

# **GOVERNMENT INTERVENTION IN THE MALAYSIAN ECONOMY, 1970-1990: LESSONS FOR SOUTH AFRICA**

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# **GOVERNMENT INTERVENTION IN THE MALAYSIAN ECONOMY, 1970-1990: LESSONS FOR SOUTH AFRICA**

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## **KEYWORDS**

Colonialism

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Poverty Eradication

Restructuring

Industrialisation

NEP Outcomes

Growth

Intervention

South Africa



## ABSTRACT

GOVERNMENT INTERVENTION IN THE MALAYSIAN ECONOMY,  
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MPA research report, Faculty of Economic and Management Sciences, University of the Western Cape.

The research report examines the role the Malaysian government played in developing the Malaysian economy as a means to eliminating poverty and inequality and explores the lessons South Africa can learn from Malaysia's development experience.

Under British colonial rule Malaysia developed a divided multi-ethnic society characterised by gross inequality and high levels of poverty. Jolted by the 1969 race riots and in a major departure from the laissez-faire economic policy, the government embarked on the New Economic Policy (NEP) in 1970. This ambitious twenty-year social engineering plan ushered in greater state intervention in the economy. It greatly reduced poverty among indigenous Malays and made substantial progress towards achieving inter-ethnic economic parity.

The pragmatic Malaysian government used a combination of policy measures to achieve most of its targets. On the one hand it employed growth promoting measures favoured by proponents of neo-liberalism. It placed a high premium on political stability and continuity of government, macro-economic stability, an efficient civil service, human resource development, agricultural reform and export orientation. On the other hand it pursued interventionist policies on a scale unprecedented in Malaysia's history. It was successful in redirecting vast resources to the disadvantaged Malays without negatively impacting economic growth. Faced by deficits during the world recession of the mid-1980s, the government was prepared to adapt its policies and to forge a partnership with the private sector. Its adaptability to changing conditions was a hallmark of the government's economic management.

While the Malaysian model cannot be superimposed on South Africa, lessons can be learned and adapted to suit local conditions. The Malaysian experience emphasises the importance of economic growth since growth played a key role in the successful restructuring of the economy, poverty reduction and the redressing of ethnic imbalances. To this end it points to the importance of economic fundamentals. However, it also provides a concrete example that the government has a necessary and indeed crucial role to play in redressing poverty and historical imbalances since these are not automatic outcomes of neo-liberal policies.

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## DECLARATION

I declare that *Government intervention in the Malaysian economy, 1970-1990: Lessons for South Africa* is my own work, that it has not been submitted for any degree or examination in any other university, and that all the sources I have used or quoted have been indicated and acknowledged by complete references.



RALPH ARTHUR SIMPSON

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To Rennis, for the encouragement and infinite patience.



# CONTENTS

Title Page .....	(i)
Keywords .....	(ii)
Abstract .....	(iii)
Declaration .....	(iv)
Acknowledgements.....	(v)
CHAPTER 1 INTRODUCTION .....	1
CHAPTER 2 AN HISTORICAL OVERVIEW .....	10
Introduction .....	10
Pre-independence Malaysia .....	10
Post-independence Malaysia .....	15
CHAPTER 3 GOVERNMENT INTERVENTION: THE NEW ECONOMIC POLICY (1970-1990).....	20
Introduction .....	20
Objectives and targets of the NEP .....	20
Increased government intervention .....	22
Poverty eradication and income distribution .....	23
Eliminating the identification of race with economic function .....	28
Equalising equity ownership .....	30
Industrial policy .....	32
Post-NEP financial crisis .....	43
CHAPTER 4 AN ASSESSMENT OF THE NEP .....	47
Introduction .....	47
Poverty eradication and income inequality .....	47
The restructuring of Malaysian society .....	50
Social services and quality of life .....	56
Other NEP outcomes .....	61
CHAPTER 5 LESSONS FROM MALAYSIA .....	65
Introduction .....	65
The importance of economic growth .....	65
Factors which influenced Malaysia's growth performance.....	67
Conclusion .....	73
BIBLIOGRAPHY .....	78

## CHAPTER 1: INTRODUCTION

### PURPOSE OF STUDY

The purpose of this study is to examine the role the Malaysian government played in developing the Malaysian economy as a means to eliminating inequality and poverty.

In the process of conducting the study the following critical questions will be addressed:

- To which extent has the Malaysian government intervened in the economy?
- What were the objectives of government intervention?
- What forms did government intervention take?
- What was the impact of government intervention on poverty and inequality in Malaysia?
- What lessons can the South African government learn from state intervention in Malaysia?



### RATIONALE

There are a number of similarities between South Africa and Malaysia. Malaysia, like South Africa, is characterised by deep ethnic divisions. Its population consists of three major ethnic groups, namely the indigenous Malays or *bumiputera* (sons of the soil), Chinese and Indians. In 1996 the Malaysian population of 20 million people consisted of 61 % Malays, 30% Chinese and 8% Indians while the remaining 1% consisted of other minor ethnic groups (Gomez and Jomo, 1999:1). A feature of Malaysian society has always been the gross inequalities in income and wealth distribution among different groups in the population as well as rural-urban differences in economic opportunities. As a consequence poverty was mainly prevalent in the Malay community who lived mainly in the less-developed rural areas.

Secondly, the Malaysian government is dominated by the bumiputera who are economically disadvantaged. This reality is in stark contrast to multi-ethnic countries such as the United States of America, where the economically dominant group is in control of the government.

Thirdly, the minority non-bumiputera, consisting mostly of Chinese but also including Indians and foreigners, dominate the economy.

The above realities have produced serious economic imbalances but also ethnic political imbalance in Malaysia.

Since 1970 Malaysia implemented the policy changes embodied in the New Economic Policy (NEP) and Outline Perspective Plans in a concerted drive to address the above concerns, particularly the elimination of poverty and inequality. These policies marked an about-turn from the colonial laissez-faire approach to a more interventionist role for the state in promoting economic redistribution.



In view of the pressure on South Africa to pursue neo-liberal economic policies and in particular the desire on the part of the international financial institutions and the wealthy nations to see less government intervention in the economy, a study of events in Malaysia from the inception of its new policy framework in 1970 to its conclusion in 1990 will shed light on the efficacy of an interventionist philosophy aimed at eliminating poverty and achieving greater equity.

An analysis of the NEP and subsequent economic policy interventions of the Malaysian government, and an analysis of its results will provide an indicator as to whether there is a case for the South African government to play a more than regulatory role in the development of the economy or whether it should leave economic growth and the eradication of poverty and inequality entirely in the hands of market forces.



## LITERATURE REVIEW

The World Bank (1993) propounds the neo-classical view in its attempt to explain the success of Malaysia and other East Asian economies. It argues that these economies performed well because they got the basics right. It cites the provision of fundamentals such as a stable macroeconomic environment, adequate infrastructure, a free trade regime, high investment in human capital and limited price distortions as providing the basis for the rapid growth of the East Asian economies. While there is an element of truth in this assertion, the Bank's assessment provides scant recognition of the role the state played, hence advocating 'limited government activism' as a precondition for success. It is noted that the World Bank's interpretation of the evidence has been strongly criticized for shortcomings such as selective use of evidence, flawed econometric analysis and rudimentary analysis of market failures that are not related to the facts (Lall, 1996:153). As Lall contends: 'it therefore smacks of ideology rather than reasoned analysis' (1996:153).



In its 1993 report the Bank acknowledges, albeit reluctantly, that the success story of the region 'sometimes included extensive government intervention in markets'. This report however, still largely propagates neo-liberal orthodoxy while downplaying the role of the state in East Asian economic development.

Snodgrass (1980) contends that the Malaysian government pursued a massive affirmative action programme, the NEP, in an attempt to reduce ethnic economic inequality. Malaysia undertook its redistribution and restructuring drive in the 1970s and 1980s within the context of economic growth. Malaysia achieved a high growth rate while at the same time achieving most of its redistributive affirmative action goals.

Snodgrass (1996) dismisses the allegation that the growth rate would have been higher in the absence of redistribution. He argues that Malaysia could have suffered violent political strife similar to the race riots of 1969, which would have scared away domestic

and foreign investors, placing Malaysia on a much lower, if not negative, growth trajectory. He ascribes Malaysia's remarkable performance in growing the economy while redistributing to a combination of three factors: good policy, good luck and pragmatism. He regards the most significant to be government pragmatism which is illustrated by key policy changes undertaken as circumstances changed.

Emsley (1996) also stresses the importance of economic growth, saying it is indispensable for a successful redistributive policy. Economic growth and a policy framework that encourages a high employment growth rate lead to a reduction in racial disparities. While poverty reduction was facilitated by government intervention in the economy he regards economic growth and structural change in the economy as the principal factors responsible for poverty reduction. Of particular significance to Emsley is the fact that the Malaysian government could successfully redistribute because it redistributed the growth increment while leaving the underlying distribution of existing assets intact. Economic growth can thus allow the space for policy makers to make redistribution a positive-sum rather than a zero-sum game. Emsley regards the Malaysian government's ability to foster growth as one of the world's best performances and cites policy design and fortuitous natural resource endowments as central to its good performance.

Ahuja, Bidani, Ferreira and Walton's (1997) research into poverty and inequality in East Asia found that sustained economic growth has generated considerable benefits for the poor. Countries such as Malaysia, China, Indonesia and Thailand have experienced absolute poverty reductions that are exceptional by any international or historical standards. However, it also found that poverty remains unevenly distributed in most East Asian economies and is primarily a rural phenomenon. The major contribution of the report is the finding that growth led to an improvement in the standard of living because of policies that augmented the capabilities or expanded the opportunities of the poor. Policies such as public investment in primary and secondary education, basic health care and water and sanitation are examples of the former, while policies such as more equal

land distribution, public provision of rural infrastructure and the encouragement of employment growth in the manufacturing and services industries expanded their opportunities.

The ideas of Wade (1990) are instructive and present an alternative to the neo-liberal interpretation of East Asian economic success. Where the World Bank and other neo-classical economists tend to downplay the positive role of the state, Amsden and Wade assert that the success of the East Asian economies cannot simply be ascribed to a strict adherence to free market principles. They convincingly argue that governments played a key role in East Asian developmental success by intervening in order to ameliorate market failure. The success of East Asian economic performance is a result of the effectiveness of industrial policy in developing various industries in the economy in order to maintain global competitiveness. Using incentives, controls and mechanisms to spread risk these policies enabled the government to guide or govern the market. Thus, by 'getting prices wrong' governments produced different production and investment outcomes than would have occurred with free market policies. Wade's contention that the government has led, and not followed, the market helps to provide a more balanced picture of the development processes in East Asia.

Gomez and Jomo (1999) agree that the reforms instituted by the NEP reduced poverty substantially and led to the growth of Malay middle and business classes. They contribute to the debate on Malaysian development policy by focusing on political patronage and the rentier activities resulting from it. They argue that executive dominance enhanced not only the government's developmentalist capacity but also political patronage. This facilitated the channeling of state-created rents to well-connected businessmen.

Yet, despite rentier activities leading to inefficiencies, rents were not always wasted by unproductive activities and may also have contributed to capital accumulation and productive investments. After all, the rentier strives to maximize rents and profits.

However, the most significant contribution to the debate on Malaysian economic development is their detailed argument that rents could have been better deployed to accelerate growth and to generate productivity gains.

## **THEORETICAL FRAMEWORK**

The research will operate from the premise that there still is a strong need for government to intervene in the economy in order to ensure social delivery and equity since these are not automatic outcomes of the free market economy.

The validity of this postulate will be explored by focusing on the role and form of government intervention in the Malaysian economy and the results thereof.

## **METHODOLOGY**

This research is a one-country study and will examine the writings of various authors focusing on the role of government in economic development in Southeast Asia and in Malaysia in particular.

The sources of data will be books, journals, newspaper articles and other relevant documents published by government departments and scholars which deal with a description, analysis and critique of Malaysian socio-economic transformation. The statistics and other information gained will enable a comparison of earlier socio-economic indicators with more recent indicators and serve as a pointer to the successes and/or failures of government intervention in the economy.

In addition, the Internet and non-written sources will be utilised to obtain an even wider range of data relevant to the research topic.

Data collected from the above sources will then be analysed. The accumulated information will be scanned and irrelevant or inaccurate information discarded. Information will then be organised in a manageable form so as to make sense to the researcher.

## **SIGNIFICANCE OF THE STUDY**

The significance of the study lies therein that it will shed light on the extent and nature of state intervention in the Malaysian economy. What should become clear is the extent to which such interventions contributed to the rapid economic growth of the country and the concomitant improvement in the quality of life of ordinary Malaysians, notably the *bumiputera*. Despite reservations about the replicability of the Malaysian model in South Africa, there will nonetheless be lessons that South Africa and other developing economies could learn from the Malaysian experience.

## **ORGANISATION OF THE STUDY**



**Chapter 1** will be an introduction aimed at providing an overview of the purpose and scope of the study. It will furthermore provide the theoretical and conceptual framework that will guide the study. In order to obtain a broader view of the theoretical underpinnings and diverging opinions in this field of study, the thinking of key theorists and authors will be explored.

**Chapter 2** will analyse the recent history of Malaysia in order to trace the roots of ethnic identities and the ethnic division of labour. British colonialism has had a profound impact on shaping the socio-economic landscape by, inter alia, assigning economic roles along ethnic lines. This stratification of Malaysian society not only led to deep divisions but also reinforced uneven development and the subsequent unequal distribution of wealth between ethnic groups. These inherent contradictions came to a head in the 1969 race riots which jolted the state into adopting a programme of economic restructuring.

**Chapter 3** addresses the policy responses of the state. After the 1969 riots the federal government responded with its New Economic Policy. The main thrust of the NEP was to propel Malaysia from a society characterised by poverty and inequality to one geared at eliminating poverty and inequality, especially among the bumiputera. Since political power was concentrated in the hands of the disadvantaged indigenous population it was not surprising that the government sought to correct the economic imbalances by using the state apparatus. Thus government intervention in the economy increased significantly while the unbridled functioning of free market forces was curtailed. This chapter will look at the nature of government policies with a special focus on industrial policy.

**Chapter 4** assesses the impact of Malaysia's policy reforms. The results achieved after twenty years of government-driven NEP restructuring show to which extent the lives of ordinary Malaysians have improved. Structural change in the economy led to the relative decline in agriculture's share in the growing economy while that of both industry and services grew rapidly. The fact that many Malays could be employed in the industrial sector made massive inroads into poverty and income inequality. Significant progress was made towards greater ethnic parity in employment and occupation distribution although there remained an employment imbalance in certain lucrative occupations. While the target for ownership equity was not met, the outcome was remarkable given the low level of Malay ownership equity at the start of the NEP. Furthermore, the chapter will also shed light on negative outcomes of government policies, for example the proliferation of political patronage and increased intra-ethnic inequality, especially amongst Malays.

**Chapter 5** concludes the research project by highlighting the reasons behind the successful transformation of the Malaysian economy, the elimination of poverty and the reduction in inequality. The contribution of the government to this process is evaluated while highlighting some of the lessons the developing world and South Africa in particular, could learn from the Malaysian experience.

