## A colossal debt trap

But further injections of taxpayer money to keep the "recovery" on life support face another major problem. After ten years of economic policy paralysis and mistakes, Japan's public debt is out of control. Since the beginning of the 1990s, Tokyo has poured more than $800 billion into eight major public stimulus packages, with almost nothing lasting to show for it beyond an exploding public debt.

According to Prof. James Savage of the University of Virginia, who was posted to the Japanese Finance Ministry in 1998, "Japan's budgetary position is the most precarious in the industrialized world." In 1999, Japan's public budget deficit, 12% of GDP, will surpass the worst deficit of the United States during the Great Depression.

Gross debt has doubled since 1990 to now stand at 109% of GDP, more than double that of the United States. Worse, Japan faces the worst aging crisis of any G-7 nation. Costs of financing Social Security for the elderly, in a country with the lowest fertility rate in the industrialized world, and longest life expectancy, set up a fiscal crisis in the coming five to ten years, even were Japan to undergo a growth renaissance comparable to the 1952-72 era. Fears of how to finance the aging led the previous government to impose sharp hikes in taxes to control public debt costs. That plunged Japan into new depression just as the Asia crisis hit in 1997.

Costs of servicing Japan's public debt, despite the official near-zero interest rates, are the largest single budget item, consuming 24% of the 1999 budget. Social Security costs are the second largest, consuming 20% of budget outlays.

This hints at the reality of Japanese economic prospects. Details only amplify cause for alarm in the face of failure of Tokyo to undertake any fundamental long-term economic reform, beyond the present unsustainable crisis management. The mood in recent weeks has become euphoric at the reports of the huge foreign fund inflows. Weary Japanese see this as confirmation that they are finally doing the "right thing." They aren't. The banking system is still drowning in $2 trillion in bad loans. The industrial sector is obsolescent. The workforce is demoralized and fears job loss. Public debt is out of control and due to rise from here. This is the actual backdrop for the investor euphoria, Japan's "virtual recovery." Some might call it an old-fashioned suckers' rally.

It's time for the Japanese to take a serious look at the advice Lyndon LaRouche gave them last year, in his widely circulated Sept. 21, 1998 statement "Save Japan! Not Banks!" (see *EIR,* Oct. 2, 1998). LaRouche outlined the internal measures Japan must take (none of which have occurred) and the necessity for the nation's leaders to hook up with leaders in China, the United States, and other nations to establish a new monetary system devoted to international economic development based on scientific and technological progress. Without such measures, no "good press" can save Japan from the financial disaster.

# Malaysia shows national sovereignty works

by Richard Freeman and Gail Billington

On Sept. 1, 1998, the nation of Malaysia exerted its sovereignty, by adopting selective exchange controls and other emergency nationalist measures. It showed the world that a nation can survive by rejecting entirely the advice of the British-American-Commonwealth (BAC) faction and its International Monetary Fund, which demand monetarism, globalism, and free trade. It is now one year later, and we shall show that Malaysia has succeeded, while nations that followed the BAC's prescriptions face economic breakdown and even ruin.

In the course of the 1998 crisis, Malaysia's survival depended on forthright and courageous action. A worldwide financial disintegration was ripping Asia apart. Within this setting, the BAC's assets, such as hedge fund speculator George Soros and the IMF, steered an attack to devastate the currencies and economies of Malaysia, Thailand, South Korea, and Indonesia.

On Sept. 1, 1998, Malaysia's Prime Minister Dr. Mahathir bin Mohamad, acting on behalf of the Malaysian nation, stunned the City of London and Wall Street. He adopted the principle of national sovereignty: that a nation-state has the moral responsibility and power, if it uses it, to protect its population and economy against private predators. It is the nation-state, not the so-called "free markets," that should regulate the economy and affairs of state. This concept was understood at the original 1944 meeting in Bretton Woods, New Hampshire, that set up the Bretton Woods monetary system; it traces back to the Leibnizian-Hamiltonian American System of Economics. Dr. Mahathir imposed selective capital controls, as well as exchange controls—hot money flows would not be allowed to enter Malaysia, rake off some quick loot, and scurry out. He effectively shut down the activity of the Singapore-based Central Limit Order Book, from which venue speculators had attacked Malaysian stocks. He increased bank lending to manufacturing and agriculture, and made significant budget expenditures for infrastructure building.

