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Abstract

Examines the design and implementation of the bumiputra policy, Malaysia's New Economic Policy, in 1979. Effects on foreign investment; Elevation of the economic and educational status of ethnic Malays; Effort to harness foreign capital to attain the government's domestic social goals; Goals for social restructuring in the areas of equity ownership, employment and other fields.

MALAYSIA, THE BUMIPUTRA POLICY, AND FOREIGN INVESTORS: AN EVALUATION

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Malaysia has been viewed as one of the less-developed world's success stories since its independence from Britain in 1957. Its annual GNP growth rate averaged more than 7 percent for over twenty years, and its changes of government, with one exception, have been according to constitutional processes. The country has taken advantage of its rich agricultural and mineral endowments to expand its export base, while more recently the economy has been diversifying into the production of manufactured goods for both the domestic and export markets. Foreign companies have played a major role in the expansion of both the extractive and manufacturing sectors, alongside businesses owned by Malaysian citizens. Multinational investors found the country's political and economic stability and relatively open, free-market environment quite attractive for investment. But the government adopted a series of laws in the 1970s designed to achieve certain social objectives and one of the inevitable effects was to change the country's attractiveness to foreign investors.

The major policy initiative was the New Economic Policy—the so-called bumiputra policy—adopted in 1971 to elevate the economic and educational status of the ethnic Malays. Numerically bumiputras or native Malays constitute the largest population group in the federation of Malaysia, but in the business sector they are dominated by the immigrant Chinese. The bumiputra policy was intended to redress imbalances in the educational and economic position of the Malays. The policy was not designed primarily for its impact on foreign investment, although foreign-owned companies were supposed to be major instruments to help achieve its objectives. This effort to harness foreign capital to attain the government's domestic social goals had a great potential for unanticipated damage to the country's reputation and growth record. This paper examines the design and implementation of the bumiputra policy, its effects on foreign investment, and lessons other developing countries may learn from Malaysia's experience.

COMPARATIVE CONTEXT

Malaysia's policy was fairly typical of developing countries that have reached a certain level of development. It was an attempt to change the country's policy toward foreign investment so as to increase the economic benefits inuring to the host country, to channel foreign investors into certain areas and activities considered desirable by the host government, and to utilize foreign business ventures to promote the country's domestic political and social objectives. Other developing countries have similarly tried to convert foreign-owned companies—which are motivated primarily by *economic* objectives—into instruments to achieve domestic *socio-political* goals. Among the objectives frequently sought by host countries are: local ownership and joint ventues with local partners, investment in remote or backward geographic regions, upgrading of technology (i.e. technology transfer), employment creation, training and advancement of host citizens, opportunities for local suppliers and contractors, facilities to establish industries or produce products the local economy is not yet able to provide, exports, and government revenues (Stoever, 1982).[1]

These countries' attempts to obtain more of these benefits from foreign investors have varied, depending on their ideologies, levels of development, past history of foreign investment, methods of implementing their demands, alternative sources of technology, and many other factors (Stoever, 1981, 1979a, 1979b).[2] A few examples might include the Andean Pact countries' efforts to require foreign parent companies to phase down their ownership in local subsidiaries to a 49 percent minority holding over fifteen years; Nigeria's and India's ownership rules allowing foreign companies to hold different percentages depending on the level of their technology, how much they export, where they are located, and so on; Singapore's and Korea's drives to upgrade foreign companies into more capital-intensive, higher-technology ventures; and Indonesia's *pribumi* policy designed to increase the level of local citizens' participation in ownership and mangement of foreign-invested companies. Malaysia's bumiputra policy would clearly fit into the same category as the above examples.

BACKGROUND TO THE BUMIPUTRA POLICY

Malaysia's potential for economic prosperity and for ethnic strife both predate the country's independence. In colonial times overseas investors, mainly from the United Kingdom but with a smattering from other industrialized countries, were attracted by the rich lodes of tin and other minerals and the good soil and climate for rubber growing. The territory's commerical development was greatly advanced by Chinese immigrants who had arrived by way of Singapore and spread northward into the Malay peninsula. The British government limited the right of the Chinese to acquire land and enter the colonial administrative service in an effort to "protect" the ethnic Malays, who were considered lazy and less sophisticated and thus vulnerable to exploitation. As Moslems, the Malays were also "protected" from Christian missionary schools, with the result that their education usually ended with primary school. The Malays' economic advancement was further hindered by their preference for remaining in their rural *kampangs* (villages) and by the fact that, as Moslems, they had a religious prejudice against the charging of interest on loans and, by extension, against financially complex transactions or other "big business" (Hanna, 1968a and 1968b; Arles, 1971).[3]

Malaya became independent in 1957.[4] The constitution contained provisions for "positive discrimination," including reservation of land, scholarships and civil service jobs for the ethnic Malays. Tunku (or Prince) Abdul Rahman, a Malay, became Prime Minister as the head of a coalition of communally-based political parties. The parties were able to cooperate on the basis of a formula that gave the more numerous Malays political control while allowing the Chinese to exercise economic dominance. A third group, recent immigrants from India, constituted about 10 percent of the population and were also underrepresented in the governing coalition.

