

MALAYSIA'S SOCIO-ECONOMIC TRANSFORMATION IN HISTORICAL PERSPECTIVE

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ABSTRACT

This study attempts to explain the pattern and evolution of economic development in Malaysia since independence. It focuses on the impact of growth and analyses how the government policy of positive discrimination (also known as *Bumiputeras*) has helped to address historical backwardness and thus reduce ethnic tensions in the country. The state also launched the policy of diversification, which involved various combinations of policy initiatives; for instance, the expansion of new industries was encouraged, especially if they focused on production for foreign markets. As a result, job opportunities increased. The government also undertook measures to tackle rural poverty, modest land reforms, protection of tenant rights, and other rural development measures to protect the rural poor. All these measures to a certain extent helped to reduce rural poverty.

This paper offers an explanation as to how the net implications for employment and growth have been achieved. I think this study is important because a review of Malaysia's economic strategies and development could be a very useful example for other developing countries. The key finding of the study is that the state has to a great extent been successful in its role and objective of promoting economic and social development in Malaysia. However, the economic strategy that is based on export markets and credits to provide the stimulus for growth may likely encounter difficulties due to increased competition unleashed by the forces of globalisation. These difficulties could arise despite evidence on trends in economic growth and employment creation which suggest that Malaysia's recent transition to a high-growth trajectory has been accompanied by low inflation and decreased levels of unemployment and poverty.

KEYWORDS: Malaysia, Export-Led Growth, Diversification, Islam, State Intervention, FDI, and Ethnic Relations.

INTRODUCTION

This study will focus on the post-independent period, when the government took strategic decisions to move production from low value to higher value products. Currently, Malaysia is the second fastest growing economy in the South East Asian region with an average Gross National Product (GNP) growth of eight-plus percent per year since 2000. In 2010, Malaysia's gross domestic production was US\$ 235.2 billion, with GDP per capita (PPP) equal to US\$ 14,564 with major industries including electronics, petroleum, chemicals, textiles, palm oil, timber and tourism. (World Bank, 2011; Economic Report, 2011)

Together with a stable political environment, increasing per capita income and the potential for further regional integration throughout the Association of South East Asian Nations (ASEAN), Malaysia is an attractive prospect for FDI (foreign direct investment). Decades of industrial growth have made the country one of the most vibrant and successful economy of the South-East Asia. The aim of this article is to identify and to critically analyse the factors that contributed towards this rapid economic growth.

There have been a number of studies on economic development in Malaysia⁽ⁱ⁾. However, -new developments such as globalisation and the expansion of export sectors as seen in China and Vietnam will most likely bring a new dimension of competition and challenges for growing export sectors in particular and economic growth in general in the near future.

Also for a country with a multi-ethnic population and past ethnic tension that has done relatively well during the last two decades Malaysia may provide important lessons and serve as a model for many other developing countries. A review of relevant literature shows that there is noted a lack of discussion on these particular issues (Hamilton and Gereffi, 2009; Khoo, 2003).

This paper will examine the class structure in the colonial and post-colonial period, tracing the development of capitalism and its implications for the political economy of the country. For instance, the rubber plantation was entirely the creation of British capital (Jomo, 1998; Junid, 1980).

I think this study is important because a review of Malaysia's economic strategies and development could be a very useful example for other developing countries. The Malaysian experience offers an interesting lesson for a developing country as to how government policies could be used to promote domestic businesses. It demonstrates the need to formulate industrial policies making use of market and government intervention to turn markets to favour government opted policies.

How did all this happen? How was Malaysia able to transform itself from a colonial backwater to an economic powerhouse? How did a multi-racial and multi-religious society with a history of racial tensions, and even bloody racial riots in 1964, transform into a peaceful, productive and politically and economically secure society?

This paper is composed of several sections. After the introduction, the colonial economy will be discussed, followed by an analysis of post-independent economic policies. In the third section the importance of foreign capital in the economy will be examined, while the fourth section examines the issues of promotion of Malay capitalism. The fifth section analysis Malaysia in the context of the East Asian debate. Finally, the relationship between Islam and capitalism are discussed, followed by the conclusion.

Malaysia gained independence from Britain in 1957. It was largely inhabited by three ethnic groups: namely Malays, Chinese and Indians, which have different ethnic origins, each with their own culture and identity. More than a quarter of Malaysia's ⁽ⁱⁱ⁾ population is Chinese and they have historically played an important role in trade and business. Those of Indian descent comprise about 7% of the population. The process of building the new independent country has been a challenging and difficult task of creating social harmony in a multicultural society inherited from a colonial past, while at the same time pursuing prosperity and modernisation.

Modern race relations in Malaysia are a by-product of British colonisation of the peninsula in the late 19th century. Racial antagonism and ethnic divisions developed during the colonial administration. Prior to colonisation inter-ethnic relations among the people were marked by cultural stereotyping. British colonial policies initiated an unrestricted immigration policy and their policies of "divide and rule" did little to support a positive environment of cohesion among various ethnic groups in the country (Hirschman, 1986). Soon the colonial administration realised that huge financial gains could be made with the expansion of tin mining and cash crop cultivation due to a favourable climate; along with the exploitation of huge natural resources (such as timber, minerals etc.). For this purpose, a large number of Chinese, Indian and Indonesian labourers were invited to work and settle in the western regions of the country.

At the end of the Second World War the United Malays National Organisation (UMNO) was formed by the Malay aristocrats. The Malayan Chinese Association (MCA) was also formed in 1949 by the wealthiest Chinese business people to ensure their economic interests. The Malayan Indian Congress (MIC) was established in 1946. Malaysia inherited a colonial administration and economy largely geared towards producing primary commodities for exports⁽ⁱⁱⁱ⁾. At the time of independence Malay workers accounted for nearly 52 % of the workforce, mostly involved in traditional and

low income agricultural sector, while the Chinese formed about 37 % of the population, but engaged in modern economic sectors such banking, trade, plantation management etc. This study will also analyse the government policy of positive discrimination also known as *Bumiputera*^(iv), which was aimed to address historical backwardness and thus reduce ethnic violence and injustice in the country. Thus, in post-independence, the country faced enormous challenges to achieve economic growth while preserving communal harmony and balance economic activities between various ethnic groups. On the economic front, the availability of huge natural resources such as timber, water and minerals for the manufacturing sector could be sustained.

Malaysia, gradually adopted an export oriented policy and various protective measures were gradually removed. For instance between 1970 and 1987, the corporate tax rate of protection on industrial chemicals was reduced from 160% to 16%, fertilizers 300% to 8% and tobacco from 125% to 26%, while at the same time those firms who were exclusively set up for exports and were provided financial incentives such as protection rates increased from 28% to 131% (Rasiah and Shari, 2001). Since 1989, the rapid increase in growth rates, especially in the export sector led to the dramatic expansion in the construction and property boom, fuelled by short term bank loans favoured by the financial sector over the longer term risky loans given to industrial projects. This was coupled with an inward flow of foreign saving and already high domestic savings, which accelerated further the rate of capital accumulation. Besides these factors, businesses and banks also borrowed heavily from abroad - thus further increasing the availability of capital in the domestic markets. With Malaysia's adoption of the Banking and Financial Act of 1989, the regulatory control was tightened. As a consequence, the monetary and banking policies were proved to be better prepared to face the subsequent financial crisis compared to other East Asian neighbours. However, in order to develop the stock markets, the government relied on market-friendly policies. Thus, the country's vulnerability arose from the vitality of international capital flows into stock market. The government abandoned capital controls on financial flows.

Therefore, at the time of the financial crisis it was mainly equity not debt that was the problem. This meant that the economy became hostage to the 'portfolio investors' confidence. Any move to undermine their confidence would lead to instability and negatively affect stock market growth, which in fact happened in Malaysia in 1997.

Malaysia introduced capital control measures to stabilise the economy, which was seen as a rejection of IMF's pro-market policies. The impact of financial crisis became worse by the imposition of austerity policies. The crisis of 1997 indicated that the country's economic boom of early 1990s was based on weak and shaky grounds and could not be sustained. The growth was largely reliant on overseas supply of capital, highly skilled labour and technology.

Commenting on the 1997 East Asian crisis Joseph Stiglitz (2001) argues that besides the "institutional" weaknesses such as poor banking regulation and lack of transparency, these factors alone cannot provide a full explanation of the crisis.

For instance, foreign borrowing by non-financial corporations was made possible by the capital account liberalization, and these policies were encouraged by the IMF and the World Bank^(v) and led to a build up of short-term dollar-dominated debts. The fact is that the credit rating agencies did not downgrade the East Asian countries until after the onset of the crisis, but suddenly started doing so only after the crisis was underway.

Researchers have argued that the property price bubble in South East Asia has its roots in Japanese business model, policies and culture, which comprises relations between the state and businesses, involving rent seeking behaviour. Thus, elimination of such practices is claimed to contribute to levelling the playing field and bringing convergence towards Anglo-American business model^(vi).

THE COLONIAL LEGACY

During British colonial rule the economy was built around the production of rubber and tin. The colonial government encouraged specialisation in these products as primary export commodities and Malaysia (then known as Malaya) became the major world producer of them. Infrastructural developments in the form of ports, railways, roads, electricity etc. were developed to support the investment in rubber plantations and tin mines that ultimately made attractive and profitable returns for British investors. But it is worth noting that such capitalist expansion in agriculture was lopsided and uneven. As a result, ethnic Malays remained largely marginal to the growing capitalist sector. The colonial administration adopted a policy framework that turned the country into the supplier of raw materials and an importer of manufactured goods.

The colonial policy also encouraged the Chinese, Indian and Indonesian immigrants to work in the areas of plantation labour and administration. Despite the huge number of immigrants who settled in the country, there was hardly any interaction between the different ethnic groups. The Chinese were mainly engaged in the cities and in economic activities like tin mining, commerce and trade, while the Indians settled and worked in semi-rural plantations. The Malays overwhelmingly lived in the rural areas and worked in the agricultural sector (Gomez and Jomo, 1999:10). Moreover, Chinese people migrated to Malaysia in large numbers during the colonial period and formed intra-ethnic partnership in business. These Chinese businessmen found it easy to do business deals with other Chinese. Thus, during the colonial period the ethnic Malay population was hardly involved in business enterprises. The colonial administration perhaps saw the wisdom in keeping the native Malay population in agricultural sector, in a form of *divide and conquer* through class and ethnic segregation.

