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Department of ASIAN STUDIES

The University of British Columbia
Vancouver, Canada

Date May 26, 1997
Abstract

Malaysian economic development policies since independence have been strongly influenced by the relationship between the two major ethnic groups, Malays and Chinese, and by the political complexion of the state which is dominated by the Malays. Ethnic considerations in shaping economic development policies resulted in official preference of foreign investment in financing Malaysia's industrialization and economic growth. The preference was most obvious since the implementation of the New Economic Policy (NEP) in 1971. The NEP, a sweeping affirmative action program, had two official objectives: poverty eradication irrespective of race and the restructuring of society to abolish the identification of race with economic function. Determined to advance Malay economic status in relation to Chinese, the Malaysian government throughout the 1970s employed various policies to redistribute wealth in favour of the Malays. Foreign investment was encouraged to finance the country's industrialization, particularly the development of the manufacturing sector, and to provide new job opportunities and business ventures to the Malays. Restrictions on industrial investment were implemented at the expense of the non-Malays, especially Chinese. The strategy to align with foreign capital remained central to government policies in the 1980s to achieve NIC status through heavy industrialization. The economic recession in 1985-86 forced the government to rely even more on foreign investment to generate growth need for redistribution to take place. The pursuit of this strategy exacerbated ethnic relations under the implementation of the NEP from 1971 to 1990. To remain legitimate in the context of Malaysian politics, the Malay dominated government after 1990 pressed for a strategy of growth with distribution to enhance Malay economic strength vis-à-vis Chinese through the anticipation of continued influx of foreign investment since 1988.
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List of Major Events

1957 Malaysia achieved formal political independence.
1958 The Pioneer Investment Incentives was introduced.
1968 The Investment Incentives Act was introduced.
1969 May 13 post-general elections race riots. Malaysian Parliament was suspended and a state of emergency was declared by the National Operation Council which ruled for a year and a half.
1971 The New Economic Policy (NEP) was announced. This was in conjunction with the introduction of the Second Malaysia Plan. The Released of the Outline perspective Plan, 1971-1990.
1981 Mahathir took office as the fourth Malaysian Prime Minister. The launching of the Heavy Industrialization Policy; the ‘Look East’ policy; Privatization; and ‘Malaysia Incorporated’.
1985 The announcement of holding the NEP in abeyance.
1986 Industrial Co-ordination Act was amended to grant up to 100 per cent ownership to foreign investors that export over 80 per cent of their products, and to exempt firms with paid-up capital of less than $250,000 or employed less than 75 workers from conforming with the NEP restructuring regulations. Investment Promotion Act was introduced. Deputy Prime Minister resigned unexpectedly and UMNO’s internal split became public.
1987 UMNO’s triennial party election results were ruled void and null and the party was declared illegal by the high court in June. Mass Arrests took place in October.
1989 The establishment of the National Economic Consultative Council to formulate a new policy to substitute the NEP.
1990 Malaysia’s general elections.
## Abbreviations

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<tr>
<td>ASEAN</td>
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<td>MARA</td>
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<td>Malaysian Chinese Association</td>
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<td>MIDA</td>
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<td>Perbadanan Nasional, or <em>National Corporation</em></td>
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<td>PNB</td>
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<td>SEDCs</td>
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<td>UDA</td>
<td>Urban Development Authority</td>
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<td>UMNO</td>
<td>United Malays National Organization</td>
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Acknowledgement

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Chapter One     Introduction

Malaysia's ethnic relations have had an important impact on the country's economic development policies since the 1970s. The economic policy pursued by the Malay dominated government has tried to correct economic imbalances and at the same time achieve ethnic harmony. This has been done through the New Economic Policy which has basically been a strategy of wealth redistribution between the different ethnic groups, most notably between the Bumiputera and the Chinese. To achieve economic growth and to facilitate redistribution, the policy favoured foreign investment. The strategy, however, has not come without a price. While Malaysian economic growth is impressive, the question remains whether or not the ultimate goal of inter-ethnic harmony has been reached.

The Origins of the New Economic Policy

During British colonial rule, the Malayan economy was developed by foreign investment along the lines of production and exports of tin and rubber. The import of foreign wage labourers in the last decades of the 19th and the first of the 20th century, mainly Chinese and Indians, into the country changed the demographic composition of Malaysia. In order to acquire land for mining and rubber plantation, the British legislated laws to permit ownership of land by foreigners. The main beneficiaries of these new laws were the British and some Chinese miners and planters. They bought into Malay peasants' land and had threatened to disrupt the life of the Malay peasantry. To minimize these disruptions, the British practiced a

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1 The term *bumiputera* or 'son of soil' refers to Malays and other indigenous peoples in Malaysia. It was first officially introduced along with the NEP in 1971. In this thesis, however, the terms 'bumiputera' and 'Malay' will be used interchangeably because the Malays form the majority of bumiputera (over 80 per cent) and government policies under discussion benefit Malays most.
policy of ‘divide and rule’ and created the practice of ‘protection’ under which Malay peasants and fishermen would be ‘protected’ in their traditional way of existence while the Malay ruling elites retained their symbolic sovereignty and economic compensation. However, this ‘protection’ had actually hindered Malays from participating in modern economic activities and consequently left them behind other immigrant communities who advanced with economic growth. As a result, Malaysian society became segregated and the Malay community came to regard non-Malays as threatening aliens.

Upon acquiring formal political independence in 1957, the Alliance government was committed to achieving economic nationalism in the nation-building process. The government adopted a growth-oriented and laissez-faire strategy in economic development policy and guaranteed non-Malays the freedom to engage in economic activities. It was generally hoped that a liberal economic policy aimed at maximizing economic growth would resolve the country’s ethnic problems. Much of the literature dealing with economic development policy prior to the 1970s argues that it was political in nature: the commitment of the Alliance government was an ethnic compromise to be achieved through elitist consultation at the time of independence. The non-Malays were to recognize Malay political dominance and Malay special rights in exchange for citizenship and economic freedom. To remain legitimate in the eyes of the Malays and to avoid being perceived as discriminating against non-Malays, the

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2 In 1913, the British passed the Malay Reservation Enactment which designated certain areas to be reserved for Malay ownership only and prohibited non-Malays or foreigners from holding mortgages on these lands.

3 For example, the Rice Land Act prohibited Malay peasant from cultivating any cash crop other than rice on Reservation Land.

4 The Alliance government consisted of three parties, the United Malays National Organization (UMNO), the Malayan Chinese Association (MCA), and the Malayan Indian Congress (MIC). The latter two became the Malaysian Chinese Association and the Malaysian Indian Congress respectively in 1963.

Malaysian government favoured foreign investment, which was already preeminent during the colonial period, to provide the basis for economic diversification and to reduce dependence on primary commodity products.

Hence, the modernization of the Malaysian economy, particularly the development of manufacturing and service sectors, came largely under the aegis of foreign investment. It was also hoped that foreign capital would provide the Malays job opportunities in modern industries. The 1958 Pioneer Industries Ordinance and the 1968 Investment Incentives Act were introduced in this light. Favourable investment policies attracted more capital-intensive industries which prospered behind the new government-set tariff wall. But the industries did not generate the massive employment that had been anticipated. In fact, the state-owned Malayan Industrial Development Finance was established in 1960 to help finance promising private-sector industrial ventures, but it proved beneficial only to the large or sophisticated (often foreign) firms.

Mindful of Malay economic backwardness, the Malaysian government played an active role in trying to raise Malay living standards. These efforts primarily involved rural development projects intended to improve the lot of the predominantly rural Malays. In addition, the government set up several institutions, including the Majlis Amanah Rakyat (Council of Trust for Indigenous Peoples) or MARA and the Bank Bumiputera, in response to the rising demands from the Malays for more state intervention to promote their participation in the modern commercial economy.

