

## Mahathir in Zimbabwe: lessons for recovery

*Malaysian Prime Minister Dr. Mahathir bin Mohamad delivered the following speech to the South African International Dialogue '99 Smart Partnership dinner, in Victoria Falls, Zimbabwe, on Oct. 4, 1999. It was entitled, "Malaysia's Experience in Managing Economic Recovery while Safeguarding the Socio-Economic Responsibilities." Subheads have been added.*

I believe you are all aware that Malaysia is a multi-racial country. More than that, the racial differences are heightened because the different races believe in different religions; the indigenous Malays, the biggest group, are Muslims, the Chinese are Buddhists, and the Indians are Hindus. These religions are usually incompatible.

But to make matters worse, their shares of the wealth of the country are also linked to their racial origins. The indigenous Malays are the poorest, owning only 1% of the economic wealth when we gained independence, the Chinese and Indians had 30%, the rest being with the British and other expatriates.

Despite these differences, the three major races managed to work together to obtain independence. There was a kind of social contract in which, in exchange for citizenship for most of the Chinese and Indians, the Malays should have a bigger portion of the economic wealth.

A decade into independence it became obvious that the indigenous people were not getting a fair share of the wealth. They began to condemn Chinese economic domination. Tension rose, and in 1969 race riots broke out in Kuala Lumpur following an acrimonious election campaign. More than 100 people were killed, motor vehicles and buildings were razed to the ground.

The government declared an emergency, suspended Parliament, and quickly put a stop to the riots. But the government also studied the causes of the racial animosities and decided that the Malays must be given a greater share of the economic wealth while the Chinese and Indians should be given bigger participation in the government.

An affirmative action program was initiated to bring the indigenous people into the economic mainstream, while the government invited more Chinese and Indians, largely from the opposition parties, to join the government.

The scheme worked out so well that racial tension was



*Malaysia's Prime Minister Dr. Mahathir bin Mohamad. His policies have been vindicated, and his critics discredited.*

practically eliminated, and Malaysians enjoyed almost three decades of stability and economic growth. So successful was the handling of race relations in Malaysia that even the recent recession caused by the currency devaluation and the collapse of the share market failed to spark racial fights, as they did elsewhere in Southeast Asia.

But the attacks on Malaysia's currency and share markets nevertheless damaged the carefully planned redistribution of economic wealth. The still young and friable indigenous business community suffered the most. If the economy is not resuscitated quickly and put back on the growth path, racial antagonism would return and Malaysia would be politically unstable. And political instability in turn would make economic revival difficult.

### **The government's responsibility**

The government is acutely aware of this danger of racial tensions, riots, and consequent political instability recurring, and [that we] have to resolve the economic problems caused by currency and share devaluation without disturbing the delicate balance in term of race relations.

Other countries faced with economic turmoil quickly resorted to IMF [International Monetary Fund] help. Unfortunately, the IMF wants to use the loans given by it to force through its so-called economic reforms. For the IMF, affir-

mative action, the active government intervention in the distribution of economic wealth between races, is unacceptable. The economy [according to the IMF] must be completely free of government interference, and furthermore it must be open to total and unrestricted foreign participation.

The result would be to deprive the indigenous people in particular of their share in the business sector and the wealth accruing from it. The Chinese, on the other hand, might still retain or even enhance their share.

The IMF solution is therefore not for Malaysia. We have to devise our own solution so that the government can continue with the eradication of poverty among all races and elimination of the identification of race with economic function—the so-called New Economic Policy which had so successfully created a stable and prosperous Malaysia.

### Resuscitating the economy

To restore the economy in the face of attacks by currency traders and share-market manipulators, the government set up the National Economic Action Council (NEAC). The NEAC studied the impact of the devaluation on the economy and came up with numerous proposals on resuscitating the economy. The banking and corporate sectors had to be reformed so as to be more resilient. Imports were curtailed while exports were stimulated. Consumption of imported sugar, milk, and wheat flour was reduced. Price control was fully enforced to prevent undue inflation. Retail prices of food and goods were monitored closely so as to ensure no profiteering takes place. The retrenchment and unemployment figures were scrutinized for sign of recession.