From the beginning Malaysia welcomed foreign investors and made little attempt to regulate or restrict them. Kasper noted that the usual post-colonial, anti-Western "economic xenophobia" seemed to be absent (Kasper, 1974; see also Kanapathy, 1970). After independence there were no immediate changes in policy, either in moving to socialism or in instituting "Malaysianization" policies; the economy continued to be distinguished by its openness and commitment to laissez-faire capitalism. The government soon moved to establish an incentive plan for new foreign investors, creating a "pioneering industry" status which entitled firms entering designated industries to a number of tax and import duty exemptions. These included investment tax credits, tariff protection for firms selling in the domestic markets, free trade zones and bonded facilitiers for exporters, industrial estates, easy access to utilities, and other special relief for labor-intensive industries and those locating in remote regions. Two conditions for qualifying for pioneer status were to employ Malays at all levels and to reserve a "reasonable percentage" of capital shares for Malay investors (Hanna, 1968b).

Foreign companies responded well to Malaysia's growing market, low wages, incentives, and good investment climate. Many new investors and some long-established ones sought to qualify for pioneer status by offering large numbers of shares to Malays—often 10 to 30 percent of their total Malaysian capital. However, it was difficult to find bona fide Malay investors; often the Malay purchaser was only a front for a Chinese buyer, to whom the stock would soon be transferred. In order to prevent this subversion of the law's intent, the government began providing capital to so-called "Malay mutual funds" which bought up the "reserved shares" on behalf of the Malays.

The Investment Incentives Act of 1968 offered tax incentives to investors to establish labor-intensive industries, expand their use of domestic raw materials, increase their efficiency, and raise exports. It also increased tariff protection for infant industries (Kanapathy, 1970; Chopra, 1977; Fisk and Osman-Rani, 1983; Rabenau, 1976). Not long after this act was passed, international electrical-goods and electronics firms began to consider Malaysia as an alternative to Taiwan, Hong-Kong, and Singapore for low-wage plants to perform their labor-intensive assembly work.

By the late 1960s Malaysia's per capita gross national product (GNP) was among the highest in Southeast Asia, and the country was regarded as one of the most successful democracies in the Afro-Asian world. Its manufacturing sector expanded more than 200 percent in that decade, allthough it produced only 11 percent of the country's GNP in 1969. Agriculture still accounted for the bulk of output and constituted 60 percent of exports.

Although all races were benefiting from Malaysia's development, the Chinese were benefiting the most. They were concentrated in the urban, developed areas and, although constituting less than 35 percent of the population, held more than 50 percent of the nation's wealth. Their average household income was more than double that of the Malays'. Bumiputras remained concentrated ithe rural areas and were still primarily subsistence farmers or fishermen. Ambitious Malays were more likely to go into the civil service, police or the military rather than trade or commerce. But at the same time, exposure to news media and sources of politicizing information was making rural bumiputras more aware and resentful of their backwardness and poverty compared to the immigrant races (*Asian Trade and Industry*, 1975; Rogers, 1975; Stockwin, 1973; *Economist*, 1969).

The accumulated racial resentments finally touched off four days of bloody communal rioting in May, 1969. Tunku Abdul Rahman's coalition government fell, prompting him to suspend the constitution and decree rule by a National Operations Council consisting of political, military, and police leaders. This council ruled by fiat for two years.

THE NEW ECONOMIC POLICY AND THE BUMIPUTRA POLICY

When parliamentary rule was re-established in 1971, the New Economic Policy (NEP) was anounced. A twenty-year plan divided into four five-year components, the NEP was intended to allocate resources and regulate investment so as to create national unity and abolish poverty. It provided for continued economic development through an increase in manufacturing from 13 percent to 27 percent of GDP. More controversial were the sections laying out a blueprint for dealing with racial economic imbalance and removing identification of race with economic function. The Second Malaysia Plan (Stockwin, 1973; Kamm, 1980; *Investors Chronicle and Financial World*, 1980),[5] covering the years 1971-1975, argued that without government action economic growth alone would only result in increased disparities between bumiputras and other Malaysians. Therefore the plan set goals for social restructuring in the areas of equity ownership, employment, and other fields:

Ownership of productive resources: By 1990 foreign ownership was to be reduced to 30 percent of equity shares. Of the 70 percent locally owned, 30 percent should be in bumiputra hands and 40 percent owned by "other" Malaysians. (This became known as the "30-40-30 rule.") The NEP set down a schedule for projected growth of the bumiputra proportion of such share capital: by 1980 they were supposed to own 16 percent, and by 1990, thirty percent of the equity of all companies, domestic or foreign-owned.

Employment: In order to achieve employment patterns more representative of the nation's racial composition, bumiputras were to be given preference in hiring by both public and private employers. The stated goal was to have bumiputras filling 30 percent of all corporate job categories (including top management) by 1990.