## **DEFINITION OF KEY TERMS**

### **Government intervention**

The term government intervention will be viewed, within the context of a free market economy, as the deliberate action taken by the government to influence the economy by means of legislation, fiscal and monetary policy as well as direct government participation in the productive sectors of the economy.

### **Economic Growth**

Economic growth will be deemed to be an expansion in the capacity of an economy to produce increased quantities of goods and services and can be measured by the increase in real Gross Domestic Product (GDP).



### **Equity**

The promotion of equity will refer to a more even distribution of the wealth generated by the economy and can be measured by the extent to which economic growth leads to a narrowing of the income gap between the different ethnic groups but also within ethnic groups.

### **Higher living standard**

This concept will denote the reduction in poverty and the improvement of the quality of life of the general citizenry as measured by the real per capita GDP.

## **CHAPTER 2: AN HISTORICAL OVERVIEW**

### **Introduction**

Malaysia, like South Africa, was first a Dutch, then later, a British colony. Like South Africa, modern Malaysian society was fundamentally shaped by the impact of colonialism. It brought about the transformation of Malaysia's largely agrarian peasant economy to a new free trade economy where commodity exchange predominated. Under British colonial rule the country's ethnic diversity was established and cemented, as was the division of economic function along ethnic lines. The country's economic and political structures as well as many of its problems were shaped by its colonial experience. This chapter will give an overview of Malaysia's history in order to understand the effect colonialism had on shaping its economy and its economic development priorities.



### **Pre-Independence Malaysia**

The Malay Archipelago was an active trading area for centuries before European intervention. Many trading posts were developed along the coastline where regular interaction took place between the indigenous Malay people, Chinese and Indian traders. There were many cross-cultural influences with Indian concepts of kingship and political power exerting a strong influence on Malay rulers. Later the rapid spread of Islam provided an important aspect of Malay identity which, apart from language and custom, further distinguished them from Chinese and Indian immigrants who poured into Malaya in vast numbers during the nineteenth and twentieth centuries. The origins of the modern plural society in Malaysia, therefore, are commonly traced back to the colonial inspired influx of Chinese and Indians (Eyre, 1997:124).



### *The British East India Company*

The British East India Company came to the region in the late eighteenth century in search of trading and military bases. The fragmented Malay rulers ceded territory to the British in exchange for recognition and protection against internal and external threats. The British managed to gain possession of two strategic islands, Penang and Singapore. These ports, together with Melaka were combined into one administrative unit, the Straits Settlement. Because conditions in the Straits Settlements were very stable many traders, especially Chinese, were drawn to the area. Many Chinese entered the tin-mining industry in the Malay states. Malay chiefs who had been involved in tin-mining on a small scale found the Chinese very useful since they were able to mine deeper with technology adapted from rice farming. Also, the Chinese mining communities were small and could be closely controlled by the Malay chiefs.

### *Chinese Migration*



However, when the demand for tin increased dramatically during the 1850s there was an influx of Chinese labour and capital into the tin-rich states of Perak and Selangor. Subsequent rivalry for tin-mining land between Malays and Chinese and between Chinese secret societies started to threaten trade and investment in the Straits Settlements. The British intervened and established protectorates over the main tin-producing states. In 1895 they created a new federation with a centralised bureaucracy with the aim of overseeing the states of Perak, Selangor, Pahang, and Negeri Sembilan. Control was gradually extended to all of the states and by 1914 the Federation was complete.

According to Faaland, Parkinson and Saniman (1990:4) the history of ethnic pluralism began to be significant when the British took control and dominated the Malay states. Under British administration the development of tin-mining and the immigration of Chinese accelerated. Between 1880 and 1910 six million entered Malaya from China.

Many of the industrial towns that emerged in the tin-mining areas in the western part of the peninsula were overwhelmingly Chinese (Faaland et al. 1990:3).

### ***Indian Migration***

At the turn of the nineteenth century the demand for natural rubber increased substantially because of increased demand in the United States of America and Europe as tyres were being produced in massive quantities. Coffee planters, experiencing a slump in the market, diversified into rubber. Because of their access to capital markets, British companies soon dominated the rubber industry. The fact that the British colonial government made a concerted effort to keep Malay peasants in paddy rice and other food production left British companies in search of a workforce. They recruited Indian indentured labour to fill this void. The Indians came primarily from South India and Sri Lanka, with significant Sikh and other minorities. At the peak of this immigration immediately prior to the First World War, approximately 100 000 Tamils were entering Malaya each year (Drakakis-Smith and Davids, 1992:129). Chinese and Indian immigration was allowed to continue unregulated until the Depression after which the colonial government instituted a restricted immigration policy. However, by this time the demography of the country had undergone unalterable change.

### ***Ethnic Divisions in Malaysia***

Despite the formation of a plural society in Malaya with the mass migration of Chinese and Indians into the country, there was very little integration and only limited interaction among the ethnic communities (Gomez and Jomo, 1999:10). Chinese and Indian immigrants viewed their stay in Malaya as a temporary means of accumulating savings and saw no need for integration. The colonial period created a situation where Chinese were mainly involved in the urban-based tin mining activities, the Indians providing labour in semi-rural plantations and the indigenous Malays owning or working the remaining agricultural land. Chinese and Indians later diversified into trading, banking

and other services while the Malays remained mostly in the lowly paid traditional sectors. The only Malay involvement in the modern economy was in the civil service, the police and army where wages were relatively low. Not only were the ethnic groups kept apart by economic specialisation, but also by spatial segregation (Eyre, 1997:126-128). Chinese and Indians were employed along the rich west coast where most of the commercial activities were to be found while a large proportion of Malays remained on the poorer north and east coast where they had less contact with the colonial economy and Chinese and Indian immigrants. They therefore remained embedded in their traditional value system, largely untouched by the new economic and social forces (Emsley, 1996:15). Deep ethnic differences prevented the various groups from unifying along class lines. As a consequence the British were left with a colony that was easy to administer (Drakakis-Smith and Davids, 1992:129).

Racial differences in Malaysia were sharpened with the Japanese occupation during World War II. The Communist Party of Malaya (CPM) with its essentially Chinese membership actively resisted Japanese occupation. They were brutally treated by the Japanese. In contrast the Japanese cultivated the Malays, often placing them in high administrative positions (Emsley, 1996:18). To compound matters the Japanese used Malays in para-military forces to fight Chinese resistance movements. Action against collaborators by the Chinese-dominated Malayan Peoples Anti-Japanese Army (MPAJA) led to mutual killings between the two ethnic groups.

### ***Towards Self-Rule and Independence***

When the British returned to Malaya after the Japanese occupation ended, they were prepared to lay the basis for self-rule and eventual independence. It was partly in an attempt to reduce the attractiveness of communism to the Chinese population that the British proposed the Malayan Union Scheme in 1946. Its aim was the establishing of a unitary state. It proposed the extension of citizenship to all locally born residents in addition to those who lived in Malaya for a specified period. All citizens were to enjoy

equal political status irrespective of race. In addition, the sultans were to retain their positions but all real power was to be transferred to the crown. The Malays, already insecure because of their inferior economic position, feared that they were to lose their political ascendancy over the immigrants. They were vehemently opposed to the idea of the Union which they saw as an attempt to abolish the Malay Sultanate. They also rejected the idea of providing equal political rights to all Malaysians, regardless of race (Gomez and Jomo, 1999:11).

### ***The Realignment of Political Forces***

In the face of the Union Scheme the previously divided, uncoordinated and therefore weak Malay indigenous population united to fight the common threat. In May 1946 a number of smaller Malay clubs, associations and political parties banded together to form the UNITED MALAYS NATIONAL ORGANISATION (UMNO). Under UMNO's leadership mass demonstrations and protests were organised forcing the British authorities to back down on their union scheme. UMNO became the leading political force in the country, with its support base largely in the Malay-dominated rural areas. The Malaysian Indian Congress (MIC) was also founded in 1946 with its primary aim the protection of Indian vested interests while the Malaysian Chinese Association (MCA) was founded in 1949 to protect and advance Chinese vested interests (Gomez and Jomo, 1999:11-12). The three parties formed the Alliance Party which together obtained independence from Britain in 1957.

### ***The Malaysian Bargain***

Immediately prior to independence a bargain was struck between UMNO and the MCA which was later reflected in the Constitution for Independent Malaya. In exchange for a relaxation of citizenship requirements and a tacit understanding that Chinese economic interests would be safeguarded, the non-Malays agreed to Malay political and symbolic paramountcy in society (Jesudason, 1990:44). Islam was recognised as the state religion,

Malay as the national language and the position of the Malay sultans was protected within the framework of a constitutional democracy. Furthermore, the Constitution provided for fast tracking Malay development by allowing for official favouritism in the bureaucracy, education and business. Thus the expectation was created amongst Malays that the government of the newly independent Malaya would gradually reverse the backwardness compounded by decades of colonialism. Singapore, Sabah and Sarawak, who joined the Federation of Malaya in 1963, converting it into the bigger Federation of Malaysia, also became party to the 1957 bargain. Singapore, however, withdrew from the Federation in 1965.

### **Post-Independence Malaysia**

The British left the Malay elite in political control of Malaysia after Merdeka (Independence), albeit without economic power. The Chinese on the other hand wielded economic power but had very little political power. The state retained the open, export-oriented economy after Independence, thus operating within a *laissez-faire* framework with a strong initial focus on primary commodity exports. A 1955 World Bank report drew attention to the fact that Malaysia would be saddled with an unemployment problem if nothing was done to diversify the economy (Jesudason, 1990:48). According to Jesudason this dilemma stemmed from a population growth of 3.3 percent amid diminishing employment prospects in the rubber and tin sectors because of the decline in natural rubber prices and the anticipated exhaustion of tin deposits. To exacerbate matters, Malay smallholders were suffering from low productivity and diminishing plot sizes. The World Bank report recommended tariff protection in order to encourage diversification into import substituting industrialisation and furthermore advised that foreign capital be utilised to achieve this goal.

### ***Import-Substituting Industrialisation***

As a consequence, the government diverted from colonial practice to encourage import-substituting industrialisation (ISI) by offering infrastructure, credit facilities and most importantly, tariff protection, to the mainly foreign manufacturing companies. The 1958 Pioneer Industries Ordinance offered tax relief allowances on profits for pioneer firms who were mainly import substituting manufacturing firms (Gomez and Jomo, 1999:16). British investors in particular, seeking to maintain and increase their colonial market share, made full use of these incentives. Domestic capital participation in ISI initiatives was very limited and normally restricted to Chinese companies because the incentives tended to favour large, capital-intensive, foreign companies. Consequently the local manufacturing and technological base remained small and dependent on foreign capital.

Foreign companies merely established subsidiaries for the assembling, finishing and packaging of goods produced with imported components. The motorcar assembly industry, for example, replaced imports of completely built-up units with imports of completely knocked-down packs to be assembled locally (Gomez *et al*, 1999:17). The fact that the materials and technology utilised in the production process were imported from parent companies located elsewhere did not encourage linkages to the rest of the Malaysian economy. By the mid 1960s the inherent contradictions of the Malaysian ISI strategy had become quite apparent. Moreover, many transnational corporations were beginning to relocate their more labour-intensive production processes to East Asia in an attempt to reduce production costs. In 1965 the Federal Industrial Development Authority (FIDA), now known as the Malaysian Industrial Development Authority (MIDA), was set up to encourage new industrial investment. By 1967 it began to attract and develop export-oriented industries. However, it was the 1968 Investment Incentives Act which 'signalled the strategic switch from ISI to export oriented industrialisation (EOI)' (Jomo, 1987:115). The government also provided for the amendment of labour laws to minimise industrial relations problems in the labour-intensive export-oriented industries.

### ***Deficit Financing***

A further departure from colonial economic policy was the new government's willingness to resort to a measure of deficit financing in order to drive its development policies. This policy gained impetus after the 1959 elections when the radical Malay nationalist party, the Pan-Malayan Islamic Party, (now called PAS) threatened to make inroads into UMNOs traditional Malay support base. Despite pressure from British commercial interests, Tun Tan Siew Sin who took over as Finance Minister in 1957 pursued a policy aimed at increasing government development expenditure, even allowing for a moderate budget deficit. The Alliance government could therefore mobilise much more resources than before. A large portion of its financing requirements was derived from the government-run Employees Provident Fund (EPF). As the number of workers and therefore the tax base increased, there was a concomitant increase in the resources available in the EPF. This enabled the government to draw up to 50 percent of its financing requirements from the fund while the rest was obtained from the commercial banking sector (Jesudason, 1990: 49).

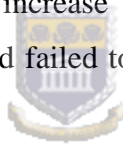
### ***Increased Government Expenditure***



As the government became more successful in extricating itself from foreign business pressures, it became more confident and more prepared to tax businesses, thereby increasing its revenue markedly. The government's increased spending can be seen in its five year development plans. In the First Five Year Plan (1956-60) development spending was \$1 billion, in the Second Five Year Plan (1961-65) \$2.7 billion and in the First Malaysia Plan (1966-70), \$3.6 billion. As a percentage of GNP public investment was 2.7 percent, 7.3 percent and 6.0 percent respectively (Jesudason, 1990:50). Greater fiscal capacity made it easier for the government to intervene and shape its development policies to satisfy internal political priorities. The First Five Year Plan (1956-60) concentrated on the development of urban infrastructure in the hope that dynamic urban development would lead to a trickle-down to the rural areas by way of an increased demand for rural products. In the Second Five Year Plan (1961-65) government spending was diverted to agriculture and the rural sector. The government moved to

diversify agriculture with the promotion of oil palm, tobacco and cocoa production. Substantial amounts of money were invested in infrastructural and technological improvements for the plantation sector. As a result, production per worker more than doubled between 1960 and 1970 (Drakakis-Smith and Davids, 1992:132). However, Drakakis-Smith and Davids (1992:132-133) assert that improvements in productivity did not translate into an increase in real income and therefore an improvement in the standard of living of rural dwellers did not occur.

The government furthermore made a special allocation of \$124 million for the promotion of Malay economic development in the First Malaysia Plan (1966-70). It set up a Malay bank, Bank Bumiputera, and established the Mjlis Amanah Rakyat (MARA), a trust for the indigenous people aimed at providing commercial loans to existing and aspiring Malay entrepreneurs (Jesudason, 1990:52). However, the \$124 million amounted to only 3.8 percent of the total expenditure of the First Malaysia Plan. This shows that even though government was prepared to increase its intervention in the economy, such intervention was of a limited nature and failed to address the backward economic status of Malays.



### ***Economic Inequality and Malay Discontent***

The government of Tunku Abdul Rahman was severely criticised for its gradualistic approach to Malay economic development. Malays were unhappy with the policy of *laissez-faire* and generally felt that it served to benefit non-Malays more than Malays (Hui, 1988:24). The rumblings of Malay discontent were driven home at the First and Second Bumiputera Economic Congresses in 1965 and 1968. At the Second Congress participants, mainly Malay businessmen, politicians and bureaucrats, called for a reorganisation of the economic system along the lines of the early Japanese industrial period. This proposal required the state to participate more actively in capital accumulation on behalf of a weak indigenous bourgeoisie and then transfer resources to



them at a later date (Hui, 1988:20). The Congress laid the foundations for the post-1970 New Economic Policy.

