

Release No.: 28\SEP

02-2\91\09\20

**ADDRESS BY MR LEE KUAN YEW, SENIOR MINISTER OF
SINGAPORE, TO THE KAZAKHSTAN SUPREME SOVIET**

ON 20 SEPTEMBER 1991

I hesitated when I was invited by your President to address you on possible reforms of Kazakhstan's economy to make it into a free market economy. My experience is limited to Singapore, a small island in Southeast Asia with a very different economy. It has little or negligible agriculture, no mining and no heavy industries. Our livelihood depends on trade, services and light industries. I am therefore unqualified to give advice on how to reform your planned economy. However because your President has urged me to give my views, I proffer these observations on the principles of a market economy.

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After 74 years of the experience of communism in the Soviet Union since 1917, there is no question that the command economic system is not as productive as the free market economy. The free market system is able to satisfy the consumer better because each individual consumer is able to indicate what he likes and wants by the price he is prepared to pay for the product. And this

signal sets off people to grow, mine, manufacture and convey the product to the buyer.

This price mechanism predated industrialisation in the 18th century and the rise of capitalism. The world economy of 1991 has evolved from the earliest history of barter, first between peoples in a tribe, then trade and barter between tribes and finally across nations. The inconvenience of barter led to a common durable unit of exchange called currency or money. In Greece of 7th century BC, the issuance of coinage was taken over by the government from private individuals. In China, of Shang Dynasty, about 1500 B.C., cowry shells became the unit of currency because they were durable and impossible to forge. By the Tang Dynasty of the 7th century, paper money had appeared.

Currencies and exchange rates between currencies became the mechanism that has made possible the extended world order of trade in goods, services and intellectual property that provides people all over the world with a wide variety of goods and services. No one single mind can see, let alone comprehend, the extensiveness and complexity of the extended world economic order. Nor indeed can any government. The needs of the world's six billion people are infinite and complex. Price is the mechanism that sends signals worldwide so that goods and

services are moved to reach those who need and will pay for them at a price in money which is universal like gold, or paper currency which can be converted into other currencies at certain exchange rates.

Now, let me illustrate with a few examples how the two different systems have fared in the last few decades. First compare Austria and Czechoslovakia, per capita in 1937:

| | <u>1937</u> | <u>1990</u> |
|----------------|-------------|----------------|
| Czechoslovakia | \$170 | \$2,100* X 9.6 |
| Austria | \$190 | \$20,215 |

(pg 2. footnote - Economic Survey of Europe 1948 Geneva 1949)

*Source: IMF International Financial Statistics

| | <u>GDP Figures in US\$</u> | |
|--------------|----------------------------|------------------|
| | <u>1960</u> | <u>1990</u> |
| East Germany | \$974 | \$4,144 (x 5.8) |
| West Germany | 1,320 | 23,980 |
| North Korea | 140 | 1,080 (x 5) |
| South Korea | 160 | 5,550 |
| China | 70 | 320 (x 25) |
| Taiwan | 150 | 7,750 |

Sources:

(1) E. Germany, B.R. Mitchell, European Historical Statistics, 1750 - 1970;

Economic Bulletin German Institute for Economic Research, Aug 91

(2) W. Germany: IMF, International Financial Statistics

(3) S. Korea: IMF, International Financial Statistics

N. Korea: World Bank Atlas, Asian Yearbook, FEER

(4) China: IMF, International Financial Statistics

(5) Taiwan: Taiwan Statistical Data Book

If the people of Kazakhstan are to enjoy a standard of living and a quality of life comparable to that of the people in America, Western Europe, Japan, and the Asian Newly Industrialising Economies (NIEs), South Korea, Taiwan, Hong Kong and Singapore, you have to change your centrally planned economy to the free market system. These NIEs have developed so fast because they were able to maximise the benefits of the free market system. That is the only way to get maximum benefits from modern science and technology, especially communications and transportation technology which have created a world in which mountains, oceans and rivers are no barriers to the movement of peoples or goods and services.

