

The National Economic Action Council

Syrian Arab Republic, 18 August 2003

"The Malaysian Experience in Nation-Building and Development and the Management of the Financial Crisis of 1997"

I would like to thank the National Economic Action Council of Syria for this invitation to speak about the Malaysian experience in Nation-Building and Development and the Management of the Financial Crisis of 1997.

2. Right from the beginning of Malaysia's independence from the British in 1957, we had focused on giving the fruits of independence to our people. We wanted them to have peace and prosperity. The independent Government had inherited a country wrecked by a guerrilla war to overthrow the elected Government and an economy based entirely on the extraction of tin and rubber for exports. The majority of the people were poor and landless. There was only subsistence agriculture. We had little experience in the administration of the country during the British period.

3. Fortunately the support for our party which had fought for independence was very strong. With this support we were able to fight against the insurgents and to focus mainly on the rural areas which had been completely neglected by the British. We began to provide land to these people under a scheme which enabled the land to be managed as big estates by competent managers. Initially we even used British estate managers.

4. But land is not unlimited and we could not provide employment for the growing number of our workforce. We decided to industrialise in order to create jobs. Not having industrial expertise, capital, management skills and knowledge of the market for manufactured goods, we invited foreigners to invest in the manufacturing industries. We gave them attractive tax incentives.

5. So successful was the strategy that today we have to accept almost two million foreign workers. There is statistically no unemployment in Malaysia. In addition our workers and managers acquired skills and expertise and today they can venture into these industries themselves.

6. Strong support for the Government party was sustained. Here I would like to point out that Malaysia is a multi-racial country. The Muslim Malays are in the majority but the Chinese, Indian and others make up almost 40 percent of the population. It is an explosive mixture because the ethnic

differences are heightened by cultural, lingual and religious differences.

7. To prevent racial conflicts we decided to govern the country together. A coalition of racial parties was formed right from the beginning. Today we have fourteen parties in the Government coalition representing practically every race and tribe. A culture of respect and sensitivity for each other was promoted. Adhering to the teachings of Islam, the Muslim majority accepts that other people believe in other religions. This Islamic tolerance has enabled multi-ethnic Malaysia to remain stable and peaceful. Development can therefore take place.

8. But the great disparity in the economic wealth of the different races lead to race riots in 1969. Following this we instituted the New Economic Policy in order to level up the wealth of the indigenous people, largely Muslim Malays with those of the non-indigenous people. This affirmative action reduced the tension between the different races so that even during the financial crisis there was no racial violence as happened in other countries.

9. The stability achieved by this and the strong support of the people for the Government party enabled the country to focus on economic development. Foreign Direct Investment was followed by ventures by Malaysians into the manufacturing industry, trade and property development.

10. Government revenue increased greatly and much of the money was spent on education and training of the workforce. Huge numbers of Malaysians were sent abroad to study science, engineering and all the other professions. A good number study religion as well. So there is a balance in spiritual and other knowledge.

11. A business friendly attitude was adopted by the Government under the Malaysia Incorporated concept. Since 28 percent of the profits of business go to the Government as corporate tax, helping the private sector helps to increase Government revenue.

12. The work ethics of the people were changed through the Look East Policy whereby the work culture of the Japanese, the Koreans and the Taiwanese were adopted. These countries had developed very fast and this is because of their attitude towards work.

13. Malaysia had always been a trading nation. Its domestic market is small and poor. The world must be its market. But trading with the world must be balanced. Malaysia imports

almost as much as it exports. Most of its imports go into the manufacture of products for export. Today Malaysian trade is worth nearly \$200 billion USD, making it the 17th biggest trading nation in the world.

14. But trading with the countries of the world can be difficult at times. Some countries obstruct the import of our palm oil and rubber. Tariff and non-tariff barriers had to be overcome. Government and the private sector have to work hard to overcome these barriers and to find new markets. The economic problems of our trading partners affect our economy adversely.

15. Now we have to make adjustments for globalisation. We cannot protect our products as we used to. Equal tariff has to be applied to products from all countries. Large foreign companies and banks will soon be able to enter our country and operate as if they are our own national companies. As our corporations are small and weak, the likelihood is that they will be swallowed up or be pushed aside by foreign companies. Our ability to control the direction of our economy would be lost.

16. Before globalisation Malaysia was doing very well economically. In 1970 Malaysia's exports was only worth RM5.2 billion equivalent to about \$2 billion USD. By 2002 exports had grown to RM354.5 billion. If Malaysia's currency had not been devalued, it would be equal to \$140 billion USD. But because of devaluation it is worth slightly less than \$100 billion USD.