More than a decade after Independence the Malaysian economy was characterised by the diversification of economic activity and relatively high growth. The twin pillars of the colonial agriculture-based economy, rubber and tin, were successfully diversified with the introduction of palm oil, tobacco and cocoa production. The growth of the industrial sector also enhanced the development of a diversified economy. However, economic growth had not addressed poverty and inequality. As Drakakis-Smith and Davids (1992:131) point out, the main problem with the 1960s was not that economic growth failed to materialise but that the distribution of the benefits was poorly managed. Emsley (1996:19) is very specific, asserting that economic growth was largely confined to the modern sector, thus bypassing the traditional sector where most Malays were employed. According to Gomez and Jomo (1999:19) inter-ethnic income differences were reduced only slightly while intra-ethnic differences grew, especially among Malays. Poverty thus remained widespread, especially in the rural areas, while income inequality increased. Bumiputera progress in the corporate sector had not occurred on a large scale with the result that corporate ownership remained largely in the hands of Chinese (22.5 percent) and foreign capital (60.7 percent) (Gomez *et al*, 1999:19). Malays continued to be active in the low-income sectors of the economy such as peasant agriculture and the public sector and therefore remained disproportionately poor. Their aspirations to improve their economic status relative to the Chinese did not materialise. As inequalities grew ethnic tensions mounted.

### ***The 1969 Race Riots***

On the other hand the non-Malays, especially the Chinese, began to question the special rights afforded to Malays in the 1957 bargain. A younger generation began to emerge who questioned the validity of past agreements. They demanded political equality and started campaigning for a 'Malaysian Malaysia' as opposed to a 'Malay Malaysia',

thereby calling into question Malay or bumiputera political dominance. The campaign had a negative impact. Jesudason (1990:69) argues that the Malays considered the more favourable economic position of the Chinese to be bad enough, but felt particularly threatened at Chinese attempts to extend their economic power into the political sphere. These contradictions came to a head with the 1969 elections. Even though the Alliance won the election, a large number of non-Malays and a considerable body of Malays abandoned the party and voted for the opposition. The Alliance lost its two-thirds majority while the opposition parties made considerable gains. Non-Malay opposition parties won enough votes to form the state governments in four major states. It appeared that the Chinese would have significant power in national politics in addition to their control of the economy. Chinese opposition parties arranged victory processions through the streets and the Malays responded with their own processions. Bloody racial riots erupted on 13 May 1969, prompting the government to declare a state of emergency and to suspend parliament (Emsley, 1996:20; Gomez and Jomo, 1999:22).



UMNO's response was to place the blame for the inter-ethnic violence squarely on economic inequality between the races. It replaced moderate Prime Minister Tunku Abdul Rahman with his deputy, Tun Abdul Razak Hussein who reconstituted the Alliance as a broader coalition, the Barisan Nasional. The new coalition, which included most opposition parties, strengthened the leadership position of UMNO. This dominance allowed Razak to usher in a new era, characterised by the abandonment of the laissez-faire economic policy in favour of greater state intervention in the economy (Gomez and Jomo, 1999:23). The nature and extent of government intervention which resulted from this change in policy, was unprecedented in Malaysian history. Its initial thrust came in the form of the New Economic Policy (NEP), a bold and ambitious affirmative action programme aimed at incorporating the indigenous Malays into the economic mainstream and promoting interethnic harmony.

## **CHAPTER 3: GOVERNMENT INTERVENTION: THE NEW ECONOMIC POLICY (1970-1990)**

### **INTRODUCTION**

In the early 1970s the Outline Perspective Plan (OPP) for the period 1971-1990 was unveiled for the implementation of the New Economic Policy (NEP). It was an ambitious twenty-year social engineering plan which aimed to reach set targets incrementally under a series of five year plans, starting with the Second Malaysia Plan (1971-75) and culminating in the Fifth Malaysia Plan (1985-90). This chapter will look at the objectives of the NEP and the major policy initiatives the Malay-dominated governing coalition used as a vehicle to achieve their aim, with a special focus on industrial policy.

### **OBJECTIVES AND TARGETS OF THE NEP**

The primary objective of the NEP was to achieve national unity by

- eradicating poverty by raising income levels and increasing employment opportunities for all Malaysians irrespective of race;
- restructuring Malaysian society to achieve inter-ethnic economic parity between the predominantly Malay Bumiputera and the predominantly Chinese non-Bumiputera, thereby eliminating the identification of race with economic function.

Amongst other targets, the NEP aimed to

- reduce poverty levels from 50% in 1970 to 16.7% by 1990
- increase Bumiputera corporate equity ownership from 2.4% in 1970 to 30% in 1990, that of other Malaysians (mainly Chinese) from 35% to 40% and to reduce foreigners' share of corporate wealth from 63% to 30%. (Drabble, 2000:197; Gomez and Jomo, 1999:248).

The NEP was essentially redistributive in nature and the goals were to be achieved on the basis of sustained economic growth. The government emphasised the fact that the NEP would be undertaken in a growing economy in order to quell non-Bumiputera misgivings that they would be deprived so that redistribution could take place. The first goal was to be achieved by a restructuring of employment and the second through a redistribution of shares in the corporate sector (Drabble, 2000:197).

## **INCREASED GOVERNMENT INTERVENTION**

Under the new development policy there was a dramatic increase in the state's involvement in the allocation of public resources as well as public sector ownership and control of business enterprises. Public enterprises, regarded as the new engine of growth, were to participate to a much greater extent in all sectors of the economy, particularly in the modern sector. These enterprises fall into three major categories. Firstly, departmental enterprises that are responsible for providing public services such as water, telecommunications, civil aviation and refuse collection. Secondly, statutory bodies such as the Malaysian Industrial Development Authority (MIDA), Petrolia Nasional Bhd (Petronas), the Tourist Development Corporation (TDC), the various state economic development corporations (SEDCs), etc. Thirdly, government-owned private or public companies established under the Companies Act of 1965. The equity of the latter group is either fully or partly held by the government. The most prominent of these are the Heavy Industries corporation of Malaysia (HICOM), the property developer Peremba Bhd and the Food Industries of Malaysia (FIMA). The public enterprises were established with the aim of increasing Bumiputera participation in commerce and industry (Gomez and Jomo, 1999:29-30).

Also important for advancing Bumiputera share of corporate equity was the establishing of the Bumiputera trust agencies that purchased and held shares in trust on behalf of the community. Some of the major trust agencies are Perbadanan Nasional Bhd (Pernas), Permodalan Nasional Bhd (PNB) and its wholly owned subsidiaries, Amanah Saham

Nasional (ASN) and Amanah Saham Bumiputera (ASB) (Gomez and Jomo, 1999:31; Khan, 1996:60).

Public enterprises established before 1970 operated mainly in rural and infrastructural development, while the post-1970 public enterprises were created to function in the fields of finance, commerce and industry, which were formerly dominated by private enterprise. During the two decades of the NEP the number of public enterprises owned by state and federal authorities grew rapidly from 109 in 1970 to 1 149 in 1992 (Loh, 2000:69; Gomez and Jomo, 1999:31).

As a consequence public development expenditure increased substantially. Where the allocation under the First Malaysia Plan (1966-70) was 4.6 billion *ringgit*, it increased to RM10.3 billion under the Second Malaysia Plan (1971-75). Public development expenditure in the Third Malaysia Plan (1976-80) tripled to RM31.1 billion. Although a similar rise was projected under the Fourth Malaysia Plan (1981-85) the actual increase was only around RM8 billion. Under the Fifth Malaysia Plan (1986-90) RM74 billion was initially allocated, but this was revised downward to RM57.5 billion with the Mid-term Review of the Fifth Malaysia Plan (Jomo, 1990:111).

The rest of this chapter will explore the measures used by the Malaysian government to:

- eradicate poverty
- restructure Malaysian society by: equalising equity ownership and eliminating the identification of race with economic function

Because of the central role of industrial development in achieving these outcomes, particular attention will be paid to the state's industrial policy initiatives.

## **POVERTY ERADICATION AND INCOME DISTRIBUTION**

When compared to most Less Developed Countries (LDCs) Malaysia was not poor. In 1970 its GNP was second only to Japan in Asia (Emsley, 1996:26). However, Malaysia's

income distribution was highly skewed and ethnically biased. At the government's poverty line of RM33 per month per capita in 1973, 55 percent of the Bumiputera population were poor as opposed to 20 percent of the Chinese and 28 percent of the Indian populations; 78 percent of all poor were Bumiputera (Emsley, 1996:26). Since the vast majority of Malays lived in the rural areas and were involved in the least productive sector of the economy, poverty in Malaysia was therefore primarily, though not exclusively, a Bumiputera phenomenon.

This reality was instrumental in determining the type of policy interventions required. Addressing poverty in Malaysia meant addressing poverty in rural Malaysia. An anti-poverty campaign had to benefit mainly the Bumiputera since they constituted the majority of the rural poor (Emsley, 1996:26). The productivity of Malays had to be increased since a growing rural population coupled with static rural productivity led to a decline in productivity, hence an increase in the incidence of poverty. The reasons for low rural productivity were poor education and ignorance which curtailed training and the utilisation of modern techniques; primitive medical facilities and knowledge which resulted in a poor state of health; the lack of capital for machinery and other productivity boosting inputs and continuing land division (Emsley, 1996:27). However, changes were not only required within sectors, i.e., policies to raise the level of productivity and income of Malays in each sector, especially the tradition rural sector, but also between sectors. The latter entailed policies to change employment patterns to relocate Malay workers to higher paid occupations. The logic was that Malays would participate increasingly in the production of the Malaysian 'cake' and gradually share more equally in the outcomes. In this manner equality could be achieved without taking from non-Malays.

## **Education and health**

### ***Education***

Education was regarded as the most basic means to ensure the Malays of their rightful place in society. Ahuja, Bidani, Ferreira and Walton (1997:49) underscore the importance of education in enhancing 'movement into better nonfarm rural work and migration to towns for industrial and service employment'. A massive national education initiative, skewed towards rural Malays, especially those in the lagging eastern half of the Peninsula, was launched in the 1970s under the auspices of the NEP. Primary education was nearly universal in 1970, but the quality needed improvement. The number and quality of teachers, especially in the backward and less attractive areas of the country were therefore actively improved. Great efforts were made in the 1970s and 1980s to bring secondary education closer to universal coverage. Secondary school enrolment consequently increased from 34 percent in 1970 to 72 percent in 1985 (Emsley, 1996:39).



In the sphere of tertiary education the Council of Trust for the Indigenous People, MARA (Majlis Amanah Rakyat), established technical colleges and institutes whose primary purpose was to train Malays in order to redress their poor scientific and technological education. These institutions were also meant to act as feeders to the universities. More universities were established to double their numbers between 1981 and 1989 (Emsley, 1996:40).

### ***Bahasa Malaysia***

The enforcement of the indigenous language, Bahasa Malaysia, as the medium of instruction proved to be a more controversial aspect of education policy. The language was made compulsory in all state-aided secondary schools, while the use of Mandarin or Tamil as medium of instruction was discouraged. To hasten the reduction of racial disparities in education, quotas in admissions and results were introduced. The effect was

that Chinese and Indian over-representation at university level was replaced by Malay over-representation by the end of the 1970s. This denial of educational opportunities caused tremendous resentment resulting in many Chinese students opting to study abroad. The government responded by relaxing quotas in the 1980s, allowing the proportion of Chinese university students to increase.

The rapid increase in the level of Malay education and training enabled a much higher participation in the modern economy as well as higher productivity in the traditional sectors. The World Bank estimated that the returns to education expenditure were higher in Malaysia than in nearly any other developing country. Snodgrass (1996:34) confirms that Malays in particular have received high private rates of return because of huge government subsidies.

### ***Health***

A similar drive at improvement occurred in the field of health. Large numbers of rural health clinics were built while the provision of safe drinking water was increased. Inequalities in health care between rural and urban dwellers were vastly reduced while the general level of health was raised. The improved level of healthcare can be seen in the decline in the infant mortality rate (IMR) from 45 per thousand in 1970 to 14,2 per thousand in 1988 (Emsley, 1996:28). The explanation for this good performance was Malaysia's emphasis on primary and preventative measures in the rural areas.

### **Restructuring agriculture**

Since about 80 percent of the rural population are engaged in agriculture-related employment and activities, agriculture and land development typically formed the crux of rural development programmes (Siwar, 1996:211). The main aims of these programmes were to increase productivity and incomes and ultimately to reduce poverty among rural households.



The subdivision of land because of the Muslim law of inheritance, which required division of land among heirs, led to inefficient farm sizes. Large and expensive land development schemes were undertaken which took two forms. One undertook improvements, rehabilitation and consolidation of land within existing settled areas while the other opened up new areas to which settlers would move, from areas experiencing pressure on land where holdings were uneconomically small. Virgin tropical forests were cleared, model villages built and provided with complete infrastructure. By the end of 1985 1.7 million hectares had been developed and 224 700 families settled in the new villages (Emsley, 1996:30). In this manner one Bumiputera household in five had been transplanted and transformed under the auspices of Federal Land Development Agency (FELDA) or other government agencies, thereby alleviating the population pressure faced by Malay villages (Emsley, 1996:30).

FELDA also implemented a strategy of shifting cash crop production away from rubber towards palm oil since the price of palm oil rose more rapidly than the price of rubber. The result was an increase in the incomes of FELDA settlers cultivating oil palm, pushing their incomes to double the poverty line. The Rubber Industries Smallholder Development Authority (RISDA) provided funds for the replanting of old rubber trees with new higher-yielding clones and provided modern production technology, the combination of which resulted in higher yields (Emsley, 1996:30).

Subsidising capital works such as irrigation, and inputs such as fertiliser and pesticides, also enhanced productivity. Credit was provided through the Malaysian Agricultural Bank while a price subsidy was maintained for rice by means of a guaranteed minimum price. These policies enabled poor people to participate in growth as producers and investors, rather than being passive recipients of income transfers from the government. Rural development programmes undoubtedly helped to raise the productivity and income of agricultural producers. Despite the general success of targeted interventions, World

Bank figures maintain that the general income-enhancing effect of growth was a very significant factor in reducing poverty (Emsley, 1996:35).

## **ELIMINATING THE IDENTIFICATION OF RACE WITH ECONOMIC FUNCTION**

The segregated participation of different race groups in different sectors of the economy was a dominant feature of Malaysia. There was a high proportion of Malays in the traditional sector and a very low proportion in the modern urban sector. Value added by workers in the modern sector was four times as high as in the traditional rural sector (Emsley, 1996:37). While policies to improve Bumiputera incomes in traditional rural occupations had the potential to reduce income disparities by only a limited extent, it did not address the identification of race with economic function. What was required was to move large numbers of the Bumiputera from the rural villages to take up new jobs being created in industry and commerce. This not only required a massive investment in human capital through a high quality process of education and training, but also required the creation of jobs in the modern sector to accommodate such people.

### **The creation of jobs in the modern sector**

A key element in attaining greater ethnic economic equality is the continued restructuring of employment. In this regard the government implemented a two-pronged policy. Firstly, it aimed to manage the economy in a manner that would ensure the growth of the modern private sector which would be a source of direct job creation. Increased tax revenues from this source would allow for the expansion of the public sector, thereby creating more jobs. Secondly, the government ensured through the imposition of quotas and other administrative measures that the Malays were allocated a high percentage of these jobs.

