

**THE 6TH PRIME MINISTERIAL LECTURE OF THE HARVARD CLUB HOTEL
THE PALACE OF THE GOLDEN HORSES, SG. BESI, KUALA LUMPUR, 5
OCTOBER 1998**

"MANAGEMENT OF AN ECONOMY IN CRISIS"

I am happy to be back for this year's Prime Ministerial Lecture of the Harvard Club. Harvard of course is the seat of liberalism. It is where the struggle against the role of Governments in the market has been carried out. But I would like to maintain that Governments are more than just a necessary evil. As I see it, Governments create the framework, without which tolerably free markets cannot survive. In addition, Governments deal with the market's unwanted "excesses" in order to ensure that society's interest is protected; to ensure that the impact of what academic economists call "externalities" arising from the blind pursuit of individual self-interest does not collectively lead to panic and contagion; to ensure that the happiness of the greatest number always prevails. Though Adam Smith talks of the "invisible hand", it must be remembered that he is also aware of the crucial significance of the state. I believe that Adam Smith tried to establish in his work a balance between the market and Government. Indeed, he had clearly indicated his willingness to depart from his laissez faire strategy in the event there were compelling reasons for Government regulation, as in the case of banking, currency and even, interest rates. Smith also argued that by providing defence, social justice and infrastructure, Governments can create the preconditions for a market economy and for "that universal opulence which extends itself to the lowest ranks of the people". Nor did Smith believe that wealth was all that mattered. Quite the opposite. He worked to create a society that would be more stable and more civil, one that tempered "people's worst passions" for greed and gain. Greater wealth, by relieving suffering, enabled people to be more "benevolent". Clearly, Smith's emphasis on the positive role of government in the "Wealth of Nations" has often been down played. In this sense, the spirit of Adam Smith embedded in his lofty vision of a decent society is not dissimilar with Malaysia's own long term goals. The market mechanism is but one means to that end. Government is the other. Not unlike Smith's world, we need to constantly probe for the best mix of government and the market so that one does not get the better of the other. I believe that the markets, and here I do not mean a few ultra-rich capitalists in a developed country, when well regulated and prudently supervised, whether domestically or globally, can be an enormous force for social good. Much of our own Vision 2020 is dependent upon the exertions and creative energies of individuals and enterprises.

2. More than a year has passed since the Asian financial crisis first began. To be fair, no one at the beginning envisaged that what started as an isolated situation in Thailand could be the turmoil that now engulfs not just most of Asia but Russia and many parts of Latin America as well, and possibly the world as recent events seem to indicate. In US dollar terms, indications are that world output could fall by 2-3 percent in 1998, reflecting the impact of the Russian and East Asian turmoils, and pressuring debtors and corporate earnings as well as living standards world-wide. As we enter the final quarter of 1998, the risks of global

deflation seems more real than ever. Neither the IMF nor the G-7 have been able to deal effectively with the twin problems of the artificially strong dollar and the large and spreading manipulated devaluations. For the affected nations, the combination of massive short term capital flight, stock market collapses, sharp devaluations, high interest rates and austerity programmes had led to a tragic destruction of hard-earned wealth and a severe contraction of living standards. Certainly we do not see market forces creating Smith' s "universal opulence which extends itself to the lowest ranks of the people". In a world of 6 billion people only about 1000 currency traders and a few rich investors in their funds seem to enrich themselves further through the unbridled manipulation of the free market.

3. The standard IMF prescription for all economic ills of nations -- high interest rates, balanced budget and current external payments adjustment -- are shortsighted and lacking in consideration for the great differences in the economies of different countries. To these were added banking reforms calculated to increase failure rates. To the IMF the means matters while the results are regarded not just as secondary but quite irrelevant. Thus after implementing the IMF prescriptions the economic downturn of their proteges worsened to the point where recovery may take decades, and that too if some of the medicine is withdrawn. The IMF has now admitted that it had made a "slight mistake" in dealing with the Asian economies. It may be slight for the IMF but the cost to the countries of Asia is horrendous. Trillions of dollars of hard-earned assets and economic capacities have been destroyed, lost forever. In fact lives have been lost, Governments have fallen and racial animosities intensified. The partnership between neighbouring countries has been undermined and regions destabilised. Clearly the result of the small mistake by the IMF is anything but small. It has destroyed the work of decades of a huge chunk of the world.

4. The abuse of the free market by a few capitalists in the developed countries may have earned them quick and mind-boggling profits amounting to billions but the destruction they wreak on their victims is far greater than what they make for themselves. There is a massive nett loss for so little gain on the part of the capitalist manipulators.

