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Market, government and Malaysia's new economic policy

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Leading economic institutions such as the World Bank have argued that liberalisation holds the key to growth, poverty alleviation and redistribution. Even recent efforts to model increasing returns within the framework of new growth theories have not resulted in prescriptions for stronger roles for governments. The fast-growing Southeast Asian economies are still being used to demonstrate causation between liberalisation, and growth, poverty alleviation and redistribution. Using Malaysia as an example, this paper argues that growth, poverty alleviation and redistribution in the country was achieved under circumstances of both interventionist policies as well as market coordination. Throughout the New Economic Policy (NEP) period (1970–90), strong incentives were offered to both the import-substitution and export-oriented manufacturing sectors, and the state made strong forays into the market to redress poverty and inequality. The paper also argues that poorly coordinated government intervention generated substantial unproductive rent seeking.

Key words: Market, Government, New Economic Policy, Malaysia
JEL classifications: H3, H5, L5

1. Introduction

Economists have long grappled with the fundamental question of how to govern economic growth. Neoliberal economists point to the invisible hand of the market as the best allocating force to bring about systematic growth. Production and distribution are regarded as best driven by private enterprise with little or no state intervention. Since the allocative role is given to markets, governments are at most only recommended a minor role (Little, 1982; World Bank, 1993). Even recent efforts to model increasing returns within the framework of new growth theories have not resulted in prescriptions for stronger roles for governments (see Krugman and Helpman, 1989; Lucas, 1988).[1] Fast-growing economies are still being used to demonstrate causation between liberalisation and economic growth. Some orthodox economists have labelled the first-tier Asian Newly Industrialised Economies (NIEs) as liberal (Ranis and Fei, 1975; Balassa, 1982). Under-

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[1] New growth modellers contend that the problems of government failure far outweigh that of market failure and therefore discourage government intervention.

developed economies, such as India and Turkey, have often been characterised as distorted economies (Little, 1982).

While excessive regulation characterised a number of institutions and industries in developing economies, suggesting a need for liberalisation, successful developers demonstrate the need for selective intervention to overcome market failure and enhance economic performance. The evidence on selective intervention by governments in South Korea, Taiwan and Singapore is now clear (Luedde-Neurath, 1986; Deyo, 1987; Evans, 1987; Amsden, 1989; Wade, 1991; Lall, 1996). The World Bank (1993) recognised the significance of state intervention in the above-mentioned first-tier NIEs, but considered the second-tier NIEs of Malaysia, Thailand and Indonesia as better demonstration models, on account of their supposed amenability to global liberalising currents.

Malaysia has been one of these second-tier NIEs, classified as liberal, and with its export-oriented industries governed by markets (Sheperd, 1980, pp. 186–7). Salleh and Meyanathan (1993) and the World Bank (1993) have argued that growth and international competitiveness in Malaysia has been achieved as a result of liberalisation from the mid-1980s.

A similar explication is also apparent on Malaysia's redistributive policies. The 20-year period of Malaysia's New Economic Policy (NEP) ended in 1990. Despite not quite achieving 30% *Bumiputera*[1] corporate equity participation in the economy, it heralded an era of rapid growth and redistribution. Poverty and inequality have declined since 1971 and 1976, respectively. The unemployment rate, too, fell to just 2·5% by 1996, from 8·0% in 1970. The improved performance evident from the late 1980s occasioned a reinterpretation of the NEP. Salleh and Meyanathan (1993) and the World Bank (1993) argue that the improved conditions were the result of non-distortionary market-oriented policies. The NEP's distribution goals are now considered to be internally consistent and market friendly, and hence non-distortionary. In short, neo-liberal orthodoxy has portrayed Malaysian economic fundamentals as having been fortified by market-friendly policies.

This paper, however, argues that Malaysia's growth and restructuring policies throughout the NEP period were interventionist, with strong roles for both market and government. A blend of government intervention and markets helped make export-oriented industrialisation a success, which, along with specific distributive policies, helped reduce poverty and inequality in the country. Ineffective planning and misguided deregulation in some areas also resulted in the growth of unproductive cronyism.

The second section of this paper examines the NEP, followed by its impact on economic growth. The third section looks at its impact on redistribution and Section 4 concludes. Given that the NEP was terminated in 1990, the paper avoids discussion of the financial crisis that has gripped the country since 1997.

2. The New Economic Policy

Manufacturing was earmarked as the engine of growth to spearhead restructuring in the Second Malaysia Plan, launched alongside the NEP in 1971. The post-colonial state adopted an interventionist strategy, but one designed to attract foreign capital, as early as 1958, following the Pioneer Industry Ordinance. Early intervention was, however, limited

[1] The word *Bumiputera* literally means sons of the soil, but for official considerations it is generally taken to refer to the indigenous peoples of Malaysia.

to incentives (financial and non-financial) and tariffs on final goods. The non-financial incentives included severe controls on labour organisation: unions were not allowed in pioneering industries such as textiles and electrical goods. These incentives were offered to all pioneering firms irrespective of ownership. The lack of technological and performance conditions led to the proliferation of 'screw-driver' operations behind high tariff walls (see Edwards, 1975). There was also no strategy for supporting financial research, training and market promotion. It is little wonder that manufacturing's contribution to gross domestic product (GDP) stagnated at 9% in 1960 and 1965 (World Bank, 1980). When growth fizzled out in the mid-1960s, the government switched emphasis towards exports. The non-discretionary use of protection ran against the infant industry argument, which was premised on sheltering infant firms for eventual international competition (see Lewis, 1955; Kaldor, 1957; Myrdal, 1957). However, this never happened; rather, foreign transnationals in Malaysia slowed down production once the small internal market became saturated (see Rasiah, 1993).

Outward orientation began with the enactment of the Investment Incentives Act (IIA) in 1968 but expanded only after the opening of the free trade zones in 1972. Given the low starting base, the annual real growth in GDP of 6·3% in the period 1961–70 (Hasan, 1980, Table 2.1) was not impressive. Employment on average grew at only 3·6% annually in the period 1961–72 (Rasiah, 1993A, Table 4.9). The unemployment rate had risen from 6·0% in 1962 to 6·5% in 1965 and 8·0% in 1970 (Wong, 1979, Table 5.6; Malaysia, 1976). Ethnic inequality, too, had increased in this period. The ratio of Chinese to Malay median incomes rose from 1·99:1 in 1957/58 to 2·20:1 in 1967/68. The ratio of Malay to non-Malay median incomes rose from 1·83:1 to 1·88:1 in the same period (Jomo and Ishak, 1986; Snodgrass, 1980). This worsening economic situation coupled with frustration, especially amongst the Malay élites and recent graduates, and the subsequent ethnic bloodshed of 1969, formed the basis for the promulgation of the NEP in 1971.

