

## **At The Lariba Life Time Achievement Award Ceremony**

Chicago, USA 1 September 2000

### **"MALAYSIA'S EXPERIENCE - LESSONS FOR THE UMMAH"**

I wish to express my sincere appreciation to the American Finance House LARIBA for conferring on me this Life Time Achievement Award for my role in resolving the financial crisis in Malaysia. I am particularly honoured since I understand that I am the first ever to receive this award.

2. While I accept this recognition with much humility and appreciation, in reality it is the Malaysians who truly deserve this award. It was with the sincere support, deep understanding and full cooperation of the vast majority of the Malaysians that we succeeded in defending our economy against the deliberate attempts by certain forces to destroy it. We had to do it on our own without resorting to IMF or World Bank or other countries' help. I would therefore like to accept this prestigious award from LARIBA as an honour for the Malaysian people.

3. The Islamic world today is full of paradoxes and contradictions. Despite being resource rich, we are economically poor and weak. While some of us live amidst plenty, the majority of the ummah live in abject poverty. While there are many breakthroughs in science and technology, for most of the Muslim ummah the condition is one of widespread ignorance and backwardness.

4. This is in stark contrast to the golden age of Islam, which was a period of temporal as well as spiritual achievement, an age of conquest and brilliance. The Persian empire and much of the Roman Empire fell to the Muslims. Islam quickly established a new order stretching from the Pyrenees to the Himalayas, an empire larger than the Roman at its height.

5. How low have we fallen today, compared to what we were before. It is time for the Islamic World to take a hard look at itself and decide whether we want to move forward and how we can do so. I say whether we want to move forward because a significant number of us do not want to do so and many others are afraid to oppose them because they invoke Islam as the reason for their stand and everything that they do. Unless we decide to go forward, it is useless for us to attempt to do so.

6. Like the early Muslims, who were great traders, Malaysia believes in free trade. In Malaysia, there are no restrictions against exports or imports. We also welcome foreign direct investments (FDIs) into Malaysia and we do not restrict the repatriation of profits and capital. We established an Islamic financial system to enable Muslims to enjoy the benefits of a modern financial system, but on bases consistent with Islam. We were prudent in our financial management. We prepaid our external loans, whenever we had excess funds. The Government never, in all its history, resorted to the Central Bank for deficit financing. We created a viable and vibrant stock exchange to enable Malaysian companies to raise capital easily. We embraced privatisation in a big way. We believed that the

Government has to be practical and pragmatic in its development strategy, and emulate what has been successfully implemented elsewhere. There was no point in reinventing the wheel.

7. At the same time, however, we were, like the early Muslims, original in our approach. The first has to do with growth. While we did all that is traditionally required to promote GDP growth, we also ensured that there was growth with equity, a concept that was criticised by the West, which believes in the survival and prosperity of the fittest and the most efficient.

8. The objective of growth with equity has a particular significance in Malaysia with its multi- ethnic and multi religious population. The indigenous population (known as Bumiputeras), make up about 60 per cent of the population. About 90 per cent of the Bumiputeras are Muslims. In terms of wealth and income, the Bumiputeras had always lagged behind the non-Bumiputeras. In 1970, we embarked on a New Economic Policy (NEP) to ensure that the Bumiputeras enjoy their fair share of the economic pie. The NEP was not to be implemented by taking away from the rich in order to hand out to the poor. The NEP was to be implemented by ensuring that a bigger portion of an expanded economic pie goes to the Bumiputeras. We were relatively successful in this socio-economic restructuring and in the process we ensured socio- political stability in the country. As 90 per cent of the Bumiputeras are Muslim, the NEP is almost synonymous with enhancing the economic status of the ummah in Malaysia.

9. We were also original in the way we implemented privatisation. While the standard practice in developing countries is to sell government assets and entities to foreigners, we sold Government assets and entities to Malaysians. Since growth with equity should be at all levels, able Bumiputeras were given more opportunities from the privatisation process so as to ensure that the Bumiputeras would be represented at the topmost levels. As can be expected, this was criticised by the West which saw the profits from Malaysia' s privatisation slipping from their hands. They labelled the NEP as cronyism. But we were successful in balancing the wealth of our multi-ethnic population even at the highest level.