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Indeed, Kazakhstan, like all the other constituent Republics of the Soviet Union, has little choice after what has taken place. The old Soviet system has already malfunctioned and been partially dismantled. It cannot be repaired or restored. Even if a young Stalin were to arise and tries to re-establish the old system, he will fail because the world has changed.

In this information age with TV, satellite, fax, jumbo jet, people with these facilities are well-informed. They cannot be cut off from the rest of the world, and it is impossible to coerce the Soviet people as was done in the 1930s to accept policies which they know left them so much poorer than their neighbours in Western Europe. I may add that the tumultuous and historic events in Moscow on 19 August that came to such a climax on 21 August, three days later, were only possible because the Soviet Union was already in the information age. If the coup had been in the 1970s in the Brezhnev era, it would probably have succeeded.

PART II - SOCIALIST COUNTRIES ALREADY ATTEMPTING REFORM

The first socialist country that tried to use the free market system was Hungary. The West called it Goulash Communism. But Hungary did not change the basics of the centrally planned economy. She used the market only at the retail or small shop level. The first major centrally planned economy that decided to break from planned economy was China. The Chinese knew that their economy was malfunctioning. Wisely they started in 1979 with agricultural reforms, abandoning the commune system, Mao's equivalent of the collective farm. They succeeded in increasing production enormously, providing more than

enough food for people in both the country side and the cities. Output of major farm crops in China increased by 35 per cent between 1979 and 1989, whilst the output of the industrial crops more than doubled over the same period.* They do not have to depend on external aid to feed themselves. Their success in agriculture has given them a secure basis for further reform in industry, tourism and services. They have also been successful in establishing enterprises based on the free market in special economic zones which they have designated in the coastal regions of China. Most of these were formerly trading ports where the Americans and West Europeans had established their business in the 19th century.

Vietnam has since taken steps to follow China in going for the free market. The Vietnamese freed agriculture in December 1986 and can now feed their own people. They have allowed small enterprises and petty traders. They have invited foreign investments.

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The CMEA (Council for Mutual Economic Assistance) countries of Eastern Europe have all started their reforms. The most advanced in their reforms are Poland, Hungary and Czechoslovakia. Less advanced in their reforms are Rumania, Bulgaria, Albania. They are all going through the pangs of transformation, with a drop in production, lower real incomes and increased unemployment, as inefficient factories are closed and new ones have not yet been established.

The former GDR (German Democratic Republic), now Eastern Germany, is a special case. It is best placed to succeed because of West Germany. Overnight, on reunification, they were given a viable, proven and successful framework of the free market economic structures, price mechanisms, financial institutions, banks, insurance companies, a strong currency and access to capital, management know-how, skills plus generous financial help to provide high standards of living.

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In spite of all these advantages, Eastern Germany is also facing severe short-term problems. Many unproductive factories have closed. Those that have not closed have found few buyers for their products which are out-dated and costly. Unemployment has increased dramatically. Progress has been slow in privatisation of enterprises and restructuring. New investments and new jobs

have also been slow in coming. Perhaps the most difficult to achieve is a change in the attitudes and thinking of workers accustomed to a non-competitive system. For the last 40 years, productivity and individual performance were irrelevant and their right to work and be rewarded with equal pay had become a way of life. It will take some effort and much time to get them to change and to adapt to working harder in response to incentives, ie to cut out malingering during working hours and to work smarter.

The first lesson to draw from the reforms of other centrally planned economies is that the people must be first prepared for the hardships that will accompany reforms. They must be told truthfully and must understand the cost for several years in lower standards of living, unemployment and greater effort. But they can also be told truthfully, that without reforms, hardships are in any case unavoidable because the former economic arrangements in the Soviet Union are not working. And without basic reforms to move into the free market, these hardships will be endured in vain. Only fundamental reforms can bring benefits which the free market system can begin to deliver several years after the initial disruptions caused by a change in the system.