The NEP aimed at fostering national unity and nation-building through eradicating poverty and economic restructuring so as to eliminate the identification of ethnicity with economic function (Malaysia, 1991, p. 31). These dual objectives were to be achieved through rapid growth. The First Outline Perspective Plan (OPP1) set the broad socio-economic framework for the achievement of NEP targets. The first prong was to reduce poverty irrespective of ethnicity. The target set was a reduction of poverty from 49·3% of households in 1970 to 16·7% of households in 1990 for Peninsular Malaysia (see Table 1).[1] The target for rural–urban breakdown was a reduction from 58·7% and 21·3% respectively in 1970 to 23·0% and 9·1% respectively by 1990. Ethnically, the incidence of poverty in 1970 was 74% for Malays, 26% for the Chinese, 39% for the Indians and 45% for other ethnic groups.

The second prong was to be achieved through the restructuring of employment, ownership of share capital in the corporate sector and the creation of a *Bumiputera* Commercial and Industrial Community (BCIC). The achievement of the second objective inevitably meant expanding *Bumiputera* participation in the formal sectors. *Bumiputera* employment in agriculture, secondary[2] and tertiary sectors were 66·2%, 12·1% and 21·7% respectively in 1970 (see Table 2). The NEP aimed at restructuring these figures to 37·4% in agriculture, 26·8% in secondary and 35·8% in tertiary sectors respectively in 1990.

When examined across ethnic groups, *Bumiputeras* contributed 67·6%, 30·8% and 37·9% respectively to overall employment in agriculture and the secondary and tertiary

[1] When launched in 1971, the NEP set targets only for Peninsular Malaysa.
[2] Includes mining, manufacturing, construction and utilities.

Table 1. *Poverty eradication target and achievement, Malaysia, 1970, 1976 and 1990 (%)*

	1970	1976	Target 1990	Achieved 1990
Peninsular Malaysia				
Poverty incidence	49·3	39·6	16·7	15·0
By location				
Rural	58·7	47·8	23·0	19·3
Urban	21·3	17·9	9·1	7·3
By ethnicity				
Bumiputera	65·0			20·8
Chinese	26·0			5·7
Indian	39·0			8·0
Others	44·8			18·0
Malaysia				
Poverty incidence	42·4			17·1
By location				
Rural	50·9			21·8
Urban	18·7			7·5
By ethnicity				
Bumiputera	56·4			23·8
Chinese	19·2			5·5
Indian	28·5			8·0
Others	44·6			12·9

Source: Adapted from Malaysia (1991, Tables 2–6).

sectors in 1970. The NEP restructuring efforts when pursued to plan would have changed *Bumiputera* participation to 61·4% for agriculture, 51·9% for secondary and 51·0% for the tertiary sectors respectively in 1990.

In corporate equity terms, *Bumiputera*, non-*Bumiputera* and foreign participation was set at 30%, 40% and 30% respectively for 1990. It was 2·4%, 32·3% and 63·3% respectively in 1970. The remaining 2·0% was held by nominee companies. The specific targets were defined only in 1976. Regulation became particularly strong in the primary and service sectors (e.g., banking) (see Liow, 1986; Hing, 1987). *Bumiputeras* and *Bumiputera*-controlled companies began buying into plantations, mines and penetrating the media. Foreign capital was gradually displaced by *Bumiputera* trusts in several plantations.

While these quantitative targets are fairly clear, the NEP also emphasised the creation of a pool of *Bumiputera* entrepreneurs, so that their participation in corporate equity could be backed by managerial control. This qualitative target is interpreted in various ways: some look at it as merely the creation of a group of *Bumiputera* millionaires, while others see it as the creation of a dynamic class of efficient *Bumiputera* entrepreneurs. Since the achievement of the NEP targets required rapid growth, the OPP1 set specific growth targets to be met by 1990. Average annual growth rate targets for GDP, private and public investment, exports, imports, employment, savings and unemployment were set as shown in Table 3.

Tables 1–3 show that the government generally succeeded in achieving these targets and, in many respects, over-achieving them. Poverty fell to 15·1% of households, dipping below the 16·7% set in the NEP for 1990. This was also the case with rural and urban households (see Table 1). Income inequality dropped as well; the Gini coefficient fell

Table 2. *Restructuring targets and achievements, Malaysia, 1970 and 1990*

	1970[a]		Target 1990[a]		Achieved 1990[a]		Malaysia 1990	
	'000	(%)	'000	(%)	'000	(%)	'000	(%)
Employment								
Bumiputera								
Agriculture	951·1	66·2	1,091·4	37·4	875·2	29·0	1,404·6	36·7
(%)	67·6		61·4		71·2		76·4	
Secondary[b]	173·1	12·1	782·7	26·8	918·5	30·5	1,038·9	27·2
(%)	30·8	12·1	782·7	26·8	918·5	30·5	1,038·9	27·2
Services	312·4	21·7	1,046·80	35·8	1,219·8	40·5	1,381·9	36·1
(%)	37·9		48·9		51·0		50·9	
Non-*Bumiputera*								
Agriculture	454·9	33·5	686·2	27·1	354·0	14·0	433·0	15·5
(%)	32·4		38·6		28·8		23·6	
Secondary[b]	389·7	28·7	725·4	28·7	996·1	39·5	1,048·6	37·5
(%)	69·2		48·1		52·0		50·2	
Services	512·5	37·8	1,116·6	44·2	1,170·5	46·5	1,314·0	47·0
(%)	62·1		51·6		49·0		49·1	
Corporate equity ownership (%)								
Bumiputera	2·4			30·0				20·3
Other Malaysians	32·3			40·0				46·2
Foreigners	63·3			30·0				25·1
Nominee companies[c]	2·0							8·4

Note: [a]Peninsular Malaysia.
[b]Includes mining, manufacturing, construction, utilities and transport.
[c]Includes trust agencies and other related institutions
Source: Malaysia (1991, Tables 2–7).

from 0·513 in 1970 to 0·446 in 1990 (Malaysia, 1991, p. 9).[1] *Bumiputera* participation in the secondary and tertiary sectors expanded rapidly, reaching 30·5% and 40·5% respectively in 1990, compared with its target of 26·8% and 35·8% respectively. *Bumiputera* corporate equity of 20·3% in 1990 is one of the rare cases that fell well below the target. Here again, the 46·2% figure for non-*Bumiputeras* out-achieved its target of 40% (see Table 2). In addition, the savings and investment shares in GNP achieved in 1990 were well above the targets. To explain these successes, the following section examines the role played by the government in promoting growth and redistribution.