5. It may be that their objective is more than just making profits for themselves. It may be that their mission is to reform the way Governments of Asia manage their economy. But even if this is their objective the cost is indefensible, even unjust. There must be better ways to promote an economic system than to destroy whole countries and regions and to cause untold misery for millions of people.

6. The so-called creative destruction indulged by the powerful Western countries is not creative at all. Creative destruction is nothing more than an attempt to explain away a destructive self-serving act, an attempt to justify the unjustifiable.

7. The Governments of East Asia may not be the best of Governments. There is no doubt that there are corrupt practices. But can America and Europe claim that they are totally free of Governmental corruption, or crony capitalism, or lack of transparency? Besides, the level of corruption of East Asian countries has clearly

not gotten in the way of their economic and social development. Unlike developing countries in other regions, East Asian countries had all grown at a rate well above that of the developed countries of the West. And their growth can be shown to have benefited their people as a whole. Only the blind and the prejudiced would insist that only a few cronies and family members benefited.

8. Per capita incomes had grown by leaps and bounds, standards of living had improved for all, employment rates were high, a huge middle-class had emerged, there was better housing and ownership of motorcars, and more money for leisure and even for investments in the booming economies. Certainly the people as a whole were well-fed and well-clothed, living in better houses. Contrast this with the recent picture of a woman boiling a cat for food, or the food-riots, the return to searching for food in rubbish dumps.

9. Obviously the devaluation of the currencies and shares of these economies by the West has resulted in destroying everything that these supposedly corrupt Asian Governments had built. From being economic tigers they are now more impoverished than even the least developed countries. Decades of hard work by their Governments and their people to develop their countries have been destroyed. Their development has been pushed back 20-30 years.

10. Can anyone in his right mind say that the present situation of these countries is better than before they were hit by the economic turmoil? Even if the destruction is intended to change the practices of these Governments and these practices will lead to a healthier economic recovery, there can be no justifying the massive damage that has been wrought. It is certain that economic recovery if it happens at all will take a very long time and will cause prolonged sufferings by their people. Only the distorted in mind will be able to justify the destruction for a very uncertain recovery.

11. The Western media and their economic and other experts seem to believe that Asian Governments must all be corrupt and incompetent. Whatever success that they may achieve in developing and enriching their countries must be due to criminal acts involving corruption, nepotism and crony capitalism. That such practices on a scale implied will certainly prevent economic development from becoming successful is ignored. That in fact the benefits of economic development are clearly enjoyed by the majority of the people of these Asian nations is brushed aside. Consistently and repeatedly any mention of Asian Governments must be accompanied by derogatory remarks about their corruption etc. Clearly the view taken by the Western media is racist. But such is their power that no one dares to state this obvious fact. Malaysia's New Economic Policy designed to reduce the economic and social disparities between races and to achieve a harmonious society is also regarded as cronyism by Western economists and their press. Obviously they want to perpetuate economic inequalities and racial animosities. That this will result in instabilities and poor development is perhaps their aim. Then they would be saved from having to compete with these countries.

12. Asian values and Asian ways of doing business are different from Western

ways. That does not mean that Asian ways and values must be inferior or wrong. Thus with high savings Asian businesses can borrow much more. What are savings for if they are not to be put to use through lending. The important thing is whether the loans are serviced or repaid. Apparently they were. Such was their servicing that foreign banks rushed to offer very attractive terms for them to borrow.

13. But when they borrowed from abroad, the Asians did not expect that they could have their capacities to repay foreign loans undercut. When the currency traders deliberately devalued Asian currencies, the Asian borrowers found themselves owing more than they borrowed. And so they could not repay or even service their foreign loans. Eventually they could not service even local loans. Is this their fault? Is this the fault of the Asian way of doing business?

14. High loans to equity ratio are not bad for business if the projected cash-flow allows the borrowers to service and repay the loans. The Asian borrowers fully intended to repay what they borrowed. And indeed they could for their expected cash-flow would allow them to do so. However when their currencies are devalued they would need much more of their own currencies to repay. With economic recession forced upon them, there is no way they can make enough money to service their debts.

15. Are the Asians wrong in having high gearing? They are not. What is wrong is the undermining of the value of their currencies by the greedy currency traders. Any business however good will fail if suddenly their borrowings are increased well above tolerable levels.

16. Matters are made worse when interest rates are increased and credit lines are withdrawn. Yet the IMF insists that interest rates must be raised and a tight money policy imposed in order to help recovery. Far from helping, the IMF regime not only makes loan repayment higher than projected but earnings from business actually diminished.

