself with the Non-aligned Movement (NAM) and the Commonwealth.

This also avoided the country from being drawn into the increasingly heated East-West Cold War in the decades following World War Two, despite its close relationship with Britain.

Our first prime minister, Tunku Abdul Rahman, exemplified this pragmatism and created a tradition in all his decisions; from the pre-

Merdeka political bargaining with the British and among the races within Malaya to foreign and domestic economic policies.

Not only was the country's politics largely non-ideological, a trait we need to preserve today, it also started further ahead than most newly independent countries in terms of gender equality.

While the rates of female participation in education and in the workplace were low then as was the overall participation rate, their participation itself is not a novelty.

When access to education improved, there were no institutional gender biases. In fact, the participation and performance of women in education today have outstripped those of men.

Thus, while many developing countries today still struggle with political challenges coloured by ideological debates — on the choice of "isms" created by man, and on the position of women in society — we must remind ourselves that we are where we are today largely because divisive issues such as these were resolved back then.

We proceeded by getting everyone — regardless of race and gender — on board. Not only that, we knew all along that our economic security depends on our ability to compete internationally as our economy has always been integrated with the global economy — well before globalisation became the fad it is today.

The developmental results, some 50 years later, have been commendable. We have, today, almost eradicated abject poverty and have witnessed the formation of a sizeable middle class.

Though we may take it for granted, the extent of upward economic and social mobility that we have seen is enormous. It is quite remarkable if

the fragility of the political situation and the vulnerability of the economy at Merdeka are taken into consideration. Too many things could have gone wrong.

The 1969 racial riot was one of the very few manifestations that something had indeed gone wrong.

The resulting New Economic Policy (NEP) represented a form of governmental intervention that was conceptualised then and that has remained ingrained in many of today's policies and political thinking.

Besides the issue of national unity, still a crucial issue even 50 years later, the country went through some severe economic crises that could have easily destroyed the fabric of the country. In many ways, political and economic issues were and still are intertwined. It is a cumbersome relationship, but it has also provided the recipe for an equilibrium, a stability that is necessary to forge ahead.

We have responded at each juncture of economic crisis; from 1974 to 1986 to the 1997/98 financial crisis. As was the case when we first gained independence, we showed practicality and independence each time we faced a crisis.

When property and commodity prices collapsed in 1986, we needed to boost foreign investments. In spite of the dictates of the NEP, we showed practicality by relaxing various requirements on equity participation and foreign ownership.

When Asia was "swept" by the 1997/98 financial crisis, we showed independence and even audacity in the solutions we prescribed. We made the necessary and painful decisions, but we did it "our way".

It is also the case that, as time passes, the factors that led to our economic development and our economic

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crises are increasingly international as the Malaysian economy harnessed global economic opportunities to become the diversified economy it is today. Our past and future will continue to be linked to our ability to survive internationally.

We know we have to improve domestic standards to ensure our competitiveness and we have embarked on that journey, judiciously and practically. Today, we can consider ourselves among the success stories of the second half of the 20th century.

Malaysia's success story is a story of continuity, in small increments or in large doses, but always building on the same foundation.

The challenge in Malaysia has always been the courage to move away from the familiar, not for the sake of being different, but in response to changing imperatives.

The ability to adopt changes in the basic assumptions, the approach to development, and institutional framework will be crucial in ensuring further success. Otherwise, the very approach that has resulted in success will constrain future growth.

The notion of nationhood of the future will be drastically different from the one we are used to. In fact, we have begun to see how the forces of technology and the ascendancy of the market as an institution has changed the very concept of sovereignty of nations in this globalised world.

The free mobility of knowledge, the almost free mobility of capital and, to a lesser extent, the mobility of labour have all changed the levers that control an economy. It makes the future more uncertain and, therefore, more challenging.

When Malaya was born rather late in the post-Second World War period of decolonisation, Africa, the Middle East, and most of Asia were suffering from birth pangs of various forms. But Malaya, and eventually Malaysia, despite initial problems, started out much better than most.

Today, the world is a much different place. While Africa remains largely immersed in the same sort of problems besetting it half a decade ago, the world is witnessing the ascendancy of two of the world's ancient civilisations. The scale of economic transformation in China is a phenomenon not seen before in economic history.