2.1 Growth promotion

Economic growth is characterised by a series of complex structural changes supported by dynamic and complementary investments (see Gerschenkron, 1962; Kaldor, 1979; Kornai, 1979; Pasinetti, 1981). Recent new growth theorists recognise the importance of increasing returns in the creation of dynamic comparative advantage (see Krugman, 1980; Romer, 1986; Lucas, 1988). Hence, even if problems of information asymmetry, rigidities in resource mobility, specific attributes of learning experience and government-generated distortions are overcome, very risky investments (often associated with innovation and lumpiness) require some form of subsidy or protection. To use Schumpeter's

[1] The Gini coefficient as an indicator of income inequality shows higher inequality with figures closer to 1 and lower inequality with figures closer to 0.

Table 3. *OPP1 Sectoral targets and achievements, Malaysia, 1970 and 1990 (%)*

	1970	Target 1990	Achieved 1990
Share in GDP (%)			
Agriculture	29·0	19·7	18·7
Mining	13·7	2·6	9·7
Manufacturing	13·9	26·2	27·0
Construction	3·8	4·7	3·5
Services	36·2	48·3	42·3
Import duties less bank service charges	3·4	–1·5	–1·2
Share in total employment (%)			
Agriculture	53·5	35·1	27·8
Mining	2·6	1·5	0·6
Manufacturing	8·7	16·8	19·5
Construction	2·7	3·6	6·4
Services	32·5	43·0	45·7
Average annual real output		*Target*	*Achieved*
Growth rate 1971–90 (%)		OPP1	OPP1
Agriculture		5·4	4·4
Mining		3·8	4·9
Manufacturing		12·2	10·3
Construction		8·3	6·4
Services		8·5	7·6

Source: Malaysia (1991: Tables 2 and 3).

(1987, ch. 8) words, under perfectly free trade conditions, there will be little incentive for innovation as the 'entrepreneurial profits' or monopoly rent will vanish instantly. Investors will obviously expect higher returns if they are to be attracted to risky investments, which require longer gestation periods.[1] Participation in such ventures requires distorting relative prices. The history of industrial expansion in Germany, the US, Japan, South Korea and Taiwan lends support to this view (see Gerschenkron, 1962; Kaldor, 1989; Amsden, 1989; Wade, 1991). However, Schumpeter (1987) also emphasised the need for competition, which opens firms to the 'gales of creative destruction' to force technical change. Hence, the market has a role to play but one that shares the allocative role with other institutions and government.

The evidence does not support Sheperd's (1980) claim that the import-substitution (IS) sector was distorted and hence sluggish, while the export-oriented (EO) sector was largely market driven and therefore productive. If IS was prescribed by structural economists such as Lewis (1955), Myrdal (1957) and Kaldor (1957) to spawn and develop local infant industries for eventual international competition, the Malaysian government confined the use of incentives primarily to attracting foreign firms. The Malaysian experience also did not see IS as a means for export promotion.[2] Foreign firms, from Singapore and Britain in particular, relocated 'screwdriver' operations to benefit from the high tariffs imposed on finished goods (see Edwards, 1975; Saham, 1980). As raw materials and

[1] Schumpeter (1987, pp. 88–90) argued that new things need returns higher than the prevailing market rates necessary to induce investment, which he referred to as entrepreneurial profits to attract capital to untried trials.

[2] See Krugman (1980, 1989) for an analytical account of neoclassical tools used to demonstrate gains from IS as a strategy for promoting exports.

intermediate goods generally faced low tariffs, IS firms enjoyed high effective protection. Most foreign firms that expanded operations during this phase had productive operations abroad, which generally discouraged exports from Malaysia. Besides, pioneer status incentives during the IS phase were only offered to IS firms. Thus, when the small domestic market became saturated by the mid-1960s, there appeared little demand-pull to stimulate export expansion. Manufacturing's contribution to gross domestic product (GDP) in 1960 and 1965 thus stagnated at 9% (World Bank, 1980).

Although the high protection levels reduced competition in the IS phase, it was caused by misguided IS, rather than simply lack of competition. If the South Korean and Taiwanese states offered IS rents to infant firms in return for stringent performance standards (Amsden, 1989; Wade, 1990; Chang, 1991), the Malaysian state offered monopoly rents to foreign and local firms irrespective of their productive capabilities and without performance conditions, i.e., the carrots were indiscriminately given without any stick.[1] The state assumed a complementary role with the market and other intermediary institutions to force technical change and efficiency improvements in Taiwan and South Korea. The South Korean and Taiwanese governments succeeded in creating dynamic comparative advantage initially through IS, and later through a dual strategy of IS for export promotion. The Malaysian state used none of these progressive tools, which could have been a consequence of the absence of economic nationalism, with the state being led by the economically weak Malays as opposed to the Chinese or Indians.[2]

It is the lack of efficiency-enhancing intervention that plagued the IS sector in Malaysia. The general discouragement of domestic sales and purchases for firms enjoying Free Trade Zone (FTZ) and Licensed Manufacturing Warehouse (LMW) status in the 1970s and much of the 1980s largely accounted for the lack of integration between the two sectors (see Rasiah, 1992). When rents associated with tariffs and incentives fell following deregulation in the 1990s, local firms gradually shifted operations to the unproductive property and real estate sectors (see Rasiah, 1998A). Hence, unlike South Korea and Taiwan, where the state intervened to promote dynamic comparative advantage, often introducing IS for gradual EO, the Malaysian state appears to have launched misguided IS policies.[3]

Following the shift to EO after 1968, IS gradually lost its significance in terms of output and employment generation, although it continued to coexist alongside the former. The IS sector fell in significance as tariffs on several IS industries also gradually fell, thereby reducing the distortionary rents enjoyed by these industries. For example, between 1969 and 1987, the effective rate of protection (ERP) of basic industrial chemicals fell from 160% to 16%, tobacco from 125% to –26%, fertilisers and insecticides from 300% to 8%, and structural metal products from 35% to 1% respectively (Edwards, 1991; see also Table 4). Hence, while EO firms continued to enjoy generous financial incentives, most IS firms gradually lost tariff protection. However, some IS industries, especially those sponsored by the government, experienced an increase in ERP; e.g., the ERP of basic iron and steel rose from 28% in 1969 to 131% in 1987. Although the nominal rate of protection on several IS industries were gradually reduced in the 1980s, locally controlled

[1] See Amsden (1989) for an account of the South Korean experience.

[2] See Jomo (1986) for a class account of the political economy of the ethnic redistribution-oriented NEP introduced in 1971.

[3] The sugar processing industry with an effective rate of protection rate of around 600% in 1987 (see Edwards, 1991) is one example where there appears no dynamic reasoning behind tariffs. The producers enjoyed a huge monopoly rent for over a decade.