17. Another common Asian practice is to give life-time employment in exchange for loyalty to the business entity concerned. But ethnic Europeans believe in dismissing employees whenever businesses is bad. The employees have to be taken care of by the Government through unemployment benefits. This is the safety net that Western sociologists boast about. Their people consider this as their right, as their entitlement. As a result a large number of workers prefer not to work, but to be on unemployment allowance instead. They believe that the Government is paying their allowance but in fact the other workers and the consumers have to pay their allowance through taxes and higher prices for goods and services.

18. To remain competitive the developed countries try to force their competitors in the developing countries to raise wages and to pay unemployment allowance. Of course their explanation is that they care for the unemployed in the developing countries. The fact that life time employment obviates the necessity for costly safety nets is ignored.

19. The Asian system of lifetime employment and low wages is in fact superior. When workers have a lifetime income what need is there for employment benefits? When taxes on incomes are low why is there a need to pay high wages? The fact is that the Western countries are stuck with their uneconomical system and want others to be similarly burdened.

20. But the Europeans are not about to leave Asians, their values and their systems alone even though these have proven effective in developing their economies and have rendered them competitive against the West. The Asians must be forced to accept Western methods so as to render them less successful and less competitive. When attempts to use GATT and the WTO failed, the West found an effective way through impoverishing the Asian countries by devaluing their currencies.

21. The West vehemently deny that they conspired to prevent the Asian countries from developing and catching up with them. They swear that it is the Asian Governments and their cronyism, nepotism etc which caused a loss of confidence on the part of the Western capitalists, caused them to withdraw their money and precipitate an economic and financial crisis. But the fact is that where before they were unable to get the Asian countries to accept their practices, now, through the impoverishment of these countries and forcing them to seek IMF help, the Asian countries have been forced to adopt the effete and burdensome Western concepts and practices. More than that the Asian countries have been forced to open up their markets and to allow Western takeovers of their businesses and banks.

22. It is not even true that opening up their own countries is something the ethnic Europeans believe in and practice. Obstacles have always been put in the way of Asian businesses wishing to participate in their economies or taking over their businesses. In one classic case, a club bought by Asians refuse to allow Asians to use the facilities of the club. And many brand name ethnic-European companies were prevented from being sold to Asians.

23. The so-called loss of confidence resulting in withdrawal of capital and impoverishing the Asian countries are not due to the Asian values or practices but are motivated by Western capitalist greed and a desire to dominate the Asians and stop them from developing. The ethnic Europeans will deny this of course but the fact is that today Asian countries have become economically emasculated and are definitely being dominated by the Europeans.

24. Malaysia has been independent only slightly more than 40 years. Whatever may be the way we achieved this independence, we still value that independence highly.

25. Our development since independence has been largely due to our own efforts. We have not been dependent on handouts from anyone. True our industrialisation depended to some extent on direct foreign investments. But we paid for this. We paid through foregoing taxes, something which we impose upon our people. We paid by actually providing the larger proportion of the capital

needed for these investments. We accepted low pay to ensure the profitability of these foreign-owned industries. We accepted transfer pricing because of the threat of losing these industries to other low-cost countries. Even after the pioneer status period is over hardly any foreign companies pay taxes on their profits. They somehow manage not to make profits.

26. We are not about to reject direct foreign long term investment in productive capacities. We will still welcome them. But let us be truthful. Malaysia pays a high price for foreign direct investments. With our shortage of labour much of the money gets expatriated, leaving us with very little by way of earnings.

27. If Malaysia tends to be prickly about things it is because we have reasons to be. If Malaysia tends to do things on its own it is because we have learnt that we can rely only on ourselves, our own efforts.

28. And so after appealing for international action to stop the destructive currency trade and short term investment in the stock market and getting no response, Malaysia decided to take the bull by the horns and work out our own solution.

29. When we decided to internalise our currency we were not doing something unusual. Control of the flow of money across borders is common even now among the developed countries. Malaysians have been arrested and charged in developed countries for failing to declare the money they carried with them while crossing certain borders. For the greatest country in the world there are strict regulations about how much money can be taken in and out of the country.

30. Malaysia is more liberal than most countries in this world. You could take any amount of money in and out of the country without having to fill forms or declaring anything. It is this excessive freedom which has resulted in our money flowing out of the country to be used by currency traders to devalue the currency. Foreign countries actually offer attractive interest rate in order to lure the Ringgit, leaving our banks without funds.

31. To keep the money in the country we tried offering higher interest rates. But this was not effective at all. In the meantime the high interest and low liquidity rendered our companies incapable of servicing debts to continue to do business, to make any profit. Their shares plummeted making them even less able to meet margin calls. Eventually they must fail.

32. They were ripe for plucking by foreigners. Between the rock-bottom share prices and the devalued Ringgit, foreigners could literally buy Malaysian companies for a song. But the Government remained insistent that foreign shares in local companies be limited to a certain percentage only. And so the pressure against the currency and the share prices was kept up so as to force us to seek IMF help and be subjected to market-opening conditions imposed by it.

