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EVENT: THE LUNCHEON MEETING ORGANISED BY NIKKEI

VENUE: IMPERIAL HOTEL, TOKYO, JAPAN

DATE : 16 NOV 1998

TIME:

" THE EXCHANGE CONTROL POLICY OF MALAYSIA "

Once again I would like to thank Nikkei for inviting me to address this luncheon meeting. I would like to talk about the Exchange Control Policy of Malaysia.

2. About a year ago I spoke in Hong Kong on the Asian financial crisis and the need to regulate the activities of currency speculators to protect developing countries from having their limited wealth destroyed. Mine was a voice in the wilderness and my views were regarded as ridiculous in a world that was moving rapidly in the direction of ever greater globalisation, deregulation and liberalisation. When borders and the obstacles against free trade were being dismantled how could anyone talk of regulating the free flow of capital worldwide? Regulation would stifle international investments by the rich which would help the capital-poor countries to grow.

3. Malaysia of all countries should not talk of obstructing capital flow because it had benefited greatly through Direct Foreign Investments. Not only was Malaysia's industrialisation the result of investments by foreigners, but the Malaysian Stock Market, the biggest in Southeast Asia was enriched greatly by massive injections of capital from the rich countries. The capitalisation of the Kuala Lumpur Stock Exchange rose to around USD350 billion following road-shows conducted by Malaysian companies to attract institutional investors from the West. So why should Malaysia talk of curbing the activities of foreign funds, including the hedge funds?

4. Malaysia is no more capable of predicting the future than anyone else. No one actually predicted the extent of the economic turmoil which now engulfs the whole world. No one can claim they expected that the financial problems of Thai banks would spread so widely that today not only is the whole of East Asia affected, but Russia and Latin America are also affected. Even the great United States of America is not beyond being affected by the turmoil which began in East Asia as demonstrated by the effect of massive losses by the Long-Term Capital Management Fund in their investments in, affected countries.

5. As I said, Malaysia did not foresee the extent of the damage that could be caused by the currency trading of the hedge fund managers. Malaysia was concerned largely with the possible effect on the development objectives of the country.

6. Many experts talk about fundamentals, about confidence, about herd instincts and contagion effects. It was suggested that sound fundamentals and good transparent financial management would prevent contagion and the flight of capital. Countries of Asia would do well to reform their financial system in order to create confidence among the people who control the flow of funds.

7. Malaysia was and is not convinced that currency traders do business based on their confidence or lack of it in any country. We believe they are motivated by pure greed, by their desire to make as much profit for their funds as they can, irrespective of the cost to others. If they have to destroy the wealth of countries and the livelihood of poor people they would not hesitate to do so, if there is good profit to be made.

8. We believe, and we said so, that currency traders are not speculators but are manipulators instead. The difference is that while speculators depend on their perception of the trend of the market and they place their bets accordingly, manipulators know exactly what direction the market would take because they have the capacity to manipulate the markets. Thus if they want the currency to be devalued, they can do so simply by repeated selling of that currency until the target is achieved.

9. Of course Central Banks may defend the currency by buying it repeatedly. But the capacity of the Central Banks is limited by the reserves they hold. For developing countries like Malaysia the usual reserve would be around USD20 billion. But hedge funds can leverage their funds by twenty times through credit made available by giant international banks. In the case of the Long-Term Capital Management Fund, for their

USD4 billion, they were able to borrow USD120 billion and leveraging on this they obtained credit amounting to one trillion dollars. Between the hedge funds which are involved in currency trading, they hold about USD180 billion. Leveraged by twenty times even, they would have at their disposal USD3.60 trillion. No Central Bank can match them. Defending a currency under attack is an exercise in futility.

10. But hedge funds are not the only ones involved in currency trading. The big banks worldwide have made currency trading their principal activity, their main source of profits. Clearly these funds have unlimited resources to manipulate the market. They can buy or borrow any amount of any currency and sell to devalue. They are in a position to devalue any currency at will. They are not dependent on the vagaries of the market at all.

11. If they want to short sell any currency they can do so. And of course they can literally determine how much profit they want to make for themselves. Their investors believe that the size of the funds they invest in will ensure that they can never lose. How can they when they can revalue or devalue according to the profit making plans that their Nobel laureates had designed.

12. Clearly these funds and their managers have tremendous power, power which far exceeds those of Governments and countries. This power is real and the exercise of this power not only bring profits for them but can actually force Governments, affected or not, good or bad, to cringe and kowtow before them. They, the funds' managers can actually force the Governments of the countries they attack to submit to their whims and fancies. In fact they can and they have brought down Governments.

13. With this enormous power, it would be a miracle if they do not become corrupted. We repeat ad nauseam, power corrupts and absolute power corrupts absolutely. The hedge funds and the great banks of the world have absolute power and they are therefore absolutely corrupted. They would abuse that power to satisfy their greed. The LTCM debacle has proven this to be true.

