

THE FIFTH SYMPOSIUM OF THE INSTITUTE FOR INTERNATIONAL MONETARY AFFAIRS

TOKYO, JAPAN, 2 JUNE 1998

" REVITALISATION OF JAPANESE AND EAST ASIAN ECONOMIES "

Let me begin by noting what a difference a year makes.

2. Last year, at this time, there was some concern about the Thai economy, which had successfully repulsed two attacks on its currency. But there was still much talk about 'the East Asian Miracle', a characterisation invented, if I am not mistaken, in the impressionable West. All of us, we thought, were 'not Thailand', a unique, special case.
3. Many foreigners -- including the most tough, hard-nosed personalities and organisations -- told us the most flattering things, which strengthened us in our conviction that our 'fundamentals' were very strong indeed.
4. The annual World Competitiveness Yearbook, issued by the prestigious International Institute for Management Development (IMD) told Malaysians, for example, that we had some problems here and there, some quite serious. But on the basis of what it called the 'overall evaluation of the strength of the domestic economy at the macro level', Malaysia was the second most competitive economy in the world. We were in the best of company. At number one was the United States. At number three was Singapore. At number four was Luxembourg.
5. Most of the other economies which have been so severely hit since the IMD issued its 1997 report also scored highly according to the 244 criteria, or fundamental factors, that were used. I wait with great interest their annual report for 1998 which should be issued later this month.
6. I hope the IMD will stand by its analysis of the fundamentals and not change its analysis of the 200-plus fundamentals, which so convincingly argue that the turmoil of the last year are not the result of fundamentals but of forces that have very little to do with the economic fundamentals. I hope the IMD will not alter the facts so that they will fit into some sacred truth, some hallowed theology.
7. It is so easy for some analysts to slip into the view that currency movements are purely the function of fundamentals. The market fundamentalists tell us this is so with incredibly sincere conviction, however loudly the speculators chuckle all the way to the bank. Since, according to the theology, currencies cannot fall unless the fundamentals are weak, and since the Asian currencies have fallen so dramatically, then ipso facto the fundamentals must be weak even if you have said that they were strong immediately before. The truth is that the currencies plummeted even though our fundamentals were very strong. The truth is that, ipso facto, the fall of our currencies were not a function of our basic fundamentals.
8. The IMD was not the only one with such a good impression of my country one

year ago. In mid June, 1997 -- in fact, on June 17, 1997 -- just two weeks before the July 2 collapse of the Thai Baht which resulted in a horrendous collapse of the regional currencies, Mr Michel Camdessus, Managing Director of the IMF was handing bouquets to Malaysia for our sound economic management, for our superb economic fundamentals. He told an international conference on Global Capital Flows in Los Angeles: and I quote ` Malaysia is a good example of a country where the authorities are well aware of the challenges of managing the pressures that result from high growth and of maintaining a sound financial system amid substantial capital flows and a booming property market.'

9. He noted: ` Over the last year, output growth has moderated to a more sustainable rate, and inflation has remained low. The current account deficit -- which is primarily the result of strong investment spending -- has narrowed substantially. The increase in the fiscal surplus targeted for this year is expected to make an important contribution towards consolidating these achievements' .

10. There had been complaints that we were growing too fast. So we brought our growth rate down very substantially. There had been complaints that our current account deficit was too high. So we halved it, to the obvious delight of the IMF, which rightly noted that in any case our high current account deficit was not because of excessive consumption but was the result, in Mr. Camdessus' words, ` of strong investment spending' .

11. You may say there is no need for more testimonials. But how about the banking and financial sector? If you can believe Mr Camdessus, again I quote: ` The Malaysian authorities have also emphasised maintaining high standards of bank soundness. Non-performing loan ratios of financial institutions have fallen markedly in recent years; risk-weighted capital ratios are above Basle recommendations' .

12. You might just wish to note that in 1988, the non- performing loans in the Malaysian banking system had stood at 32.5 percent. In June 1997, just eight years later, as luck and a tremendous amount of sweat would have it, our non-performing loans stood at a historic low of 3.5 percent. This is as dramatic a performance as you can get. Perhaps this was why the IMF was so impressed and so complimentary.

13. Today, there are all sorts of talks about transparency. I agree that transparency is important. But I suspect that when so many complain about a lack of transparency, what they are complaining about is simply their own lack of knowledge, which is not so surprising because five years ago or even five months ago some of the younger money movers might have thought that Malaysia was somewhere in the Himalayas. As for the transparency of the Malaysian financial system, let Mr Camdessus speak for Malaysia. In the same Los Angeles speech, Mr Camdessus said: ` In an effort to increase the flow of comprehensive up-to-date and reliable information to markets, Malaysia was also among the first to subscribe to the IMF' s Special Data Dissemination Standard' .