33. It is to avoid this that we decided to enforce exchange control and to prevent Malaysian shares from being traded in illegal markets. This way the manipulation

by the so-called "market forces" would be stopped.

34. By legalising the Ringgit only within Malaysian borders the Government regained control of the exchange rate. Today the exchange rate against the US dollar is fixed at RM3.80. That with other currencies depend on their cross rates against the US dollar. At the same time the abuse of the provision for nominees was stopped by insisting that all shares must be registered with the KLSE in the names of the beneficial owners. No transaction by the beneficial owners outside the KLSE would be recognised.

35. With the Ringgit rendered valueless outside Malaysia, off-shore Ringgit has been forced to return and circulate within the country. Much of the liquidity problem has now been resolved as billions of off-shore Ringgits return.

36. Interest rates can now be lowered to reasonable levels without the Ringgit and the share market being attacked by currency traders and stock-market raiders. Businesses which could not service loans and could not borrow because of high interest rates, can now service loans from their cash-flows and budget with confidence for the future.

37. Businesses had suffered when Bank Negara reduced the period for unserviced loans to be classified as Non- Performing from six months to three months. Even in normal times this would have increased the number of Non-Performing Loans (NPL). But at a time when the economy was being forced into recession and share prices as well as other collaterals have been devalued, the reduction in the period by half increased the number of NPL considerably. Good profitable companies faced with inflated costs and an impoverished market just failed. Additionally Bank Negara insisted that if a company has a non-performing loan with one bank then its loans with other banks, even if regularly serviced must be regarded as non-performing as well. With that the number of NPL and failed businesses increased tremendously.

38. When the Assets Management Company was formed to buy out these NPL, international rating agencies immediately lowered the credit-rating of the country, making it extremely costly to raise funds in foreign markets. That way they hoped that the Asset Management Company will fail to resolve the NPL problem. It would be naive to believe that the rating agencies were only doing a good service to potential lenders. The timing of their downgrading bears all the marks of deliberate sabotage.

39. But the problem of the NPL and the liquidity crunch was initiated largely by Bank Negara' s attempt to please the IMF. Today with the exchange control and a return to more sensible financial regime, the NPL problem has been mitigated.

40. As for the stock market and the plummeting share prices, action was taken to make trading in shares more transparent. Instead of having a huge number of shares registered in the name of a few nominee companies, the KLSE now requires them to be registered in the names of the beneficial owners. Any trading within the nominee companies will not be recognised. This has stopped the

operation of illegal share markets and forced the shares to be returned to the KLSE. The immediate effect is to cause the share prices to recover to more reasonable levels.

41. Of course all the things that we have done to revive the economy have been immediately condemned as attempts to help members of the leaders' families and their cronies. It is impossible for our non-Asian foreign detractors to believe that Asian Government leaders can be honest at all. If they do anything at all for the good of their countries it must be because they are corrupt and want to help their cronies and their families. These racist views will persist. It must be remembered that these racists are the descendants of the old white-supremacist colonialists. They cannot get rid of their spots and stripes no matter how far their civilisation has advanced. We cannot expect justice and fair-play for Asians and Africans from these racists. We have to ignore them and get on with rebuilding our country. We have to uphold Asian traditions and values; traditions and values which are in no way inferior to those of the ethnic Europeans.

42. It is worth noting though that when the hedge fund Long Term Capital Management lost almost one trillion dollars, the Fed (Federal Reserve Board) ordered Western banks to bail out the Fund. Since the share holders and directors of the banks actually invest in the fund, they were actually using the banks' money to bail themselves out. Of course this is not cronyism in their eyes. But using public money to bail yourself out is worse than nepotism or cronyism.

43. It must be admitted though that what Malaysia is doing is not guaranteed to succeed. There are weaknesses and flaws and there is every possibility that we ourselves will undermine what we are doing. Of course the West will try to break us, to find fault lines which can be widened and prised apart. We must be prepared for all these, to protect ourselves and our strategies and to innovate. We must not be rigid in our approach and in solving problems.

44. Neither should we be gloating because some people have already admitted that we have done the right thing, that it is they who are wrong. We cannot afford to pat our backs too soon. Difficult days lie ahead, but we must strengthen our resolve to face and overcome every move, every attempt to frustrate us and make us fail.

45. Malaysia can prevail. We can succeed. We can preserve our independence. It is not just on the playing field that we should shout "Malaysia Boleh". We must carry this spirit, this faith in our abilities everywhere. And certainly in the management of our economy and our politics, we must believe that "Malaysia Can", "Malaysia Boleh". We must and we can manage our economy in a crisis.