

# NAVAL POSTGRADUATE SCHOOL Monterey, California



## THESIS

**REDUCING INCOME DISPARITY FOR STABILITY AND  
DEVELOPMENT: MALAYSIA'S EXPERIENCE**

by

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June 2002

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**REDUCING INCOME DISPARITY FOR STABILITY AND  
DEVELOPMENT: MALAYSIA'S EXPERIENCE**

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## **ABSTRACT**

Malaysia, a plural nation comprising of the indigenous Malays (*Bumiputeras*), and the immigrant Chinese and Indians has embarked on a unique program called the “New Economic Policy” (NEP) to ensure a fairer share of wealth, income, prosperity and opportunities between the ethnic groups. The NEP aimed to promote national unity by pursuing the twin objectives of the eradication of poverty and the restructuring of society to eliminate identification of race with economic functions. The policy makers planned to reduce poverty amongst the entire population, especially the rural poor. They established policies to bring the Malays into the mainstream of business, commerce and education through redistribution of new, accrual wealth. A powerful Government, compromise and continued growth were vital factors to administer the policy. The NEP was an appropriate policy for plural Malaysia as it kept the nation prosperous, peaceful and economically successful since the 70s whereby Malaysia had enjoyed peace and prosperity with average annual growth of nearly 7%. NEP’ s success, current development such as globalization, the Asian Crisis and new awareness for transparency and a more liberal democracy necessitate Malaysia to readjust its policy responses for continued peace and prosperity.

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## LIST OF ABBREVIATIONS

|       |  |
|-------|--|
| ASB   | Amanah Saham Bumiputera                        |
| ASEAN | Association of Southeast Asian Nations         |
| ASN   | Amanah Saham Nasional                          |
| BCIC  | Bumiputera Commercial and Industrial Community |
| CIA   | Central Intelligence Agency                    |
| CLOB  | Central Limit Order Book                       |
| CPM   | Communist Party of Malaya                      |
| DAP   | Democratic Action Party                        |
| FDI   | Foreign Direct Investment                      |
| FEER  | Far Eastern Economic Review                    |
| FELDA | Federal Land Development Authority             |
| HICOM | Heavy Industry Corporation of Malaysia         |
| ICA   | Industrial Coordination Act                    |
| IMF   | International Monetary Fund                    |
| ISA   | Internal Security Act                          |
| KLSE  | Kuala Lumpur Stock Exchange                    |
| KMM   | Kumpulan Mujahidin Malaysia                    |
| MARA  | Majlis Amanah Rakyat                           |
| MAS   | Malaysian Airlines                             |
| MCA   | Malaysian Chinese Association                  |
| MIC   | Malaysian Indian Congress                      |
| MPAJA | Malayan Peoples' Anti-Japanese Army            |
| NCC   | National Consultative Council                  |
| NDP   | National Development Policy                    |
| NEP   | New Economics Policy                           |
| NEAC  | National Economic Action Council               |
| NF    | National Front Party                           |
| NOC   | National Operations Council                    |

|          |                                     |
|----------|-------------------------------------|
| NPL      | Non Performing Loans                |
| NVC      | National Vision Policy              |
| PAP      | People's Action Party               |
| PAS      | (See PMIP)                          |
| PERNAS   | National Trade Corporation          |
| PETRONAS | Petroleum Nasional                  |
| PKI      | Parti Komunis Indonesia             |
| PMIP     | Pan Malaysian Islamic Party         |
| PNB      | Perbadanan Nasional Berhad          |
| PRC      | People's Republic of China          |
| PROTON   | Perusahaan Otomobil Nasional        |
| UMNO     | United Malays National Organization |
| TNC      | Trans-National Corporations         |

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# I. INTRODUCTION

## A. THESIS

In 1971, after a near catastrophic racial riot, Malaysia implemented its “New Economic Policy” (NEP), a social reengineering policy. This policy sought to fundamentally redistribute the nation’s wealth by bringing the Malays and other *Bumiputras*, the indigenous people of the country, into the main stream of economic life. The NEP, by adopting affirmative action programs, was carefully designed to redistribute wealth by means of economic growth, and not through the expropriation of wealth belonging to other communities.

This paper attempts to examine whether the “New Economic Policy” is an appropriate strategy for Malaysia. In view of recent developments, we seek answers as to whether Malaysia should continue with the strategy, and if so, what modifications may be necessary. The NEP was a controversial decision, seemingly unfair to the more advanced racial groups, as it entailed a restructuring of the society and a redistribution of wealth and opportunity in order to achieve unity and stability in favor of the less advanced racial groups. In this paper we will outline the historical developments, the compromise made to share political and economic powers between the different groups of the population, and the arguments behind the government’s active participation and the decision for the NEP. We will also discuss how the country should adapt to new expectations after 30 years of the current policy and realign with the new demands such as globalization.

## B. BACKGROUND

Most developing countries pursue economic development and industrialization as one of their main objectives. The hope is that industrialization will transform poor rural farmers into more efficient, better-paid urban industrial workers. Underdevelopment is usually associated with problems of poor health, low literacy rates, high mortality rates, delinquency, low morale, low self-esteem, feelings of hopelessness and other traits linked to poverty, especially in developing and less developed countries. Policies that encourage development have brought a better life to people in developing countries as seen from an improvement in the development indices of increased household incomes, access to better educational facilities, and a decrease in mortality rates to name a few.

Chasing doggedly after economic growth targets without considering social consequences can be detrimental to a country's sustainable development. For example, accelerated growth is desirable, but sometimes may be subordinated to a redistribution of income if extreme poverty threatens political stability or forestalls the mobilization of human resources.<sup>1</sup> In many cases, development policies not qualified with social and political considerations have resulted in increased inequalities in wealth, income, and opportunities between social, ethnic and religious, or geographical groups. The inequalities then spiraled into social tensions, instability, riots and even civil wars<sup>2</sup>.

Inequality, or uneven development, manifests itself in many forms such as income disparity, spatial distribution of growth, differences in access to education and business opportunities, savings rates, and access to affordable and quality healthcare, and other forms too numerous to mention. Persistent inequalities can give rise to social tensions. Income differentials, especially if they coincide with racial divisions, can be an explosive social mixture. High levels of income inequality are not desirable because they may adversely affect growth, promote additional poverty and result in a loss of social cohesion<sup>3</sup>.

Malaysia is one of the countries that have addressed the issue of unequal development. The country has developed a strategy called the "New Economic Policy" (NEP) that seeks to strike a balance between the goals of sustained economic growth with social and economic equity between racial groups. In the case of Malaysia, it will be argued, inequalities have arisen due to concentrations of ethnic-based activities in different areas such as agriculture in rural areas amongst the Malays and urban commerce with the Chinese and Indians.

Malaysia, a postcolonial nation, inherited a unique mix of a multi-ethnic, multi-religious, pluralistic society comprised of three major groups: the Muslim Malays, the mainly Buddhist Chinese, Hindu Indians and various other groups. As a result of factors

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<sup>1</sup> Malcolm Gillis, et al., *Economics of Development*. (New York: Norton & Company, 1996). p. 15.

<sup>2</sup> This unfortunate situation had happened or continues to haunt many developing nations such as Nigeria, Sri Lanka, Peru, Argentina, Russia, China, South Africa, Zimbabwe, Fiji, Indonesia and Malaysia to name a few.

<sup>3</sup> Phillipe Aghion, Eve Caroli, and Cecilia Garcia-Penalosa, "Inequality and Growth: The Perspective of the New Growth Theories", *Journal of Economic Literature*, Vol. 37, December 1999, p. 1630.

to be discussed later, income and wealth disparity, educational prospects and other disparities emerged between these racial groups, which also contributed to a growing social and economic chasm. These disparities, plus unresolved racial issues, exploded in the form of a bloody communal riot in 1969 that threatened the continued stability and the future development of Malaysia. In response to this turmoil, Malaysian political leaders developed the New Economic Policy with the objective of promoting national unity and stability. The New Economic Policy consisted of the two strategies: to eradicate poverty and restructure the society to eliminate the identification of race with economic functions as a solution to avoiding further civil disorder. Meanwhile, several new issues have emerged which include globalization, a shifting of the political landscape in the country, expectations of the new generations, and the Asian economic crisis and its aftermath.



Figure 1. Map of Malaysia

### C. REASONS FOR THE STUDY

Malaysia's New Economic Policy, which resorts to positive discrimination of the *Bumiputera* racial group in order to reduce the economic income gaps between the major races for racial harmony and political stability, is a contentious policy issue. It certainly goes against the flow of contemporary opinion especially in this era of globalization where competitiveness is the buzzword. However, Malaysia has to combine racial equity with economic growth in order to remain politically stable and have harmonious relations between different ethnic groups. In reference to the controversies, the present Prime Minister, Dr. Mahathir Mohammad states:

Malaysia's NEP was a form of affirmative action, a form which stressed the results. Here was an instance where the ends justify the means. Having admitted that the distribution of wealth between the races in the country was unfair, we were willing to be unfair, in order to achieve fair results and the equitable distribution of wealth.<sup>4</sup>

We will study the NEP by looking at balanced development through various means. The United States of America, for example, tempers development with restraints such as anti-trust laws and fair labor laws, equal employment opportunities and affirmative action programs and environment protection policies. One of the resolutions of the White House Conference on Balanced National Growth and Economic Development in July 1978 stated "We believe that economic well being for all will be best served by balanced long term economic growth with specific targeted programs for the distressed ..."<sup>5</sup>. This statement illustrates the need for development with socio-economic responsibility or growth with equity.

The relationship of cultural pluralism to economic inequality in a postcolonial society has to be closely examined. Economic progress, political stability, even perhaps the survival of many developing countries, largely depends on how well they solve or live with the problems of cultural and religious pluralism. Much of the renewed focus on inequality is driven by concerns that some groups are being left out of development, that

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<sup>4</sup> Mahathir Mohammad, *The Way Forward*, London: Widenfeld and Nicholson. 1998. p. 85.

<sup>5</sup> Balanced National Growth and Economic Development, White House Conference, Final Report July 1978 Washington D.C. Jan 29-Feb 2, 1978.

globalization and technological change favor those better off and the more skilled individuals, and that the rich acquired their wealth unfairly.<sup>6</sup>

If the NEP is proven to have worked for the betterment of Malaysia for the past thirty years, then it is likely that the policy will be continued in some form. However, Malaysia also needs to be aware of new realities, and the necessity to modify the NEP in order to balance the desire to maintain the policy of giving economic parity between the racial groups in the country and the need to seek competitiveness, maximum efficiency, and the confidence of investors.

The day may come when such delicate balancing may not be necessary at all as everyone will have a level playing field and will be content with their share of the country's wealth and prosperity, whatever the race. Malaysians eagerly await that day. Until then, their country has to modify the development policies to suit the situation for longer-term development, growth and stability.

In view of the frequent worldwide religious and ethnic conflicts, it is edifying to analyze how this policy has managed to contain ethnic strife in a pluralistic Malaysia. Malaysia is a good case to study because it has much in common with other significant groups in developing countries. The problems and challenges of inter-ethnic relationships are not unique to Malaysia alone. The lessons learned and experiences in dealing with these issues are applicable to the entire world.

#### **D. STRUCTURE OF THESIS**

The study includes looking at the path Malaysia has adopted for balanced economic growth and development; its experience and challenges with an economic experiment on socio-economic equality that emphasizes the ethnic theme. The emphasis is on how a country can reduce inequality and how these efforts affect economic growth.

Chapter II will discuss development with equality. The reasons that led to widening inequality will be examined in Chapter III. Chapter IV will analyze the NEP. Chapter V will compare Malaysia's case with some selected countries that do not have a NEP. Chapter VI will conclude the study.

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<sup>6</sup> Vinod Abuja, et al., *Everyone's Miracles? Revisiting Poverty and Inequality in East Asia*. Washington D.C., The World Bank, 1997.

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## **II. LITERATURE REVIEW**

### **A. INTRODUCTION**

The premise behind Malaysia's New Economic Policy is that an economically equitable nation will enjoy a more sustainable development and growth. An equitable society, we believe will be more united, stable and resilient, due to reduced jealousy and envy among the people involved. The resultant unity will foster political stability and contribute to peaceful coexistence, which is vital in a multi-ethnic, multi-religious nation. Enduring peace creates the safe haven for governments to build infrastructures and plan competitive strategies in order to foster attractive climates for commercial, economic or other development activities that promote confidence to attract foreign investors. Foreign Direct Investment (FDI), in turn, further contributes to the economic development of the country.

The focus in this chapter is on the relationship between inequality and development, with an emphasis on the pluralistic society. The intent is to establish the relationship between inequality and development, and examine strategies countries should adopt to maintain the maximum equilibrium. The belief is that pursuing development while simultaneously maintaining economic, social and political equality is a better model in the long run especially amongst ethnically diverse groups. Disparity, be it economic, social or in political power, has created havoc in many developing nations such as Zimbabwe, Liberia, South Africa, Sri Lanka, the former Yugoslavia, India, Tajikistan, Somalia and Nigeria to name a few. Havoc, riots, and civil wars are anathema to development and stability.

Answers to the question whether and how inequality affects growth are very important. They lead into the discussions of what policies, if any, governments should adopt to ensure continuous growth in their respective countries, and prosperity for their citizens. These discussions are especially important now since some believe that globalization has replaced the Cold War as the major determinant internationally, that it has no role for governments bent on protecting their citizenry from competition, and therefore let the fittest survive. Most economists now counsel governments to depend

substantially on markets to set prices and allocate resources<sup>7</sup>. However, even a strong advocate of globalization, Thomas Friedman (2000), argues that there should be a balanced globalization that takes into account the needs of markets, individuals and communities<sup>8</sup>.

## **B. INEQUALITY, STABILITY AND DEVELOPMENT**

The question of the relationship between inequality and the process of economic development remains contentious. Does inequality adversely affect development or is it a consequence of development, which must be accepted in a free market economy? One school of thought states that inequality is good for incentives, and thus good for growth. They argue that it is part of a process of change that would ultimately benefit all strata of society. Yet there are scholars that argue, “Greater equality in developing countries may in fact be a condition for self sustaining growth.”<sup>9</sup> These polemics lead to the important question of whether equality, especially income and wealth equality, can promote stability, higher rates of growth and prosperity in a developing nation.

### **1. Inequality Motivating Competition**

Ludwig von Mises (1955), in his work *Ideas and Liberty*, states that inequality of wealth and income is an essential feature in a market economy.<sup>10</sup> He describes competition in a market economy as a tool that makes the consumer supreme by giving them the power to force all those engaged in production to comply with orders, and forces those involved in production to do their utmost for the consumers. According to him, he who best serves the consumers profits the most and accumulates riches.

It is true that competition works in a market economy, and competition produces inequality as argued by Ludwig Von Moses (1955). However, in our opinion, Ludwig’s acceptance of inequality as an inevitable outcome in a market economy is flawed. Unequal incomes cause discontent, such as mutinous feelings by peasants towards large landowners. In such cases, there is cause for concern and government intervention, such as with efforts at redistribution. Even in America, the greatest free market country in the

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<sup>7</sup> Malcom Gillis, et al, *Economics of Development*, (New York: Norton and Company), 1996, p. 15.

<sup>8</sup> Thomas Friedman, *The Lexus and the Olive Tree*, (New York: Random House), 2000, p. 474.

<sup>9</sup> Phillipe Aghion, Eve Carolli, and Cecilia Garcia-Penalosa, “Inequality and Economic Growth: The Perspective of the New Growth Theories”, *Journal of Economic Literature*, Vol. 37, Dec 1999, p. 1615.

<sup>10</sup> Ludwig Von Mises, *Ideas and Liberty*. May 1955. <http://pages.prodigy.com/sovereign/mises.htm> dated 28 Feb 2002.

world, there is a significant amount of redistribution occurring as a result of the Civil Rights Movement of the 1960s<sup>11</sup>.

## **2. Equality For Stability**

At least in theory, equality of income and wealth was the centerpiece of socialist ideology, and democratic countries too, stress equality. Gradstein and Milanovic (2000) found an inverse relationship between the variables of democracy and income equality,<sup>12</sup> indicating that the more democratic a country, the lower the level of inequality of wealth and income. According to them, a poorer individual becomes a decisive voter and will choose parties that favor higher redistributive taxes and lower inequality. New democratic ideology legitimates a major redistribution of political power that favors the majority, which is the disadvantaged element of the society<sup>13</sup>. This increased political inequality has led to more social equality because the major electoral demands made on modern political elites has been for a more egalitarian distribution of material goods<sup>14</sup>. Citizens vote for parties appealing to the middle and the working classes. Therefore, both the socialist systems and democratic systems strive to avoid inequality. Only the approaches differ, but the intentions are the same.

Large income inequality exacerbates the vulnerability of populations in humanitarian emergencies. Alesina and Perotti's (1994) study of 71 developing countries in 1960-1985 finds that income inequality, by fueling social discontent, increases socio-political instability as measured by the number of deaths in domestic disturbances and assassinations per million population and coups both successful and unsuccessful<sup>15</sup>. As the masses of the poor see their chances of escaping acute poverty diminish, they are likely to grow resentful of those whose growing wealth is painfully evident around them. Once a population is dissatisfied with income discrepancies and social discrimination, as were the majority of nonwhites in white-ruled South Africa, the rising anger that occurs when the government fails to reduce poverty and inequality might actually spur a revolt.

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<sup>11</sup> Bakri Musa, *Malay Dilemma Revisited*, (San Hose to Excel), 1999, pp. 191-210.

<sup>12</sup> M. Gradstein, and B. Milanovic, *Does Libert  = Egalit ? A Survey of the Empirical Evidence on the Links Between Political Democracy and Income Inequality*. Working Paper. Washington, DC: World Bank. 2000, p. 3.

<sup>13</sup> Ibid, pp. 4-5.

<sup>14</sup> Ibid, p. 5.

<sup>15</sup> Ibid, p. 3.

Nafizer (2000) states that objective grievances of poverty and inequality contribute to war and “humanitarian emergencies”. The risk of political disintegration increases with a surge of income disparities by class, region and community.<sup>16</sup>

Economic unrest has also emerged in other societies where the gap between the rich and the poor has become conspicuously greater. For example, even prior to the Asian Crisis, economic discontent fueled protests and riots in Indonesia, where the rising national income failed to improve the lives of millions of low paid factory workers<sup>17</sup>. Similar unrests have been seen in Brazil, Mexico, Thailand and other newly industrialized nations.<sup>18</sup>

Siddharth Chandra (2002) has studied the causes of anti-Chinese violence in Indonesia and concluded that disproportionate gains in wages between the Chinese and non-Chinese have been the cause of ethnic violence. She also noted that greater “relative deprivation” contributed to higher discontent<sup>19</sup>. Even an icon of globalization, George Soros, has admitted that inequality is stressful. In an interview with the *Wall Street Journal*, he said: “It is generally acknowledged that the gap between the haves and have nots is getting wider, and that is a basis for growing disenchantment and stress”<sup>20</sup>

Jack Snyder (2000), in his book, *From Voting To Violence*, describes Sri Lanka’s failure to address the disparities in income, wealth and political power between the majority Buddhist-Singhalese and the minority Hindu-Tamils as the major cause of its ethnic strife and underdevelopment.<sup>21</sup> Snyder describes that (though) Malaysia’s approach is less democratic after the 1969 riots, enabling it to impose “lopsided compromises that discriminated massively in favor of the ethnic Malays in education and

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<sup>16</sup> Wayne Nafziger and Juha Auvien, “Economic Development, Inequality, War, and State Violence” in *World Development*, Vol. 30, No. 2, pp. 153-163, 2002, <http://www.elsevier.com/locate/worlddev> dated 1 March, 2002.

<sup>17</sup> Michael Claire and Yogesh Chandrani, *World Security: Challenges for a New Century*, (New York: St. Martin’s Press), 1998. pp. 61-71.

<sup>18</sup> Ibid.

<sup>19</sup> Siddharth Chandra, “Race, Inequality and Anti-Chinese Violence in the Netherlands Indies”, *Explorations in Economic History*, Vol. 39, No. 1, Jan 2002, pp. 88-112.

<sup>20</sup> David Bank, “The Man Who Would Change the World”, *Wall Street Journal*, March 14, 2002, pp. B1.

<sup>21</sup> Jack Snyder, “Nationalism and Democracy in the Developing World” in *From Voting to Violence*. (Washington: Norton and Company, Inc. 2000).

state employment”, it also creates “a favorable economic conditions for Chinese owned private enterprise”. In contrast, various Sri Lankan governments were beholden to the Singhalese majority only. Malaysia had used the cross ethnic power sharing alliance, whereas in Sri Lanka, the government had to rely on the powerful and partisan Buddhist monks in the villages to appeal to the majority of the rural Singhalese. Snyder has also advised that Malaysia should use the successful economy to transition to more cross cutting in cultural, economic, class, and gender areas that may reduce the significant Malay-Chinese split.

Snyder’s article has indicated that reducing inequality is a delicate process of trade-offs, even by truncating democracy. Nevertheless, equality is essential to economic growth, peace, stability and prosperity. He described Malaysia’s attempts as a trade-off between sharing political power between the Malays with the Chinese, and the policies of positive discrimination for the Malays in government employment and education as contributing to a better situation in Malaysia than in Sri Lanka.

### **3. Causes of Inequality**

After three decades in which rapid growth and reduced inequality have been the defining characteristics of what has become known as the East Asia economic miracle, there is growing evidence that inequality is beginning to appear again in some of the region’s economies. Recent figures have shown that in China, Hong Kong, Thailand and the Philippines, inequalities are on the increase. Only in Malaysia, from 1973-1989, has there been any sign of pronounced decline in inequality<sup>22</sup>. Table 1 shows the trend.

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<sup>22</sup> Vinod Ahuja, Beru Bidani, Francisco Ferreira et al *Everyone’s a Miracle? Revisiting Poverty and Inequality in East Asia*. (Washington: The World Bank) 1999, pp. 25-31.

| Economy     | Period | Measured Variable  | Gini Coefficient <sup>23</sup> |         |
|-------------|--------|--------------------|--------------------------------|---------|
|             |        |                    | 1 <sup>st</sup> Yr             | Last Yr |
| Hong Kong   | 71-91  | Income/household   | 40.9                           | 45.0    |
| Singapore   | 73-89  | Income/household   | 41.0                           | 39.0    |
| China       | 85-95  | Income/capita      | 29.9                           | 38.8    |
| Philippines | 85-94  | Expenditure/capita | 41.0                           | 42.9    |
| Thailand    | 75-92  | Expenditure/capita | 36.4                           | 46.2    |
| Malaysia    | 73-89  | Income/capita      | 50.1                           | 45.9    |
| Indonesia   | 70-95  | Expenditure/capita | 34.9                           | 34.2    |

Table 1. Inequality in East Asia.  
(From: World Bank Report)

Ahuja, et al. suggest that two basic mechanisms are at play in the increase of income inequality in East Asia:<sup>24</sup>

- Higher education opportunities have increased the wedge between skilled and unskilled labor. Higher education begets higher wages
- Spatial disparity in economic prosperity stemming from a concentration of economic activity in certain areas to the exclusion of others.

There are three basic reasons why inequality is undesirable:

- Inequality tends to lessen poverty reduction efforts. As the income wedge gets greater, more resources are needed in order for the relatively poorer section to catch up. This puts a damper on efforts to catch up.
- Individuals in society may place an intrinsic value on equality and a sense of social cohesion arises from it. If the inequality gap is not addressed, there will be social discontent.
- May hamper growth, as a policy on redistribution may be needed to allow the poorer sections to catch up at the expense of additional growth.

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<sup>23</sup> In this thesis the term inequality is used to mean differences in income and wealth, measured from the differences in household incomes and corporate wealth ownership across racial lines. The Gini coefficient is a measure of the equality on a scale of 1 to 0, where 0 represents uniform equality and 1 represents total inequality.