14. So, ladies and gentlemen, on June 17, 1997, just two weeks before the currency hurricane struck, the IMF gave Malaysia not just a clean bill of health but the IMF in fact praised Malaysia's economic fundamentals. The IMF had the best of things to say about our economic management. And the IMF commended Malaysia to investors as an economy that 'justifies the confidence of the markets'.

15. I cite all this in order to address all those extremist 'market fundamentalists' who believe that the market is always right and that the reason why so many of us are in desperate straits today is because we mismanaged our economies and because all our 'fundamentals' were rotten to the core.

16. If all our fundamentals were wrong, why were the foreign investors so eager and so foolish as to pour billions upon billions of investment dollars in our region? Of course all the international banks kept on lowering interest rates in order to persuade us to borrow even when we were without need for additional funds. Obviously they, as the definitive market, had a lot of confidence in Malaysia, its economic management and its future.

17. If our fundamentals were rotten to the core, why did all the clever analysts not say so? Why is it that not a single economist, financial analyst or economic soothsayer has dared to come out to say that he or she had predicted what has happened? Not a single one. And yet these same people continue to predict, to be believed in and to influence the market. If it is wrong for insiders to leak information which can affect share prices, why is it not wrong for forecasters to forecast something which influences the market to their advantage.

18. Professor Paul Krugman has for years been arguing that the East Asian miracle was not a miracle at all and was bound to hit a brick wall. Many Western journalists credit him with forecasting the Asian Crash of '97. He has in fact publicly stated that he did no such thing; that he could not in his wildest dreams have imagined anything like it. In Hong Kong on March 26 this year, Professor Krugman admitted: 'I was 90 percent wrong about Asia's future. The only consolation is that everyone else was 150 percent wrong'.

19. The analysts and all those who are obviously cleverer than us simple elected leaders must know that we have had not ten years but forty years of economic growth unparalleled in human history. Since some of them are young enough to be our grand children, perhaps we should remind them that many of the things that they complain about and which they say are the reasons why we are in such difficulties today were things that we ourselves started complaining about when we ourselves were their age. So many of the so-called fundamentals which are now listed as the main causes of the currency and financial turmoil of the last 12 months -- corruption, monopoly, crony capitalism, inadequate human resources, very far from perfect banking systems and practices -- have always been with us. Yet we were able to grow faster and longer than anyone before in human history.

20. All of Asia must obviously work on our numerous weaknesses, to get rid of the stones around our necks and the chains on our feet. We must do this not

because they are the causes of our economic turmoil but because they are bad and they weaken our capacity to compete and to succeed. We must do this because we cannot allow corruptive influences to determine who supplies us with what. But the true causes of why our currency plummeted and why we are facing an economic crisis must be sought elsewhere.

21. Our meeting today is not focused on the causes. It is also not focused on the consequences, the terrible consequences. Our task is to focus on the remedies, the things which must be done if we are to re-vitalise ourselves, if we are to ensure the re-vitalisation of all of Asia. So let me concentrate on the things that must be done in order to ensure the quickest, most healthy and sustainable re-vitalisation.

22. Quite obviously, there is a need for short term imperatives as well as medium term measures and longer term strategies. At this stage, although we must not neglect the medium and longer term, we must remember the admonition of Keynes that in the long run we are all dead. Seldom has the short term been as important. This is why I speak of the 'short run imperatives'.

23. Quite obviously also, there are three principal theatres of operation: * the things that we should aspire to achieve internationally; * the things that we should try to achieve regionally; and * the things that we must achieve at home, within the confines of our own borders.

24. Given the nature of this meeting, I will concentrate on only a few areas. I will focus on some issues that should be of primary interest to this Institute for International Monetary Affairs and its strategic intellectual constituency.

25. At the international level, I believe that the time has come to deal with the entire issue of reform of the international financial system to ensure currency stability and to contain the activities of those who buy and sell money for no other purpose than to make profits. Let me say once again that currencies need to be changed if there is going to be international trade. That is why the leaders of the Western nations met to draw up the Bretton Woods Agreement, the purpose of which was to agree on a mechanism for determining the value of one currency against another. The system worked very well and enabled the countries bankrupted by the war not only to recover but to prosper as well. Of course the Marshall Plan and the opening up of the American market to Japan played a role. But if there had been no system for stabilising currency values, all the plans in the world would not have succeeded.

