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“Global Financial Uncertainties and the Future of Malaysia”

1. I would like to thank the organisers of this “Bridges Dialogue towards a culture of Peace” for inviting me to speak on the “Global Financial Uncertainties and the Future of Malaysia”.
2. For some time now the world has been facing a financial crisis of unprecedented proportions. The crisis has become truly global and is clearly leading to a worldwide recession far worse than that experienced in the late 1920’s or before that. Huge banks and financial institutions have collapsed and are dragging down with them other major businesses. Even the small businesses have not been spared.
3. The enormity of the situation can be gauged by the total sum of money which the Federal Reserve Bank and the American Government have allocated to rescue banks, insurance companies, mortgage companies and hedge funds. The sum is US 8.5 trillion dollars i.e. Eight Thousand Five Hundred billion. We cannot really imagine the existence of this amount of money; certainly not all of it in one place.
4. How come such an enormous amount of money could be lost by the banks and other financial institutions without us knowing anything about it until it is clearly upon us.
5. The answer is really very simple. There have been massive cover-ups by the institutions and the United State Government of the losses until they became too big to hide under anything.
6. The cover-ups have been going on for a very long time – maybe more than 30 years. It began in the banks and institutions themselves. The CEOs of

these institutions kept on telling their clients and the public that everything was all right, that they had the money to make good the losses, that it was all a misunderstanding, that it was temporary, that everything was secured.

7. All the while the losses were accumulating. But the books were not showing them. There was a lot of creative accounting and losses could often appear as gains. And these fictitious gains were credited to the genius of the CEOs and CFOs. They should be rewarded. And they were rewarded with millions and millions of dollars in bonuses and stock options.

8. These geniuses were often literally bought by other banks and institutions so they may benefit from their expertise in cooking the books. And why not? The investors were getting good; extraordinarily good returns on their investments.

9. When you get a return of 10, 20 or 30 percent why should you scrutinize the running of the company? Just collect the dividends and invest more.

10. And when you can get such returns from investing in these financial instruments why should you invest in the production of goods and services where the dividends would be 5% or less.

11. Very soon the business of producing goods and services and the trade in these represents only a fraction of the business in financial instruments. It is said that the trade in currencies for example is twenty times bigger than total world trade. And the profits are equally big.

12. Millionaires appear by the hundreds every year, and billionaires by the dozens. Yachts and private jets became very common. And everyone thought this was going to go on forever.

13. But we know now that it is not forever. We know now that the bubble has burst with a bang that reverberates throughout the world. The great banks are collapsing like a house of cards and rich countries are going bankrupt. And we all ask why.

14. Why? It began with the delinking of money from gold. It began with fiat money. Basically these are paper tokens, with no intrinsic value at all. We never question how these pieces of paper can have a value. We never ask who has been printing these notes. We do not ask how the printers determine how much notes they should print. We all merely accept them as money.

15. In most countries Central Banks owned by the Government would print the money. We assume Government would control how much is printed so as to avoid devaluation and inflation.

16. But in United States of America, the richest country in the world the money is printed by a private bank. The Federal Reserve Bank is owned by twelve other private banks. The Fed prints the money and actually lends the money to the Government. Yet the world accepts this basically private bank notes as the reserve currency for all countries, as the currency used for international trade.

17. At one time banks like the HSBC and Chartered Banks actually issued their own banknotes. But today it is not really necessary because effectively cheques represent money. So can credit cards. How many cheque books or credit cards are issued the public does not know. But these are money also. In some very advanced countries no one carries cash anymore. They pay for everything with credit cards. So credit cards are a form of money.

18. Money in the form of currency notes or cheques can be deposited with a bank and cheques can be made out to be drawn on the bank when payments are to be made. When cheques are paid in, the money appears in the accounts of the payer. He need not withdraw money to pay for anything. He merely makes out a cheque to the amount.

19. We all believe the banks business is based on the capital invested and the deposits taken. We think that the money lent by the bank comes from its capital and the money deposited with it. But actually what the bank lends is far more than the sum total of the capital and the deposits.

20. In a well regulated situation the amount that a bank can lend is limited by the Central Bank. But actually a bank can lend as much as 10 times the money deposited with it. Since, except with fix deposit, the deposited money cost the bank nothing, in fact may actually earn for the bank a service charge, the earnings of the bank on the deposits comes at no cost. If it can lend 10 times the deposited amount, than its interest earning must be on 10 times the deposited amount.

