

**SPEECH BY THE HON TUN DR MAHATHIR BIN MOHAMAD
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“The Impact of the Increasing Oil Price on East Asian Economies”

I would like to thank the organisers for inviting me to talk on the “Impact of the Increasing Oil Price on East Asian Economy”. I hope you wouldn’t mind if I talk about something else which may not be quite what you may expect. I want to keep up my reputation for not being conventional.

2. In 1973 the world experienced the 1st Oil Shock. Oil prices shot up more than 400%.
3. Today we have forgotten the impact of this 1st high increase in oil price. We had adjusted.
4. Then there was the 2nd oil shock due to the crisis in Iran. I don’t think many of us remember the impact of this 2nd Oil Price increase. Roughly the price increase was only 100% above the purchasing price in 1978, registering 35 US Dollar per barrel. In the 1st Oil Shock the price increase was 400%.
5. The world economy, after some consternation, fairly rapidly adjusted to this minor shock and then growth continued.
6. The talks about alternative fuels subsided. The switch to small cars and the compacts did not really catch on. The rich countries began to build fuel-efficient but bigger vehicles. Today we use the big four-wheel drive SUVs with engines of 3000 to 5000 c.c. And oil consumption increases every year. The number of petrol engined vehicles on the roads increase yearly as more and more people become able to afford cars.
7. Talks about substitute fuels is hardly heard now. Instead the search for oil has been stepped up as the high prices make marginal fields and deep water exploration and production economically viable.
8. More countries are finding oil within their jurisdiction, are exploiting their reserves and are becoming rich. New players have entered the oil business to get a share of this highly profitable industry.
9. Oil is traded in US Dollar. As huge funds in US Dollar accumulate for the producer countries, the need to recycle these huge US Dollar reserves becomes acute. Many take the easy way out – investing in US Dollar Bonds at low interest rates.
10. Effectively this amounts to lending money to the US. Confident that the inflow of dollars would continue, the US, especially under Bush, spent beyond their means. Today US deficit is estimated at more than 10 trillion dollars.
11. With its need to import and consume more petroleum and more of everything, there is no way for the US to pay its debts, even though it may earn some money from lending out the funds deposited with it by the countries of the world. There simply is too much US Dollars within the world’s financial system. And so the deficit of the US will continue to grow, for such is the size of its debt that it cannot pay even the interest from earnings. It will have to repay from the loans it receives. It will continue to need the loans to finance its bloated budget. Reducing taxes merely aggravates the situation.

12. In the meantime the US involved itself in expensive foreign adventures in the hope of getting the oil it needs at cheap prices. The strategy to take over the world's 2nd biggest oil country backfired. Instead of getting the oil, it created such uncertainty that the supply of oil in the market actually diminished in a situation where the world is consuming more and more oil. At the same time the US needs more money for its army of occupation, which actually has to continue to fight an expensive anti-guerilla war.

13. Knowledge of the financial weakness of the US affected the value of the Dollar. Where before it was 80 cents to one Euro, now it is 130 cents to one Euro. The depreciation of the Dollar has reduced its value by more than 50%. Acceptance of payment in US Dollar would mean receiving less than half of the price quoted in US Dollar.

14. Obviously if the oil price in US Dollar remained the same, the producers would actually be short changed – getting paid less than half the price they used to get before the US Dollar devalued. To get back their money's worth they have to increase the price.

15. At the same time China came into the picture. Its rapid growth created unprecedented demands for oil. To meet the needs of its 1.3 billion people, China is prepared to pay higher prices. In any case the Renminbi is pegged to the US Dollar and has depreciated along with it. Like the US, if China pays the old oil price, it would be short-changing the oil producers. Since China is prepared to pay more, and the pegged Renminbi still keeps Chinese products competitive in the world market, China has no reason to help depress oil prices. And so the oil price gets another push upwards. For China it is simply a correction for a distorted oil market. Its cost will not be much affected. Indeed for China it is not the price but the availability of the oil to meet its growing needs that matters. If necessary it will pay more.