Hence, an explicit commitment, a consensus to establish a market economy is very necessary at the outset of reforms. People of Kazakhstan must be told of the difficulties other countries with planned economies are going through, even though some of them like Czechoslovakia, Hungary and Poland had been thriving free market economies before Communism was established after World War II.

PART III - FUNDAMENTAL CHANGES NECESSARY

Depending on how power is distributed between the centre and the Republic of Kazakhstan, these basic steps have to be undertaken by either the government of the Soviet Union or of Kazakhstan:

(a) Macro-economic stabilisation. The huge budget deficits must be

reduced and controlled. Money supply must be restricted so that there is hard budget constraint on all enterprises. In simple terms, money must have value and meaning, which it will not have with inflation or worse hyper-inflation which a 23 per cent deficit in the budget of the Soviet Union for 1991 must cause, as it is paid for by the issuing of more roubles. Only when inflation has been checked will prices send meaningful signals to producers, buyers and sellers. If inflation is

rampant, then the price signals are distorted and become meaningless and the reforms will not work. Furthermore, roubles should be convertible. Only then can you attract foreign investments, earn foreign exchange through more foreign trade, and make your producers compete both domestically and internationally.

(b) Price, market and trade reforms.

(c) Private sector development, privatisation and enterprise restructuring.

Kazakhstan has to privatise its state run industries and it must restructure its agriculture so that individual families of farmers and herdsmen will get the full rewards of their efforts. There are many ways to achieve privatisation. But whatever the method, in each case an effective and competent core management team must be put in charge. Otherwise privatisation will not lead to increased productivity, nor produce higher returns on capital.

(d) Change the role of the state in the economy from that of principal economic actor to that of a neutral referee or regulator.

These four are complementary packages, not separate items to be implemented one after another.

There are different ways of achieving the specific objectives in the four packages above. However, as in Eastern Germany, economic dislocation is unavoidable during the transition period between the command economy and the free market system. Inefficient factories and enterprises will have to shut down. Workers unemployed. So there will have to be an economy “safety net” to minimise hardships.

PART IV - LEARN FROM OTHERS WHO HAVE STARTED REFORMS

It is best to learn from the experience of others who have travelled the same road away from the planned economy to the free market and avoid repeating the errors that they have made. The experts who can best help you benefit from the experiences of these other countries are the IMF and World Bank teams that have worked in China, and in Central and Eastern Europe. Their experience and knowledge will make Kazakhstan’s learning curve less arduous.

I do not wish to dwell on the technical details of the problems related to the privatisation of enterprises and the restructuring of agriculture. They are well documented by many World Bank and IMF reports. Their experts are better

qualified to describe these difficulties and explain how you can minimise them. Instead it may be of more value to you if I talk about the political and social conditions which are necessary for your reforms to succeed. The basic conditions needed are stability and consensus. Without them, the reforms will not be given enough time to establish themselves and take root, for it will take several years from the time all the basic changes are implemented, before they produce results. People will become impatient and feel a sense of frustration during this period as is happening in Poland. Therefore there has to be broad agreement on the direction of policies. Only if there is support and cooperation of the people for their government to implement these reforms will they be patient enough to let the reforms take hold and work.

PART V - CONSENSUS AND CO-OPERATION CRUCIAL FOR SUCCESS

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If you study the history of Western Germany and Japan after World War

II, and that of the newly industrialising economies of South Korea, Taiwan, Hong Kong and Singapore in 1960s and '70s the years when their economies took off, you will find they all had these pre-conditions of political stability and broad consensus. In other words, their people were prepared for several years of hardship and short supplies, during which they nevertheless gave their support

and cooperation to their governments to pursue policies for rapid industrialisation and rapid growth.