### ***Bumiputera Participation***

Bumiputera participation grew most in those sectors that have increased their employment most rapidly. Whilst primary sector employment remained dominated by the Bumiputera the secondary and tertiary sectors were characterised by substantial increases in Bumiputera participation. Between 1970 and 1990 the Malaysian labour force increased from about 3.2 million to 6.4 million. This represented an average annual growth rate of 3.53 percent against a population growth of 2.7 percent. Due to the increased rate of industrialisation the numbers in manufacturing grew sixfold from 225000 to over 1.3 million (Drabble, 2000:246). The Bumiputera represented 48 percent of the workforce in the secondary sector and 51 percent in the tertiary sector. 56.3 percent of new jobs in manufacturing went to the Bumiputera compared with 28.8 percent to the Chinese (Emsley, 1996:45).

### ***More Opportunities for Women***



A notable feature of employment restructuring was the large numbers of rural women to enter the industrial sector. Between 1957 and 1987 the labour force participation rate for women rose from 30 percent to 46 percent in Peninsula Malaysia (Drabble, 2000:248). The growing work opportunities afforded women employment and the chance to move to the towns where, despite redistributive spending in favour of rural areas, health and educational facilities were better. They also earned a higher wage than they did in rural areas. The result was a drop of women as a proportion of the primary sector workforce from 50 percent to just over 27 percent between 1975 and 1986 (Drabble, 2000:248).

It should be noted though, that capital-intensive industries preferred to employ skilled male labour, while female labour was largely required by labour-intensive industries. Thus, despite growing employment opportunities in the industrial and services sectors, the largest growth in women's participation was in low- and middle-level jobs. As a consequence women were largely employed in low-wage jobs in the electrical,

electronics, textiles and garment industries in FTZs, where, with the collusion of the Malaysian government, multinational companies could exploit female labour. Cecilia Ng (2004:2) therefore argues that the success of the electrical and electronic export industries and therefore the Malaysian economy 'has been built on the back of low-waged women's labour'.

These structural changes were more than a mere change in the nature of Bumiputera employment, it changed the way of life of many. Not only did their work change but also their residence and thus the network of kinship ties, duties and obligations that characterised Malay society (Emsley, 1996:47).

### **EQUALISING EQUITY OWNERSHIP**

Part of the NEPs aim to restructure society was to abolish the identification of ethnicity with economic function. In order to achieve this end a subsidiary goal of equalising equity ownership was declared. This translated into efforts to create, expand and consolidate a Malay bourgeoisie and petty bourgeoisie. Government efforts were aimed at increasing the share of Bumiputera capital, as well as the number of Bumiputera businessmen and professionals within the context of continued open capitalist development (Jomo, 1990:154).

The restructuring of equity ownership mainly involved state intervention to increase Malay ownership of the economy by developing large public enterprises on behalf of the Malays. The main thrust of the government's effort to change ownership patterns was focussed on the 30 percent corporate equity target. An important part of achieving this aim was the passing of the Industrial Co-ordination Act of 1975 (ICA). The main purpose of the ICA was to restructure equity ownership according to the 30:30:40 formula by 1990, i.e., 30 percent Bumiputera, 30 percent foreign and 40 percent Chinese ownership (Gomez and Jomo, 1999:24; Snodgrass, 1995:7). The ICA focussed mainly on new and not existing activities. It required all new manufacturing ventures and

projects of a predetermined size to have Bumiputera equity of at least 30 percent. Thus the Bumiputera were guaranteed a substantial ownership stake in most new manufacturing activity. Initially only projects with equity less than M\$0.25m were excluded from this stipulation. This figure was later increased to encourage foreign investment. Another exception was that export-oriented companies were allowed much higher foreign equity shares.

While the ICA ensured that equity was made available to the Bumiputera, mechanisms had to be created to ensure that the equity was purchased. A two-tier market was created, allowing Bumiputera to buy stock at a lower price than other investors. In the absence of strong Bumiputera demand, the Perbodanan Nasional Berhad (PERNAS) was created to purchase stock on behalf of the Bumiputera. In the plantation sector PERNAS gradually gained controlling stakes in the largest companies. Interests were obtained in commercial banks with a view to advancing credit to Bumiputera business.

### *National Equity Schemes*



The Permodalan Nasional Berhad or National Equity Corporation and Amanah Saham Nasional (National Unit Trust Scheme) were agencies designed to buy shares on behalf of the Bumiputera and resell it to them at a later stage. Because of the unwillingness of the Bumiputera to take risks in addition to their consumption preferences these agencies had to hold the equity on behalf of the Bumiputera until they had developed sufficiently to hold the equity themselves. The first divestment of this nature happened in 1981 when 660m shares worth M\$1.5bn were transferred to unit trust organisation ASN and to PERNAS subsidiaries for sale to employees (Emsley, 1996:57). The ASN emerged as the major vehicle whereby equity was distributed to the Bumiputera. It was effective as it marketed units widely in suitably divided packages. There was widespread public interest in the units, with 44 percent of the qualified population holding units in 1990 (Emsley, 1996:58). Jesudason (1990:115) contends that this strategy was ‘brilliant’ because it ‘simultaneously kept the state managerial stratum in control of the companies, spread the

profits to the wider community, and kept the shares in Malay hands, since an individual could only buy and sell through ASN'. The PNB-ASN scheme greatly increased ownership of equity by the Bumiputera population.

It should be noted that the boards of most of the above and other public enterprises consisted of politicians, active or retired government officials and members of the royal houses. Former or seconded senior officers of the Malaysian Civil Service dominated the management level. Despite being appointed by the political authorities, the opportunity was there to acquire financial resources and operational autonomy. Snodgrass cautions that it creates several dangers: firstly, the possibility of large scale corruption; secondly, the use of wealth and power to 'buy' a political following; thirdly, that the policy will spawn an industrial empire which will eventually become uncontrollable by political authority (Snodgrass, 1980: 221).

## **INDUSTRIAL POLICY**



### **Import-Substitution Industrialisation (ISI)**

Early industrialisation efforts were erratic and haphazard. After independence, the Malaysian government implemented a policy of import-substitution industrialisation. The aim of ISI was to broaden the industrial base, diversify the economy, reduce the dependence on imported consumer goods and to create more employment opportunities. Government intervention took the limited form of providing infrastructure, protective tariffs, tax holidays and other incentives to attract foreign direct investment (FDI). Foreign investors were encouraged to set up production, assembly and packaging plants to supply finished goods previously imported from abroad. To encourage these industries the government directly and indirectly subsidised the establishment of new factories.

According to Lall (1996:151) the initial period of import-substitution in the domestic private sector was dominated by light or first-stage assembly and packaging activity.

Chinese-owned firms dominated this area. Unfortunately there was not sufficient deepening of this sector into second-stage import-substitution. Indigenous Malay-owned industry was mainly small-scale and traditional and was concentrated in the rural areas. Because of tensions between the government and the Chinese business sector, the government was reluctant to promote the local private sector in more complex industries (Lall, 1996:151; Bowie, 1994:170). The fiscal incentives offered during this period favoured larger companies and consequently resulted in the establishment of manufacturing companies employing more capital-intensive production processes.

In practice import substitution involved the domestic assembly, packaging and final processing of finished goods by domestic labour using machines and material mostly imported from abroad. It could not generate many employment opportunities because of the capital-intensive foreign technology used, the weak linkages to the rest of the economy and the small domestic market (Jomo, 1990:122).

### **Export-oriented Industrialisation (EOI)**



Because of the limitations of ISI the government pursued a new policy direction with the adoption of the 1968 Investment Incentives Act, thereby departing from its inward-looking approach to Malaysia's industrialisation. It widened the range of industries eligible for inducements such as deductions for overseas promotional campaigns, exemption from payroll tax for companies exporting more than 20 percent of production, etc. (Drabble, 2000:237). This legislation marked the government's switch from ISI to export-oriented industrialisation (EOI) and aimed to encourage the expansion of manufactured exports. In order to expedite the process labour laws were amended to control workers in the new labour-intensive export-oriented industries by preventing workers in electronic factories from forming a union; restricting the right to strike; not allowing the formation of a single national union for textiles and garment workers. The switch in emphasis to EOI gave new momentum to industrial growth. This development

was encouraged by the policies contained in the NEP which were committed to an open, industrialising capitalist economy.

While the earlier policy of moderate import substitution continued, the NEP involved several new domestic industrial interventions. Among the most important was the taking of an increasing domestic share in foreign-owned plantations and non-export enterprises and the setting up of state enterprises to foster local supplier industries and create new industrial skills (Lall, 1996:154). State enterprises and Malay-owned businesses were given preferential treatment in the allocation of finance and government contracts.

### ***Free-Trade Zones***

On the other hand new measures, especially the establishing of free-trade zones (FTZs), were implemented. FTZs are enclaves located physically and administratively outside a country's customs barrier and were intended to attract foreign investors with such incentives as duty-free imports of raw materials and capital equipment, tax concessions and simplified customs procedures. The government saw FTZs as a cost-effective way of achieving efficient export industries and in the process obtain advantages such as technology transfer from multi-national companies, the upgrading of skills of Malaysian workers and management, job creation and local purchases of raw materials and electricity. FTZs enabled many transnational companies to relocate various production, assembly and testing processes to secure locations which offered reduced wage and other costs. In return these companies had to export at least 80 percent of their output (Drabble, 2000:264). Two prominent types of export-oriented industries developed. Resource-based industries involved the increased processing of older (rubber and tin) and newer (palm oil, petroleum and timber) primary commodities for export. The growth of these industries slowed down during the 1980s. Resource-based industries were constrained by transport and other trade deterrents, which favoured the export of raw materials rather than more processed products. On the other hand, non-resource-based industries have been far more successful in its growth and employment generation. Much



of this development happened in the stable low-wage environments of the FTZs. Within a decade, firms in the FTZs came to dominate Malaysia's manufactured exports. The most dramatic growth involved electrical and electronic products, which accounted for 15 percent of manufacturing output in 1981 and 23 percent in 1986, but at least half the total value of manufactured exports since 1981 (Jomo, 1990:121).

Export-oriented industrialisation tended to create more employment because of their labour-intensive production techniques. However, as Jomo (1987:117) asserts, these industries are also more sensitive to changes to wage costs and are therefore more capable of relocating elsewhere.

### **Heavy Industrialisation**

The powerful and influential Dr Mahathir assumed office as Prime Minister in early 1981. Under his leadership the government's role in economic development, as represented by the NEP, came under increasing scrutiny. Notwithstanding gains made from the shift to EOI, the continued shallowness of the MNC-led export sector and especially its lack of linkages to the rest of the industry prompted the government to adopt stronger industrial policy measures in the early 1980s.

### ***The Look East Policy***

Mahathir induced the government to adopt a 'look East' policy. According to Jomo (1990:203) the 'look East' policy originally appeared as a campaign to promote productivity, by inducing hard work and promoting more effective modes of labour discipline associated with the Japanese. But it was subsequently seen as a fairly wide-ranging series of initiatives to become a 'newly industrialising country' (NIC) by emulating the Japanese and South Korean 'economic miracles'. Mahathir emulated the Korean model by initiating a return to import-substitution industrialisation, with a new focus on the establishment of heavy industries. The focus of the government's

involvement in the economy therefore shifted to the Heavy Industries Corporation of Malaysia (HICOM). Because private investors were reluctant to take the lead HICOM became the government's vehicle for driving Malaysia's process of heavy industrialisation, unlike Japan and Korea where the private sector played a much more prominent role (Lall, 1996:151).

Mahathir argued that Malaysia had relied far too long on light import substitution, raw material processing and light export-oriented manufacturing for its economic growth. Therefore a prominent feature of his leadership was his commitment to develop heavy industries. After all, the industrialisation experiences of Sweden, Japan, South Korea, Taiwan and other countries indicated the necessity for the state to support the development of certain heavy industries in order to establish a more balanced and integrated industrial sector and economy (Jomo, 1990:128). HICOM became instrumental to this endeavor, so much so that Mahathir shifted responsibility for HICOM from the ministry of Trade and Industry to his own office. The objective of HICOM was to diversify manufacturing activity, create modern manufacturing activity outside FTZs, create more linkages to the local economy, promote small and medium enterprises and lead technological development by collaborating with foreign firms and investing in local research and development. HICOM established several joint ventures in steel, motorcycle engines, the national car project, petrochemicals and cement, with various Japanese companies as minority shareholders. The HICOM investment programme was financed by public expenditure which came from funds borrowed externally, particularly from Japan.

### ***Problems with Heavy Industrialisation***

Malaysia's foray into heavy industries was fraught with many problems. The heavy industries chosen for development, i.e. steel, cement, petrochemicals, shipbuilding and the Proton car project required an enormous injection of funds. Since the government argued that the local Chinese-dominated manufacturing industry had neither the interest

nor the technology to invest in projects offering uncertain returns, it turned to foreign investors to establish joint ventures. As a consequence Malaysian heavy industrialisation became overly dependent on foreign partners, contractors and consultants (Jomo, 1990:130).

Furthermore, these industries faced very stiff international competition because of excessive global production capacity. To survive, they relied heavily on government protection which in turn proved very costly. In order to fulfill its financial obligations with regard to the process of heavy industrialisation the government resorted to heavy foreign borrowing. Total foreign debt increased from about \$15.4 billion in 1981 to \$50.7 billion in 1986, the latter equivalent to approximately 76 percent of GNP, far above the average for LDCs of 47.9 percent (Drabble, 2000:261). In an attempt to counteract the global recession in the early 1980s, the government resorted to counter-cyclical expenditure in the hope that it would stimulate the economy. Unfortunately this brought only temporary relief. The expansion of public expenditure from 1980 to mid-1982 was also an attempt by the government to make up for the shortfall in private investment. In two years, 1980-81, development expenditure rose 168 percent, while the budget deficit rose by 199 percent (Jomo, 1987:124). Coinciding with this rapid take-up of debt were two shocks that reduced Malaysia's capacity to service the high levels of debt. Firstly, interest rates rose causing the cost of debt to Malaysia to rise from a real interest rate of -6.9 percent in 1980 to 22.0 percent in 1986 (Emsley, 1996:78). The second shock was the decrease in the prices of Malaysia's most important export commodities in the mid-1980s. Oil prices fell by 50 percent, rubber prices by 7 percent, tin prices by 47 percent and palm oil prices by 63 percent (Emsley, 1996:78). Gomez and Jomo (1999:77) contend that while the government was better able to absorb costs during the 1970s when growth and revenues were high, especially after Malaysia became a net petroleum exporter in the mid-1970s, this was no longer possible by the mid-1980s, when the world economy slipped into recession and revenues fell. The negative external factors combined with the sluggish performance of domestic and foreign private investment forced the government to critically re-examine its development policy. As a

consequence, the government curtailed its public sector-led industrialisation programme by trimming projects already in progress while cancelling or delaying others still at the planning stage. In addition to these measures, the government took urgently needed corrective action by adopting more pragmatic strategies.