The ethnic communities were thus segregated geographically, economically and socially from the local population. Mining and rubber plantations were completely populated by Chinese and Indians, while Malays were encouraged to remain within subsistence agriculture. The colonial administration initiated a capitalist economy at much larger scales in urban and industrial centres, but maintained Malay social structure in the rural areas. Through these policies, the British rulers reaped enormous economic benefits^(vii). During the late 19th century with European economic, military and political domination over the Southeast Asian regions, the need for justification of colonial rule was ‘discovered’ through the so-called “racial superiority” theory. This in turn led to the propaganda of the myth that caste the natives as being lazy. This stereotype was created on the back of the unwillingness of the Malay to work for British mining and cash plantation companies and businesses. The reason seems to be very logical, given the terms of employment; i.e. low wages and harsh working conditions offered by British companies relative to potential higher earnings that could be made in traditional sectors such as agriculture and fishing. Given the availability of abundant fish and natural resources, the Malays made the economically rational choice (Hirschman, 1986).

Hirschman (1986) also characterises Malaysia with the following words: “Nineteenth century colonial society was modelled on racial principles: belonging to the dominant white upper caste provided one with prestige and power largely independent of one’s personal capabilities. A strict ritual was introduced and maintained, by force when necessary, to preserve the white caste from contracts with Asiatic on the basis of equality and to maintain the former’s prestige as the dominant group” (Hirschman, 1986:354). The colonial policy of controlling trade, mining and plantations played exclusively into the European hands in the late 19th century, and removed any chances of creating Malay entrepreneurship. Moreover, to become a successful business in the growing capitalist economy required capital, labour and land and these were generally in the hands of the Europeans and Chinese.

Therefore, the most notable impact of colonialism has been on the Malaysian economy and society such as the creation of a multi-ethnic society with the arrival of huge number of Chinese and Indians immigrants. The economy was modified to suit the needs of British imperial interest by specialising the periphery towards primary products - i.e. mining and plantation. As a result, during the colonial period the development of an indigenous bourgeoisie was hindered.

The Malaysian economy grew fast as the international demand for tin and rubber increased, which was mostly controlled by the British, with the Chinese control being only a very small proportion. The rubber industry was a very profitable investment and investors received very high returns. For instance, in 1910 companies paid dividends ranging from 225% to 375% (Bach, 1975). By 1940, about 93% of the British capital investment in Malaysia was in plantation and mines (Junid, 1980:18). Almost all British capital investment was limited to plantations and mines, with none in manufacturing, food production or consumer goods. For instance, European companies controlled 60% of tin output, while remaining 40% into Chinese hands. Similarly, in rubber plantation, 83% was owned British and 14% was owned by Chinese (Junid, 1980).

POST-INDEPENDENT POLICES

Upon gaining independence in 1957 from Britain, the Malaysian economy was largely based on a handful of agricultural and mineral exports and the ethnic Malay people largely worked in areas of low productivity and poverty was widespread among them. The government ensured that the policy of redistribution was not at the cost of long-term economic growth and the Malaysian consensus created a developmental state with an aim to address the historical shortcomings and tackle backwardness among the largest racial groups. The rural population had until then been neglected with regards to education and modernisation. Primary and secondary education in rural areas were therefore expanded and made available with a view to rectifying historical imbalances that had occurred during the British colonial period.

Table 1 below shows that the gross domestic product grew by an average of 7% per annum between 1960 and 2010, except in 1998. During 1998 due to the financial crisis affecting the whole region there was a dramatic fall in growth rates, which I will elaborate later on in this article. One remarkable feature of Malaysia's development is the steady growth in domestic savings as indicated in Table 1. The export of goods and services has fluctuated between 1961 and 2010. For example, it has risen initially, but sharply fell during the East Asian crisis, but again began to rise during the post- crisis period. Despite the current global economic slowdown, Malaysia's economy remains strong. Macro-economic indicators are shown in the figures 1.

Table 1: Malaysia: Key Macroeconomic Variables (%)

	1961	1970	1980	1989	1991	1996	1998	2000	2005	2006	2010
GDP growth rates	7.6	6	7.4	9.2	8.7	8.8	-7.4	8.9	5.4	5.9	5.7
Gross domestic savings (% of GDP)	21.1	24.3	29.8	29	28.4	36	48.7	47.3	43.5	41.8	41
Gross capital formation (% of GDP)	16.1	17.1	27.4	23.5	37.8	41.5	26.7	27.3	19.9	18.7	18.1
Exports of goods & services (annual % growth)	5.5	5	3.2	15.2	15.8	9.2	0.5	16.1	8.6	5.5	6.7
Imports of goods & services (annual % growth)	4.6	17.1	20.5	25.7	25.2	4.9	-19	24.4	8	5	6.2

Source: World Bank – National accounts data, OECD national accounts data (2 & 3), Government Finance Statistics Yearbook, Malaysia.

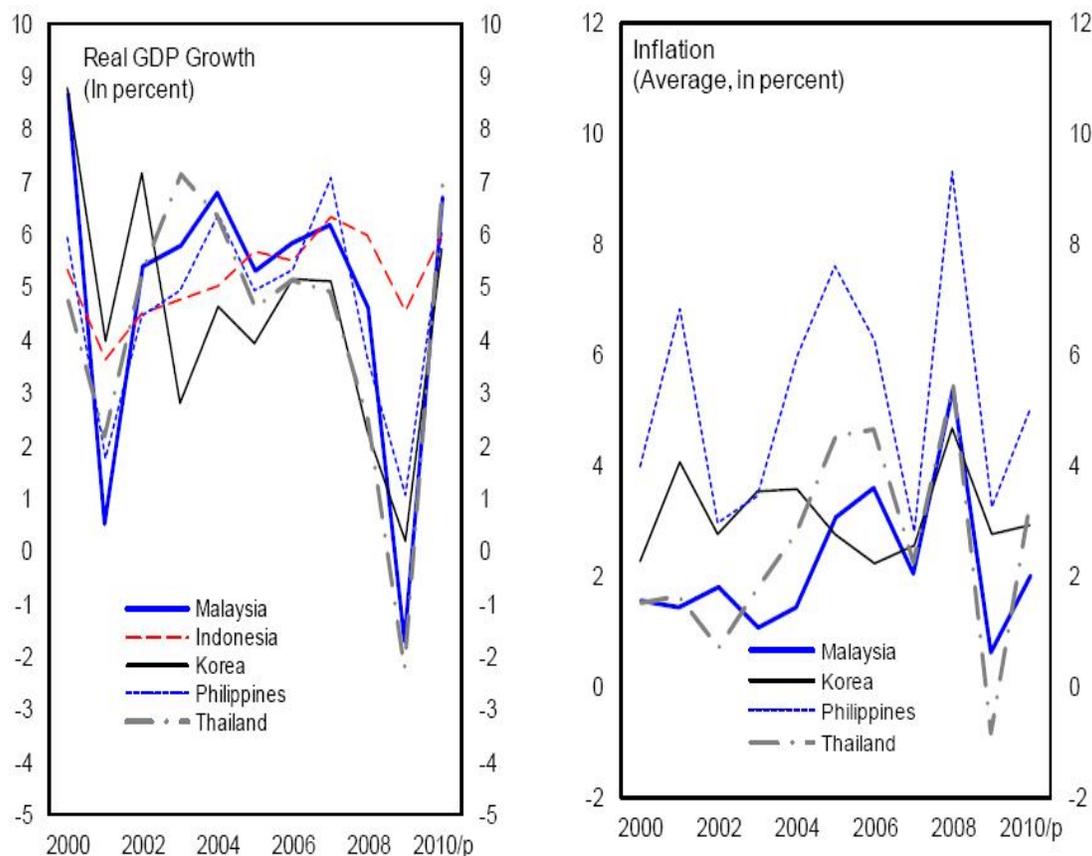


Figure 1: Macro-Economic Indicators - the GDP Growth Rates and Rate of Inflation between 2000 and 2010

Moreover, the Malays were given privileges such as public sector jobs, scholarships in higher academic institutions and also business licenses and permits. The government intervention was considered necessary to address ethnic imbalances which arose from the colonial legacy and to elevate the economic positions of Malays. To overcome these historical injustices, government established in the 1950s the Rural and Industrial Development Authority (RIDA) and the Federal Land Development Authority (FELDA). RIDA focused on increasing Malays participation in business by providing access to credits and training. FELDA initiated land reforms - i.e. to allot land to the rural poor and encourage the cultivation of cash crops, mainly palm oil and rubber (Gomez and Jomo, 1999:15).

RIDA was also set up to encourage and assist the participation of Malay people in business. It aimed to develop entrepreneurial skills by providing initial business training and credits. In its early stages it was not very successful in meeting the desired goals. "In terms of enterprises initiated, credit granted and repayment experience". (Golay et al, 1969:366) FELDA was started in 1957 to re-distribute land to landless farmers for the cultivation and the production of cash crops. Nearly 250,000 hectares of lands were distributed by FELDA among the landless and small farmers between 1957 and 1970. And 20,700 families were resettled under FELDA, which was far less than initially aimed for (Gomez and Jomo, 1999:15).

Table 2 illustrates the rapidly changing sectoral contribution to GDP. During the 1960s, the government attempted to diversify its economy from a key focus on tin and rubber towards greater contribution of higher-valued manufactured goods. In 1975, the production of oil off the East Coast of the Malaysian Peninsular began and since the mid-1980s petroleum and gas exports to Japan have provided another lucrative source of income for the government.