Feeling endangered, the City of London financiers and their minions responded with rage and threats. A sampling of responses shows the policy fight at the time:

"The recent imposition of exchange controls has seriously undermined foreign investors' confidence in Malaysia and set the economy on an unsustainable path that could adversely



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affect external credit worthiness." This was the warning, on Sept. 10, 1998, of the London-based Fitch IBCA credit rating agency. Fitch-IBCA didn't just predict that Malaysia would suffer loss of "investors' confidence"; it acted to make Malaysia fail, by lowering its rating on Malaysia's short-term foreign currency to a level of F3, which is junk status.

"The Malaysian government's restrictions effectively remove Malaysia from the investment world for investors and investment managers operating outside the country," warned the Dow Jones World Index on Sept. 21, 1998. Dow Jones owns and publishes the *Wall Street Journal*.

"Some countries, such as Malaysia, may fall by the wayside if they persist with their xenophobic, anti-market policies," declared speculator George Soros in his book *The Crisis of Global Capitalism,* which he wrote in late 1998, after Dr. Mahathir's emergency actions. During 1997, BAC front man Soros's Curaçao-based Quantum Fund had speculated against the Malaysian currency, the ringgit, in order to crash it.

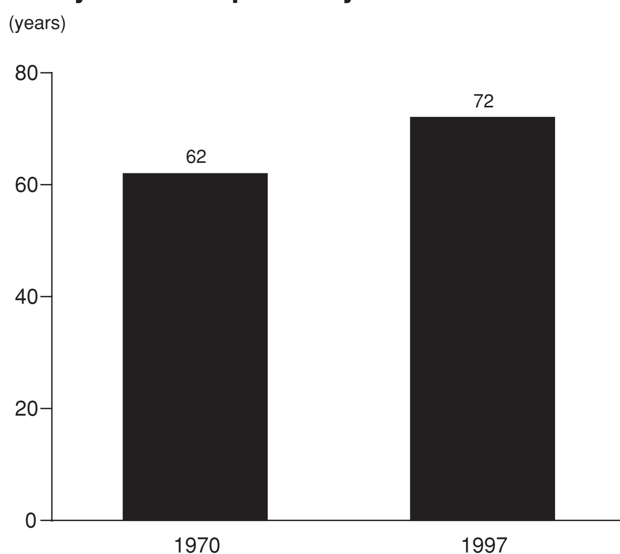
Finally, not to be outdone, on Nov. 16, 1998, U.S. Vice President Al Gore, in his keynote address at the Asian Pacific Economic Cooperation Forum (APEC) summit in Kuala Lumpur, said, in criticism of Malaysia's emergency actions, that "free markets [should be allowed] to work their magic," and "protectionism will only protect us from prosperity itself." Gore arrogantly praised ongoing street demonstrations directed against the government of Dr. Mahathir, which demonstrations had been organized by circles linked to London and the IMF.

But Dr. Mahathir was not swayed by these hysterical attacks. Dr. Mahathir had given an interview to *EIR,* in Malaysia, published in our Feb. 19, 1999, issue. Dr. Mahathir asserted: "Our appeals to the international institutions to curb currency trading failed to incite any response at all. They did nothing. And our currency kept on going down and down, and that had a very bad effect on our economy. . . . We were going to go bankrupt—the whole country would go bankrupt—if we were to wait for the IMF to curb currency trading. *Since they are not going to do it, we had to do things for ourselves*" (emphasis added).

Lyndon LaRouche strongly supported the sovereign actions of Dr. Mahathir. He said that they were defensive, but nonetheless essential measures. By crystallizing a fight with the dying BAC-centered world financial system, this set the stage for a next higher move: sovereign nations' adopting a new development-pivoted Bretton Woods economic-monetary system.

It should be stressed that Dr. Mahathir had to battle on a two-front war: He had to stop the BAC's incessant attack from the outside that was undermining his country, as well as set the groundwork for restoring growth in the real economy, including infrastructure. Other members of the core leadership of Malaysia helped develop and implement Malaysia's policy, and thereby also helped to determine the outcome of this fight.