Other areas: Malays were supposed to be given extra advantages in such matters as university admissions, access to bank loans and credit, and exclusive rights to enter businesses such as forest products and fisheries.

The NEP originally specified that foreign-owned companies engaged entirely in export and those established prior to 1970 could maintain 100 percent foreign ownership, but entering companies selling in the Malaysian market were required to have at least 51 percent local ownership from the beginning. An established business had to accept 51 percent local ownership if it expanded or changed its line of business. New investors were normally required to set up a schedule for achievement of the 30-40-30 rule by 1990. The exact percentage of required local ownership varied by company according to its contribution to the economy, level of technology, location, and use of local raw materials.

Regarding bumiputra employment, the NEP target was to have Malays represented in every job category in proportion to their share of the national population by 1990, and it suggested interim targets to be achieved in five-year intervals. Although it did not mandate precise quotas, the government made clear its intention to push both foreign and locally (Chinese) owned companies to hire Malays whenever possible and to scrutinize the companies' efforts to live up to the spirit of the plan.

The second Malaysia Plan was thus a considerable tightening of previous policy. Foreign investment would still be welcome—in fact, it was projected to grow eightfold by 1990—but it would be subject to increased regulation in regard to ownership and employment. In order for bumiputra gains to be accomplished without deprivation to the Chinese community, the NEP projected 7.1 percent annual growth rate in GDP. Achieving this targeted growth would require increased levels of foreign investment—at the very time the government was tightening restrictions and imposing new requirements on such investment.

IMPLEMENTATION OF THE BUMIPUTRA POLICY

In implementing the bumiputra policy, the government wavered between its need to continue attracting foreign capital, technology, and skills and its desire to assert a greater degree of economic control and to promote national goals more rapidly. On one hand, it avoided strong-arm tactics and remained flexible in its enforcement of the policy. It frequently reiterated that foreign investors were welcome and, aided by its continuing strong balance-of-payments position, continued to allow unrestricted repatriation of capital, dividends, service fees, and royalties. On the other hand, it began pressing investors, especially those producing goods for sale in the local market, to comply with the guidelines on hiring of bumiputras and restructuring of ownership, and it tried various ways of tightening the laws and policies governing foreign companies throughout the 1970s and early 1980s.

The government's efforts to differentiate among various types of investments showed up most clearly in the case of electronics firms seeking a cheaper labor source for their assembly and export operations. It offered them free import of component parts into several free-trade zones, amended the labor laws to allow round-the-clock shifts, offered ten-year tax holidays, and exempted assembly plants from any kind of local ownership requirement. At the same time, however, it was pressuring other companies to sell part ownership to individual Malays or the Malay mutual funds. One such fund, Permodalan Nasional (Pernas), became the chief agency through which public sector capital was channeled to increase bumiputra ownership of corporate capital.

Companies began reporting difficulties finding enough qualified bumiputras to satisfy the government's targets for the restructuring of employment. Compliance was difficult for several reasons: many bumiputras did not want to relocate to urban centers on the western side of the peninsula where the bulk of industrial jobs were located; civil service salaries were better than private industry's; and few bumiputras were trained for accounting, middle management, or engineering jobs. (Indeed, the government itself was reported to be having difficulty meeting its own guidelines in some job categories.) Many companies tried to alleviate the shortage by setting up extensive training programs; National Semiconductor, for example, established eleven different training programs in Malaysia, complete with bumiputra scholarships and "campuses" of classrooms and libraries at two different plants.

In a controversial and much-publicized move to strengthen regulation, the government passed the Industrial Coordination Act (ICA) in 1975. This law gave sweeping powers to the Industries Minister to override corporate decisions regarding equity, pricing, directorships, production, and distribution. One requirement of the ICA was that every business had to register with the government annually and obtain an operating license specifying existing business capacity. If the capacity subsequently increased from the registered amount, the requirement for majority local ownership would then apply.

The number of foreign investment projects approved, after a record of steady growth, fell from 525 in 1974 to 461 in 1975, 425 in 1976, and

400 in 1977 (Malaysia Industrial Development Authority, 1981). Among the main reasons for this slowing of foreign investors' interest were an economic downturn in most investor nations and the bumiputra policy (*Business Week*, 1975; Hartley, 1976; Andelman, 1977). Interestingly, it was not the requirements of the bumiputra plan which were most discouraging—for investors were becoming accustomed to even more strigent regulations in other countries—but the unpredictability and uncertainty of how the regulations were going to be administered and enforced on a case-by-case basis. The ICA and other legislation caused investors to be concerned about the sweeping powers and degree of discretion left to government officials. With regard to licensing requirements, stories circulated about how overzealous junior civil servants were interpreting minor modifications in product line or replacement of old equipment as "expansions," thus requiring companies to take in local equity.