Table 4. *Protection and subsidies in manufacturing, Malaysia*

	ERP (%)	Xi/Yi (%)	% Projects approved with special export incentives (1986–90)	Incentives (1990)[a]			Government ownership
	1987[b]	1990		Training	R&D	PS and ITA	
Food	13[c]	21·7	57·5	W	W	M	N
Beverage and tobacco		5·1	31·3	W	W	W	N
Textiles and garments	10	85·7	74·2	M	W	S	N
Wood	233	25·4	71·1	M	M	M	N
Chemicals	57	19·6	45·4	M	M	M	N
Rubber	20	9·4	95·5	M	M	S	N
Not-metal mineral products	86	24·6	46·6	M	M	M	Y
Iron and steel	131[d]	15·0	n.a.	S	M	W	Y
Metal	22[e]	60·4	54·9	W	M	M	N
Machinery	18	81·9	59·6	M	M	M	N
Electric/electronics	–5	94·0	88·5	S	M	S	N
Transport equipment	230	41·9	22·9	S	M	W	Y

Note: [a]From interviews with with MIDA officials in 1990; n.a., not available.
[b]From Edwards (1991).
[c]Includes food, beverages and tobacco.
[d]Of basic industries only (ERP of primary iron and steel was 447%).
[e]Of wire and wire products; Xi, export of industry I; Yi, gross output of industry I; W, weak; M, moderate; S, strong; N, no; Y, yes.
Source: Complied from MIDA, unpublished data; Edwards (1991); Malaysia, *Industrial Surveys*, various issues; Malaysia, *External Trade Statistics*, various years.

industries were still generally inward looking. Of the 12 industries shown in Table 4, more than half the output demand of seven was still generated from the domestic economy. Only five were outward-oriented, with electrical goods and electronics, and textiles and garments, being the most export-oriented.

The government launched the Heavy Industries Corporation of Malaysia (HICOM) in 1981, and since then has intervened strongly to promote heavy industry in Malaysia. Government ownership became important in heavy industries from the 1980s as a consequence (see Table 4). The government offered subsidised capital, imposed stringent controls on competitors in the domestic market and introduced other promotional tools to encourage the manufacture of cement (Kedah Cement and Perak Hanjoong), steel (Perwaja Steel) and cars (Proton). The government's objectives here, *inter alia*, included the development of a strong capital goods sector and linkages with the domestic economy, especially involving *Bumiputera* enterprises. These industries remain strongly subsidised and protected. Indeed, by controlling Proton's purchases, the government has been gradually enforcing domestication of supply and *Bumiputera* participation through the umbrella concept of vendor development. However, the lack of performance standards, and of monitoring and appraisal mechanisms, has undermined the capacity of heavy industries to compete in international markets. Rent dissipation has generated high costs for downstream industries and consumers. Steel, clinker and its end-user product cement, and cars are still priced substantially higher than world prices, and maintained through the use of both quotas and duties (see Rasiah, 1998C).

Industrial policy focus shifted from IS to EO manufacturing in the late 1960s and 1970s and again from the mid-1980s periods.[1] A costly IS sector that burdened the economy and the Plaza Accord of 1985 which pushed up the currencies of Japan, South Korea and Taiwan as well as the withdrawal of the Generalised System of Preferences from the Asian NIEs in 1988 influenced the shift. The Investment Incentives Act of 1968 first triggered EO industrialisation in Malaysia. After 1972, the government opened FTZs[2] and LMWs[3] to ensure better police protection, coordination and control of export processing activities and incentives. Incentives were critical at least in the initial stages to match the risks involved in redeploying production in unproven and unstable foreign sites (see Table 4). Malaysia had faced serious ethnic bloodshed in 1969, which aggravated the risks of relocating production there. Lucrative incentives such as pioneer status (PS) and investment tax credit (ITC) for a period of between five and ten years, became the main inducements for attracting EO firms. Whenever PS expired, firms were easily approved for ITCs for additional periods of five years. Other firms still enjoyed accelerated depreciation allowances. Firms often opened new plants to enjoy a new round of incentives (see Rasiah, 1993C), and foreign firms have been allowed to retain total ownership. Also, the government completely blocked unionisation in the electronics industry until 1989, and

[1] EO was originally promoted by the World Bank, United Nations Industrial Development Organisation (UNIDO) and other international agencies, and the success of other East Asian export processing zones were important external factors that influenced the switch (see Jomo, 1990).

[2] Free Trade Zones (FTZs) (renamed as Industrial Free Zones since 1992) lie outside the principal customs area (PCA), thus goods imported to and exported from them are not liable for customs duty. Goods imported from, and exported to the PCA are liable for customs duty unless exemptions have been granted by the Treasury (Malaysia, 1988, p. 55). Generally, firms producing not less than 80% for export can apply to locate in FTZs. Until the 1990s, FTZ firms were expected to import most of their inputs.

[3] Licensed Manufacturing Warehouses (LMWs) were introduced to encourage industrial dispersal and to enable the location of factories producing generally entirely, but not less than 80%, for export. LMW status is granted to firms sited in places where the location of FTZs are neither practical nor desirable (Malaysia, 1988, p. 56). Until the 1990s, LMW firms too were expected to import most of their inputs.

since then only allowed in-house unions under very restrictive conditions (Rasiah, 1996). Hence, though IS industries continued to enjoy high tariffs until the 1990s, financial incentives shifted towards EO firms from the late 1960s. Only state-sponsored heavy industries continued to enjoy high tariffs and financial incentives from the 1980s in the IS sector.

As the aggregated industries data in Table 4 show, EO industries have enjoyed various other government subsidies in training, exporting and R&D support activities. Although export incentives that offer double deduction benefits on corporate tax are given to all exporting firms, the prime beneficiaries, given their scale of exports, have been EO industries. Furthermore, EO firms also tended to make most use of the double deduction benefits given for training, as well as for process and design research and development. Apart from resource-based industries (e.g., wood and rubber) and government controlled car, steel and cement production firms, foreign firms were the major beneficiaries of training and R&D incentives. In general, with the exception of state-sponsored heavy industries, EO firms have gradually become more subsidised than IS firms.

It is small wonder that EO industries have expanded rapidly since the early 1970s. The electric/electronics industry, in particular, has become the most important manufacturing industry in terms of fixed assets, employment, output and exports (see Table 5). EO industries easily dominated exports, with electric/electronics and textile/garments together contributing more than 63% of overall manufacturing exports in 1990 (see Table 6). With the exception of wood, which faces heavy import tariffs and export restrictions on timber, and rubber, whose prime inputs are sourced mainly domestically, EO industries have demonstrated greater improvement in trade balances. However, EO industries have also showed higher import penetration ratios with no trend decline, reflecting fairly weak backward pecuniary linkages.