FIGURE 1
**Malaysia: life expectancy at birth**
(years)




Over the next year, the financiers would do what they could to destroy Malaysia. We will review the extent of the British attack against Malaysia; look at the scope of the emergency sovereign policy actions undertaken by Dr. Mahathir; and examine the outcome of those policies.

## Malaysia's development

First, consider a few features of what Malaysia has done positively during the past three decades in nation-building. In the process of overcoming a past of underdevelopment, the Malaysian government, which has been led by Mahathir bin Mohamad since 1981, has invested in infrastructure: health and sanitation, water management, education, etc. This resulted in significant improvements in economic growth and conditions of life.

**Figure 1** shows Malaysian life expectancy at birth, which rose from a life expectancy of 62 years in 1970, to a level of 72 years in 1997.

**Figure 2** depicts the infant mortality rate, which fell from 45 deaths per 1,000 live births in 1970, to 10 in 1997. The latter level is comparable to that of most advanced-sector nations.

**Figure 3** shows the decrease in the number of Malaysians living in poverty. Between 1970 and 1995, this number was reduced by 90%, from 2.1 million, to 200,000 people.

Malaysia has built railroads, light rail in the capital city of Kuala Lumpur, and a national car company called the Proton (which uses advanced robotics in some plants), various dams, and was in the process of building the ambitious Bakun Dam, in Sarawak, when the economic crisis put a halt to it. The

FIGURE 2
**Malaysia: infant mortality rate at birth**
(deaths per 1,000 live births)

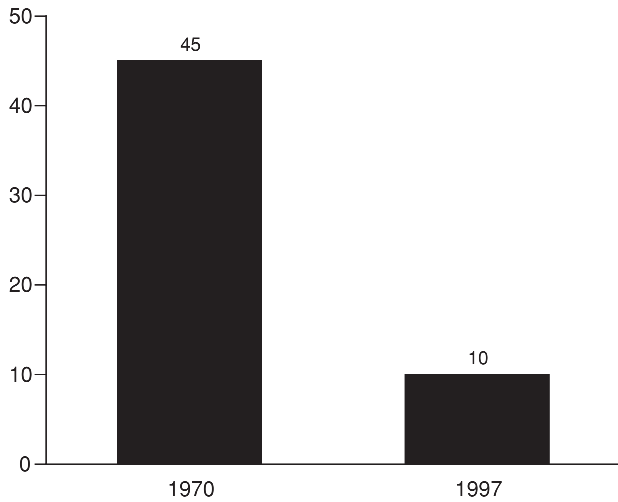
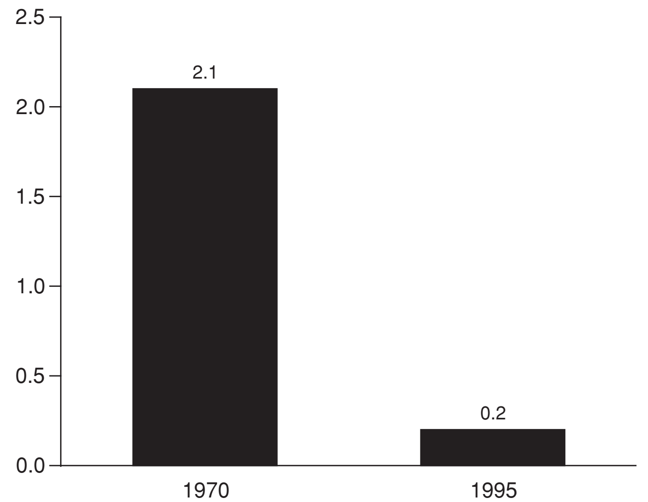



FIGURE 3
**Malaysia: poverty**
(millions of people)




oligarchy's financial-economic warfare was intended to put a halt to such progress.