<sup>24</sup> Ahuja, et al., (1999)

#### 4. Development and Growth<sup>25</sup>

Growth can be an antidote for misery and poverty. Growth, or the absence thereof, affects the material well being of 4.5 billion citizens of developing countries. Without growth, people can only become better off by transfers of income and assets from others. However, at times, growth can be pursued for the wrong reasons. Governments are known to pursue development and growth to augment power and glory of the state and its rulers such as by buying unnecessary weaponry or pursuing egomania development projects. Others heavily invest resources for further growth without much immediate gain for the poor. The incomes and consumption of nations can increase, yet the benefits are mostly distributed to the already relatively well off<sup>26</sup>. This course of action will, obviously, set off inequalities and social discontent as discussed earlier. Policies for growth must also be rational and generate the maximum cost-benefit for the country, yet must be sensitive enough not to leave any group behind in the development process. Judicious concentration of efforts and resource allocation is very pertinent if nations are to obtain the maximum benefit.

According to Gould and Raffin (1993), variables that encourage growth are schooling, educational investment, capital savings, investment in equipment and human resources, whilst variables that discourage growth are government consumption spending, political and social instability, trade barriers and socialism<sup>27</sup>. Thus, governments and policy makers should intervene in the economy to adopt policies that promote growth, and refrain from falling into the areas that cause a reduction in growth. The NEP of Malaysia has tried to follow this course of action by promoting growth-inducing policies and thereby prevents instability.

Gillis, et al., (1996) argue that nations can concentrate on balanced growth by developing all aspects of an industry such as mining, agriculture and industrialization, and on unbalanced growth such as import substitution, or entertain an all out export strategy<sup>28</sup>. They also advocate that material growth must have a close relationship with

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<sup>25</sup> Though they are quite different, this paper treats them as interchangeable.

<sup>26</sup> Cit, p. 69.

<sup>27</sup> Gould and Raffin, "What Determines Economic Growth?", *Economic Review*, 2<sup>nd</sup> Quarter, 1993.

<sup>28</sup> Gillis, et al, pp. 63-65.

human welfare and development, and issues of inequality and poverty must also be addressed. This is in accordance with Malaysia's policies of expanding the economic pie, whilst restructuring the society. The twin objectives of the NEP were:<sup>29</sup>

- Eradication of poverty irrespective of race
- The elimination of the identification of race with economic function

### **C. WHAT STRATEGY SHOULD BE ADOPTED?**

It is obvious that countries need growth and development to progress. Balanced growth and development is an indisputable way to eradicate poverty. Economic growth enables some or even all people to become better off, without anyone necessarily becoming worse off. Nevertheless, economic growth alone is not a sufficient condition for improving mass living standards, as distribution of income is also important<sup>30</sup>. The preceding discussions point to the need for a balance in development, especially for the need of equitable development or growth.

It is our belief that governments should pursue a balanced and equitable growth. For countries that are ethnically and religiously divided, equality, especially in income and wealth, should be of concern if it crosses ethnic and religious lines. Governments should be striking an optimum balance between the goals of economic growth and equity; ensuring a balanced development of the major sectors of the economy, reducing and ultimately eliminating the social, economic and regional inequalities and imbalances, and ensuring material welfare while instilling positive social and spiritual values.

Policy makers should also give priority to human resource development; making science and technology an integral component of development planning; and ensuring the protection of the environment to maintain the long-term sustainability of the country's development. Klaus Deininger and Pedro Olinto in a World Bank report recommended that human capital should be made a growth-enhancing asset, supporting the emphasis of policy makers on education as one instrument to overcome inequality. They also recommend innovative programs to foster the acquisition of productive assets to help the poorer segments to utilize labor in more productive ways<sup>31</sup>.

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<sup>29</sup> Mahathir Mohammad, (1999) p. 9.

<sup>30</sup> Malcom Gillis, et al, *Economics of Development*, (New York: Norton and Company), 1996, p. 68.

<sup>31</sup> Klaus Deininger and Pedro Olinto, "Asset Distribution, Inequality, and Growth", *World Bank Report*.

The question of the intervention of the government in this age of globalization still exists. Globalization is a new phenomenon to be reckoned with. Thomas Friedman (2000) in his book *The Lexus and the Olive Tree* advises nations to take heed of the forces of globalization that have no boundaries and cannot be stopped from entering the country. If a country tries to prevent this new force, it will be left behind in the economic development due to a lack of foreign direct investments and capital inflows. The author calls for competitive policies and transparency to foster investors' confidence. A policy of redistribution must take these factors into consideration in planning.

The author is correct that, as in a globalized world, investors want to go where costs are lowest and seize the chance to make maximum profit. A redistribution policy must not make Malaysia's costs higher. While redistributing wealth and income, Malaysia has to improve its productivity and become more cost effective.

#### **D. CONCLUSION**

Growth and development are desirable, as they can eradicate poverty and improve the standard of living in developing nations. However, uncontrolled growth and economic development, if left to the total mercy of market forces, tend to be disadvantageous to the already weaker groups in a nation. This situation will develop into disparities and inequalities in wealth and income between the various groups. If the rift is across racial and religious lines, the situation can cause instability and escalate into riots and civil war, which is detrimental to further growth. Inequality or disparity in income, wealth or political power is the major cause of conflicts in the developing world. When this happens, economic growth will suffer and lead to more problems for the country. Thus, governments are advised to adopt policies that provide growth with equality.

We believe that government policies must address the issue of reversing inequality. Strategies such as reducing poverty, redistributing wealth, taking affirmative actions, and having access to higher education are just some of the strategies. Attempts to reduce imbalances can make an economy less efficient in the allocation of resources, and can hinder the competitiveness of a country. However, judicious policies that strive to develop whilst maintaining equality amongst the population are more sustainable in the long term as they provide political and social stability. Stability will in turn encourage further economic growth.

Efforts to narrow the gap will help nations develop and become more peaceful and prosperous. However, the country cannot perpetuate this redistribution policy forever, as the measures are a hindrance to competitiveness, which is very much needed in this era of globalization. At most, it should be used as a respite to give the stragglers time to catch up, and then the country should move forward towards sustained growth with maximum competitiveness.

### III. HISTORY OF MODERN MALAYSIA

#### A. INTRODUCTION

This chapter traces events from the founding of the Malay Sultanate to modern day Malaysia. It is a chronicle of the development of the Malaysian people, namely the Malays, Chinese, Indians and other ethnicities that compose the multi-racial and pluralistic Malaysia. For the Chinese and Indians, it is a history of having to adapt to a new homeland. For the Malays, it is a history of being colonized by the Western powers of Portugal, Holland and Britain and having to learn to adopt the policies imposed upon them. The Japanese occupation taught them that an Asian people could also defy the mighty British, and had germinated the awareness that they would be able to control their own destiny one day through self-governance.

The Malays had no choice but to resign the fate of their nation to the British who brought in the Chinese and the Indians to exploit the country's resources. Eventually, the Malays were forced to take in these immigrants as equal citizens as a prerequisite for independence.<sup>32</sup> However, they adjusted, and were willing to share political power for an equal share of the nation's economic prosperity.<sup>33</sup> Snodgrass (1980) describes the onset of independent Malaya as "...the beginning of a political system in which Malays, Indians and Chinese representatives in a permanent coalition aimed at resolving conflicts of group interests through elite bargaining."<sup>34</sup>

#### B. THE EARLY DAYS

The written history of Malaysia began in 1405 with the founding of Malacca by a Hindu prince from Sumatra. He then embraced Islam and started the Malacca Sultanate, which evolved into various other Muslim Malay Sultanates in the states of the Malay Archipelago after the fall of Malacca to the Portuguese and then to the Dutch.

After Malacca was captured, the new Muslim trading centers flourished in Johore and later in Perak. Both the Minangkabau immigrants from Sumatra and the Bugis from

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<sup>32</sup> Mahathir Mohammad, *The Way Forward*, (London: Weinfield and Nicholson 1999), p. 3.

<sup>33</sup> Ibid. p. 8.

<sup>34</sup> Donald Snodgrass, *Inequality and Economic Development in Malaysia*, (Kuala Lumpur: Oxford University Press, 1980), p. 7.

Celebes immigrated to the peninsula in large numbers leaving lasting cultural influences. In the late 1860's, a number of Malay kingdoms began fighting each other for control of the throne of Perak causing enough of a disturbance in the region to inspire Britain to intervene and essentially force the Malay rulers to sign a peace treaty known as the Pangkor Agreement in 1874. The treaty, unsurprisingly, gave Britain a much greater role in the region, which it would need in order to maintain its monopoly on the vast amount of tin being mined in the peninsula<sup>35</sup>.

### **C. BRITISH RULE**

Though various colonial powers had ruled Malaysia<sup>36</sup>, it was the British who were the most influential in latter day Malaysia. Under British rule, nine Malay states combined and formed the Federation of Malay States together with Malacca, Singapore and Penang. These states evolved into the Federation of Malaya, and in 1963, Malaysia. British administrators changed Malaysia's racial composition forever by transplanting large numbers of Chinese and Indians from their homeland into Malaysia, and forcing the local Malays to accept and live with the immigrants as equal citizens. Their divide and rule policy resulted in uneven economic, educational and social developments much favorable to the former immigrants and started the stereotyping of ethnicity with economic activity. These initial disparities later perpetuated into race relations problems in Malaysia.

The British role on the Malaysian peninsula began in 1786, when Francis Light of the British East India Company, while searching for a site for trade and a naval base, obtained the cession of the island of Penang from the Sultan of Kedah. In 1791, the British agreed to make annual payments to the Sultan, and in 1800, the latter ceded Province Wellesley on the mainland. In 1819, the British founded Singapore and in 1824, they formally acquired Malacca from the Dutch but actual control had been exercised since 1795. A joint administration was formed for Penang, Malacca and Singapore, which became known as the Straits Settlements.<sup>37</sup>

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<sup>35</sup> *Colonial Malaysia AD 1400-1957*, <http://www.geographia.com/malaysia/history04.htm>, dated 8 April 2002.

<sup>36</sup> The Portuguese captured Malacca in 1511, the Dutch took over in 1641, and the Japanese in 1942. The English exchanged Malacca for Batawi in Indonesia in 1795.

<sup>37</sup> Foreign Influence <HTTP://WWW.INFOPLEASE.COM/CE6/WORLD/A0859448.HTML>, dated 8 April 2002.

Newly discovered veins of tin deposits eventually led to British control of the Malay States. Fighting over the thrones and control of the tin revenues, the Malay rulers sought help from the Chinese secret society clansmen and the British. Eventually, the British intervened in all Malay States to “keep law and order”, or to prevent other colonial powers such as the Germans from peddling their influence<sup>38</sup>. During 1878-88, the British entered into agreements with the Sultans of Perak, Pahang, Selangor and the Ruler of Negeri Sembilan to provide British Resident Advisors on all matters except Malay customs and the Muslim religion.<sup>39</sup> These states then formed the Federated Malay States (FMS) in 1896. By 1914, five more states, Johor, Kedah, Perlis, Kelantan and Trengganu, were forced to accept Resident British Advisors and the Unfederated Malay States was formed. These nine states, together with Malacca and Penang of the Straits Settlements later formed the Federation of Malaya in 1948.

Naturally, British companies managed the tin mines and established rubber plantations. These were premium commodities from the late 1800s until the 1960s. Since the local Malay population was neither large nor interested in working in the tin mines or on the rubber estates, migrant workers from China and India were brought to Malaya. From 1786-1947, a large number of workers from China and India immigrated, and to a lesser extent from Indonesia<sup>40</sup>. Some groups of Indians were brought in from India and Ceylon as colonial public service officers due to their greater competence in English and their familiarity with the British administrative system in India<sup>41</sup>. Thus, a large portion of civil service, such as the Public Works Department, the railways or technical services were dominated by the Indians in the early days. Most of the Chinese worked in the tin mines and the majority of the Indians in the rubber industry<sup>42</sup>.

The rubber and tin mining industries spawned urban townships where the Chinese and Indians settled. Much to their merit, the early immigrants worked very hard and were tenacious. They endured hard labor and harsh conditions to live spartanly on the estates,

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<sup>38</sup> Anis Chowdhury, “Malaysia in Transition” in Abu Walid, (ed) *The ASEAN Region in Transition*, (Singapore: Ashgate 1997), p. 44.

<sup>39</sup> Ibid.

<sup>40</sup> David Lim, *Economic Growth and Development in West Malaysia 1947-1970*. (Kuala Lumpur: Oxford University Press, 1973), p. 69.

<sup>41</sup> Snodgrass, (1980) p. 40.

<sup>42</sup> David Lim (1973), p. 69.

the *kongsi* or clansmen dormitories. Others, however, had access to education and were involved in commerce established by British administrators. British import and export houses needed intermediaries to trade with the rural population and the commercially-minded Chinese immigrants were quick to seize the opportunity<sup>43</sup>. The emphasis on Chinese enterprise at that time was a common feature in Southeast Asia then. Under colonial rule, the Chinese were merchants, tax collectors and operators of trading monopolies. This provided the springboard for the Chinese in Indonesia, Thailand and Malaysia to become the driving force behind capitalist development.<sup>44</sup>

The indigenous Malays farmed their rural lands and mostly involved themselves in agriculture and fishing. Malay access to many important forms of employment, such as professional, administrative and clerical, was largely a function of education. Colonial policy quite explicitly held the Malays back from the types of education that would provide such access<sup>45</sup>. Colonial fears of the political effects of widespread proficiency in English on the urban oriented education for Malays were often explicit in official pronouncements of the times<sup>46</sup>. Education in Malay was rural in its orientation, aiming “to make the son of a fisherman or peasant a more intelligent fisherman or peasant than his father had been, and a man whose education will enable him to understand how his own lot fits in with the scheme of life around him”<sup>47</sup>

The Malays posed no competitive economic threat to European economic interests but because their political legitimacy in Malaya was never directly challenged, they were, by far, the greatest political threat. This fact does seem to provide at least a partial explanation for official policies that limited Malay economic opportunities.<sup>48</sup> On the other hand, both the will and ability to make more sophisticated and far reaching adjustments to changes for opportunity readjustment which required changes in living

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<sup>43</sup> David Lim (1973), p. 69.

<sup>44</sup> Vera Simone and Anne Thompson Feraru, *The Asian Pacific Political and Economic Development in the Global Context*, (New York: Longman’s Publications), 1995. p. 198.

<sup>45</sup> Snodgrass (1980) p. 31.

<sup>46</sup> Ibid.

<sup>47</sup> Ibid.

<sup>48</sup> Snodgrass, (1980) p. 34.

conditions and life styles do seem to have been weak, especially when compared to the impressive ability of the Chinese in these matters.<sup>49</sup>

The British left the Malays to tend their padi-fields, put the Indians in the fledging civil service and encouraged the Chinese to dabble in commerce. Thus, amid the neglect of the Malays and paternalism of the colonial masters, the Chinese businessmen prospered.<sup>50</sup> It was to be the beginning of a situation where economic activity was identifiable by ethnicity, and income inequality widened amongst the ethnic groups.

#### **D. JAPANESE OCCUPATION**

British rule was interrupted for four years during World War II when the Japanese occupied Malaysia from 1941-1945. The Japanese occupation was a period of deprivation in which inter-group relations worsened under the strain of sharply differing treatments by the Japanese occupation forces. China and Japan had been at war since 1934, and therefore, the Chinese in Malaya received the harshest treatment and provided practically all the underground opposition<sup>51</sup>. Being bitter enemies of the Japanese, a number of Chinese men formed a resistance guerrilla group called the Malayan Peoples' Anti Japanese Army (MPAJA) with ties to the Chinese Communists. By contrast, the Malays and Indian accepted the occupation with more equanimity and in many cases actively cooperated with the Japanese.

#### **E. THE MALAYAN COMMUNIST PARTY INSURGENCIES**

Japan's surrender in 1945 before the arrival of the British reoccupation forces was followed by a brief period of chaos. The MPAJA guerillas saw the opportunity to seize power in Peninsular Malaysia. This further exacerbated the ethnic tensions when wartime scores were settled and Chinese guerilla forces temporarily seized control of some small towns<sup>52</sup>. In the process, this movement, consisting mostly of the Chinese "freedom fighters", had also committed acts of atrocities against the Malay villagers and soldiers. The Malays retaliated in kind and became even more anti-Chinese in the immediate years

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<sup>49</sup> Snodgrass (1980) p. 34.

<sup>50</sup> Ibid. p. 60.

<sup>51</sup> Ibid p. 19.

<sup>52</sup> Ibid, p. 20.

that followed<sup>53</sup>. This period ended with the arrival of the British reoccupation forces in the form of the British Military Administration (BMA) a few months later.

#### **F. INDEPENDENCE AND SOCIAL CONTRACT OF 1957**

Immediately after the war, the British returned with a scheme to form the “Malayan Union” that proposed placing all nine Malay states and Penang and Malacca under one government. Singapore was to be designated a separate state. The Malays, however, vehemently opposed the plan by denouncing it as a British ploy to abolish the Malay Sultanate. They also objected to the Union’s goal of providing citizenship with equal political rights to all Malaysians, irrespective of race.<sup>54</sup> In May 1946, the Malays formed the political party called the United Malays National Organization (UMNO) whose purpose was to object to the formation of the Malayan Union.

The Malayan Union was abandoned and by 1948 the British had decided to grant self-government to the Federation of Malaya, and worked to find a consensus among the various ethnic groups. The negotiations among the various groups resulted in a compromise whereby the Malays retained political power, and in exchange, allowed the Chinese to continue their economic functions with the understanding that in time more equality would be achieved among the races both economically and politically<sup>55</sup>. There was a social contract that stipulated that the acceptance of the immigrants as citizens and the right to participate in the political process be a trade off with them agreeing to the use of the Malay language, special privileges for the Malays and their broader economic participation<sup>56</sup>.

According to Snodgrass (1980), the essence of the compromise of the “Bargain of 1957” was that the Malays made substantial concessions with respect to citizenship, while the non-Malays recognized the special rights of the Malays without any time limits<sup>57</sup>. The Malays feared being overrun by the non-Malay citizens and losing their political hegemony, which they saw as a counterbalance to the economic strength of the

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<sup>53</sup> Mahathir, (1999) p. 3.

<sup>54</sup> Gomez and Jomo KS, *Malaysia’s Political Economy*, (Cambridge: University of Cambridge Press) 199. p. 11.

<sup>55</sup> Chowdhury, p. 45.

<sup>56</sup> Ibid, p. 46.

<sup>57</sup> Donald Snodgrass, (1980), p. 46.

Chinese<sup>58</sup>. In return for granting the “immigrants” the right to become citizens and tacitly accepting their dominance economically, the Malays were given control politically. Hence, the demand for the recognition of their special position as an indigenous people of the country and measures to accelerate socio-economic progress competitively with the more aggressive immigrants.

In response to accepting the citizenship issue, the Malays received certain tangible and non-tangible benefits. Article 153 of the new Constitution stated that “it shall be the responsibility of the (King) to safeguard the special position of the Malays and the legitimate interests of other communities...” These included employment quotas in public services, scholarships, business permits and licenses and (in Article 89), the reservation of certain lands for the exclusive right of the Malays.<sup>59</sup> Malay was designated the national language but the private use of other languages was specifically guaranteed. Thus, the Malay privileged status as the *Bumiputera* (the sons of the soil) is protected by the Constitution<sup>60</sup>.

It is obvious that the positions of the Malays, Chinese and the Indians differed greatly when independence was declared. Economically, the Chinese and the Indians were by far in the strongest position, not only because they had amassed relatively large amounts of wealth, were very educated and experienced but also because they demonstrated the capacity to adapt to changing circumstances and opportunities. In the political arena, however, the Malays had already seized the initiative because of their historical advantage of legitimacy and their earlier development of nationalism that focused on Malaya. The Chinese and Indians had earlier regarded their stay in Malaya as temporary as they were to return home to China or India after accumulating enough savings, and regarded Malaya as a place of transition rather than as their new homeland.<sup>61</sup> Through their preoccupation with the fast-moving affairs in their homelands, the Chinese and Indians bungled whatever chance they had for a major political say in

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<sup>58</sup> Snodgrass (1980), p.46

<sup>59</sup> Ibid, p. 47.

<sup>60</sup> Vera Simone and Anne Thompson Feraru, (1995) p. 129.

<sup>61</sup> Gomez and Jomo, (1999) p. 11.

post-war Malaya. When they finally decided to opt for Malaya, it was too late to obtain anything more than something along the lines of a junior partner's role.<sup>62</sup>

By August 1957, the Malayan Federation achieved independence. Singapore was also to be given self-rule as a separate nation. In Malaya, a new Constitution also embraced the provisions for granting the Chinese and Indian immigrants citizenship either by birth or by fulfilling the requirements for residency. An additional one million non-Malays were given full citizenship in a country of only five million people<sup>63</sup>. The census in 1953 put the Malayan population at 5.7 million<sup>64</sup>. See Table 2. This is significant because in the 1955 election, the Malays comprised 84 percent of the electorate, whereas in the 1959 election, they comprised only 57 percent<sup>65</sup>.

However, members of the Malayan Communist Party (CPM) regarded the restrictive requirements of citizenship and compromise as a betrayal of their loyalty to the British during the Japanese occupation<sup>66</sup> and launched the same guerilla warfare that they had once deployed against the Japanese<sup>67</sup>. The Malayan Government had to declare a state of emergency from 1948-1960. The ongoing insurrection was by Chinese Communists bent on making the Malay Peninsula a Chinese-dominated communist state<sup>68</sup>. Other Southeast Asian nations such as Vietnam were also undergoing the pro-communist struggle and were well supported by the local population. In Malaysia, the CPM, though receiving Chinese sympathy, did not receive much support from the Malays and finally negotiated for peace in 1989.

## **G. POWER-SHARING**

The preceding events, from the perspective of the Malays, put into doubt the loyalty of the immigrants. Yet, despite their distrust due to the perceived disloyalty of the Chinese and Indians towards the Malayan Federation, the Malays nevertheless were

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<sup>62</sup> Snodgrass, (1980) p. 42.

<sup>63</sup> Mahathir Mohammad, (2000) p. 43.

<sup>64</sup> Frank Golay, et al., *Underdevelopment and Economic Nationalism in Southeast Asia* (London: Cornell University Press). 1969. p. 357.

<sup>65</sup> Snodgrass, p. 48.

<sup>66</sup> During the Japanese occupation, the Chinese had established a guerilla anti-Japanese movement from the Malayan jungles, and this organization again had gone into the jungle to fight against the newly independent Malaysia and British military.

<sup>67</sup> Chowdhury, p. 45.

<sup>68</sup> Mahathir Mohammad, (2000) p. 53.

prodded into accepting them and sharing political power with them. The colonial government had made it a condition that independence would only be granted to a multi-ethnic leadership<sup>69</sup>. Thus, a political alliance calling itself the Alliance Party, led by UMNO leader Tunku Abdul Rahman (later was elected as Malaysia's first Prime Minister) was created in 1955 comprising the United Malays National Organization party of the Malays (UMNO), the Malaysian Chinese Association party (MCA) and the Malaysian Indian Congress (MIC) to form the Malayan Government. It was synergic relationship, too as UMNO, which consisted of poor Malays, was also heavily dependent on the wealthy MCA for financial support, while the MCA needed the UMNO to win seats in elections because, although the Malays comprised only 49 percent of the population in 1955, they made up 80 percent of the electorate.

