

## **MAJLIS MAKAN MALAM INSTITUSI-INSTITUSI KEWANGAN**

PUSAT DAGANGAN DUNIA PUTRA, KUALA LUMPUR, 7 SEPTEMBER 1994

Saya mengucapkan terima kasih kepada Persatuan Bank-Bank Dalam Malaysia kerana menjemput saya dan isteri ke Majlis Makan Malam Institusi-Institusi Kewangan yang dihadiri oleh bankers, financiers dan insurers tanahair. Majlis seperti ini amat berguna untuk merapatkan hubungan dan kerjasama antara ahli-ahli institusi kewangan negara dan untuk Kerajaan memberi sedikit 'input' dalam industri ini.

2. The current economic expansion which began in 1987 is now well into its eighth year of growth. Economic activity is expected to remain strong in the next couple of years, making this the longest and strongest expansion in over three and half decades. The latest indicators are that growth in 1994 and 1995 should be sustained at the eight percent plus level.

3. While the outlook for the Malaysian economy is up-beat, there is no room for complacency. We must never ever take growth for granted. Recession has been experienced by Malaysia before and it can happen again. And it will happen sooner if we forget the lessons of the past. Of particular importance is the challenge to curb inflationary pressures.

4. I know I have been widely quoted to have proposed zero inflation for Malaysia. To many I must sound rather naive. The world has come to expect and to accept inflation as a matter of course. Indeed many countries build into their costs and prices the inflation factor. Unions demand and employers agree to fixed increases in wages annually in order to cope with inflation. At the very least 3-year and

5 - year salary revisions are implemented irrespective of productivity. They believe that by so doing they neutralise the effect of inflation. Actually they know they are in fact contributing towards and ensuring that inflation does take place. But they cannot use this argument because no one would accept it. Besides, executives like to go along with the union demands because they get similar increases in their salary, usually at a higher percentage. The proprietors are happy too because they think they will get bigger profits.

5. It does not take a genius to work out that the increase in wages and incomes is quite meaningless, because the prices of everything go up too. The amount of income is bigger but the purchasing power does not increase. To use a hackneyed term, you are back to square one.

6. I would like, if I may, to throw to you, the economists, the financiers and the bureaucrats, some rather naive

theories. It is about not just achieving zero inflation but actually rolling back prices so as to achieve minus inflation, or deflation, although the term does not quite mean reduction in prices, the opposite of inflation.

7. Is this absurd? You must admit that quite by accident countries have experienced minus inflation. Unfortunately we notice that the economy was not doing well at the time. There was in fact zero or minus growth. We immediately conclude that negative inflation is associated with what we consider as an unhealthy failure of the economy. So we are not quite happy with it and we would not like to artificially induce it.

8. But surely we all know that the amount of money we earn is meaningless unless we can purchase goods and services with it. Of what use is an increase in income if we cannot purchase more of whatever we used to purchase before? Of what use is it to talk in terms of millions, billions and trillions if conversions to the U.S. dollar for example reduce the zeros at the end of the figures to nothing?

9. Many countries, off and on, knock off the last two or three zeros, not only because they are cumbersome but they are quite meaningless. Yet we do not seem to notice that when they knock off three zeros from a million Turkish Liras, they are in fact reducing prices and wages by 1,000 times. In other words they have rolled back inflation. No one was really hurt. The only problem is that inflation psychology then initiate another round of wage and price hikes. They then roll back again by issuing new currency. But the charade continues.

10. Supposing in Malaysia we decide to pay ourselves in British Pounds or U.S. Dollars instead of Malaysian Ringgit, then immediately we would be dealing with lesser amounts of money. But in terms of purchasing power we would not be worse off. On the other hand if we decide to pay ourselves in Italian Lira or Japanese Yen we would be rolling in money, but we would not be any richer either.

11. Clearly, amounts of Pounds, or Dollars or Lira or Yen are quite meaningless. What is meaningful is what they purchase. Similarly, amounts of ringgit are not important. What is important is how much the ringgits can purchase. If we get a certain amount of goods or services for a lesser amount of ringgits because our incomes have also been proportionately reduced, what does it matter to us?

12. I must admit this subject fascinates me. I have gone through many bouts of inflation and deflation and I find the phenomenon absolutely ridiculous and unnecessary.

13. As a little boy I remember going to the provision shops to buy things with only a one cent coin in my pocket. Yet what I bought would be as much, if not more, than what you can buy with RM1 today. Was I poor because I had one cent then? Am I rich because I have RM1 to buy one cent worth of things?

14. One of the most intriguing phenomena we went through was the rapid devaluation of the Japanese banana currency. From using 1/2 cent coins in the immediate pre-invasion period, we went on to deal in 100 dollar and 1,000 dollar notes. Towards the end everything was priced in multiples of 100 dollars. We carried sacks of money but we were not rich. Indeed, we were rather poor, having to do without many necessities.