## Financial warfare

In February 1997, George Soros and some other hedge fund operators began speculating against Thailand's currency, the baht. On July 2, Thailand floated its currency. Simultaneously, Soros et al. had also been speculating against the Malaysian ringgit. Two weeks after the flotation of the baht, Malaysia severed the peg between the ringgit and the U.S. dollar, and floated the ringgit. By Jan. 1, 1998, the ringgit had depreciated by 35%. Dr. Victor Wee, of Malaysia's National Economic Action Council (NEAC) Secretariat, presented on June 28, 1999, at the Securities Association of China and Asian Securities Analyst Federation meeting in Dalian, China, a speech entitled, "Malaysia's Experience in Dealing with the Financial Crisis." In that speech he stated that, "Meanwhile [during 1998], the rising number of corporate failures and non-performing loans affected the willingness of banks to lend. The country was in the grip of a severe credit squeeze, and the full impact of shrinking demand and rising corporate distress were felt by the entire economy."

The Kuala Lumpur Stock Exchange (KLSE) plunged, with the Composite Index falling from a high of 1,271 points in February 1997 to 267.2 on Sept. 1, 1998, a fall of 70%.

Most important, the physical economy buckled. Between the fourth quarter of 1997 and the first quarter of 1998, Malaysia's manufacturing shipments fell by 10.4%. This reflected the level of output (in constant inflation-adjusted ringgit, the manufacturing fall was even larger, at 18.2%). Malaysia's agricultural sector held out a little longer, but started steeply falling by the fourth quarter of 1998.

Thus, Prime Minister Mahathir and the entire Malaysian government faced a contracting physical economy, increased bankruptcies, reduced bank lending. The British-directed economic warfare was unrelenting.

## Emergency policy of Sept. 1, 1998

Dr. Mahathir knew that half-measures would not work against the enemy he was facing. The BAC's International Monetary Fund was offering its conditionalities poison to nations in the region: severe budget-cutting; increased interest rates (allegedly to protect the country's currency, but which further wiped out the country's manufacturing and agriculture); increased privatization, etc. The totality of the IMF program did not address itself to the fundamental problem: the hyperbolic growth of the speculative financial instruments, such as derivatives, which were simultaneously sucking the wealth out of the physical economy, and also causing the bankruptcy of the world financial system. In fact, the IMF program worsened the destruction caused by the financier oligarchy's bad policy.

Dr. Mahathir instituted a policy package that went in a completely opposite direction and relied upon the sovereign authority of the nation-state to regulate the economy for the benefit of the nation and its posterity. The majority of policies derived from the perspective of the American System of Economics.

1. *Selective capital controls*. On Sept. 1, Dr. Mahathir stopped the speculation against Malaysia, and the hot money

flows into and out of the country, by instituting selective capital controls. There were three elements that were broadly part of this policy.

First, the unlicensed trading of Malaysian stocks outside of Malaysia was terminated. The Central Limit Order Book, based in the financial center of Singapore and which had the equivalent of $20 to $25 billion of ringgit accounts, was closed down on Sept. 15, 1998.

Second, exchange controls were part of this package; that is, the Malaysian currency, could no longer trade or float freely. Holders of the Malaysian ringgit, outside of Malaysia, had to either bring the currency back into Malaysia by a set date, or they were effectively rendered worthless. If an individual wanted to obtain dollars, it had to be shown that it was for a legitimate economic purpose. Further, the ringgit, which had badly depreciated since mid-July 1998, when Malaysia allowed its currency to float, was now pegged at the set rate of 3.80 ringgit to the dollar. This was the only accepted rate of exchange, and no other rate would be allowed. This stabilized the currency, and freed Malaysia's central bank, Bank Negara, from having to expend (and possibly lose) a large amount of its foreign reserves in an attempt to hold up the value of its currency.

Third, as regards capital controls, Malaysia imposed a 12-month holding period on foreigners' portfolio investment in Malaysian stocks and bonds, that is, once foreign money (capital) was invested in stocks and bonds in the country, it could not be repatriated outside of the country for one year. The capital controls worked well for five and one-half months. They stopped speculation inside Malaysia. It was felt that by Feb. 15, 1999, the capital control measures could be relaxed. Instead, on that date, a levy or tax was adopted. But as for foreigners' portfolio investment into Malaysian stocks and bonds made after Feb. 15, the earnings on that investment were to be subject to a levy/tax if they were to be repatriated out of the country; however, the principal amount of the foreigners' investment was not subject to a tax. This blocked any quick-buck investment, since any quick-buck profits could not be siphoned out of Malaysia without paying a significant tax.