By 1976 the government was becoming alarmed at the decline in foreign investment. Concerned about the adverse effects on new and existing investors, it expurgated the more vigorous pro-bumiputra statements from the third Malaysia Plan (covering the years 1976-1980) and made exceptions to the ICA. Companies were given a right of appeal in adverse decisions. On a personal level, government officials gave assurances about their commitment to reasonableness, gentle persuasion, and long lead times before implementing any policy changes. They asked to be judged on their past flexibility and stressed that targets were to be met by the economy as a whole, not necessarily by individual companies. The government also eased the terms it demanded from foreign oil companies in order to encourage more exploration and production and thus avoided severe foreign exchange losses due to the energy crisis. This attitude of compromise and pragmatism seemed to restore the country's attractiveness: approvals rose to 428 in 1978, to 484 in 1979, dipped somewhat to 460 in 1980, and then soared to 613 in 1981 (Malaysia Industrial Development Authority, 1981).

Meanwhile, the Malay mutual funds (which by now had been taken over by the government and had become state corporations) continued acquiring shares in trust for the bumiputras. Pernas, the pre-eminent fund, had eight wholly-owned subsidiaries and 37 sub-subsidiaries in 1977. Petronas, the state oil company, was making special efforts to acquire stock in foreign-owned mining, oil and plantation companies, which many Malaysians believed had been purchased too cheaply during British rule. The state corporations paid compensation in various ways for the shares they acquired: as capital contributions to new ventures, as purchases from foreign companies complying with the 30-40-30 rule, or (in a few cases) as open-market takeovers of publicly-traded companies on the London Stock Exchange. But all the while the government was trying to walk a careful line between commitment to acquiring shares for bumiputras and commitment to private enterprise. Thus it sought to avoid levels of control that would constitute "indirect nationalization."

The state corporations' purchases of shares in trust for bumiputras gave the government a means of advancing its employment restructuring guidelines; for example, Pernas used its power in Goodyear's local subsidiary to give tire distributorships to Malays, and with 50 percent equity in a Kuala Lumpur hotel, Pernas was able to enforce a policy of 50 percent Malay staff. The trust schemes were criticized, however, on the grounds that the so-called bumiputra purchases were really only a transfer of government funds into a column called "Malay ownership." Since few shares were actually getting into individuals' hands, critics said little progress was being made in creating "capitalists" among the Malays.

New foreign investors were usually required to submit a schedule for indigenization of expatriate-held jobs. Originally this policy was enforced even in areas such as Penang where only 15 percent of the resident population was bumiputra, but later the government revised the policy so that hiring was supposed to be proportional to the population distribution in each area. Companies near Kuala Lumpur were supposed to aim for 40 percent bumiputra hiring while companies in Penang need only aim for 15 percent bumiputras. The guidelines also allowed foreign companies to retain certain key posts for expatriates when foreign capital exceeded M$1 million, and in practice individual corporations were able to obtain exemptions if they could present viable and convincing reasons to the government.

Malaysia made substantial progress towards the goals of the NEP by 1980, although it was less than halfway to the target set for 1990. The country's real GNP grew at an average of 7.8 percent per year during the 1970s. "Bumiputra" ownership was up to 10 percent of the average company's shares, although the large majority of this was owned by the state corporations. The bumiputra share in administrative and managerial jobs climbed from 24 percent in 1970 to 32 percent in 1980, although most of these were in the lower ranks.

Against this backdrop of economic progress, racial and religious tensions were building among both Chinese and Islamic groups in response to the government's attempts to advance the Malays. "Millions and millions" of Chinese investment dollars were reputed to be leaving Malaysia for Singapore and Australia in fear of the racially discriminatory policies. Non-bumiputra local investment dropped from $174 million in 1971 to $94 million in 1980. Also the government was finding it easier to persuade large corporations to adopt pro-bumiputra policies than small, closely knit Chinese companies. Among the Malays an Islamic revival movement was growing; its leaders praised the Iranian revolution, decried the corrupting influence of multinationals, and criticized the government as opportunistic for allowing foreign businesses in.

In early 1981 the government announced its "unit trust share" scheme, a ten-year program to shift bumiputra ownership from institutional holders like Pernas to individuals. A national investment company, Permodalan Nasional Berhad (PNB), was to hold the stock of selected foreign and domestic state companies. A large part of PNB's shares was held by Amanah Sahan Nasional (ASN), the National Unit Trust, in effect a kind of mutual investment fund. Units or shares of ASN would be sold to individual bumiputras for M$1 each. A minimum return of 10 percent was guaranteed, plus additional "bonus" shares depending on the trust's earnings. Malaysian government representatives said the trust could guarantee 10 percent minimum return because it "only acquired stock in companies that made money."[6] In order to persuade individual bumiputras to invest in the units, Pernas was to make a market for them, offer them widely at post offices and banks, and mount a massive media campaign to overcome bumiputra resistance. An individual could buy his first 100 units, his "basic share," for M$10 down, the balance to be paid out of dividends over the next ten years. He was permitted to purchase up to 49,900 more units at par. Thus the scheme was designed to reach poorer bumiputras and to spread "capitalism" as widely as possible. Outsiders viewed the scheme with a certain skepticism, however. There were doubts as to how well it would work and fears that it could cause a major drain on the national treasury if the government's optimistic economic and administrative assumptions did not work out (Keatley, 1981; *Wall Street Journal*, 1981a; *Investors Chronicle and Financial World*, 1980).