During the 1960s, despite an annual growth rate of over 5 per cent, and government agricultural development efforts, rural-urban income disparities persisted. Malay employment in the manufacturing sector amounted to only 30 per cent of the total and was even lower in
higher-skilled jobs and managerial positions. The Malay share of corporate capital stood at 2.4 per cent in 1969 as compared to 23.7 per cent for Chinese and Indians and 62.1 per cent for foreigners. The uneven development of different ethnic groups resulted in widespread dissatisfaction towards the government among the Malay community. The Malays were frustrated by the fact that government policies benefited only a handful of Malay bureaucrats and politicians, and a few well-connected Malay businessmen. Furthermore, economic competition between immigrant and indigenous communities, which was seen as the underlying cause of ethnic tensions, generated a sense of deprivation among the Malays that the Chinese stood to gain more from the government’s policies.

Consequently, the social and economic tensions expressed along ethnic lines served to aggravate the already exacerbated ethnic relations. Both the frustrations of the Malays about their socio-economic position vis-à-vis the Chinese and the political agitation of the Chinese finally erupted into the country’s most serious race riots in May 13, 1969. The Parliament was suspended and a state of emergency was declared immediately by the National Operation Council (NOC) that took control to maintain order in the country for more than a year. The NOC attributed the root cause of the riots to the Alliance government’s failure to solve the problem of economic inequality between Malays and non-Malays, and formulated a new economic policy.

The New Economic Policy

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6 Second Malaysia Plan, p.40.
The most important development in economic policy following the riots was the introduction of the New Economic Policy (NEP). The Barisan Nasional or National Front (BN), the successor to the Alliance government, adopted an interventionist approach designed to strengthen the economic status of bumiputera or Malays relative to non-Malays. Direct participation by the government in commercial and industrial undertakings represented a significant departure from past practices. The government justified such efforts as necessary to create a Malay commercial and industrial community significantly altered Malaysia’s political economy.

The NEP was guided by a twenty-year Outline Perspective Plan, 1971-1990 and was incorporated into the Second Malaysia Plan, 1971-75. The two formal objectives of the NEP were the eradication of poverty among all Malaysians, regardless of race, and the restructuring of Malaysian society to reduce and ultimately to eliminate identification of race with economic function. In operational terms, poverty eradication was projected to reduce the poverty rate from 49 per cent in 1970 to 16 per cent by 1990. The government did not define poverty clearly but only associated it with those who were unemployed, underemployed and those who engaged in low productivity activities. By increasing the access of the poor to credit, capital, employment and training, and public services, the government hoped to reduced large numbers of Malaysians living in poverty. The poverty line was generally believed to be drawn at monthly household income of $33 in 1970 price and no differentiation between rural and urban poor had been made. In the face of the complexity of poverty, the official definition of the incidence and approach appeared too simplisitic. Despite impressive government data on

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8 In general, however, many people tended to identify the Outline Perspective Plan, 1971-1990 with the NEP itself.

9 Currency used in the present thesis is given in Malaysian Ringgit (dollar) unless otherwise indicated.
poverty eradication, poverty remained a major problem in Malaysia and more work should be done to reveal the underlying problem of the issue.

Social restructuring was to be realized by achieving two explicit quota goals. First, employment by sector was to reflect the racial composition of the population, which was 54 per cent Malay, 35 per cent Chinese, 10 per cent Indian and 1 per cent other. Secondly, bumiputera should own and manage at least 30 per cent of the share capital of the corporate sector by 1990, as compared to 2.4 per cent in 1969-70. This social engineering programme to reduce racially reinforced economic imbalances was officially identified as crucial to create the socio-economic conditions for national unity.

The government adopted a strategy that emphasized sustainable economic growth based on industrialization and manufacturing. In the 1970s, the government promoted the manufacturing industry as the leading sector for economic development by encouraging private, including foreign, investment to generate the growth needed for redistribution to take place. Foreign investment such as joint ventures continued to enjoy official preference and provided ownership and employment opportunities for bumiputera. Investment incentives included a provision whereby the length of a tax holiday was dependent upon the number of workers employed. The Foreign Investment Council (FIC) was founded in 1974 to ensure that proposed acquisition of assets or interests, mergers or take-overs by foreign firms in Malaysia should have majority Malaysian ownership with at least 30 per cent bumiputera participation.

The BN government, determined to correct the ethnic economic imbalances, imposed in the 1976 Industrial Coordination Act (ICA), which required all industries to comply with

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10 Second Malaysia Plan, p.41.
11 Fourth Malaysia Plan, p.137.
the NEP restructuring goals. It stipulated that all existing firms and future investment ventures with paid-up capital of more than $100,000 or employed over 25 workers must allow for 30 per cent Malay share ownership or hire Malays to reflect the composition of the population. Instead of encouraging private investment, this legislation had the effect of curtailing the more prevalent local Chinese capital of small- and medium-size enterprises. It was argued that official policies that favoured foreign investment would take up the slack of domestic capital. Many have argued that these foreign investment policies were designed to facilitate collaboration between bumiputera and foreign capital and to bypass, perhaps even challenge, domestic Chinese capital.12

The impressive Malaysian economic growth in the 1970s, averaging 5.6 per cent per annum, was supported by buoyant commodity prices, the discovery of petroleum, and a rapidly growing labour-intensive export manufacturing industry. However, a considerable portion of the fruit of rapid growth went to financing the restructuring efforts. In order to increase Malay control of corporate capital, restructuring policy involved extensive state intervention and the development of large public enterprises at federal and state levels. Under the name of assisting and promoting the participation of Malays and other indigenous people in commerce and industry, the main objective of the public enterprises was to hold share capital in trust for Malay individuals. These public enterprises, normally known as off-budget agencies (OBAs), such as MARA, Perbadanan Nasional or National Corporation (PERNAS), Urban Development Authority (UDA), and State Economic Development Councils (SEDCs), Bank

12 The strongest argument along this line can be found in James V. Jesudason, Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia, NY: Oxford University Press, 1989.
Bumiputera, and Development Bank received direct and indirect state funding under foreign loans.

The government also invoked Malay Special Rights as a basis for state protection to help the development of Malay businesses.13 Three major strategies were used to achieve this end: (1) legislated Malay quotas for the issuance of trading/business licenses and permits, ownership of equity, and employment; (2) provided credit, training, and business sites to Malay businessmen; and (3) acquired shares in private corporations on behalf of bumiputera. The major beneficiaries were state-owned public enterprises and those who have connection with UMNO. It became clear that, over time, it was in the interest of Malay ruling elites to hold the ‘Malay interests’ in trust to strengthen their base of patronage rather than to distribute them among Malay individuals.14

The implementation of the NEP in the 1970s greatly increased the role of the state in the economy. Some have argued that enhanced executive power resulted in increased concentration of economic power under bureaucratic control and sacrificed economic efficiency. This caused adverse effects on non-Malay, especially Chinese, investment.15 Inequality in the distribution of income and wealth within the Malay community also widened. The NEP had also reinforced the ‘Ali-Baba’16 type of business practice since the 1960s in which Malays acted as owner in name with actual control in the hands of their Chinese partners. In short, zealous restructuring efforts were increasingly centred around enhancing the

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16 ‘Ali’, a common Malay name, refers to Malay while ‘Baba’, descendant of Straits Chinese, refers to Chinese.
bumiputera share of corporate capital, as well as nurturing a bumiputera commercial and industrial class at the expense of domestic Chinese capital.

Objectives and Organization of Thesis

Using various Malaysian government publications and secondary materials, this thesis explores the argument that successive governments since the 1980s have continued to promote foreign investment in order to advance the economic position of ethnic Malays. The thesis focuses mainly on the restructuring aspects of the NEP and limits its discussion to Peninsular Malaysia where the majority of bumiputera concerns are found.