The depreciation of the Malaysian currency and the foreign quick-buck speculation came to a halt.

2. *Lowering interest rates and providing liquidity for the real economy*. During the Asia phase of the world financial disintegration, Malaysia's physical economy contracted, while its impaired banks were cutting back lending, which threatened to further collapse its physical economy. The IMF advised nations to swallow its harsh monetarist medicine, telling them to raise interest rates and further reduce bank lending. Dr. Mahathir decided that Malaysia should completely reject the IMF's advice.

Following Mahathir and the Malaysian government's suggestion, Bank Negara lowered its three-month intervention rate. It started lowering the rate in June 1998, when the rate stood at 11%, and continued through June 1999, when the rate stood at 6%, a reduction of five percentage points. Normally, the intervention rate acts like the floor under other interest rates in the economy, which means that most other interest rates could usually be brought down by the same five percentage points.

Bank Negara also reduced the statutory reserves requirement, the mandatory amount of reserves a Malaysian bank must maintain, from 13.5% down to 6%, over a period from February 1998 through Sept. 16, 1998. By reducing the amount of reserves a bank had to hold, it freed up the amount that a bank could lend. This increased banking system liquidity for manufacturing and agriculture.

3. *Increased federal government budget expenditures for infrastructure and the poor*. In July 1998, the Malaysian government set aside a special allocation of funds for infrastructure building. Dr. Victor Wee of Malaysia's National Economic Action Council reported in his June 28, 1999, paper, "Malaysia's Experience in Dealing with the Financial Crisis," that in July 1998, "the government also announced the establishment of a RM [ringgit] 5 billion fund for infrastructure projects, such as mass-transit, railway transportation, ports, highways, water supply projects and waste disposal and sewage projects." These are the sort of projects that U.S. President Franklin Delano Roosevelt built in the United States during the 1930s.

In addition to the infrastructure special fund, the Malaysian budget also emphasized programs for the "protection of lower income groups from the adverse effects of the financial crisis." This included programs for low-income housing and food provision. Malaysia honored its commitment that the poor would not be forced to fend for themselves. Malaysia did not experience the explosion in the number of poor people, as occurred in many other nations during the same time period.

4. *Banking and debt reorganization of companies*. Malaysia also set up three agencies:

- Danaharta, an asset-management company to deal with the problem of a large number of non-performing loans on the books of Malaysian banks;
- Danamodal, to capitalize and consolidate the banking sector by injecting capital into troubled banks; and
- The Corporate Debt Restructuring Committee, to facilitate debt restructuring and reduce the heavy debt load of viable companies.

The banking and debt reorganization of companies were auxiliary but helpful features of the overall emergency package.

Dr. Mahathir has subsequently related, that when he first conceived the idea of imposing selective capital controls, there was disagreement and resistance within the Malaysian government's Cabinet. Eventually Dr. Mahathir convinced

FIGURE 4
**Malaysia: Assembly and manufacture of motor vehicles rose by 112%**
(index)