Dr. Mahathir Mohamad became Prime Minister in July 1981. As Deputy Prime Minister during the last half of the 1970s, he had played a primary role in shaping the flexible and pragmatic approach to NEP implementation. However, as Prime Minister he sought legislation to increase government regulation of foreign investment and expressed concern that restructuring of equity ownership had fallen short of the mid-term target of 16 percent. He said his government was willing to accept slower growth if that was the price Malaysia had to pay to enforce its national goals (*Asian Finance*, 1981; Wain, 1981).

The fourth Malaysia Plan (1981-1985) recognized that real wage levels were rising—an indication of the country's increasing prosperity—and that Malaysia was becoming progressively less able to compete in the market for labor-intensive production. The market for its principal manufactured exports—electronics, textiles and clothing—was becoming saturated and was subject to business cycle fluctuations and protectionist pressures in the industrialized countries. Hence the plan called for the government to offer incentives for foreign investment in the less labor-intensive areas of higher technology and heavy industry (*Asian Finance*, 1981; *New York Times*, 1980; *Business Week*, 1981; Fisk and Osman-Rani, 1983; *Wall Street Journal*, 1981b).

The country's rate of growth slowed significantly in the early 1980s. It was fortunate in that its oil production had risen enough to supply its own needs and produce a modest surplus for export, thus avoiding the worst hardships of the second OPEC oil price rise. But prices of its main commodity exports fell in 1981, and the country experienced its first serious shortage of foreign exchange. The government was forced to impose some exchange controls, including restrictions on foreign investors' purchases from abroad and a requirement to obtain central bank approval before earnings could be remitted to their home countries. These restrictions plus a worldwide recession cut the rate of investment inflow in 1981-1982. Within Malaysia per capita GNP growth fell to 6.7 percent in 1981 and below five percent in 1982. Pernas's request for a further allocation of M$1 billion to continue buying shares in foreign companies was shelved. A few foreign companies (notably including some big British plantations and trading companies) felt that they could continue to resist government efforts to restructure their ownership (*Economist*, 1982, 1983).

By the mid-1980s the Malaysians had made substantial progress towards the goals of the NEP, although they were behind the ambitious schedule they had set for themselves. "Bumputra" ownership was up to 15 percent of total equity in Malaysian-chartered corporations and subsidiaries, although two-thirds of this was still held by the state corporations. The unit trust share scheme had worked fairly well so far. ASN's early issues had been oversubscribed, partly because wealthy Malays were purchasing large blocs. Foreign ownership was down to 45 percent of total equity, and other Malaysians held 40 percent. A few Malays had become heads of business corporations.

But a debate was intensifying over whether the policy should be extended beyond its originally-scheduled expiration date of 1990-91. Some persons interviewed by the author (mostly bumiputras) argued that it should be extended because its objectives had not been fully achieved, especially in the areas of ownership and higher-level employment. Others argued that preferential treatment of Malays should end as scheduled because the racial imbalances had been substantially reduced, especially in the areas of university education and entry-level opportunities; the policy had discouraged Malaysia's own Chinese businessmen from undertaking new entrepreneurial activities and had instead caused them to ship much capital out of the country; and it was likely to discourage more foreign investors in the future when they saw that its burdens were likely to become "permanent." Some also said that "certain persons" had benefited disproportionately from the favored treatment and were preparing to raise a political storm if their advantages were threatened.[7] Clearly the story of the bumiputra policy is not over yet.

ANALYSIS: IMPLEMENTATION OF THE BUMIPUTRA POLICY

This study proposes five principles of cost-benefit analysis for examining the efficacy of a host-government policy such as the NEP.

Principle 1: A host country can seek more benefits and objectives from foreign investment as the investors find the host economy more attractive and profitable, that is, more beneficial and less costly for doing business.

Judging from investor reactions and from the author's interviews, Malaysia appears to have done a fairly good job of coordinating the increases it sought in benefits from foreign investors with the growth in investors' profit possibilities and in the country's ability to support and service their investments (thereby reducing the investors' costs of doing business). That is, the government's increasing demands on foreign investors did not outpace the growth in investors' ability to afford the demands.

Even before the NEP, the benefits the Malaysians sought from foreign investment were growing varied and complex: increased industrial development, manufactured exports, some plants in more primitive regions, a slowly growing proportion of Malay ownership, and so on. Announcement of the NEP in 1971 marked a major escalation in the benefits sought by the host country. Now specific quotas were set for the proportion of Malay and other local ownership required of most foreign investors, eventually resulting in substantial majority (70 percent) local ownership. Investors were also to be pressured to accelerate greatly their hiring and promotion of Malays. These demands could have imposed heavy costs on many investors, but the government actually made considerable efforts to help contain the costs: long lead times (20 years for equity restructuring), adequate compensation, a flexible and pragmatic approach to the increased hiring of bumiputras, stepped-up educational opportunities to increase the supply of capable Malay job applicants, and so on. And of course the country's continued growth meant that profit opportunities kept expanding.