Since the introduction of the Industrial Master Plan (IMP) and the Promotion of Investment Act in 1986, efforts to deepen domestic participation and localisation took on a new dimension. As shown in Table 4, incentives for exports, training, and R&D were offered (see also Malaysia, 1992). Pioneer status and investment tax allowances were extended to strategic firms. A 30% domestic content condition was added in 1991. If the government merely tied EO incentives until the mid-1980s to firms meeting static employment and investment targets, it has assumed a more pro-active stance since the second half of the 1980s by adding technological and domestic content conditions. This strategy has, *inter alia*, influenced EO transnationals, especially Japanese firms, to relocate their suppliers, including their own subsidiaries in Malaysia (see Rasiah, 1993A). In addition, apart from incentives to strategic industries, the 1990s also experienced a reduction in tax exemptions from 100% to 70%.

While it is true that global markets were the prime growth stimulant of manufacturing, subsidies through financial incentives raised returns sufficiently to at least offset the additional risks involved in relocating in a more risky site. Incentives became less important over the later years, when Malaysia became a safe haven for export-processing activities. Without denying the comparative advantage of foreign transnationals in accounting for rapid export expansion, their efforts to redeploy production in Malaysia cannot be explained just by cheap wages. Given the risks involved in large-scale production, firms relocating in Malaysia would have looked for returns significantly exceeding prevailing interest rates. Thus, the subsidy element in infrastructural support services and tax exemptions cannot be written off as negligible, as suggested by Sheperd (1980, pp. 186–7). The offer of such subsidies distorted relative prices facing competing interests domestically

and competing sites internationally. A strong state not only ensured political stability, and collaboration in solving theft and other problems, but also bulldozed through policies that were clearly resented by workers' representatives. Curbs on unions involving electronics firms obviously meant that capital enjoyed a significantly distorted hold on relative prices facing the factor market.[1] Besides, tax exemptions in relative terms not only meant a direct subsidy (or monopoly rent) to firms enjoying them, [2] but also offered them the potential for practising transfer pricing. Informal interviews with eight out of the 30 firms who responded to a survey (enjoying such tax exemption) show that firms preferred recording profits in tax havens to reducing tax at taxable sites. For example, a German firm paid a 14% value added tax in Germany for profits recorded in Malaysia when it would have paid a 56% corporate tax if the profits had been generated in the former. Such an international distortion not only stimulates firms to locate production in low or no tax zones, but also to practise transfer pricing so that the tricks of under-pricing and over-pricing enable firms to record profits in low or no tax and tariff zones. FTZ firms alone generated more than 50% of manufactured exports for much of the 1970s and 1980s (see Rasiah, 1993C).

In addition, Sheperd (1980) and the World Bank (1993) imply that EO, being more competitive, is also more market oriented, and therefore less distortionary. The implicit assumption here seems to link competitiveness and efficiency with relative prices and policy neutrality.[3] The structure of incentives used in Malaysia—EO or IS—has clearly been interventionist and has distorted relative prices. As has been argued above, both EO and IS have strong links with government policy. Given the significance of scale and competition, it is true that export-orientation tended to breed greater competitiveness than does import-substitution. Competitiveness depended not only on endogenous factors such as innovative ability, but also on exogenous factors such as the size of market, barriers to entry and the number of firms in the industry. Transnationals' access to frontier technological and marketing support from their parent and subsidiary plants embedded in developed national innovation systems easily supported processing, assembly and test activities in Malaysia. However, transnational firms had to be attracted to relocate production in Malaysia which, given the risks associated with underdeveloped sites, was made possible through the additional use of financial incentives and a pro-capital industrial relations environment.

Thus, it can be seen that both the IS and EO sectors faced considerable government intervention. The latter appeared more successful than the former, owing to the technological capabilities and market access of transnational corporations. Misguided policies restricted efficiency improvements in the IS sector.

3. Redistribution efforts

This section examines the World Bank (1993) and Salleh and Meyanathan (1993) argument that liberalisation from the mid-1980s helped improve distribution in Malaysia. As the World Bank (1993) noted, there is little correlation between higher growth and higher

[1] Apart from a handful of in-house unions, unions are still effectively banned in the electronics industry (see Rasiah, 1993C).

[2] It is indeed strange for Sheperd (1980) to regard a 40% tax exemption (in addition to tariffless trade) as not overwhelming.

[3] See Wade (1991) and Chang (1993) for a critique of neoclassical arguments on using average incentives in explaining policy neutrality.

Table 5. *Growth and composition of manufacturing industries, Malaysia, 1968–90 (%)*

	Average annual growth					Composition				
	1968–73	1973–79	1979–85	1985–90	1968–90	1968	1973	1979	1985	1990
Output										
Food	5·45	5·41	5·45	6·62	5·7	18·91	16·61	27·68	26·17	16·71
Beverage and tobacco	8·70	8·15	–0·26	2·41	4·51	7·66	5·11	3·67	3·72	1·97
Textile and garment	20·46	10·95	4·73	12·79	11·70	2·76	8·53	6·11	4·20	5·46
Wood	14·70	3·66	–4·53	13·11	5·79	6·78	10·50	7·93	4·68	5·51
Chemical	3·20	8·86	2·81	7·89	5·67	5·69	5·23	4·72	9·59	6·94
Rubber	0·42	1·35	4·22	24·99	6·88	18·41	14·63	9·58	6·01	5·51
Non-metal mineral	4·43	8·18	3·6	7·4	5·88	3·2	3·11	2·96	3·95	3·27
Iron and steel	19·82	5·14	6·86	9·05	9·69	1·04	3·14	3·02	3·38	4·14
Metals	14·27	1·58	9·78	4·68	7·3	25·29	19·71	10·78	5·51	3·08
Machinery	14·92	1·98	8·97	6·56	7·77	1·71	2·62	2·44	1·58	4·66
Electric/electronics	7·99	15·83	7·99	16·37	14·08	1·56	5·24	12·59	12·92	25·37
Transport equipment	10·95	10·20	9·04	14·99	11·12	2·23	2·61	2·71	3·15	4·80
Employment										
Food	27·66	5·49	3·01	4·11	9·12	11·11	14·66	13·61	14·28	10·42
Beverage and tobacco	12·13	–0·14	–2·12	–0·92	1·78	6·67	4·6	3·07	2·37	1·35
Textile and garment	44·42	8·19	1·5	11·97	14·43	5·35	13·08	14·14	13·58	14·26
Wood	16·35	3·83	1·22	10·75	7·38	19·09	15·84	13·37	12·63	12·56
Chemical	19·38	6·05	2·71	6·56	8·11	4·04	3·81	3·65	3·77	3·09
Rubber	5·24	3·56	–1·2	16·13	5·32	19·09	9·59	7·97	6·51	8·21
Non-metal mineral	12·81	6·33	5·67	–6·45	4·5	14·04	9·98	9·72	11·88	5·08
Iron and steel	16·41	4·34	4·8	5·38	7·34	2·93	2·44	2·12	2·47	1·91
Metals	20·44	1·31	2·43	10·66	7·83	7·37	7·27	5·3	5·37	5·32
Machinery	25·34	0·62	–0·61	15·28	8·72	4·34	5·23	3·65	3·09	3·76
Electric/electronics	65·99	19·31	1·96	21·64	23·76	2·02	9·90	19·25	19·00	30·19
Transport equipment	19·70	9·71	4·20	5·89	9·46	3·54	3·38	3·97	4·47	3·55