26. But then some countries in the West decided to devalue their currencies in order to enhance competitiveness. Very quickly a currency market emerged which took advantage of the mildly unstable exchange rate. True speculation took place because the funds were relatively small and depended on intelligent guesswork as to the movements of the exchange rates.

27. But soon the funds grew huge and were in fact able to move the exchange rates through their interventions. The famous herd instincts replaced economic

fundamentals. With the invention of arbitrage and futures trading, the need for exchange rate stability for the purpose of trading gave way to the desire of currency traders to make massive amounts of money in the shortest possible time. An artificial system of devaluation and revaluation of currencies was devised which enabled currencies to be appreciated or depreciated literally within seconds. Thus the Indonesian Rupiah was at one time devalued by more than 600 percent, then in the space of a few days recovered by 200 percent. It is still moving up and down by 100 percent to 200 percent in the space of one day or even half a day.

28. Mr Volcker in a speech in Hong Kong stated "An exchange rate system that produces a 60 percent swing in the yen/dollar rate over a period of 18 months cannot reflect the fundamentals in any sensible sense". Well the Indonesian Rupiah moved 600 percent in the space of five months. Can it be that all the assets of that huge country with 220 million hardworking people are suddenly worth only one-sixth of its previous value? What indeed is the worth of a nation if suddenly someone can devalue and even bankrupt it?

29. If currencies can be made useless so easily then, what is the point in a country issuing its own money? We should go back to barter trading.

30. It is said that the currency will strengthen if confidence is restored. But there is no certainty as to what will bring back confidence. Who is monitoring what and who determines whether confidence should return or not. There is a lot of talk about market forces. But who constitute market forces and how do market forces determine what value to give to each act of a Government or an economy under attack.

31. All in all, the present system, if there is a system at all, is messy, unreliable and destructive. Can world trade depend on these shadowy market forces whose methods are not known to anyone except themselves? True, through hedging the effect of the fluctuation in the exchange rates can be minimised. But again, this hedging profits only the hedge funds, adding to the cost of goods and services. If exchange rates are minimally volatile, hedging and the profits for the hedge funds, would not be necessary at all.

32. There is nothing to indicate the need for currency trading other than the vast profits that can be made by currency traders. On the other hand we now know the extent of the damage to the economies of whole countries and regions that currency trading can inflict.

33. The excuse that currency trading provides market forces with the means to discipline Governments is totally unacceptable.

34. Currency traders thrive on unstable currency. It is ridiculous to suggest that they would discipline Governments and reward them with exchange rate stability when such stability will deprive the traders of the opportunities to make money. Governments do need to be disciplined but the international financial regime must be bankrupt of ideas if it cannot find other ways which are less destructive

to discipline Governments.

35. Everything points to the need for an international financial system which will bring about stability of exchange rates among other things. Admittedly we cannot bring back the Gold Standard or the Bretton Woods system. It would be a sad commentary on the ability of the world' s financial and economic experts if they cannot come up with proposals on a new international financial system. Their habit of merely trying to explain the present turmoil as being due to bad practices by the Governments concerned sounds too much like an apology and a defence of currency traders. Money does not know whether a Government is good or bad and react by adjusting their rates of exchange. Somebody is doing that and is evidently making a lot of profit. Do we need to protect these people' s interest at the expense of world trade?

36. Fixed exchange rate is no longer possible or realistic. Obviously the political, economic and social performance of a country will have an effect on the value of its currency. If a country is having a revolution it is likely that its currency would be less acceptable and therefore should be devalued. As for the economy there are various indices which can be given points indicating the strength of the economy and therefore the currency. It is not beyond the capacity of the world' s great economists to devise a measurement of the economic performance of a country using the political, economic and social indicators and then determine the relative values of currencies. The currency traders can still speculate but whether they buy or sell should not affect the value of a currency.

37. This is of course only a suggestion. The financial experts and the economists may laugh but it will stop the currency traders from laughing all the way to their banks.

38. There is a belief that when currency depreciates the goods produced by the country concerned become cheaper and more competitive in the world market. It may do so but the reduction in cost is always far less than the percentage of depreciation. This is because all imported inputs will cost more in local currency and will negate the devaluation of the currency. Imported inflation will push wages and other domestic costs up reducing further the advantage of currency depreciation. In the end the lowered cost is hardly detectable. The products of countries with a depreciated currency are no more competitive than they were before. In at least one case the capacity to import foreign inputs is lost altogether because of the extreme depreciation of the currency.