The government's demands threatened to outpace the investors' capabilities twice during this period, during the worldwide economic downturns in the mid-1970s and the early 1980s. That is, the increased costs and decreased benefits of doing business in the country discouraged some investors, causing the rate of new investment applications to fall off and some investors in place to consider pulling out. Both times the government responded by restoring a more favorable balance of benefits and costs to the investing community.

The assessment of benefits and costs for the electrical goods and electronics assembly plants that started coming into the country in the 1970s was different than for the import-substituting industries. For these investors the biggest single benefit was the cheap labor, of course. But this was available in quite a few other developing countries, forcing the Malaysians to forgo some of their desires and to throw in various incentives in order to meet the competition. For the host country the two biggest benefits—eagerly sought by most developing countries—were the substantial net earnings of foreign exchange and the employment opportunities and training for relatively uneducated Malaysian citizens. The downside—the costs of these investments—were relatively small: such things as increased dependence on foreign markets and foreign decision-makers and greater vulnerability to economic downturns overseas. Hence the government was willing to allow these plants to remain 100 percent foreign-owned and to exempt them from some of the other requirements of the NEP.

Principle 2: Seek objectives where the value or benefits to the host country greatly exceeds their cost to the investor.

The Malaysian government obviously placed a very high priority on the objective of equity restructuring (although see discussion below on the actual benefits obtained thereunder). Many foreign investors were able to accede to the demands for transfer of part ownership to bumiputras and other Malaysians, as shown by the high degree of voluntary compliance. Some companies resisted the demands, presumably considering the costs of giving up part control to be too high; in a few of these cases the Malaysians attempted to force compliance, either through market takeovers or through continued pressures on the recalcitrant companies. On balance, therefore, the Malaysians appear to have adhered fairly well to Principle 2 as regards the perceived benefit of equity sharing.

The government also placed a high priority on employment restructuring, although it soon backed away from trying to enforce rigid quotas and demonstrated a willingness to compromise and be flexible. Government officials were aware of the problem of finding skilled and qualified Malays to fill technical and managerial positions. They were probably also aware of the inevitable losses in efficiency, the potential for mistakes and wastage, and other costs that could result from pushing untrained and inexperienced people into high-level responsibilities. The drive to expand the opportunities for bumiputras to acquire university education or technical training was a long-range solution to this problem, although the authorities fortunately seemed to realize that merely acquiring a diploma did not automatically make a graduate into a competent manager. Hiring of bumiputras at entry levels did increase significantly during the 1970s, and a few foreign subsidiaries selected bumiputras for their top officers. No doubt there were some adjustment problems on both sides, but the companies voiced few overt complaints about their new Malay managers and trainees. Companies may have experienced some additional costs of carrying employees who were not able to make a full contribution, but on the other hand they may have discovered some added benefits by having more employees who understood the culture of their labor force and their customers better. Thus the employment restructuring program appears to follow Principle 2 reasonably well, precisely because of the government's moderation and sensitivity in implementing it.

It should be noted, however, that compliance with both the equity restructuring and hiring-and-promotion requirements was easier for foreign investors than for domestic Chinese companies. Multinational enterprises were more diverse and had a greater range of experience to fall back on than local businesses. They could spread and absorb the costs over more resources. The Chinese businesses tended to be more inward-looking, family-run, and community-oriented, making it more difficult for them to accept outsiders in positions of trust. American companies, and to a lesser extend Western European, were accustomed to "affirmative action" programs and to mixing a variety of ethnic groups in their home countries. Their executives probably had fewer prejudices against the Malays than the Chinese. And even language was less of a barrier: most foreign companies did most of their business in English (even the continental Europeans tended to learn English for service in Malaysia), and most Malays with any education could communicate in the same language. The Chinese, by contrast, were accustomed to keeping their records in Chinese and doing a lot of their business in their own dialects, which few Malays could understand. For these reasons it is not surprising that more equity was restructured and more and higher-level positions were given to bumiputras by the multinationals than by local Chinese companies.

Principle 3: Give investment incentives if the benefits to the investor exceed the costs to the host country, that is, if the incentives are cost-effective.

Giving incentives to encourage foreign investment in industries or areas considered desirable by the host government has become the conventional wisdom in many LDCs. Malaysia has long followed this practice: as the benefits it sought became more numerous and more complex, the government tried to structure an ever more elaborate and differentiated set of incentives, controls and regulations. Like many host LDCs, it thus showed a tendency to move toward a more interventionist, less free-market policy. But there were dangers in this: investors were likely to perceive that the economy was becoming less open and unfettered than the attractive environment they had known. As a result, they could decide to leave the host country. Furthermore, the regulations (and the bureaucracy that enforced them) were likely to become more cumbersome, intrusive, and expensive to comply with; the planners and policy-makers could make mistakes, create the wrong incentives, cause unintended and undesirable side effects, etc.; and the free-market "price signals" could become more and more distorted, making it harder and harder for either private investors or the government to determine where the country's true competitive advantages lay.