Fixed assets										
Food	19·52	12·46	11·35	2·4	11·32	14·27	18·74	20·71	13·00	9·90
Beverage and tobacco	1·53	12·32	13·84	–4·09	6·29	6·80	3·95	4·33	3·11	1·70
Textile and garment	38·79	13·61	–1·35	12·55	14·17	3·60	9·98	11·73	3·56	4·35
Wood	28·16	6·18	8·58	8·00	11·93	6·43	11·97	9·37	5·06	5·03
Chemical	3·13	5·14	50·32	–1·42	13·72	12·14	7·63	5·63	21·39	13·46
Rubber	58·65	10·87	11·17	19·72	22·49	1·16	6·28	6·38	3·97	6·60
Non-metal mineral	7·60	11·03	25·71	4·87	12·57	10·51	8·16	8·36	10·86	9·32
Iron and steel	61·05	–2·05	50·40	0·73	24·06	0·89	5·20	2·51	9·57	6·71
Metals	–1·40	7·90	18·26	12·68	9·46	9·71	4·87	4·21	3·79	4·65
Machinery	27·64	1·80	13·76	28·40	16·45	1·87	3·41	2·07	1·48	3·49
Electric/electronics	33·31	21·83	19·97	24·58	24·46	2·52	4·71	8·42	8·27	16·77
Transport equipment	3·52	24·97	20·47	–2·46	12·05	4·69	2·48	5·16	5·19	3·10

Note: Includes primary processing; excludes leather, furniture and fixtures, paper, printing, publishing, plastics, petroleum and coal products and other manufactures; composition figures are for all manufacturing.

Source: Computed from Malaysia, *Industrial Surveys*, various issues.

Table 6. *Manufacturing trade indicators, Malaysia, 1968–90*

	1968	1973	1979	1985	1990	1968	1973	1979	1985	1990
			(Xi–Mi)/(Xi+Mi)					MI/(Yi+Mi–XI)		
Food	–0·562	–0·358	–0274	–0·308	–0·163	0·623	0·510	0·227	0·234	0·277
Beverage and tobacco	–0·752	–0·106	0·150	–0·800	–0·509	0·221	0·188	0·170	0·120	0·141
Textile and garment	–0·897	–0·482	–0·058	–0·106	–0·159	0·789	0·416	0·410	0·635	0·813
Wood	0·778	0·935	0·913	0·874	0·932	0·025	0·011	0·010	0·014	0·012
Chemical	–0·736	–0·628	–0·710	–0·721	–0·675	0·030	0·023	0·017	0·006	0·009
Rubber	–0·149	0·230	0·470	0·113	0·342	0·429	0·225	0·491	0·586	0·457
Not-metal mineral	–0·665	–0·507	–0·335	–0·518	–0·038	0·129	0·094	0·068	0·052	0·093
Iron and steel	–0·910	–0·780	–0·759	–0·826	–0·736	0·616	0·259	0·306	0·251	0·198
Metals	0·707	0·627	0·570	0·252	–0·307	0·569	0·357	0·802	0·669	0·890
Machinery	–0·824	–0·778	–0·706	–0·746	–0·573	0·820	0·640	0·685	0·948	0·806
Electric/electronics	–0·877	–0·723	–0·031	–0·037	0·100	0·873	0·647	0·669	0·987	0·902
Transport equipment	–0·808	–0·813	–0·652	–0·624	–0·595	0·869	0·822	0·810	0·839	0·834
			Xi/Yi					Xi/SXi		
Food	0·316	0·329	0·143	0·139	0·216	0·175	0·196	0·123	0·127	0·081
Beverage and tobacco	0·039	0·157	0·217	0·015	0·051	0·009	0·029	0·025	0·002	0·002
Textile and garment	0·170	0·199	0·382	0·683	0·857	0·014	0·061	0·072	0·100	0·105
Wood	0·170	0·257	0·176	0·170	0·254	0·034	0·097	0·043	0·028	0·031
Chemical	0·179	0·275	0·235	0·098	0·196	0·030	0·052	0·034	0·033	0·031
Rubber	0·017	0·032	0·055	0·041	0·094	0·009	0·017	0·016	0·009	0·012
Non-metal mineral	0·088	0·096	0·114	0·084	0·246	0·008	0·011	0·010	0·011	0·018
Iron and steel	0·167	0·167	0·24	0·084	0·150	0·005	0·019	0·015	0·010	0·014
Metals	0·889	0·612	0·919	0·730	0·604	0·658	0·433	0·307	0·140	0·042
Machinery	0·506	0·408	0·488	0·917	0·819	0·025	0·038	0·037	0·051	0·086
Electric/electronics	0·160	0·110	0·728	0·990	0·940	0·007	0·021	0·284	0·446	0·534
Transport equipment	0·393	0·287	0·398	0·394	0·419	0·026	0·027	0·033	0·043	0·045

Note: Manufacturing trade includes simple processing; Xi, exports of industry i; Mi, imports of industry i; Yi, output of industry i.
Source: Rasiah (1995, ch. 5).

inequality and both the relationships differ with individual economies. However, what the World Bank failed to examine is the specific measures the state undertook to redress poverty and inequality in the high-performing economies of Asia (see Rasiah *et al.*, 1996). Why, for example, has income inequality in Latin America continued to widen when that of East and Southeast Asia generally narrowed until liberalisation increased from the mid-1980s and 1990s. It is the specific forms of state intervention under specific conjunctural forces rather than the extent of liberalisation or regulation that explain such a divergence.

As noted by the World Bank (1993), rapid manufacturing growth helped absorb women and Malays into the modern labour market and in that way helped alleviate poverty and inequality. Increasing integration into the wage-based capitalist system has gradually undermined the traditional sector, thereby reducing inter-ethnic labour market fragmentation, as is clearly seen from the occupational restructuring that has occurred since 1970. Such an account, however, fails to recognise the forms of regulation the state adopted to ensure this greater restructuring.