With a combined population of over two billion people and the civilisation history that dates back thou-

sands of years, the advent of China and India will be a primary force shaping future history.

While we cannot predict with any accuracy the changes that will occur in the future, we know what we need to have in order to adapt and manage those changes. Without that ability, we will most likely fail to build a better tomorrow. I will outline three elements that we must have.

There must be the formation of a Malaysian identity from among the diversity of who we are. In spite of our differences, there must be a shared collective memory that we carry forward. That is our biggest challenge. Recent history has shown how nations can be disintegrated fairly quickly on this score alone.

The failure to address this issue manifested itself tragically only 12 years after Merdeka. We, thereafter, put in place a policy framework that addresses the causes of that tragic failure.

It provided us with the political stability that enabled us to undertake an economic development journey. We have achieved much in that regard.

However, we have some way to go to the goal of a national identity in the true sense. We have to develop a common prism of who a Malaysian is. We must figure out a way so that our whole is bigger than the sum of our distinct parts.

Concurrent with the formation of a national identity is the development of national institutions. We need to continue to build on the strength and resiliency of our national institutions: from social institutions such as the family, the community and educational institutions to financial, political and legal institutions.

The efficacy and efficiency of the market as an institution depends very much on the strength of other non-market institutions.

The market economy, left unattended, can be vicious without the existence of complementary institutions, which represent our collective values. They also define the "rules of the game" and as such, they define the incentive mechanisms that dictate the way we behave.

Continuous economic prosperity is very much the outcome of the correct rules of the game, and these rules of the game are embedded in institutions. Countries with similar endowments can have different developmental paths because their institutional infrastructures are different.

We were fortunate that we inherited a set of working institutions at the



Malaysian investors studying share prices at a private stock market gallery in Kuala Lumpur during the bull-run prior to the 1997 economic crisis.

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time of Merdeka, a luxury not enjoyed by many colonised countries. However, we modified some of them and created new ones as we evolved as a country.

Underlying these imperatives on national identity and the strengthening of institutions is knowledge and wisdom. If we agree that the sources of change will come about from technological change and the ways in

which it affects life and the marketplace, we must realise that our ability to survive as a country depends very much on our aggregate capacity to learn, create and use knowledge.

We have always recognised the importance of education and the overall human capital development agenda — that agenda has consistently taken up the biggest share of our national budget — but we must rethink the way we do things. Our perception of knowledge, the means to acquire, use and diffuse it will have to be different.

At the stage Malaysia is today and certainly for its future, we have to take a pioneering posture with regard to the knowledge enterprise. Those at the frontiers of change will reap the most reward.

We must have the requisite knowledge and entrepreneurial spirit to be there. Land and capital alone, even in abundance, will be inadequate.

While the government of the day will do all it can for its citizens, it is becoming evident that continued national economic security, the foundation for national unity in this increasingly globalised but uncertain world, requires the nation to optimise the use of its total resources.

Private citizens, collectively, control much more of the nation's resources than the government itself. It is, therefore, imperative that the citizenry — individuals, communities and associations — assume a larger role in developing national capabilities. They can do more for the country.

The spirit of voluntarism and serving the collective interest must be imbued among us. It is through service to local needs that we serve the na-

tional interest.

Germany and Japan, after the Second World War, had no semblance of government and had most of their physical infrastructure destroyed, but both nations rose to great heights afterwards because of its people, their values, knowledge and their sense of national mission.

With these elements in place, Malaysians will have the resilience and adaptability to face the vagaries of change in ways that will protect our economic security as well as our political entity.

The permutations of possibilities are countless but we must choose one that works for us.

We must do it on our own and not let circumstances or others define it for us.

Those of us who were around at the time of Merdeka will no longer be around 50 years from now, in 2057. Our responsibility is to effect an inter-generational transfer of responsibility, a succession planning. The responsibility for the future of Malaysia is now yours.

You owe it to those who come after you to leave behind a better Malaysia than the one my generation leaves to you today.

Let me assure you that the Malaysian revolution is still on. It needs individuals to come forward and be leaders in the mould of those in the past.

There is a will to create more space for the young to participate in this ongoing quest to chart the future of our beloved country. Come join us. Bring your differences, your idealisms, your energy, your love for the country and a sense of history.