16. In the meantime the depreciated US Dollar may be rejected as a trading currency. Its depreciated value would earn exporters, including oil exporters, less than the real value of their exports. They have not yet demanded to be paid in other currencies but they have to change US Dollar earnings quickly in order not to lose through further depreciation of the currency. By changing to Euro or Yen, the market will be flooded with US Dollars. And this too would push down the value of the US Dollar. When eventually the oil producers demand to be paid in Euro or Yen, the US Dollar will be almost useless.

17. Central Banks which keep their reserves in US Dollar would be switching away from it to avoid losses when it depreciates further. Gold has proven to be a good investment. It is appreciating in most currency terms. But Euros, Pounds and Yen would be safer to keep than US Dollar. It is likely the increases in national reserves quoted in dollar terms are not due to economic performance alone but due to the appreciation of other reserve currencies and gold held by Central Banks.

18. But we continue to quote prices in US Dollar. The increase in oil price in US Dollar is about 100%. But in Pound, Euro and Yen it is much less. What we are seeing is a distorted picture of the world's finances because of the fall in the value of the standard currency that we are using. Actually the US Dollar no longer reflects the true value or wealth of nations. For example in US Dollar terms Malaysia's reserves has doubled over the last one year. Has it truly doubled? If designated in Euro or Yen or even Pounds, what is the increase in the value of the reserves?

19. We would like to know the impact of the increase in oil prices on the countries of East Asia. There is some impact no doubt. But more important is the impact of the depreciation in the US Dollar on the East Asian countries. Except for countries like Malaysia and China, the rise in the price of oil is not significant because of the depreciation of the US Dollar.

20. Japan is hardly touched. Despite trying to prop up the US Dollar to keep the value of its 800 billion US Dollar reserves, the Dollar is still depreciating against the Yen. The price

increases for Japan is perhaps less than half than what the US Dollar prices indicate. Although oil constitutes a big percentage of Japan's imports, the high value products of Japan would hardly change because of a 50% increase in oil price in Yen terms. What is the percentage of the cost does oil constitute in the thousand dollar plus selling price of Japan's magnificent digital cameras? Or Japan's plasma TV which sells in Malaysia for upwards of RM 10,000? The only loss for Japan come from the depreciation of its 800 billion dollar reserves.

21. It is almost the same with South Korea with its ever more sophisticated export products. The cost of oil to produce their cellular phones wouldn't be very significant, even if we take into consideration transport and electricity costs. And South Korea has a lot of nuclear power plants.

22. I have already mentioned China. All it has to do is to revalue the Renminbi and the increase in the oil price would disappear almost completely. China needs oil mostly for power. It still has a small number of motor vehicles relative to its population. A revalued Renminbi would enrich its people without significantly increasing the cost of its export products. There would be some adjustments to be made but the so-called over-heated economy would produce less heat with the revaluation.

23. For Southeast Asian countries the effect would vary because some produce oil and some don't. Obviously the non-oil producers would suffer some difficulties and would be interested in alternative fuels. These countries need to ignore the international environmentalists who object to hydro-electric projects. Of course due care should be taken not to destroy forests etc. but the international environmentalists should be reminded that their countries had fully exploited their hydro-potentials without care for the environment, and they have become rich because of this. If they don't want others to develop their hydro-potentials then they should compensate these countries by paying for the oil needed. If they are not prepared to do this then they should refrain from condemning others.

24. The hydro-potentials of the poorer Southeast Asian countries should not only be developed for domestic use but for export as well. Laos must be congratulated for its plan to sell hydro-generated electricity to neighbours.

25. The other Southeast Asian countries all have some oil reserves which have been exploited or can be exploited. The problem is political and bureaucratic rather than lack of oil resources. With political will the impact of the increase in oil prices on these Southeast Asian countries would be negligible.

26. As I said earlier the problem is really not about increases in oil prices but the depreciation of the US Dollar. Should the countries of Asia, especially China, choose to revalue their currencies, the effect would be to devalue the US Dollar. This could again lead to dumping of the US Dollar and its further devaluation.