As part of the OPP1 plan, the government spent heavily in developing agriculture through irrigation and drainage systems from 1970. Clearly, world rice prices were significantly below domestic prices. Tariffs and quotas, and various farm subsidies were introduced to protect and subsidise rice farmers who traditionally supported the ruling United Malays National Organisation (UMNO) party within the National Front. Against the more established estates (Salleh, 1989), the government launched smallholder cultivation of rubber and oil palm to expand *Bumiputera* participation. As in rice farming, *inter alia*, intervention in smallholder-based cash-crop farming took the form of price controls, and farm and land subsidies. Government expenditure on poverty eradication and rural development also rose substantially under the first three Malaysia Plans (see Table 7). This is important, as it had a direct bearing on the improvement of rural Malay incomes, thereby reducing overall poverty and inequality (see Table 8). Rubber acreage under special land schemes rose from 1,079 hectares in 1983 to 1,247 in 1987 (Ishak, 1998, p. Table 5). Oil palm output per hectare in special land schemes, which was substantially lower than in the estates in the initial years, became roughly equal by the end of the 1980s. One land scheme even outperformed the estates in 1990. For example, the Federal Land Development Authority (FELDA) and the Rural Industry and Smallholder Development Authority (RISDA) achieved output per acre of 10·9 and 12·7 kilograms respectively in 1983, compared with 15·9 kilograms achieved by estates. The average for special state-supported land schemes was only 8·7 kilograms in 1983. The comparable figures for FELDA, RISDA and estates in 1988 were 16·8, 16·0 and 18·1 kilograms, respectively. The overall average for special state-supported land schemes in 1988 was 17·7 kilograms. FELDA's per acre output of 18·7 kilograms in 1990 exceeded the 18·5 kilograms recorded by estates.

The government also drew substantial participation from *Bumiputeras* into the bureaucracy, thereby expanding sharply their participation in services. As shown in Table 9, public sector employment grew strongest in the 1970–81 period.[1] The slower growth and hence, relative fall after 1981 is accounted for by both rationalisation and privatisation. The absorption of large numbers of *Bumiputeras* into administration helped raise their urban employment and incomes. In addition, through regulation, the government also helped raise *Bumiputera* participation in services and manufacturing. Although

[1] This point is noted by the World Bank (1993, p. 269).

Table 7. *Allocation of development expenditure, Malaysia, 1971–90 (RM million)*

	2MP (1971–75)	3MP (1976–80)	4MP (1981–85)	5MP (1986–90)
Poverty eradication (A)	2350	6373	11618	13661
Agriculture and rural development	2127	4443	n.a.	611
Industry and trade	0	176	n.a.	71
Social	113	781	n.a.	2597
Infrastructure	110	974	n.a.	3382
Others	2550	8455	n.a.	28940
Total (T)	7250	21202	49025	49262
A/T (%)	32·4	30·1	23·7	27·7

Note: n.a., not available.
Source: Compiled from Malaysia (1981, 1986).

Table 8. *Reduction in poverty and inequality, Malaysia, 1970–90*

	1970	1976	1979	1984	1987	1990
Incidence of poverty	49·3	39·6	n.a.	18·4	17·3	15·1
Gini coefficient[a]	0·513	0·529	0·508	0·480	0·456	0·445

Note: [a]Of households; n.a., not available.
Source: Compiled from Malaysia (1981, 1986, 1991).

Table 9. *Public sector employment in total employment, Malaysia, 1970–87 ('000)*

					Average annual growth (%)		
	1970	1975	1981	1987	1970–75	1975–81	1981–87
Public sector (P)	398	520	757	836	5·5	6·5	1·7
Total (T)	3340	4020	5031	5881	3·8	3·8	2·6
P/T (%)	11·9	12·9	15·0	14·2			

Source: Adapted from Ismail and Osman (1991).

generally not enforced, the labour ministry (renamed as the human resource ministry) provides guidelines encouraging the employment of *Bumiputeras*, and firms enjoying financial incentives tended to view this requirement quite seriously.[1] Hence, though rapid growth offered the avenue for employment creation, the state visibly encroached into the market to meet its NEP targets. Indeed, this role as the '*Bumiputera* protector' seems to have strengthened intra-ethnic solidarity amongst the Chinese (see Khong, 1991). It is believed that the Chinese, fearing increased ethnic encroachment into the market by the state, started ethnic networks to protect their interests in the private sector, thus uniting even the once clannishly divided Chinese. Inter-ethnic divisions seem more apparent at the level of employees. Even in foreign multinationals, where the extent of government regulation has varied with its relative bargaining position *vis-à-vis* firms, the upper rungs of employment (e.g., professional and technical) are still dominated by the Chinese.

[1] Based on interviews with 126 firms operating in the manufacturing sector.

Nevertheless, the trend towards absorbing *Bumiputeras* at least to recommended levels is evident. Interviews with 126 firms undertaken between 1986a d 1993 show that firms have offered special incentives to retain *Bumiputera* professionals.

Special institutions were also started to help expand Malay participation in the economy. The Majlis Amanah Rakyat (MARA), Bank Bumiputera Malaysia Berhad (BBMB) and Perbadanan Nasional (PERNAS) were given wider roles and access to capital to raise the position of the Malays. Indeed, PERNAS attempted to wrest control of several foreign-owned plantations in the early 1970s, and MARA boosted Malay businesses and educational achievement. In addition, the Industrial Coordination Act (ICA), promulgated in 1975, imposed regulation for firms meeting a registration scale, which was RM250,000 paid-up capital and 25-employee workforce initially (Hing, 1984).[1] The Minister of Trade and Industry generally required a 30% *Bumiputera* equity condition to be met for registration. Foreign firms exporting over 80% of output were exempted from such conditions. Paid-up capital for registration was gradually raised to RM2·5 million in 1986.

The government also launched the Bumiputera Investment Foundation in 1978. This foundation introduced the Permodalan Nasional Berhad (PNB) in the same year to help expand *Bumiputera* participation in business directly (Malaysia, 1981, 1991). A policy for transferring equity from *Bumiputera* trustees to individuals and companies was launched in 1981. Hence, institutions such as MARA, PERNAS and the State Economic Development Corporations (SEDCs) which had acted as trustees had their corporate equity ownership gradually acquired by PNB and other *Bumiputera* enterprises and individuals. In 1985 alone, PNB spent RM6200 million on purchasing 158 firms. PNB shares in turn have been sold to individual *Bumiputeras* through the Skim Amanah Negara unit and the Amanah Saham Nasional (ASN). By the end of 1988, PNB had successfully transferred from its ownership RM632 million worth of shares to ASN (see Seaward, 1986). Until October 1988, 2·35 million of *Bumiputeras* had investments in ASN which comprised 44·7% of the *Bumiputeras* eligible to invest (Malaysia, 1991). The distribution of shares through the ASN in particular helped raise *Bumiputera* incomes, including the poor: households (17·1%), farmers (16·5%) and labourers (16·2%) were the prime beneficiaries of this scheme in October 1988.