One great advantage my government enjoyed in Singapore was the support of the people for the difficult policies we had to implement. We faced immense difficulties in the 1960s. Our economy was based in international trade and the British expenditure on their military bases in Singapore. When the British bases were dismantled in 1968, we had to create a new way to make a living. The people gave my government solid support and cooperation freely expressed by secret ballot in multi-party general elections held every 4 - 5 years.

This rapport between the government and the people was crucial for high morale and wide consensus. When they were retrenched and unemployed, workers learned new skills and knowledge willingly and enthusiastically. Thus productivity increased each year. Had our workers merely passively accepted the difficulties but had no commitment, or enthusiasm, to push for a successful implementation of new policies, we would not have been successful.

Indeed, although this is not the conventional wisdom in the West, I venture my belief that perestroika or restructuring in the Soviet Union could have been more boldly and successfully implemented in the last six years if glasnost had not preceded but had followed it. In other words, only after basic reforms have been put in place as they could have been in the past six years, should glasnost have been introduced. Indeed, Mr Yeltsin in an interview with the London Sunday Times about two years ago, said that he had advised Mr Gorbachev to do this. Restructuring means economic dislocation, lower standards of living, with pain and suffering when inefficient enterprises and factories are closed and new ones are not ready to provide new jobs. During this period, if everybody vents his personal desires and frustrations, clamouring for immediate relief and results, there will be confusion and discord. What people want they cannot get, namely the immediate fruits of the free market economy. Pain and suffering has to be endured whilst the old system is abandoned and the new system established.

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With glasnost, the widespread venting of frustration has led to increased confusion. The determination to press on with basic but painful reform was weakened. Policies could not be pursued with the same vigour and single minded determination. If like China, the Soviet Union had implemented perestroika without glasnost, events would not have developed in the way they had. Today, the Soviet Union needs external economic help for fundamental

reforms. China has had little or no external help for her reforms and she has made seven to nine per cent growth per annum in the last 10 years. Glasnost has increased the expectations and aspirations of the Soviet peoples and made tough policies difficult to implement. This was not the case with China.

What I am saying goes against the current of Western liberal opinion. Western political scientists and commentators believe that glasnost is a recondition for perestroika. However my observations of conditions in Korea, Taiwan and Hong Kong during their period of rapid growth has led me to a contrary view.

Kazakhstan will need some 10 years to get the free market economy going in full stride. During this period, you require stability which only a strong government which has the support of the people, can provide. In other words, the people have to be educated to understand and be convinced of the need to make sacrifices to reach their higher long term goals. There must be wide consensus that stability and discipline are necessary for a successful transformation of a centrally planned economy into a free market economy.

Let me emphasise a word of caution. Nothing is more destructive of economic growth than political unrest or worse, political conflict. And in multi-

national (multiracial)** societies, nothing is worse than ethnic (racial) rivalries and collisions over the sharing of land and resources. In Singapore we have three of Asia's major nationalities (races), Malays, Indians and Chinese.

Without inter-ethnic (interracial) tolerance, inter-religious harmony and equal opportunities for every citizen regardless of nationality (race), language or religion, we could not have progressed. Kazakhstan, like many constituent republics of the old Soviet Union, has to establish this accommodation and cooperation between its different ethnic (racial) groups.

From my experience, a spirit of give and take plus a certain generosity of spirit from the majority nationality (race) is an essential basis for peace, stability and growth. But the minority nationalities (races) have to be realistic in their demands and place the nation's objectives above ethnic concerns. With the collapse of communist ideology as the unifying force in a multinational (multi-racial) society, the temptation is to fall back on ethnicity and religion as the unifying force of society. This temptation must be resisted or at least restrained, otherwise the results can only be disastrous as in Yugoslavia.