Table 2: Gross Domestic Product by Economic Activity at Constant 2000 Prices (RM Million)

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Agriculture	30,647	30,594	31,471	33,369	34,929	35,835	37,701	38,177	39,828	39,992
		-0.2	2.9	6	4.7	2.6	5.2	1.3	4.3	0.4
Mining and Quarrying	37,617	36,980	38,610	40,959	42,627	42,472	42,030	42,881	41,831	40,246
		-1.7	4.4	6.1	4.1	-0.4	-1	2	-2.4	-3.8
Manufacturing	109,998	105,301	109,640	119,687	131,127	137,940	147,154	151,257	153,171	138,809
		-4.3	4.1	9.2	9.6	5.2	6.7	2.8	1.3	-9.4
Construction	13,971	14,427	14,762	15,031	14,903	14,685	14,639	15,707	16,366	17,321
		3.3	2.3	1.8	-0.9	-1.5	-0.3	7.3	4.2	5.8
Services	175,649	182,821	193,500	201,568	214,528	230,043	247,099	272,406	292,555	300,153
		4.1	5.8	4.2	6.4	7.2	7.4	10.2	7.4	2.6
GDP at purchaser's prices	356,401	358,246	377,559	399,414	426,508	449,250	475,526	506,341	530,181	521,095
		0.5	5.4	5.8	6.8	5.3	5.8	6.5	4.7	-1.7

Source: Department of Statistics, Government of Malaysia, several years, Malaysia.

In the rural sector, after independence, Malaysia did not carry out comprehensive land reforms as was done during the post war period in Japan (Siddiqui, 2009a) and later on in China and South Korea (Siddiqui, 2009b). However, various small measures were launched to promote rural cooperatives and to limit rents charged by rice land tenancy and credit interests. Government provided and regulated credits and encouraged investment in the agricultural sector. Government-controlled banks were encouraged to provide credits through credit guarantees and subsidies to farmers and rural industries. Economic diversification has been considered an important component of the country's economic development especially since the 1960s.

After independence, the government began public investment in rural areas to undermine the influence of communist rebellions and also to capture votes from the rural inhabitants. The ethnic affirmative action programmes have contributed to lessen inter-ethnic disparities; also inflows of foreign capital in the labour intensive export sector along with a massive increase in the public sector by the government in the 1970s further benefited the rural inhabitants through increased job opportunities opened up by these government policies (Khoo, 2003).

During the 1970s rice cultivation was overwhelmingly carried out by the Malays and large numbers of poor people were engaged in rice cultivation. The government aimed to improve rice cultivators' income through productivity growth with the help of subsidised irrigation, chemical fertilizers, pesticides and the price support of rice. The government also encouraged the creation of a positive environment for the expansion of rural industries and small and medium enterprises (SMEs) in rural areas ^(viii). The government also launched various programmes to benefit small farmers by giving subsidies and training for the cultivation of cash crops such as rubber and palm oil. These interventionist policies did help the rural poor and played a very positive role in the economic improvements of rural inhabitants, which happened to be overwhelmingly ethnic Malays.

In mid-1980s, the government emphasised the policy of 'looking towards East' influenced by the experiences in Japan and South Korea, and targeted certain heavy industries such as petro-chemicals, steel and automobiles on the basis of joint ventures with significant possibilities for 'Bumiputera' participation into modern industrial sectors. Henderson and Phillips (2007) on the issue and consequences of foreign capital finds that "Unlike industrialisation experiences elsewhere in East Asia, FDI led industrialisation in Malaysia has not has not stimulated significant, nationally owned export industries. Given that local input has remained towards the lower end of the production chain, there have been no 'product-life-cycle effects' associated with the production strategies of TNCs themselves that might otherwise have provided

incentives for local companies to upgrade to meet their requirements for higher value-added supplies or opportunities for the latter to enter export markets ...” (Henderson and Phillips, 2007:88).

During the mid-1990s the government privatised of new international airports, high ways, telecommunications etc. There was huge expansion of export-oriented industries, coincided with rapid rise in investment in infrastructure has played a positive role to achieve average around 8% annually since 1988. With privatisation state assets were transferred into private hands at discounted prices. In Malaysia the availability of migrant workers at lower wages seems to have provided incentives for foreign investors to expand or maintain their utilisation of the country as a regional hub for low costs, labour incentives for intermediate goods and technology and also to be assembled in Malaysia.

Malaysia’s GDP contribution by sector-wise in 1970 was the following: Agriculture contributed 40 %; mining and manufacturing 6 % respectively; agriculture decreased to 31 %; mining remained the same while manufacturing rose to 13 %. During the 1980s agricultural contribution dropped further to only 18 %, while mining rose to 10 %, the manufacturing sector rose to 26 %. Further in 1995, agriculture declined to 14 %, mining dropped slightly to 7 %, while manufacturing rose to 33%. It appears that while agriculture dropped to less than half between 1960 and 1995, mining rose slightly (from 6 % to 7%), manufacturing rose dramatically from just only 6 % in 1960 to 33 % in 1995. ^(ix)

On the export side, agricultural commodities contributed to 66.1%, while mining and manufacturing made up 22% and 8.5% respectively of the total exports in 1960. However, two decades later in 1980 agricultural exports declined to 43.6%, while mining and manufacturing rose to 33.8% and 21.6% respectively. Again in 1995 we witness export of agricultural products declining further to 14.2%, mining to 6.4%, while manufacturing rose to 80.2%. It also seems that the country was able to successfully diversify from low value agricultural commodities to medium value manufacturing products ^(x). Thus, by 1995 manufactured goods comprised more than 80% of exports. The rapid transformation of the Malaysian economy was mainly due to the expansion of the manufacturing sector, which heavily relied on foreign inflows of capital and the availability of technology and skills supplied by the rising Multi –National Corporations (MNCs).

Table 3 indicates the share of exports of manufactured goods for the last ten years. The data shows that electronics and electrical machinery is the largest contributor to the total export, although it has declined but still quite large compare to other products. While other products such as iron and steel has increased from 22,921RM million in 2006 to 26,695 RM million in 2007 and further rose to 29,594RM million in 2008. In 2009 it appears due to the global financial crisis it declined to 22,917RM million. However, the rapid increase

Table 3: Shows Exports of Manufactured Goods between 2006 and 2010 (RM Million)

	2006	2007	2008	2009	2010 ¹⁾	%share
Electronics, electrical machinery and appliances	281,348	266,454	255,360	227,778	146,200	51.6
Chemicals and plastic products	37,716	41,572	45,531	38,239	27,110	9.6
Petroleum Products	23,930	26,089	36,080	24,846	16,830	5.9
Iron, Steel & Metal Products	22,921	26,695	29,594	22,917	15,457	5.5
Machinery & Equipments	19,439	21,871	21,922	19,188	12,784	4.5
Wood Products	14,791	14,391	14,957	12,728	8,032	2.8
Textiles, apparel & footwear	10,925	10,631	10,911	9,375	5,446	1.9
Other manufactured goods	56,382	61,369	71,453	62,410	45,200	16

Source: Department of Statistics, Government of Malaysia, Malaysia.

1) January to July 2010

Since the mid-1980s the Malaysian government has moved towards a process of privatisation and restructuring of state owned enterprises. By 1994, the state owned enterprises and industries producing automobiles, petro-chemicals, cements, iron and steel had been privatised.

The New Economic Policy (NEP) was launched following the ethnic riots in 1969. The main cause identified for being the root cause of ethnic tensions between indigenous Malays and non-Malays, was the issue of 'poverty' and inequality. With the help of NEP policies the government aimed to reduce poverty from 49% in 1970 to 17% by 1990. Provisions for free education and scholarships for Malays, along with highly skilled professional training and job opportunities in the public sector were created. This involved a government supported initiative to target a specific business group who would be able to receive state aid and support. With the launching of NEP in 1971, the government proclaimed to be able to correct economic imbalances and eventually the removal of the problem of ethnic strife^(xi) by using economic measures to eradicate poverty in the country.

It appears that the adoption of NEP had meant abandoning the policy of *laissez-faire* policy in favour of state intervention. The government acted through selective patronage for a few selected industries. The government was also very keen to promote the investment of Malay capital. As researchers note: "Regulation to promote *Bumiputera* businesses also received a strong boost from the launching of government-sponsored heavy industries, i.e. cement (Kedah cement and Perak Hanjoong), steel (Perwaja steel) and motor vehicle (Proton). Despite the use of foreign-local joint venture ship, the bulk of the employees occupying professional positions in these organisations were *Bumiputeras*, which is rare in large privately owned manufacturing establishments. In addition by offering a generally captive domestic market through high tariffs and quotas, the government offered the incentives for modern *Bumiputera* entrepreneurship to evolve". (Rasiah and Shari, 2001:73-74)

There was an effort to shift higher value added products and services by focusing on greater specialisation through international linkages. The government realised that industrial upgrading requires a strong domestic base of high skills, infrastructure and knowledge. It also required huge investments in high tech, and research and development sectors over the long term. During the 1970 government encouraged Malay participation in manufacturing sector. Between 1971 and 1981, the presence of public enterprise increased and in 1975 the government directed that each quoted firm on the stock market should allocate a minimum of 30% of its equity to *Bumiputera*. Earlier, the Chinese had dominated key modern sectors such as banking, property and construction.

Prior to becoming Prime Minister, Mahathir was critical of neo-liberal economic policies, which the country pursued in the first decade after independence. He argued that state involvement in the economic policy is crucial to address the problems of economic inequalities between various ethnic groups^(xii) Mahathir Mohammed became Prime Minister in 1981. Soon after he put forward a grand vision for Malaysian economic development, which was intended to help the country join the developed economies by 2020. Then the government decided to steer the general direction of the economy in order to expand the domestic economy. The government also encouraged Malaysian firms to establish joint ventures with European manufacturers for new products. The inflows of foreign capital during the 1990s contributed to the expansion of the manufacturing sector. However, unlike Japan and South Korea, Malaysia heavily relied on foreign capital to industrialise the country. "The government's subscription to policies under the developmental state model, particularly during the more than two decades of Mahathir Mohammed's premiership (1981-2003), has established to Malaysia's fairly rapid economic development. State-led development, replicating post-war Japan's form of economic growth, was imperative for Mahathir in order to support domestic enterprises and encourage the rise of large business groups. His desire to develop huge conglomerates was influenced strongly by East Asian corporate models, especially the

Japanese *Zaibatsu* and South Korean *Chaebol*, with their emphasis on the close links between the financial and industrial sectors to advance industrialisation.” (Gomez, 2009:348-49)

However, the appreciation of the Japanese yen against the US dollar in 1985 as a result of the Plaza accord with United States resulted in an increase of Malaysian external debts denominated in Japanese yen. Under these international circumstances, Malaysian government allowed a depreciation of its currency the *ringgit*, which led to a sudden increase in external debts to a level of 76% of GDP in 1986.