14. This was what Malaysia saw when we condemned the hedge funds and currency trading. We saw shadowy figures in the world's financial centers wielding enormous power without any rule or regulation or morality. We saw them exploiting developing countries like Malaysia which had reached a certain stage of development and is therefore rich enough to make their kind of financial abuse profitable to them. And since no one supervises these funds, and there are no regulations, rules or laws for them to submit to there is no limit to their quest for quick and limitless profits. Countries and people must suffer as a result.

15. That was what we saw and it was this that frightened us. It was the possibility of unending suffering from the destruction of what we painstakingly build every time. Human greed can only be curbed by human society. If society gives a free hand to powerful greedy individuals they will destroy everything in order to satisfy their lust for wealth and power. They will destroy society itself.

16. When Malaysia urged either the abolishment of currency trading or regulating it we had not taken into account the role of the IMF. This relic of the defunct Bretton Woods system has now become an instrument of the rich to dominate the poor. The IMF is supposed to promote the restructuring of the financial system of the developing countries in order to improve their economic performance. But the remedy it proposes seems more likely to destroy the economies than to improve. In the end the banks and corporations will fail and their Governments bankrupted. Knowing this the clients of the IMF would refuse to comply but if they refuse the currency traders and the stock-market raiders would devalue the currency and the shares. Thus the developing countries would comply with the demands by the IMF including opening up the markets. With the shares scraping bottom and the currency devalued, the foreign banks and corporations would be able to buy up the banks and all the businesses at rock bottom prices.

17. Between the IMF, the currency traders and the big foreign banks and corporations, between them they would be able to buy up all the worthwhile businesses in the developing countries under IMF control. Once they have control of these businesses, it would be an easy matter to strip the assets or to refloat the economy and control the countries completely.

18. Maybe Malaysia is paranoid but what has happened today has shown that it has reasons to fear, to be paranoid even.

19. Malaysia appealed to everyone to regulate currency trading. Most laughed at Malaysia for not understanding the workings of the world financial system, for not understanding herd instincts, the role of confidence etc. A few, and this include the IMF, humoured Malaysia, promised to study and then did nothing. Time was running out and the Malaysian currency and shares were falling rapidly. In neighbouring Indonesia the currency had fallen through the bottom. Could Malaysia wait while the IMF and others fiddled?

20. Believing that the world, especially the rich and powerful would not help, Malaysia decided to do things on its own. It toyed with the idea of adjusting wages and prices to reflect the exact level of devaluation. Thus if the currency is devalued by 20 percent, then all wages and prices would be increased by 20 percent. This way the people would not feel the effect of the currency devaluation. But the implementation of this solution would be too complex.

21. The best way was to isolate and insulate the Malaysian currency from the other currencies of the world. The Ringgit should be legal tender only within Malaysia. Any Ringgit found outside Malaysia would be prohibited from being brought back into the country. This makes the Ringgit outside Malaysia completely worthless.

22. Of course most of the Ringgit outside is not in the form of cash. Such offshore Ringgits would have to be reflected in Vostro accounts in Malaysian banks. Any offshore transaction must involve transfers from one Vostro account to another Vostro account in Malaysian banks. To stop the offshore Ringgit from being lent, bought or sold and so to have value abroad, transfers from one Vostro account to another is forbidden. Thus lending or sale of offshore Malaysian Ringgit will not be acknowledged in Malaysia. Since the Ringgit is not legal tender outside of Malaysia, owning Malaysian Ringgit abroad becomes quite meaningless.

23. For the first month the offshore Ringgit may be transferred back to Malaysia. After that it may not be transferred at all thus rendering the offshore Ringgit useless and without any value.

24. Within the borders of Malaysia the Ringgit remains legal tender and can be used for all transactions including the purchase of all foreign currencies. The exchange rate of the Ringgit was fixed at RM1.00 to US26 cents or RM3.80 to the USD1.00 and to the Dollar equivalent of all other currencies. Since the exchange rates between the US Dollar and other currencies fluctuate, obviously the exchange rates between the Ringgit and other currencies except the dollar will also fluctuate. But this is not much of a problem as changes can be made to the exchange rate against the dollar in order that the competitiveness of Malaysian products will be maintained. However this will not be done until every avenue for ensuring competitiveness has been explored and applied. A fixed exchange rate can only be regarded as fixed if it remains at the level for a considerable length of time.

25. Besides the exchange rate of the Ringgit, Malaysia has also insulated its stock exchange from being manipulated by foreigners who care nothing for the well-being of Malaysian companies or its people in their quest for quick profits from capital gains. Today, as a result of the measures we have taken, the share prices reflect the performance and asset value of the businesses more closely. Other measures have been taken to prevent manipulators from deliberately bankrupting the businesses so they may buy them cheaply, probably in order to strip assets.

26. We can expect the greedy foreign capitalists and their collaborators in their Governments and other institutions to try to undermine the measures we have taken. They would want to force us to submit to them again. But so far we have been able to withstand their attempts.