21. The bank is therefore a money making institution even when supervised.

22. But then came the idea of free markets and deregulation. The market would regulate itself and Government should not interfere. Once this was accepted the crooks moved in. Since the earnings of the bank are directly related to the size of the loans, then banks should try to lend as much as possible, whatever the capital or deposits they have.

23. What if the loans turn sour. The geniuses devised a way of securing the loans. The good loans and the bad loans are bundled together and insured. The investors in the banks, principally the hedge funds, need no longer worry about non-performing loans. If they fail to perform the insurance companies will make up the loss. Besides in the case of housing loans the houses would serve as

collaterals. If the loan go bad the collaterals can be sold off and the loans recovered, if not wholly at least partially.

24. There would not have been any problem except that the amounts of loans were enormous. The borrowers run into millions and the total sum of non-performing loans add up to billions.

25. When these sub-prime loans failed, the insurance companies could not pay the huge amounts due to be collected by the banks. And when the housing market failed, the collateralized properties could find no buyers.

26. Unable to recover the loans given out the banks went bankrupt. The share prices of the banks plummeted. The hedge funds which had invested a lot of borrowed money in the banks, find themselves unable to repay the huge loans (20 times the size of the investments they had taken) which they had taken. The banks which had lent money to the hedge funds, lost all their money.

27. Added together the losses by the banks, the insurance companies, the mortgage companies, the hedge funds, the lenders to the hedge funds come up to trillions of dollars.

28. When one bank experiences a run, other banks may come to its rescue. But when all the biggest banks fail simultaneously, no other banks can rescue them. The Central Banks of the Government, the printers of money may be able to bail out the bankrupt banks and institutions. The problem with printing currency notes to bailout on such a scale is inflation. And inflation must lead to recession.

29. Recession for one country is bad enough. But when the whole world go into recession, the problem is nearly impossible to resolve. Certainly no one country can resolve it. A world recession must be resolved by the world acting in concert.

30. What is the future for Malaysia in the face of a worldwide recession? It is very difficult to predict with any degree of accuracy, but certainly what happens to Malaysia must be determined by the degree of its involvement with the world's economy. The greater the linkage the more serious will be the problem and the more gloomy the future of the country.

31. We know that Singapore has felt the adverse effect of the present international financial uncertainty more than Malaysia. This is because Singapore is a financial center and is much involved with investments in hedge funds and other financial instruments. It has too much money with too few opportunities within the country to invest. The developing countries provide too few investment opportunities. So much of Singapore's money is invested in the rich countries. And we now know that the rich countries have been really badly

managed, especially financially. So Singapore has to pay a price for its confidence in the free market and in money making more money.

32. At the other end of the spectrum we see a number of countries which have been sanctioned by the powerful and rich countries of the world. They have hardly any involvement in foreign investments, certainly not in financial instruments and funds. The financial turmoil would not affect them as badly since they have become insulated though the sanction etc. But still they will be faced with some relatively minor problems.

33. We may say that Malaysia is a country in between the two examples mentioned. We have not been great investors in foreign funds or even in the foreign industries which are collapsing. But we are a trading nation and for a trading nation the sufferings of its trading partners cannot but affect it adversely. We are going to find our trading partners unable to pay, partly because their banks are bankrupt and partly because their countries' recession must affect their buying power and their priorities when they buy. Our trade must therefore diminish and this will affect our industries and jobs for our workers.

34. This is the environment in which Malaysia will have to function and it will have to handle. How it handles this environment will determine its future.

35. The last time Malaysia had to face a financial crisis, its economy went down the way other countries did. The people became poor suddenly and the growth became stunted. It seemed like it would have to borrow from the IMF and surrender itself to IMF dictates. The result would be a less independent country with no certainty of recovery as the IMF loan was for settling Malaysia's foreign debts and not really to help its economy to recover.

36. It therefore chose not to seek IMF and World Bank "help" because Malaysia had to continue with its New Economic Policy. We did not think the IMF would be interested in our principle objective of correcting the economic imbalance between the races. They believe in competition in which the losers should be put to death like the gladiatorial fighters of old. Such an attitude would increase the ill feelings and tensions between the races, would in fact lead to racial clashes and instability for the country. And the instability would have an adverse effect on the economy.