PART VI - BALANCE BETWEEN EGALITARIANISM AND PERSONAL REWARDS

Every country has its own norms or standards of what is fair between its citizens. In communist countries, the ideal aimed for is egalitarianism or nearly equal rewards. The problem however is that the system does not work efficiently, because few human beings are socialist heroes who are motivated by altruistic objectives, and ignore personal rewards. The survival of the human race has depended on each person instinctively looking after his immediate family and himself, then his relatives in the extended family, and then his clan or tribe. If this individualism is too strong then the tribe or society will become weaker because it is less cohesive and united. So a balance must be struck.

The Chinese, together with Koreans, Japanese and Vietnamese have the concept of 'yin' and 'yang', the female and the male principles expressed in the 'yin-yang' symbol which looks like two big headed fish equally and symmetrically sharing a circle. For my analogy, 'yin' denotes the all embracing female principle standing for equality and cooperation. 'Yang' denotes the male principle of all powerful virility, competitiveness and the will to win. Too much 'Yin' or equality leads to poor all round effort and performance. Deng Xiaoping called this the iron-rice bowl syndrome, which means every worker's rice-bowl cannot be broken. In other words, nobody can be sacked, indeed everybody is entitled to equal pay. So there is less and less rice to go into the bowl because no one exerts himself.

On the other hand, all 'yang' and little 'yin' leads to high performance, but at a price: no sense of unity in the people of being one nation. You can see this when comparing Hong Kong with Singapore. Hong Kong has shown that with little subsidy for education or health or housing, because each worker has to pay for his basic needs, including those of his children's education and health, he performs better. He works harder and faster. But Singapore cannot afford this each man for himself philosophy. There is the overriding political and social necessity for national unity so that the people can defend themselves and survive. As a British colony, Hong Kong does not have this responsibility. In other words, Singapore has to be worth defending because it offers every citizen equality of opportunity. We have moderated differences in rewards because of unequal abilities or skills by progressive taxation, with the successful paying much more taxes, so that all workers and their families will enjoy comparable standards of housing, health and education.

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Too much 'yang' or male competitiveness makes each man go for himself alone and risks undermining national solidarity. Therefore each nation must decide at which point between these poles of 'Yin' and 'Yang' it can achieve the best results. Examples of the high 'yin' free market societies are welfare state societies like Sweden, and Britain before Mrs Thatcher. But extensive welfare

requires many heavy taxes to make benefits more equal. This leads to a less efficient economy as the incentive to work one's best is blunted and a dependency mentality spreads over the mass of workers. At a certain point, the talented and educated from high 'yin' countries, like Britain, regularly emigrate to high 'yang' countries like America, where they find their talents and hard work better appreciated and rewarded.

Because Singapore has no natural resources, her economic growth and prosperity are totally dependent on human resources. Therefore we have had to be careful to emphasise the 'yang' qualities of competitiveness and to moderate the 'yin' qualities of equal rewards through redistribution of incomes. We have drawn lessons from intractable problems of high 'yin' countries, where high welfare expenditure has caused a slackening of effort, slower growth, and budget deficits.

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A centrally planned economy with incomes which are regulated and made more or less equal inevitably produces much less than a free market economy. The rational choice for Kazakhstan is a free market economy. How much egalitarianism you want to achieve through progressive taxes to redistribute wealth and unequal incomes is a matter of judgement for your leaders. You will have to choose your point of balance between these two poles of 'yin' and 'yang'.

Finally, may I thank you, President Nazarbayev, for inviting me to Kazakhstan and according me this honour of addressing this distinguished gathering of members of your Supreme Soviet, academia, officials and managers of enterprises and cooperatives. Let me wish you and the distinguished members of the Kazakhstan Supreme Soviet every success in your great endeavour to bring peace, progress and prosperity through the free market economy to the people of Kazakhstan.

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Footnotes:

*Industrial crops: cotton, oil-bearing crops, hemp crops, sugar crops, tobacco, silkworm cocoons, tea and fruits.

Source: China Statistical Yearbook, Various years

** Soviet usage is to refer to different ethnic or racial groups as nationalities.

The words in brackets are the usage in Singapore.

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