Again, after the 1969 riots, the Malaysian power-sharing concept was expanded to accommodate a coalition called the National Front (led by Tun Abdul Razak who succeeded Tunku Abdul Rahman) consisting of 10 other parties that were mostly non-Malay based. Three major non-Malay political parties, the Malaysian Chinese Association (MCA), the Malaysian Indian Congress (MIC) and the Gerakan Party, an erstwhile opposition party prior to 1969, represented Chinese and Indians interests. Two East Malaysia based parties represented the interests of non-Muslim *Bumiputeras* from Sabah and Sarawak. The Gerakan was a Chinese and Indian based political party with a few Malay supporters. Chinese and Indian political leaders were given prominent ministries to lead.<sup>70</sup> Again, there were trade offs between the races akin to the social contract at the onset of independence. The Malays could have ruled Malaysia alone as a Malay coalition government with the Islamic Party (PAS) as they had the majority seats in the Parliament. Despite different interests, the three major races managed to work together to share political power to rule the nation.

#### **H. MALAY AND NON-MALAY FEARS AND DISSENT**

Not all citizens agreed with the political and economic compromises of 1957. Although the Chinese business community supported the power-sharing formula by participating in the Government through MCA via the coalition Alliance Party, many

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<sup>69</sup> Terence Gomez and Jomo KS, *Malaysia's Political Economy: Politics, Patronage and Profits*, (Cambridge: University of Cambridge). 1997. p. 12.

<sup>70</sup> Ibid.

others disagreed. The opposition political parties took the opportunity to encourage these dissidents. Amongst the forefront of these opposition parties was the People's Action Party (PAP) headed by Lee Kuan Yew of Singapore<sup>71</sup>. He led the challenge against the MCA for the Chinese support. PAP did not subscribe to the concept of the Malay political hegemony and Malay special rights in Malaysia<sup>72</sup>. Their battle cry was "Malaysian Malaysia"-----equal rights for all citizens based entirely on meritocracy with no discrimination amongst the races. PAP also championed the right for the existence of Chinese schools and retaining the Chinese language and culture. It was an explicit attack on Malay special rights. This political challenge from Singapore only served as a catalyst to increase Malay awareness of the forced compromise with the non-Malay community as represented by the MCA and MIC<sup>73</sup>. In fact, Lee Kuan Yew's approach was very inflammatory and caused Malay-Chinese racial riots in Singapore in July 1964<sup>74</sup>. However, Lee claimed that the riots were instigated by "Malay Ultras" in UMNO as a weapon to discredit his struggle.<sup>75</sup>

When Singapore was asked to leave the Malaysia Federation over these issues and many fundamental disagreements on 9 August 1965<sup>76</sup>, the Chinese and Indian opposition dissenters were championed by new opposition political parties, namely the Gerakan Party, and the Democratic Action Party (DAP) formed in early 1969. A portion of the Malays who did not approve of the power sharing discussions for independence had already formed an opposition party called the Pan Malaysian Islamic Party (PMIP), better known latter by the acronym PAS on 24 November 1951<sup>77</sup>. This Muslim theocratic party wanted to turn Malaysia into an Islamic state, and did not approve of non-Muslims in the government.

The attitude of the People's Republic of China towards overseas Chinese aggravated the suspicions of the Malays concerning Chinese loyalty to Malaya.

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<sup>71</sup> Singapore, a Malaysian state prior to 1948 and in 1963-1965, was ruled by the opposition People's Action Party led by Lee Kuan Yew.

<sup>72</sup> Lee Kuan Yew, *From Third World to First*, (New York: Harper's Collins) 2000. p. xiv.

<sup>73</sup> Zainuddin Maidin, *The Other Side of Mahathir*, (Kuala Lumpur: Utusan Publishing) 1994. p. 17.

<sup>74</sup> Lee Kuan Yew, (2000), p. xiv.

<sup>75</sup> Ibid.

<sup>76</sup> Ibid, p. 3.

<sup>77</sup> PAS webpage [http://www.parti-pas.org/sejarah\\_latar.htm](http://www.parti-pas.org/sejarah_latar.htm), 4 June 2002.

According to Lee Kuan Yew (2000), now the Singapore Senior Minister in his book *From Third World to First*:

The People's Republic of China (PRC) aimed to increase the loyalty of the overseas Chinese to Beijing. In 1949 it formed the Overseas Chinese Affairs Commission. It supported the Chinese education overseas and encouraged the Nanyang (Southeast Asian) Chinese to send home remittances for their relatives. It appealed to (qualified Chinese) to rebuild the Motherland. It was a subversive challenge to the newly independent governments of Southeast Asia<sup>78</sup>.

## **I. POST INDEPENDENCE**

The most salient feature of Malaysian politics since independence is the maintenance of a precarious balance between the conflicting interests of the Malay majority and the Chinese and Indian minorities, and particularly the Chinese. The tacit agreement after independence between the Malay and Chinese leaders was that politics and economics were to be kept separate with the Malays dominating the former and the Chinese the latter.

However, this agreement proved less than satisfactory to the majority of Malays as Chinese wealth brought with it political clout as the income gap between the Malay masses and the Chinese and Indians widened. The Indians and the Chinese had worked their way into an economically advantaged position while the majority of the Malays remained in their traditional occupations of subsistence farming and fishing<sup>79</sup>. The economic policy after independence up to 1970 was basically laissez-faire and this suited the Chinese, Indians and foreign interests. Meanwhile, the ever-resourceful wealthy Chinese businessmen also allied themselves with the politically powerful traditional Malay aristocrats who monopolized government positions despite ethnic rivalries.<sup>80</sup> Some of these arrangements were later to result in a new form of business-political cronyism and thereby causing rifts in intra-Malay relations. These developments further increased the wealth and income gaps between the Malays and non-Malays and a great deal of latent dissatisfaction festered.

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<sup>78</sup> Lee Kuan Yew, *From Third World to First*, (New York: Harper's Collins) 2000. p. 574.

<sup>79</sup> Simone and Anne Thompson Ferura, (1995) p. 129.

<sup>80</sup> *Ibid*, p. 198.

From independence to the late 1960s, the government was preoccupied with defense, internal security and before August 1965, Lee Kuan Yew's attempt to gain power in Malaysia, as well as the need to adjust to Singapore's expulsion from the Federation. Economic growth was to be achieved by a liberal economic policy that assigned the development of mining, industry and much of commercial agriculture to the private sector, which was overwhelmingly foreign and ethnic Chinese in its ownership and management. The government was cast as a rather passive facilitator of such development as well as a more active promoter of rural development, which was intended to improve the lot of the predominantly rural ethnic Malay.<sup>81</sup>

The major events occurring in 1960s were the formation of Malaysia, the Indonesian confrontation and riots, and the NEP. The states of Sarawak and Sabah in East Borneo, and Singapore joined the Federation to form Malaysia. The political position of the Malays worsened as the population of Singapore was 75 percent Chinese, Sabah and Sarawak had a large population of non-Muslim indigenous people, and the Malay-majority Brunei had opted not to join Malaysia at the last minute. However, as stated earlier, Singapore was asked to leave in 1965 over policy differences such as the special rights of the Malays, Chinese education and culture and other fundamental racial issues<sup>82</sup>. Singapore's departure also helped to decrease the non-Malay percentage of the population in Malaysia.

Indonesia, under President Sukarno, objected to the formation of Malaysia and launched the "Konfrantasi" from 1963 until 1966. The Indonesian confrontation had given Malaysian race relations a short respite with people of all races were united for the time being by a common enemy.<sup>83</sup>

## **J. COMMUNAL RIOTS**

Political developments in Malaysia are primarily driven by ethnic tensions and compromises. The Malay-Chinese racial conflict, never far beneath the surface, was exacerbated by an official colonial policy of importing the Chinese, and to a lesser extent the Indians, to develop, under British tutelage, the country that nominally belonged to the

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<sup>81</sup> Snodgrass, (1980) p. 1.

<sup>82</sup> Lee Kuan Yew, (2000) p. xiv.

<sup>83</sup> Zainuddin Maidin, (1994) p. 17.

Malays.<sup>84</sup> The compromise generated between the coalition partners (the Alliance Party) on the eve of independence failed to fulfill the growing expectations of the younger generations. The new generations of Malays, fearing their country was to be dominated by the Chinese especially economically, as had happened in Singapore<sup>85</sup>, wanted more and faster economic gains, whilst the non-Malays were unhappy with their lack of political control.

Tunku Abdul Rahman, then Prime Minister of Malaysia, and his apathetic attitude in race relations and his compromises were causing distrust and uncertainty among people of all races<sup>86</sup>. The Malays continued to lose faith in Tunku Abdul Rahman's<sup>87</sup> leadership, as he was perceived to be too conceding to non-Malays<sup>88</sup>. Malay "young Turks" especially disagreed with his stand of "Let the Chinese be traders and Malays be politicians".<sup>89</sup>

The Chinese felt that they were not being given equal treatment, while the Malays felt that they had already conceded too much and stood to lose all.<sup>90</sup> "The Malaysian Malaysia" concept as introduced by Lee Kuan Yew had deeply wounded the Malays as well as accentuated the resentment of the Chinese. Thus, it was not surprising that racial relations were in a state of disharmony and at times clashes erupted in the country with the potential to destabilize the young nation. It was a potential time bomb, ticking away, with increasing tension.

An early post-independence Malay-Chinese communal riot occurred in July 1964 in Singapore, which was at that time a part of Malaysia, after Lee Kuan Yew's party, the PAP, had demanded the "Malaysian Malaysia" concept<sup>91</sup>. Five people were killed in this riot.

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<sup>84</sup> M. G. Pillai, *Shotgun Wedding Paves The Way for Economic Success*  
<http://www.worldpaper.com/Archivewp/1996/Sept96/pillai.html> dated 8 April 2002.

<sup>85</sup> Singapore was a former Malaysia territory taken over by the British. The population is about 75% Chinese compared to 14% Malay.

<sup>86</sup> Zainuddin Maidin, p. 17.

<sup>87</sup> The first Prime Minister after independence was the main architect of the racial compromise.

<sup>88</sup> Zainuddin Maidin, (2000) p. 17.

<sup>89</sup> Ibid. p. 14.

<sup>90</sup> Chowdhury, p. 46.

<sup>91</sup> Lee Kuan Yew, (2000) p. xiv.

The most damaging chaos, and one that shaped Malaysia's subsequent economic and political policies, however, happened on 13 May 1969. In the general elections of 10 May 1969, the Alliance Party coalition of the three ethnic groups of the Malays, Chinese and Indians fared poorly. Though they had won the Parliamentary elections, albeit by a reduced majority, they lost the two states of Kelantan to the PAS Party and Penang to the Gerakan Party. Communal tensions ran high as the results were perceived in some quarters as reflecting a decrease in UMNO, and hence, Malay political hegemony<sup>92</sup>.

The Alliance Party lost 22 seats in Parliament. UMNO had a net loss of seven; the MIC one seat and the MCA suffered the worst with a loss of 14 seats of the 27 it contested.<sup>93</sup> The implication was the apparent withdrawal of the Chinese support for the MCA and the Malays concluded that the Chinese were repudiating the "Bargain of 1957" and directly challenging Malay political control. It was frightening to the Malays as their economic backwardness had not been overcome while awareness of the economic disparities and determination to do something had increased<sup>94</sup>. The announcement by the MCA leader, Tun Tan Siew Sin that the MCA would withdraw from the Cabinet, although it would continue to support the Alliance in Parliament, had seemed to confirm the impression that the power-sharing formula of inter-ethnics politics was finished.

The opposition parties considered the poor performance of the Alliance to be a major victory. The Chinese opposition parties in particular went further and celebrated what they declared was a Chinese victory over the Malays. The riots' countdown began when the competing political party workers were permitted to hold victory celebration parades in Kuala Lumpur, during which they deliberately taunted each other. The racial riots of 13 May 1969 in Kuala Lumpur<sup>95</sup> were triggered by the perception of the Chinese opposition parties' culturally offensive behavior and insults at their subsequent "victory celebration" and UMNO's angry "victory procession" in response. The official casualty figures were 143 Chinese, 25 Malays, 13 Indians, and 15 others killed and 439 wounded.<sup>96</sup>

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<sup>92</sup> Ian Marsh, Jean Blondel and Inoguchi, (ed), 1999. p. 247.

<sup>93</sup> Snodgrass (1980) p54.

<sup>94</sup> Ibid, pp. 55-56.

<sup>95</sup> Mahathir Mohammad, (1998), pp. 49-50.

<sup>96</sup> Lee Kuan Yew, (2000) p. 233.

As a result of the May 1969 riots, the Malaysian King proclaimed a state of emergency and suspended the Parliament. Democracy was cut short. The country was to be administered by the National Operations Council (NOC) chaired by Deputy Premier Tun Abdul Razak, to govern by decree to restore law and order.<sup>97</sup> Tunku Abdul Rahman, the Prime Minister who was perceived to be too accommodating to the non-Malays, was no longer in charge and ignored. It was a “palace coup” amongst the Malays.

The recession of 1987 had precipitate a near disaster with the potential for another bloody racial riot. The government avoided it with strong measures. Rumors of Malays running amok due to the deteriorating economy brought widespread panic, escalated racial tensions and chaos in Kuala Lumpur. The nation was brought to the brink of another series of racial riots. Emotional speeches by political leaders worsened the situation. However, swift action by the police who had to resort to using the Internal Security Act (ISA), which allowed detention without a trial, kept the situation under control. In the subsequent “Operation Lalang” about 106 people were arrested. Sixty were later released and forty-six were detained for up to two years. According to the White Paper explaining the arrests, various groups who had played up "sensitive issues" and thus created "racial tension" in the country had exploited the government's liberal and tolerant attitude. According to the official explanation, this racial tension made the arrests necessary and forced the government to act “swiftly and firmly” to contain the situation<sup>98</sup>.

Towards the end of the economic crisis of 1997-1998, a Hindu-Malay fight erupted in a place called Kampong Medan in Kuala Lumpur in 2001. Though the reasons sparking the riots were trivial, a petty abusive act of a drunkard, the underlying factors were again economic and social dissatisfaction along racial lines in an economically depressed atmosphere. Six people died in this riot on March 4, 2001<sup>99</sup>. Poor living

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<sup>97</sup> Lee Kuan Yew, (2000) pp. 234-5.

<sup>98</sup> Johan Saravanamuttu, Human Rights Report 2000: Malaysia, University Sains Malaysia. <http://www.undp.org/hdro/events/rioforum/SARAVANAMUTTU.PDF> dated 20 April 2002.

<sup>99</sup> S. Jayasankaran “Poor Squatter Districts Erupt in Violence Prompting Malaysians to Fear for their Racial Harmony”, Far Eastern Economic Review, <http://www.geocities.com/sounvx/klanglama5.htm>, dated 20 April 2002.

conditions and uneven developments of the Malays and Indians living in the community had increased tensions and encouraged the riots.<sup>100</sup>

#### **K. FORMATION OF A NEW ECONOMIC POLICY**

While the immediate cause of the May 1969 riots was political, Malaysian leaders concluded that the root cause was economics. Chinese leaders concluded that the 1969 riots were due to insufficient private investment and economic growth, as there had been a recession in 1967-1968 that the Alliance government did little to counter. The Malay view was that the riots resulted from “economic imbalances” not only in income but also in employment patterns and in the ownership and control of wealth<sup>101</sup>. It was this view that eventually became the official policy.

Tun Abdul Razak created the National Consultative Council (NCC) with representatives drawn from the major races to formulate a new economic policy to restructure the economy so that a more equitable distribution of wealth could be achieved between the races. The emphasis would be to bring the Malays and other *Bumiputeras* into the mainstream economically. The idea was to enrich them without impoverishing the other races and without expropriating their existing wealth. It was hoped that the outcome of the New Economic Policy (NEP), as it was called, would be to foster national unity by eradicating poverty amongst the races and restructuring society by eliminating the identification of occupation by race.

As finally announced, the policy obligated the government to work for the virtual elimination of all “economic imbalances” over a twenty year period and specifically to ensure that by 1990 the income disparity between the Malays and non-Malays was substantially reduced. The Malay share of all levels and types of employment was made to reflect the community’s share in the total population and the Malay stake in the ownership and control of all shares and types of economic enterprise was brought from its current negligible level up to 30 percent of the total. In 1991 the National Development Policy replaced the NEP.

When normalcy returned, the NOC Chairman, Tun Abdul Razak, who was then elected the new Prime Minister, announced the return to democracy and the continuation

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<sup>100</sup> Ibid.

<sup>101</sup> Snodgrass, (1980) p. viii.

of the Parliamentary System in February 1971. Restoration of the constitutional government, however, was followed by the adoption of constitutional amendments prohibiting public discussion of “sensitive issues” that might cause civil unrest<sup>102</sup>. To maintain stability and peace, especially after such an emotional upheaval, chauvinistic feelings had to be contained with the expansion of the Sedition Act. The Act prohibited the discussions of sensitive issues such as Malay rights, the Sultans, the Malay language and other such matters<sup>103</sup>.

The government took various steps to enhance racial harmony, such as to establish a national ideology, the Rukunegara. In this ideology, people of all races were to advance together toward a just and progressive society through a belief in God, loyalty to King and country, the upholding of the constitution and rule of law, and the promotion of moral discipline, tolerance and mutual respect<sup>104</sup>. This surely was emulating Indonesia, a similar pluralist and diverse nation, where the state ideology of “Pantja Sila” was designed as an ideological foundation for rival political forces to live together under the same roof.

To address the perceived lack of political say for the non-Malays, opposition political parties were invited to join the government. The political landscape was changed with the enlargement of the original three-party Alliance Coalition into a ten-party “National Front”. This new coalition consisted, amongst others, of the erstwhile opposition parties of Gerakan which was non-Malay based and had captured the state of Penang, PAS which was Islamic based and had captured Kelantan<sup>105</sup>, and the People’s Progressive Party, an Indian based party, and two East Malaysia non-Muslim based parties. Only the Democratic Action Party remained in opposition. When Parliament was reconvened in February 1971, the National Front cabinet that included new ministers from PAS and the Gerakan party took over the governance of Malaysia from the NOC.

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<sup>102</sup> Vera Simone and Anne Thompson Furera, (1995) p. 251.

<sup>103</sup> Zainuddin Maidin, (1994) p. 111.

<sup>104</sup> Lee Kuan Yew, (2000) p. 236.

<sup>105</sup> However, PAS left the National Front five years later over internal leadership issues and the formation of an Islamic state in Malaysia.

The NEP was presented to Parliament by the new government and was endorsed after debates<sup>106</sup>.

#### **L. THE ASIAN FINANCIAL CRISIS**

The country's three decades of unprecedented economic growth and prosperity was shaken in 1997-1998 with the major economic downturn known as the Asian Financial Crisis. This crisis also affected Thailand, Indonesia and South Korea. Fortunately, with some sensible though controversial policy responses, Malaysia was able to emerge from the crisis fairly successfully.

This is another important era, as it was a test of the efficiency of the NEP. Some NEP policies helped to cause the crisis, such as unbridled loans to inept *Bumiputera* businessmen who used the NEP to gain favorable treatment through political connections. The aftermath of the Asian Crisis laid bare some abuses of the NEP and the Malay community was torn asunder with charges of nepotism in the UMNO leadership by Anwar Ibrahim, heir apparent to Dr. Mahathir, who had fallen out of favor and was subsequently charged and found guilty of corruption and sexual misconduct.

#### **M. CONCLUSION**

British colonialism contributed to the ethnically heterogeneous population by allowing and encouraging immigration especially from China and India. By organizing the Indian immigrants to work the nascent public and plantation sectors, the Chinese in commerce and the tin mines and the Malays in agriculture and fishery, they started the close identification of race with economic functions. With the immigrants concentrated in towns and the Malays in rural areas, the ethnic groups were also geographically divided.

Economic disparity began when the commercially better exposed immigrants had better access to business activities and education and thus were able to secure good jobs and build up commercial networks. They had a good head start and the government's totally free market policy from 1957 to 1970 perpetuated this advantage. The ensuing Chinese hegemony in business networking ensured that they controlled commerce and industry making it difficult for new Malays to compete. The Malays, the majority of whom had been encouraged to remain farmers and fishermen and lacking in education and opportunities, did not advance economically or socially. They remained poor. The

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<sup>106</sup> Mahathir Mohammad, (1999) pp. 58-59.

landmark May 13<sup>th</sup> riots erupted when the Malays' political hegemony was challenged and because they became aware of their wretched and unequal economic situation. They had used their political control to demand economic equality with the other races. It would not be appropriate to let only the Chinese and Indians reap the benefits of Malaysia's success while the Malays remained poor and backward.

The historical development of Malaysia is replete with compromise. The Malays compromised by accepting the Chinese and Indian immigrants as full citizens and brothers after independence although animosity had existed between them earlier. They were willing to share political power by forming alliances with these ethnic groups for a peaceful transition to an independent state from the British, or else the struggle might have turned bloody as occurred in Indonesia when they fought against the Dutch. Later, it was a compromise for peace after the May 13<sup>th</sup> racial riots, even though they could have taken advantage of their majority status in a democratic system and ruled alone as an entirely Malay government. The Chinese and Indian acceptance of the NEP is a compromise for peace, political power sharing and equity between the races. However, most of all, history teaches Malaysians to plan for their own destiny in their own way that will work for them.

| <b>Nationality</b> | <b>Population</b> | <b>Presently<br/>Citizens</b> | <b>Eligible by<br/>Birth for<br/>Registration<br/>as citizens</b> | <b>Eligible<br/>For naturalization</b> |
|--------------------|-------------------|-------------------------------|---|--|
| <b>Malays</b>      | 2, 803, 000       | 2,727,000                     |   | 81,000                                 |
| <b>Chinese</b>     | 2,153,000         | 1,157,000                     | 443,000   | 566,000                                |
| <b>Indians</b>     | 666,000           | 222,000                       | 168,000   | 243,000                                |
| <b>Others</b>      | 84,000            | 33,000                        | 36,000  | 21,000                                 |
| <b>Total</b>       | 5,706,000         | 4,139,000                     | 647,000   | 911,000                                |

Table 2. Citizenship Statistics, 1953.

From: Federation of Malaya Annual Report, 1953. (Kuala Lumpur: The Government Printers, 1958). pp. 5, 6 and 17.

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## IV. THE NEW ECONOMIC POLICY—SHARING OF WEALTH, OPPORTUNITY AND PROSPERITY

### A. INTRODUCTION

In the last chapter, we discussed political power sharing and the social contracts between the races in post-independent Malaysia. In this chapter, we will discuss the sharing of economic wealth, opportunity and prosperity in Malaysia. Specifically, we will examine the reasoning behind the New Economic Policy (NEP), its implementation, progress and problems including the Malaysian financial crisis in 1997-98.

The post-independence period should have been the time to implement the bargain of 1957. For thirteen years after independence, however, the economic situation did not change much and thus resulted in dissatisfaction, especially amongst the Malays, which ultimately led to the May 13, 1969 riots. Galvanized into action in its soul-searching aftermath, the leadership reaffirmed and eventually actively implemented the Malay rights programs that were promulgated in the Constitution in 1957. These programs seemed to work, except for a break during the 1986-87 recession. Malaysia experienced unprecedented growth, stability and prosperity for nearly thirty years. The acid test of the policy's efficacy and effectiveness came during the 1997-98 Asian financial crisis. The country was battered by the ensuing internal turmoil due to economic and political developments. Though buffeted by economic chaos, the nation survived, without seeking help from the International Monetary Fund (IMF). Whereas there was inter-ethnic turmoil in Indonesia, there was relative calm in Malaysia<sup>107</sup>.

The Asian Financial Crisis, nevertheless, brought to light many aspects of the NEP that needed to be reexamined. Externally, a new force called globalization has also put things in a different perspective, as it thrusts upon the people a new openness, realization and changing expectations for nation building.