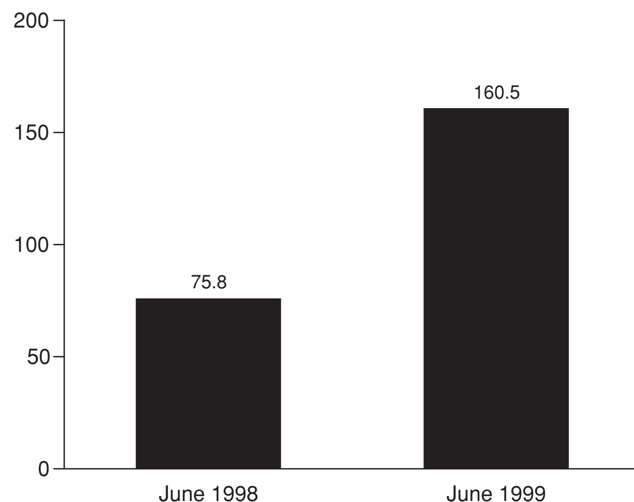
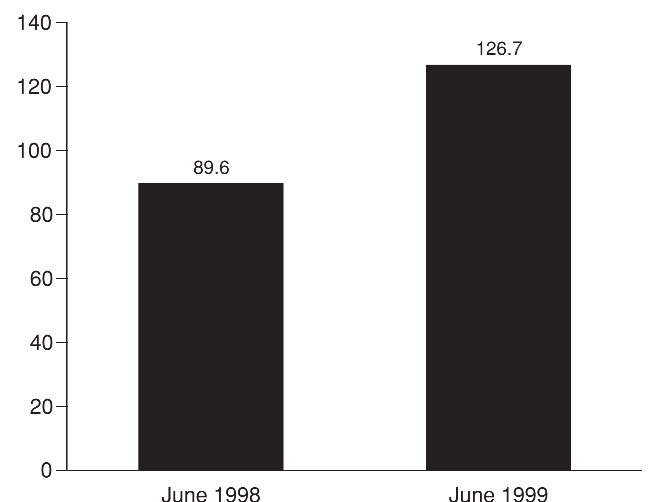



FIGURE 5
**Malaysia: Primary iron and steel production rose by 41%**
(index)




Cabinet members of the necessity of this perspective, including, initially, Anwar Ibrahim, who in September 1998 was Malaysia's Finance Minister. Eventually, Anwar Ibrahim's friends in the circles of London and Wall Street caused him to break with and denounce this perspective.

Malaysia's enemies were counting on Dr. Mahathir's policy failing, hoping that Malaysia would experience mass unemployment and economic meltdown. They helped foster demonstrations inside Malaysia, whose purpose was to seriously destabilize and perhaps topple Dr. Mahathir. Their efforts did not prevail.

## The success

The Malaysian economy had been seriously hurt. One could not expect Dr. Mahathir to announce the emergency measures that he did on Sept. 1 and thereafter, and have the economy turn around within a matter of days. But, with a certain lag time, the economy has turned around. By late spring of this year, the difference was noticeable.

**Figure 4** shows that between June 1998 and June 1999, the assembly and manufacture of motor vehicles shot up by 112%, rising from an index number of 75.8 to an index number of 160.5.

**Figure 5** shows that between June 1998 and June 1999, primary iron and steel production rose by 41%, rising from an index number of 89.6 to an index number of 126.7.

**Figure 6** documents that for the period between June 1998 and June 1999, food manufacture (a large part of which is food processing) increased by 16%. Along with federal budget expenditures for food provision, Malaysia made sure that the population had sufficient food.

FIGURE 6
**Malaysia: Food manufacture increased by 16%**
(index)

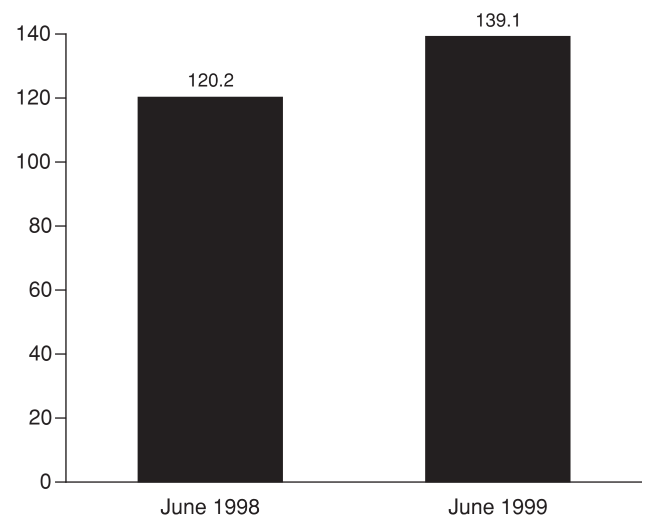



**Figure 7** shows the banks' weekly disbursement of loans. During the month of June 1998, on average, Malaysian banks disbursed 4.98 billion ringgits worth of loans to industry, agriculture, etc., per week; during the month of February 1999, on average, Malaysian banks disbursed 6.55 billion