Statutory reserves of banks, which stood at 13%, were reduced by 4% to improve banking liquidity. Hire-purchase terms were also improved. Property, vehicles, and retail sales were boosted through forgoing taxes during government-endorsed sales carnivals. Studies were made to improve food production, as the biggest import item for the country is food.

The performance of the stock market and individual companies were also studied so as to know the effect of the downturn on them and to help them if necessary. An asset management company was set up to buy up non-performing loans, in order to relieve the banks and to help the companies to turn around. A company was also set up to refinance banks.

Mergers of banks and of stock-broking companies were encouraged.

Sources of funds within the country were identified and assessed so as to reduce the need to raise funds abroad. Malaysia has one of the highest savings rates in the world, i.e., 40%. This money could, of course, be put to better use so as to maximize returns. In the end, it was found that domestic funds were sufficient to finance much of the recovery process and borrowing abroad became less urgent.

Many more studies and actions were undertaken so as to minimize the impact of currency devaluation and the fall in

share prices. However, despite all that was done or could be done, the devaluation of the currency and the stock market's near collapse placed the country in a very difficult position. In all, the country lost about \$50 billion in terms of purchasing power of imports and \$150 billion in market capitalization. If the currency devalued further, the economy could be so weakened that we would have to turn to the IMF and accept its terms.

A solution had to be found which would protect the country from the rapacious currency traders and stock-market manipulators. Malaysia actually had some experience in cur-

## Dr. Mahathir warns West on East Timor

*Malaysian Prime Minister Datuk Seri Dr. Mahathir bin Mohamad was the featured guest on PBS-TV's "Charlie Rose Show" interview program, on Sept. 27, 1999, in New York City. The following exchange on the crisis in East Timor and how the United States is viewed from abroad concluded the broadcast. However, in his monthly column in the Japanese newspaper Mainichi Shimbun, on Oct. 11, Dr. Mahathir stated: "It is well known that the West would like to see Indonesia broken into smaller countries. . . . And so, when the currency crisis plunged Indonesia into political and economic turmoil and [former President] Suharto was overthrown, the West seized the opportunity to once again break up Indonesia. . . . The main beneficiary of a broken-up Indonesia will be Australia. It is not surprising that Australian forces have moved into East Timor first. . . . The need to protect East Timor will be permanent, and Australia is ready to provide this protection. It may become Australia's Vietnam."*

*Here are excerpts from the Charlie Rose interview:*

**Rose:** East Timor.

**Dr. Mahathir:** Yes.

**Rose:** Are you pleased to [see] UN troops there? . . .

**Dr. Mahathir:** Well, I think the whole thing has been very badly handled.

**Rose:** By? Indonesians?

**Dr. Mahathir:** No, I think people want to see that East Timor will not be integrated with Indonesia. They have always been agitating and urging East Timorese to seek independence from Indonesia. And the moment they found Indonesia is facing a lot of problems, like economic prob-

rency trading. In the early 1980s, the Central Bank traded extensively in the currencies of Europe, America, and Japan. It was pure speculation, and the funds available were not adequate to move the market. In the end, Malaysia lost a lot of money and decided to get out of the business. But the knowledge gained was useful nevertheless.

### Reassert sovereignty over the currency

Malaysia studied the mechanism of currency trading thoroughly. It became obvious that the free convertibility of the local currency, the ringgit, which facilitates trade, is also the

Achilles' heel which exposed us to the attacks of currency traders. We have to stop the free convertibility of the ringgit and to reassert the sovereignty of the government over our currency.