The thesis is organized chronologically and divided into three chapters. Chapter 2 argues that the government continued to align itself with foreign capital and launched ambitious heavy industrialization and other related policies which were designed to challenge non-Malay capital in sectors traditionally dominated by the Chinese. It explores the inter-relationship of politics and economic policy during the mid-1980s recession that halted both the heavy industrialization drive and the NEP restructuring goals. Chapter 3 demonstrates how the change in policy approach in relation to foreign investment was an expediency adopted by the Malay government to salvage itself from economic difficulty. It also delineates the result of the policy changes in attracting foreign investment and explores the ethnic concerns that followed. Chapter 4 analyzes the politics of the formulation of a new economic policy to replace the NEP at the end of the decade. It precedes to outline the various new policies after 1990 and how the government continued to be concerned about advancing Malay economic interests through foreign investment. It concludes that the redistribution strategy failed to bring about a harmonious and integrated society.
Chapter Two     Ethnicity, the Politics of Industrialization, and Foreign Investment

Beginning in the early 1980s, a decade of buoyant economic development and a rapidly growing labour-intensive export-led manufacturing sector proved vulnerable to external developments. The NEP’s goals of 30 per cent Malay ownership showed satisfactory reward, but was still lagging behind set targets. Consequently, the Malaysian government under Prime Minister Mahathir’s leadership,1 launched an ambitious economic restructuring programme that incorporated the promotion of heavy industries and other supporting policies. The heavy-industries policy aimed both at broadening the country’s industrial base and enhancing the bumiputera’s control of corporate shares. This chapter looks at two aspects of the political-economic development of Malaysia in the mid-1980s. Firstly, it delineates the ethnic biases contained in the new industrial policy and its subsequent supporting policies. Secondly, it explores the consequences of the NEP and the heavy industrial drive in the face of a severe economic recession and political difficulties.

The Heavy Industrialization Policy

Through the 1970s the Malaysian economy achieved impressive growth records and redistribution performance. The GDP grew at an average annual rate of 12.5 per cent while the manufacturing sector contributed 20.5 per cent to GDP in 1980 as compared to 13 per cent in 1970.2 Employment in the manufacturing sector multiplied. Foreign investment increased as a result of active state promotion. The pursuit of NEP redistributive goals were impressive in

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1 Mahathir Mohamad took office as Malaysia’s fourth Prime Minister in 1981.
2 Second Malaysia Plan, p.15. Fourth Malaysia Plan, p.15.
that the bumiputera share of corporate ownership increased dramatically from a negligible 0.9 per cent in 1970 to 12.4 per cent in 1980. Nevertheless, despite an unprecedented scale of government promotion, the Third Malaysia Plan's target of 16 per cent by 1980 was still not reached. Beginning in 1980, however, the negative impact of the global recession, aggravated by protectionist measures overseas, began to affect Malaysia's economic performance. The slowdown of economic growth led to a rethinking of development strategy. The result was the Fourth Malaysia Plan (1981-1985), which sought to sustain an overall faster rate of growth.

In this light, the government under Mahathir reacted by introducing a heavy-handed industrial policy which attempted to upgrade the manufacturing industry and accelerate the pace towards realizing the 30 per cent Malay ownership target. This meant that the annual growth rate required in the remaining years of the NEP from 1981 to 1990 would have to be at a pace even faster than that recorded between 1971 to 1980. The government believed that a heavy industrialization drive based on rapid growth and a structurally more diversified agricultural and manufacturing sectors would assume a significant role in the development of the economy. The export manufacturing sector could be left to foreign investors through a favourable investment environment which would be sufficient to maintain growth.

In the 1970s, the major thrust of government's involvement in the commercial and industrial sectors rested primarily on the establishment of public enterprises to obtain shares in

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3 The bumiputera ownership of equity capital in the corporate sector grew by 44 per cent per annum under the Second Malaysia Plan from 2.4 per cent in 1971 to 7.8 per cent in 1975. Second Malaysia Plan, p.40. Mid-Term Review of Second Malaysia Plan, p.11-12, table 1-4. Fourth Malaysia Plan, p.62, table 3-14.

4 Third Malaysia Plan, p. 86-87, table 4-16.

private corporations for the Malays. The heavy industrialization policy marked a departure from the past in terms of direct state involvement to boost a heavy industry sector through the creation of the Heavy Industries Corporation Malaysia Berhad (HICOM), which selectively promoted heavy industries that are suitable for development in Malaysia. The heavy industrialization drive aimed to reduce Malaysia’s dependence on commodity exports, to upgrade production from mere assembly operations,\(^6\) and, more importantly, to develop indigenous technology and to acquire technical and managerial skills for large-scale industrial establishments in the long run.\(^7\)

_Malaysia’s Heavy Industrialization Drive and the NIC Model_

Mahathir’s heavy-industrialization and HICOM projects have been the object of much controversy since their inception. HICOM was said to be the brainchild of Mahathir, who envisaged Malaysia as following the growth pattern and attaining the status of the Newly Industrializing Countries (NICs) by the turn of the century. It was mandated to undertake joint ventures with foreign capital, mostly Japanese, on projects identified as suitable for national development. The agency was responsible solely to the Prime Minister. HICOM projects also aimed to achieve a more even industrial dispersal, particularly along the less-developed east coast in Peninsular and in the two east Malaysian states, Sabah and Sarawak. Major HICOM projects including the plan for a national car (Proton Saga), steel mills, cement plants, pulp and paper mills, and refinery and petrochemical plant—obviously a ‘take off’ path as exemplified by some NICs. In other words, Mahathir believed that a state-led heavy industrialization drive

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was necessary to achieve a self-sustained national economy and industrial sector.

In financial and technological terms, the state favoured foreign capital in its effort to achieve these goals. HICOM selected Japanese investors in most of the joint-ventures. The officials justified the choice on the ground that the domestic Chinese neither had the interest nor the technology to invest and that these projects entailed higher risk and a longer maturation period. While the capital- and technology-intensive nature of these ventures served as one obvious reason why foreign investment was sought, the underlying reason was that these foreign investors and corporations in particular, were more willing to comply with the NEP’s distributive regulations because they could retain corporate control by possessing advanced technology and managerial skills. Hence the state appeared to ally itself to foreign corporations to compensate for the lack of domestic private investment. At the basis of such initiatives was the government’s attempt to create new opportunities and enlarge its patronage system, which was of growing importance to UMNO top leaders as they sought to further expand and consolidate their domination of Malaysian politics.

Many have criticized HICOM’s scale and excessive financial burden, its direct competition to the existing industry in the private sector, and its economic feasibility. In terms of the national objectives of the NEP, the new strategy was designed further to enhance the bumiputera ownership and control of corporate wealth. Critics of this front have centred their arguments on the intense hidden ethnic calculations of Malay planners. Akin to the

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numerous non-financial public enterprises (NFPEs) set up in the 1970s,\(^\text{12}\) one of HICOM’s basic roles was to accumulate wealth which would ultimately be transferred to individual bumiputera ownership and management. Furthermore, it aimed to increase the participation of Malay managers and skilled workers in sectors traditionally dominated by the Chinese, especially the automobile assembly and steel production, which thus posed a direct challenge to the existing economic balance.\(^\text{13}\)

In face of the challenges posed by a slowing economy, the constant launched attacks by academic circles, and the Chinese business sector’s protests, Mahathir’s government did not retract its promotion of the policy. Mahathir distinguished his government with firm leadership, appropriate values, and a modernized administration through restructuring in every aspect. His justification for the heavy industrialization policy was its impact on economic restructuring, which he proclaimed to be essential for national development. The new emphasis on restructuring brought about the emergence of three policies: ‘Look East’, ‘Malaysia Incorporated’ and privatization. Though the former withered away with the recession in the mid-1980s, the latter two continued to be emphasized well into the early 1990s.