The Malaysian economy grew by average about 7 % over the two decades of NEP. As a result, the country’s GDP doubled in a decade. It is hoped that the current development programme just launched will be successful known as “vision 2020”, it has the goal to increase GDP by 2020 to eight times larger than that in 1970. The Malaysian economy has already diversified considerably when compared to the 1960s, when its main industries were associated with tin and timber, which were main economic activities during the colonial period. In recent years petroleum and gas industries have expanded along with the production of more cash crops such as pepper and cocoa which have increased their export share.

By 1990, the government replaced the NEP with the NDP (National Development Policy). The NDP proclaimed a grand vision of transforming the country into developed economies by 2020. The plan was to keep GDP growth rates at 7% annually. It was suppose to be achieved with the help of the public sector, contrary to the earlier NEP where state played a crucial role in achieving the goals. The government also initiated privatisation and in 1985 established the Economic Planning Unit (EPU) to provide guidelines on privatisation policy. The government privatisation policy appears to have provided incentives for bureaucrats and managers of public sector corporations to make a transition to the private sectors.

Ibrahim Anwar, then deputy Prime Minister was sacked immediately after the imposition of capital control in September 1998 as he publically disagreed with Prime Minister Mahathir regarding corporate bailouts and capital control. Capital control had been used as a means of lowering interest rates while at the same time reducing the pressure on the financial sector. There was no doubt that the capital controls and *yen* pegging of the *ringgit* were important policies measures, which distinguished Malaysia from other East Asian economies, who have been more deeply affected by the East Asian financial crisis.

In order to regulate capital inflows, the government created the Foreign Investment Committee (FIC) in 1974. The aim was to monitor foreign takeovers of domestic companies. But by the mid-1980s, despite the launching of NEP, the country’s exports still largely consisted of raw materials, though they had managed to build some heavy industries with state support. Then with the global commodity prices slowing down in 1986 the country witnessed a rapid fall in the prices of rubber and tin, which dropped by nearly half compared to 1984. However, government spending through NEP period remained high.

The manufacturing sector’s contribution to GDP rates remained stagnant between 1960 and 1965 and foreign capital inflows slowed down during this period as domestic markets witnessed stagnation. The slow growth in the 1960s meant worsening economic situation for the majority of the people leading towards increased frustration and tension between ethnic groups leading towards ethnic riots in 1969. The government launched NEP in 1970 and set out to reduce poverty. Ethnic wise poverty in 1970 was 74% for Malays, 39% for Indians, and 26% for Chinese. This was supposed to be achieved by creating more jobs in public sectors and by creating Malay entrepreneurs. The employment distribution in various sectors in 1970 in the primary, secondary and tertiary sectors were 66.2%, 12.1%, and 21.7% respectively. The NEP aimed to restructure the economy with job expansion in the manufacturing sector. However, by the end of 1970s the

Malay ethnic group ownership of shares in major sectors of the economy was still insignificant. More than two-third ownership of the economy remained in foreign capital and Chinese ownership amounted to 22.5% (Gomez and Jomo, 1999:19).

The government ethnic policy in Malaysia was to improve the living conditions of the majority Malay people in response to the 1969 race riots. The government launched the New Economic Policy (NEP) with an objective to redistribute the wealth and economic activities from non-Malays to Malays. As a part of this strategy the government set-up heavy industries under state ownership, known as Heavy Industries Corporation of Malaysia (HICOM), and also encouraged joint-ventures with foreign partners. Proton car manufacturing is one prime example of such government initiative. Experiences of government initiatives were summarised by Park (2000: 239) as: "A slowing world economy had depressed prices for Malaysia's major commodities to their lowest levels in thirty years, resulting in contraction of the domestic economy. Almost all units under HICOM went into red. Management of state industries was passed to private sector managers who were mostly non-Malays. These management changes indicated a new government emphasis on market signals and the profit criterion for evaluating state enterprise performance. HICOM management changes are by no means the only steps that have been taken since 1988 to reorient government industrial policy away from the earlier effort at state-led industrialisation. Privatization and de-nationalization have gained momentum" (Park, 2000: 239).

For example, Malaysia's two decades of redistribution policy has had some positive impact on the stated goals of achieving 30% *Bumiputera*. Since the adoption of the NEP unemployment had fallen from 8% in 1970 to only 2.5% in 1996. This was achieved on the basis of market friendly policies (World Bank, 1993). However, a number of researchers have found that the rapid reduction of unemployment seen under the NEP period were largely due to pro-market and government interventionists policies. A combination of both policies did assist to make export-based industrialisation a success, while at the same time government re-distributive policies, particularly in rural areas, proved to be helpful to address issues of inequality.

Adam and Cavendish (1995) concluded that "while real GDP growth had been impressive (during the last two decades of NEP) and the standard of living of the *Bumiputeras* as a whole had improved dramatically, the overall performance of the economy had not been outstanding by regional standards. It has been widely argued that growth was hampered by NEP. When it was introduced, Malaysia ranked third only to Japan and Singapore among East Asian nations in terms of GDP per capita; by 1990 it had fallen behind South Korea, Taiwan and Hong Kong as well. Had growth not been constrained by NEP, it is argued, the economic performance and welfare of the *Bumiputera* would have been even more greatly enhanced" (Adam and Cavendish, 1995:15). Another researcher, namely Khoo (1994) argues that the government acknowledged disappointment. As he notes, "Malay businessmen had been nurtured on easy credit, business licenses, government contracts, and other forms of preferential treatment They did not fulfil NEP's vision of a class of competitive Malay entrepreneurs NEP's restructuring appeared to have removed the racial imbalances only in form because in reality NEP fostered a 'dole', 'subsidy' or 'get-rich-quick' mentality among the Malays. State protection had perpetuated Malay dependence on the state" (cited in Gomez and Jomo, 1999: 118).

The NEP's goal of reducing poverty had been achieved by the end of 1980s. Poverty overall, for instance, declined from 49% in 1970 to 15% in 1989. The identification of ethnic groups with 'occupation' had been reduced. The governments' preferential policies towards Malays did facilitate an increase in their proportion of public listed companies from a 2.4% share in 1970 to 19.3% in 1990. This has had a positive effect on both rural social and income mobility and certainly resulted in a trickledown effect. However, despite some noticeable economic changes, *Bumiputera* still dominate

agriculture and the public sector. The principal beneficiaries of government policies thus seemed to be business persons linked with political elites. Malays found a quick way to make money.

The National Economic Policy also created an environment of expanded bureaucracy, economic inefficiency and high costs and low levels of entrepreneurship and innovations. Such businesses also lacked managerial expertise and therefore, it affected their decision making ability as well. As a result, decisions were taken which were not always most profitable. Overall, most of them relied on government support and thus were not part of the competitive market ethos. In the mid 1970s, Malaysia became a net oil exporter and along with higher commodities prices, the issue of fiscal discipline were seen as unnecessary. However, by the mid 1980s the global recession had brought the commodity prices sharply down, which adversely affected Malaysia's overall export incomes. Capital flights increased and private investment fell sharply. Under these circumstances government reacted by investing in heavy industries such as steel, cement car etc. with collaboration from global corporate groups.

Foreign capital had been displaced by the Malay during the NEP period, as it was hoped such policies would encourage Malay farmers to opt for cash crops cultivation. Economic growth was achieved by a structural changes supported by increased investment in the manufacturing sector (Kaldor, 1979), while latter growth theorists advocated for the creation of comparative advantages so that increasing returns to scale could be achieved (Krugman, 1980, Romer, 1986).

Despite the widespread literacy and availability of schools in rural areas, Malaysia still is far behind in investment in research and development compare to other East Asian countries in the industrial related research. However, in the agriculture sector, Malaysia has a long tradition of high quality research. In the area of rubber plantations, which was earlier owned exclusively by European capital, the Rubber Research Institute (RRI) and also Palm Oil Research have both achieved world class standards in R&D in these areas, which have enormously benefitted the plantation sector. Through the NEP the government provided various economic incentives to both import substitution and Export Oriented policies as regards the manufacturing sectors as well as taking a number of steps to address the issues of rural poverty and infrastructure.

Neoliberal economists have pointed out the 'invisible hand' as the best way to allocate resources and stable growth. They also argue that economic activities such as production and distribution should be left on private enterprise with little or no state intervention in order to get the best outcomes (World Bank, 1993). The World Bank (1993) study has acknowledged that rapid growth and international competitiveness has been achieved as a result of economic liberalisation. Contrary to this, various studies not only in Malaysia, but other East Asian countries have found that there is a clear evidence of government intervention, which played a crucial role to achieve rapid growth rates. (Lall, 1996; Wade, 1991; Amsden, 1989)

Lall (1996) has emphasised the importance of innovation and research with companies as industry matures in developing economies. The highly technical research and development base enables a quicker diffusion of technology within the economy. It also lowers the costs of transfer, strengthens diversification and the spillovers which have a further multiplier effect within the wider economy.

The main objectives of the NEP were to eradicate poverty and restructure society to eliminate the wide disparity between races with regard to their share of economic function. The government target was to raise Malay ownership of share capital in private companies and the proportion of Malays employed in management positions. The government

stated goals were that the corporate share of Malays to be raised from 2% in 1970 to 30% by 1990 while raising employment in the modern sector to enable the country to reflect the racial composition of the country.