10. We also implemented a unique system of Islamic banking, called the dual system, where a full fledged Islamic banking system functions in parallel with conventional banking system. Everyone, Muslim or non- Muslim can avail themselves of the facilities of Islamic banking. It is an approach which is accepted by everyone irrespective of religion and it did not disrupt economic activities or affect growth.

11. We also established bilateral payments arrangements (BPAs) with 26 developing countries in order to reduce dependence on hard currencies to finance trade. As a result our trade with the developing countries increased by 400 per cent.

12. Our development strategy was successful. At the end of 1996, real GDP was growing at almost 8.5 percent per annum for 10 consecutive years and it looked

like this rate of growth was going to continue for many more years. By 1997 total external trade reached more than 157 billion US Dollars, making Malaysia the 18th biggest exporting nation and the 17th biggest importing nation in the world, according to the World Trade Organisation (WTO). The Government was enjoying a fiscal surplus. The external debt was generally low, at 40 per cent of GNP. The current account of the balance of payments had narrowed from a deficit of 10 per cent to five per cent of GNP, and was expected to improve further. Inflation was at its lowest at 2.1 per cent. On the financial front, the banking system was sound as reflected in the strong capitalisation and the high asset quality. Malaysia' s saving rate, at about 40 per cent of GDP, was one of the highest in the world. The national savings was sufficient to finance 95 per cent of total investment outlays.

13. Malaysia was clearly on the path of sustained growth towards achieving a developed country status by the year 2020 when the financial crisis hit the region in July 1997. Our currency was devalued to half what it was. We implemented a number of measures to contain the downturn, but all these measures failed. Many expected us to go to the IMF for loans to tide over our crisis. But we did not do that. Calling in the IMF would have been a disaster for the Malaysian ummah, as the NEP policies are not in keeping with the IMF' s idea of free unfettered competition in which the strongest would take all. Equity is not of concern to the IMF. Efficiency, maximising profit for the already rich are.

14. We had to rack our brains for a solution which would still leave us independent. Alhamdulillah, with the Guidance of Allah S.W.T., we came out with a formula that saved the nation and the Malaysian ummah. However, before I go into the formula that we implemented, namely the selective exchange control regime, let me describe what happened in July 1997.

15. When the Baht was attacked in July 1997, Malaysia was not unduly worried. We knew that the Malaysian financial situation was much healthier than that of Thailand. In the case of Thailand, the residents had been borrowing large amounts of short-term off-shore funds to finance long term domestic projects in Thailand. This strategy made sense to them since the interest rate of the US Dollar was much lower than the Baht interest rate. However, this strategy depended entirely on a stable Baht exchange rate against the US Dollar.

16. It was for this reason that the Thai Central Bank tried to defend the Baht during the initial stages of the speculative attack on the currency. If the Thai Baht depreciated, paying debts in foreign currencies would cost more Bahts. If the Thai borrowers were unable to earn enough Bahts then a financial crisis would hit Thailand and the Baht would depreciate further, deepening the financial crisis. And so the Central Bank tried defending the Baht until it had practically no reserves left. Unable to defend further the Central Bank decided to float the Baht and this resulted in a more rapid fall. Thailand was in great financial and economic trouble from which it could not come out by itself.

17. Although Malaysia was financially sound and could even prepay its debts, the theory of contagion was invoked and the Malaysian Ringgit must also

depreciate. The currency traders therefore began to get rid of their Ringgit in order to save themselves. But actually they owned no Ringgit at all. They just saw a plausible excuse for the Ringgit to fall and they precipitated it in order to make a fast buck for themselves.

18. As you know currencies do not have their own sensors to monitor and react to the economic and financial performance of nations. They do not know whether a country borrowed too much or too little, whether they could pay or not pay debts, whether neighbouring currencies are sick with infectious disease, whether there is good governance or not, whether the Governments are not transparent, corrupt, given to cronyism or nepotism. Currencies do not know but people do, and currency traders in particular do. More than that the currency traders knew they could manipulate the exchange value of currencies simply by massive selling or buying of the particular currency. When the rogue traders saw that a currency might fall all they did was to ensure and hasten the process by borrowing that currency and selling it repeatedly. It is the selling by the traders that caused the currency to fall and to fall lower than justified by the economic performance of a country.