## **Deregulation and Privatisation**

### ***Deregulation***

The government's change in strategy was signified by the liberalisation of foreign equity ownership in manufacturing in 1985. To make it easier for industrialists to invest in new projects or to expand or diversify existing investments the government amended the Industrial Coordination Act. The Promotion of Investments Act (1986) granted additional tax incentives and pioneer status for periods of five years for export oriented manufacturing, agriculture and tourism (Lall, 1996:157; Jomo, 1990:141). The aim was to encourage foreign investment to help revive the economy. This was followed in 1987 by a second amendment to the ICA which reduced the firms that had to comply with NEP requirements to those having more than 75 (previously 25) workers or RM2.5 (previously RM1) million paid-up capital (Loh, 2000:72). The government was prepared to either suspend or relax some NEP requirements to promote investments. Clearly, Mahathir had chosen to restore economic growth rather than pursue redistribution unabated.

### ***Privatisation***

The above deregulatory measures were accompanied by another new policy initiative, namely privatisation. The 1983 announcement of privatisation and restructuring in Malaysia was a radical move since it involved a reversal of the state's earlier promotion of public enterprises to boost economic growth, redistribute wealth and create opportunities for employment. It tied in with Mahathir's new 'Malaysia Incorporated' slogan which aimed to improve relations between the government and the private sector.

Indeed, as Gomez and Jomo (1999:80) confirm, the private sector became Malaysia's new engine of economic development, especially after the mid-1980s.

Dr Mahathir's new direction was not only inspired by Malaysia's economic woes but also by the global trend towards privatisation as spearheaded by Margaret Thatcher in Britain and Ronald Reagan in the USA as well as the World Bank, the International Monetary Fund and the Asian Development Bank (Jomo, 1990:204,211). These countries and institutions were strongly biased towards private enterprise and advocated policies to deregulate economies, reduce government economic intervention and government spending.

### ***The Implementation of Privatisation in Malaysia***

Privatisation, broadly defined as the transfer of government services and enterprises to the private sector, involved a wide variety of mechanisms. The practical implementation of privatisation in Malaysia included the following mechanisms: (Jomo, 1990:214; Gomez et al, 1999:81-85)



- The sale or divestment of state businesses. The enterprise first had to be 'corporatised' before divestment through public listing in order to determine its financial position, to introduce managerial reforms and to make the company more marketable for listing on the stock exchange. Examples are the establishment of Syarikat Telekom Malaysia Bhd in 1987 to take over the activities of the Telecoms Department and Tenaga Nasional Bhd to take over the National Electricity Board.
- The issuing to the public of shares in a state-owned public company, for example, the Malaysian Airline System (MAS) in 1985 and Malaysian International Shipping Corporation (MISC) in 1987.
- The transfer of shares to institutional investors, such as the sale of a small percentage of MAS stock to the Brunei government in 1986.

- Leasing or selling physical assets, for example, the lease of the Lady Templer Hospital in 1984 to Rampai Muda.
- Joint ventures with the private sector such as the formation of the Perbadanan Otomobil Nasional (Proton) in 1983 with 70 percent shares held by HICOM and 30 percent by Mitsubishi.
- Initiatives to draw the private sector into construction projects like the North Port Kelang toll road bypass, the Jalan Kuching-Jalan flyover and the North-South Highway which were privatised through the build-operate-transfer (BOT) method.
- The ‘contracting out’ of services previously provided by the public sector such as parking services and garbage disposal, Port Kelang’s container terminal services and the Telecoms Department’s RM2.5 billion telecommunications development projects.
- The issuing of licences in areas where the government had previously enjoyed a monopoly such as the issuing of a licence in 1983 to Sistem Televisyen Malaysia Bhd to run a third television channel, TV3. In 1993 and 1994 licences were also awarded to Metro Vision and the Melewar Group.



Malaysia privatised 106 enterprises between 1985 and 1990 (Thomas and Wang, 1998:234). The restructured public sector retained a role in industries such as the petrochemical, iron and steel, automotive and cement industries where the investment requirements are large and long gestation periods are involved (Lall, 1996:158). However, these industries were restructured to improve management and make it more market-oriented. There was great hope that with privatisation public enterprises would become ‘less politicised, more efficient and able to provide higher quality products and services’ (Saleh, 1996:31).

Privatisation was received with mixed feelings in Malaysia. On the one hand there were those who opposed the initiative, mainly from the ranks of the Bumiputera. They felt threatened by privatisation and could potentially lose the benefits they had received under the NEP. This pro-distribution grouping wanted the restructuring component of the NEP retained as the first priority of the government. On the other hand there was the pro-

growth group, mainly non-Bumiputera, who felt that privatisation would free Malaysia from the political patronage which had developed and at the same time restore productive private sector investments and economic growth. These diverging opinions were also felt within the ruling UMNO and precipitated a clash in 1987 in which the pro-growth faction of the party, led by Dr Mahathir, emerged victorious (Drabble, 2000:202).

### **The Industrial Master Plan**

In tandem with its deregulatory measures and privatisation initiative the government, via the Malaysian Industrial Development Authority (MIDA), launched the Industrial Master Plan (IMP) in early 1986 (Jomo, 1987:137). The first IMP was drawn up for the period 1986-1995 with a new one formulated for the new millennium. It was the first master plan of its kind in Malaysian history and provided a medium and long term policy framework to encourage the development of a more diversified and integrated manufacturing sector. It proved to be a valuable document in that it provided a surprisingly critical analysis of Malaysia's industrial heritage and problems.



### ***Shortcomings of Malaysian Industrial Development***

According to Jomo (1990:135-138,140) the IMP identified the major problems afflicting Malaysian industrialisation as follows:

- The narrowly based manufacturing sector which relied heavily on a few labour-intensive and resource-based industries.
- Very weak inter-industry linkages, for example, during the mid-1980s less than 10 percent of raw materials used in the free trade zones were from local sources outside the free trade zones.
- Technological dependence and lack of an indigenous industrial technology capacity. The IMP regarded the manufacturing sector's technological dependence as excessive. It resulted in the outflow of royalty payments, fees and other charges to the parent

transnational company. Jomo (1990:138) suggests that there is, in fact, little evidence of any significant and meaningful transfer of technology. He furthermore points out that other industries could hardly benefit from whatever technology transfer might have taken place because of weak linkages to the rest of the economy.

- Inadequate private sector initiative.
- Deficiencies in industrial incentive schemes, including:
  - excessive domestic market protection;
  - large firm and capital-intensive biases due to pioneer status incentives;
  - neglect of small industry problems and requirements;
  - biases in export incentives;
  - insufficient incentives for technological development.
- The shortage of skilled manpower, especially engineers and technicians because there were too many industries which produced low-skill, labour-intensive exports requiring simple final-assembly activities.

### ***Liberalisation***



Because the success or failure of the government's economic strategy depended largely on the performance of the industrial sector, the IMP introduced a number of policy measures to liberalise industrial investment and reduce market distortions. Some of these measures included the further liberalisation of foreign investment; the reduction of public-sector service charges for water, electricity etc.; greater incentives for using local material as inputs together with efforts to promote small- and medium-scale industries (SMIs) as suppliers of industrial inputs; reduction in protectionism and more incentives for export-oriented growth; greater export-promotion efforts; concentration on a few selected industries with greater potential (Jomo, 1990:140-141).

### ***Growth in FDI***



From 1988 onwards the fruits of the government's policy switch became apparent with strong export and income growth. Real GDP accelerated from a modest 1.2 percent growth in 1986 to 8.9, 8.8 and 9.8 percent in the years 1988-1990 (Drabble, 2000:202). This took place on the back of an increase in FDI. It should be noted though, that the increase in FDI and growth were not only inspired by the change in government strategy, but also by the recovery of the world economy as well as the rise in the value of the Japanese and Taiwanese currencies, the cost of production in the NICs and the loss of General System of Preferences (GSP) trading preferences by the NICs. This triggered a search by manufacturers in these countries for offshore manufacturing opportunities in order to take advantage of both weaker currencies and lower labour costs. Malaysia, with its political stability, developed infrastructure, open economy and newly deregulated investment policies gained billions of dollars of FDI, more than most other countries in the region (Drabble, 2000:240-242; Snodgrass, 1995:8). Taiwan and Hong Kong became prominent foreign investors while Japanese MNCs continued to relocate their assembly operations in Malaysia as the Yen strengthened, and induced many of their suppliers to invest along with them.



The NEP came to a formal conclusion in 1990. The government's industrial policy was henceforth articulated in the New Development Policy, a policy which sought to move much closer to the industrial interventions practised by the East Asian NICs, and which was to culminate in a fully industrialised economy by 2020.

## **POST-NEP FINANCIAL CRISIS**

The events which unfolded after the conclusion of the NEP had such a significant impact on the Malaysian economy that they warrant some attention. The Asian financial crisis which started with the collapse of the Thai Baht in mid-1997, not only threatened the gains that had been made over the previous decades but threatened the political and social stability which served as a springboard for economic growth in the past.

## Causes

The successful growth experienced in Southeast Asia made the region attractive to investors in the USA, Japan and Europe. With the capital liberalisation of the early 1990s, lower interest rates internationally and exchange rate pegs, financial institutions were encouraged to borrow foreign exchange abroad. Cheap money flowed into the region. While capital inflows in the 1980s had been in the form of long-term FDI, this changed during the 1990s when capital inflows were redirected towards liquid portfolios which were short-term investments. Vast funds were invested in non-tradable sectors such as property, construction and purchases of stocks which required long-term commitments. Domestic banks financed such long-term development projects with short-term borrowing from foreign banks and so created what Ito (2001:67) calls the 'maturity mismatch'. Thus domestic institutions became exposed to currency and maturity risks which proved devastating when capital inflows were reversed.



In addition to the large volume of short-term capital inflows, weak bank and non-bank supervision, overvaluation of currencies and the persistent 1990s current account deficits were other major causes of the Asian financial crisis (Ito, 2001:78). When the yen depreciated against the dollar, the dollar-pegged Asian economies experienced a decrease in exports as their exports became more expensive. The loss of export income coupled with increasing foreign debt contributed to a loss of confidence in Thailand's economy. Investment confidence in the currency plummeted and capital began flowing out of the country. Despite government efforts to prop up the currency capital flight persisted leading to further depreciation of the currency.

Because of investors' inability to differentiate between regional economies the events in Thailand affected their confidence in the Asian region in general. Strong contagion caused the currency crisis to spread rapidly from Thailand to Indonesia, Korea, Malaysia and the rest of East Asia prompting Jomo (1998:1571) to observe that 'the market is

driven by sentiment as much as by fundamentals'. Like Jomo, Ito (2001:85) and Sato (2001:214) also question the rationality of global financial markets.

In Malaysia the ringgit slid against most major currencies when it moved from 2.48 against the US dollar in March 1997 to 2.57 in July. Attempts by the government to defend the currency failed and it fell to 3.77 by the end of the year and to an all-time low of 4.88 in early January 1998 (Meow-Chung, 2001:46). Investors then began a mass selling of stocks on the Kuala Lumpur Stock Exchange (KLSE) with market capitalization shrinking from RM826 billion in January 1997 to RM200 billion in August 1998 (Meow-Chung, 2001:49). As capital flight continued, the depreciating currency together with falling asset prices caused large-scale insolvency among financial institutions and the corporate sector. The currency crisis had developed into a financial crisis and the economy plunged into recession.

### **Government Response**



After initial policy measures failed to restore stability the Malaysian government adopted selective exchange controls on 1 September 1998 and subsequently pegged the ringgit at 3.80 to the US dollar (Teik, 2001:196). The control measures were aimed at containing short-term speculative capital flows by ending the free convertibility of the ringgit. The temporary capital controls gave the government the breathing space to lower interest rates, improve liquidity and to comprehensively reform the banking sector.

The government created three institutions to reform the banking system. Danaharta was an asset management company charged with taking over the non-performing loans of financial institutions thus freeing them to provide loans to their customers. Danamodal was established to recapitalise the banking sector by providing credit injections to leading banks. The Corporate Debt Restructuring Committee was tasked with providing a platform for borrowers and lenders to work out amicable solutions to debt problems (Meow-Chung, 201:53-54; Teik, 2001:197). In addition, a programme was established to

merge banks in order to create stronger banks that were better able to withstand shocks. The government also strengthened banking and corporate supervision and required a greater disclosure of financial statements in order to increase transparency of corporate activities.

## **Recovery**

The measures introduced after the implementation of capital controls brought stability and restored confidence among investors and consumers. Short-term capital flows stabilized in the fourth quarter of 1998 while GDP showed an increase in the second quarter of 1999, after having decreased for five consecutive quarters. GDP growth for the whole of 1999 amounted to 5.8 per cent and for the first half of 2000 increased to 10.3 per cent (Meow-Chung, 2001:55). Share prices recovered substantially, retrenchment numbers declined and job vacancies increased from late 1998. By late 1999 the economy started to emerge from recession. As the economy recovered capital controls were progressively relaxed. Malaysia's credit rating improved and the country was reincorporated in the Morgan Stanley Capital International index in early 2000 after which fund managers started to re-enter the KLSE (Teik, 2001:198).

The crisis has shown that most of the problems of the East Asian economies were related to a weak financial sector functioning in a deregulated financial environment (Tongzon, 2002:157-158). However, there were also defects in the international monetary system such as its inability to monitor and control short-term capital flows and the lack of proper tools and processes for evaluating financial risks (Meow-Chung, 2001:57). This has highlighted the need for an international framework aimed at ensuring orderly global markets.

## **CHAPTER 4: AN ASSESSMENT OF THE NEP**

### **INTRODUCTION**

The New Economic Policy was the most ambitious social engineering programme ever attempted in the history of Malaysia. This affirmative action programme achieved a fundamental, Bumiputera-biased, restructuring of Malaysian society as part of the government's drive to enhance national unity by eliminating poverty and inequality as well as restructure the economy in order to eliminate the identification of race with economic function.

At the time of its official conclusion in 1990, spectacular strides had been made towards meeting most targets. At the same time, the pursuit of some goals achieved limited success. This chapter will assess the outcomes of the NEP, highlighting the successes and failures of the Malaysian government's intervention in the economy. It will assess the achievement in quantitative terms by measuring numeric outcomes against the goals set at the commencement of the NEP period. The fact that the use of numbers could be misleading, also necessitates a more qualitative analysis of NEP outcomes.

### **POVERTY ERADICATION AND INCOME INEQUALITY**

Spectacular results were achieved in poverty alleviation. The NEP projected a reduction in the official poverty rate from nearly 50 percent in 1970 to 16.7 percent in 1990. According to official figures, the poverty rate was reduced to 15 percent for Peninsula Malaysia (see Table 4.1) and 17 percent for the whole country (Drabble, 2000: 278; Ghosh, 1996: 126; Gomez and Jomo, 1999: 27).

**Table 4.1 Malaysia: Incidence of Poverty by Ethnic Group, 1970, 1976, 1984, 1990 (%)**

	1970	1976	1984	1990
<b>Peninsula Malaysia</b>				
All ethnic groups	49.3	35.1	18.4	15.0
Bumiputera	64.8	46.4	25.8	20.8
Chinese	26.0	17.4	7.8	5.7
Indian	39.2	27.3	10.1	8.0
Others	44.8	33.8	22.0	18.0
<b>Sabah</b>				
All ethnic groups	n.a.	51.2	33.1	34.3
Bumiputera	n.a.	82.9	39.2	41.2
Chinese	n.a.	5.7	6.2	4.0
Others	n.a.	11.4	12.4	6.0
<b>Sarawak</b>				
All ethnic groups	n.a.	51.7	31.9	21.0
Bumiputera	n.a.	85.9	41.6	28.5
Chinese	n.a.	14.0	9.3	4.4
Others	n.a.	0.1	4.0	4.1

n.a. = not available.