39. Devaluation or revaluation are not the answers to the world' s economic problem. Improvements in productivity are and such improvements can be achieved through greater skills, better management and continuous technological improvements.

40. Nations depend on different factors for competitive advantage. Low labour cost is one, but capital, management skills and technology are more important. While those with capital, technology and management skills are loath to share these advantages freely, they are demanding that low labour cost should be

nullified by raising wages.

41. We are moving inexorably towards globalisation. Like the proposal to link human rights, the environment and labour practices to trade, globalisation, liberalisation and deregulation are ideas which originate in the rich countries ostensibly in order to enrich the world. But so far the advantages seem to accrue only to the rich. True the poor countries can gain access to the markets of the rich, but then they do not have many things to export to these markets. The raw materials which they produce are controlled by commodity markets in the rich countries. The terms of trade for these keep on deteriorating.

42. In preparation for globalisation the pace of mergers and acquisitions have been stepped up. Super large banks and corporations are being formed in the developed countries which will dominate the world. There will be no room for the small companies in the poor countries to exist, much less to expand and spread into the rich markets now opened to them.

43. Perhaps the peoples in the developing countries should be happy because they will be served by the most efficient and the biggest companies of the world. They will have the choice of three giant banks, four makes of cars, five hotel chains, ten fast food chains etc. But it is going to be a dull world and I suspect some people would be stupidly nationalistic and feel unhappy without their poor quality national brands.

44. In a globalised world should there be national Governments? We have seen that market forces can change Governments. What is the need for national elections if the results have to be approved by the market?

45. These are some of the international issues which have either to be attended to immediately or at least debated seriously. Far too often decisions on these issues are far from democratic, yet the same people insist on democracy for everyone. It is about time that international democracy be recognised as being as important as national democracy.

46. Whether we acknowledge it or not East Asia is a region, a closely linked region. It is not an accident that the fastest growing economies are found in this region. Nor is it an accident that the most serious economic crisis the world has seen since the Great Depression involves this region. The fact is that this region grew together because we worked together. It is reasonable to expect us to get out of our present economic morass by working together.

47. Japan is the richest depressed country in the world. The capacity to grow and to be the locomotive of growth for the region is still there in Japan. You need to clean up the bad practices of the past and largely you have done so. Your Government, your businessmen and your people should now rehabilitate your confidence and rebuild your economy quickly.

48. You have the capital, the technology, the skills and everything else needed to grow your economy. You should employ all these assets and provide the lead that the region needs. You should invest in the countries of East Asia as you did

before. You should buy their products in order to enrich them. You should help in making East Asia a market for itself and the world.

49. In Malaysia we are still looking East. Many have asked us why, when it is so obvious that Japan has failed. We admit that in several areas Japan has failed. But even failures provide lessons for us. There are still many things we can learn from you. Your exceptional skills, your technology, your discipline and work ethics are still worth copying.

50. What Malaysia and the rest of the region needs is a revival of Japanese investments, to create jobs, to enrich the people, stimulate economic growth and incidentally to create good markets for Japan. Some of the money the Japanese Government is pumping into your economy could very well be pumped into the troubled economies of East Asia. As before when Japanese investments created prosperity for East Asia and in turn provided good markets for Japan's products, Japanese money to revive East Asian economies would benefit these countries and Japan. Japan has the means to resuscitate East Asia, if only it thinks less about what others will say if Japan frustrates them.

51. As for Malaysia, the only way we can overcome the instability in the Exchange Rate and to rebuild our economy, is to do away with currency in trade as much as possible. We will revert to bartering. We would want to balance our trade with countries which have a trade surplus with us and Japan is the country with the biggest trade surplus. Where we have to pay we will pay in the currency of the trading partner concerned.

52. Regionally we have agreed with the ASEAN countries that trade between us should be enhanced as the devaluation of our currencies is approximately at the same rate. We will also use our own currencies and balance our trade. This arrangement will probably be permanent, unless of course a new international financial system is put in place which will reduce violent fluctuations of exchange rate.

53. Malaysia intends to revitalise its own economy through several local measures. It will take note of the various criticisms directed at it by market forces and will study their alleged effect on Malaysian economy including the recent devaluation of the Ringgit.

54. I have tried to itemise the factors which need to be corrected in order to revitalise the economies of Japan and East Asia. I am no expert in this area but I have had some success in my own country. I think I know what I am talking about more than the theorists who had never run any country, much less help it grow. Left to themselves the economies of East Asia will grow again. But the chances are they will never be left to themselves. And so the revitalisation will not be easy.