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<sup>107</sup> Khoo Boo Teik, *Managing Ethnic Relations in Post-Crisis Malaysia and Indonesia*, UNRISD Conference Paper on Racism and Public Policy, Durban, South Africa, 3-5 September, 2001. p. 5.

## **B. WHY THE NEW ECONOMIC POLICY?**

In the last chapter we traced the historical developments that lead to the NEP. In our opinion, a few related reasons to be discussed below had guided to the leadership to formulate the NEP.

### **1. The Malays' Worsening Economic Situation**

The Malays' euphoria over independence wore off after the first decade due to the minimal change in their status. Apart from replacing the British in the administration, the Malays had not seen significant gains in political or economic sectors. The Malays were still poor in comparison to the Chinese<sup>108</sup>. Having accepted the immigrants as equal partners through the ethnic "settlement" bargained for among the Malays, Chinese and Indians at the time of independence in 1957<sup>109</sup>, the Malays discovered that the ensuing stability had benefited Chinese economic activities the most, and continued Chinese economic dominance perpetuated the British era's "separate and unequal" development of the three communities.<sup>110</sup> During the 1960s, economic development not only maintained, but also increased income inequalities, including the income gaps within each major ethnic group in Peninsular Malaysia.

Income distribution in Peninsular Malaysia<sup>111</sup> worsened between 1957 and 1970, especially among the Malays.<sup>112</sup> For example, in 1970, the poverty rate among the Malay households and other *Bumiputera* groups was the highest, at 65%, compared to the Chinese at only 26% and Indians at 39%. The Malays formed the majority of the poor, accounting for 74% of all poor households in Peninsular Malaysia<sup>113</sup>. These developments steadily widened the economic gap between the Malays, the Chinese and the Indians. The Malays began to condemn Chinese and Indian economic domination. A

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<sup>108</sup> Mahathir Mohammad, *The Way Forward*, (London: Weidenfeld & Nicholson) p. 45.

<sup>109</sup> Anis Chowdhury, "Malaysia in Transition", in Abu Wahid (Ed) *ASEAN Region in Transition*, (Aldershot: Ashgate Publishing) p. 56. The British policies were to encourage Chinese and Indian commercial enterprise, and educational progress whilst relegating the Malays to the rural areas to till their lands.

<sup>110</sup> Anis Chowdhury, p. 57.

<sup>111</sup> Peninsular Malaysia is interchangeable with West Malaysia. Sabah and Sarawak are known as East Malaysia.

<sup>112</sup> Edmund Terence Gomez and Jomo Kwame Sundaram, in Ian Marsh, Jean Blondel and Takashi Inoguchi, (ed), in *Democracy, Governance, and Economic Performance: East and Southeast Asia*, United Nations University Press, Tokyo, Japan, 1999, pp. 247-248.

<sup>113</sup> Malaysia, Prime Minister's Department, *Review of the First Outline Perspective Plan, 1971-1990*. <http://www.epu.jpm.my/mservis/opp2/bab203.htm>, dated 22 March 2002.

decade into independence it became obvious that the indigenous people were not getting a fair share of the wealth.

## 2. Ethnic Chinese Economic Dominance

In a study conducted by Yuan-li Wu (1980) in 1970, ethnic Chinese enterprises accounted for 22.5% of the outstanding stocks of limited companies in West Malaysia, compared with 1.7% of the Malays, 61.7% of the foreigners and 14.9% for other Malaysian residents, including statutory bodies, the federal government and state governments. For corporate wealth, the proportion of relative Chinese corporate wealth in Malaysia in 1970 was 26.2% as compared to 0.9% for the Malays, 57.2% for foreigners, 0.1% for Indians, and 15.6% for other residents. These figures are nearly similar to the statistics in Tables 2 and 3. In addition, the Chinese, who constituted 36% of the population, were said to control 85% of the retail trade. The authors quoted government sources that the Chinese controlled 90% of the Malaysian economy at the beginning of the 1970s<sup>114</sup>.

| <u>Ownership</u>           | <u>Amount Owned</u>          | <u>Percentage</u> |
|----------------------------|------------------------------|-------------------|
|                            | <u>Million, Ringgits(RM)</u> | <u>(%)</u>        |
| <b>Individual Malay</b>    | <b>168.7</b>                 | <b>2.6</b>        |
| <b>Trust Funds (Malay)</b> | <b>110.9</b>                 | <b>1.7</b>        |
| <b>Non- Malay</b>          | <b>2233.2</b>                | <b>34.0</b>       |
| <b>Foreign Nationals</b>   | <b>4051.3</b>                | <b>61.7</b>       |
| <b>TOTAL</b>               | <b>6,564.1</b>               | <b>100.00</b>     |

Table 3. The Ownership of Corporate Wealth by Race, 1970.

| <b>Race</b> | <b>% In Poverty</b> | <b>Average Household Income per Month</b> |
|-------------|---------------------|---|
|             |                     |   |
| Malay       | 64.80               | \$ 172.00                                 |
|             |                     |   |
| Chinese     | 26.00               | \$ 394.00                                 |
|             |                     |   |
| Indians     | 39.20               | \$ 304.00                                 |
|             |                     |   |
| Others      | 44.80               | \$ 813.00                                 |

Table 4. Poverty By Racial Composition, Peninsular Malaysia, 1970.

<sup>114</sup> Yuan-li Wu and Chun-his Wu (1980) p. 30.

The perception of the Chinese hegemony in business and commerce in Southeast Asia can be summarized in the June 4, 1974 issue of the *Economist* which stated:

Fourteen million Overseas Chinese are the most formidable economic power in Asia outside Japan. Eighty five percent of them were born in the countries in which they now live. They have no territory of their own except Singapore, but they are united across many borders by a common language, culture and heritage. They operate economically rather like a huge multi-national corporation with its own conduct<sup>115</sup>.

Many Malays believed Chinese economic hegemony to be responsible for Malay economic underdevelopment. For example, attempts to give some Malay agencies the opportunity at cigarette distribution were opposed by the Chinese, who responded by implementing an effective boycott<sup>116</sup>. Advertised job opportunities in Chinese controlled firms often cited fluency in Chinese as a criterion for employment, effectively shutting out Malay applicants<sup>117</sup>. These were examples of Chinese attempts to maintain their supremacy by actively cooperating amongst themselves to prevent new entrants from challenging them. Thus the government needed to actively intervene, so that those left behind could catch up.

### **3. Challenges to the Malays' Political Dominance**

The violent reaction to the non-Malays' challenge to the political concept of power sharing and ethnic bargaining was the manifestation of more than a decade of the Malays' frustrations. It was perceived in some quarters as reflecting a decrease in UMNO's (United Malays National Organization Party), and hence, Malay's, political hegemony<sup>118</sup>.

Malay political control was agreed to in the "bargain of 1957". In August 1965 the Malays in Malaysia gave up Singapore, which was dominated by the Chinese partly due to the fears that Singapore's overwhelmingly Chinese population would tilt the political balance against the Malays in elections. In Malaysia, the Chinese had already been conceded economic hegemony. Thus, maintaining political control in Malaysia was

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<sup>115</sup> Yuan-li Wu and Chun-hsi Wu, *Economic Development in Southeast Asia: the Chinese Dimension*, (USA: Hoover Institution Publication 209) 1980, pp. 29-30.

<sup>116</sup> Mahathir Mohammad, (1998). p. 45.

<sup>117</sup> Utusan Malaysia On line, (trans.) *Deputy PM—Stop Discrimination on Job Applications*, 18 May 2002.

<sup>118</sup> Ian Marsh, Jean Blondel, and Inoguchi, (ed), 1999. p. 247.

a matter of utmost significance to the point of hysteria for the Malays. For the Malays, it was not only a matter of symbolism and psychology, but also a matter of political survival.

#### **4. Uneven Development in Peninsular Malaysia**

The largest contributing factor to dissatisfaction was uneven development, which followed racial lines. Due to many factors to be discussed later, from the time of independence in 1957 until 1970, the distribution of wealth, household income and participation in job sectors was lopsided. In the late 1960s, for example there was high unemployment amongst the educated, and especially so amongst the Malays. The unemployment rate amongst the latter was 25%. Also during this period, the concentration of Malays in the low productivity, agricultural sector was on the increase.<sup>119</sup>

In essence, in the Malaysia of the 1960s, dualism existed. Particular races were generally identified with particular economic functions. The unsettling fact of such dualism was substantial inequality. In addition to economic well being, the inequality could be linked to such areas such as occupation, geographical location, schooling and education opportunities, social mobility, size of the community and household composition.<sup>120</sup>

Amongst the poor, 14% were urban dwellers, and 86% lived in rural areas.<sup>121</sup> The majority of rural dwellers were Malays. Of the country's corporate wealth, as seen from ownership shares in registered business corporations, only about 2.6% belonged to the individual Malays and other indigenous races such as the *Bumiputeras*. Their breakdowns according to racial lines are shown Tables 2 and 3.

Unevenness in income and wealth that happens along ethnic and religious lines in a plural society is a recipe for disaster; a time bomb waiting to explode. Poorer sections felt that the vicious cycle of poverty and helplessness were racial in intent. Resentment degenerates into very intense, emotional, and sometimes, violent ethnic struggles. We

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<sup>119</sup> Kevin Yong, Willem Bussnik, Parvez Hassan, *Malaysia Growth and Equity in a Multiracial Society*. (Baltimore and London: John Hopkins University Press, 1980) pp. 120-121.

<sup>120</sup> Mahathir Mohammad (1998) p. 45.

<sup>121</sup> Malaysia. Prime Ministers' Department. *Dasar Ekonomi Baru*. <http://www.smpke.jpm.my/Rancangan>, dated Jul 24, 2001.

believe this happens everywhere, with the Palestinians and Israelis in the occupied territories, in Bosnia and Sri Lanka to name a few. In Malaysia, it had resulted in the infamous May 13, 1969 racial riots, threatening the very foundation of peaceful Malaysia. Thus, the first major step to solving the problem is to transform unequal racial splits into national cohesiveness unity.

### **C. REASONS FOR DISPARITY AND UNEVEN DEVELOPMENT**

We argued earlier that the colonial policy was the general root cause contributing to the disparity and uneven development in Peninsular Malaysia. In this section we discuss how that occurred.

#### **1. Large Agricultural Sector for the Malays**

A major reason of the inequality in economic progress was the propensity of the Malays to engage in agriculture. Despite the presence of the estate sector, which had high productivity, most agriculture households were engaged in low income, traditional activities with rice and rubber smallholdings. Malays, being the earlier settlers, owned most of the existing developed land and had generally stayed in the traditional areas of agriculture. The immigrant groups of the Chinese and Indians, having no landed property to start with, entered the sectors that proved to be more dynamic such as tin mining, agricultural estates, commerce and manufacturing.

#### **2. Urban-Rural Divide**

The burgeoning rubber and tin industries established townships and the immigrant Chinese and Indians embraced urbanization where opportunities abounded in education, commerce, small-scale industries and estate cultivation. The Malay landowners preferred the laid back lifestyle in the rural areas<sup>122</sup> rather than the hustle and bustle, competitive environment in the towns, mines and plantations. In urban areas where about a third of the total employment was to be found, the non-Malay share of jobs was almost 75%. British colonial policy reinforced this preference and kept the Malays separate from the modern sector. Representation of Malays in most economic sectors, particularly in managerial, professional and supervisory areas, was poor. Poverty remained very much a

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<sup>122</sup> Snodgrass (1980).

rural problem. 88% of poor households were rural, and almost 60% of rural households were poor.<sup>123</sup>

### **3. Pluralism and Multi-Ethnicity**

Many of Malaysia's problems are believed to stem from the multi-ethnic and plural nature of its population. Out of Malaysia's 20 million people in 1996, the *Bumiputeras* constituted 61% of the population, the Chinese 30% and the Indians 8%<sup>124</sup>. The remaining 1% was from minor groups. Racial differences were heightened because the different races believe in different religions. Of the indigenous Malays, the largest group is Muslims. The Chinese are Buddhists and the Indians are Hindus. To make matters worse, the races' share of Malaysia's wealth is also linked to their racial origins. The challenge is not class-based but religious-ethnic in characteristics. The cleavage is sufficiency profound to lead to genuine sense of difference<sup>125</sup>.

As shown in Chapter III, the Malays and other indigenous races or *Bumiputras* had little choice in Malaysia's pluralism because colonial masters brought in the immigrants. When it was time for self-rule and independence, pluralism was also forced upon them because Britain had insisted on converting the migrant Chinese and Indians into Malaysian citizens in exchange for independence for Malaysia. The Chinese and Indians had also insisted on preserving their own culture, way of life and religions. Thus, Chinese and Indian schools exist side by side the national schools. These arrangements were part of the social contract on the eve of independence and promulgated into the Constitution. The Malays had to accept pluralism and live with it. Unfortunately, inter ethnic cooperation was lacking especially in business and commerce. Thus, the Chinese and Indians, with a head start in business, were able to control business and commerce and exclude new entrants such as the Malays by using clanship of the "Kongsis" or trade association networking. It was in their interest to remain in control, but those wishing to enter new fields would never be able to establish themselves and share the prosperity in trading and business. The Chinese controlled small firms and a major part of the

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<sup>123</sup> Prema-chandra Athukora and Jayant Menon, *Globalization, Employment and Equity: The Malaysian Experience* International Labor Organization Regional Office for Asia and Pacific, Bangkok in <http://www.ilo.org/public/english/region/asro/bangkok/paper/malaysia.htm#6pov> dated 15 Mar 2002.

<sup>124</sup> Terence Gomez and Joko ks, *Malaysia's Political Economy: Politics, Patronage and Profits*, (Cambridge: Cambridge University Press) 1999. p. 1.

<sup>125</sup> Ian Marsh, Jean Blondel, and Takashi Inoguchi (1999) p. 339.

country's business matrix did not employ or train Malays or give them managerial appointments. <sup>126</sup>Therefore, ethnic divisions persisted and unfortunately remained along economic lines.

#### **4. TNC Did Not Promote Evenness**

The transnational corporations (TNC) that helped in Malaysia's countrywide industrialization program with foreign direct investments (FDI) rightly concentrated on profits, not social work such as providing better schools, health facilities or other social benefits to their factory workers. Providing amenities would cut into profits. Since most factory workers being Malays, working in factories only made the Malays' economic plight marginally better, but did not enable them to catch up with the Chinese. Thus, promotion of labor-intensive industries did not contribute significantly in the Malays' pursuit of economic parity with the non-Malays.

#### **5. Competitive Austerity Did Not Promote Evenness**

The race for FDI funds was a race of "competitive austerity". Most developing countries try to promote their countries as a place of the cheapest source of manufacturing base. Thus, the government did not support policies to encourage wage increases, union assertiveness, or minimum wages, lest they lose their "competitiveness in austerity" and drive away potential foreign factory owners. Malaysia too, had fallen into this trap in its earlier years of its labor-intensive industrial push. With weak labor unions, wages and social benefits of the "have-nots" did not improve much.

### **D. MEANS OF NEP IMPLEMENTATION**

The logic and arguments for the NEP were accepted by the political leadership and were apparently announced to create the socio-economic conditions for achieving 'national unity' and "nation building" through re-distributive policies. The NEP had two overriding objectives, namely to 'eradicate poverty' regardless of race and to 'restructure society' to eliminate the identification of race with economic function.<sup>127</sup>

The most important objective was poverty reduction as the poor are always the most disgruntled lot in any society. As seen earlier, the incidence of poverty in 1970 amongst the *Bumiputra* was also the highest at 65 % compared to 26% for the Chinese

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<sup>126</sup> Chris Dixon and David Smith, Ed. *Uneven Development in South East Asia*. (Alders Hot, England: Ash Gate Publishing, 1997) pp. 134-144.

<sup>127</sup> M. Bakri Musa, *The Malay Dilemma Revisited*, (New York: to Excel,) 1999. pp. 113-126.

and 39% for the Indians. According to the Post Enumeration Survey of 1970, 78% of poor households were Malays. The mean household income among the Malay community was RM 41 per month, compared with RM 79 per month for the Indians and RM 86 per month for the Chinese.<sup>128</sup> The largest numbers of poor households were in the rural areas where the poverty rate was 58.7%<sup>129</sup>.

The goal was to reduce the official poverty level from 49.3% of all households in 1970 to 16.7% in 1990.<sup>130</sup> The plan was to reduce rural poverty to 23% by 1990 and in urban areas, to 9.1% from 21.3%.

As to the first objective of eradication of poverty, the overall development strategy formulated emphasized export-oriented industrialization, and ambitious rural and urban development programs. Various long-range programs were created to reduce poverty amongst the entire population with an emphasis on the rural poor.

The objectives of restructuring society were to reduce income imbalances among the major ethnic groups and between the urban and rural areas, to restructure the employment pattern at all levels and categories of occupation to reflect the ethnic composition of the population, and to restructure the pattern of ownership and control in the corporate sector so that *Bumiputeras*' share equity will be raised from 2.5% to at least 30%, with the non-Malays Malaysians' share from 34.3% to 40% while the foreigners' holdings would decline from 63.3% in 1970 to 30% in 1990.<sup>131</sup> It also sought to create and develop a viable *Bumiputera* Commercial and Industrial Community through its participation in modern commercial and industrial ventures<sup>132</sup>.

The second objective targeted restructuring the composition of jobs and occupations in Malaysia to reflect the mixture of the ethnic components in all kinds of

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<sup>128</sup> Prema-chandra Athukora and Jayant Menon. Globalization, *Employment and Equity: The Malaysian Experience* International Labor Organization Regional Office for Asia and Pacific, Bangkok in <http://www.ilo.org/public/english/region/asro/bangkok/paper/malaysia.htm#6pov>, dated 15 Mar 2002.

<sup>129</sup> As the Malays were primarily concentrated in the rural areas where there were limited opportunities, the situation led to poverty.

<sup>130</sup> A Review of the First Outline Perspective Plans, 1971-90 at <http://www.epu.jpm.my/mservis/opp2/bab201.htm>, dated 22 March 2002.

<sup>131</sup> Malaysia, Prime Minister's Department. Review of 1<sup>st</sup> Outline Perspective Plans, 1971-1990. <http://www.epu.jpm.my/mservis/opp2/bab201.htm>, dated 22 March 2002.

<sup>132</sup> Malaysia, Prime Minister's Department, Review of 1<sup>st</sup> OPP Plans, [http://www.epu.jpm.my/Bi/issues/restruc\\_society/restruc\\_society.html](http://www.epu.jpm.my/Bi/issues/restruc_society/restruc_society.html), dated 6 May 2002.

occupations. For example, to address the lack of *Bumiputras* in business and commerce, the policy planned to establish *Bumiputera* share capital ownership in limited companies, and increasing the proportion of *Bumiputera* employed in manufacturing and in managerial positions<sup>133</sup>. Policies were established to bring the Malays into the mainstream of business and commerce and education through a redistribution of accrual wealth and not the redistribution of already existing wealth.

The policy needed to be expanded to cater to new programs to eradicate poverty and restructure society. The sources of funds had to come from accelerated growth in order to redistribute “newly acquired wealth”. The old approach of dependence on primary products of rubber and tin for economic resources were unsuitable and inadequate. Establishing import-substitution industries would not be adequate due to the nation’s small population. The government resorted to strategies such as export-oriented manufacturing, gas and petroleum industries, privatization of state industries and some strong authoritarian laws also.

Accordingly, the NEP in the years after 1970 concentrated on aggressive anti-poverty programs “and restructure of society” efforts by way of industrialization, capital investments for the poor, improving quality of life, education, skills training, direct aids to the hardcore poor, building *Bumiputera* entrepreneurship and management expertise.

### **1. Manufacturing and Industrialization**

The most important factor underlying the reduction in poverty and increase in overall living standards in post-970 Malaysia were the growing opportunities for non-agricultural work, particularly in the rapidly expanding export-oriented manufacturing industries. As an economy relying too heavily on agricultural products and primary commodity did not quickly lead to prosperity, Malaysia embarked on rapid industrialization in the 1970s, 1980s and 1990s. Generous tax policies encouraged foreign direct investments (FDI) but with better terms for the workers. When the Japanese and Americans multinational companies relocated their increasingly costly labor-intensive industries to Malaysia where labor was cheaper, the demand for unskilled labor raised real wages by bringing about an overall reduction in poverty in the country.

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<sup>133</sup> Prema-chandra Athukora and Jayant Menon. Globalization, *Employment and Equity: The Malaysian Experience*, International Labor Organization Regional Office for Asia and Pacific, Bangkok in <http://www.ilo.org/public/english/region/asro/bangkok/paper/malaysia.htm#6pov>, dated 15 Mar 2002.

The breakthrough from import substituting industries to the export of manufactures occurred with the establishment of free trade zones, first in Penang in 1970 and then around Kuala Lumpur in 1971. In the 1970s, the Japanese and Americans were looking for alternatives to relocate their increasingly uncompetitive electronic assembly work relying on high cost labor at home. Malaysia was an attractive choice. It was politically stable, was a nice place for foreigners to live as one could even drink the tap water, and Malaysia welcomed foreign investment unlike Taiwan or South Korea<sup>134</sup>. Hence, the beginning of Malaysia's highly profitable electronics assembly, and later, the manufacturing industries.

However, starting in the mid-1980s, the proliferation of cheap labor-intensive industries necessitated a sizeable population of immigrant workers, especially from Indonesia, and Bangladesh, and thus creating new social problems. Again, the government readjusted policy to encourage capital-intensive enterprises that slowly phased out labor-intensive industries and emphasized the transfer of technology and high technology industry.

The success of the electronics industry, flush with funds from booming commodity prices, and petroleum, helped lay the groundwork for a government led effort in the 1980s to change Malaysia's industrial structure towards heavy industries in an attempt to "emulate Japan" as part of Prime Minister Mahathir's "Look East" policy. The government established the Heavy Industries Corporation of Malaysia (HICOM) and other state bodies to go into partnership with foreign companies in setting up ventures in areas such as petrochemicals, iron and steel, cement, paper and pulp, and motor vehicles<sup>135</sup>.

The government's heavy industrialization projects, nevertheless, with the exception of Proton and PETRONAS, was not very successful. In fact, Perwaja Steel suffered massive losses and was a constant source of political embarrassment to the ruling National Front coalition. Heavy industries were supposed to accelerate the

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<sup>134</sup> Dwight Heald Perkins and Wing Thye Woo. *Malaysia in Turmoil: Growth Prospects and Future Competitiveness*. <http://www.econ.ucdavis.edu/faculty/woo/davosmal.html>, dated 18 March 2002, p. 4.

<sup>135</sup> Prema-chandra Athukora and Jayant Menon. *Globalization, Employment and Equity: The Malaysian Experience* International Labor Organization Regional Office for Asia and Pacific, Bangkok in <http://www.ilo.org/public/english/region/asro/bangkok/paper/malaysia.htm#6pov>, dated 15 Mar 2002.

restructure. The crux of the plan was a new cement plant (Kedah Cement), a new steel mill (Perwaja Steel), and an automobile plant (Proton Saga). These heavy industry projects were managed by a new state-owned corporation, HICOM, which undertook massive external borrowing to do so.

These large external borrowing practices also contributed to the Asian financial crisis in 1997. The blowout in public expenditures as a result of massive government investment programs was reflected in widening budget and current account deficits between 1981 and 1986. The macro imbalance was compounded by the terms of a decline in trade in the early 1980s and the subsequent world recession in the mid-1980s (Corden 1993,). The required cuts in government expenditures had invariable contractionary effects on the domestic economy. At the same time, the uncertainty in the policy environment was reflected in the stagnation of private investment, both local and foreign, in the economy. These factors brought the economic advances of the 1970s to a temporary halt and created an environment in which race relations became increasingly tense. In this volatile climate, the government clamped down on various opposition groups and embarked on a series of radical policy reforms<sup>136</sup>.