‘Look East’

The Look East policy can not be treated separately from Mahathir’s wish to emulate the NICs-Japan and South Korea. The ‘Look East’ campaign was intended to advance Malaysia’s economic development and industrialization by adopting and imbibing Japanese and Korean-

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\(^\text{12}\) NFPEs were previously referred to as off budget agencies (OBAs). They were divided into three categories, namely, socio-economic, commercial and industrial, and public utilities. HICOM belongs to the third category. *Fifth Malaysia Plan*, p.224.

\(^\text{13}\) Rapheal Pura, “Doubts over Heavy Industrialization Strategy,” in Jomo K.S. ed *The Sun Also Sets*, p.380.
style work ethics. Mahathir attributed Japanese and Korean economic miracles to high productivity generated by their work ethics and management practices which stressed hard work, loyalty to the enterprises, dedication and the necessity of individual self-reliance through determination and initiative.\(^\text{14}\)

The explicit choice of Japan and South Korea also entailed ethnic considerations. The heavy industrialization strategy aimed to promote more active bumiputera participation in the Chinese predominant sectors, therefore, the mentality of the Malays had to change in order to compete with the relatively more economic-minded Chinese. In addition, Islamic values were tied to the look east policy. Mahathir proclaimed that both Japan and South Korea preserved their national culture as they advanced in the industrialization process. The government maintained that economic progress could be achieved simultaneously with the propagation of Islamic values and traditional Malay culture. Modernization and industrialization then did not mean subjugation to western cultural dominance.\(^\text{15}\) In short, the policy encouraged the Malay community to adopt a new work ethic, as exemplified by Japan and South Korea, which the government defined as beneficial and crucial to nurture an economically more competitive Malay community vis-à-vis non-Malays.

Many speculated that the choice of South Korea was carefully made because this country stood out as an exemplary non-Chinese country. The other NICs, Singapore, Hong Kong and Taiwan, were predominantly Chinese.\(^\text{16}\) Malaysia’s diplomatic considerations may


\(^{16}\) Jomo is one of the first few who criticized the ‘Look East’ policy to have hidden ethnic calculation. See Jomo K.S., “Economic Crisis and Policy Response in Malaysia,” in R. Robinson, K. Hewison and R. Higgott eds Asia
have served to exclude Taiwan from consideration as well.\textsuperscript{17} On the other hand, Mahathir pragmatically chose to emphasize the need to emulate Japan and South Korea’s work ethic as a possible means of overcoming obstacles to industrialization presented by the ethnic division of labour.\textsuperscript{18} The NIC model also served, however, to provide a convenient reference that could be used to legitimize a state-led challenge to the existing communal balance. A direct result of the ‘Look East’ policy was the handsome awards of construction contracts to Japanese and Korean companies.\textsuperscript{19} (Appendix 1)

\textit{Malaysia Incorporated’}

Malaysia Incorporated’s origin derived from the ‘Look East’ policy that aimed to emulate Japanese-style industrial relations. ‘Japan Incorporated’ was initially meant to be pejorative: Japanese as mere economic animals. It emerged in industrial West in the 1960s as it first faced stiff competition from the more strongly state-backed Japanese business interests.\textsuperscript{20} Over time, it became a term of praise and even a source of emulation.\textsuperscript{21} Mahathir promoted his version of the ‘Malaysia Incorporated,’ an idea entirely borrowed from ‘Japan Incorporated’. The concept was to promote closer and mutually supportive cooperation between the government as facilitator and the private sector as the investment arm of national enterprise.\textsuperscript{22} The Malaysian

\textsuperscript{17} Ibid.
\textsuperscript{19} A lot of Japanese and Korean construction companies lost their lucrative contracts in the Middle East after the late 1970s’ oil collapse but generally found compensation in Southeast Asian countries.
\textsuperscript{21} Ibid.
state continued to stress the importance of private investment in domestic economic expansion and the attainment of the NEP.\textsuperscript{23} Thus it was desirable to maintain harmonious relations between the state and the private sectors to enhance Malaysia's economic development and dynamism. More importantly, the Malaysia Incorporated slogan reminded government of its traditional role of serving private capitalist interests. The campaign neglected the other aspects of Japanese corporate culture such as job security and life-long employment. Ironically, harmonious industrial relations through the establishment of in-house unions and various amendments to the labour law over the years have come mainly at the expense of labour.

‘Privatization’

The concept of privatization was first introduced in 1983 as a national policy. It complemented other national policies, such as the Malaysia Incorporated policy and was designed to promote the private sector in the development of the Malaysian economy.\textsuperscript{24} Privatization also represented the government's attempts to reduce the relative size of the public sector. It involved the gradual transfer of selected government services and interests in railways, ports, airlines, telecommunications and other infrastructure services, including car parks and housing schemes to private sector ownership and management. The rationale of privatization was based on the conception that it would accelerate the pace of restructuring. The main thrust remained racially distributive in tone. Privatization was designed to be implemented within the context of the NEP.\textsuperscript{25} The growth of private sector investment arising out of privatization provided

\textsuperscript{23} Fourth Malaysia Plan, p.207.
\textsuperscript{25} Mid-Term Review of the Fourth Malaysia Plan, p.23.
additional opportunities for ownership participation, employment and business for bumiputera.\textsuperscript{26}

In sum, these supporting policies served as a justification for the government’s emphasis on heavy industrialization. Nevertheless, the application of the heavy industrialization policy clearly indicated that the redistribution in favour of one ethnic group at the expense of others was the overriding goal in the early years of the 1980s.

**The Recession and the Political Difficulties**

*The Recession of the mid-1980s*

A recession in the mid-1980s had profound repercussions on the political economy of Malaysia. From the early 1980s to mid-1987, the Malaysian economy experienced a significant downturn. In contrast to the 1970s, and despite heavy counter-cyclical spending, the economy from 1981-2 worsened following a deteriorating trade balance.\textsuperscript{27} The economy experienced an even worse recession in 1985.\textsuperscript{27} Since independence, the economy experienced its first negative growth rate in the absence of the cushion of counter-cyclical measures and easy petroleum revenues.\textsuperscript{28}

\textsuperscript{26} Ibid., p.15.  
\textsuperscript{27} The government adopted the counter-cyclical measures with the expectation that the global recession would ended by mid-1982. However, the recession had continued and the falling government revenues due to the poor export earnings and declining domestic economic activities, coupled with increased cost of borrowings, gave rise to the emergence of constraints in the government financial position which limited the capacity to continue the counter-cyclical stance. *Mid-Term Review of the Fourth Malaysia Plan*, p.38.  
\textsuperscript{28} Petroleum price dropped from $682.40 per ton in 1981 to $287.40 in 1986 while the petroleum exports fell from $8.7 billion in 1984 to $5.4 billion in 1986, cf. Jomo K.S., *Growth and Structural Change in Malaysia*, p.61.
Table 1  Annual Average Rate of GNP and GDP, 1981-88 (%)  

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<td>GNP</td>
<td>7.5</td>
<td>4.6</td>
<td>3.9</td>
<td>6.7</td>
<td>-1.2</td>
<td>2.6</td>
<td>4.8</td>
<td>8.6</td>
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<tr>
<td>GDP</td>
<td>7.1</td>
<td>5.6</td>
<td>6.3</td>
<td>7.6</td>
<td>2.8</td>
<td>1.2</td>
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Source: Bank Negara Report, 1988; Mid-Term Review of the Fourth Malaysia Plan, 1984; Mid-Term Review of the Fifth Malaysia Plan, 1989.