The government established Heavy Industries Corporations of Malaysia (HICOM) in 1980 initiated partnerships with foreign companies to set up industries in areas such as: iron and steel, cement, paper and petrochemicals etc. These industries were expected to “strengthen the foundation of manufacturing sector [by providing] strong forward and backward linkages for the development of other industries” (Government of Malaysia, 1993).

The East Asian crisis of 1997 had a different impact on Malaysia due to its banking sector having little exposure to foreign debts. This was the reason why it was able to deal with such a difficult situation without an IMF rescue package. However, a few months later, the government announced various austerity measures, both fiscal and monetary. The government introduced a capital controls policy in order to reduce capital flight associated with loosening monetary policy and lower interest rates. There was no negative impact, as the government clearly said that it was a short term measure. For the last five decades, Malaysia's economic performance has been very impressive compared to many other developing countries. For instance, in South Korea and Taiwan the state took a complementary role along with the market to compel businesses to adopt technical and efficiency improvements. Later on in 1990s with de-regulation, tariffs and incentives were reduced leading domestic businesses to find it more lucrative to invest in land and estate property sectors.

The Mahathir government had created greater power in the hands of bureaucrats and the top tier of political leadership through constitutional amendments. Such amendments did facilitate the implementation of NEP along with state involvement to reduce inter-ethnic economic disparities and privatisation of over grown and inefficient public sector. The mid-1990s saw the government privatisation of new international airports, high ways, and telecommunications etc. There was also a huge expansion of export-oriented industries, coinciding with a rapid rise in investment in infrastructure that has played a positive role in achieving an average growth of around 8% annually since 1988; but alongside this went the privatisation of state assets that were transferred into private hands at discounted prices.

ECONOMIC POLICY AND INFLOW OF CAPITAL

Malaysia has been quite successful in attracting huge amounts of foreign inflows of capital (FDI). The data published by UNCTAD (2004) indicates that Malaysia has become the most popular destination in Asia for foreign capital. The policy reforms, including: the introduction of Investment Incentives Act of 1968; the establishment of free trade zones in the early 1970s; and the provisions of export incentives alongside the acceleration of open policy in 1986, led to a surge of FDI inflows into Malaysia. It is also said the availability of skilled labour force helped contribute to attract foreign capital into the country.

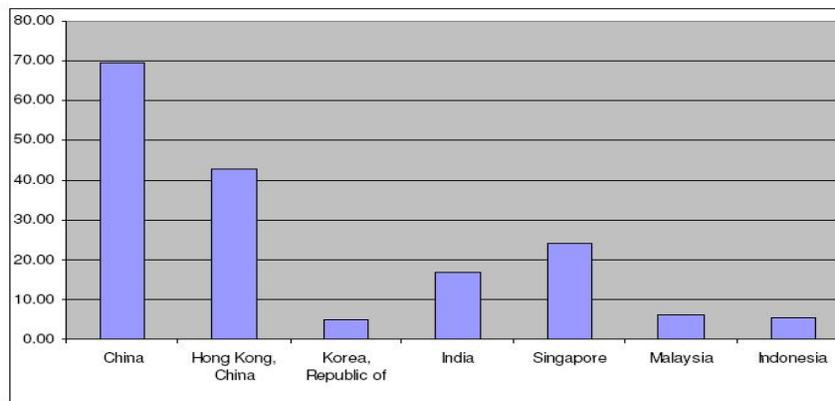
Since the early 1960s the country had tried to attract foreign capital through small incentives such as lower tariffs on final goods and by strict control on trade unions. Moreover government banned trade union activities in export sectors, particularly in textiles, electrical and manufacturing.

However, with the Plaza Accord of 1985, a rapid increase in foreign capital inflows to South East Asian countries took place, with Malaysia becoming but just one of the major beneficiaries of the external changes. For instance, Malaysia stood second only to Singapore in terms of receiving foreign investments. There is no doubt, however, that foreign capital did contribute towards a transformation of the economy. For example, the output share of agriculture in GDP fell from 21% in 1985 to 12% from 1985 to 1997, while during the same period, the share of manufacturing rose from 20% to 36%. More significantly the government succeeded in diversifying the economy and the manufacturing sector was able to successfully upgrade its production. The share of value-addition in manufacturing moved away from agricultural based

low-value food processing activities to higher-value more capital intensive production. It is generally accepted that a mature technological base is propelled by vibrant and innovative research and development activities. However, contrary to this Malaysia's rapid expansion of the manufacturing sector was not achieved with a similar increase in indigenous research activities. This led to many researchers questioning the long-term sustainability of the manufacturing sector.

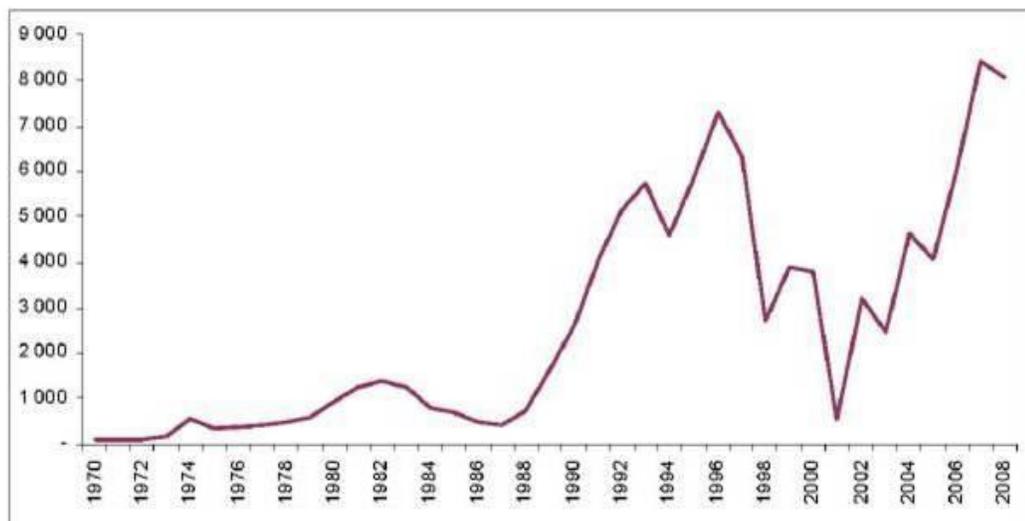
Until 1993, foreign investment contributed 60% of all investment in Malaysia. FDI grew strongly in the late 1980s to reach a peak of RM17.7 billion in 1992. Figure 2 indicates the difference of capital inflows in the region. China receives the highest foreign capital investment followed by Singapore. Within the developing countries China, Hong Kong, Taiwan, Singapore, Thailand and Malaysia received a significant amount of the share of developing world's foreign capital inflows. Among the developing countries, the top 10 countries received 64 % of the total FDI in 2006.

Figure 2: FDI Inflows into Asian Countries in 2006 (US\$ billions)



Source: UNCTAD, World Investment Report 2007 database

This was followed by a sharp drop to RM6 billion in 1993 due to the world recession, but rose again to RM15.2 billion in 1994. Malaysia is among the top five recipients of foreign direct investment in the world. Japan and Taiwan are clearly the largest overall investors with the US third, followed by France, Singapore and the UK (McLeman 1994, 19).



Source: UNCTAD, FDI/TNC database

Figure 3: FDI Inflows in Malaysia (Million US\$)

Malaysia, perhaps, represents one of the most successful developing nations that has been able to effectively incorporate economic policy objectives with foreign funds, knowledge and networking through FDI. The inflow of foreign capital in Malaysia is therefore an important catalytic factor; increasing exports, knowledge and providing an economic vehicle towards the Malaysian 2020 vision.

Among other government policies intended to promote the development of business culture among Malay people was the allowing of quotas imposed in public sector employment, business licenses and scholarships to higher academic institutions. By following these policies, government aimed to create and expand Malay owned businesses. Malays were generally given various supports to facilitate their entry into modern businesses.

In the late 1960s, the government abandoned ISI policies and starting advocating export oriented industrialisation (EOI). To facilitate this in 1968 the Employment and Export Oriented Investment Incentives Act was introduced, which offered tax holidays to approved firms of up to a maximum of 8 years. Exemptions were also given from import duties of technologies and raw materials for export oriented industries. However, domestic producers were protected through a new tariff policy on imported consumer goods.

Under Free Trade Zone Act of 1971, the free trade zones of manufacturing were set up to receive FDI. These export zones were given all possible incentives to attract foreign capital, technology and management to produce for overseas markets. By the early 1980s these industries overtook Malaysia's manufactured exports. These foreign companies however, were not under any pressure from the government to set up joint ventures with domestic firms unless they produce for domestic markets (Jomo and Edwards, 1993)

Despite some industrialisation, the over dependence of rubber, tin and palm oil was seen continuing until 1969. For example, the major export items in 1956 in percentage terms such as rubber, tin, timber and palm oil were 63, 17, 2 and 2% respectively, while it changed to 44, 25, 5 and 4% in 1969 (Lim, 1973: 122). Despite the fall in the prices of rubber, these primary commodities still accounted for nearly 80% of total gross export earnings of the country. The effects of the free trade export zone were limited as it was largely located in the urban areas.

The situation of South Korea's economic development is remarkable. The country, which had a per capita income lesser than that of the Philippines in 1965, could by 1995 boast a per capita income of US\$ 13,269 compared to that of the Philippines of only US\$ 2,475. This is an increase of 770% in just three decades (Ahuja, 1997) Unlike Indonesia, South Korea's industrialisation path was based mainly on mobilising domestic savings which was partly due to rural reform of the 1950s. Foreign capital however, did play a part in development of the manufacturing sector in Singapore. The government did manage to build a close relationship between state and private sector. It adopted the policy of 'choosing strategic sectors and industries', providing them with subsidized credits through government directed banking system - at the same time protecting them from foreign competition and these *Chaebol* later on were pushed international markets. However, in early 1980 inefficiency and corruption in the *Chaebol*, banks and government was becoming obvious. By mid-1990s it became more critical, which was mainly due to government's inability to invest significantly in research and development; to join OECD membership, which led to the adoption of more liberal policies towards foreign capital. South Korean big business rather than investing in R&D invested in real estate and stock markets. By the 1990, there were only 32 engineers per 10,000 workers in South Korea compared to 240 in Japan and 160 in the US. Most of the high technology was imported from Japan, which led to massive trade deficit with Japan. While at the same time, competition in global markets from other East Asian countries cheap labour put increased pressures on South Korea.