Apparently no cash is involved in currency trading. When money is sold or bought, the figures on the bank's computers move and the buyer gets the figures representing the amount of money credited to him. Since the money is only legal tender in the issuing country, the actual money is held in banks in the issuing country. The foreign bank would instruct the domestic bank to credit the money to the buyer's account. Clearly the

lems, and needed help, that's when the pressure is brought upon Indonesia to hold the referendum.

I think it is the wrong time to hold a referendum.

**Rose:** Why? . . . What's wrong with a democratic vote on the part of the people from East Timor?

**Dr. Mahathir:** You see, for 25 years, those people are not complaining very much. Indonesia is pouring a lot of money into East Timor. Development in East Timor during Indonesian time is far greater than during the Portuguese time, and many of the people in East Timor have accepted the integration.

**Rose:** Well, obviously—Evidently not, if you look at the results of the referendum.

**Dr. Mahathir:** Well, you know, when you have an election, for example, you campaign. Actually, people were campaigning against—urging the Timorese to reject integration. Foreigners were telling them, "Look, if you become independent, we'll help you. We'll give you protection. We'll give you money and, *et cetera*."

Naturally, I mean, the East Timorese are going to vote for independence.

**Rose:** So, you oppose the referendum, and you think they would have been better off if they had stayed . . . as part of Indonesia, even though the United Nations never recognized that annexation?

**Dr. Mahathir:** Well, there have been annexations of other territories and the United Nations said nothing about it. I wouldn't say which territory because I might hurt other countries who are friends of ours.

But, in this case, let's allow Indonesia to make its liberal democracy work first. . . . They are in trouble. At that time, you apply pressure on them. It's not fair, because they are not in a position to even campaign among the Timorese to vote for integration.

**Rose:** It wasn't so much the government that they seemed to be worried about. It was, in fact, the military.

**Dr. Mahathir:** The military has contributed toward Indonesia's stability. Once you remember that these are

new countries—we have become independent only about 50 years or so. And our idea of how to run a democratic government is not the same as yours.

You have had more than 200 years. Other countries in Europe have [had] even a longer period. When you first became independent, you were not very nice to the slaves, for example.

**Rose:** That's true.

**Dr. Mahathir:** So, you must allow Indonesia time to practice democracy and show the Timorese that they have—they can gain from being with Indonesia.

**Rose:** There was much talk about America as the democratic ideal. Do you believe that in terms of the nations of Asia we still stand for something special in the world?

**Dr. Mahathir:** Well, we felt like that at the end of the last war.

**Rose:** At the end of World War II?

**Dr. Mahathir:** Yes, at the end of World War II we looked to America as our savior. But, since then, you have changed. You don't any longer feel any understanding of the problems faced by new countries like us.

**Rose:** We're insensitive to your culture and to understanding—

**Dr. Mahathir:** Yes, I think that is true. You don't understand us. In fact, Americans usually look inside, rather than outside and make comparisons with America. We cannot be compared to America. You are older than we are. We have just become independent. . . .

You know, under the colonial rule there was no democracy. Everything was determined by Whitehall in London. We had no idea what democracy was like, and yet we chose democracy because we thought it is a good system. But it's not easy, having accepted it, it is not easy to make it work.

A lot of countries fail simply because they don't understand the intricacies, the weaknesses, the tendency toward destabilization that comes along with democracy. So, you must give people time to manage these things.

buyer can only have the money if the domestic bank credits it to his account.

To stop the trade in currency the local banks were instructed by the Central Bank not to transfer any foreign-owned ringgit held by foreigners except during the first month of the control. Effectively, this made the foreign-owned ringgit worthless unless it is transferred to a local account in the first month. After that no more transfers would be allowed.

Thus, money belonging to foreigners held in their accounts in domestic banks would be useless after one month if it is not already transferred. If it is transferred, it means that foreign-owned ringgits would have been repatriated and would be available for banks to lend. Billions of ringgits were repatriated in this way. Once repatriated, it cannot be taken out of the country again, as it would not be allowed to return. Taking out the ringgit would render it useless, as it cannot be legal tender in any other country. And no one would accept it in exchange for other currencies.