Another significant government instrument that enabled equity redistribution ethnically was the privatisation policy launched in 1983 (see Kassim, 1991). Apart from reducing the government's financial burden following the introduction of the austerity drive to overcome the burgeoning foreign debt, this policy also acted as an important platform for *Bumiputeras* to extend their participation in business. Eight of the 14 projects privatised in the 1986–89 period went to *Bumiputeras* (Malaysia, 1991). The government not only offered largely *Bumiputeras* ownership of businesses with monopolistic markets, but also allowed the participation of previously public employees as private employees. With regulations to control their operations, the government also ensured that *Bumiputeras* continued to dominate their workforce after privatisation. Such transfers, *inter alia*, also accounted for the sharp fall of public sector employment in total employment in the 1980s. While it can be argued that a significant slice of privatisation initiatives dissipated rents through unproductive crony relationships, it did not appear conspicuous, as the rapid growth generated from export-manufacturing masked losses in consumer welfare.

Regulation to promote *Bumiputera* businesses also received a strong boost from the launching of government-sponsored heavy industries, i.e., cement (Kedah Cement and

[1] The ICA was subsequently amended in 1979, 1985 and 1986; the ceiling for compulsory registration was raised to RM2·5mn and a workforce of 75 employees in 1986.

Perak Hanjoong), steel (Perwaja steel) and motor vehicles (Proton). Despite the use of foreign–local joint-ventureship, 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 (tariffs on cement was gradually replaced by quotas from the 1980s) and quotas (especially in steel production), the government offered the incentives for modern *Bumiputera* entrepreneurship to evolve. However, unlike the South Korean and Taiwanese experiences, the Malaysian government generally avoided imposing standards and discipline. Large operations involving government-sponsored heavy industries also became an important avenue for developing *Bumiputera* small and medium-scale industries (SMIs). For example, suppliers to Proton were continuously required to raise *Bumiputera* equity to remain as suppliers and also to enjoy financial incentives. This way, Proton not only managed to source locally 80% of its components by 1993, but also to expand *Bumiputera* participation in supporting industries. Hence, though, *Bumiputera* equity ownership in 1990 still fell short of the NEP target, it had expanded significantly, to 20·3% in 1990 (see Table 10). However, many of such supplier networks developed superficially to generate deadweight losses in consumer welfare, exacerbating income inequality as consumers and other end-users transferred rents to state-supported ventures (see Rasiah, 1998B).

It can be argued that deregulation of distribution following the displacement of the NEP with the New Development Policy (NDP) in 1990 has aggravated income inequality. Divestment of ownership through privatisation initiatives using stock market listing and the gradual shrinking of state-supported agricultural and service sector programmes from the late 1980s have resulted in rising concentration. Agricultural land and property became a major source of short-term gains as speculators entered the real property sector using loans leveraged against inflated prices. The share of loans to the broadly defined property sector rose from 18·1% in 1990 to 32·0% in 1992, before falling slightly to 30·3% in 1996. In contrast, the share of loans to manufacturing fell from 23·2% in 1990 to 21% in 1996. General commerce and agriculture also experienced relative declines (see Rasiah, 1998B, p. Table 3). The positive redistribution effects generated by FELDA and RISDA were undone in the 1990s following asset inflation, as land was increasingly the object of speculation and shifted to property development. FELDA and RISDA gradually reduced emphasis on agricultural production in the 1990s. In addition, falling tariffs and subsidies have also driven out a number of the small and medium farmers and manufacturers as food imports became cheaper. Thus, the Gini coefficient rose from 0·446 in 1990 to 0·459 in 1993 and 0·464 in 1995 (Ishak, 1998, Table 7).

The essential point to note here is that the Malaysian state as an active agent pursued an aggressive ethnic restructuring policy, inducing firms to conform to NEP guidelines. The

Table 10. *Corporate equity ownership, Malaysia, 1970–90 (%)*

	1970	1975	1980	1985	1990	Average annual growth
Bumiputera	2·4	9·2	12·5	19·1	20·3	29·6
Other Malaysian	32·3	37·5	34·3	35·9	46·2	18·4
Foreign	63·4	53·3	43·0	26·0	25·1	11·1
Total	100·0	100·0	100·0	100·0	100·0	16·3

Source: Malaysia (1991).

latter were also achieved through direct state regulation of business contracts and employment in public service. There was hardly any economic contest generated in the distribution of business contracts and employment of *Bumiputera* employees. The government managed to achieve a significant decrease in poverty and inequality during the NEP period as a consequence of policies that targeted *Bumiputeras* specifically. Infrastructure, land schemes, farm subsidies, price controls employment policies helped improve *Bumiputera* incomes during the period. However, eclectic and unproductive crony alliances also sapped the economy. The politically well-connected from all ethnic groups have continued to enjoy rents for long periods. Deregulation, which started from the mid 1980s, added to the worsening of distribution from the 1990s.

4. Conclusions

The Malaysian experience offers important lessons for policy. The NEP, however distressing it was to certain groups, was a conjunctural result of the socio-political and economic events of the 1960s. Its implementation required the state to be actively involved in the economy. The IS sector which emerged prior to the NEP remained largely unproductive, as a consequence of misguided policies (see also Rasiah, 1998A). If IS was interventionist, so was the EO sector. The state distorted relative prices by exempting FTZ/LMW firms from taxes and tariffs, and offered subsidised infrastructural support services. As production in the EO sector was geared towards the global market, foreign firms accessing their innovative resources from parent plants located in developed economies and facing already established markets undertook large-scale export processing. Export expansion inevitably became the main growth stimulant in the manufacturing sector.

While ethnic-based distribution policies, especially those involving the promotion of crony interests, sapped the economy of rents, many critical instruments assisted poverty alleviation and distribution, which helped enhance political stability. The mixed experience of Malaysia demonstrates the need to formulate effective industrial policies, taking cognisance of the market and the institutions necessary to ensure effective coordination between firms, factor markets and product markets. Through preferential policies, the state expanded *Bumiputera* employment in public services, and stimulated their greater participation in manufacturing, thereby succeeding in its efforts to restructure the occupational identification of ethnicity, which was complemented by land schemes and the distribution of shares among poor *Bumiputera* households. Thus, when intervention in distribution began to fall and divestment of privatised companies increased from the late 1980s, distribution started to worsen. Its negative effects began to be felt a few years later as income inequality has continued to rise since 1990.

While a mixed framework involving interventionist policies and market coordination had a bearing on growth, poverty alleviation and distribution, poorly coordinated planning also generated substantial unproductive rent seeking. Access to carrots was hardly countered by the discipline of the stick. The Malaysian state lacked the right institutional framework to monitor and coordinate such rents to ensure their effective use. The present framework supported by strong resource rents managed to attract foreign firms and spawn domestic firms through fairly good infrastructural support services and political stability. The lack of dynamic technology-deepening potential from such a framework has blocked the country's capacity to move beyond simple and original equipment manufacturing activities to original design and brand activities. Rising production costs along-

side the emergence of more attractive cheap cost sites, such as China, and overheating threaten to stall further expansion.

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