Initially, Malaysia hoped to attract local businesses to invest in heavy industries, but it proved to not be very successful. Local businesses were reluctant to invest because of the massive capital investment and long gestation period that was required. Therefore, government encouraged foreign investors and brought in the Investment Protection Act in 1986, which provided generous tax holidays for a period of five to ten years. During the 1980s the international financial institutions advocated de-regulation to reduce government spending, cut down red tapes and finally, provide for a greater role of private enterprises in the economy.

In the late 1960s, the government abandoned ISI policies and starting advocating export oriented industrialisation (EOI). To facilitate this in 1968 Employment and Export Oriented Investment Incentives Act was introduced, which offered tax holidays to approved firms of maximum 8 years. Exemptions were also given from import duties of technologies and raw materials for export oriented industries. However, domestic producers were protected through new tariff policy on imported consumer goods.

On the question of the benefits of the privatisation, Kirkpatrick (1993) has critically observed that effective use of resources by the public sector, rather than its size should be the measure of its performance. For instance, in South Korea and Taiwan the public sector has performed efficiently. He also suggested that privatisation does not necessarily provide a solution to inefficiencies associated with the public sector. Privatisation may lead to reduced fiscal deficits as well as it may lead to the state selling off its assets too cheaply. In Malaysia nepotism did take place due to the absence of an independent monitoring body.

Experiences of government initiatives were summarised by Park (2000: 239) as: “A slowing world economy had depressed prices for Malaysia’s major commodities to their lowest levels in thirty years, resulting in contraction of the domestic economy. Almost all units under HICOM went into red. Management of state industries was passed to private sector managers who were mostly non-Malays. These management changes indicated a new government emphasis on market signals and the profit criterion for evaluating state enterprise performance. HICOM management changes are by no means the only steps that have been taken since 1988 to reorient government industrial policy away from the earlier effort at state-led industrialisation. Privatization and de-nationalization have gained momentum”. (Park, 2000: 239)

THE PROMOTION OF MALAY CAPITALISM

In the early 1980s, the government increased emphasis on ‘Import Substitution’ with an aim to protect certain industries, such as steel, aluminium, cement, chemicals etc. However, by 1985 the government began to promote an Export Oriented policy. The question arises as to why the government changed its policy? It seems that the policies of early 1980s to favour domestic industries did not create rapid expansion of the manufacturing sector. The achievements were far below expectations. The country witnessed an economic crisis in 1985 and to overcome this situation, it was decided to take a u-turn and to adopt an Export Oriented policy.

In 1985 the prices of primary commodities declined sharply due to global recession, resulting in the rapid decline of export revenues. Also public and private expenditures were reduced. The cumulative effects of all these factors led to a negative GDP growth rate of -1.1% in 1985. Therefore, the government decided to encourage foreign capital inflows with the hope that foreign companies would increase investment and economic activity and thus boost the domestic economy. The government took a further initiative and changed the rules to allow 100% foreign ownership of capital for companies which exported more than 50% of their products in 1986, reduced from 80% which was the previous requirement. During the mid-1980s, the inflows of foreign capital were stagnant, but after the change in foreign ownership rules and along with fiscal incentives the FDI rose sharply by the late 1980s. At the same time the country also witnessed an increase in the

share of export in the total production of manufacturing from 36.5% to 50% between 1985 and 1990. It is widely accepted that the export sector played a positive role towards achieving overall high GDP growth rates. Within the manufacturing sector, for example, electronic and electrical machinery industries but also plastic, furniture and industrial output rose dramatically.

When Mahathir became prime minister in 1981, the country had witnessed a rapid change in the ownership patterns; the government appeared to be committed to facilitating the development of capitalism, especially among the ethnic Malays. Mahathir Mohammed prior to becoming prime minister was already advocating for greater government roles through encouraging Malays participation in top businesses (Mahathir, 1981). In 1981, the government setup the Heavy Industries Corporation of Malaysia (HICOM) and increased the country's heavy industrial activity. With this the government aimed to build a capital goods industry with close linkages to *Bumiputera* enterprises. The rapidly growing manufacturing sector provided employment to the female workforce, thus reducing poverty and inequality.

The collapse of the asset price bubble had been encouraged by the policy of financial liberalisation. Jomo (1998) argues that financial interests and financial liberalisation led to an overvalued currency, which ultimately had adverse macroeconomic consequences. "*Bumiputera*-controlled conglomerates emerged, usually with the patronage of powerful politicians, e.g. in the form of soft loans from state-owned banks and the award of major projects and licenses as well as other lucrative business opportunities. The ownership of financial institutions as well as top corporations by the government and by the state owned enterprises and later, the privatisation of some of them, served to encourage such developments. Huge loans could be obtained without going through proper procedures, and were often given for speculative get-rich-quick schemes, rather than for productive investments". (Jomo, 1998:709)

During later half of the 1980s, Malaysia accelerated its trade liberalisation policy. The electronic industry had been upgrading and shifting towards a higher value added products and services through international link. Also of critical importance was the ability to bring in at short notice specialists from abroad who were required to fill the knowledge gap. It appears that both the reintegration of geographically dispersed production sites into integrated global production networks and the use of IT systems to management, encouraged a diffusion of knowledge and new technology.

Ethnic based positive discrimination, despite creating crony interests, did however contribute towards poverty reduction and helped to create more political stability. Through preferential government policies, the government provided employment to Malays in the public sector and also encouraged greater participation in the manufacturing sector, thereby taking concrete measures to restructure the occupational demographics of ethnicity.

Gomez and Jomo (1997) argue that this patronage has figured prominently in the awarding of privatised projects, with major beneficiaries of state assets being *Bumiputera* companies where owners were closely connected to UMNO. The privatisation, particularly of infrastructure projects occurred where the contract was awarded to party members, especially those close to the UMNO. As Yoshihara (1999) argues, "If Malaysian businessmen want to be successful they have to be close to UMNO leaders because those leaders influence the way business games are played in the country. If they have good connections, they can win by participating in games where the outcomes are largely pre-determined. The trouble with this arrangement is that those who are successful, are good political entrepreneurs but often, poor businessmen" (Yoshihara, 1999:17). Moreover, the state controlled banks were quite willing to provide loans to those who were well connected to the ruling party to purchase formerly public sector companies.

The availability of abundant of natural resources in Malaysia made possible rapid GDP rates based on this primary sector and thus may have weakened the focus on the need to industrialise and encourage the export growth sectors.

Being resource rich is bad for growth. The natural resource is seen by some as a “resource curse”, weakening the motive to industrialisation (Sachs, 1997). Contrary to such perceptions, Malaysia has successfully diversified the range of their primary exports and later on the government encouraged the development of processing capacities to increase value-added. However, such development was only possible due to government support to make this happen.

At first economic diversification took place in other primary products. However, as a broader strategy this may prove difficult in small resource rich countries whose natural resource endowment is more likely to be skewed towards the production of one commodity, as seen with such examples as oil producing countries of the Gulf region (Hesse, 2008; Al-Kawaz, 2008; Rodrik, 2006; Rodrik, 2005). There are a number of studies which have focused on this ‘resource curse’ (also known as ‘issues and supply of the abundance of natural resources on development’) and how this curse could be overcome. This is also termed as the ‘Dutch disease’, whereby a resource boom leads to an appreciation of the real exchange rate that may work negatively against manufacturing and other export sectors.

Historically, to begin with economic diversification tended to take place in primary production. It involved various combinations of policy initiatives - for instance, the expansion of new industries were encouraged, especially if they focus on production for foreign markets. Also in the agricultural sector, government sponsored research was aimed at higher productivity to help farmers. It was thanks to this government help that by the 1980s the country had become the world’s largest producer of palm oil, cocoa and pepper, while losing the world’s leading role that it previously had in the production of tin and rubber.

However, this may prove difficult in small resource rich countries whose large natural resource endowment is more likely to be skewed towards the production of one commodity such as oil producing countries of the Gulf region (Hesse, 2008; Al-Kawaz, 2008; Rodrik, 2006; Rodrik, 2005). There are a number of studies (as seen above), which have focused on ‘resource curse’ also known as issues and supply of abundant of natural resources on development and how this curse could be overcome. This is also termed as ‘Dutch disease’, whereby a resource boom leads to a appreciation of the real exchange rate and that may work negatively against manufacturing and other export sectors. They mean to say the resource abundant countries have performed poorly in the overall economic development.

Anne Krueger (1980) has pointed out that natural resources could help a country to make the transition from less developed to developed country. While others have criticised such views and argue that the nature of international commodity markets put less developed countries who rely on their natural resource exports at a disadvantage (Prebisch, 1950; Rodrik, 2003). It is true that most of the findings do support the above view, but evidence is by no means conclusive. For instance, most abundant resource developing countries such as Congo, Nigeria, Zambia, Ivory Coast, and many Central American countries have performed worst, but some such as Malaysia, Norway, Australia and Canada have performed very well and used natural resources to advance their economies (Stevens, 2003). Stevens (2003) states that “the resource curse suggest that the main problem with natural resource abundance is not that it leads to economic dependence on natural resources or a skewed export structure per se but that it creates rents – that is, excess earning above normal profits” (Stevens, 2003:10-11). The existence of these rents are seen as negatively contributing to development and encouraging political and social elites towards rent seeking behaviour and thus likely to undermine growth promoting policies.

In 1998, Malaysia experienced a recession. To fight this recession government introduced capital control measures to minimise capital flight and stop foreign portfolio investors from withdrawing their funds for at least a year.