## **2. Timber, Petroleum and Gas**

Malaysia had an unusually rich natural resource base on which to begin its restructuring, and just as the restructuring was underway, that resource base became even richer with the development of the offshore extraction of petroleum and natural gas, and petroleum and timber channeled large amounts of funds into government and private coffers.<sup>137</sup> The newly formed oil company, Petroliam Nasional (PETRONAS), played an important role in funding ambitious plans to provide capital and loans to newly established entrepreneurs. In the aftermath of the Financial Crisis, it was PETRONAS that was able to rescue many a Malay businessman from total collapse. The commodity price boom in the 1970s also helped, and Malaysia improved its oil palm output to become the largest producer of palm oil.

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<sup>136</sup> Perkins and Wing Thye Woo (1999) p. 4.

<sup>137</sup> Ibid.

### **3. Increasing Women Workers**

In addition, the increase in the number of two-income households contributed to an increase in total household income for poor families. This was underpinned by the increasing importance of women in the work force. The labor force participation rate for women increased from 37.2% in 1970 to 46.7% in 1990, while the share of employed women increased from 31% to 35% during the same period of time.<sup>138</sup>

### **4. Capital Investments**

The government set up a share-trust corporation named the Perbadan Nasional Berhad (PNB) that managed trust funds such as Amanah Saham Bumiputera (ASB) and Amanah Saham Nasional (ASN) that purchased discounted *Bumiputera* –allocated shares in the Kuala Lumpur Stock Exchange (KLSE) companies. Ordinary citizens could then buy shares in the ASN/ASB schemes to ensure the participation of citizens in corporate wealth and ownership. They share corporate profits through the dividends and capital gains. By 1994, 17.6% of KLSE stocks were held by these trust funds for Bumiputeras, up from 0% in 1970.<sup>139</sup>

The poor, especially landless Malays, were lured to open new land schemes from the jungles that eventually earned them land titles to cultivate rubber, palm oil and other crops. Farmers received subsidies in the form of cheaper fertilizers and grants in replanting old rubber/oil palms crops with better varieties. The government established agencies and corporations such as the Federal Land Development Authority (FELDA), MARA, National Trade Corporation (PERNAS) et al. whose duties were to plan and implement poverty eradication measures irrespective of race and were to concentrate on the rural poor.

### **5. Quality of Rural Life**

The government also intensified efforts to improve the quality of life, especially in rural areas by upgrading the quality of basic amenities, housing, health, recreation and educational facilities; improving the distribution of income and narrowing income imbalances between and within ethnic groups, income groups, economic sectors, regions and states.

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<sup>138</sup> Ibid.

<sup>139</sup> Perkins and Wing Thye Woo (1998) p. 4.

## **6. Redistribution of Employment Sectors**

The authorities took steps to stop identifying employment sectors by race. More *Bumiputera* students were accepted to study the sciences and professional courses so that they would be suitably employed as professionals or become businessmen. In order to create and develop a viable *Bumiputera* Commercial and Industrial Community (BCIC), they would need to participate in modern commercial and industrial ventures<sup>140</sup>. It was done through employment restructuring, and ownership and control in the corporate sector. The government policy required companies to have the *Bumiputeras* represent at least 30% of the managerial as well as overall company personnel composition. As the number of non-Malays in government service, especially in the police, and the military were low, they were encouraged to join civil service, the police and military.

## **7. Building *Bumiputera* Corporate Equity and Entrepreneurship**

One of the major strategies to accelerate *Bumiputera* participation in industry was the introduction of the Industrial Coordination Act (ICA) of 1975. The ICA required all enterprises with equity over a certain limit to sell 30% of their shares to *Bumiputras*. However, firms that exported over 80% of their output were not subjected to this requirement, thus ensuring that multinationals relocating to Malaysia, an important source of growth, were not alienated. None of the Kuala Lumpur and Penang electronics firms, therefore, felt any impact from the ICA<sup>141</sup>.

## **8. Privatization and Public Enterprises**

One of the initial plans to help *Bumiputeras* in business was to establish public enterprises to help and guide them in business ventures, such as giving them sub-contracts, and management advice, and also to create opportunities for employment for future *Bumiputra* managers and entrepreneurs. In time, the number of these public enterprises grew in size. In 1981, the value of investments of these state owned enterprises amounted to RM 2.527 billion or 27% of the total public sector investments<sup>142</sup>. These state business enterprises had the conflicting objectives of being a

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<sup>140</sup> Bakri Musa (1999), pp. 113-126.

<sup>141</sup> Perkins and Wing Thye Woo (1998) p. 9.

<sup>142</sup> Gomez and Joko, *Malaysia's Political Economy: Politics, Patronage and Profits*, (Cambridge: University of Cambridge Press) 1999. p. 75.

redistributive tool and achieving profit maximization and efficiency. Not surprisingly, many of them did not do well, lack competitiveness, and were not profitable.<sup>143</sup>

By the 1990s, a large number of Malaysians, including government leaders, had become increasingly disillusioned with state owned enterprises as vehicles for achieving both growth and social goals. Many of the state owned enterprises experienced sustained losses even though private enterprises in the same lines of business were doing well<sup>144</sup>.

In the 1980s, also, there was a shift to more private sector oriented development and deregulations, encouraged by the World Bank, the Asian Development Bank, and championed by Prime Minister Thatcher in Britain and President Reagan in the United States. The Malaysian government embraced the privatization concept first by corporatizing many formerly state-controlled enterprises, such as Malaysian Airlines, and privatizing new infrastructure projects such as the North-South Highway. It took the opportunity via the privatization exercises to implement the redistributive objectives of the NEP by selling controlling shares to selected *Bumiputera* businessmen to manage them. For example, PROTON, Malaysia Airlines, Malaysia International Shipping Corporation, the water board and telecommunications companies were sold to individually selected *Bumiputeras* or *Bumiputrera* controlled corporations.

A major question from the outset was how to distribute the *Bumiputra* shares. Few *Bumiputras* had any experience with corporate shares, and the number with the money to buy them was equally small. The initial approach was for the Ministry of Trade and Industry to draw up a list of names to which the shares should be distributed. Typically, the chosen individuals bought the *Bumiputra* shares at a significant discount from the other shares in the same company. The entrepreneurs who received these shares, such as Yahya Ahmad, who took control of HICOM, and Tajuddin Ramli, who took control of MAS, were mainly *Bumiputras* and members of UMNO.<sup>145</sup>

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<sup>143</sup> Ibid.

<sup>144</sup> Perkins and Wing Thye Woo (1998) p. 9.

<sup>145</sup> Ibid. p. 10.

Share allocation, therefore, became a vehicle for political patronage<sup>146</sup>. However, in his book, *The Way Forward* (1999), Dr Mahathir has this to say about the selection of share recipients:

It was always believed that, if a company was run by a capable *Bumiputera* who had invested a substantial sum in the enterprise, the company would be better run and more profitable. The persons must have a proven track record, which indicated their ability to manage, and a good credit rating to ensure that the banks would lend them the substantial sum of money required to buy the blocks of shares.<sup>147</sup>

It must be noted here that while the acquisition of assets by UMNO members strengthened their allegiance to the top ministers, it also rendered their support of the existing UMNO leadership disproportionately influenced by the state of the economy in general, and by the state of the stock market in particular. The root of the extraordinary economic and political developments during the 1997-8 financial crisis lies in this massive asset redistribution program.

## **9. Improvement in Education**

Recognizing education as a means to better a society, the thrust in this direction was to educate the poorer portion of the population through better educational facilities, more scholarships, and reserved places in universities. To accommodate both Malay and non-Malay demands, Malaysia saw a proliferation of new universities and colleges, from just one in 1957, the University of Malaya, in Singapore, to 14 in 2001<sup>148</sup>. The quota systems ensured that public higher education opportunities were apportioned according to population ratio. The 1961 education Act and each of the 5-year Plans have sought to improve the education of the Malays and other indigenous races people by giving more attention to rural schools and the needy. This is an important step towards reducing income inequality for Malays.

Thus the government implemented the NEP by economic and social measures. However, these planned measures must be agreeable to the majority for successful implementation. This agreement was obtained via the political aspects.

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<sup>146</sup> Perkins and Wing Thye Woo (1999) p. 10.

<sup>147</sup> Mahathir Mohammed, (1999) p. 97.

<sup>148</sup> Carolyn Hong, *PM's Dialogue With UK-Based Students*, NST on line 26 Feb 2002.

## **E. ASPECTS OF POLITICAL POWER**

An important aspect of the implementation of the NEP was political power sharing between the races. The National Operations Council (NOC) proposed the NEP, and was endorsed by the UMNO, MCA, MIC and seven other parties. As explained in Chapter III, erstwhile ethnic based political opposition parties were invited to share power in the expanded government coalition. The original tri-party governing Alliance Party was expanded to ten parties called the National Front (NF) to bring aboard a broad mix of representations of all races in Malaysia. Partly due to the smaller remaining opposition parties, and their difficulties to reach the population through a government controlled mass media, the ruling National Front achieved successive successes in all general elections from 1972-1999, in turn ensuring that the NEP policies were carried out smoothly.

### **1. Executive Dominance and Authoritarianism**

When the NOC proposed, and the reconvened Parliament endorsed, the NEP in 1971 after two years of emergency rule, it also qualified total free speech by barring ethno-national messages and the assertion of state authority over the media, and created a very powerful Executive Branch. It was the Executive Branch's domination that enabled the implementation and enforcement of key policies such as the NEP, which called for active state intervention to reduce inter-ethnic economy disparity, and privatization, which was started to roll back the state and trim inefficient state public sectors. Truncating democracy is always controversial and exposes the system to abuse. However, the government's stand was that reducing democracy was the price for unhindered development.

The government was not shy in using the stick. Thus, during the 1987 recession, when the political climate in the country was decidedly tense with opposing sides airing racially sensitive rhetoric publicly, the government clamped down hard and invoked the Internal Security Act to jail about 60 personalities for acts deemed prejudicial to racial harmony.

Malaysian authorities have arrested dozens of suspected Jemaah Islamiah members and 50 members of Kumpulan Muhajiddin Malaysia (KMM) since August

2001, and are searching for about 200 more they believe are present in the region. KMM seeks to establish an Islamic state composed of Malaysia, Indonesia and the southern Philippines.<sup>149</sup>

These tough measures might not be conducive for liberal democracy, but they kept the peace and enabled the catching up process to be implemented smoothly. Jack Snyder (2000) attributed to a strong Executive Branch that managed to save Malaysia from racial chaos, compared to Sri Lanka. He wrote:

Malaysia has enjoyed 30 decades of extraordinary economic growth without serious ethnic violence...A key factor in this success is the power of Malaysian state administration over society.<sup>150</sup>

## **F. SUCCESS OR FAILURE OF NEP?**

The NEP's main goal was to foster national unity, through a more equitable redistribution of economic wealth, income and opportunity. In the process, it also strengthened the government's hand via political power sharing among the ethnic groups, creating an overwhelming majority in Parliament. Based on measurable stated objectives, the NEP has achieved the desired goals. Although some localized disturbances occurred in 2001, and a near racial explosion in 1987, there were no recurrent racial riots on the scale seen in 1969. However, it also created a climate of illeberalism. Let us examine the success or failure of the policy by looking at some important areas, such as national unity and psyche, economic wealth along racial groups, Malaysia's growth, economic performance and quality of life will now be examined.

### **1. Overall Growth**

The economy achieved a large degree of restructuring, and growth continued at an annual average per capita rate of 6.7% per year over the NEP period. From 1987 until 1997, it achieved an average annual GDP growth of more than 7%. If per capita GNP (measured in Purchasing Power Parity) in Malaysia continues to grow at 4% per year, Malaysia by the year 2020 will have a per capita GNP nearly equal to that of the United States in 1993.<sup>151</sup> Thus, by any reasonable measure, the NEP strategy is successful.

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<sup>149</sup> Al Qaeda In Southeast Asia, In <http://www.cdi.org/terrorism/sea.cfm> dated 30<sup>th</sup> May 2002.

<sup>150</sup> Jack Snyder (2000) p. 286.

<sup>151</sup> Dwight Heald Perkins and Wing Thye Woo. *Malaysia in Turmoil: Growth Prospects and Future Competitiveness* <http://www.econ.ucdavis.edu/faculty/woo/davosmal.html> dated 18 March 2002. p. 3.

## 2. Wealth Creation and Poverty Eradication

The success of the poverty eradication programs is evident from the sharp decline in poverty, which decreased from 49.3% in 1970, and to 15% in 1990, 6.1% in 1997 and to 7.5% in 1999<sup>152</sup>. In absolute terms, the number of poor households dropped from 791,800 in 1970 to 764,400 in 1976 and further to 483,300 in 1984, before rising slightly to 485,800 in 1987. Due to the implementation of the long-term measures, the impact of the 1997 financial crisis was minimal with poverty reaching 8.5% in 1998 and declining to 7.5% in 1999 as seen from the following graph.

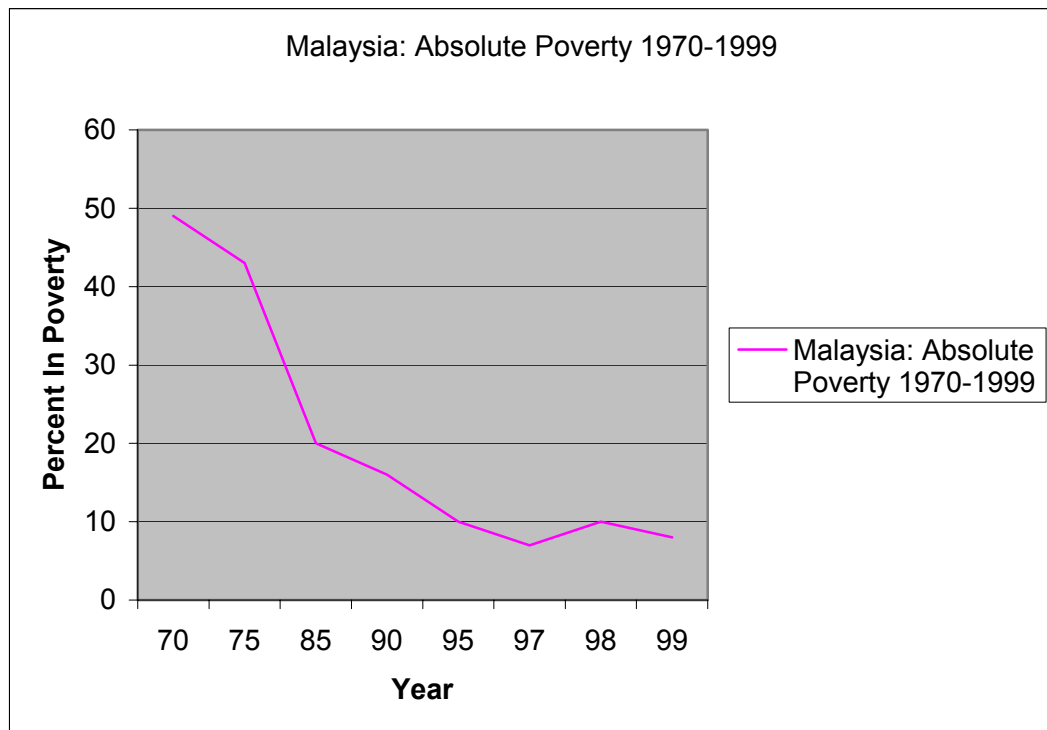


Figure 2. Percentage of Absolute Poverty, Malaysia.

From: Malaysian Economic Planning Unit, Prime Minister's Department, and Putra Jaya<sup>153</sup>

The rapid economic development and substantial growth in income brought about a reduction in the incidence of poverty. There was a significant reduction in the level of poverty among all ethnic groups. Poor rural households had the most rapid growth in

<sup>152</sup> Jomo KS *Malaysia's New Economic Policy and National Unity*, UNRISD Conference on Racism and Public Policy, Durban, 3-5 Sep 2001.

<sup>153</sup> Malaysian Economic Planning Unit, Prime Minister's Department, Putra Jaya Malaysia at <http://www.epu.jpm.my/Bi/issues/poverty.pdf>, dated 10 May 2002.

incomes as they diversified their economic activities. Part of the gains in rural incomes came from productivity increases brought about by modernization, commercialization and technological improvement of smallholder agriculture and from more intensive farming. More significant gains, however, came from the structural changes in rural employment resulting in the diversification of the sources of rural income with non-agricultural activities accounting for more than half of the income of rural households. In addition, the growth in the demand for non-agricultural labor encouraged large numbers of self-employed and unpaid family workers to enter the wage-labor market, making wage income a more important determinant of rural household income. The public sector programs for rural development such as education, rural roads and communications also contributed to higher participation rates especially among female labor, thus contributing to higher earning capacity among them. Rural households are therefore now less dependent on agricultural incomes as opportunities for non-agricultural employment become more readily available.

Statistics suggest very impressive reductions in poverty in the 1970s and early 1980s and 1990s. More significantly, it appears that per capita income levels have generally risen with growth. It could, however, have been further reduced, if more just and effective redistributive policies had been implemented, government waste minimized, and government allocations ostensibly for poverty eradication used effectively for reducing poverty instead of enriching politicians and contractors securing rural development projects<sup>154</sup>.

There are, however, still pockets of poor Indians in the rubber estates. Despite the progress made in eradicating poverty, the inter-ethnic and rural-urban dimensions of poverty, however, continued to be of concern. Poverty was still highly concentrated within the traditional primary sectors and in the rural areas, especially in the rubber smallholders, padi farmers, coconut smallholders and fishermen and mostly amongst the

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<sup>154</sup> Jomo KS (2001) p. 5.

Malays<sup>155</sup>. From the regional perspective, high levels of poverty were recorded in the states of Kelantan, Terengganu, Kedah, Perak, Sabah and Sarawak.<sup>156</sup>

### 3. Progress In Equity Sharing/Wealth Sharing

In terms of growth rate, *Bumiputera* equity ownership grew by an average of 29.1% per annum during 1970-1990 and 12.3% during 1990-2000. Although the *Bumiputera* have not achieved the 30% equity ownership target, the progress made was substantial. The *Bumiputera* share of ownership in the corporate sector rose sharply from 2.4% in 1970 to 19.3% in 1990, 20.6% in 1995 and 19.3% in 1999<sup>157</sup>.

The implementation of policies for increasing *Bumiputera* participation in the modern sectors of the economy during the NEP period has been generally successful in terms of achieving the quantitative targets. While efforts continued to be geared towards increasing *Bumiputera* ownership and participation in the corporate sector, the 30% target set under the NEP continued to guide the implementation of the equity restructuring programs during the NDP period. At the same time, emphasis was also placed on managerial and entrepreneurial development among the *Bumiputera*, as this was the least successful restructuring aspect of society.

The fact is that the government has succeeded in creating a professional and entrepreneurial *Bumiputra* community that equals the *non-bumiputra* community in competence and competitiveness. By most indications, Malaysia now has a large, well-educated *Bumiputra* middle-class that is actively engaged in nearly most industrial and modern service activities<sup>158</sup>. As a result of the further implementation of various programs under the NDP period, the *Bumiputera's* share of the corporate equity in 1999 increased to about RM59,400 million or 19.1% of the total share capital in the corporate sector. As for the *non-Bumiputera* category, the Chinese owned 37.9% while the Indians owned 1.5%. At the same time, foreigners owned 32.7% and the nominee interest accounted for 7.9%.

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<sup>155</sup> Gomez and Jomo KS (1999) p. 166.

<sup>156</sup> Macro Economic Performance of First Outline Perspective Plans  
<http://216.239.39.100/search?q=cache:5uCPh9cAAfIC:www.epu.jpm.my/mservis/opp2/bab218.htm+First+outline+perspective+plans&hl=en> 10 May 2002.

<sup>157</sup> Jomo KS (2001) p. 9.

<sup>158</sup> Dwight Heald Perkins and Wing Thye Woo. *Malaysia in Turmoil: Growth Prospects and Future Competitiveness* <http://www.econ.ucdavis.edu/faculty/woo/davosmal.html> dated 18 March 2002. p. 27.

#### **4. Employments Restructuring and Education**

*Bumiputera* employment in the professional and technical category was also increased to about 63.8% in 2000. However, a larger number were in the sub-professional and technical worker as well as teacher and nurse occupational categories. In the professional category, *Bumiputera* accounted for only 44.3%. In the administrative and managerial category, the proportion of *Bumiputera* was 36.9%. In selected professional occupations, such as accountants, architects, engineers and lawyers, the proportion of *Bumiputera* increased from 20.7% in 1990 to 28.9% in 1999

At the end of the New Economics Policy (NEP) period in 1990, public sector asset accumulation on behalf of the *Bumiputeras*, government regulation business opportunities and preferential policies for *Bumiputera* business had all helped to increase *Bumiputera* equity in the corporate sector. However, *Bumiputera* peasants still dominate agriculture. Poverty, though reduced, is still a grievance. The Chinese continue to dominate wholesale and retail trades, despite considerable inroads made by the *Bumiputeras*<sup>159</sup>.

While the NEP presented quite a setback to the expansion of Chinese business interests, and while Chinese discontent was widespread, the overall economic position of the community did not suffer. Chinese entrepreneurs, particularly the wealthiest and most influential businessmen, prospered by forging strategic alliances with well-connected partners/patrons from the Malay power center. At the same time, the United Malays National Organization (UMNO) leadership, faced with the country's worst recession since independence, pragmatically responded by liberalizing the NEP in the mid-1980s and implementing the growth-oriented National Development Policy (NDP) in 1991<sup>160</sup>.

#### **G. NEP CRITICS**

Undoubtedly, the NEP has done a tremendous job in atoning for past imbalances and ensuring a fairer distribution of wealth, income, employment and social benefits to the Malaysian society as a whole. Non-Malays benefited also, as their share of the country's corporate wealth and business, and income levels also improved and there was

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<sup>159</sup> Gomez and Jomo KS (1999) p. 166.

<sup>160</sup> Hang Peek Kong, *The New Economic Policy and Chinese Community in Peninsular Malaysia*. pp. 262-92.

no widespread re-distribution of their existing wealth to the *Bumiputera*. However, critics of the NEP have claimed that the quota policy, excessive coddling of the Malays in business and education opportunities have made the Malays less competitive, and also the NEP causes resentment amongst the non-Malays.

The cost of the reservation or quota system is that it often excludes the best persons for a job, business opportunity, a placement in universities or other benefits. If done pervasively and without regard, it will also affect the competitiveness of Malaysia as a country competing in the global markets. The Chinese and Indians naturally did not embrace the NEP whole-heartedly. Though most understand the reasons for the NEP, resentments from perceived unfair treatment occur. These negative factors also tore at the national fabric cohesiveness of Malaysians as a nation.

Parceling out business opportunities under the privatization scheme to selected Malay personalities has resulted in charges of nepotism, favoritism and political patronage on the part of the ruling party and political leadership. The power to allocate rent-seeking projects that lie with the political leadership, if unfettered, tempts the culture of political patronage and corruption<sup>161</sup>. A culture of businessmen acquiring projects due to political patronage certainly places a damper on competitiveness and will not contribute to efficiency, export-oriented industrialization, and the technological upgrading desired for competitive development. The government's bailing out of politically connected *Bumiputera* companies such as Tajuddin Ramli's Malaysia Airlines in February 2001, and Halim Saad's Renong Corporation in 1999 caused public uproar and foreign investors' disapproval<sup>162</sup>.

Too strong a concentration of power in the Executive Branch is worrisome due to the possibility of the abuse of power. In Malaysia this has led to patronage through the majority party<sup>163</sup>. The royalty, landed aristocrats and the newly rich businessmen, in wanting to perpetuate their wealth, will make use of political connections, using affirmative action as an excuse to grab the largesse in the name of the redistribution of

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<sup>161</sup> Gomez and Jomo, (1999) pp. 1-9.

