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**SPEECH BY
THE HON. TUN DR MAHATHIR BIN MOHAMAD
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“Application of Economics Knowledge in the Real World”

I would like to thank the Faculty of Economics, University Utara Malaysia for this invitation to speak on “Application of Economics Knowledge in the Real World”. I hope I can do justice to this complex subject.

2. There was a time when knowledge was acquired for the sake of knowledge. But even then whatever knowledge was acquired would eventually result in some application.

3. In the pragmatic modern world knowledge is sought not for itself but in order to contribute to the wellbeing of human society. Certainly knowledge of the workings of the economy is intended to increase wealth and enhance the quality of life, when it is applied.

4. Unfortunately economics is not a precise science. Thus we joke about economists who are fond of saying “On the one hand, and on the other hand”.

5. I am reminded of the doctor in the days before ultra-sound who ensured that his diagnosis of the sex of the unborn child would always be right. He would tell the expectant mother that she would be having a boy. But unseen by the mother he would write “girl” on a piece of paper and put it in a convenient hiding place in the house. Should the new-born turn out to be a girl and the mother complain that he had made a wrong diagnosis, he would protest and insist that he had diagnosed correctly as he had noted that it would be a girl. He would then say that he had written it down so as not to forget, and had hidden it somewhere in the house. And sure enough he found the paper and showed that he had diagnosed the baby was a girl. He has never been wrong.

6. Economists are like this doctor. They want to be sure that they are always right. They hedge. And we can never fully trust their forecasts. But economics is still a useful discipline and can help us in managing what you call the “real world”.

7. What is the real world? It is as we know a world divided between the rich and the poor countries, divided by colour and creed, and by religions. A single world of the same people with the same values does not exist. And because of that a single economic formula cannot be applied to the whole world. And if you try then the results would be very different for different peoples and different countries. The result would be inequity and chaos.

8. This is the first bit of economic knowledge that we must sincerely admit. Unfortunately many won't accept this truth. Thus currently the great economists of the rich ethnic European countries believe that free trade and unrestrained capitalism will create heaven for everyone because it has done so for America.

9. I am reminded of a cartoon character from the Li'l Abner series (no longer available now) called General Bullmoose. He was fond of saying that what is good for General Bullmoose is good for everyone. This is a parody of the declared philosophy of General Motors of America that what is good for General Motors is good for the United States. And since the United States is the world to the Americans, what is good for General Motors is also good for the world.

10. Accordingly if free trade and unreformed capitalism are good for the US they must be good for the world. But they are not, at least not completely.

11. Imagine if the whole world submits to free trade and capitalism, then the free traders and the capitalists can of course go anywhere unrestricted. Who would they be? Not Malaysia's petty traders and relatively tiny banks. The free trade and unrestricted capital would be those of the giants from the rich countries. It wouldn't take them long to wipe out the competition and monopolise everything in the world.

12. There was a time when America saw danger in monopolies. When Rockefeller tried to monopolise the oil business, the US Government enacted anti-trust laws to prevent him from doing so. They knew that once Rockefeller monopolised the oil business he could hold the whole country to ransom.

13. But now the World Trade Organisation seem bent on creating a situation of oligopoly where in every business there would be only a few giant players. The small and the inefficient should be wiped out for the good of the consumers. Since free competition is the essence, there would eventually be world monopolies in every business. The world would be beholden to these monopolies. Already we are all drinking Coca Cola and eating MacDonald's

hamburger. We are not likely to stop eating nasi lemak or roti canai. But there will be more who will be breakfasting on Kelloggs cornflakes, marmalade and butter. There will not be a nasi lemak franchise world wide, that is for certain. Nor roti canai.

14. With other products, some will disappear completely being replaced by powerful brands and products. In the automotive field we no longer see such well-known makers as Austin, Morris, Hudson, Taunus etc. Now we only see Daimler-Benz, Chevrolet, Toyota and Hyundai.

15. Banks are a favourite target for monopoly. Malaysia had forced the amalgamation of its 58 or so banks into 10. But they are still too small to compete with giant international banks like Citibank, HSBC or Standard Chartered. In open competition can Maybank survive if attacked by Citibank etc? Very unlikely. The international banks can afford to lose in Malaysia because they are making money worldwide. But the local bank will fold up if they lose locally. They are not making money elsewhere.

16. Why do we need giants in business? The economists are fond of the economies of scale. The bigger you are, the lesser would be the waste. There would be no need to repeat anything. One process or one formula can be used for all the operations of the corporations.