15. Then the British returned and reintroduced the Straits dollar. Immediately everything went down in price. I remember buying pre-invasion Straits dollars in the black market during the occupation. I paid hundreds of thousands of dollars of banana notes for \$100 Straits. Immediately after the war I bought a second hand Underwood typewriter for \$40 and began to learn touch typing. I was better off with my \$100 Straits settlement legal tender than many people with millions of worthless banana dollars.

16. What happened was deflation on a grand scale. Suddenly prices were 1,000 or more times cheaper. Of course salaries went down too. When I worked as a temporary clerk in the office of the Custodian of Enemy Property I was paid \$80 per month. Regular clerks were paid the pre-war salary of \$60 per month. I was actually richer than when I was selling bananas in Pekan Rabu during the Japanese occupation making tens of thousands of dollars a month.

17. I am not recalling this because of nostalgia. Somewhere I think there is a lesson for us. And that lesson is very much concerned with inflation, with the perception of wealth and poverty.

18. Wealth or poverty is not determined by how much money you earn but by how much goods and services you can buy with your money. We have always argued that because the cost of living in Malaysia is lower, our people are not as poor as their GDP per capita in U.S. dollar seems to indicate. They can buy far more in Malaysia with their earnings than the people in countries with a high cost of living can buy with the same amount of dollars in their own country. For this reason we have always opposed attempts by Western trade unions to force wages in this country to go up.

19. Now of course this fact is acknowledged. Beginning with the MacDonaldd Hamburger Index we now have the Purchasing Power

Parity (PPP) as a basis for comparison between the wealth of nations. According to the PPP, the U.S. dollar equivalent of our earning is US\$8,050 per head and not US\$3,230. We are therefore less far behind the developed countries than we think. Japan has a per capita GNP of \$37,500, but in PPP terms is only worth \$20,160, just slightly more than twice that of Malaysia. On the other hand we are not so far ahead of our neighbours where the cost of living is lower than ours even though their per capita is lower.

20. We should feel heartened by this. But we should not congratulate ourselves. The important thing is that the PPP is a very realistic index. It recognises purchasing power as more important than the actual amount of money we have.

21. Now the price of goods in terms of currency units is quite irrelevant. Whether we call it dollar or yen, or pound or ringgit, whether the units are small or big, all these are quite irrelevant. What is relevant is what we get in exchange for the money we pay. If it is possible to pay less, why should we pay more for the same thing? The question is how can we pay less without causing someone to lose money? Surely if we pay less for something that cost more, people will not be in business for long.

22. But actually it is possible to pay less without anyone losing money, without putting people out of business, without bringing on economic ruin in double-quick time.

23. Supposing in Malaysia we decide to reduce the price of everything by 10 percent, what could be the effect? The reduction, of course, should not be just in the price of goods and services only. The wages and taxes should also be reduced by 10 percent. Indeed, every transaction involving almost purely domestic items should be reduced by the same factor. Please note that we are neither revaluing nor devaluing the ringgit. The exchange rates remain.

24. Everyone would then have 10 percent less money to spend or save or whatever. But since what he wants to buy will also be 10 percent lower in price, his reduced income does not reduce his purchasing power. He will not be any poorer. He will in fact be as well-off as he used to be in almost every sense.

25. The seller of goods and services will also not lose as he pays lower wages and lower prices for all his locally produced inputs. The investors will not lose either as his capital cost would be 10 percent cheaper except for imported inputs.

26. Imported goods will not be reduced in price, of course. It will remain at the same price as before since the local currency is assumed to retain its current exchange rate.

27. However, imported inputs in the production of local products is usually only a small fraction of total cost. So even where there is imported inputs the 10 percent reduction in price can be almost achieved.

28. Now the effect of a 10 percent reduction in the price of all goods and services is to reduce inflation by almost 10 percent. Since income is also reduced by the same amount the people will not really gain greater purchasing power. Purchasing power would remain as before.

29. The greatest advantage is that goods produced locally for export will be cheaper, at times 10 percent cheaper. This will attract both local and foreign investors. Exports will be more competitive. Industry will grow. Economic growth would be accelerated. In the end the incomes of everyone in actual terms and in PPP terms will increase without affecting costs and stifling economic growth.

30. On the other hand imported consumer and capital goods will increase slightly in price, relative to earnings and purchasing power. Fortunately in Malaysia very few essentials are totally supplied from outside. Even luxury items are locally produced now. The lowering of taxes by 10 percent would mitigate the relative increase in imported goods. Only the very rich with a penchant for luxury imports will have to expand more. Even then not much more. We tax 300 percent on luxury cars. A reduction of that by 10 percent would certainly be a great help in reducing the 10 percent effective increase in price. Assuming the imported price is RM100,000. In terms of the purchaser's earnings it will be 10 percent dearer or notionally RM10,000 more. But a 10 percent reduction in import duty amounts to RM30,000. The old price was RM400,000 but the new price will be RM370,000. Still this represents a reduction of 7.5 percent and not 10 percent. I don't think it matters for someone wanting to buy such a car.