<sup>162</sup> S. Jayasakaran, "Malaysia Turns Around", *Far Eastern Economic Review*, May 23, 2002, pp. 40-41.

<sup>163</sup> Blondel and Marsh (1999) p. 344.

wealth and opportunities by becoming cohorts with non-Malays by acting as their silent proxies. Obtaining business opportunities and then turning over the management to the non-Malays in return for easy profits, or rent seeking without honest efforts, will undermine the policy's good intentions.

Authoritarianism and illebaralism have created a climate of fear amongst critics. There is a sense of repressive-ness and Malaysia being perceived as unfair, with poor corporate governance. The trial of Anwar Ibrahim and subsequent internment tarnished Malaysia's image internationally as the cases were widely considered unfair.<sup>164</sup>

Thus, the most emotive political campaigns of the 1999 were the charges of government abuse and nepotism in the implementation of the NEP. Then, the battle cry of the opposition parties was to curb abuses of power by abolishing cronyism, nepotism and corruption, which the government leadership vehemently denied

The recent split in Malay unity was due to similar charges directed at the elites of UMNO, the royalty and the "new rich". As a result, more Malays are gravitating to the opposition Islamic party to search for "honest leaders", and solace in religion, perceiving the Islamic party leadership to be God fearing individuals able to deliver them. In time, there might exist a group of ultra conservatives fighting against the more liberal Malays, creating a much more alarming social split amongst the majority ethnic groups and amongst Malaysia as a whole. This is a significant concern in a pluralistic nation, given the troubles with resurging militancy attributed to certain of the Islamic groups such as Laskar Jihad in Indonesia. In fact, in July 2000, a militant Islamic group of about 30 people calling itself the "Al Maunah" staged a weapons heist at an army armory in a remote part of Malaysia, hoping to initiate an armed struggle for an Islamic state<sup>165</sup>. In the process, they captured and killed two non-Malay security personnel.

Malaysia's chosen path to directly address ethnic imbalances and remove ethnic identification by economic function by adopting a far-reaching policy will forever have its detractors, but the most important thing is that it addresses the main causes of the problems in Malaysia ethnic relations. Nevertheless, the above are fair criticisms and this

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<sup>164</sup> Ibid.

<sup>165</sup> <http://www.geocities.com/Tokyo/3399/bul894.html>, dated 30 May 2002.

must be subsequently addressed because the NEP is based on consensus, goodwill and acceptance by all.

However, Malaysians in general still supported the policies of Prime Minister Mahathir, as seen from the opposition's failure to win the 1999 general elections. The government was again returned with more than two-thirds majority in the federal Parliament, though they lost the state of Trangganu and Kelantan to the Malay based Islamic party, PAS.

The acid test for the NEP came in the wake of the Asian crisis in 1997-98 when it redeemed itself with the critics. There was relative calm in handling the racial situation in Malaysia during the recent recession caused by the currency devaluation and the collapse of the share market. The tension due to spiraling economic conditions failed to spark racial fights as they did elsewhere in Southeast Asia, especially in Indonesia, a country composed of similar ethnicities. The street demonstrations that happened were due to the political support for the sacked Deputy Prime Minister, Anwar Ibrahim, rather than an expression of inter-ethnic hatred. Though the crisis was a major jolt, Malaysia emerged relatively intact.

#### **H. THE ASIAN CRISIS**

Malaysia was one of the countries that were severely affected by the economic downturn. Its currency, and stock value took a freefall, shaking the very foundations of the economy and the banks and business corporations and the Kuala Lumpur Stock Exchange (KLSE). In all, the country lost about 50 billion US Dollars in terms of purchasing power of imports and 150 billion US Dollars in market capitalization.

It was another watershed in Malaysian economic development, and would inevitably have a far-reaching impact on its future social-economic reengineering policy. Fortunately, though the financial crisis had wide-ranging effects, particularly in terms of meeting the NEP, its successor National Development Policy's (NDP) objectives, Malaysia has successfully avoided the extreme effects of the crisis such as large-scale unemployment, mass poverty, massive bankruptcies, and civil unrest experienced by others in the region.

## 1. Before the Crisis

There are many favorable aspects to the Malaysian economy prior to the crisis in 1997<sup>166</sup>. During the five years leading up to 1996, its real GDP growth averaged 8.7% per annum, inflation was low around 3.8%, and the unemployment rate for 1996 was only 2.5%<sup>167</sup>. Unlike some other East Asian economies with high external debt, Malaysia has a relatively lower external debt of US\$45.2 billion or 42% of the GDP in June 1997. The debt service ratio was only 6.1% of exports at the end of 1996. The banking sector was healthy, with non-performing loans (NPLs) at only 3.6% of total loans in June 1997. The nation's saving rate of 38.5% in 1996 is one of the highest in the world.

Although aggregate or macro numbers can sometimes mask some inefficiency in the case of neighboring countries, this was less so for the Malaysian economy. However, the nervousness of the market over some issues in countries such as Thailand, Indonesia and South Korea led to the 'contagion' effect that brought the economic crisis to Malaysia, resulting in gross under valuation of the exchange rate and collapse of the stock market.

## 2. Causes of the Financial Crisis in Malaysia

Two major causes have been attributed to the financial crisis: weakness in macroeconomic fundamentals and the openness of the capital account.<sup>168</sup>

### a. *Openness of the Capital Market*

As already seen in Chile in 1981, and Mexico in 1995, opening the capital account has pitfalls. The inflow of short-term funds can quickly create an asset bubble. Once foreign capital inflows accumulated in the domestic financial system, small perturbations or shocks can quickly lead to a massive withdrawal of finance with a consequent deflation of asset prices, loss of investor confidence, increasing domestic bankruptcies, and a decrease in real activities<sup>169</sup>.

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<sup>166</sup> Malaysia, National Economic Recovery Council, Kuala Lumpur. *Crisis and Response* <http://thestar.com.my/archives/neac/nerp/chapter1d.asp> dated 6 May 2002.

<sup>167</sup> IMF Issues Brief 2001, *Recovery From The Asian Crisis and Role of IMF*, 23 Sep 2001.

<sup>168</sup> Amir Hashim, *Malaysian Economic Crisis: Causes, Effects, Recovery Actions and Lessons Learned.*, Monterey, Naval Postgraduate School Thesis, pp. 14-20.

<sup>169</sup> Jeffrey Sachs, "Glimmers of Hope", *Far Eastern Economic Review*, November 5, 1998, p. 53.

**b. Weakness in Macroeconomic Fundamentals**

Reduction in the competitiveness of the Malaysian economy and competition from relatively “cheaper” countries such as China has resulted in erosion of its share in export markets and more competition for scarce foreign direct investment. Poor regulation of its financial system, as seen from the accumulation of poor assets bought by easy credit was another example. The policy of fixing the exchange rate of the ringgit with the American dollar also aggravated the problem. With the exchange rate risks absorbed by the central bank, higher interest rates in Malaysia had lured domestic companies to borrow from offshore markets rather than domestic ones. As a result, there was an unsustainable accumulation of short- term foreign indebtedness<sup>170</sup>.

A close relationship between the political ruling elites and the business personalities, or “crony capitalism” as charged by detractors, exacerbated this crisis because of the need to support and encourage hard-hit *Bumiputera* entrepreneurs. It was widely assumed that problems of cronyism, nepotism, lack of good corporate governance and transparency resulted in mediocre companies obtaining loans and contracts had also been attributed to exacerbating the crisis<sup>171</sup>.

**3. Tackling the Asian Economic Crisis**

To restore the economy the government set up the National Economic Action Council (NEAC) tasked with tackling issues such as strengthening the balance of payments, fiscal account, improving competitiveness, and seeking financial and monetary stability.

Some of the steps taken to combat the problems were severe budget cuts for the 1997 and 1998 fiscal years, import restraints, and limited opening of *Bumiputera* companies for non-*Bumiputera* control and ownerships and reforming the banking and corporate sectors to be more resilient. Price control was fully enforced to prevent undue inflation.

Statutory reserves of banks, which stood at 13%, were reduced by 4% to improve banking liquidity. The government set up Danaharta, an asset management company to buy Non-Performing Loans in order to relieve the banks and help the companies turn

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<sup>170</sup> Amir Hashim (2000). pp. 14-20.

<sup>171</sup> Gomez and Jomo KS (1999) p. 186.

around. Another company, Danamodal, was tasked to help refinance banks and the mergers of banks and stock broking companies.

*a. Currency and Capital Controls*

However, the most controversial steps taken were the currency and capital control announced on 1st September 1998, before the sacking of the Deputy Prime Minister and Finance Minister, Anwar Ibrahim. The Malaysian currency, the Ringgit was pegged to the US dollars at 3.88 Ringgits to 1 dollar. Capital invested in the KLSE was not allowed out of the country for a period of one year from date of purchase of shares.

To stop the trade in of currency the local banks were instructed by the Central Bank not to transfer any foreign-owned Ringgit held by foreigners except during the first month of the control. Effectively this made the foreign-owned Ringgit worthless unless transferred to a local account in the first month. After that no more transfers would be allowed.

Thus, money belonging to foreigners held in their accounts in domestic banks would be useless after one month if it were not already transferred. If it was transferred it meant that foreign owned Ringgits would have been repatriated and would be available for banks to lend. Billions of Ringgits were repatriated in this way. Once repatriated it could not be taken out of the country again as it would not be allowed to return. Taking the Ringgit out of the country would render it useless, as it could not be legal tender in any other country, and no one would accept it in exchange for other currencies.

This meant no Ringgits would be available outside the country for currency traders to borrow and sell. Trading in the Ringgit stopped and the government was then able to fix the exchange rate within the country. Anyone needing foreign currency to pay for imports could exchange their Ringgits for foreign currency at the Central Bank. On the other hand, if exporters earn foreign currency they could change it into Malaysian Ringgits at the government fixed rate at the Central Bank or any authorized bank. All the while the government would keep track of all incoming or outgoing money in whatever currency.

Had the government fixed a high rate for the Ringgit, exports would be costly and there would be a black market in foreign currencies. A low exchange rate would make imports more costly and result in inflation. The government selected a rate that was neither too high nor too low.

Once the rate was fixed, businesses could operate without the uncertainties of fluctuating exchange rates and the need to hedge. The return of all the Ringgits from abroad meant the banks had plenty of money to lend. Interest rates could therefore be reduced without fear of traders devaluing the currency further. Businesses could borrow and repay loans. The rapid rise in non-performing loans was reversed.

To recover fully, the slide in the price of shares also had to be stopped. Initially, the Government disallowed short selling on the Kuala Lumpur Stock Exchange. However, short selling continued as Singapore had opened a market in Malaysian shares without the consent of the Malaysian Government. They were able to continue short selling and consequently the share prices kept on dropping. As a result, Malaysian companies and banks were in distress as margin calls could not be met, and debts could not be paid.

Malaysia had to stop the operation of the so-called Central Limit Order Book (CLOB) in Singapore in order to make currency control effective. To avoid reporting changes in ownership of shares through sales on the CLOB, all shares were registered in the name of nominee companies on the Malaysian Stock Exchange. The Malaysian authorities could not track the transactions on the CLOB and so short selling went on, depressing Malaysian share prices. To stop the CLOB they required all shares to be registered directly in the name of the substantive owner. Transactions not so registered would not be legally recognized. Nominees were not recognized. Trade on the CLOB stopped immediately and the Composite Index of the KLSE climbed rapidly. It was almost 50% higher than when the CLOB was operating.

Malaysia also stopped the repatriation of proceeds from the sale of shares for one year. Thus, the possible massive withdrawal of capital from KLSE by foreign investors was stopped, which would have caused a severe plunge in the index, and a serious loss of market capitalization.

It was believed that when one year had passed, there would be a massive outflow of capital. However, that did not happen. The stock market remained sound and the banks and companies were released from the pressure of bad loans. Besides, the Asset Management Company and the bank re-capitalization exercise helped the banks and the companies to deal with non-performing loans.

The efforts to revive the economy did not end with the stoppage of currency trading and short selling of shares. Numerous other steps were taken to restore the growth of the Malaysian economy. However, the most important steps were frustrating the currency traders and short selling on the CLOB.

The selective control of capital flows was very effective. Foreign reserves increased rapidly, up to about 32 billion US Dollars compared with 20 billion when the controls started. The stock market index rose from 262 points on September 1<sup>st</sup> 1998 to over 800 that same day. Loans given out by banks picked up fairly well, vehicle and property sales increased, and infrastructure work began again. The contraction of the GDP was slowed and Malaysia achieved a growth rate of 4.1% in the 2<sup>nd</sup> quarter of 1998.

#### **4. The Merits and Demerits to the Malaysian Measures**

According to an IMF brief, Malaysia's imposition of capital controls does not appear to have made a substantial difference, either positive or negative, to economic development so far.<sup>172</sup> The stabilization of the currencies in the region and the relative under-valuation of the Ringgit, resulting in a large balance of payments surplus, have facilitated the implementation of these controls. Potential negative impacts of controls may have been subdued, given that when they were imposed, most of the capital flight had already abated, and the acceleration of regional recovery, together with progress in financial and corporate restructuring and generally sound macroeconomic management in Malaysia, helped bolster confidence.

However, in the eyes of foreign capital-market investors, Malaysia had changed the rules in midstream. Thus, capital control caused a lot of damage in terms of their goodwill. This will be somewhat detrimental in the long term, as Malaysia still needs

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<sup>172</sup> "Recovery From the Asian Crisis and the Role of IMF—an IMF Brief", *International Monetary Fund*, <http://www.imf.org/external/np/exr/ib/2000/062300.htm>, 9 Sep 2001.

foreign investors for growth in its capital markets. With this in mind, Malaysia lifted the ban in 2001.

The current fixed rate of the Ringgit to the dollar (1USD= 3.8 Ringgits) was hurting Malaysia's competitiveness with other ASEAN countries and China. Given that the country's reduced productivity and competitiveness had in part contributed to the crisis, this matter must be carefully addressed. Also, if the dollar becomes much stronger in the future, it will be very expensive for the central bank to continue to maintain the fixed rate. However, abandoning the fix rate in haste will precipitate a serious lack of confidence in Malaysia's policy stability amongst foreign investors.

The call for structural reforms by the IMF by more transparent governance and regulating the financial institutions has strong merit. It is common knowledge in the country that loans were given based on political connections. The migration of a significant portion of UMNO's supporters to the opposition coalition, led in spirit by ex-Deputy Premier Anwar Ibrahim, is a manifestation of their frustration with the state of affairs.

## **5. Asian Crisis Effects**

The Asian Financial Crisis had two serious effects on Malaysia both economically and politically. The economic and social aspects were expected, but a more serious one, and unexpected, was political.

### ***a. Political***

The political effect was the disunity among the Malays after Dr. Mahathir, the Prime Minister, sacked the highly popular and equally charismatic Deputy Prime Minister Anwar Ibrahim and the Finance Minister on 2 September 1998. Anwar was later charged in court and found guilty of corruption and sexual misconduct. His arrest did not sit well with his supporters and even less so when he was punched in the eye by then Malaysia's Inspector General of Police.

Apparently there was a power struggle between the country's topmost leaders, Anwar, who was groomed for 16 years by Dr. Mahathir to take over the leadership of the country and the nation, and his mentor, Dr. Mahathir. The pressure of

responding to the crisis brought their different approaches to light. Anwar favored IMF policies and Dr. Mahathir did not.

Anwar Ibrahim then charged his former boss and his advisors with practicing cronyism, nepotism and politics of patronage and claimed to fight to clean the country of these evils. However, it was difficult for Anwar to dissociate himself from the same sins if it were so as he was part of the leadership for nine years.

The veracity of the charges notwithstanding, it has split the *Bumiputeras* into two opposing camps and thus an intra-cleavage was created in Malay unity. However, in the subsequent general elections in 1999, Anwar's forces failed to take over the nation's governance with the incumbent winning a seat in Parliament with more than a two-thirds majority. Anwar Ibrahim's ally, the PAS, won two Malay majority states, those of Kelantan and Trengganu.

***b. Threats to NEP***

Concerning economics, the attacks on Malaysia's currency and share markets nevertheless damaged the carefully planned redistribution of economic wealth. The still young and feeble indigenous business community suffered the most. If the economy was not resuscitated quickly and put back on the path to growth, racial antagonism would return and Malaysia would be politically unstable. Political instability, in turn, would make economic revival difficult.

While most of the indicators are positive, the economic turmoil precipitated by the crisis destroyed much of Malaysia's achievement in correcting the imbalance between the economic performances of its multiracial population. While everyone was hit by the downturn, the indigenous businessmen were hit the hardest. The big corporations that they had successfully created were unable to withstand the burden of the debts they carried. The fall in profits and in share prices rendered many large *Bumiputra* conglomerates financially illiquid or insolvent. The decline in their share prices reduced the value of the collateral pledged against their bank loans, and the drop in profits caused by the economic slowdown made them unable to service their bank loans.

They were forced to sell off to the non-indigenous people and this of course undid much of the redistribution the nation had achieved. The indigenous middle

class, small compared to the non-indigenous, practically disappeared. Once again, the indigenous people were found only among the low paid workers, hawkers and petty traders.

The crisis had eroded much of the wealth redistribution. Malaysia has to almost start all over again and it is not going to be easy. The hard fought efforts at the redistribution of wealth had almost been wiped out overnight by the crisis. The crisis has exacerbated the danger of racial tensions, riots and consequent political instability recurring. The country has to resolve the economic problems caused by currency and share market devaluation without disturbing the delicate balance in terms of race relations.

Other countries faced with economic turmoil quickly resorted to IMF help. Unfortunately the IMF wanted to use their loans to force through its so-called economic reforms. For IMF, affirmative action, active government intervention in the distribution of economic wealth between races was unacceptable. To them, the economy must be completely free of government interference and furthermore it must be open to total and unrestricted foreign participation.

The result would be to deprive the indigenous people in particular of their share of the business sector and the wealth accruing from it. The Chinese, on the other hand, might still retain or even enhance their share. It was the recipe for the unraveling of the NEP.

The IMF solution was therefore not for Malaysia. The country had to devise its own solution so that the government could continue with the eradication of poverty among all races and the elimination of the identification of race with economic function - the so-called New Economic Policy that had so successfully created a stable and prosperous Malaysia.

The devaluation of the currency and the near collapse of the stock market placed the country in a very difficult position. If the currency were devalued further, the economy could be so weakened that Malaysia would have to turn to the IMF and accept its terms. Then 30 years of painstaking work on social-economic reengineering would be unraveled in a matter of weeks.

## I. POST NEP

The NEP ended in 1990 and continued with a more liberal National Development Policy (NDP) from 1991- 2000 and the National Vision Policy from 2001-2010. The ultimate objective is a Malaysia that is a fully developed country by the year 2020. The primary thrusts of the NDP entailed striking an optimum balance between the goals of economic growth and equity; ensuring balanced development of the major sectors of the economy; reducing and ultimately eliminating the social, economic and regional inequalities and imbalances; and ensuring material welfare while instilling positive social and spiritual values. The NDP also gave priority to human resource development; making science and technology an integral component of development planning; and ensuring the protection of the environment to maintain the long-term sustainability of the country's development.

While the NDP maintained the basic strategies of the New Economic Policy, it also introduced several new dimensions. The dimensions included shifting the focus of the anti-poverty strategy to address hardcore poverty; emphasizing on employment and the rapid development of an active *Bumiputera* Commercial and Industrial Community (BCIC) as a more effective strategy to increase the meaningful participation of *Bumiputera* in the modern economic sectors; relying more on the private sector to achieve the restructuring objective; and strengthening human resource development.

National Vision Policy was planned for the period 2001-2010. The objectives of the distributional agenda will be re-emphasized through the National Vision Policy (NVP) to ensure balanced and equitable participation among and within ethnic groups as well as regions. The NVP will maintain the basic thrust of the New Economic Policy (NEP) where the two-pronged strategy of poverty eradication irrespective of race and restructuring of society in the context of rapid growth will remain vital to achieve the overriding objective of national unity. The implementation of the NVP will also build upon the successes that were achieved in the past, particularly through the NEP and the National Development Policy (NDP)<sup>173</sup>.

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<sup>173</sup> Kuala Lumpur, Prime Minister's Department, *Third Outline Perspective Plan, 2000-2010*.

Thus the basic thrust of the NEP will continue, but as the redistributive objectives are near the target levels, strategy for growth will have to be emphasized more. These continuation policies have ensured stability and favorable investment climate for Malaysia. Malaysia's outlook can be summarized by the CIA 1999 country report on Malaysia's economy overview:

Malaysia made a quick economic recovery in 1999 from its worst recession since independence in 1957. GDP grew 5%, responding to a dynamic export sector, which grew over 10% and fiscal stimulus from higher government spending. The large export surplus has enabled the country to build up its already substantial financial reserves, to \$31 billion at yearend 1999. This stable macroeconomic environment, in which both inflation and unemployment stand at 3% or less, has made possible the relaxation of most of the capital controls imposed by the government in 1998 to counter the impact of the Asian financial crisis. Government and private forecasters expect Malaysia to continue this trend in 2000, predicting GDP to grow another 5% to 6%. While Malaysia's immediate economic horizon looks bright, its long-term prospects are clouded by the lack of reforms in the corporate sector, particularly those dealing with competitiveness and high corporate debt.<sup>174</sup>

Three years ago, Malaysia's lashing out with unorthodox measures has made the country an international financial pariah. However, as reported in the May 23<sup>rd</sup>, 2002 issue of the *Far Eastern Economic Review* (FEER) the situation has changed tremendously, as they reported:

Apart from Korea, Malaysia could be the best-regulated and most transparent market in Asia right now." Today, Malaysia's banks are among the best in the region. They have been recapitalized, consolidated to 10 from 58 banks and financial institutions previously and have had their bad debts pruned to internationally acceptable levels. Danaharta, the asset-management agency set up to resolve the bad-debt crisis in 1998, could become the first such global agency to turn a profit when it ceases operations in 2005. It took out 48 billion Ringgit (\$12.6 billion) worth of bad loans at 45 cents on the dollar in 1999-2000 and expects to recover almost 60 cents on the dollar. The banks have received almost 9 billion Ringgit from Danaharta. In fact, China and Turkey recently sent teams to study the Malaysian debt-recovery model.<sup>175</sup>

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<sup>174</sup> 2000 Federal Information and News Dispatch, Inc. CIA World Fact Book. <http://web.lexis-nexis.com/universe/document>? Dated 16 April 2002.

<sup>175</sup> Restructuring: Malaysia's Amazing Turnaround. *FEER Online*, 23 May 2002. <http://www.feer.com/> dated 21 May 2002.

Foreigners have ploughed \$2 billion into the stock exchange, sending it 36% higher since May of last year. Growth could hit 6% this year, up from 0.4% in 2001 while tax revenues reached 24% of the GDP in 2001, among the highest figures in Asia. Meanwhile, Malaysia's sovereign ratings have been upgraded by every international agency, making the country's debt hugely saleable. Credit spreads on an upcoming jumbo bond by national oil corporation PETRONAS, considered quasi-sovereign, are expected to trade at around 175 basis points above U.S. Treasury Bonds. In 1998, similar bonds traded at almost junk levels.<sup>176</sup>

With the depletion of surplus labor reserves, the major challenge currently facing the Malaysian economy is the upgrading of the workforce to create the resource base to enter world trade in high-tech, human capital-intensive, and competitive productions.

## **J. GLOBALIZATION**

The Asian crisis saw a new force creating havoc to the unwary. It was called the Borderless World, or globalization. This new force ensures no nation can be isolated with its own set of special rules for itself. In fact, globalization supposedly brings with it its own unilateral only rule, and it centers on fast-paced competitiveness. Malaysia's initial reaction was to shut off this force but later, the country modified its policies to accommodate the demands of globalization such as transparency and good corporate governance.