17. In the automotive field the highest cost is in the development of new models. If the production is big then the same components can be used by all models. The platform, the engines, the transmissions would all be the same. If the company produces 10 million cars then 10 million of all these components can be produced by automated machines rapidly. Small producers cannot afford to buy such costly machines. They have to rely on human labour with imperfect products. Their cost per unit would be high and their products faulty.

18. And so small automakers such as Proton have been urged to just stop trying to produce cars and sell the company to the giants. Logically, after takeover by the giants, in order to enjoy economies of scale, the national car should cease to be produced. Using platforms, engines and transmissions of the giant automaker, a car would be produced which is not designed, tested and built in Malaysia by Malaysians. Perhaps the car would be of better quality but if it is not a Malaysian effort why bother to produce this apology of a Malaysian car. Why not simply assemble the cars of the parent company and save cost. The consumers will get a high quality car at low prices.

19. To carry this logic further why not just import these cars, designed and built in the country with the lowest cost in engineering and labour. The consumer will enjoy quality cars of impeccable brands at the lowest cost.

20. It is assumed that a giant company will not fail. But Daimler-Benz failed to turn around Chrysler and Mitsubishi Motors. Enron and Arthur Andersen cheated, Global Crossing, World.com and a host of other giant corporations which straddled the world, all failed.

21. Size is no guarantee of success. They can be very inefficient and they can also cheat. And when they do the cost is very high. They are likely to bring down with them others who had hitched on to their wagon.

22. Retailing has also gone the same way. No more M.S. Ally or Naina Mohamad and their little provision shops. Supermarkets knocked them out. But supermarkets in turn have been knocked out by Hypermarkets. Someone will soon develop a new concept, give it a new name, and the hypermarkets will become history.

23. We can no longer drop in for a chat with the proprietors of the friendly neighbourhood store or newsagents. The little automobile component makers will also disappear. The proprietors will be working as supervisors in the factories of the giants, if he is lucky. Or he may be among the unemployed as all manufacturing is done in the lowest cost countries.

24. The imports will be cheap. But Governments still need to fill their treasuries. Taxes will increase the prices of everything, including the motorcars. Since the local industries have been shut down, workers and managers are likely to be unemployed. They would not be able to buy the cheap cars and other things. Their not being able to buy will reduce consumer spendings, reduce wealth creation and the taxes that the Governments depend on.

25. Additionally local skills and engineering capabilities will be eroded and will disappear. This is a likely scenario resulting from rampant capitalism and the elimination of small businesses.

26. It is important to remember that every economic solution has a down side to it. In the past unfettered capitalism resulted in a backlash in the form of socialism and communism. It was believed that if all the means of production are owned by the Government, then 100% of the profits will accrue to it. This can then be shared equally and fairly by the workers and the managers. The disparities in the income between the capitalist owners, the executives and the workers would be removed.

27. But nationalisation of privately owned means of production impoverished the rich so that the market for expensive products disappeared. The only market would be for the cheap products. But the margins from these would not give the Government much profit. The workers need to have higher incomes, higher than when they were employed by private capitalists. Higher wages mean less profit for the Government.

28. Taxes would be low as they will only be paid by salaried workers whose salaries are small. With low taxes the Government cannot build needed utilities, or pay Government employees adequate wages. The standard of living can actually fall.

29. Equal wages act as disincentive for workers and managers alike. Yet increases in wages would just increase the prices of all the products. The increases in income would not be able to purchase any more than before.

30. The only way to earn more profits for the Government owned enterprises would be to export to rich countries. Invariably these are capitalist countries. Dependence on capitalist countries imply admission that capitalism is necessary. In fact in order to earn a profit by selling to the capitalists, the workers in the communist and socialist countries would have to be paid low wages. This is not too different from the capitalists exploiting the working classes.

31. It took 70 years of suffering by the workers for their leaders to realise that the economic theories of Marx did not work in the real world.

32. In Malaysia we are neither socialists nor capitalists. We are really pragmatists, choosing any system that will work for our society. There is free trade but rules, regulations and laws ensure that free trade doesn't result in the exploitation of the workers and the markets of capitalists. We have trade unions and the right to industrial action but workers and their union may not hold general strikes, may not use violence etc. They are encouraged to seek arbitration. Once a case goes for arbitration, no industrial action by the unions or the employers may be taken. And there are other regulations which stop unions from using industrial action for political reasons.