FIGURE 7
**Malaysia: banks' weekly disbursement of loans**
(billions of ringgit)

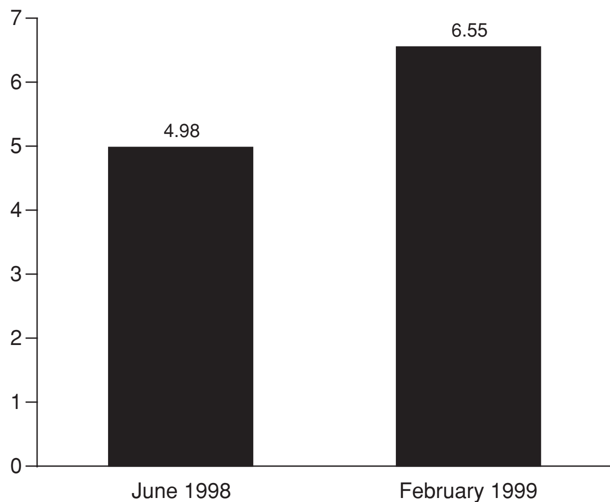
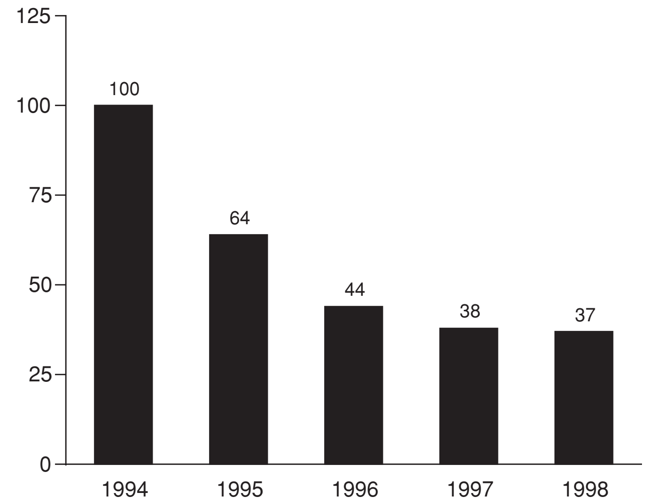



FIGURE 8
**Mexico: commercial bank loans**
(index 1994=100)




ringgits worth of loans to these core economic areas, per week. Malaysia's policy of increased bank lending to inject liquidity into manufacturing, agriculture, and the productive side of the economy, has worked. Contrast this to the fall in the volume of lending in Mexico, under the general dictates of IMF conditionalities (**Figure 8**). Between 1994 and 1998, the volume of loans extended by Mexico's commercial banks was cut by 63%. Mexico's industrial economy has been contracting.

Finally, **Figure 9** depicts that Malaysia has built up its foreign reserves from a level of $20.5 billion in June 1998, to $31.7 billion in July 1999.

The policy of nation-state economic sovereignty can only fully work, if a solution is found to the broader problem of the dying, bankrupt world financial system. Dr. Mahathir has acknowledged this, saying that the world must go next to a "new financial architecture." Lyndon LaRouche has scientifically situated this as a New Bretton Woods monetary system, centered around the Eurasian Land-Bridge, the development project of the 21st century.

It is evident that Malaysia's approach has been a success. Its outcome stands in sharp contradistinction to the outcome in Thailand and Indonesia, in both of which nations the BAC and IMF's conditionality programs were applied. Thailand's economy is seriously contracted; Indonesia's economy is disintegrating, in part, because of the added feature of a BAC-directed political destabilization program.

What Dr. Mahathir demonstrated, is that the economic method based on sovereignty works. Malaysia is a small nation of 22 million people; it stood up to the attack of the world's financiers, and won. But there is also a matter of morality here, which should be the standpoint of economics. Other nations cowered in front of the financiers, and failed. What Malaysia in general, and Dr. Mahathir in particular, reflect, is the courage that maintains that great tasks can be achieved. Nations and individuals who master this quality can bring an end to this dying world financial system.

FIGURE 9
**Malaysia: foreign reserves**
($ billions)