17. Eighty percent of Malaysia's exports is made up of manufactured goods. Petroleum and petroleum products, liquefied gas, palm oil and rubber make up the rest of Malaysia's exports.

18. Acquisition of technology and business expertise is very important for Malaysia. Despite high duties, sometimes as much as 300 percent, Malaysians like to own motor cars. The Government decided to produce a national car using Japanese expertise. Today Malaysia produces two makes of national cars amounting to 350,000 vehicles per year, some of which are exported even to Europe.

19. But it is in the petroleum industry that the biggest progress was achieved. In 1974 the National Petroleum Company or Petronas began to operate. At first it merely collected royalty from foreign oil companies. But soon it began to acquire expertise in the production of oil, in gas liquefactions and in oil trading. It went on into prospecting and downstream into petro-chemicals and retailing.

20. Today Petronas is involved in all the upstream and downstream petroleum business and operates in over 30 countries worldwide. It is listed by Fortune magazine as the 270th biggest company in the world, but is among the top in terms of profits. It has contributed much to Government revenue.

21. We have been able to grow quite fast because we regulate the openness of our country. While we allow the world's products to be imported freely, a selective taxation policy enable us to protect our industries and nurture them. We were therefore able to ensure that certain industries do well through differential taxes. Thus while foreign investments in the electronic and electrical industries were encouraged through giving tax-free status, the automotive industry benefited from high taxes on imported completely built up cars. On the other hand import of luxury items like watches and pens attract no tax and this has improved the retail sales, increased the number of outlets and given the traders good profits. The tax on those profits is bigger than the import duty of 100 percent imposed on luxury goods in the past.

22. An important element of Malaysia's economic success is the heavy investment in physical infrastructure, which was maintained at around 20 percent of development expenditure most of the time. Malaysia's high quality infrastructure and its trainable and skilled workforce have often been cited as important factors for the country's efficient and competitive business environment.

23. To keep pace with changes in the economic environment, we took a bold step by embracing information technology. We created the Multimedia Super Corridor (MSC) in 1995, which is a 15km by 50km area where the administrative city of Putrajaya, the "Smart City" of Cyberjaya, the Kuala Lumpur International Airport and the Petronas Twin Towers are located. Several universities are also located within this area, including the Multimedia University. The MSC aims to bring together, an integrated infrastructure with all the unique elements and attributes necessary for the creation of a perfect global multimedia environment. Today the well-known multinational companies like HSBC, Sun Microsystems, Sony, Fujitsu, Nippon Telephone and Telegraph and FedEx have begun operations in the MSC. More than 900 companies have been given MSC status as of June this year, involving the creation of 21,102 jobs for knowledge workers. In 2002, total corporate expenditure amounted to RM4.77 billion. This exceeds by far the targeted 500 companies by 2003 with 30 world class corporations.

24. Malaysia's development approach has also been premised on close public-private sector collaboration. The private sector is the engine of growth, while the government provides active support and direction. Under the Malaysia Incorporated concept, the nation is perceived as a corporate entity jointly owned by both the public and private sectors. Regular meetings and constant dialogues between the public and private sectors have removed the suspicions and divisions of the past and created a harmonious environment that fosters growth and enterprise.

25. Privatisation has further consolidated public-private sector relationship. Blazing a trail that few have taken before, Malaysia made impressive strides in its privatisation programmes since its adoption in the early 1980s. Privatisation of electricity generation, telecommunications, highways, ports and airports has contributed to the accelerated economic growth in the 1990s, while reducing the financial burden of the Government. Between 1983 and 2002, a total of 471 Government entities have been privatised with gains to public sector amounting to RM149 billion. The divestment of public sector entities and the subsequent listing of 40 corporations in the Kuala Lumpur Stock Exchange accounted for a market capitalisation of RM117.4 billion or 24.2 percent of total market capitalisation in 2002.

26. Malaysia's privatisation is not for the purpose of selling Government assets to foreigners to raise funds to pay foreign debts as encouraged by the IMF. We privatise in order to strengthen the private sector. Foreigners may buy some shares when the company is listed.

27. In our efforts at material development, the country's social needs have not been neglected. Major strides have been made to eradicate poverty. For 30 years, we instituted anti-poverty measures, ranging from land development schemes to the provision of agricultural infrastructure and support services to raise the income of poor households. Our labour intensive industrialisation created jobs for the workforce and helped to reduce poverty. Education and intensive training have produced the skilled labour to meet the changing industrial environment. For the hardcore poor, special programmes for income generation and increasing the access to social amenities were implemented. By 2000, the incidence of poverty was reduced to 7.5 percent and that of hard-core poverty to 1.4 percent. This was a far cry from the situation in 1970 where one in every two households lived in poverty.