19. When the crisis hit Thailand, Malaysia's strong economic fundamentals were totally ignored by the rogue traders. Screaming 'contagion' they then borrowed and sold the Malaysian Ringgit in a short-selling frenzy. It was this frenzied selling that caused the Ringgit exchange rate to depreciate sharply against the US Dollar. This was accompanied by the pulling out of foreign short-term capital from the Malaysian stock market, reducing market capitalisation to a third of its original value and putting most companies in distress.

20. The leadership of the country felt helpless. We correctly identified the currency traders as the culprits behind the depreciation of the Ringgit. As can be expected, the Malaysian leaders condemned the currency traders for the rogues that they were. The Malaysian leaders were in turn condemned by about everyone, from the managers of international agencies to self-proclaimed experts and currency traders. All these people maintained at that time, that the cause of the currency devaluation was bad governance and all that was required to restore confidence and ensure recovery of the currency was to replace bad governance with good governance. These experts were convinced that the turmoil was temporary. At that early stage of the crisis, only Malaysia saw the real long-term danger in currency speculation.

21. After implementing a number of traditional measures, which failed, we decided to implement the 'unorthodox' formula of selective exchange control. These measures were actually minimal. The most important were:-

i) The off-shore Ringgit market was eliminated and currency speculators were prevented from having access to Ringgit funds. This was done by 'freezing' the external Ringgit accounts of the non-residents in Malaysian banks. The non-residents can continue to invest freely in Malaysia using their Ringgit funds, but they were no longer allowed to lend or sell their funds to others. Unable to borrow or buy the Ringgits, the currency traders were forced to stop their

speculation.

ii) The Ringgit exchange rate was fixed against the US Dollar at 3.80, which was the rate prevailing at the time control was imposed.

iii) A "12-month rule" was imposed prohibiting the repatriation of portfolio funds for 12 months. This "12 month rule" was necessary given the prevailing instability of the financial market. There was the possibility that the bad publicity following Malaysia's 'unorthodox' measures could result in massive short-term capital outflows. A 12 month restriction was therefore considered necessary. However, when the situation stabilised 6 months later, this "12-month rule" was replaced with a levy (for new funds) and subsequently even this levy was diluted further to apply only to a minimal tax on dividends in the stock market. Interestingly, when the 12-month rule expired in September 1999 there was no massive outflow. The market perception had obviously changed dramatically between September 1998 and September 1999. Foreign investors were happy with the appreciation of their shares in the KLSE and the general performance of the Malaysian economy.

22. The primary objective of Malaysia's selective exchange control regime implemented in September 1998 was for Malaysia to regain control of its economy from the currency speculators and manipulators so that Malaysians can decide the destiny of Malaysia. The measures implemented were very carefully crafted so as to optimise the positive aspects of globalisation and remove the negative aspects of globalisation. The positive aspects of globalisation that were retained were the complete freedom in matters of international trade and foreign direct investments. The liberal regime that governed trade transactions and foreign direct investment were left unchanged. The negative aspects of globalisation that were eliminated were the off-shore market for the trading of Ringgit and the free flow of short-term funds that easily destabilises the economy. Hence the selectivity of the controls.

23. How were we able to come up with this formula, while others could not? The reason is that we took the trouble to understand how the foreign exchange market works. We spent months studying the foreign exchange market, the concept of off-shore Ringgit, the motivations of the foreign exchange traders (greed and fear), the mechanism of pricing etc. Once we understood how the foreign exchange market works, it was not difficult to come out with a solution to neutralise the currency speculators.

24. At the same time, we also undertook a thorough study of how the Central Limit Order Book or CLOB, an over the counter off-shore share market, was able to trade in Malaysian securities in Singapore. This was creating problems in the Malaysian equity market, as there was much short selling of Malaysian shares through CLOB in Singapore. As CLOB was outside Malaysia's jurisdiction, there was nothing we could do to regulate it. Once we understood the detailed mechanism, we were able to put a stop to CLOB in September 1998.

25. Once the selective exchange control measures were implemented and CLOB was closed, both the currency and the share market stabilised. The Government

then took several measures to revive the economy. The interest rates were lowered and credit was increased. Government expenditure was increased by reviving projects which had been postponed during the crisis. Contracts and sub-contracts helped businesses to recover.