The sluggish economy adversely affected almost every sector. The economy suffered from falling commodity and oil prices, reduced manufactured exports, and resulted in lower state revenues and a slash in state expenditure. During this time, the government’s finances began to weaken to a precarious state in terms of balance of payments and the budget. Foreign debt accumulated as a result of massive external borrowing to expand the public sector. By 1984, the cumulative external public debt constituted 387 per cent of GNP, the highest among the ASEAN countries. The Malaysian government was forced to impose austerity measures to curb public expenditure. This was coupled with increased financial disciplining of NFPEs which started in mid-1982 and accelerated greatly after 1985. In addition to privatization alternatives, these enterprises were instructed to restructure, to merge with others, or simply to close down.

The manufacturing sector, Malaysia’s major job-creating sector, was badly hit by the

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29 Mid-Term Review of Fourth Malaysia Plan, p.6.
32 Mid-Term Review of Fourth Malaysia Plan, p.205; Fifth Malaysia Plan, pp.13-4. The development expenditure between 1983 and 1988 was cut by almost half. The public development expenditure allocated for 1981-85, $80,331 was revisied to $59,669.38, while the allocation for 1986-90 was revised from $74,000 to $47,681. Mid-Term Review of the Fourth Malaysia Plan, p.218; Fifth Malaysia Plan, p.224; Mid-Term Review of Fifth Malaysia Plan, pp.109-110.
33 The Code on Take-overs and Mergers was introduced into the Companies Act, 1965 in 1981 to regulate the take-over and merger activities. Fourth Malaysia Plan, p.260.
rising protectionist measures against manufacturing exports in advanced industrialized countries. Instead of providing new jobs, the sector cut back the existing labour force. The unemployment rate rose from under 6 per cent in 1980 to over 8 per cent in 1986. From mid-1983 onwards, the consolidation of public sector finances and the partial freeze since mid-1982 on both the creation of new jobs and recruitment into the government services sector affected the university graduate labour force market and contributed to rising graduate unemployment. For the first time since the massive expansion of the universities under the NEP, severe graduate unemployment, especially Malays who would otherwise have been absorbed by the public sector, became a serious social problem.

Business failures also became commonplace and these included some of the biggest names in the commercial sector. Bankruptcy and near insolvency resulting from a stagnated construction sector were especially serious among the smaller bumiputera businessmen whose very survival depended on government patronage. Moreover, the proposed reduction in agricultural subsidies threatened to provoke grievances from the rural Malay community which had enjoyed substantial government support since independence.

Foreign investment during this period fell despite state encouragement. Foreign investment during this period fell despite state encouragement.

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34 Mid-Term Review of the Fourth Malaysia Plan, p.5.
35 The workers retrenched from this sector between 1983 to 1987 were reported to be over 50,000, or more than one half of total workers retrenched, cf. Khoo Kay Jin, “The Grand Vision: Mahathir and Modernisation,” in Joel S. Kahn and Francis Loh Kok Wah eds Fragmented Vision: Culture and Politics in Contemporary Malaysia, Honolulu: University of Hawaii Press, 1992, p.53.
Source: Mid-Term Review of the Fourth Malaysia Plan, p.127; Mid-Term Review of the Fifth Malaysia Plan, p.87.
37 The number of new jobs created in this sector during 1981-85, fell short of the anticipated 860,600 stood only at 651,600. Fifth Malaysia Plan, p.137.
39 Foreign investment in the early 1980s was largely sustained by Japanese investment in heavy industries despite the amendment of the ICA in 1979, the establishment of overseas centres by Malaysian Industrial Development
investment in the manufacturing sector began to fall in the early 1980s, and reached the lowest point in 1984 and 1985. Even the set target of 30 per cent of foreign participation appeared difficult to attain when the foreign equity share in paid-up capital fell sharply from above 40 per cent in 1980 to 22.7 per cent and 17.8 per cent in 1984 and 1985 respectively. The fall in foreign investment was attributed to the saturation of the labour-intensive export manufacturing and constraints on manufacturing exports; the introduction of automation in assembly operations; competition from countries with more advanced infrastructure facilities, well-developed industrial linkages, and skilled and technical work-force. Competition also came from other neighbouring manufacturing exporters such as Thailand and Indonesia with even lower wages given the same tax incentives. The small domestic market with limited potential for further industrial expansion also deterred foreign investors.

The weak economy made the attainment of the NEP’s redistribution goals difficult. Besides continued rising unemployment, the bumiputera ownership goal fell far behind the set target. Bumiputera ownership was projected to reach 23 per cent by 1985, but progressed only slightly from 12.4 per cent in 1981 to 15.5 per cent in 1982. When the target was revised in light of the recession, it projected only 22.2 per cent by 1990. Thus, it appeared that the negative growth, the drop in domestic and foreign investments, and the generally unfavourable international economic climate cast serious doubts among Malay leaders about their ability to meet the originally projected NEP redistribution goals by 1990.

Amidst the bleak economy, Mahathir’s government was further plagued by a series of

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Authority in major financial capitals and numerous investment missions abroad led by high ranking government officials. *Mid-Term Review of the Fourth Malaysia Plan*, p.141, 192.

Jesudason, pp.144-46.

*Fifth Malaysia Plan*, p.108.
financial scandals and the general mismanagement of the public sector which incurred losses of billions of Malaysian Ringgit. The financial scandals occurred between 1984 and 1985 included the government’s attempt to corner the tin market through the state-owned Maminco which resulted in a loss of $660 million; the use of Employees’ Provident Fund (a social security scheme for wage earners) to corner the tin market, the BMF affair; the Pan Electric affair; the North-South Highway Scandal; and the state’s bailout of numerous ailing public financial institutions. A number of major public enterprises suffered from financial losses in their business ventures with foreign capital. HICOM as the controller of the development of the heavy industries, in particular, received no less criticism on its unfeasibility and huge losses. In 1986, HICOM’s after-tax losses accumulated to $117.8 million while its operating losses stood at $249.6 million. By early 1987, the losses were reported to be $206.4 million. The biggest share of these losses were made by HICOM’s two flagship projects, the ‘Proton Saga’ national car and the Perwaja steel mill. This forced HICOM to restructure at the managerial level, where some of the top managers were replaced by Japanese in the case of

42 Bumiputera Malaysia Finance, a subsidiary of state-funded Bank Bumiputera operating in Hong Kong, was badly hit by the collapse of the Hong Kong property market due to the enormous loans of over $2 billion made improperly to one single client, Carrian believed to have connections with some Malaysian government officials. Far Eastern Economic Review, 12 June 1986, pp.144-45.
43 Pan Electric Corporation defaulted on its repayment of loans estimated to total $400 million and resulted in Singapore and Malaysia stock market crashes and the subsequent three-day closure. The major share holder of Pan-Electric, Tan Koon Swan, president of MCA and businessman, was sentenced to jail in both countries. Far Eastern Economic Review, 12 December, 1985, pp.87-90. Khoo BT, pp.212-15.
44 The luxurious highway contract was awarded to a bankrupt company, United Engineers Malaysia, shortly prior to its being taken over by UMNO. Khoo KJ, p.56.
45 There were financial irregularities in 24 deposit taking co-operatives (DTCs) which had led to a run on these financial institutions when their depositors tried to withdraw as the news spread, and the National Bank of Malaysia had to pump in huge amount of money to rescue these DTCs. Khoo BT, pp. 209-19.
49 The losses made by the two projects were reported to be $145 million and $584 million respectively. It was believed that Perwaja’s total losses can be as high as $1.3 billion in 1989. Far Eastern Economic Review, 1 June
the car project and by Chinese for Perwaja.\textsuperscript{50} Despite extensive state intervention in the heavy-industries, the poor performance of this sector severely undermined the already dwindling public confidence in HICOM. The government’s credibility was undermined. As a result, the attainability of NIC status through a policy of state-led heavy industrialization was put to question.