Malaysia now aspires to become a fully developed economy by 2020. This dramatic economic transformation has occurred against a background of massive shifts in the world economy as a result of increasing internationalization of production and trade. Malaysia has shown it could position itself within this new world economic order. As a small-open economy, Malaysia's economic policy stance has been not to isolate itself from these global trends. Rather, it has tried to respond to developments on the international front as they unfolded.<sup>177</sup>

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<sup>176</sup> Ibid.

<sup>177</sup> Prema-Chandra Athukorala. Globalization, Employment and Equity: The Malaysian Experience\* ILO Conference.

## K. CONCLUSION

The NEP was a reaction to perceived injustice in Malaysian society, which was the impoverishment of the majority by circumstances they could not control mostly in the pre-independence period. A social contract amongst the races when independence was granted gave political legality to the migrant groups and economic hope to the indigenous people for equity in all aspects of freedom and prosperity. It was not a socialist revolution for seizing existing assets to redistribute amongst the poorer and less advanced in Malaysian society. It was about giving more chances and opportunities for the “have-nots”, the ones left behind because of an unfavorable colonial policy, to catch up, rather than allowing perpetual lopsided opportunities to go to the already richer racial groups.

Far from destroying Malaysia, the 1969 riots sparked a series of political changes that helped fuel the economic boom of the 1980s and 1990s. The country's economy is now driven by a multiracial partnership, with the politically dominant Malays and the economically powerful Chinese working in tandem within what is essentially a Malay-dominated framework<sup>178</sup>.

After the race riots or after the financial crisis it would have been easy to give a free hand to the very dynamic and business oriented non-indigenous Chinese Malaysian to develop and enrich the country. However, then, the indigenous people would remain poor and still feel deprived. They would be bitter and angry. Inevitably, they would rise against the people, whom they regard as foreigners, who had the most stolen wealth that rightly belongs to them. They would destroy the wealth which had been created, and the country would fail to develop. In the end, everyone would lose and the country would have to beg for foreign aid and accept the conditions imposed.

The implementation of the NEP has undoubtedly changed the culture of the Malays and other *Bumiputeras*. They have acquired the culture of modern commercial and industrial society. The result of this change is that they have entered the mainstream of life in Malaysia. This has enabled the NEP largely to achieve its principle goals.<sup>179</sup>

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<sup>178</sup> Pillai, (2002).

<sup>179</sup> Mahathir Mohammad, p. 133.

Malaysia was lucky to have natural resources to fund NEP, but excellent efforts to attract FDI in the form of manufacturing industries, and a strong and powerful Executive Branch that can convey unpopular policies facilitated the NEP implementation. Liberal democracy was set aside for the loftier political stability and unfettered economic programs.

The Asian financial crisis had nearly undone 30 years of the NEP's hard work. However, the pragmatic response by authorities, at times relaxing the NEP, has enabled Malaysia to bounce back to a pre-crisis level. The Asian financial crisis was also a test case in the NEP's efficacy, and despite destabilizing economic and political conditions, race relations in Malaysia remained stable and peaceful.

An open economy and structural weakness in the economy caused the Asian crisis in Malaysia. The NEP, by facilitating large bank lending to inexperienced *Bumiputera* entrepreneurs, borrowing heavily to facilitate equity-sharing public enterprises might have worsened the situation. However, other countries that did not have an NEP to put them at a disadvantage also were caught in the financial crisis. Following the IMF proposals was not the solution for Malaysia, as it would have meant dismantling the NEP, which has proven to be successful.

Malaysia's growth has not been stunted because it had a political and social agenda intricately bound with the economic agenda as seen from the average 6.9 % annual growth for 30 years from the start of the NEP. As the Prime Minister said,

We think we can continue to grow with equity by adhering to the objectives of our New Economic Policy, now that we have been able to defeat the attempt to destroy our economy and political independence by devaluing our currency and impoverishing us.

Globalization brings competition and a market economy to accelerate and bring success to the borderless economy. It promotes preconditions for success by fostering the laissez-faire market. Yet Malaysia must not totally abandon the NEP policies that it used to successfully navigate itself for half a century, as the forces of instability in an ethnically based plural society are ever present. The country's future depends on efforts to improve national integration, accelerate inequality reduction and unevenness across class and ethnicity and work towards growth, peace and prosperity. These are divergent

objectives but not impossible to manage, given the will, and from proven successful past experience.

The key lesson to come from the Malaysian experience is that in a small open economy, the task of achieving the conflicting objectives of growth and equity is facilitated by a long-term commitment to an open and liberal trade and investment policy regime. Coupled with the stable political climate, the Malaysian economy can be well placed to take full advantage of the new opportunities arising from integration with the global economy.

However, a note of caution on the political front—political oppression, patronage and corruption---which are also amongst the biggest danger for any country's march towards developed nation status. Progress in the economic front must also be balanced in tandem by a more liberal political atmosphere, transparency and absolute zero tolerance on corruption, especially amongst those in power. Since the September 11 event in USA Malaysia has detained a total of 62 people believed to have terrorist links, including eight members of the main opposition Islamic Party. Though Washington seemed supportive of these moves, declaring that those detained posed genuine terrorist threats<sup>180</sup>, the use of ISA has been widely condemned internationally and domestically. ISA in the wrong hands can be a powerful weapon for political oppression, a development Malaysia do not need like the plague. Detention without trial has outlived its purpose, creating a sense of oppressiveness amongst the populace, which can backfire in the form of protest votes in the elections, and also an unneeded blot to the nation's credibility.

Corruption and political patronage have been widely discussed in Malaysia. Prime Minister Mahathir Mohammad has shown that he is sensitive to such criticism, as it diminishes investor confidence. As remarked by an emerging markets guru Mark Mobius, who runs funds worth \$12 billion for the Templeton group: "investors worry about political stability, lack of corporate governance and cronyism".<sup>181</sup> It is heartening that the government has begun to shun dubious corporate bailouts as seen from its refusal to bail out TajuddinRamli's TRI Industries recently.

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<sup>180</sup> "US Pragmatic Towards Malaysia", *Far Eastern Economic Review*, June 6, 2002, p. 10.

<sup>181</sup> Penny Crisp, "Discord", *Asiaweek*, April 27, 2001.  
<http://www.asiaweek.com/asiaweek/magazine/nations/0,8782,106834,00.html>, dated 4 June 2002.

While there were some policy excesses triggered by conflicting objectives in a plural society, the policy makers have been successful in rectifying policy errors swiftly. It was this flexibility and pragmatism, which put the Malaysian economy back on the path towards growth in the mid-1980s, and after the Asian crisis in late 1990s. The 1970s and early 1980s were created by the excessive emphasis placed on distributional objectives. In spite of the expected decrease in growth in the industrial world, the outlook for the Malaysian economy for the remaining years of the 2000s remains good. So long as the liberalization and deregulation of the domestic economy continues, the environment for private initiatives and enterprise as well as private savings and investments will continue to improve.

Economic and social equitability is important, but so is growth. In the past thirty years prior to the Asian crisis, Malaysia has successfully towed the line. It has miraculously managed to achieve both hand in hand, thanks also to some trade offs between the races, and very autocratic laws. However, the financial crisis has shown significant structural macroeconomic weakness, such as the need for more competitiveness, transparency, and fairer regulations. This will make future social economic efforts for equal wealth distribution along the races more difficult, as meritocracy will have to be an important factor for competitiveness.

Income inequality and redistribution can make an economy less efficient in the allocation of resources. However, left unchecked, it can foster dissatisfaction if the divide is across ethnic and religious groups, and it destabilizes, as had happened in numerous occasions. When this happens, economic growth will not be promoted.

Malaysia's efforts in that direction has shown some success but the country must look to the future and use the economic success to ensure the need to enforce economic and social parity between its diverse ethnicities which will truly transform the country into a fully competitive and stable country. Malaysia should not be developed only in the economic sense. It must be fully developed in terms of national unity and social-cohesion, in terms of the economy, in terms of social justice, political stability, system of government, quality of life, social and spiritual values, national pride and confidence.

## V. IS NEP AN APPROPRIATE POLICY FOR MALAYSIA?

### A. INTRODUCTION

Without a doubt, the Government must address the worsening inequality, especially in wealth, income and social advancement, between the ethnic groups in Malaysia. The central question is whether the NEP was the appropriate policy for the country. Measured from Malaysia's relative economic success, political stability and social harmony compared to other developing nations, it appears that the NEP was appropriate. However, just for the sake of argument, we will examine a scenario in which the NEP did not exist in Malaysia.

It is impossible to envision Malaysia without the NEP during 1970-1990 but we can construe the scenario of continuing laissez-faire developments during 1957-1969. To obtain different perspectives on other methods of development we can also compare the policies adopted by neighboring countries such as Singapore, led by Prime Minister Lee Kuan Yew after its 9 August 1965 independence and Indonesia, from the start of General Suharto's "New Order" regime beginning 1 October 1966, as these countries faced similar economic and development challenges during the same period as the implementation of NEP in Malaysia.

### B. CONTINUATION OF 1957-1969 POLICIES

As seen from the events culminating in the May 13, 1969 riots, continuing total free-market policies in the immediate post independent years in Malaysia would have perpetuated the disadvantageous situation of the Malays and the disparity would have grown over time. It would be increasingly difficult for the weaker group to catch up, as seen from the experience of South Africa after their independence from Britain<sup>182</sup>. In fact, the deteriorating position of the Black majority was a cause of apartheid, as the Blacks were so completely at the mercy of the White minority.<sup>183</sup> The same situation happened in Zimbabwe. The former British immigrants continued their economic domination to the point where Prime Minister Robert Mugabe forcibly nationalized the

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<sup>182</sup> *Apartheid in South Africa*, <http://www-personal.umich.edu/~jrajzer/nre/apartheid.html> dated 28 May 2002.

<sup>183</sup> *Ibid.*

former immigrants' properties, especially large farmlands, for redistribution to the poor indigenous population, leading to much chaos,<sup>184</sup> and the expulsion of Zimbabwe from the British Commonwealth of Nations in 2002.

## C. SINGAPORE

Singapore was asked to leave the Malaysian Federation on 9 August 1965 due partly to Mr. Lee Kuan Yew's opposition to the concept of special rights for Malays. In the years since, Singapore has successfully forged their own development concept, based amongst others, on competitiveness and meritocracy of their human resources. However, the PAP Government also practices authoritarian interventionist policies in their political, economic and social policies on development in Singapore. In fact, Mr. Lee Kuan Yew and Dr. Mahathir Mohammad are at the forefront with their arguments on interventionist policy, and that too much democracy hinders development.<sup>185</sup>

### 1. History

Sir Stanford Raffles of the British East India Company founded the Singapore settlement in early 1819, through an agreement with Malay Sultan Hussein Shah of the Johore Sultanate and the Temenggong (a local chief). Singapore at the time had around 1,000 indigenous inhabitants, consisting of Malays as well as the *Orang Laut*, i.e., Sea Nomads. There were also some Chinese traders and gambier planters in the interior of the country<sup>186</sup>.

Sir Stanford Raffles found Singapore's geographical position was even better than that of the Riau islands near Indonesia. With its excellent harbor and plentiful supply of good drinking water, the island was suitable as a port. Most importantly, the new southern British port would be much nearer the main trading areas in the archipelago than Penang in the north of the Peninsula, being much nearer to Java and the eastern part of the Malay Archipelago. It could be a center of free trade to attract traders from all over

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<sup>184</sup> Politics Widens Rift Between White, Black Zimbabweans <http://iafrica.com/news/features/906001.htm> dated 28 May 2002.

<sup>185</sup> Jean Blondel, Takshi Inoguchi and Ian Marsh, *Democracy, Governance, and Economic Performance*. (New York, United Nations University Press) 1999, p. 1.

<sup>186</sup> Singapore Info Map Website, Founding of Modern Singapore. [http://www.sg/flavour/profile/profile\\_singapore.html](http://www.sg/flavour/profile/profile_singapore.html) dated 21 May 2002.

the archipelago. This would allow the British to begin to break the Dutch monopoly on trade<sup>187</sup>.

Singapore proved to be a prized settlement. With the advent of the steamship in the mid-1860s and the opening of the Suez Canal in 1869, Singapore became a major port of call for ships sailing between Europe and East Asia. Also, with the development of planting rubber, especially after the 1870s, it became the main sorting and export center in the world for rubber. For example, during the Indonesian confrontation from 1963-1966, the Sumatra rubber industry collapsed for want of an export-processing center, as trade with Singapore was banned during that time.<sup>188</sup> Before the end of the 19<sup>th</sup> century, Singapore was experiencing unprecedented prosperity. The prosperity attracted immigrants from areas around the region. By 1860, the population had grown to 80,792. The Chinese accounted for 61.9% of that number; the Malays and Indians 13.5% and 16.05% respectively; and others, including the Europeans, 8.5%.

Singapore, together with Malacca and Penang, the two British settlements in the Malay Peninsula, became the Straits Settlements in 1826, and by 1832, Singapore had become the center of Government for the three areas. On 1 April 1946, Singapore became a Crown Colony. Penang and Malacca became part of the Federation of Malaya in 1948.

In the first political elections in Singapore, the Labor Front won and its leader, David Marshall, became Singapore's first Chief Minister on 6 April 1955, with a coalition Government consisting of his own Labor Front, the UMNO and the MCA. However, when Singapore gained self-governance in 1959, in the elections that year, the PAP won 53.4% of the total votes and thus Mr. Lee Kuan Yew was sworn in on June 5, 1959 as Singapore's first Prime Minister. Singapore joined Malaysia on 16 September 1963 but parted ways on August 9, 1965.

## **2. The Malays in Singapore**

As stated earlier, the Malays were amongst the original settlers in Singapore. The Chinese were descendants of immigrants from China and India.<sup>189</sup> Nonetheless, since

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<sup>187</sup> British Search for A New Port, <http://library.thinkquest.org/10414/founding.html>, dated 21 May 2002.

<sup>188</sup> Thomas and Panglaykim, in Jac Mackie (ed), *The Chinese in Indonesia*. (Honolulu: University Press, Hawaii) 1992. p. 178.

<sup>189</sup> *Ibid*, p. 135.

the early 1900s, the Malays were a minority group in Singapore when the immigrant traders, laborers and commercial workers overwhelmed them. In the 1990 census, out of 2.69 million people in Singapore, the Malays were 0.38 million, (14%) of the Singapore population, whereas the Chinese were 2.089 million (77.7%), and the Indians 0.191 million (8%).<sup>190</sup>

Politically, the Malays in Singapore were weak, compounded by Mr. Lee Kuan Yew's policy to scatter and mix them with the majority Chinese populace. The Singapore Government broke up Malay settlements, in the guise of banishing ghettos, and dispersed them. As a result, there were no Malay majority political constituencies in Singapore. Mr. Lee Kuan Yew describes this in his book *From Third World to First*:

As part of our long term plan to rebuild Singapore and rehouse everybody, we decided to scatter and mix Malays, Chinese, Indians, and all others alike and thus prevent them from congregating...Although we mixed the races by making them ballot for their homes, we found that they were collecting together again. ...This forced us to in 1989 to put percentage limits of 25% for Malays, 13 % for Indians and other minorities at block level (resident-housing)<sup>191</sup>.

Since Singapore and Malaysia shared the same fate under the British at the same time, the Malays in Singapore suffered the same predicament as the Malaysian Malays. They were backward and economically inferior to the Chinese and Indian immigrants. Nonetheless, no affirmative actions were taken in their favor. In fact, in some sectors, they were negatively discriminated against. For example, Malays were not allowed in sensitive military units such as the Air Force or armor units. Deputy Prime Minister Lee Hsien Loong once had stated that in the event of a conflict, the Singapore Armed Forces (SAF) did not want any of its soldiers to be put in a difficult position where loyalty to the nation might conflict with emotions and religion.<sup>192</sup> As far as this writer is aware, the SAF does not have a Malay with the rank of General. In a survey of all 24 Singapore officers studying at the Naval Postgraduate School, on 23 May 2002, none were Malays or Indians. Thus, there was a 0% representation out of 24 for non-Chinese Singaporeans.

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<sup>190</sup> Singapore, Ministry of Information, *Singapore Facts and Figures 1991*, (Singapore: Singapore National Printers) 1991 p. 3.

<sup>191</sup> Lee Kuan Yew (1999) pp. 207- 209.

<sup>192</sup> Ibid. pp. 247-8.

### 3. Economics, Stability and Development

By any measure, Singapore's economy is a success. It attained the elite status of a NIC, a newly industrialized country. It is one of the four tiger economies in Asia. Singapore has improved its per capita Gross Domestic Product (GDP) of US\$ 400 in 1959 to US\$ 22,000 in 1999<sup>193</sup>. Singapore's rapid growth has been described as an "economic miracle". The size of the economy as measured by real GDP was nearly eleven times that in 1965, and its economy grew on average of 8.8 % annually for three decades. As seen from Table 4, the data shows Singapore to indeed be an economic success.

| <b>Indicator</b> | <b>Year</b>  |              |              |             |
|------------------|--------------|--------------|--------------|-------------|
|                  | <b>65-70</b> | <b>71-80</b> | <b>81-90</b> | <b>1993</b> |
| Real GDP         | 11.9         | 9.1          | 7.1          | 9.9         |
| Inflation Rate   | 1.5          | 6.3          | 2.8          | 2.4         |
| Savings Ratio    | 17.2         | 29           | 41.5         | 47.5        |
| Investment Ratio | 26.4         | 41.2         | 42.2         | 43.8        |

Table 5. Main Economic Indicator, Singapore.  
(From: Source: Department of Statistics, Singapore, 1994)

In terms of stability, apart from growing pains, Singapore's society was generally peaceful, with strict Government regulations. During the Asian Financial Crisis in 1997-1998, Singapore did not suffer many setbacks.

### 4. Government Role

Singapore is one of the most regulated city-states in the world, with the Government intervening in many aspects in economical, political and social areas. However, the interventionist measures are of "high quality", very transparent with no hint of corruption<sup>194</sup>. Its public service and education system is based on meritocracy that attracts the brightest from Singapore and abroad. Mr. Lee Kuan Yew, who ruled with an iron hand, guided its early years. He did not tolerate much dissent and Singapore has not

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<sup>193</sup> Lee Kuan Yew, *From the Third World to First*, (New York: Harper's Collins) 2000. p. xv.

<sup>194</sup> Habibullah Khan, A Brief Assessment of Singapore's Economic Miracle, in Abu Walid (ed) *The ASEAN Region In Transition*, (England: Ashgate Publishing) 1997. p. 98.

been categorized as a democratic country, though it has regular, transparent elections because the opposition was not given much leeway as the Government tightly controlled the press and broadcasting stations. For example, the UnionWorks' Mandarin radio station has been fined Singapore\$ 15,000.00 recently for adding "personal remarks and observations by the newsreader, which were unwarranted in normal news bulletins" as explained by the media watchdog Singapore Broadcasting Authority (SBA)<sup>195</sup>. As in Malaysia too, strict measures such as the Internal Security Act and Seditious Act exist. Singapore's parliament has almost been a single party throughout its history since separating from Malaysia.

#### **D. INDONESIA**

The majority of Indonesia's population of 224 million is Muslim Indonesian Pribumis (indigenous people), which accounts for 88% of the populace. However, the Chinese, who number about 5 million, control the economy. No specific affirmative action policy exists for the poorer majority.

##### **1. History**

Indonesia, a collection of over a thousand islands, started out as a series of Hindu Kingdoms around 78 AD<sup>196</sup>. Like Malaysia, the Portuguese, Dutch, English and Japanese colonized it. However, unlike Malaysia or Singapore, its struggle for independence was through bloody and violent wars of revolution. On August 17, 1945, Sukarno, leader of the struggle for independence, proclaimed independence from the Dutch and become Indonesia's first president. Sukarno's authoritarian, "Guided Democracy" rule, was not a prosperous time for Indonesia. Embracing socialist ideologies of the Chinese Republic and the Soviet Union, Sukarno plunged the republic into economic stagnation. Though Sukarno was a founder of the Non-Aligned Movement, he also was against the creation of Malaysia, and withdrew from the United Nations.

##### **a. *The Communist Abortive Coup***

A defining point for Indonesia was the abortive communist coup by the Indonesian Communist Party (PKI) on 30 September 1965. The Armed Forces under Major General Suharto, then Commander of the Army's Strategic Command, however,

<sup>195</sup> *Radio Station Fined For Commenting on News*, New Straits Times online [http://www.nstpi.com.my/Current\\_News?NST/Tuesday?World/20020604092211/Article/](http://www.nstpi.com.my/Current_News?NST/Tuesday?World/20020604092211/Article/), dated 4 June 02.

<sup>196</sup> Early History of Indonesia, <http://www.prica.org/indonesia/general/history.html#neword>, dated 27 May 2002.

quickly crushed the uprising. This paved the way for the ouster of President Sukarno, and the rise of General Suharto to become the second Indonesian president who then embarked on his “new order” policies<sup>197</sup>. This new order regime persisted until Suharto’s resignation in the wake of the Asian Financial Crisis in May 1998.

**b. President Suharto’s New Order**

To emerge from the political and economic legacy of Sukarno's Old Order, the new Government set out to complete the restoration of order and security and to establish political stability, carry out economic rehabilitation, prepare a plan for national development and execute it with an emphasis on economic development. Its detailed goals were:

- To end confrontations and normalize diplomatic relations with Malaysia
- To return to the United Nations, which Indonesia had left in January 1965
- To consistently pursue an independent and active foreign policy
- To resolve the West Irian question
- To regain Indonesia’s economic credibility overseas
- To hold general elections once every five years

**2. The Chinese in Indonesia**

In the 1970, it was estimated there were probably about 3 million Chinese in Indonesia amidst a population of 120 million<sup>198</sup>. Nevertheless, by the 1990s, most estimates placed Chinese ownership of domestic private corporate capital at around 70% of the total, and Chinese capital dominated the strategic large corporate sector<sup>199</sup>. Ethnic Chinese businessmen called Cukongs were able to link themselves to the ruling elites, the military and the Presidential family in order to corner the lucrative monopolies. Examples are Liem Sioe Liong in the clove monopoly to make Indonesian cigarettes, Yap Swie Kie in export/export and Bob Hassan in forestry and timber. Almost all Suharto family holdings were minority shares in mainly Chinese–owned corporate groups, notably those of Liem Sioe Liong, William Soerjadjaja, Agus Nursalim and Mukmin Ali.<sup>200</sup>

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<sup>197</sup> Indonesian History--The Communist Abortive Coup in Indonesia, <http://www.prica.org/indonesia/general/history.html#birth>, dated 28 May 2002.

<sup>198</sup> Mackie and A. Coppel, A Preliminary Survey in J. A. C Mackie (ed) *The Chinese In Indonesia*, (Honolulu: The University Press of Hawaii). 1976. p. 1.

<sup>199</sup> Ruth McVey (ed), *Southeast Asian Capitalists* (New York: Cornell University Press). 1992. p. 68.

<sup>200</sup> Ruth McVey (1992) p. 71.

At the start of General Suharto's "New Order" autocratic rule, the Chinese were very much at a disadvantage as they were accused of supporting the Indonesian Communist Party (PKI), whose abortive 30 September 1966 coup in Jakarta had propelled General Suharto into power, eventually replacing President Sukarno as Indonesia's strongman in 1967. Also, the Chinese allegiance to the Republic was suspected by the indigenous Indonesians because of events occurring after the Indonesia gained independence in 1945 as many had identified themselves as Chinese citizens under China's dual citizenship policy<sup>201</sup>. When the dual citizenship option was abrogated in the 1960s, the Chinese that remained in Indonesia were still suspected and many were officially termed "stateless persons". After stability returned in the "new order", the Chinese business community had to establish protection through friendships with elites and resorted to bribing underpaid public officials. This reinforced the notion amongst Indonesians of the Chinese as the corruptor of lowly paid Indonesians<sup>202</sup>.