26. We had set up a National Economic Action Council (NEAC) in 1997, and the NEAC Executive Committee met everyday during the crisis. The Executive Committee of the NEAC gave particular attention to the operations of an asset management company (Danaharta), a bank recapitalisation company (Danamodal) and the Corporate Debt Restructuring Committee (CDRC) which were set up during the crisis to address the problems of non-performing loans (NPLs) and bank recapitalisation. Danaharta was to carve out the NPLs from the banking system so that the banks could refocus on their function of lending to revive the economy. Danamodal was to recapitalise the financial institutions and to bring up the capital strength of the banking system to a much healthier level. The role of CDRC was to provide a platform for companies and banks to come together and work out a debt- restructuring programme in an informal manner.

27. Once the selective exchange control measures were implemented, the three organisations went into high gear. By March 31, 1999 Danaharta had acquired NPLs amounting to 16 billion Ringgit, Danamodal had recapitalised 10 banking institutions amounting to 6.2 billion Ringgit, and the CDRC was fully focused on the restructuring of a number of large companies.

28. The Executive Committee of the NEAC scrutinised every aspect of the economy daily. Figures on trade performance, external reserves, interest rates, lending by banks, sales of property and motor vehicles, retail sales, tonnage and containers handled by the ports, passengers and freight at the airports, details of goods manufactured and exported, details on imports, new businesses registered and bankruptcies, unemployment and job vacancies, wages, Government projects and contracts, electricity consumed etc were all laid out daily before the Committee for discussion. Quite often specific actions were immediately taken. When motor vehicles were not selling well the Committee decided on special hire-purchase terms and ensured that the prices were right.

29. Two property ownership campaigns were held to reduce the large overhang in the property sector. The developers participated enthusiastically in the property fairs bringing in their models and brochures and equipping their booths with many sales people, while banks, insurance companies, lawyers and Government officers concerned with registration of property sales and other legal procedures were all brought under one roof. A total of 6.4 billion Ringgit of properties were sold during these two campaigns.

30. Malaysia' s experience in handling the economic and financial turmoil has a number of lessons for other developing countries, particularly the Organisation of Islamic Conference countries. The most important lesson learnt from the experience is the need to know the true causes of the downturn, how they work and the inter-relationship between different factors. Once the details become known, it is not too difficult to design a strategy to combat the forces causing the

problem. Several solutions may present themselves for any one problem and these solutions need to be debated and tried out. Back-up solutions must be ready should the chosen method fail. The implementation of strategy or solution requires hands-on action by the decision makers, at least in overseeing the implementation process and in taking corrective action.

31. Complete and continuous information on what is happening on the ground is absolutely essential. Figures, graphs and charts tell a better story than wordy reports. Explanations must be made orally by those reporting. Of course those getting the reports must be sufficiently knowledgeable on the subjects to be able to make assessments and to decide on what action has to be taken. The system is important but the people working the system are more important. In fact, the best system by itself will only deliver partial solutions at most. The people manning the system are the ones who make the system work.

32. An important lesson is that the Government must always be careful in the management of its economy. It must never allow itself to be weakened by carelessness in the maintenance of its financial and economic strength. Only with absolute vigilance can we ensure that Malaysia' s rate of growth will be sufficient to achieve a developed country status as envisaged in our Vision 2020.

33. The currency crisis is an unnecessary crisis and need not have happened if the objective of the international financial system is really to facilitate trade and other economic interactions between nations, including foreign direct investments. But the big capitalist powers want more than that. They want to promote their political agenda as well, and it is because of this political agenda that the international financial system not only permitted but at times even encouraged currency trading, a totally unnecessary activity, which destroys more wealth than what is made by the unscrupulous currency traders themselves.

34. The economic future of the Muslims is in the hands of the Muslims. True, we live in a world dominated by non-Muslims economically and politically. True, we live in a world which is not particularly fond of Muslims. But there is nothing to prevent the ummah from rising again, if the ummah wants to.

35. The most important change that the Islamic world has to make is to accept reality and to adjust to it without deserting the fundamentals of Islam. I use the word fundamental deliberately because the fundamentals of Islam were what created the centuries of the glorious Islamic civilisation. The so-called Islamic fundamentalists of today are interested only in the trappings of Islam and not the true fundamentals. Their way will only lead to more and deeper schism among the Muslims, retarding their progress and perpetuating their oppression by others. True ` jihad' is the struggle for Muslim unity, acquisition of Muslim statecraft, knowledge and skills so that the Muslims will be freed of oppression and be able to take their place as successful members of a regenerated Muslim civilisation.

36. Once again I thank LARIBA for this award.