Sources: Gomez and Jomo, 1999 p167.



Gomez and Jomo (1999:27-28) furthermore point out that should the poverty rate be looked at in per capita terms rather than per household, the official poverty rate would be further reduced to an even more impressive 1.3 percent by 1987. No targets were specified for the East Malaysian states of Sabah and Sarawak. Although the official 1990 poverty rates for Sabah and Sarawak were relatively high at 34.3 and 21.0 percent respectively, Gomez and Jomo argue that they were in all likelihood much higher in 1970 (Gomez and Jomo, 1999:28). This leads them to conclude that the poverty rate for Malaysia as a whole was therefore probably higher than 50 percent in 1970. If this is indeed the case, the outcome of 17.1 percent for the whole country in 1990 is even more remarkable. Clearly then, when measured by the official poverty line, poverty in Malaysia has been significantly reduced since the inception of the NEP.

## **Criticism of Government's Poverty Statistics**

There is some scepticism towards the poverty reduction figures released by the government as details of the poverty line income level and the way it was calculated have not been released by the government's Economic Planning Unit. Analysts such as Jomo (1990:149), Gomez et al (1999:28) and Drabble (2000:275) suggest that the use by the government of at least two poverty lines partly explains the phenomenal results achieved in surpassing the Outline Perspective Plan's original poverty target of 16.7 percent. They allude to the fact that the poverty line of \$33 per month in 1970 may have been reduced to \$30 per month when the government compiled the final NEP outcomes. It explains, they assert, the dramatic reduction in the official rate of poverty incidence in Peninsula Malaysia, well ahead of schedule.

However, Snodgrass (1995:10) refutes such claims by citing independent research done by Ishak Shari, which he asserts, confirms a very substantial decline in poverty over the twenty years of the NEP. Snodgrass posits the view that urban poverty had been virtually eliminated and that rural poverty is a fast shrinking phenomenon in Peninsula Malaysia mainly because of growing opportunity for non-agricultural work. Even Gomez and Jomo (1999:28) concede that, notwithstanding scepticism over official figures, poverty in Malaysia had been significantly reduced since 1970. Thus Malaysia's overall household income shares show a decrease in the top 20 percent and middle 40 percent, while the bottom 40 percent grew over the NEP period (Drabble, 2000: 279).

## **Relative Poverty**

Thus far poverty has been viewed in absolute terms, i.e., in relation to a poverty line. If poverty is viewed in relative terms, i.e., by looking at income inequality, another perspective emerges. Whilst the general poverty levels have been drastically reduced and inter-ethnic income ratios have narrowed considerably, intra-ethnic income inequality among Peninsula Malays was higher than in 1970. The Gini coefficient as a measure of

income inequality increased among Malays from 0.466 in 1970 to 0.477 in 1987 (Drabble, 2000:279). The fact that it was lower among Chinese and Indians indicates a reduction in income inequality in these groups. Also, despite the narrowing of the income gap between Bumiputera and non-Bumiputera, the latter were still much better off.

### **Regional Variations in Poverty**

In regional terms too, there were few large shifts in national income and the incidence of poverty. States with a higher degree of industrialisation showed higher per capita incomes and consequently a lower incidence of poverty. On the other hand, less-industrialised and therefore poorer Peninsula states revealed higher poverty levels (Drabble, 2000:279). Drabble (2000:279) pinpoints another anomaly: in a number of primary-product dependent states both per capita income and poverty levels were relatively high. For example, the state of Terengganu, formerly in twelfth place in per capita income, moved to first place after the discovery of oil and gas in the mid-1970s. However, Terengganu still had the second highest incidence of poverty, 31.2 percent, in 1990 despite its increased per capita income (Drabble, 2000:279). This indicates a greater concentration of wealth in the hands of a small group of people. This problem was compounded by the fact that a sizable proportion of the export earning, i.e. the federal petroleum royalty, was removed from these states by the government and therefore did not benefit the majority in the state. In contrast to Terengganu, the incidence of poverty in Penang was only 8.9 percent (Eyre, 1997:131), confirming the notion that spatial differences in poverty levels, albeit not as wide as before, still existed at the end of the NEP.

### **THE RESTRUCTURING OF MALAYSIAN SOCIETY**

The restructuring of Malaysian society to eliminate the identification of race with economic function was the other major tenet of the NEP. The most important aspects of this strategy were the restructuring of employment and equity ownership.



## The Restructuring of Employment

Ghosh (1996:124) notes that the occupation structure of a country is a good indicator of its degree of economic development. He argues that developed countries have a high percentage of workers - 80 percent - in non-agricultural occupations. On the other hand, in less developed countries only 30 percent are in non-agricultural occupations, with the remaining 70 percent involved in agricultural activities. Using the historical experience of DCs he contends that the rate at which LDCs are able to change their occupation ratio from 70:30 (agricultural:non-agricultural occupations) to approximately 20:80, will provide a good indication of its rate of economic development. As Table 4.2 indicates, significant changes have occurred in Malaysia's occupational structure during the twenty years of the NEP (Ghosh, 1996:125).

**Table 4.2 Occupational structure in Malaysia - % of labour force**

	1970	1980	1990
Agriculture	53	40.6	29.9
Industry	14.5	22.7	24.6
Services	32.5	36.7	45.5

Source: Ghosh, 1996 p125

In 1970 the primary sector employed 53 percent of the labour force but by 1990 could only absorb slightly less than 30 percent. In contrast, the non-agricultural sectors, i.e. industry and the services sector, grew from 47 percent to 70 percent. The rapid growth of Malaysia's industrial sector is mirrored in the fact that it could accommodate almost 25 percent of the labour force in 1990, up from 14.5 percent in 1970. Ghosh (1996:125) regards Malaysia's 30:70 ratio of agricultural *vis-à-vis* non-agricultural occupations, achieved within a period of two decades, as highly commendable. He concludes that Malaysia can be regarded as a developed country, and upon reaching an occupational ratio of 20:80 it will indeed be regarded as highly developed.

The change in employment patterns had a positive impact on poverty because many of the mainly Bumiputera rural poor, especially women, could be absorbed into higher paid non-agricultural occupations. This allows Emsley (1996:44) to argue that ‘...the main thrust of income equalisation and ethnic homogenisation of economic function came from the rapid development of the modern, urban sectors and the movement of the Bumiputera into those sectors’. As a result, the number of Bumiputera working in the industrial sector in Peninsula Malaysia increased from 173 000 in 1970 to 918 000 in 1990 while Bumiputera employment in the service sector increased from 213 000 to 1.2 million over the corresponding period (Snodgrass, 1995:10). In achieving these outcomes, Malaysia exceeded the targets set in the Outline Perspective Plan.

In terms of occupation per ethnic group, Table 4.3 (see Drabble, p273, table 13.2) shows how the restructuring of employment systematically weakened the links between race and economic function.

**Table 4.3 Malaysia: distribution of employed persons by occupation and ethnic group, 1960 and 1988 (%)**



**CATEGORY**

Year	(1)		(2)		(3)		(4)		(5)		(6)		(7)	
	1960	1988	1960	1988	1960	1988	1960	1988	1960	1988	1960	1988	1960	1988
<b>Peninsula Malaysia</b>														
Bumiputera	41	58	17	35	27	54	16	36	40	59	62	70	27	46
Chinese	39	33	67	55	46	37	66	56	36	27	24	19	54	41
Indian	11	8	12	6	19	9	17	7	13	12	13	11	19	12
<b>Sabah</b>														
Bumiputera	1	77	1	32	1	66	1	51	2	82	91	96	6	74
Chinese	5	22	1	65	7	33	15	46	9	16	35	3	28	25
<b>Sarawak</b>														
Bumiputera	n.a.	51		15		53		30		64		90		53
Chinese	n.a.	42		80		46		69		31		9		46

n.a. = not available.

Sarawak 1960 data n.a.

Key: (1) Professional, Technical and Related; (2) Administrative and Managerial; (3) Clerical and Related; (4) Sales and Related; (5) Services; (6) Agriculture, Husbandry, Forestry, Fishermen, Hunters; (7) Production, Transport Equipment Operators.

Source: Drabble (2000), p273.

As Table 4.3 shows, the number of Peninsula Malays in all middle class categories increased appreciably while the proportion of Chinese and Indians fell in all categories. However, in absolute terms more Chinese and Indians were employed in all sectors except the agricultural sector. This was made possible by the general growth in employment, largely in the formal sector.

The earlier low Bumiputera involvement in the modern sector was turned around to reflect dominance of the Bumiputera in all sectors except Administrative/Managerial and Sales. It is therefore not surprising that under the NEP the Bumiputera middle class showed the largest proportional growth, followed by the Chinese. The middle class component for each ethnic group was approximately 27 percent for the Bumiputera and Indians, and 43 percent for the Chinese in 1990 as opposed to roughly 13 percent, 23 percent and 29 percent respectively in 1970 (Drabble, 2000:274). Clearly, Indians were least able to break away from earlier employment patterns as 63 percent of Indian households were still employed on rubber plantations. Indians therefore showed a relatively smaller increase in middle class occupations (4 percent) even though they were well represented in professions such as law and medicine.

The successful restructuring of employment meant that the Bumiputera could now be found in professions where they were not represented in 1970. In fact, by the early 1990s they were slightly over-represented in professional and technical and in service occupations and almost proportionally represented in clerical work. Although the NEP helped to develop a significant Malay middle class, the fact that the Bumiputera still predominated in peasant agriculture was one of the shortcomings of employment restructuring. Another shortcoming was in the public sector where Malay-dominance was extended so that more Malays could enter high-level jobs. Despite the overall gains made by the Bumiputera, they were still vastly under-represented in administrative and managerial positions and in sales work. They have had considerable success in entering the private sector, but did so predominantly at the lower levels of the occupational ladder. This imbalance was partly 'attributable to the longer period of time required to obtain the

educational and work experience needed to occupy a professional, technical or managerial position' (Snodgrass, 1996:32). Also, as alluded to above, Indians failed to make significant gains from the restructuring of employment.

### The Restructuring of Ownership Equity

In practice, restructuring efforts were largely aimed at increasing the share of Bumiputera capital, as well as the number of Bumiputera businessmen and professionals. The NEP aimed to increase Bumiputera share of equity from the pre-NEP 2.4 percent to 30 percent, that of non-Bumiputera (mainly Chinese) from 34.3 percent to 40 percent and to reduce the share held by foreigners from 63.3 percent to 30 percent in 1990 (see Table 4.4 below). The restructuring of corporate ownership and wealth was regarded as the most ambitious and controversial targets of the NEP.

**Table 4.4 Ownership of share capital of limited companies at par value, 1970 and 1990 (%)**



<b>Ownership group</b>	<b>1970</b>	<b>1990</b>
<b>Bumiputera</b>	<b>2.4</b>	<b>20.3</b>
Bumiputera individuals & institutions	1.6	14.2
Trust agencies	0.8	6.1
<b>Non-Bumiputera</b>	<b>28.3</b>	<b>46.2</b>
Chinese	27.2	45.2
Indians	1.1	1.0
<b>Nominee companies</b>	<b>6.0</b>	<b>8.5</b>
<b>Foreigners</b>	<b>63.3</b>	<b>25.1</b>

*Source:* Adapted from Gomez and Jomo, 1999 p168 and Snodgrass, 1995 p11.

The official figures in Table 4.4 put the outcome of the restructuring of equity ownership at just over 20 percent for the Bumiputera, 45 percent for the Chinese and 25 percent for

foreigners. For the latter two groups the outcomes were respectively about 5 percent over and 5 percent under the official target (Drabble, 2000:203).

While the 20.3 percent outcome for the Bumiputera is short of the 30 percent target, it is still regarded as a phenomenal achievement given the meagre starting point of 2.4 in 1970 as well as the fact that the restructuring drive was curtailed by the mid-1980s recession and concomitant budgetary constraints (Snodgrass, 1995:11; Jesudason, 1990:109).

Moreover, a convergence of opinion among a number of analysts, notably Jomo (1990: 160), Snodgrass (1995:11) and Emsley (1996:61) gives credence to the notion that the corporate restructuring outcome for the Bumiputera is understated. Firstly, a large share of equity is held by nominee companies that cannot be allocated to any ethnic group since such categorisation is not provided. Nominee companies are often used to obscure the real ownership of equity, especially by politicians and political parties who wish to hide their participation in equity schemes. Jomo (1990:160) is of the opinion that much of this share may involve Bumiputera investors working through nominee and other locally controlled companies whose ethnic ownership cannot be determined. If this is true, then non-Bumiputera share of equity should be reduced and Bumiputera share increased. Snodgrass also points to considerable Bumiputera involvement in Chinese companies. He cites a 1991 review by Fujio Hara of the business empires of the ten richest Malaysian Chinese. The review shows that all their companies have significant Malay involvement (Snodgrass, 1995:11).

Secondly, if the current market values of Bumiputera-owned shares, instead of par values were considered, Bumiputera share of capital would increase substantially. The combination of the above factors leads Jomo to believe that Bumiputera share of equity ownership may even have exceeded 30 percent in 1990 (Jomo, 1990: 160,161).

This debate notwithstanding, it is true that the increases in both Bumiputera and non-Bumiputera shares were made possible by the sharp decrease in the ownership share of

foreigners from 63.3 percent in 1970 to 25.1 percent in 1990. Malaysians thus went from owning less than 40 percent of their corporate sector in 1970 to owning three-quarters of it in 1990 (Snodgrass, 1995:11). This outcome was achieved relatively smoothly and without seriously impeding economic growth.

While the outcomes here seem fairly positive, criticism has been leveled at the nature of ownership restructuring among the Bumiputera. On the positive side, the government's ownership scheme attracted very wide participation and also helped improve income distribution among the Bumiputera. Over 2 million, i.e. 44 percent of those eligible had participated by the late 1980s (Jomo, 1990:160). On the other hand, while 85 percent had invested \$500 or less, 75 percent of all ASN shares were owned by approximately 1.3 percent of the eligible Bumiputera (Jomo, 1990:160).

It is abundantly clear that elite and middle class Malays derived more benefits from restructuring. It is also true that many ordinary Malays such as farmers, labourers and housewives received tangible benefits, which were previously unavailable to them. Although their gains were minimal, ordinary Malays saw it as a demonstration by the government of its intent and ability to give poor Malays a better livelihood. It also fostered the perception with individuals who had not benefited yet, that sometime in the future, either they or members of their families would get benefits under a Malay-dominated government. This expectation translated into continued political support for UMNO and ultimately greater social and political stability in Malaysia. Such stability proved an important factor in attracting FDI and creating an environment for sustained economic growth.