A specific example could be the government's drive in the early 1980s to raise the capital intensity and technology level of new and existing investments. One trouble was that many others were trying to get into "hi-tech" at the same time; it was becoming fashionable. There was a danger that Malaysia's policy-makers were simply responding to the industrial fad of the moment. The country could end up competing with Singapore, South Korea, a host of Western European countries, and even several individual American states in trying to offer the most attractive incentives and subsidies for the same kinds of industries. Malaysia's competitive advantage was less apparent here than it had been in natural resources and low-wage industries in earlier years; thus the prospects for continued exports from these industries were not so clear. It was also not clear whether high-technology industries would be conducive to rapid advancement of Malays—one of the original goals of the bumiputra policy. Furthermore, the government was still pushing for greater "national control" through continued equity restructuring. These two drives—upgrading of investment and sharing of equity—were not entirely compatible; multinationals have been notably reluctant to impart their newest technologies and know-how when they were not sure of controlling their use and diffusion. These potential dangers and conflicts make it more and more difficult to assess incentive programs to be reasonably sure that they are mutually beneficial to the host country and the investor.

Principle 4: Reassure investors that the host country's demands for increased benefits will be limited and not constantly increased.

The Malaysian government made deliberate efforts to adhere to this principle while implementing the bumiputra policy, at least during the 1970s. Government officials were aware that they could not obtain too many benefits at investors' expense, and they sought to reassure investors that their demands would be limited. By word and deed they indicated that investors would be compensated for the equity given up, one way of reducing the cost of compliance. They showed no sense of wanting to "punish" foreign companies or blame them for the country's problems, a form of "benefit" many LDC governments have extracted from multinational investors.

A kind of implicit bargaining can be seen in the government's policy initiatives and enforcement during the 1970s. The Malaysians remained sensitive to the impact their moves were having on foreign investors, and they demonstrated a willingness to moderate the pace and rigor of enforcement when the effects were too negative. Most notably, when the government stepped up its demands in the mid-1970s, new investment fell off and investor protests and critical comment escalated; the government "got the message" and backed off from some of the more distressing demands. Another example was the government's pragmatic approach to employment restructuring; a lot of its efforts to obtain investor compliance were exerted through visits by lower-level government officials and requirements for periodic progress reports. This approach left some leeway for explanations and bargaining, and it certainly had a gentler tone than blunt directives would have. The government's actions could be described as a kind of "feel of the market" or testing to see just how far it could push its demands.

Principle 5: Be sure domestic benefits exceed domestic costs.

It is instructive to examine the government's goal of raising "bumiputra" ownership of most companies to 30 percent for the proclaimed purpose of obtaining greater "national control" of the economy. A combination of 30 percent ownership by bumiputras and 40 percent by other Malaysians would certainly create the appearance of national control. "Control" is a nebulous concept, however; it remains open to doubt just how much actual decisional control would rest with the national owners, especially if the stock were widely dispersed among many small holders. The local subsidiaries would most likely remain dependent on their overseas parents for technology and managerial know-how for many years; those that manufactured products for export would probably continue to rely on their parents for market access too. Control of these resources would further strengthen the parent companies' operating control. Thus the transfer of 70 percent ownership to local holders would shift some degree of control to the host society, although not as much as might appear from the numbers.

The next question was whether the government stock purchases were the best use the nation could make of its available funds. While Malaysia was more fortunate than many developing countries, its supply of foreign exchange was not inexhaustible, and these funds could have been used in many other ways—continued improvements in infrastructure, educational facilities, financing for industrial development, and so on. Such expenditures might well have brought more immediate and more tangible long-term benefits to Malaysian citizens than continued acquisition of equity in foreign subsidiaries. The same amount of money made available as loans to Malaysian businessmen or government-run enterprises would probably have created more jobs and training for bumiputras.

Other problems could arise from the fact that the purchases were making the state corporations into the largest "indigenous" shareholders. Large stockholdings in private companies were not entirely desirable for a government that professed to be committed to private enterprise. Not only might its image as a desirable place for private investment suffer, but it would create the temptation to inject ever more political considerations into the companies' business decisions. The result all too easily could be a loss in efficiency and a decline toward unprofitability. The Malaysian government appears to have avoided this trap so far, but its increasingly activist role in attempting to manage the economy suggests that the danger is still present.

Another more fundamental question was whether such a deep government involvement in stock purchases strayed too far from the original purposes of the 30 percent ownership policy. It was somewhat of a fiction to maintain that these purchases were "in trust for" the bumiputras; the connection between such government ownership and the individuals' own lives would be extremely distant and tenuous. The government might persuade some citizens that its partial ownership of foreign companies' local subsidiaries was to represent their interests, but this would be mainly the result of an educational/propaganda campaign. And as for teaching purposes, the fact of *government* ownership of stock hardly seems likely to teach many *individuals* about business organization, management and efficiency, no matter how much education and exhortation may accompany it. Many Malays had already shown considerable initiative in starting up small businesses, mostly small retailing establishments and artisan shops, but the demonstration effect between government stock ownership in a large public company and the entrepreneurship of a small shop was virtually nonexistent.