This means no ringgits would be available outside the country for currency traders to borrow and sell. Trading in the ringgit stopped and the government was then able to fix the exchange rate within the country. Anyone needing foreign currency to pay for imports can change their ringgits for foreign currency at the Central Bank or agent banks. On the other hand, if exporters earn foreign currency they can change for Malaysian ringgit at the government fixed rate at the Central Bank or authorized bank. All the while the government would keep track of all incoming or outgoing money in whatever currency.

Had the government fixed a high rate for the ringgit, exports would be costly and there would be a black market in foreign currencies. A low exchange rate would make imports more costly and result in inflation. The government fixed a rate that is neither too high nor too low.

Once the rate is fixed, businesses can operate without the uncertainties of fluctuating exchange rates and the need to hedge. The return of all the ringgits from abroad meant the banks have plenty of money to lend. Interest rates could therefore be reduced without fear of traders devaluing the currency further. Businesses could borrow and could repay loans. The rapid rise in non-performing loans was reversed. Debtors became solvent and could borrow again.

### **Halt the fall in share prices**

To recover fully, the slide in the price of shares must also be stopped. Initially, the government disallowed short-selling on the Kuala Lumpur Stock Exchange [KLSE]. But the short-selling went on, as Singapore had opened a market in Malaysian shares without the consent of the Malaysian government. They were able to continue short-selling, and consequently the share prices kept on dropping. As a result, our companies and banks were in distress as margin calls could not be met

and debts could not be paid.

Malaysia had to stop the operation of the so-called Central Limit Order Book (CLOB) in Singapore in order to make currency control effective. To avoid reporting changes in ownership of shares through sales on the CLOB, all shares were registered in the name of nominee companies on the Malaysian Stock Exchange. We could not track the transactions on the CLOB and so short-selling went on, depressing our share prices.

To stop CLOB, we made it necessary for all shares to be registered directly in the name of the substantive owner. Transactions not so registered will not be legal and recognized. Nominees were not recognized. Trade on the CLOB stopped immediately and the Composite Index of the KLSE climbed rapidly. It is now almost 150% higher than when CLOB was operating.

### **The repatriation of proceeds**

We also stopped repatriation of the proceeds from the sale of shares on the KLSE for one year. Thus, we stopped the possible sudden massive withdrawal of capital from the KLSE by the foreign investors, which would have caused a severe plunge in the index and serious loss of market capitalization.

It was believed that when one year was up there would be a massive outflow of capital. But so good is the performance of the Malaysian economy after controls that when the year was up, there was only a little outflow. The stock market remained sound and the banks and companies were released from the pressure of bad loans. Besides, the asset management company and the bank recapitalization exercise helped the banks and the companies to deal with their non-performing loans.

The efforts to revive the economy did not end with the stoppage of currency trading and shares short-selling. As I pointed out, numerous other steps were taken to bring back the growth performance of the Malaysian economy. But the most important steps were the frustrating of currency traders and the short-selling on the CLOB.

### **The results were immediate**

Once selective control of capital flows were put in place, the effect was quite dramatic and immediate. The Executive Committee of the NEAC watched the data daily, and what we saw was very encouraging. Firstly, the foreign reserves went up rapidly until it is now about \$32 billion, against \$20 billion when we started. Loans given out by banks picked up fairly well; vehicle and property sales went up, infrastructure work started again. The contraction of the GDP slowed down and we achieved a growth of 4.1% in the second quarter of 1999. We are on target to achieve 1% growth in 1999, although various experts predict a bigger growth of up to 4%.

The stock market index rose from 262 points on Sept. 1, 1998, to over 800 at one [point in] time. It has now come down to around 700, relieving both the banks and the companies of much of the non-performing loans.