## **SOCIAL SERVICES AND QUALITY OF LIFE**

The huge effort to increase the level of education and health services in Malaysia played a significant role in the development process since it helped to create a more literate, numerate and healthy workforce. This manifested itself in higher levels of productivity

and an improved ability to adapt to technological change. It also made it possible for ordinary Malaysians to enjoy greatly enhanced quality of life.

## **Education**

### ***Primary and Secondary Education***

At the primary school level, enrolment rates initially increased rapidly and stabilised around 91 percent by the early 1970s. By the early 1990s, gross enrolment ratios were 93 percent in primary schools (Snodgrass, 1996:30). The eastern states Sabah and Sarawak, starting from a lower base than Peninsula Malaysia, increased enrolments even more rapidly to reach about the same outcome as in Peninsula Malaysia. Of particular significance is the growing proportion of women in the rising enrolment rates.

The higher primary school enrolments had a knock-on effect on secondary schools to the extent that secondary school enrolments increased by 86 percent in the 1970s and 56 percent in the 1980s (Drabble, 2000:284). For Malaysia as a whole secondary school enrolments increased from a mere 28 percent in 1965 to 59 percent in 1987. The female component of secondary enrolments rose from 39 percent in 1975 to 58 percent in 1991 (Drabble, 200:284; Snodgrass, 1996:31).

### ***Tertiary Education***

Most of the emphasis under the NEP concentrated on tertiary education. The number of universities grew from one to seven by 1990. Numerous colleges, technical and vocational schools were also established during this time. Tertiary enrolments at government and government-assisted institutions grew rapidly from 13 000 in 1965 to reach 194 000 in 1990. In addition, there were a further 36 000 students at private institutions in 1985 and about 35 000 studying abroad (Drabble, 2000:284). Enrolment at

the tertiary level increased from 3 percent of the population aged 20-24, to 7 percent (Snodgrass, 1996:31).

The quotas imposed on tertiary institutions, while significantly boosting Bumiputera enrolment, severely limited access of Chinese and Indian students to Malaysian institutions. This, together with the enforcement of the indigenous language, Bahasa Malaysia as medium of instruction, forced Chinese and Indian parents who could afford it, to send their children abroad in large numbers to pursue tertiary education. Those who could not afford to study in Australia, America or the United Kingdom were forced to abandon their studies or study in Taiwan or India. However, degrees obtained in the latter two countries were not recognised in Malaysia. The subsequent resentment among the non-Bumiputera did not enhance national solidarity but instead engendered hostility towards Malays. The capacity of Malaysian universities was not enough to realise the government's envisaged growth in the number of Bumiputera graduates. As a result Malaysia became heavily dependent on overseas higher education. According to Snodgrass (1996:32) there were still as many Malaysians studying at foreign colleges and universities as at Malaysian institutions in 1992.

However, the education system was not producing enough graduates in the technical and engineering fields, resulting in a shortfall of about 4 000 engineers a year by the early 1990s (Drabble, 2000:286). The government's massive effort to provide more educational opportunities for the Bumiputera nevertheless played a great part in the dramatic changes in the ethnic composition of employment and the emergence of a Bumiputera middle class. The development of their productive potential and their subsequent contribution to the economy, helped boost productivity and output and contributed to the high level of economic growth achieved.



## **Health**

Over the twenty years of the NEP there was a general improvement in the level of healthcare in Malaysia. A number of health indicators confirm that social development had indeed accompanied economic development. Over the period of the NEP life expectancy increased from 61.6 to 69 years for males, and from 65.6 to 73.5 years for females and 71 years for the country as a whole. This placed Malaysia above most other middle income countries and just six years (8 percent) behind the average for the developed countries (Drabble, 2000:286; Snodgrass, 1995:13). The ratio of doctors to population improved from 1:4302 to 1:2656 while the infant mortality rate showed a dramatic drop from 39.4 to 13.5 per 1 000 births. In addition, nearly 70 percent of houses had piped water and just over 71 percent had electricity in 1985 (Drabble, 2000:286).

### ***Regional Differences in Health Conditions***



As with the incidence of poverty there were regional variations in health conditions and access to water and electricity. Peninsula Malaysia's west-coast states were much better off than some of the eastern Peninsula states as well as the Borneo states of Sabah and Sarawak. Figures for 1985 show that about 80 percent of west-coast households had piped water and electricity while the corresponding figures for the east-coast and Borneo states were between 30 to 70 percent (Drabble, 2000: 286). The level of diseases for these states, such as malaria, tuberculosis, dysentery and typhoid was also higher than that in Peninsula Malaysia, but significantly lower than the pre-NEP periods (Drabble, 2000:286).


### **Overall Quality of Life**

The Human Development Index (HDI) is a widely used index of social development, devised by the United Nations Development Program (UNDP). Siwar (1996:202), citing the UNDP's 1994 Human Development Report notes that Malaysia made remarkable

progress in increasing ‘human development levels of all classes of society’. He notes that during the twenty years of the NEP the HDI of Malays had increased one and a half times as fast as that of the ethnic Chinese (Siwar, 1996:204). This rapid development helped to narrow the disparities between the Bumiputera and Chinese. According to Snodgrass (1995:13) Malaysia ranked fourth in the world for improvement in the HDI between 1970 and 1990. The three countries to obtain a higher rating were South Korea, Saudi Arabia and Mauritius.

Ghosh (1996:127), in an attempt to analyse the quality of life in greater detail, formulated a human quality of life index (HQLI). This he did by taking into account seven aspects: literacy rate, population per doctor, life expectancy, infant mortality, calorie intake per day per person, population per television and population per telephone. His findings for Malaysia are illustrated in Table 4.5 below.

**Table 4.5 Indicators of Quality of Life in Malaysia**



<b>Indicators</b>	<b>1970</b>	<b>1993</b>
Literacy rate (%)	60.2	78.5
Population per doctor	4302	2656
Life expectancy (years)	63.5	71
Infant mortality rate (per 1000 live births)	39.4	15
Calories intake	2170	2774
People per television	45	6.9
People per telephone	59	5.8

*Source:* Ghosh, 1996 p128

From the above statistics it is clear that Malaysia has indeed made tremendous progress in improving the quality of life of ordinary Malaysians. In advancing his study Ghosh conducted a similar survey of the newly emerging ASEAN countries. He found that Malaysia had done remarkably well in occupying third position. Only Singapore and

Brunei performed better than Malaysia in most respects. He found that Malaysia lagged behind these two countries especially in regard to the literacy rate and the doctor to patient ratio. However, he points out that Malaysia outperformed all other ASEAN countries in all categories, except in the literacy rate (Ghosh, 1996:128). This serves to confirm that Malaysians enjoy a relatively high quality of life, but that there remain areas, such as the literacy rate, where tremendous effort is required for the country to catch up with its ASEAN neighbours.

## **OTHER NEP OUTCOMES**

### **Economic Growth and Structural Change in the Economy**

Apart from poverty alleviation and ethnic restructuring the other major occurrences over the NEP period were the high levels of economic growth and the dramatic change in the structure of the economy. Malaysia grew fast during 1970–1990 despite implementing a redistributive affirmative action programme. It surpassed expectations by becoming one of the world's ten fastest-growing economies between 1970 and 1990 in spite of a general expectation that a sharp trade-off between growth and redistribution would lead to a lower growth rate (Snodgrass, 1995:13). During the 1970s the economy grew at 7.8 percent per annum. Economic growth during the 1980s was lower at 6.2 percent largely because of the global economic recession and the drop in the price of Malaysia's major export commodities. However, real GDP grew at an average of over 8 percent immediately after the recession in the mid-1980s (Osman-Rani, 1996:13). The industrial sector accounted for nearly 50 percent of growth in the 1970s, with manufacturing as its sub-component alone contributing 25 percent (Osman-Rani 1996:12). Significantly, the contribution of the industrial sector continued to rise despite the decline in overall growth in the mid-1980s.

The ascent of the industrial sector occurred at the expense of the agricultural sector which traditionally provided the basis for Malaysia's exports and the economy. The share of

GDP of the industrial sector grew rapidly to overtake that of the agricultural sector in the early 1970s with the manufacturing sector responsible for much of this growth. By the mid-1980s the agricultural sector was eclipsed in size and performance by the manufacturing sector (Osman-Rani, 1996:14). The contribution of manufacturing to GDP tripled from less than 10 percent in the 1960s to about 30 percent in 1993, while its contribution to the industrial sector increased from approximately one-third to approximately three-fifths (Osman-Rani, 1996:14). In addition, manufacturing grew from a very small share of total exports in 1970 to achieve more than 60 percent in 1990 (Snodgrass, 1995:13). The manufacturing sector was largely responsible for the improvement of income distribution because of the high proportion of Bumiputera it employed. It also led to the rapid urbanisation of the Bumiputera with its accompanying developmental changes, such as access to better health and educational facilities as well as improved labour market opportunities, reduced average household sizes and greater opportunities for women. Emsley regards the fact that so many Malay women earn money wages as an important contributing factor for the Malay/non-Malay household income ratio falling much faster than the Malay/non-Malay worker income ratio. This leads him to argue that the sectoral changes in the economy rendered the largest contribution to improving the lot of the Bumiputera (Emsley, 1996:44, 49).

### **Political Patronage**

The increasing political dominance exerted by UMNO not only advanced the government's developmental capacity but also led to political patronage and other abuses of power. Although an unintended outcome of the NEP, political patronage nonetheless had a significant impact on Malaysian society.

Because of the government's increased role and influence in the economy during the NEP, it was suitably placed to distribute rents to the political elite (including leading members of the UMNO hierarchy) and other politically well connected Malay businessmen. The government provided rents in the form of overpriced contracts,

permits, licences, special loan and credit facilities as well as subsidised education and training opportunities. It also involved distributing cash and gifts and offering expenses-paid trips to members of the party. In return for rents allocated in their favour, rent-seekers would reciprocate by providing economic and political support to the UMNO hierarchy. This support was particularly useful at election time when it secured votes and financial support for campaigning for the politicians. This growing tie between government and business is popularly referred to as 'money politics' (Gomez and Jomo, 1999:237; Jomo, 1990:230-231) and 'crony capitalism' (Simone, 2001:239; Jomo, 1998:1573; Sato, 2001:213).

Opponents of the NEP, especially the non-Bumiputera, had hoped that the government's liberalisation of the economy through its switch to a policy of privatisation would curb political patronage and rent seeking activities. However, as Gomez and Jomo (1999:178) contend, 'privatisation appears to have been especially abused for the development and consolidation of politically linked businessmen'. Gomez and Jomo (1999:91-98; 100-116) cite numerous examples of how privatisation was used to centralise corporate ownership in the hands of new Bumiputera rentiers who enjoyed close ties with influential politicians. Thus political nepotism and patronage have grown with privatisation. Through privatisation the government transferred majority control of monopolies such as HICOM, MAS and Sports Toto and companies like Peremba to businessmen with strong political ties. As a consequence, their control over sectors of the economy such as property development, heavy industry and the gaming sector was enlarged (Gomez and Jomo, 1999:90).

The fact that rents were dependent upon political access and influence led to considerable jockeying and competition within UMNO. This resulted in growing political factionalism, especially among senior UMNO leaders. Also, as UMNO involvement in the corporate sector grew, individual Malay businessmen had to compete against direct UMNO involvement in the corporate sector as well as against other politically linked companies for government contracts, licences and business opportunities. This led to

increased friction amongst the new Malay middle and business classes over access to rents.

Moreover, the new Bumiputera capitalists who emerged as a result of political patronage have been severely criticised for their methods of wealth accumulation. Gomez and Jomo (1999:51) assert that they accumulated wealth by engaging in short-term rentier activities as opposed to using rents as a basis for entrepreneurial activity and further accumulation. Jesudason (1990:104) posits that many Malay businessmen used rents allocated to their businesses as a shortcut to a 'high consumption life-style'. They did very little to increase the competitiveness of the economy and to develop new opportunities for further economic growth. The abuse of political patronage, therefore, has encouraged much directly unproductive business activity.

Gomez and Jomo (1999:8) concede that rents were not always wasteful and indirectly facilitated productivity gains. Because rentiers were motivated by profits and return on investment they also contributed to capital accumulation and investment activities. However, this reality does not alter their view that rents could have been utilised more efficiently in order to maximize growth and productivity gains.

## **CHAPTER 5: LESSONS FROM MALAYSIA**

### **INTRODUCTION**

The NEP achieved remarkable success in changing Malaysian society from one characterized by widespread poverty, income inequality and race as an important determinant of an individual's occupation, earning potential and function, to a rapidly industrializing modern economy.

Through a process of systematic, planned interventions the Malaysian government succeeded in combining rapid economic growth with redistributive initiatives such as the restructuring of employment and wealth ownership and achieved a large reduction in the incidence of poverty. By 1990 Malaysia had dismantled the predominantly rural colonial economy and had in its place a vibrant economy poised for full industrialization.

As noteworthy as its economic development were the spectacular results achieved in the elimination of poverty and the identification of race with economic function. How did Malaysia achieve its rapid economic growth and what enabled the country to achieve the high level of redistribution without adversely impacting economic growth? This chapter will explore the combination of factors that contributed to Malaysia's success as well as the lessons developing countries, especially South Africa, can learn from the Malaysian experience.

### **THE IMPORTANCE OF ECONOMIC GROWTH**

Sustained economic growth played a pivotal role in the successful restructuring of the Malaysian economy and the redressing of ethnic imbalances. Government transfers and subsidies played an important role in reducing rural poverty. Governmental development expenditure through FELDA (Federal Land Development Agency) and other government agencies transformed much of the agricultural sector. However, of greater significance in

poverty reduction was the migration of low-income agricultural workers to higher-income jobs in other sectors, especially the industrial sector. Had it not been for the high levels of economic growth this phenomenon would have been greatly reduced, with a concomitantly reduced impact on poverty alleviation. Poverty would thus have remained a significant problem.

The high growth rate also impacted positively on the restructuring aim of the NEP, i.e., on eliminating the identification of race with economic function because of the close correlation between sustainable economic growth and structural change in the economy (Emsley, 1996:84). This, together with state-sponsored industrialisation, allowed for the expansion of the industrial sector. This was particularly important because prospects for continuing long-term income gains from the primary sector are limited. Had the government pursued a policy of radical redistribution in the absence of economic growth, such redistribution would have taken place at the expense of the Chinese and Indians. This would undoubtedly have brought about an exodus of skilled Chinese and Indians and may have caused political and social instability. Fortunately this did not materialize because government policies for correcting ethnic imbalances were pursued within the context of continued economic growth to ensure that no group lost out. Restructuring could then be achieved by the distribution of newly created wealth rather than redistributing existing wealth (Eyre, 1997:145).

### **Growth with Equity**

Watkins (1998:24) advances the argument in favour of the importance of economic growth. He however argues that economic growth alone is not enough for advancing human development and posits that the poor in East Asia have benefited from growth, not because of the 'trickle down' effect, but because the development of their productive potential has been central to the growth process. According to Watkins (1998:23) the redistribution of productive assets in the form of tangible assets such as land, productive inputs and credit and intangible assets such as education and health are crucial to wealth



creation. This enhances quality of life and empowers the poor to act as agents of growth through their own contribution to production. Malaysia has been very successful in converting growth into poverty reduction and human development which, in the long run, had a positive impact on economic growth since it created conditions for rising productivity and output. Thus the development of the productive potential of the poor has been central to the growth process.