The Export sector is dominated by foreign capital and between 1985 and 1990 the FDI flowing into Malaysia rose by almost 400% from US\$ 0.69 billion to US\$ 2.33 billion with even further increases to US\$ 5.18 in 1992.

‘ASIAN MODEL’ – DEBATE

It is important to briefly look at the growth experiences and strategies in the East Asia. South Korea and Taiwan provided protection to domestic infant industries in return for stringent performance (Amsden, 1989; Change, 1991) However, Malaysia offered monopoly rents to both domestic and foreign corporate businesses without performance conditions

Malaysia always had low protection tariffs compare to other East Asian countries, which were further reduced (except automobiles). For instance, the average rate of tariff protection of manufacturing was 25% in 1961, increasing to 70% in 1971, and then declining to 30% in 1989. However, in the late 1990s with the financial crisis and the collapse of the asset price bubble had been encouraged by the financial liberalisation.

Figure 4 indicates that fixed capital formation in percentage of GDP has been quite high compared to other East Asian economies.



Source: IMF, *World Economic Outlook*, April 2010.

Figure 4: Gross Fixed Capital Formation (In % of GDP)

The Table 4 below indicates the average GDP growth rates of the East Asian countries. Sectoral shares could also be seen below. Malaysia's percentage of GDP in manufacturing sector is lower than South Korea and Taiwan, but higher than Indonesia and Thailand. Table 5 shows Malaysia is quite high in term of life expectancy compared to other countries^{xiii}. In 2007, 98% children were enrolled in the primary education, which is a remarkable achievement in a developing country and its debt service is also quite low i.e. 4.6 % in 2009.

Table 4: Economic Indicators of East Asian Economies

Country	Average annual GDP growth (%)		Manufacturing GDP share (%)			Agriculture/GDP		Service/GDP	
	1970-80	1985-95	1970	1980	1995	1980	1995	1980	1995
South Korea	10.1	7.7	21	29	27	15	7	45	50
Taiwan	10	7.5	3.5	-	42	-	-	-	-
Malaysia	7.9	5.7	12	21	33	22	13	40	44
Thailand	7.1	8.4	16	22	29	23	11	48	49
Indonesia	7.2	6	10	13	24	24	17	34	41

Source: World Bank, 1997, Table 12, 13, 15.

Table 5: East Asia's Regional Data, 2009

	Population	GNI Per Capita		Life Expectancy At Birth	Primary Education Completion Rate	Total Debt Services
	Millions 2007	GNPa	PPPb	Years 2007	% of relevant age 2007	% of export 2007
East Asia & Pacific	1,912	2,182	4,969	72	98	4
South Asia	1,522	880	2,532	64	80	12.9
Latin America and Caribbean	561	5,801	9,678	73	98	16
Middle East and North Africa	313	2,820	7,402	70	90	5.8
Sub-Sahara Africa	800	951	1,869	51	60	5
Selected Economies						
China	1,318	2,370	5,420	73	98	2.2
Indonesia	226	1,650	3,570	71	99	10.5
Malaysia	27	6,420	13,230	74	98	4.6
Philippines	68	1,620	3,710	72	94	13.7
Thailand	64	3,400	7,880	71	100	8.1
Vietnam	85	770	2,530	74	--	2.3

Source: World Development Indicators database, World Bank, 2010. a) GNP average per capita. b) Purchasing power parity.

Government spending on the social sector is relatively low in Southeast Asian economies compared to the average in OECD countries. Social spending includes spending on social programmes like social insurance, labour market programmes, child protection etc. Increases in social expenditure such as health and education could increase private consumption by reducing the needs to self-insure to finance possible future expenditure areas. This will lead to higher human capital investment, thus long term growth rates. Malaysia social spending is higher than other developing countries (see Table 6). Malaysia has done well on poverty alleviation issue as shown in Table 7.

Table 6: Social Spending (In % of GDP)

	Pension 2010	Health 2010	Education 2007
China	2.2	2.2	1.9
India	1.7	0.9	3.2
Indonesia	0.9	1.3	3.5
Malaysia	2.9	2.9	4.5
Singapore	0.6	1	3.2
Thailand	0.8	1.6	4.9
Philippines	1.1	1.4	2.6
Vietnam	1.6	1.5	5.3

Source: OECD; IMF; UNESCO

Prior to 1997 East Asian crisis, Malaysia's GDP growth was among the highest in the world. Unlike other South East Asian countries, the crisis did not force Malaysia to seek IMF support. To minimise the impact of the crisis, the government introduced capital control as part of its crisis management policy in September 1998 (Doraisami, 2005). It was seen as an effective way to stabilise the economy, which was facing severe external crisis. This measure coincided with the worst contraction ever seen of GDP in 1998. Malaysia has done remarkably well on the poverty alleviation issue as shown in the figure below.

Table 7: Poverty and Inequality Indicators

	Population Living Below \$1 Per Day, 1990-2005	Income Share of Highest Decile, 2004-2005	Income Share of Lowest Decile
China	34.9	34.9	1.6
India	80.4	31.1	3.6
Indonesia	52.4	32.3	3
Malaysia	9.3		
Thailand	25.2	33.4	2.7
Philippines	43	34.2	2.2
OECD		24.2	3.1

Source: OECD, 2009: Paris

After the East Asian crisis in 1997, neoliberal economic reforms were imposed in many countries in the region. These austerity measures were meant to open up their domestic markets, to carry out financial reforms, liberalisation, privatisation and introduce flexibility in to labour markets. These reforms also meant to reduce the role of state in the economy and expand the role of the market. In return the IMF and World Bank have provided financial assistance to the crisis affected countries.

Ever since the colonisation of the developing countries the liberalisation of international trade and the free flow of foreign capital have been witnessed. However, there is something distinctive about the current phase of globalisation and that is the splitting up of production across countries. The production is split across national borders. As Dickens (1998) emphasises that production activities are being spread in various countries, which was not seen in the earlier phase of the internationalisation of economic activities across national borders. This spread of economic activities both within the firms and across the nations has been studied by various researchers (Blair, 2009). Also, in many other East Asian countries, it is not the whole product but only specific parts of the production process of the products that occur within countries. For instance, with MNEs such as Nike, Gap etc. their labour intensive segments (e.g. cut and stitch of the clothing industry) have been located in East Asian countries, but other segments of production such as design and marketing, considered the most important tasks, are is located in the developed countries.

The splitting of production activities is also described variously as a commodity chain, value chain, and production networks. These have a common characteristic where trade is not carried out in complete goods, but rather in particular segments or tasks. In manufacturing for instance such tasks are not confined to shoes and garments, but also include IT, hardware and automobiles. Apple computers, for example, focus on production design, architecture and operating system, while detailed design of components, assembly etc. is left to their suppliers. The auto firms also focus on design, new models, while leaving subcontractors to supply various manufacturing components. By splitting up activities across the countries, firms can take advantage of cost differentiation without sacrificing the gains from specialisation. The specialisation of by a number of small suppliers often leads to further increasing returns (Sturgeon and Gereffi, 2009).

For example, when Indian software firms specialise on R&D outsourcing they are able to utilise the economies of scale from performing similar services to many separate customers (Siddiqui, 2010).

The advantages seem to be that manufacturers based in developing countries do not have to go out and market their own brand, search for markets etc., but rather rely on the leading firms based in the developed countries for the above task. We should note that these tasks are quite impossible for the firms in developing countries when in an early stage of their manufacturing development.

The economic logic of setting up production activities in different countries based on a division of labour was seen as a new phase of development. Ozawa's well known Japanese formulation of "flying geese" for development (Ozawa, 2009). In the East Asian region it was Japan the most industrially developed nation, which was seen by others as leading the geese. In the first quarter of the 20th century, Japan's rapid manufacturing growth demanded raw materials from the colonies and it served as a growth base for Korea and Taiwan. It locked these countries into division of labour where manufacturing was carried out in the leading country and raw materials production in the follower countries. It is argued that the lead goose (Japan) develops the technology and manufacturing sectors, with the followers (South Korea, Singapore, Taiwan) supposed to manage the coordination of production in labour intensive commodities and also produce some technology intensive products. The splitting-up of production between a number of firms that also are located in different countries has now become an important feature of the global production networks. For instance, Japanese auto firms concentrate on the production of diesel engines in Malaysia, while the final assembly is done in Thailand.

Japan and South Korea followed more active industrial policies than those of Malaysia and Indonesia. Here the state played a stronger role to mobilise and allocate resources for national economic development. Japan has the longest industrial development in East Asia, where the state has played a crucial role to develop a modern industrial sector since the *Meiji* period from 1868. Contrary to this example, most countries in Southeast Asia do not have a strong indigenous bureaucracy such as that found in Japan. For instance Malaysia relied increasingly on market forces to determine the successful outcomes of their companies (Park, 2000).

Also, both Japan and South Korea in their periods of rapid industrial expansion relied less on foreign capital because they feared that substantial foreign ownership may undermine the government influence and control over the economy. (Siddiqui, 2009a) They adopted a more cautious and restrictive policy towards foreign capital and thus this factor played a less important role compared to later developments in Malaysia and Singapore. The governments in Japan and South Korea restricted foreign ownership including ceilings on foreign capital investment in certain sectors while at the same time providing various fiscal incentives in favour of joint ventures as opposed to full foreign ownership (Siddiqui, 2009a). Furthermore, both countries preferred to import technology through licensing agreements rather than through the entry of foreign companies into their domestic markets.

Further, Japan and South Korea prioritised export led growth policies, but at the same time also protected domestic markets and encouraged domestic research and technical capabilities of the local firms. These countries did not follow open economic policies but initially in the post war period adopted a policy of import substitution. But once their companies became internationally competitive, they then pursued export oriented policies. Japan and South Korea in their periods of rapid industrial expansion relied less on foreign capital because they feared that substantial foreign ownership may undermine the government influence and control over the economy.