Tensions also began to be felt from within government quarters concerned with the restructuring of these financially draining public enterprises. The authorized take-over of some federal- and state-level public enterprises by the establishment of the National Equity Corporation (PNB)\textsuperscript{51} was met with resentment from managerial levels and inter-corporation interest conflicts.\textsuperscript{52} Ailing companies particularly resented shrinking opportunities and the increasing institutionalized recession controls. The government’s efforts to authorize the transfer of profitable holdings generated fears among more successful enterprises that they would be left with the less profitable subsidiaries facing restructuring or closure which threatened to further weaken their economic strength.

\textit{Political Turmoil}

As the growth and the patronage system of the 1970s ceased to work, a group of disgruntled bumiputera blamed the Prime Minister himself for practicing cronyism. In the context of

\textsuperscript{51}PNB, formed in 1978, was to evaluate, select, and purchase shares in limited companies with growth potentials. As of September 1985, $918 million worth of shares had been transferred to PNB from 27 government-owned companies, federal agencies and state corporations. Fifth Malaysia Plan, p.228. Far Eastern Economic Review, 25 September, 1986, p.81.
shrinking patronage, this widespread dissatisfaction was reflected in a challenge to Mahathir’s leadership from within UMNO and the party’s eventual split. The division of UMNO, coupled with economic and political frustrations, made compromises between bumiputera and other ethnic groups difficult, and escalated ethnic tensions to a level close to that of the 1969 race riots.

The UMNO Split

In early 1986 the Deputy Prime Minister, Musa Hitam, resigned unexpectedly over disagreement in policy with the Prime Minister. This prompted early general elections in that year in August before the government’s constitutional term ended in July. In the UMNO’s triennial party elections in April 1987, Musa backed the former Minister of Trade and Industry, Razaleigh Hamzah, who was to challenge Mahathir for the party’s presidency. Razaleigh was defeated by a narrow margin. Shortly after the election, the Razaleigh faction petitioned the High Court to declare the election results invalid and had the court rule UMNO illegal. The protracted law suit and the recession had the effect of undermining UMNO’s legacy both in the eyes of the Malays and non-Malays. The population became extremely polarized along racial lines with the weakening of the political centre held by UMNO.

Tensions and Confrontations

In late 1987, in the context of the recession, ethnic politics dominated the political scene. The Ministry of Education started to promote non-Chinese educated personnel as administrators in Chinese Schools. This provoked the various parties within the Chinese community to join forces to oppose such appointments. Many of the Malay politicians, including those in the government, perceived the protests as directly challenging Malay supremacy and unity. They counteracted and planned even larger rallies, which only served to generate further ethnic antagonisms. In less than a month, the provoking gestures loaded with hostile ethnic biases by both sides soon escalated into serious ethnic confrontations. The situation was brought from the brink of violence by the mass arrests of 119 individuals under the Internal Security Act and put under detention without trial. The aftermath of the incident left an atmosphere where fearful silence prevailed.

The political turmoil had consumed much of the government leaders’ energy and attention that might otherwise have been devoted to mapping the country’s economic future, especially the salvation of the heavy industrialization drive. The need to maintain stability as well as to promote economic growth essential to national unity then became a top priority on the Malaysian Government’s agenda.

**Conclusion**

The Malaysian government’s zealous efforts in the early 1980s to pursue the heavy industrialization policy so to join the ranks of the NICs was retarded by the recession in the mid-1980s. Moreover, the political turmoil during the recession cast serious doubts about the

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attainability of NIC status through a state-sponsored heavy industrialization drive under the aegis of foreign capital as well as the NEP’s 1990 30 per cent goal. Although the recession was beyond control, the failure of the numerous public enterprises including HICOM was not entirely economic in nature. It also reflected the ill-conceived planning of decision-makers and ineffective management of primarily government officials-turned executives. In addition, government policies to advance Malay interests in the economic field had been at the expense of ethnic harmony. Most important of all, the recession revealed the country’s continued reliance on foreign investment to generate economic growth, and the feasibility of the NEP.
Chapter Three  The NEP in Abeyance and Foreign Investment

In view of the precarious political-economic environment of Malaysia in the mid-1980s, the government had to review and revise its various policies to lead the country to overcome its problems. The new policies, however, generated fears within the Malay community arising from the foreign investment boom that was perceived as threatening to the Bumiputera’s economic interests. This chapter demonstrates that the change in policy approach in relation to foreign investment was an expediency adopted by the government to salvage themselves from the economic difficulty. It analyzes the underlying fears of the Malay business community towards foreign investment with relations to ethnicity.

The NEP in Abeyance

The policy change was reflected in the further relaxation of the NEP regulations with regard to attracting foreign investment and on emphasis on growth. The rationale for doing so was, nevertheless, political. Mahathir’s ability to bring economic growth back on track was pivotal to the re-consolidation of the legitimacy of Mahathir’s regime and the recovery of the economy in the face of the recession and his party’s split.

The Origins of the Change

While the NEP was designed to benefit all Malaysians, the Malay community was the major beneficiary. There was a substantial Malay presence in the economy since the 1970s when the government sought to foster a Malay entrepreneurial class as one of its major undertakings to restructuring Malaysian society. The creation and growth of this was supported by continued
government protection over the years. Malay businessmen were nurtured on easy credit, reserved corporate shares, business licenses, government contracts, and other preferential treatments. The NEP restructuring appeared to have removed the racial imbalances only in form. State protection had fostered a ‘dole’, ‘mediocrity’, ‘subsidy’, and ‘get-rich-quick’ mentality among the Malays. The protection actually perpetuated Malay dependence which resulted in a financial drain from the state coffers. It was found that the ‘Malay middle class’ which the state helped create could only survive through state protection.

In the face of a severe recession, the practice of any form of protection was difficult. Mahathir then disassociated himself from previous forms of protection through the adoption of privatization. In other words, he announced that the state would only help those who help themselves. Privatization and corporate restructuring thus entailed a sense of insecurity among the Malays. Nevertheless, there still existed a class of successful Malay businessmen under protection. In fact, it was the government’s intention to boost some gigantic Malay corporations that parallel multinational corporations to better compete in the world market. and using Malay economic success as a symbol of economic nationalism. Their businesses had grown to the extent that they started to view protection as an economic distortion and preferred their interests to dictate the maximum growth possible. In doing so, they had channels to make their views known to Malay government leaders.

The Debate

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The problem facing Mahathir’s government amidst the recession and UMNO’s split was simultaneously to revive the economy and to fulfill the NEP goals. In this context, Malay leaders and business circles fervently discussed and debated the future of the NEP. Two groups of opinions emerged. The first group, mostly comprised of small and medium businessmen, demanded an even more aggressive approach: to push for the 30 per cent goal, which they saw as the last resort, the only source of protection. They were frustrated because the recession no longer guaranteed them jobs and business opportunities. They feared that if the state were to abandon its protection, the Malay economic status would once again fall behind non-Malays.\(^2\)

Thus they held that the state should emphasize redistribution more vigorously or the Malay achievement thus far would end in failure.

On the other hand, the second group, made up of larger capitalists and senior managerial personnel, was concerned about the reassessment of the NEP implementation. They held that the requirement of setting aside a 30 per cent share for bumiputera participation had actually hindered domestic and foreign investment. They advised bumiputera to abandon the get-rich-quick mentality to instead concentrate on growth and the creation of industries which would bring along employment opportunities and consequent restructuring. They stressed that the NEP was based on ‘growth with distribution’ as proclaimed in the NEP and wanted the state to adhere to the original version of the expanding pie theory.\(^3\) Therefore, they recommended that the primary task for the state was to stimulate the growth necessary for redistribution to take place.