27. Those of us who went through the currency crisis of 1997 – 99 would know what effect the devaluation of currencies has on economies. The US banks and businesses would experience serious trouble now. The US Government would try to bail them out. Even now it is trying to bail out the US Airlines which have all been bankrupted by the fear of terror. It will try to do even more for the US Banks and corporations to mitigate the effect of dollar devaluation. It will be a tough act. All the preachings of the past about letting failed businesses die, about transparency etc etc would have to be ignored. The sad part is that the bailouts may not work.

28. The world will continue to be in a state of economic and financial turmoil. But the ethnic European press will try to give a bright picture. The US economy will be shown to grow in US Dollar terms. In terms of Euro and Yen it would not. In fact the depreciation in the value of the US Dollar would be made out as a good thing, which the great economist would claim was planned by the US Government. The world would be persuaded to continue to use the US Dollar for trading and to keep reserves in US Dollar. Some countries would be taken in but not all.

29. When the planes crashed into the World Trade Centre on Sept 11, 2001, Bush immediately identified what he thought was the true cause. It was because the Muslims were jealous of the freedom of the American people. It was because the Muslims were poor. This exposes a lack of understanding of things on his part.

30. Likewise Bush is not likely to know the true causes of the US Dollar depreciation and the apparent rise in the price of oil. Bush is not likely to link it with the huge deficits of the US or the spendthrift ways of his Government. At best he would be in denial. We cannot expect Bush to do anything to restore the correct value of the US Dollar. Nor would he be able to correct oil prices.

31. I know the press. The ethnic European press will again say what Dr Mahathir knows about finance can be written on the back of a postage stamp. I agree entirely with them. Were they not right about the collapse of the Malaysian economy about which they wrote millions of words in thousands of pages following Malaysia's rejection of IMF advice and the institution of currency control?

32. I am sure that this seminar has attracted people who may want to know all about the Integrated East Asian Community – something which Mr James Baker prohibited. You may also want to know about the Impact of Increases in Oil Prices on East Asia. But by comparison to the first Oil Shock there is really no increase in oil price. There is only a devaluation of the US Dollar. We should really ask ourselves what is the impact of the devaluation of the US Dollar and its impending rejection as a trading currency.

33. To answer this we must recall the events which lead to the first Oil Shock in 1973 – the year of the Yom Kippur War. The American dollar was initially tied to gold according to the Bretton Woods Agreement. By 1971 the US was finding the value of the dollar too high. Nixon decided to go off gold and let the market determine the value of the dollar. As expected the dollar devalued. It should be noted that the US products were expensive not because the dollar was strong. The high price of US products was because wages were increased through pressure from workers' unions. The US allowed the dollar to be devalued to compensate for high wages demanded by the workers.

34. But the US in the early 70s was paying the same price for its imports of oil – which at that time was 3 US dollars per barrel. The producers were therefore getting less for their oil because the dollar was devalued. At the same time US products, including oil-based products were increasing in price because of high labour cost and inflation in the US. Believing that they were being shortchanged the Arab countries united and tried to demand for higher oil prices.

35. When the US helped defend Israeli forces in the Yom Kippur War, the Association of Arab Oil Producing countries together with OPEC decided to stop shipment of oil to the US.

36. The effect was instantaneous. The US economy went into a tailspin. And so did Europe and other countries.

37. Eventually the Arabs decided to increase their oil price by 400% to 12 US Dollar. Suddenly the Arabs became extremely rich. They embarked on grandiose development plans. Still there was money left over. And foreign advisers persuaded the Arabs to keep their money in the US, thus helping the US to finance itself and to make money from lending Arab petrodollars. For a time this kept the US afloat.

38. As for the Arabs, they were shocked by the devastation of the world's economy due to their embargo and increase in oil price. They are not likely to do it again as they fear it might trigger US invasion of their countries. Today's increase in price is not initiated by the Arabs. It is due to US profligacy. But the rise is so small that within a short period the world and East Asia

would adjust. What remains is how to treat the depreciated US Dollar. I would urge countries and businesses to switch to Euro and Yen or buy gold. Then oil prices would not hurt you.