While most of the indicators are positive, the economic turmoil precipitated by the currency traders and stock market manipulators destroyed much of our achievement in correcting the imbalance between the economic performance of our multi-racial population. While everyone was hit by the downturn, the indigenous businessmen were hit most badly. The big corporations they had successfully set up were unable to withstand the burden of debts they carried. They were forced to sell off to the non-indigenous people, and this, of course, undid much of the redistribution we had achieved. The indigenous middle class, small compared to the non-indigenous, practically disappeared. And once again we find the indigenous people only among the low-paid workers, hawkers, and petty traders.

### **The issue of 'cronyism'**

Now we have to start all over again, and it is not going to be easy. Already our affirmative action has been labelled cronyism. To our foreign detractors, affirmative action only benefits the family and friends of the members of the government, in particular the Prime Minister. Explanations given to prove that it is not so have been totally ignored. The Western press, the IMF, and other agencies in the West kept on repeating that our New Economic Policy, directed at restructuring our multi-racial society, benefits only the rich friends and families of the government members.

Yet, in truth, the New Economic Policy benefits every single indigenous people, and even a fair number of non-indigenous people. Obviously, the policy cannot make every one of these deprived people millionaires. They benefit according to their own capability. Thus, although everyone could get free education and scholarships, some could not progress beyond secondary schools, while others could go to the universities at home and abroad. Others went into business as a result of the opportunities, licenses, premises, and capital made available by the government. Some could only manage small businesses, while others went out to acquire and manage billion-dollar enterprises and were even able to venture abroad. That some indigenous businessmen could rise to such levels depended on their abilities. Opportunities are created by the government for all, but obviously not everyone would be able to avail themselves of these opportunities and profit from them.

But the foreign detractors and their local supporters see every one of the successful indigenous businessmen as cronies of the government. That many of these people failed miserably, and some of them were actually members of the families of government members or their friends, is ignored. Those who succeed were all regarded as cronies and families

of the government members. Even members and strong well-known supporters of the opposition were regarded as cronies or families of the government members if they succeed. If they fail, then they are not.

Because the affirmative action had produced very successful and, therefore, very rich indigenous businessmen and they were alleged to be cronies of the government, the foreigners demand that affirmative action should be stopped. This would create disparities between the races, as among the very rich and successful there would not be a single indigenous person.

The real reason for foreign dislike of affirmative action is because most of the highly profitable privatized projects went to the indigenous entrepreneurs, in order to balance the surfeit of very rich and very successful non-indigenous entrepreneurs. This policy cuts off the foreigners from getting the privatized projects for themselves. And these are areas which they are particularly interested in, as they aim to monopolize them worldwide. The impoverishment and subsequent submission of the country to the IMF would have provided the foreign companies with this opportunity. But the Malaysian government has not submitted to the IMF. We are under no obligation to jettison our New Economic Policy, our affirmative action program.

Economic management of the country is not about enriching it only. A country can be made wealthy without the wealth being evenly distributed. It was the extreme disparity between rich and poor in the old capitalist system that brought about the Socialist and Communist revolution.

### **Growth with equity**

In Malaysia it would have been easy to give a free hand to the very dynamic and business-oriented non-indigenous Chinese Malaysian to develop and enrich the country. But then the indigenous people would remain poor and have a sense of deprivation. They would be bitter and angry and would rise against people whom they would regard as foreigners who had stolen wealth that rightly belongs to them. They would destroy the wealth which had been created and the country would fail to develop. In the end, everyone would lose, and the country would have to beg for foreign aid and accept the conditions imposed.

After our traumatic race riots in 1969, we in Malaysia are determined to have growth with equity. Our New Economic Policy was successful in achieving this. We are not about to give up this formula simply because the IMF and the Western media think we should do so. Our growth had not been stunted because we had a political and social agenda intricately bound with our economic agenda. We think we can continue to grow with equity by adhering to the objectives of our New Economic Policy, now that we have been able to defeat the attempt to destroy our economy and political independence by devaluing our currency and impoverishing us.