33. Although Malaysia is not socialist or communist, the communist style economic planning is copied, certain industries are Government owned and operated, and affirmative action practised.

34. But the Government is very friendly with private businesses and has privatised many Government companies, functions and utilities. Corporate taxes have actually been reduced.

35. The Malaysian economic management does not follow any ideology or even conventional economic theories. It is much more free than the capitalist economy and not as rigid as the socialist or communist economy. If an approach fits its needs at the moment, it is adopted. If later it does not fit or does not deliver, it is dumped in favour of new approaches or reversed completely or some mixture of the ideological approaches of conflicting ideologies adopted.

36. Our knowledge of economies and finance is of course not as deep as the experts. In a way this is good for it enables us to do the unorthodox thing. The management of the currency crisis is certainly not conventional. However, it is not just about blindly going against conventions. It was the result of carefully studying the situation and the causes and then devising a way to counter them.

37. The currency crisis was due to deliberate actions by the currency traders to devalue the Ringgit. This was amplified by over the counter trading of Malaysian shares by CLOB (Central Limit Order Book), the Singapore illegal stock exchange.

38. Selling the Ringgit devalues it. Foreign investors in Malaysian shares feared the value of their holdings would depreciate along with the Ringgit. They then sold their shares to convert the proceeds into foreign currency (dollars) and to take them out. Selling the Ringgit realised through selling off the shares caused further devaluation of the Ringgit.

39. With devaluation the cost of imports in Ringgit went up. So did the repayment of loans originally denominated in Dollars or Yen etc. The economy was going into a tailspin.

40. The International Monetary Fund's (IMF) advice was to increase interest rates, and reduce Government spending to achieve a surplus budget. Increasing interest rates would undermine business, reduce their profits and reduce Government revenue. To achieve a surplus budget when Government revenues was greatly reduced meant cutting out on Government salaries and development expenditure. This would kill businesses which were dependent on the Government. And Government revenue would decrease further. Clearly a vicious cycle would be created which would end up in bankruptcy for the Government and country. To overcome this the Government would have to borrow from the IMF. Once this happen the country would be in the clutches of the IMF for a very long period, if not forever.

41. Clearly the currency trading and CLOB must be stopped. We did just that by ourselves because appeals to the IMF to stop currency trading fell on deaf ears. And Singapore was not going to stop CLOB.

42. There remained the question of determining the exchange rate of the Ringgit. If it was too strong we will not be able to export in competition with our neighbours. If too weak the cost of imports would hurt Malaysian consumers. In the end the rate was fixed at about half-way between the higher value of the Ringgit and the lowest value following the manipulation by currency traders.

43. We now know that the actions taken by the Government worked. The economy and the finances of the country recovered.

44. The actions were based on intimate knowledge of the actual workings of the economy at that point in time. There were predictions that Malaysia's economy would collapse, but it did not. The recovery was strong and has remained so to this day. Many experts still urge the country to float the Ringgit. It seems that only through this mechanism can the value of the Ringgit be determined. But is it true? One must not forget that the Bretton Woods agreement was about fixing currency value against gold. It was not about floating the currency. The float was due to pressure by speculators who obviously could not speculate and make money from predicting the movements of exchange rates. Why should the world be bound to a system for the good of currency traders if it can destroy the economies of whole regions, and of the world.

45. What we did in 1998 was to apply economic knowledge to the management of an artificially created crisis. It was not recalcitrance or pig-headedness that decided the Malaysian Government on that course of action. It was the result of a very intense study of the causes and effects of the economic and financial crisis. Once the causes were removed, the negative effects stopped.

46. This is the real world. We can learn from the experts and we should appreciate conventional wisdom. But standard formulas cannot be applied to all situations because the situations may not be standard.

47. Faced with a real world crisis, the actual situation, the causes and effects must be carefully analysed and intensively studied. The principle that must be borne in mind is that causes must be removed if the effects are to be negated.

48. Admittedly this is a medical doctor's approach – treat the disease, not the symptoms. The disease during the currency crisis was the manipulation of the currency by the currency traders and the short-selling of shares on the CLOB. Once the currency traders were refused access to the Ringgit and the transfer of shares on the CLOB were refused official recognition, the disease was cured.

49. Knowledge is only useful if used intelligently. In the real world, standard procedures have only limited usefulness. It is the intimate economic knowledge of a particular situation that counts if management is to yield positive results. We need academic views but we must temper it with the realities of the market.