28. Efforts to raise the quality of social services and amenities enabled Malaysians to live healthier, longer and more fulfilling lives. Over the last 30 years, the population

to doctor ratio increased fourfold, the infant mortality rate declined to 7.8 per thousand, and literacy rate grew to 94 percent. Some 93 percent of the population now have access to piped water and 98 percent to electricity. The life expectancy of Malaysians increased by nearly 10 years to 72 and 74 for men and women respectively during this period, thanks to better health facilities, better nutrition and educational standards.

29. Having illustrated our successes let me add that it has not been an entirely smooth journey. Malaysia's progress was hampered by three recessions. One was in the mid-1970s as a result of the oil crisis, the second in the mid-1980s as a result of global recession, and the third in 1997/98 as a result of the East Asian financial crisis. While the recessions resulted in a temporary setback for the economy, they however acted as a catalyst for policy reorientation and reforms.

30. Before the 1997 financial crisis, the Malaysian economy was growing strongly and developing well with strong fundamentals. In the period 1991-1997, economic growth averaged at 8.5 percent. In 1997, inflation was low at 2.7 percent, there was virtually full-employment. Our national savings was high at 39.4 percent of GNP.

31. The 1997 financial crisis was precipitated by sharp reversals in short-term financial flows as well as currency speculation. The crisis nearly wiped out the economic progress that was achieved over the last two decades.

32. The Ringgit, which ranged RM2.47-2.52 to the US Dollar in January-June of 1997, fell to its lowest level of RM4.88 on 7 January 1998. The share market fell by 80 percent from 1,279 on 26 February 1997 to 262 in 1998.

33. The economy went from a growth of 7.3 percent in 1997 to a contraction of 7.4 percent in 1998. As a result of the pressure on the Ringgit, per capita income fell 30 percent from \$4,400 USD in 1997 to \$3,100 USD in 1998 and inflation rose from 2.7 percent in 1997 to 5.3 percent in 1998. Unemployment rose from 2.4 percent of the labour force in 1997 to 3.1 percent in 1998.

34. In order to bring the crisis under control, selective capital controls were imposed on 1 September 1998 and the Ringgit was pegged to the US Dollar at 3.80 on 2 September. We could have strengthened the Ringgit to its previous level but that would increase our cost of production and make us less competitive than our neighbours who could not revalue their currencies. With this we also forced the closure of a

Singapore stock market which dealt in Malaysian shares causing them to be devalued. Repatriation of funds from the sale of shares was also banned. These unconventional measures ended the crisis and Malaysia was able to regain control over its macroeconomic policies. The economy rebounded quickly, and share prices rose by more than 200 percent.

35. Three major factors led to the quick recovery of the Malaysian economy.

(i) Selective Capital Controls: With capital controls and pegging of the Ringgit, speculative activities in the financial markets were stopped and certainty returned to the traders. This financial stability also enabled interest rates to be lowered, giving relief to the corporate sector. The selective capital controls were replaced with an exit levy in February 1999 and this was finally removed in September 1999.

(ii) Strengthening Banking and Corporate Sectors: The devaluation created a serious debt problem for the corporate sector and the banks. In 1998, a special purpose vehicle called Danamodal was set up to re-capitalise the banking sector, whereas another entity, Danaharta, an asset-management company, was created for the purpose of managing and removing bad debts from the books of the banks. Both measures helped to stabilise the banking system.

(iii) Fiscal Expansion: Malaysia undertook fiscal expansion in order to boost the aggregate demand of the economy. Fiscal expansion was possible because Malaysia's debt-servicing ratio was low at 5.5 percent in 1997. This fiscal expansion turned the Budget into a deficit in 1998. The economic recovery was also aided by the strength of the world economy. Malaysia's external trade position turned around, from a small deficit of \$16 million USD in 1997 to a huge surplus of \$15.1 billion USD in 1998.

36. A number of institutions worked closely together to ensure the proper formulation and implementation of the recovery policies. The National Economic Action Council (NEAC) was established on 7 January 1998 for the purpose of identifying the basic economic problems and the appropriate policies to respond to them.

37. This culminated in the National Economic Recovery Plan (NERP), which was introduced in June 1998 as a blueprint for Malaysia's economic recovery. The NERP recommendations included an expansionary fiscal policy, an easy monetary stance and various measures to restructure the distressed financial and corporate sectors.