However, Malaysia, Thailand, Indonesia, Singapore and Hong Kong had no clear policies to support domestic research and development capabilities. These countries relied much more on foreign technology and money than did Japan

and South Korea. Their greater reliance on foreign capital and technology obviously raises questions about the sustainability of their industrialisation and economic growth. For instance, in Malaysia and Indonesia foreign capital accounted for 15% and 25% of the gross domestic capital formation respectively. Compared to this, the foreign capital inflows have been less than 2% in Japan and South Korea - i.e. little dependence on foreign capital for their industrialisation. In the case of Malaysia, the significant role played appears to be due to the specific situation in the early 1970s, where the government hoped that foreign capital and businesses could play a balancing act of empowering ethnic Malays against an ethnic Chinese dominance of the economy.

The opening of financial markets of the East Asian countries to ~~for~~ foreign capital was expected to increase the inflow of capital, but once they perceived the crisis to be deepening, the foreign capital instead flowed out at even greater speed, causing a currency collapse and panic that would adversely affect the whole economy.

It is often argued that the East Asian financial crisis has dealt a severe blow to the Japanese model of state-assisted capitalism that has been copied in varying degrees by the East Asian countries since the post-war. The key features of this model are an interventionist state; the disciplined market; protected domestic demand, and protection of domestic industries against foreign competitors. It was said that the state-business partnership was the 'core' of the 'Asian model', and is the main cause of the on-going recession in Japan. State supported capitalism in Japan and later on in other East Asian economies may have helped to achieve high GDP growth rates but would be less relevant in the recent era of globalization. Shinyasu Hoshino, President of National Institute for Research Advancement, Tokyo, summarised Japanese post-war economic experience as: "the post-war Japanese approach was something close to a planned economy, not true capitalism, but capitalism under strict control ... Non-transparent methods such as the Japanese government's administrative guidance would have been regarded as 'unfair' outside of Japan and most likely would not function in the United States. In American model, emphasis is placed on the method of competition among equal powerful industries, while Japan has been emphasising an industrial policy of shifting comparative advantage" (Hoshino, 1992:22).

ISLAM AND CAPITALISM

Islam, as religion, is seen today as anti-development, against business and entrepreneurship and considered by many to hold back economic development. The limits on what women are allowed to do keep wastes the talents of half of the population. Poorly educated mother could be hardly any model for their children ^(xiv). However, such a view overlooks the lack of social hierarchy, and its historical respect for business and trade; Prophet Mohammed was himself a merchant ^(xv). They also ignore the fact that Arab countries had strong legal traditions during the 9th and 10th centuries - i.e. long before Europe even developed a legal system. For example, Arabs had trained judges' centuries before the practice was adopted by European countries. During the 9th and 10th centuries Arabian cultures were also centres of world science and mathematics (Algebra, geometry) and medicine. Back then Islam was seen as pro-development and pro-business. Even as late as the 13th century in Europe the Arabs were seen as more tolerant of science, supported research and were seen as great centres of world learning.

The corporate form during the 13th and 14th century witnessed an expansion of scale of enterprise, but the dominant form by far was the *commenda* or single-venture agreement in which the investor (the capitalist) advanced the capital to the second party (the merchant) to be used in overseas commercial ventures with profits ~~are~~ shared ~~as~~ according to terms agreed earlier. Islamic commercial law and business practice knew both *commenda* agreements (*mudaraba qirad*) and investment partnerships (*mufawada*). Udovitch (1970) finds that the partnership and *commenda* law are already included in the *Hanafite* legal compendium. Overseas trade was firmly supported by the ruling classes in the Islamic world,

with Muslim traders making a powerful contribution to the growth of early capitalism in Mediterranean countries that expanded the nascent monetary economy.

There is a need to examine this situation further to find out whether what the Muslim religion prescribes has had the effect of favouring or hindering those practices which are vital parts of the capitalist mode of production. The Quran has said nothing against private property and has even laid down rules for such things as inheritance. The birth place of Islam, Mecca, was a flourishing centre of trade at that time. The traders in the city made higher returns through trade and loans at interest; what one would call ~~it~~ rational behaviour. By buying and selling products the traders simply aimed to increase their capital. In Egypt, for instance, throughout the early Middle Ages period a large scale textile industry flourished. There were over 5000 looms and the industry was often carried out by workers in their own homes. Cairo had around 15,000 day labourers without any means of production, possessing only their labour power. As Rodinson (1980) points out “how a mainly commercial bourgeoisie took shape in Muslim world from the second century AH onwards (718-815), attained an important social position, won the respect of the other strata of society as well as their own by causing their activities to be accepted as respectable and praiseworthy, imposing the values that were bound up with these activities, during the third century (815-912), and became a socio-economic factor of the highest importance (912-1009). And yet this bourgeoisie consciousness as it was of itself never achieved political power as a class, even though many of its individual members succeeded in occupying the highest appointments in the state” (Rodinson, 1980:55).

Capitalist orders of this type, which co-existed with subsistence production ~~and~~ with the non-monetary circuits predominant in that era were witnessed in early Muslim countries. The development had made possible regional specialisation in industry and also in agriculture, bringing about economic interdependence. It seems that private capital played a greater part compared with the part played by state ~~that was~~ during the Roman Empire. Within the common market ~~and~~ formed by the Muslim countries production and trading activities were apparently highly developed and pre-date the establishment of the world market created by the Western European bourgeoisie: “If the bourgeoisie did not maintain and develop the strength it possessed in the first centuries AH, if the states dominated by hierarchy of nobles and soldiers prevented it from exercising sufficient weight in relation to political power; if the town did not succeed in acquiring sufficient domination over the countryside; if manufacturing capital did not develop on the same scale as in Europe or Japan; if primitive accumulation of capital never attained the European level – all this was due to factors quite other than Muslim religion” (Rodinson, 1980:57).

CONCLUSIONS

The study finds that in Malaysia the state has played an active role in creating a positive environment for businesses. Various steps taken in the field of agriculture through modest land reforms and helping poor peasants with land and credits did help the rural community. The government policy of positive discrimination also known as ‘*Bumiputera*’ did reverse the colonial legacy and built a positive role in creating more balance ethnic harmony. Contrary to what the mainstream economists believe our study found that rapid growth rates took place not due to market friendly policies, but with the government intervention in the economy. In fact, the government initiated a number of reforms to protect local industries and business. Malaysian government has placed the highest priority on export-oriented investments in the manufacturing sector. Moreover, Malaysia with a multi-ethnic population and past ethnic tension that has done relatively well during the last two decades, may provide important lessons for other developing countries. The 1997 the East Asian crisis affected Malaysia in various ways. The country’s currency the *ringgit* depreciated sharply which led to an enormous increase in capital flights. All these developments led to serious differences in policy matters between then country’s Prime Minister Mahathir Mohammed and his Deputy Anwar Ibrahim.

However, the Malaysian experience of import liberalisation is different when compared to Latin American countries such as Mexico and Chile. In Malaysia trade liberalisation was adopted gradually and also export-oriented policies were implemented at the very moment import liberalisation was being launched.

Export-led growth since 1986 has been followed by a construction and a property boom, fuelled by the financial sector looking to invest in short-term^(xvi). During the mid 1980s in general the developing countries experienced a series of interlinked problems, which started with the deteriorating prices of their exports, then the debt crisis and finally the abandoning of 'Import-Substitution' policies. This was replaced by 'neoliberal economic' policies with the launching of the WTO in 1995 to provide greater freedom for multinational companies.

It seems that the primary basis of capitalist industrialisation for Malaysia is the dependence on foreign capital. The countries have witnessed unprecedented growth and structural transformation in the last few decades. The average growth rates for the region were 6-7 % for nearly the last four decades. The manufacturing sector played an important role and proved to be a major contributor of the growth. Also exports rose steadily leading towards rising income levels. We also find that during the same period the proportion of primary commodities as a percentage of the total exports fell sharply, while the proportion of high value products such as machinery, electric goods, transport equipments etc. rose sharply. However, the study finds that new developments such as globalisation and the expansion of export sectors as seen in China and Vietnam will most likely bring a new dimension of competition and challenges for growing export sectors in particular and economic growth in general in the near future.

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NOTES

i) For instance see Alavi (1987); Bach (1975); Crouch (1996); Gomez (2004); Jomo (1998); Teik (2003); Ozawa (2009); Verma (2002).

ii) Peninsula Malaysia consist of eleven states on the mainland, and two other states are Sabah and Sarawak are located on the Island of Borneo about 500 miles across the south China sea from the Peninsula.

iii) For another region (i.e. Central America) about the experiences on export of agricultural commodities see Kalim Siddiqui, 1998.

iv) *Bumiputera* means in Malay language sons of the soil and also generally taken to refer to the indigenous people.

v) See the World Bank Report, 2005. Also see Williamson, 1990.

vi) For critique see Chang (1994).

vii) For detail see Alec Gordon, 2004, pp. 371-378.

viii) Rice is a staple food, which accounts for three-fourth of the grain consumption in Malaysia.

ix) See *Economic Report* (various issues), Ministry of Finance, Government of Malaysia: Kula Lumpur

x) See Bank Negara Malaysia, Annual Report (various issues)

xi) Malaysia is a multiracial nation, the indigenous i.e. ethnic Malays also known as *Bumiputera* ("sons of the soil"), while on the other hand the Chinese and Indian are known as non-Bumiputera. Of Malaysia's total population of 27 millions in 2010 (see World Bank, World Development Indicators - Last updated April 2, 2011. Out of this 58.2 % were Malay, 31.3 % Chinese, 9.8 % Indian and 0.6 % others.

xii) Mahathir Mohammed spoke about Malay issues prior to becoming Prime Minister (e.g.1970).

xiii) See Siddiqui, 2011 and 2010

xiv) See Rachel McCleary and Robert Barro (2003) on their analysis of the world value survey data

xv) As a consequence Islam has a highly developed on the issue of contracts – even at wedding ceremonies marriage contract are signed between spouses. Moreover, there are emphasis on rational thinking and learning. The prophet Mohammed famously said that “the ink of the scholar is more sacred than the blood of the martyr”.

xvi) Financial liberalisation is described a situation where investors have a choice as to when they “come and go”. For more detail see John Eatwell (1997).