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\(^2\) Chinese capital in corporate sector managed to reach a peak of 33.4 per cent in 1982 and 1985 despite unfavourable investment environment and capital flight due to the ICA. Jomo K.S., *Growth and Structural Change in Malaysia*, pp.160-61.

\(^3\) *Second Malaysia Plan*, p.1.
At the end of the debates, the second group of opinion gained prominence as it coincided with Mahathir’s own. However, a compromise was reached. The final outcome of the debate was a de-emphasis on the NEP’s foreign equity regulations.

The New NEP Direction

The best solution to the recession and to the short fall of the NEP’s 1990 30 per cent target, using Mahathir’s own terminology, was ‘holding the NEP in abeyance.’\(^4\) The main thrust of this new direction was to waive foreign equity ownership regulations in the amendment of the ICA and the introduction of more favourable investment incentives. Meanwhile, mindful of the impact of the suspension of the NEP on the Malay community, the announcement was found only in Malaysian Chinese vernacular press,\(^5\) and this new measure took a different approach to assure 30 per cent Malay share ownership.

Mahathir’s government initiated several measures to stimulate economic growth. It liberalized the guidelines for foreign equity ownership in manufacturing in July 1985 to allow higher foreign equity participation; it amended the Industrial Co-ordination Act to make it easier for manufacturers to start new projects, expand their capacity, and diversify their products in December 1985; it introduced the Investment Incentives Act in May 1986 to provide further tax incentives to the manufacturing, agricultural, and tourism sectors. At the end of September 1986, the government resolved to grant full ownership to foreign companies that exported 80 per cent or more of their products. This marked the most significant deviation from the NEP. The government announced a set of new and more liberal conditions in favour


\(^5\) Ibid.
of foreign investors. They stipulated that a company that exports 50 per cent or more of its production, or sold 50 per cent or more of its production to companies in the Free Trade Zone or Licensed Manufacturing Warehouses, or employed 350 full-time Malaysian workers would be granted whatever level of equity for which it applied. Finally, Mahathir announced that foreign investments undertaken between October 1985 and December 1990, under these conditions, would not be required to restructure their equity at any time.6

The new direction taken by the government to adjust to the recession and to seek growth appeared encouraging, but there were still sectors and other dimensions of the NEP which it did not seek to address. First, the new directions were aimed mainly at attracting foreign investment into the light manufacturing sector to prop up economic growth.7 The Malay leaders were desperate for rapid economic growth and employment generation to forestall a serious weakening of its political position. The fastest way appeared to be to get foreigners with their available technology and markets to set up production.

Secondly, it did not address the investment needs of the Chinese business community. Since 1971 the government never expected Chinese business investment to provide much employment opportunities for the Malays. Politically, giving a liberal hand to the Chinese would have signified a fundamental change in the existing political practice. It was clear that neither the Malay leaders nor the Malay middle class and business groups who had a stake in the NEP would take the risk. Some controls were only lifted by the end of 1986 where the ICA

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7 “...we are prepared to forgo equity participation in favour of jobs for Malaysians.” quoted of Mahathir from Far Eastern Economic Review, 25 September 1986, p.78.
exempted companies with paid-up capital of less than $2.5 million and 75 employees from complying with the NEP's ownership regulations.\(^8\)

Thirdly, the new direction did not amend its provision under which the employment composition of all new investments should reflect the composition of the population as a whole.\(^9\) This implied that the bumiputera share of employment generated from new investments would be guaranteed.

Fourth, and most importantly, the amended ICA still have control over the distribution of ownership in favour of bumiputera in at least three aspects in business ventures that seeking local partners. In ventures where less than 70 per cent of the equity is held by foreign initiation and no local partners have been identified, 30 per cent will be reserved for bumiputera and the balance for non-bumiputera. While projects initiated by bumiputera on a joint venture basis with foreigners holding more than 70 per cent of the equity, the balance of the equity will be reserved for the bumiputera concerned. The same applies to projects initiated by non-bumiputera on the same basis. However, in any of the above cases, if less than 70 per cent of the equity is taken by foreigners, part of the balance must be reserved to bumiputera.\(^10\) In any case, bumiputera is guaranteed by this legislation a share in ownership control in new business ventures.

Although some controls were removed for the small Chinese business sector, it was clear that the main thrust of the policy was to rely upon foreign investment to resuscitate the economy, and to solve part of the unemployment problem in light of the employment

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\(^8\) Khoo KJ, p.70. Khoo BT, p.142.  
\(^9\) ICA stipulated that companies receiving any form of government assistance, including tax break, must employ and train at least 30 per cent Malays at every level.  
generating capacity of the labour-intensive manufacturing. It was clear that the new direction represented a continuation of the redistribution rather than a change in policy. Therefore, the government took pains to adopt measures that were intended to re-generate growth vital for the country’s economic revival. Nevertheless, the new direction of the NEP was lopsided in that it was directed mainly at foreign investors. The other aspect of the NEP’s restructuring efforts, employment, remained unchanged. While the economic recession of the mid-1980s led to a greater flexibility in NEP implementation, it is by no means disavowed the NEP itself. Rather, it is a policy expediency meant to create growth during economic downturn for the continuance of the NEP restructuring. The Malaysian government would render ethnic considerations during economic recession by resort to pragmatic measures under conditions that such measures are to the favour of the government’s political ends. Thus the new direction of the NEP implied that its redistribution objective remained untouched but in a form more acceptable to all Malaysians.

**Foreign Direct Investment Boom**

In response to the Malaysian government’s favourable foreign investment regime in 1985-86 to liberalize investments and promote overall competitiveness of the economy, namely ‘holding the NEP in abeyance’, FDI started to flow into the country after 1987 in tremendous magnitude and speed, and increased its share in total manufacturing investment.\(^{11}\) In addition, the gradual global economic recovery beginning in 1988 provided a favourable international investment environment. The relocation of numerous industries from

industrialized and industrializing economies to developing countries in an effort to avoid rising production cost and new environmental regulations also facilitated Malaysia’s FDI growth.\textsuperscript{12}

The sluggish FDI growth from 1981 to 1985 which averaged only 29.9 per cent per annum ended by 1987. The rate of FDI surged by 43 per cent in 1987 and 168 per cent in 1988 (Table 2.1), and was concentrated mainly in the export-oriented manufacturing sector.\textsuperscript{13} The inflows of FDI were also consistent with the recommendations of the Industrial Master Plan (IMP) in which the manufacturing sector was targeted to lead overall economic growth, achieve greater export expansion, provide employment, and acquire technology and skills in more advanced manufacturing.\textsuperscript{14}

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<th>Table 2.1 Malaysia: Foreign Direct Investment in Approved Projects in the Manufacturing Sector (Million)</th>
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By the end of the 1980s, there had been rapid expansion of the manufacturing sector as well as manufacturing employment. Manufacturing grew at a rate of over 17 per cent in three consecutive years since 1988 and the sector accounted for 25.2 per cent of GDP.\textsuperscript{15} Manufacturing employment constituted 34 per cent of all new jobs created during 1986-88 \textsuperscript{16} and it rose from 0.6 per cent in 1986 to 10 per cent in 1988.\textsuperscript{17} The tremendous rise in manufacturing employment has led to rising Malay participation in manufacturing. Over 60

\textsuperscript{14} Industrial Master Plan (IMP), 1986-95 recommended an outward-oriented industrialization strategy based on the intensive development of resource- and non-resource-based industries for export which stressed the importance of foreign direct investment to the structural transformation of the economy.
\textsuperscript{15} \textit{Fifth Malaysia Plan}, pp.178-179.
\textsuperscript{16} Ibid., p.86.
\textsuperscript{17} Ibid.
per cent of manufacturing employment was occupied by the Malays.\textsuperscript{18} There has also been a fast rise in female participation in manufacturing employment particularly in the electronics industry.\textsuperscript{19} Furthermore, increased manufacturing output accelerated exports and also diversified the export markets. Although manufacturing ventures during this period tended to be wholly or majority foreign owned,\textsuperscript{20} this sector was forged to be the source of sustained and stable growth.