Veiled and not-so-veiled attacks on the patriotism of the ethnic Chinese have a long history in Indonesia and goes back to the Chinese role in the Dutch colonial period, and to the 1960s and the army's suspicion that the ethnic Chinese as a group were a fifth column for the Chinese Communist Party. They resonate strongly in Indonesian society, especially, though not exclusively, among more conservative Muslim groups.<sup>203</sup>

The Suharto Government had continued a policy of discrimination against the ethnic Chinese, such as restricting their admission to state universities and civil service, maintaining a ban on the use of Chinese characters, and closing Chinese schools. The Chinese tried to assimilate by changing their names to Indonesian names, withdrawing from exclusive Chinese societies, and networking with the powerful military and bureaucrats<sup>204</sup>. President Suharto, at the same time, tolerated the Chinese dominance of the Indonesian economy, which enabled a few dozen ethnic Chinese families to amass

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<sup>201</sup> Mackie and Coppel (1976) p. 1.

<sup>202</sup> Ibid. p. 12.

<sup>203</sup> *Economic Crisis Leads to Scapegoating of Ethnic Chinese*. <http://www.hrw.org/press98/feb/indo-all.htm>, 28 May 2002.

<sup>204</sup> Charles Coppel,(ed) *The Chinese in Indonesia* (1992) pp. 19-72.

fabulous wealth. These policies have resulted in the public considering the ethnic Chinese to be rich pariahs<sup>205</sup>.

### **3. Political and Economic Performance**

Although industrial development at the beginning of the Suharto era was inward looking, state-run monopolies managed by bureaucrats and the military, oil exports and import substitution industry kept the economy growing<sup>206</sup>. The economy from 1970 until 1997, for the period of Suharto's regime before the financial crisis, achieved an enviable average annual economic growth of 7%.<sup>207</sup> Relative autonomy of the political executive and the decisiveness of the political process had greatly facilitated the task of maintaining a generally sound macro-economic structure, as well as liberalizing trade, investment and financial regulations in the late 1980s<sup>208</sup>.

At the same time, however, political relations between the state and capital and their corporate clients, began to conflict with the needs of capital for effective long-term state coordination to compete in world markets<sup>209</sup>. Banks, following state directives, were overextended. Thus when the Asian crisis struck, Indonesia was hit hard.

In the political realm, Indonesia relied on the President's authoritarian power. Although Indonesia has an institutionalized party system and electoral process that holds elections every five years, (in which only three chosen political parties are allowed to participate), they are extensively staged-managed and lean heavily in favor of the ruling party, the Golkar Party.<sup>210</sup> The ability to make a decision is highly concentrated in the hands of the Executive, especially the President, who has wide ranging decree powers and can appoint members to the 1,000 member People's Consultative Assembly. This assembly met once in five years in order to chose the President and Vice-President.<sup>211</sup>

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<sup>205</sup> *Economic Crisis Leads to Scapegoating of Ethnic Chinese*. <http://www.hrw.org/press98/feb/indo-all.htm>, 28 May 2002.

<sup>206</sup> Ruth McVey (ed) (1992) p. 65.

<sup>207</sup> Andrew McIntyre, in Ian Marsh et al (ed) *Democracy, Governance and Economic Performance* (New York: United Nations' University Press) 1999. p. 261.

<sup>208</sup> McIntyre in Ian Marsh (ed) (1999) p. 274.

<sup>209</sup> Mc Vey, p. 65.

<sup>210</sup> Mc Intyre, pp. 266-7.

<sup>211</sup> Ibid, pp. 267-272.

The excessive unchecked power held by President Suharto generated a culture of nepotism and cronyism, was causing a serious economic-political issue, with those closest to the ruling family, such as the Suharto's children, *Pribumi* businesses of high officials, and rich ethnic Chinese businessmen, obtaining the bulk of the business<sup>212</sup>. There was not much attempts to redistribute the wealth to the majority masses. In a feeble attempt to do so, on March 4, 1990 President Suharto invited thirty-one of the richest businessmen (almost all non-*Pribumi*) to his estate in Tapos in West Java for a highly publicized meeting at which he called on them to transfer shares in their enterprises to the cooperatives (generally poorer, *Pribumi* business efforts). The eventual outcome of this effort was modest<sup>213</sup>. Thus, when the Asian Financial Crisis struck, there was widespread discontent among the people and a revolt forced President Suharto to resign in disgrace.

#### **4. Asian Financial Crisis in Indonesia**

In July of 1997, the Asian Financial Crisis beginning in Thailand descended on Indonesia, depreciating the rupiah and plunging the nation into economic chaos. Investors lost confidence and left the country. By the end of July 1998, the rupiah had fallen by about 65% relative to the end of 1997. The loss of confidence sparked financial instability, and output collapsed which severely impacted the poor<sup>214</sup>.

Indonesia had to ask the International Monetary Fund (IMF) to rescue it from this crisis. On November 5, 1997, the authorities entered into a three-year stand-by arrangement with the IMF for US\$ 10 billion, which was augmented by about US\$ 1.4 billion in July 1998. Large amounts were also pledged by other multilateral institutions (\$8 billion) and by bilateral donors (\$18 billion), the so-called "second line of defense". Although the rupiah initially appreciated, market sentiment began to sour again, between December 1997 and January 1998, after sixteen insolvent banks were closed by Bank Indonesia in November<sup>215</sup>.

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<sup>212</sup> Didik Rachbini, Growth And Private Enterprise, in Richard Baker (ed) *Indonesia, The Challenge of Change*, (New York: St Marti's Press) 1999. p. 36.

<sup>213</sup> Ibid.

<sup>214</sup> IMF Brief, *Recovery from the Asian Crisis and the Role of the IMF*  
<http://www.imf.org/external/np/exr/ib/2000/062300.htm#box3> dated 28 May 2002.

<sup>215</sup> Ibid.

President Suharto's delaying tactics towards reforms, and the ill advised IMF reform agenda made matters worse. There were also delays in implementing the program. The continuing serious social and political upheaval culminated in the fall of President Suharto in May 1998.

Against this backdrop of fragile and incomplete accomplishments, the newly elected Government of President Habibie negotiated a new three-year extended arrangement for about US\$ 5 billion with the IMF, which was approved by the Fund's Executive Board in February 2000. The macroeconomic framework seeks to restore an annual growth rate in the area of 5 to 6% by 2002, with an annual inflation target of below 5%. The Financial Sector Policy Committee was established with the mandate to provide leadership and direction in banking and corporate restructuring.<sup>216</sup>

The rise in prices of basic goods such as rice and cooking oil has led to violent protests across Indonesia, most of them aimed at the ethnic Chinese minority who dominated the retail economy but also the shopkeepers who constituted a critical part of Indonesia's middle class.<sup>217</sup> The rioting appeared to have been largely spontaneous, though Human Rights Watch believed that senior Government and military officials had fueled anti-Chinese sentiments<sup>218</sup>. Continued social problems forced President Habibie out. His Vice President, Megawati Sukarnoputeri, a daughter of the former President Sukarno, replaced him.

## **E. CONCLUSION**

All three countries followed almost similar economic policies of growth through direct foreign investment and industrialization, with Malaysia putting in place an additional redistributive policy of the NEP. All three countries have authoritarian rule though with different degrees of liberalism. Yet, eventually, after 30 years, their outcomes are different.

Economically, Malaysia's performance rating is between that of Indonesia and Singapore in most aspects of economic measures. Table 6 shows the progress on per

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<sup>216</sup> Ibid.

<sup>217</sup> Economic Crisis Leads to Scapegoating of Ethnic Chinese, *Human Rights Watch, Asia Division February 1998*. <http://www.hartford-hwp.com/archives/54b/064.html>, dated 26 May 2002.

<sup>218</sup> <http://www.hrw.org/hrw/press98/feb/indo-all.htm>, dated 27 May 2002.

capita GDP. Though Malaysia has progressed better than Indonesia, Malaysia lags far behind Singapore.

| <b>Country</b>   | <b><u>Real GDP Per Capita in 1995 Dollars</u></b> |                           |
|------------------|---|---------------------------|
|                  | <b>(a)</b><br><b>1965</b>                         | <b>(b)</b><br><b>1995</b> |
| <b>Singapore</b> | <b>2,678</b>                                      | <b>23,350</b>             |
| <b>Malaysia</b>  | <b>2271</b>                                       | <b>9,458</b>              |
| <b>Indonesia</b> | <b>817</b>  | <b>3,346</b>              |

Table 6. Comparison of Per Capita GDP<sup>219</sup>.

In the bitter test resulting from the Asian Financial crisis, Singapore was spared but Malaysia and Indonesia were not. However, Malaysia has managed to survive and recover, whilst Indonesia experienced the worst case of racial riots, and change of Government. While Malaysia and Singapore now have fully turned around, Indonesia has not. Thus, for countries not carrying out the NEP, their fate is very much different. Indonesia was mired in economic chaos and racial conflicts, whereas Singapore was a model of economic success.

In the case of Singapore, there are special reasons why it is advanced and did not suffer racial problems though it does not have a redistributive policy to let the less privileged catch up.

First, its Malay minority is weak and has no capacity to threaten the stability of the majority. Constituting 14% of the population, the Singapore Malays are politically dispersed through a policy of dilution by the majority Chinese in all constituencies. Second, being already advanced in trade and services, it had had a head start over Malaysia in economic development. Third, there is no doubt that the clean, transparent, merit-based administration has eradicated poverty, ensured investor's confidence by bringing in more prosperity, which in turn makes everybody happy. Fourth, there are always the Government's strict reprisals against racial agitation.

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<sup>219</sup> Vinod Ahula, *Everyone's Miracle? Revisiting Poverty and Inequality In East Asia*. (Washington: World Bank Publication) 1997. p. 4.

For Indonesia, there were calls, after the crisis, for the Government to install an NEP type policy<sup>220</sup>. The problem of discontent among the poor majority resulted in serious repercussions on the stability of Indonesia. However, the problem of its leadership, and especially President Suharto taking care of the interests of his family and cronies, has robbed the majority of Indonesians of a share of the nation's wealth. In our view, Indonesia did not take advantage of the stability, prosperity and availability of oil money in the Suharto years to embark on a special program to help the poor Malay masses through similar programs such as the Malaysian New Economic Policy because the ruling elites were cozily cohabiting with the elite Chinese businessmen in pursuit of wealth and business opportunity.

We conclude that the NEP has helped Malaysia stabilize the racial torrent and made the nation more resilient. After all, Singapore and Indonesia too have their own special policies catering for their own situation. The NEP did not drastically burden Malaysia as seen from its thirty years of relatively successful economic and social progress especially of the Malays. The policy could be further modified, however, to take cognizance of the latest developments such as the financial crisis in 1997-8. Malaysia has had to learn many lessons from the manner in which Indonesia and Singapore govern, by following the good and abolishing the bad.

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<sup>220</sup> Khoo Boo Teik (2001).

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## **VI. CONCLUSION**

### **A. INTRODUCTION**

The situation in Malaysia today is radically different from the struggling underdeveloped country of more than thirty years ago at the onset of the NEP. Racial tension has been subdued to a great extent, and multi racial, pluralistic Malaysia has been able to build a prosperous nation. It has enjoyed more than thirty years of peace and prosperity with all races sharing the wealth and Malaysian governance. For most Malaysians in the 1990s, interethnic tolerance took on new meaning and greater value when compared with the ethnic warfare in the Balkans and the former Soviet bloc. Nationhood, the elusive state that defied the Alliance Party elites at the onset of independence, and national unity, which was the NEP's overarching goal, seemed attainable<sup>221</sup>. This can be understood when things appeared to be quiet on Malaysia's ethnic front on the eve of the July 1997 financial crisis. Despite other kinds of political conflicts, no major ethnic conflicts surfaced in the aftermath of the crisis. Malaysia is mentioned more and more as a model of racial harmony and cooperation in a multiracial society.<sup>222</sup>

This chapter concludes the study of the NEP by analyzing the appropriateness of the NEP strategies from the results of thirty years of implementation, lessons learned from Malaysia's nearly half a century struggle to define its national destiny and recommending the next steps Malaysia should take to modify its economic, political and social policies to build further resilience into the nation to face the challenges ahead.

### **B. RESEARCH QUESTIONS**

The question raised when embarking on this study was whether the NEP was an appropriate policy for Malaysia. Was the policy successful? Should Malaysia continue it and what modifications are needed? The other question to answer was whether the policy was fair to Malaysians.

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<sup>221</sup> Khoo Boo Teik, *Managing Ethnic Relations in Post-Crisis Indonesia and Malaysia*, UNRISD Conference on Racism, Durban, Sep 2001. <http://www.unrisd.org/racism/a-teik.htm>. Dated 4 June 2002.

<sup>222</sup> Mahathir Mohammad (1999) p. 7.

We conclude that the NEP was an appropriate policy for the country, because first, it saved Malaysia from a further escalation of racial and religious based civil wars as happened to many other post independent countries in the same period, such as Ghana, Nigeria, Sri Lanka, and Pakistan-Bangladesh to name a few.

Second, the political and social stability created has become a magnet for direct foreign investment. By chance, NEP implementation coincided with certain developments in the global economy, such as the new international division of labor linked to the internationalization of manufacturing production. Japanese, American and European manufacturers came to Malaysia in droves due to the stability and the government's concerted efforts to opt for growth to fund NEP strategies. The subsequent stability and NEP-mandated restructuring had also enabled Malaysia to develop its industrialization capability, and privatization management that it is well on its way to becoming an Asian Newly Industrialized Economy. The percentage of exports in 2001 for manufactured goods was 85%.

Third, the efficacy of the NEP resulted in an economic resilience in Malaysia that was strong enough so that, during the Asian Financial Crisis in 1997 and 1998, the economy managed to recover and the ethnic Chinese-Malaysians were not envied because of their overwhelming prosperity. Thus, they were unharmed in contrast to Indonesia where the same financial crisis led to an economic and political implosion that brought in its wake several outbursts of ethnic violence against the Chinese population, between Christian and Muslim communities in Maluku, and between Dayaks and Madurese in Kalimantan<sup>223</sup>.

Fourth, the NEP has given a sense of self-worth to the *Bumiputeras* so they can progressively compete with non-Malays in Malaysia. Thus, when the government decided that admission for seats in public universities for academic year 2002 be based on academic merit, *Bumiputera* students managed to compete successfully, achieving admission figures greater than what they would have received under the quota system <sup>224</sup>.

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223 Khoo Boo Teik (2001).

224 Saiful Azhar Abdullah, *Bumi Intake Up in Varsities*, *New Starits Times*, Online [http://www.nstpi.com.my?Current\\_News?NST?Friday?Frontpage?20020510075821/Article/](http://www.nstpi.com.my?Current_News?NST?Friday?Frontpage?20020510075821/Article/), dated 10 May 2002.

It is a far cry from the days of British colonialism when a Malay was to be educated, if at all,

to make the son of a fisherman or peasant a more intelligent fisherman or peasant than his father had been, and a man whose education will enable him to understand how his own lot fits in with the scheme of life around him.<sup>225</sup>

Fifth, though there was some controversy on use of the oil money, on the whole a lot of the PETRONAS revenue was spent on redistribution projects. The Malaysian leadership had not wasted the income by buying sophisticated weaponry, or building grandiose projects (Petronas Towers notwithstanding), but had generally used them for development and restructuring of the Malaysian society through NEP plans.

The data on the reduction of poverty and the restructuring of economic activities show that the targets are nearly attainable but not yet fully achievable as illustrated in Chapter IV. The NEP was generally regarded as a success though its targets were not fully achieved. Chowdhury (1997) argued that much of the success for Malaysia's development was attributed to its racial composition at the time of independence and the subsequent pursuit of the NEP whose goal was racial and political harmony within the context of a growing economy. The success was in the "shared growth" enshrined in the NEP which was designed to balance the economic interests prevailing in racial groups.<sup>226</sup>

Though the NEP from 1970-1990 was generally successful in its role in preventing inter-ethnic conflict, it was not without flaws. There were still areas that needed improvement. Certain adjustments were necessary to ensure that gains from the policy continued to maintain social and national cohesion. Post NEP from 1990 onwards has been a period of reflection for Malaysia. Some unintended consequences in the implementation of the NEP have raised concerns about intra-ethnic wealth distribution, the struggle for power and wealth opportunities between groups located in the ruling parties, especially in the UMNO. Political patronage has become a serious issue as the newly rich and aspiring capitalists jostled to obtain political favors, equating political ascendancy as a ticket to obtain rent seeking business opportunity. The need for strong

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<sup>225</sup> Donald Snodgrass, *Inequality and Economic Development in Malaysia*, (Kuala Lumpur: Oxford University Press). 1980 p. 31.

<sup>226</sup> Anis Chowdhury (1997) pp. 43-64.

state control to be vigilant about political and ethnocentric disruptions is understandable but it is also causing illeberalism and limiting liberal democracy.

In addition to delaying by a few years NEP achievements in restructuring and eradicating poverty, the Asian crisis also provided a chance to reflect on the country's policies including the discretionary practice of the allocation of corporate shares to the connected Malays leading to charges of cronyism and a widening chasm of inequality within the Malay society itself. This has generated much discontent. The selective nature of the "bail out" process and procedures following the 1997-8 currency, financial and economic crisis have strengthened this resentment. Together with the political fall out of Anwar Ibrahim whose supporters have formed the Keadilan Party (Justice Party), a significant portion of the dissidents has joined forces with the Islamic party. This has split the Malay community. They have also launched the "reformasi" or reform movements demanding more transparency, a halt to perceived patronage, and a move towards more checks and balances.

In answering the issue of whether the NEP was unfair, it is necessary to look at the historical development of the Malaysian nation. Malaysia emerged from colonial rule with its own unfairness towards the indigenous people. The 1957 social contract between the racial leaders, agreeing to the need for the Malays to have special rights and policies to catch up economically had created the scenario for future development. The establishment of the NEP in 1971 was a manifestation of this agreement. In the first decade following independence, the government was too preoccupied with concerns about defense, security and law and order issues in the form of the communist armed insurgency, and Indonesian confrontations, and neglected this important social economic aspect, which led to racial and civil unrest. When looked at from the perspective of the 1957 Bargain, the NEP was a fair policy meant to compensate for the magnanimity of the Malays, and allow them to share in a portion of the prosperity of their land. However, the Malays must be cognizant that this special treatment cannot last forever. It was meant to help them catch up and to compensate for the unfair disadvantages facing them earlier. Once equality is achieved, Malaysians must be prepared to renegotiate in order to build a very cohesive Malaysian entity.

The National Development Policy (NDP) and the National Vision Policy (NVP) for 1990-2010 address the continuation of the NEP. These two policies generally follow the NEP drive to eradicate poverty and restructure society. The implementation of the NVP will also build upon the successes achieved in the past, particularly through the NEP and the National Development Policy (NDP)<sup>227</sup>.

### C. RECOMMENDATIONS

The social restructuring, sharing of wealth, power and opportunities have so far given Malaysia thirty years of peace, harmony and stability. However, there are a few lessons and mistakes that Malaysia should take into consideration for the future.

- The transformation of the Malay society has generated new “intraethnic” tensions and conflicts. The government must ensure that the wealth created be shared justly by the majority masses and the newly rich Malay businessmen-politicians elites. Distribution of opportunities must be transparent and fair.
- The continuation of the spirit of the NEP is acceptable provided it does not continue indefinitely. Once the *Bumiputeras* are in an equitable position as the non-*Bumiputeras*, the policy must be tapered and support should be formulated.
- The ethnic division of labor that divides the society along intersecting ethnic and class lines must not be allowed to occur again.
- The government should intensify efforts at national integration between the races so that Malaysian society will be less separated by race or religion. Excessive militancy of religious and racial inclinations must never be tolerated.
- The education ministry should give priority to human resource development as an instrument to overcome inequality, especially studies in science, mathematics and English and professional courses
- Malaysians must ensure that the new *Bumiputra* business class being created has acquired the right kind of experience to be able to match the earlier performances of the more successful Korean chaebols for example. These new holders of great wealth and hope of a Malay business community have to make the necessary transition to an industrial and international entrepreneurship. They must not be coddled and the government should let the best prevail.
- The government should be mindful of globalization that demands competitiveness, meritocracy, and a reliance on market forces, innovativeness and flexibility in the business and commerce. It should prepare Malaysians of all races accordingly to face this new phenomenon.

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<sup>227</sup> Kuala Lumpur, Prime Minister’s Department, *Third Outline Perspective Plan, 2000-2010*.

- The Malaysian Government must always be vigilant on efforts by any quarters to monopolize the economy, politics or education opportunities and be prepared to play the role of a strict but fair “referee” for a fair and well distributed share of wealth and opportunities

#### **D. CONCLUSION**

Malaysians have come a long way in determining their destiny. Its New Economic Policy has been controversial in its idea and implementation. However, Malaysia’s unique situation calls for unique solutions as it did during the financial crisis. The disparity of the races in Malaysia started with unequal opportunities afforded by the British, perpetuated by a harassed post-Independent government that had to cater to law and order, and internal security concerns. However, when the leaders realized their problems, they implemented the solution doggedly, despite some unorthodox methods such as state interventionist policies, “illiberal democracy” and a strong hand in maintaining law and order.

The NEP was a reassertion of the 1957 ethnic bargaining between the races, promulgated in the Constitution, as quid pro quo for the Malays accepting the immigrants as citizens. It was meant to give the *Bumiputeras* time to catch up economically. However, in implementing the NEP, certain *Bumiputera* groups and non-*Bumiputeras*, also, have taken advantage of the redistributive opportunity for quick wealth via political connections. This situation has caused intra-ethnic splits, and should be eliminated by the government to ensure a fairer redistribution, which also must include most of the majority people. It should also ensure that only genuine, quality entrepreneurs be helped to push for a *Bumiputera* business class that is hoped will lead the to greater indigenous participation in commerce and industry.

The key lesson learned from the Malaysian experience is that in a small open economy, the task of achieving the conflicting objectives of growth and equity is facilitated by a long-term commitment to open and liberal trade and an investment policy regime. Unlike many other developing countries, Malaysia never resorted to stringent quantitative trade restrictions. With this policy regime, coupled with the stable political climate, the Malaysian economy has been well situated to take full advantage of the new opportunities arising from integration with the global economy.

Malaysia has been successful in achieving its developmental objectives by adopting pragmatic policies in line with changes in the global economy. While there were some policy excesses triggered by conflicting objectives in a plural society, the policy makers have been successful in swiftly rectifying policy errors. It was this flexibility and pragmatism which put the Malaysian economy back on the growth track after the financial crisis in the mid 1990s, the recession in the mid-1980s, after the difficulties of the late 1970s and early 1980s created by an excessive emphasis placed on distributional objectives. The successor to the NEP, the NDP and NVP should also be able to guide Malaysia pragmatically towards liberalization, deregulation and competitiveness whilst maintaining a balanced growth for all its citizens. There is no doubt that if all Malaysians are united, they can achieve the vaulted dream of 2020<sup>228</sup>—i.e by the year 2020, Malaysia to be a united nation, with a confident Malaysian society, infused by strong moral and ethical values, living in a society that is democratic, liberal and tolerant, caring, economically just and equitable, progressive and prosperous, and in full possession of an economy that is competitive, dynamic, robust and resilient.

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<sup>228</sup> Vision 2020, <http://www.epu.jpm.my/Bi/speech/vision2020i.html>, dated 4 June 2002.

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