37. Today Malaysia has joined other countries in the region in being politically unstable. For 50 years political stability was what attracted investments, both foreign and local. Now a weak Government has tried to regain popularity by pandering to the demands of the extremists and the naive. The floodgates have been opened and all kinds of sensitive issues are being publicly debated.

38. The result is not the kind of liberal society that such a policy was supposed to bring. The result is the resurgence of racism on the part of all the ethnic groups.

39. In this atmosphere the Government will find it difficult to handle the oncoming financial and economic instability. The fear of political repercussions will prevent the Government from taking decisive, if unpopular, measures.

40. Admittedly the crisis is not the easiest problem to handle. But if confidence is to be restored the Government must be seen to be serious about handling it. Making a few billion dollars available is not the total answer. There is a need to identify the problem areas, to understand the underlying causes and to devise plans of actions to counter them.

41. Actually Malaysia is cash rich. It has huge savings and its reserves exceeded the statutory requirement. Its economy is made up of both the production of raw material and commodities and the manufacture of goods.

42. Its growth remained quite steady during the early period of the downturn because commodity prices were very high and were able to sustain high exports earnings despite decline in earnings from exports of manufactured goods.

43. I have no figures to support the statement but our exports used to consist in value terms of 82% of manufactured goods and 18% of commodities. But when the prices of crude oil went up from USD 30/- to USD 140/-, while palm oil went up from less than RM 1000/- to RM 4,500/-, the export earnings from commodities must be a major contributor to the USD 100 billion of Malaysia's export earnings in 2007 and first half of 2008.

44. But now we are seeing the prices of commodities making a steep dive with crude down to about USD 50/- and palm oil to RM 1500/-. Our export earnings must take a beating. It is likely that the trend will continue.

45. In the meantime exports of manufactured goods will not be rising, but is likely to decline.

46. FDI has not been flowing in either. Although there have been a lot of proposals nothing much is seen on the ground. The Arab proposal to invest in Wilayah Iskandar may not materialise nor will the other corridors see any real contribution to growth.

47. The reason is simple enough. Worldwide there has not been much FDI lately. But for corridors or regional development to take place, the infrastructure in terms of roads, railways, water supply and electricity must be assured. Sites for industries must also be identified and be well prepared. We do not see anything of these developments either.

48. Generally infrastructure projects have been neglected. It must be noted that these projects are not only necessary to support growth, but they also create business opportunities and jobs for the people. Sadly we are told many of the projects have been overpriced and there is a likelihood that much of the money will not go into real construction. This will mean the contribution of such large Government expenditure towards economic stimulation would be minimal.

49. This is the future that Malaysia is likely to experience if we go by the present economic scenario in the country and internationally. But the future can become brighter if the economic and financial crisis facing the world and their effect on Malaysia are better managed.

50. This crisis is extraordinary and the scale is enormous. The world has never seen anything like this before, not even during the Great Depression of 1929 – 31. The great financial institutions and banks survived in 1929 – 31 but we are seeing them falling like nine-pins this time.

51. For Malaysia to handle the effects on the country the crisis must be carefully studied and understood. Certainly we must know why and how they happened and how they affect us.

52. This crisis is largely Man-made. It is the result of greed being allowed to abuse the systems. This is what happens when Government abdicates its regulatory role and slavishly acceded to the demand of the bankers and financiers to leave the market to the market. The signs of a breakdown were seen early but such is the faith in the market regulating the market that the free market Governments took no notice and did nothing.

53. Fortunately Malaysia has always been conservative and has not taken to the idea that Government should not interfere with the market. As a result much of market activities in Malaysia have remained subjected to regulations.

54. So Malaysia should be in a better position to counter the effects of deregulation.

55. Now Government must look into playing a bigger role in the economy. But it should also be judicious. If it controls too tightly, business will not be attracted or it will fail, strangled by Government regulations.

56. In any case, deep knowledge of the aetiology of the crisis will help the process of identifying the effect on Malaysia's economy and finances and perhaps help formulate a plan for tackling or mitigating the fallouts from this, the greatest financial crisis ever.

57. The world has yet to acknowledge that this financial crisis needs a global solution. It needs a revision in the banking system and the monetary system. It may even need a totally new system developed with the interest of all the countries in the world.

58. Malaysia may be able to lessen the effects on the country's economy but until the world succeeds in devising new systems for banking and international monetary regime, all solutions will only be cosmetic.