The government was doubtless concerned about these problems with its extensive shareholdings, as shown by its efforts to persuade bumiputras to take up more of the "reserved" shares in their own names. But here again there were problems. The scheme for selling 100 basic shares to each individual Malay for 10 percent down and the balance paid out of earnings really amounted to a large, low-risk, interest-free loan—in effect, a government subsidy. Even the ordinary shares paid a guaranteed minimum of 10 percent. This meant that the underlying companies, whose stock was held by the national investment corporation PNB, would have to make at least 10 percent profit per year in order that the payments be made out of earnings and not out of the national treasury. True, many companies had earned 10 percent or more during the growth period of the 1960s and 1970s, but there was no guarantee that companies would continue to enjoy such profits during the latter years of the NEP. If the country's underlying growth rate fell off or if its export earnings fell, the government could eventually be forced to cut the "guaranteed" return, or it could end up financing present consumption at the cost of future investment.

Even if a substantial number of bumiputras decided to participate in the stock transfer scheme, there was a danger they would learn the wrong lessons. It would give them unrealistic ideas about how easy it was to become a "capitalist" and acquire wealth from financial investments. It could create the impression that large companies earned very high rates of return—after all, from the individual Malay purchaser's perspective, he would be receiving a yearly "stock dividend" of 100 percent on his initial investment in the basic 100 shares. He would also be gaining a false impression regarding the amount of risk inherent in a financial investment since the government would be carrying most of the risks of these investments.

When all is said and done, it seems inescapable that one of the true major purposes of the 30 percent bumiputra ownership rule (and for that matter, the rule requiring 40 percent ownership rule by other Malaysians) was political. Political benefits are not to be denigrated; it was definitely important to give the Malays a greater sense of involvement in their country's modern sector and to begin to overcome their resentment against Chinese economic domination. Enlarging bumiputra educational opportunities and creating some sort of positive discrimination in employment seem to have been helpful in this regard. But it appears doubtful that the stock ownership scheme was well suited to these needs, especially in view of the average Malay's reluctance to purchase the stock himself. From the point of view of the individual Malays, its major effect was largely cosmetic; it enabled the government to proclaim that ownership was being localized, but it didn't really give them much personal "participation" in the modern sector. In sum, therefore, the whole program of stock purchases and transfers could prove quite costly to the government and still produce relatively little social benefit.

OVERVIEW

Despite the relative successes of the 1970s, the NEP still has a strong element of risk and uncertainty. The danger is ever present that the government, perhaps driven by domestic political pressures, could push the policies too hard and too fast and thus drive away the needed capital, expertise, and technology of foreign investors. Politicians could succumb to the temptation to interfere ever more in managerial decisions and thus drive costs up and profits down. The government's objectives and desires from foreign investment could proliferate still more, causing its regulations and incentives to become too complex and difficult to follow, too costly to the investors, or inconsistent and self-defeating. The country's reputation for hospitality and reasonable treatment toward foreign investors could be damaged, thereby raising the returns and risk compensation demanded by potential investors and decreasing the net benefits received by the host economy. Malaysia might not be able to lower its expectations and retrench its policies adequately if growth should continue at a slower rate or foreign exchange earnings should fall; thus it could become locked into programs that were more expensive than it could afford. Because dangers like these always inhere in any such indigenization policy, other less-developed countries must be careful not to learn the wrong lessons from Malaysia's experiences. Ultimately the success of the NEP may be determined by how well Malaysia manages to make it pro-bumiputra without becoming anti-foreign and anti-Chinese.

NOTES

1. See Stoever (1982) for a more complete discussion of the objectives sought by host developing countries from foreign investment.
2. See Stoever (1981, 1979a, 1979b) for a discussion of the process and outcome of demands for renegotiations.
3. See Hanna (1968a, 1986b) and Arles (1971) for discussions of the traditional Malay culture.
4. The Federation of Malaya—the Malay peninsula—became independent in 1957. In 1963 the eleven Malayan states of the Federation merged with Singapore and the Bornean states of Sabah and Serawak to form Malaysia. In 1965 Singapore left Malaysia to become a separate nation.
5. Though it was the first segment of the NEP, the 1971-1975 plan was called the Second Malaysia Plan, since the First Malaysia Plan was the pre-NEP scheme for 1966-70. Some sources call them the First Malaysian Plan, etc.
6. Interview with M. Suppiah, Consul Investment/Director, and Sulaiman Rahmad, Vice-Consul Assistant/Assistant Director, Malaysian Industrial Development Authority, 630 Third Avenue, New York, N.Y., March, 1984.
7. Interviews of about a dozen Malaysian government officials, business executives, and academics conducted by the author in Kuala Lumpur in April, 1985.

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