Watkins (1998:24) correctly argues that apart from being unacceptable in ‘human terms’, poverty is ‘grossly inefficient’ in economic terms. Poverty not only reduces productivity but also lowers the capacity for savings and investment and restricts the development of markets, thereby retarding economic growth and the potential for redistribution.

Ahuja, Bidani, Ferreira and Walton (1997:46-47) concur that economic growth played an important role in raising the incomes of the poor. While prosperity did not grow at the same rate for everyone, it had grown enough to lift many people out of extreme poverty.

The important role of economic growth for poverty reduction and restructuring in Malaysia necessitates a closer look at the factors which characterised Malaysia’s rapid economic growth.

## **FACTORS WHICH INFLUENCED MALAYSIA’S GROWTH PERFORMANCE**

### **Political Stability and Continuity of Government**

Through the course of several turbulent decades, Asian governments maintained stable economies even when economies in other regions of the world spiraled out of control (Radelet, Sachs and Lee, 1997:51). Malaysia had a government of national unity over the period of the NEP that incorporated the views of Chinese and Indian Malaysians. This helped to establish and maintain political stability. While stable political leadership on its own is far from sufficient to ensure sustained economic development, it enabled the

Malaysian government to be consistent in their approach and to implement long-term economic strategies. The changes proposed by the NEP, although radical, were to be achieved gradually over a 20-year period. Because of the stability and predictability of the system under which UMNO ruled in conjunction with its junior partners, the government's promises had considerable credibility, even though the period over which they were to be achieved was very long. The stability of the political system was adequately illustrated by the government's commitment to the NEP even though the country had three prime ministers during the NEP period. The constant preoccupation of political leaders with political and social stability as a precondition for economic growth was evidenced in sound macro-economic policies.

### **Macro-economic Stability**

A strong lesson to emerge from Southeast Asia is the central role macro-economic stability played in facilitating sustained economic growth. Madavo (1996:2) argues that there are three reasons why sustained economic growth requires macro-economic stability. He argues that relative prices such as the exchange rate and interest rates are clearer when inflation is low and stable. This clarity of price reduces uncertainty and thus encourages private investment. In the second instance, macro-economic stability, particularly low inflation, contributes to higher public sector saving by broadening the tax base and increasing tax collections. Low inflation also facilitates private savings in domestic financial assets. Higher savings engenders growth by providing domestic resources for investment. Finally, the fact that the real exchange rate does not get overly appreciated, allow economies to be more outward oriented. Gradual appreciations in exchange rates have thus been consistent with rapid export growth in Asia.

The experience of Latin American economies confirms the importance of maintaining macro-economic stability. Large and unsustainable fiscal deficits set in motion a chain reaction in this region. Because governments created more money to finance their deficits inflation increased dramatically. Higher inflation, coupled with a reluctance to

undertake nominal devaluation of their currency caused the exchange rate to appreciate substantially. Because it reduced export earnings and encouraged imports, the external balance was affected negatively. This led to the mushrooming of external debt. As a consequence most Latin American economies registered negative growth (Madavo, 1996:4).

Throughout the NEP the Malaysian government managed to implement sound monetary, fiscal and exchange rate policies. Exchange rates were managed to provide constant and rewarding incentives to exporters. Except for a brief period of double-digit inflation in 1973-74, the inflation rate remained low while real interest rates were kept positive (Snodgrass, 1995:15). Government attempts in the early 1980s to spend its way out of recession resulted in fiscal imbalance which caused large deficits during this period. However, Malaysia could finance these deficits without inflationary consequences or having to resort to excessive and eventually unserviceable levels of debt because of a savings rate of well above 30 percent (Roemer, 1994:8). Malaysia's political, social and macro-economic stability played a key role in making the country attractive to foreign investors.



### **An Efficient Civil Service**

The establishment and maintenance of a high-quality civil service underpinned the successful implementation of government policy. Cloete (2000:56) describes the Malaysian public service as one of the more efficient public services in Southeast Asia. The highly competent civil service is especially proficient in functions related to economic management.

The civil service operates on the merit principle and has the ability to attract and retain well-qualified personnel. This is a direct result of Malaysia's substantial investment in education and human resource development. Merit-based selection and promotion procedures together with adequate compensation helped to foster the development of a

committed, professional and non-partisan civil service. This factor greatly enhanced the government's capacity to implement economic policies aimed at sustained growth.

### **Natural Resource Endowment and the Importance of Agriculture**

Southeast Asian countries are generally well endowed with land and natural resources. Malaysia, in particular, benefited greatly from an abundance of natural resources such as rubber, tin, palm oil and timber. The discovery of oil and gas were of special significance to the economy because it provided a tremendous boost to government revenue, especially when OPEC raised export prices. While other countries squandered the benefits of rich natural resources the Malaysian government had the wit and foresight to take advantage of its good fortune. It used its early primary sector export earnings to help finance its drive to industrialise the economy. The revenue it derived from oil and gas fields helped to finance the poverty alleviation and restructuring drive it undertook under the auspices of the NEP.



Furthermore, land reform, investment in infrastructure and the establishing of institutions and organisations for rural development played a central role in agricultural development programmes. Government subsidising of capital works such as irrigation enhanced productivity. Subsidies on inputs such as fertilisers, pesticides and credit also helped to raise the productivity and income of agricultural producers.

### **Export Orientation**

The government enhanced the rapid development of Malaysia's export performance through the promotion of a free trade regime for exports. It created several innovative programmes and institutions. Through liberalisation of the Investment Incentive Act, astute management of the exchange rate and other measures it made exporters more competitive and also helped to attract massive amounts of FDI. A considerable part of

the success story was the creation of innovative institutions such as free trade zones where the most rapid growth in production for export occurred.

FTZs led to the creation of labour-intensive electronic and garment industries driven by foreign companies. The result was rapid job creation that provided employment in the industrial sector for the children of farmers, women and other low-skilled workers. This led to a significant decline in the unemployment rate and boosted household incomes considerably. On the negative side, FTZs facilitated the exploitation of female labour.

### **Human Resource Development**

The upgrading of human skills was an important long-term component of Malaysia's development strategy. High rates of public sector spending on human resource development led to a much higher Malay participation in the modern sectors of the economy as well as higher productivity in the traditional sectors. As pointed out above, the investment in education and health had an enabling outcome since it helped participants in the growth process by virtue of their own contribution to production.

### **Role of the State and State Pragmatism**

According to Thomas and Wang (1998:238) 'the East Asian experience suggests that government has a major positive role in reforms – laissez-faire is not optimal. The government's role is crucial in making markets work, dealing with externalities and facilitating public investments.' As in the rest of East Asia's successful economies the Malaysian state fulfilled key economic functions such as the provision of public goods and infrastructure, establishing institutions to support the developing of the economy and the functioning of the private sector whilst also maintaining high standards of public sector management. The emphasis placed on, inter alia, the provision of high quality education and health services is evidence of the government's commitment to economic development. The government also actively intervened in production by establishing

public sector controlled business enterprises. When the government adopted a more flexible administrative policy from the 1980s onwards, it increasingly viewed the private sector as a partner in developing the economy.

A distinguishing feature of East Asian governments was their very creative and forceful response to new challenges as they arose. As Thomas and Wang (1998:226) observe: 'The remarkable macroeconomic stability in East Asia reflects prompt government attention to macroeconomic problems as soon as they appear.' The capacity and willingness to change policies in pursuit of its objectives became a hallmark of the Malaysian government's economic management. This pragmatism saw the government change its stance on a number of fronts and issues when needs changed or when policies were found to be ineffective. Most notable was its response to the economic crisis of the early 1980s. The government took the bold step of curtailing public spending, restructuring public enterprises and liberalising its policies to promote economic growth, even at the risk of being accused of abandoning the NEP. In particular, the timing of its investment liberalization in 1985-86 was excellent since it coincided with exchange rate appreciation in Japan, Korea and Hong Kong and the search of these countries for new low-cost production sites. This action, together with its stability increased Malaysia's attractiveness at precisely the right time and resulted in a massive inflow of FDI.

Bolstered by the loyalty of the Malay labour force, the state emerged as a powerful force, able to formulate sound policies and apply proper control mechanisms to achieve poverty alleviation, maximization of employment and increasing the standard of living of all Malaysians.

### **Political Patronage**

A negative outcome of government involvement in Malaysia's economy was the proliferation of nepotism. Through this practise some of the political elite used the expanded state machinery and UMNOs access to economic resources to patronize groups

and individuals in return for political support. Conversely, well-connected businessmen also influenced political decision-making, raising concerns about the transparency of government policy-making and implementation.

Although successful entrepreneurs developed from it, political patronage also spawned a layer of businessmen who failed to develop into entrepreneurs and instead became dependent on government protection. Thus money politics led to some inefficient allocation of resources between 1970 and 1990. This is a situation best avoided in South Africa because the country can ill-afford the divisions caused by friction over access to rents let alone the inefficient allocation of its limited resources. The experience of Malaysia also highlighted the need for an independent monitoring agency which will help with the elimination of rent-seeking activities.

## CONCLUSION

A number of factors have contributed to the high growth, redistribution and poverty alleviation rates of Malaysia over the period of the NEP. A major lesson for South Africa is the importance of **growth** and growth enhancing strategies. The importance of growth cannot be underestimated because in its absence there would be nothing to redistribute. The potential for civil strife along the lines of the 1969 racial riots in Malaysia will be greatly exacerbated if government-driven redistribution policies are not pursued in tandem with its growth promotion strategies. However, too high expectations should be tempered by the fact that programmes can only be designed within the context of what is affordable, lest the growth process itself be jeopardised.

In order for South Africa to reduce its **high levels of poverty** more jobs must be created in the formal sector so as to absorb the vast supply of surplus labour. This necessitates a high employment growth rate that will be facilitated by economic growth of a labour-intensive nature. A rapidly growing economy will also provide the government with growing revenue, boosting its redistributive potential, especially in the field of education

and training, healthcare and housing. Because South Africa is unlikely to achieve as high a growth rate as Malaysia and given that racial imbalances are worse than they were in Malaysia, the timeframe for poverty alleviation would certainly be longer.

The Malaysian experience has shown that a high-quality **civil service** is essential for successful policy implementation. It is therefore of critical importance that the transformation of the South African public service be expedited. In this regard education and training and innovative programmes should be aimed at changing the mindset within the civil service to one that values efficiency and service orientation. A competent, professional and service-oriented organisation will enhance the implementation of public policy and programmes aimed at improving the lot of the millions of South Africans living in poverty.

In the field of **agriculture** the implication for South Africa is that land reform, good investment in irrigation and inputs, financial assistance and the provision of basic infrastructure especially for small-scale black farmers are critical for improved performance. More importantly, it will contribute to the alleviation of rural poverty by improving job creation and income distribution in addition to providing security against famine. As in Malaysia, improved agricultural productivity should also be seen as laying the basis for the further development of other sectors of the economy such as manufacturing and services. The maintenance of appropriate exchange rates and the incentives it provided to agricultural producers is well illustrated by the Southeast Asian experience. It should be noted that small farmers made more productive do not only constitute an engine of growth, but also a market for industrial goods.

Thoahlane (1996:6) is of the opinion that 'given appropriate policies and adequate development of infrastructural base', Southern African countries can successfully implement **export promotion** 'as the relative success of Zimbabwe has shown.' South Africa possesses a vast pool of labour while the physical infrastructure is 'generally regarded as one of its strengths' (Calitz and Siebrits, 2002:15). It is also a fact that the



infrastructure can be further improved by careful and well-considered government investment. However, if South Africa is to be successful in export promotion it needs to attract much-needed FDI and hence needs to boost investor confidence. Foreign direct investors will be more cautious about investing in a developing economy like South Africa. To boost investor confidence South Africa must build a reputation for good macro-economic management. In addition, foreign investors' perception of South Africa as a good investment option will be considerably enhanced if domestic private investors show confidence in the economy by investing their money in South Africa.

Furthermore, Malaysia was successful in paying low wages because of a weak and repressed labour movement. Since repression and authoritarianism is not a solution in South Africa the state will have to intervene to broker an accommodation with labour and capital, which recognises the needs for growth as well as the redistributive expectation of the impoverished majority. The success of a policy of export orientation will also be contingent on political stability and economic development in the Southern African region since it constitutes a natural market for South African exports. South Africa unfortunately is not in as favourable a position as Malaysia as regards its location in a fast growing regional economy.

In South Africa the development of the productive potential of the poor can become central to the growth and redistribution process. For this to materialise South Africa needs to invest more wisely in **human resource development**. The system of basic education needs to be refined in order to obtain a much higher return on current education expenditure. Valuable resources are expended on policy implementation only for policy to change soon thereafter. New initiatives need to be thoroughly researched prior to approval and implementation and must be reoriented towards vocational education and training programmes which respond to the changing needs and requirements of the South African economy. It should address, in particular, the narrow skilled manpower base and develop the capacity of poor South Africans to fill this void. Education policy should also cement the partnership between government, the private sector and NGOs to increase

investment in education and continuous training. Human resource development therefore has an important role to play in enhancing economic growth but at the same time can also advance the development status of poor South Africans.

Malaysia pursued its growth and redistribution strategies on the back of immense **government intervention** in the economy. The government ensured that economic fundamentals, for example, macroeconomic and political stability, a productive agricultural sector and an efficient civil service were in place. However, contrary to the dictates of the international financial institutions such as the World Bank, it did not follow economic orthodoxy by pursuing neo-liberal economic policies prescribing no government intervention in the economy. Precisely because early neo-liberal policies did not deliver the so-called “trickle down” the government was forced to intervene strongly in the economy. This it did systematically and through multiple channels to foster development and redistribution to ensure that poverty and the identification of race with economic function were eliminated. The government was pragmatic in its approach and did not hesitate to amend or abandon interventions that were not working. In doing so it ensured that Malaysia did not degenerate into social conflict. There can be no doubt that the spectacular achievements in poverty eradication and the restructuring of wealth ownership would not have happened were it not for Bumiputera-biased government intervention in the form of the NEP. Government intervention did have a negative spin off in the form of **nepotism**, which for its negative consequences, South Africa should seek to avoid. However, the question is not whether the South African government should intervene in the economy, but how.

Direct emulation of the experiences of Malaysia and other Southeast Asian countries may not be feasible because their development strategies were born of particular historical, social and political circumstances. However, their experiences are nevertheless valuable because they refute neo-liberal contentions and indicate how the role of the state in developing economies can be concretely defined. They also indicate how policies in various forms and combinations can be effectively used in the pursuit of economic

development. Malaysia has certainly illustrated that elements of an open market together with a more interventionist approach that offsets distortions, can be successfully employed. Southern African countries, and especially South Africa can learn from government intervention in Malaysia and fashion economic policies to suit South African conditions. Not only should the South African government ensure that the country establishes and maintains a growing economy, but it needs to be proactive in ensuring that poverty and social inequalities are dramatically reduced. In order for this to materialise, it has to pursue policy interventions that will ensure that growth translates into redistribution and poverty reduction and a concomitant increase in the quality of life of poor South Africans. Failure to achieve such an outcome will propel South Africa down the path of civil strife and economic degeneration.



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