38. Bank Negara Malaysia, our central bank, has an impressive track record. It has been pivotal in implementing selective capital controls and played a crucial role in stabilising the banking system that was saddled with bad debts and capitalisation problems.

39. Danamodal was formed in August 1998 to ensure that the banks are sufficiently funded. This has been successfully done such that no more capital injection into a financial institution was necessary since 1999. Danamodal's outstanding investment has fallen from \$1.8 billion USD in 10 banks at its inception to \$0.6 billion USD in three banks by the end of 2002, as a result of divestment or repayment. Danamodal shall cease operations at the end of 2003.

40. As for Danaharta, it was established in June 1998 to remove bad debts from the books of the banks. Danaharta has also made good progress in its debt recovery programme and it is on track to wind up its operations by 2005. In the five years of its operation, Danaharta has resolved all 2,905 loan accounts acquired or managed by them. Their projected recovery rate is 57 percent, which is high by international standards.

41. The Corporate Debt Restructuring Committee (CDRC) did well in strengthening the corporate sector by providing a platform for borrowers and creditors to work out feasible debt restructuring schemes. Since its inception in July 1998, the CDRC has resolved 48 cases with debts amounting to \$13.8 billion USD. They represented 65 percent of the cases brought before it. Having completed its job, the CDRC was dissolved on 15 August 2002, thus concluding an important debt restructuring effort of the country.

42. The banking system was consolidated and strengthened. From a fragmented sector of 71 banking institutions the banking system has now been consolidated into 30 banking institutions under 10 major domestic banking groups. The banking groups are now well positioned to realise the synergies of the larger merged organisations. This has helped to improve efficiency and enable the banks to meet the competition posed by foreign banks.

43. For Government-related companies and companies of national strategic importance, improvements were made by the Government by bringing in professionals into corporate management and subjecting the management to greater transparency and controls. We have also revamped many government companies as part of the overall effort to strengthen the corporate sector.

44. Malaysia today is among the regions' best in corporate governance, with excellent regulations, open flexible markets

and an active community of relevant non-Government organisations.

45. As a result of its policies, the Government managed to stabilise the Malaysian economy. Consequently, confidence among consumers and investors were greatly improved and the economy rebounded. Real GDP, which contracted by 7.4 percent in 1998, rebounded with a growth of 6.1 percent in 1999 and 8.3 percent in 2000. The external trade account turned in a surplus and has remained in surplus for 67 consecutive months from November 1997 to May 2003. Foreign reserves rose from \$15.6 billion USD in 1997 to \$ 37.1 billion USD in June 2003, sufficient to finance 5.8 months of retained imports. Inflation has dropped from a high of 5.3 percent in 1998 to 1.8 percent in 2002.

46. However, since then, the international economic environment has become increasingly challenging. Excess US inventory build-up in early 2001 was followed by the September 11 incident, and the Iraq War and the Severe Acute Respiratory Syndrome (SARS) epidemic in early 2003. The Government had tried to cushion the economy with two stimulus packages, the first one in March 2001 (0.9 percent of GDP) and the second one in September 2001 (1.3 percent of GDP). These managed to keep the economy out of recession with a growth of 0.4 percent in 2001 and 4.2 percent in 2002.

47. In an effort to stimulate private investment, the Government announced new measures for the capital market in March 2003 and the economy in May 2003.

48. While the Malaysian economy has diversified itself into manufacturing and services, growth has been reliant on external demand and investment. The competition for foreign direct investment has become tougher as China and other large low-wage countries in Asia and South America have become increasingly aggressive in attracting FDI. Additionally, the world today is facing increasing risks and uncertainties such as the September 11 incident, war in Iraq and outbreak of SARS. All these have severely affected the global environment and the prospects of an earlier world economic recovery.

49. In response to international uncertainty and to strengthen the country's long-term fundamentals, Malaysia needs to reposition the economy. To achieve this, we introduced four broad strategies in May 2003. The first aims to promote private investment while the second will strengthen the nation's competitiveness. The third strategy encourages developing internal sources of growth to reduce our dependence on the external sector. These include the promotion of private education and health, tourism and the logistic chain. A plan

is only as good as its implementation and that is why the fourth strategy of the new economic package is to enhance the effectiveness of the delivery system. This involves ensuring expediency in a host of business enabling functions.

50. The Malaysian experience is of course based on its unique assets and environment. But many of its strategies can be modified and adopted by other countries in order to achieve economic development.

51. The problems are many and the solutions are numerous. There is no one single thing that can ensure economic growth and development for any country.