27. In the first month of the implementation of the new strategies the performance of the Malaysian economy has been quite encouraging. Reserves have increased and business has generally improved. The slide into contraction has been slowed. Foreign direct investment has not been adversely affected. Investors, both foreign and local are finding that the fixed exchange rate makes forward planning easier and more reliable. Business needs predictability of the future environment and the fixed exchange rate provides this.

28. Exchange rate control is not the same as control on capital flows. Capital can flow in and out of Malaysia without restriction. In even the most developed countries the movements of currency in and out of the country are recorded and controlled. Of course many developing countries require such movements to be declared. So what Malaysia has done is only to enforce currency movement regulations so as to be able to control the exchange rate.

29. Because capital can flow in and out of Malaysia, foreign investments and foreign trade are not affected. Trade settlements have to be in foreign currency because the Ringgit has no value outside Malaysia. Foreign currency must be changed into Ringgit to pay for all transactions in the country. To take out money the Ringgit must be changed into foreign currencies. As Malaysia has a large trade balance and minimal foreign short-term loans there will be no shortage of foreign currencies. Since the implementation of the fixed exchange rate and the enforcement of the rules regarding the movement of money in and out of the country there has been no major problem.

30. The allegation that Malaysia is isolating itself from the international community is completely without basis. Malaysia is a trading nation. It just cannot isolate itself if it wants to trade. A fixed exchange rate

facilitates trading. Hedging is no longer as necessary as before and this reduces the cost of trading in goods and services. Long term contracts for supply or construction can be entered into in Ringgits without having to worry that it may lose its purchasing power during the period of the contract.

31. There is of course a need for Malaysia to conserve foreign exchange. Imports must therefore be limited to essentials and exports enhanced. A "Buy Made in Malaysia" campaign has helped a lot in slowing the outflow of funds. Travel abroad is possible but funds taken out in foreign currencies have to be limited. The limit is reasonable and not too restrictive. Malaysia is mindful that it has a medium sized airline and the viability of this airline depends on the number of Malaysians travelling in and out of the country. We cannot restrict travelling too much.

32. Clearly the control of the movement of money and the restriction of the Malaysian Ringgit going out of the country is a limited exercise which is not noticeably more than the controls by many countries, developed and developing, over the movement of money crossing their borders. The main effect of Malaysian restriction on currency movement is to prevent the Malaysian Ringgit from being traded by currency traders. To them the Ringgit has zero value simply because to trade they will have to have the Ringgit outside Malaysia. Any Ringgit outside Malaysia will not be allowed to be brought back into Malaysia in whatever form. Since the Ringgit is legal tender only in Malaysia, not being able to bring the Ringgit back into Malaysia makes it useless. Therefore the main losers as a result of Malaysia's control over the movements of the Ringgit are the currency traders.

33. But who gains? The Western detractors and their media are quick to broadcast that the beneficiaries are the cronies of the Government of Malaysia, as it is an Asian Government.

34. The Government of Malaysia has no cronies. We believe in cooperating with the private sector simply because the revenue of the Government comes largely from corporate taxes. Twenty-eight percent of the profits of the private sector belong to the Government. In helping the private sector to make profits we are actually helping ourselves, the Government.

35. The measures taken by the Malaysian Government will benefit the whole business community, local and foreign. It will also benefit the indigenous (Bumiputera) businessmen, but not appreciably more than the non-Bumiputera businessmen. We are in the process of redistributing wealth between the different communities in order to eliminate racial jealousies. We will continue to do this with apology to no one.

36. If you come to Malaysia you will not believe that we are facing economic turmoil. There is an appearance of business as usual everywhere. No one is starving. People are not searching for food in rubbish heaps. The shopping complexes and restaurants are doing good business. There is minimal unemployment.

37. The reason for our appearance of normalcy is due to our very strong fundamentals from the very beginning. We have been able to manage the currency and share market depreciation fairly well. And now with measures we have taken to control the movement of the Ringgit and the share market we are less affected by outside manipulations. We think we are already seeing the economy turning around. We think we are on the road to recovery.

38. In business the most important thing is stability and predictability. Business takes time to give a return. The measures taken by the Malaysian Government are calculated to achieve stability all round; political, economic, financial and social stability for now and for the foreseeable future. Since they will do this and are already doing this, they should be welcomed by the business community, whether foreign or local.

39. The only people who will not benefit from the measure taken by Malaysia are the currency traders. We are now seeing how destructive these people can be. If they lose I don't think we should be sorry. It is their abuse of currency exchange which has caused the present economic turmoil in the world. They deserve to lose.

40. I welcome the interest shown by this forum in Malaysia's measures to deal with the currency turmoil caused by unregulated trade in currency. I hope that you will now have a better understanding and appreciation of what Malaysia has done. We may succeed or we may fail but whatever happens there will be a lot of lessons in financial management of a country that will be useful for everyone.