31. The Government has had much experience of the effect of reducing taxes. In the past taxes were increased or new taxes created in order to increase Government revenue. Indeed at one time there was even a tax on crown cork. All these increases did not yield appreciable increases in revenues. For some time now we have been reducing all kinds of taxes. Where once luxury items were heavily taxed on the principle that they were unnecessary and only the rich bought them, now we have reduced or removed totally the tax on them. The result is that no one buys them abroad to smuggle them in. Instead Malaysia

has become a shopping paradise for such goods. Naturally corporate tax and income tax on such businesses are collected. This is far more than the few dollars we collected by way of import duty before.

32. The result of tax holidays for industries and reduction in income and corporate taxes has also been most gratifying. Of course the reduction or removal must be judicious or there will be a reduction in total revenue. It is clear that reductions in taxes, judiciously determined, will actually increase the revenue of Government rather than decrease.

33. A good case study on the probable effect of price, wages and tax reduction would be Japan. The cost of living in Japan is the highest in the world. A rock melon sells for as much as the equivalent of RM300 each. The increase in the exchange rate of the yen has not helped to reduce prices even of imported raw materials and goods. The price of petroleum products has not gone down despite oil prices going down. If you combine the lower oil price and the rise of the yen against the U.S. dollar, fuel cost in Japan should go down to less than 30 percent of the highs when oil prices were at its peak. But neither the retail price nor the fuel and energy cost to industries have gone down.

34. Japan's exports now reflect only the rise in the exchange rate of the yen and not the greatly reduced prices in yen terms of raw materials which Japan imports for her industries. Surely even if the benefits of low input costs due to imports are not fully able to counter the increased cost due to a strong yen, at least there must be some tangible reduction. And Japan is one country that imports almost all the raw materials and fuel for its industries and domestic consumption. Yet Japanese exports never go down in price.

35. But what if Japan decides to reduce everything by, say, 50 percent? What if Japan deliberately reduces wages and taxes and the selling price of melons and all locally-made goods by 50 percent? The strong yen would already take care of imported inputs. The price of all products and services would be halved. Japan would be able to export competitively again.

36. The people's standard of living would not be affected in any way because the 50 percent reduced income will buy all the things they used to buy as all these would also be half-priced. At one stroke Japan would be able to solve all its present economic problems, without devaluing the Yen even by one percent.

37. The Japanese are a highly intelligent and disciplined people. If anyone can achieve this economic miracle, they can.

But of course they will not. If they do, the other six will take even more drastic action against them.

38. Still it is an interesting proposition to study. We can learn much from it. We can understand better the workings of a national economy. Perhaps we can use some of this knowledge in the management of our economy and in our fight against inflation.

39. I hope you who are experts in the fields of economics, finance and taxation will apply your minds to this study. With your powerful computers you can simulate, model and calculate the results of such a move. Certainly we can study the effect of a 10 percent all round reduction with no change in the exchange rates. Would we be poorer, richer or would the status quo be maintained? What would be the cost of the things we produce for export? Would they be cheaper and more competitive in the export market? Presently we earn US\$48.46 billion from export. Would these earnings and profits buy us more things in a Malaysia where everything is 10 percent cheaper? With Malaysian export cheaper by whatever percentage we chose, not necessarily by 10 percent, would there be an increase in exports?

40. What about investors, both domestic and foreign? Would they not be attracted to invest more in a Malaysia where their local costs would be 10 percent cheaper? If Malaysian wages are lower would there be so many illegals? Would their remittance, now approximately two billion ringgit, be reduced?

41. Subsequently, wages and purchasing power would go up. But then we would still be competitive because inflation in their countries is bound to make our competitors less competitive.

42. Even as an academic exercise it would be interesting to find answers to all these questions and more. The Government has no plans to take this approach towards making Malaysia more competitive, to reduce taxes by 10 percent, or wages for that matter. There is no need for celebration or for worry. But, naive though this suggestion is, it is quite intriguing. If indeed it is doable, what a powerful weapon it would be for the nation. So before you dismiss it as another of the Prime Minister's fantasies, why not light up your computer screens and fantasise with him?

43. Inflation has always seemed to me absurd. It is going to be even more absurd when we buy and sell and pay taxes etc. electronically. You are going to add more zeros, i.e. more nothing to all your figures. If you imagine that because of these zeros you are richer, you should really see a psychiatrist.

44. I would like to thank you for bearing with me. You may enjoy your dinner now.