The economic recovery after the recession characterized by the remarkable influx of FDI into Malaysia beginning in 1988 occupied much of the government’s attention and was a popular topic among all Malaysians. The resulting economic growth was welcome news to the government and the country. Mahathir’s government was happy to see this new development because it could serve to divert public attention from his party’s split and from Chinese resentment which had emerged out of the mass arrests in 1987. More importantly, his government believed that FDI in the manufacturing sector would provide the impetus for accelerated growth. By giving a freer hand to foreign investors, Mahathir could fully concentrate on the rebuilding of his party in the face of UMNO’s prolonged court-case and the preparation of the 1990 general elections.

One distinctive feature of FDI after 1987 was the diversity of its sources. There was a shift in the traditional sources of FDI from the United Kingdom, the United States, Singapore and Japan to include East Asia’s newly industrializing countries -- Hong Kong, Taiwan and

\textsuperscript{18} MIDA, \\
South Korea. The successful extension of Malaysia’s Generalized Systems of Preferential (GSP) status with the United States in early 1988 appeared attractive to the East Asian NICs. They could utilize Malaysia’s renewed GSP status as the frontline of their manufacturing exports to escape the US import restriction. The dramatic increase of FDI in Malaysia from the NICs could also be attributed to favourable geographical proximity and the need to diversify their market and production risks.\(^{21}\) The combined share of Taiwan, South Korea and Hong Kong in total FDI projects approved in 1988 stood at 24 per cent.

The diversity of FDI sources had significant implications for the generation of growth and provided a means of meeting the NEP’s restructuring goals. The economic stagnation of the mid-1980s had made redistribution difficult and the government’s primary concern was to attract FDI as much as possible to generate urgently needed growth.\(^{22}\) Investors from all countries were welcome. In light of the still thorny ethnic relations, the de-emphasis on the origin of FDI was important in that it eliminated the practice of choosing foreign investors based on ethnic calculations as had occurred during the early 1980s.

_Taiwanese Investment: Recycled Malaysian Chinese Capital?_

In the late 1980s, Taiwan emerged as the most important investor after Japan in Malaysia. Taiwan accounted for 36 per cent of the total approved investments in Malaysia in 1990.\(^{23}\) It

\(^{21}\) Chia, p.85.

\(^{22}\) Mahathir: ‘At the moment there is no growth, so we have decided we will not go ahead with the kind of restructuring we planned for...we have now to concentrate on growth first and then restructuring.’ cf. _Far Eastern Economic Review_, 25 September, 1986, p.78.

even overt took Japan as the single largest investor in 1990.\textsuperscript{24} Realizing that the attraction of geographical proximity could be enhanced by ethnic and cultural affinity to facilitate information flows, the Malaysian government sought to promote the existence of its relatively sizable Chinese population in order to attract Taiwanese investors.\textsuperscript{25} Part of the efforts included the overture to explore the possibility of recognizing degrees completed in countries such as Taiwan. As an additional encouragement, the Malaysian government included Taiwan in the list of ‘Look East’ countries at the end of 1988.\textsuperscript{26}

| Table 2.2 Taiwanese Foreign Direct Investment in Approved Projects In Malaysia (US$ Million) |
|---------------------------------|-----------------|----------|----------|----------|----------|----------|----------|
| Amount (Million)               | 50.39           | 91.00    | 313.00   | 815.00   | 2,383.00 | 1,314.21 | 602.00   | 346.50   |
| Number of Cases                | 138             | 37       | 111      | 191      | 270      | 182      | 137      | 86       |

Source: MIDA; Investment Division, Ministry of Economic Affairs, Taiwan.

The spectacular inflow of Taiwanese investment, however, generated fears from within the Malay commercial and industrial community. There had been allegations that a sizable proportion of Taiwanese investment was actually recycled Malaysian Chinese capital, trying to take advantage of tax breaks and incentives as well as to escape the equity restrictions applied on local investment under the NEP.\textsuperscript{27} The Malay business community feared that opportunities


presented by the inflows of foreign investment from this source appeared disproportionately favourable to advancement of the local Chinese.

Most of these allegations centred around Taiwanese equity ownership and managerial practices. A distinguishing feature of Taiwanese investments in Malaysia is that they belonged to the export-oriented small- and medium-scale enterprises which tended to hold majority equity. They fully exploited the favourable investment incentives and the ICA's provision to allow full ownership and control when exports totaled over 80 per cent of their products. The recruitment of local Chinese as managerial staff was a common practice among Taiwanese enterprises. In addition, the Malay business community believed that the majority of Taiwanese small- and medium-size enterprises only chose Malaysian Chinese businessmen as partners in their investment ventures and in the creation of local industrial linkages. Some Malays criticized Taiwanese enterprises for competing with local firms for credit facilities and the exclusive employment of Chinese managerial staff.

Such allegations could also be attributed to the uncertainties surrounding Mahathir's government by the end of the 1980s. A Malay opposition party, Semangat 46 or Spirit of 46, led by Razaleigh's camp was formed after they lost their court-case to Mahathir. In the wake of the 1990 general elections, the party took away considerable Malay votes that had traditionally supported UMNO, and posed a direct threat to Mahathir's re-registered party, New UMNO. In this context, the Malay business community feared that relaxed equity regulations and the

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28 About 60 per cent of the Taiwanese FDI projects approved during the period 1988-93 falls in this category.
29 Chung-Hua Institution of Economic Research, *Taiwan's Small- and Medium-Sized Firms' Direct Investment in Southeast Asia*, Taipei: Ministry of Economic Affairs, 1995, pp.401. Many of these Chinese had received degrees from Taiwan which are officially unrecognized in Malaysia. There are over 3,000 Chinese Malaysian students in Taiwan every year. The figure in 1994 is 3,662 students enrolled in all levels of education while the majority of them are at the tertiary level (75 per cent). Source: *Overseas Chinese Annual Education Report, 1996*, Taipei: Commission of Overseas Chinese Affairs, p.13.
weakened Mahathir government would affect the state protection they had thus far received. They also worried that the co-operation between Taiwanese investors and the Chinese would lead to local Chinese economic revival and further threatened Malay interests already facing diminishing protection.

A closer examination of how Taiwanese investment complied with the broader social goals of the NEP can easily clear up such allegations. An extensive Taiwanese survey conducted with the co-operation of the Malaysian private sector and academics reveal that about 90 per cent of the workers in Taiwanese firms are Malays. In terms of the ownership, larger Taiwanese firms showed greater willingness to hold minority shares. The survey also reveals that extensive local linkages existed between Taiwanese investors, local Chinese firms, and bumiputera companies.\(^30\) In addition, the Taipei Investors’ Association of Malaysia was reported to have undertaken efforts to help bumiputera in the form of technical assistance, marketing skills and management consultancy. Interestingly, this survey reveals that Taiwanese investors often complained about their local Chinese partners’ frequent breaches in business relationships. Taiwanese investors tended to complain about local Chinese businessmen’s opportunistic approach of ‘hit-and-run’ strategy and being uninterested in developing a long-term relationship.\(^31\) They have also complained about the high turn over rate of Chinese employees.\(^32\)

Hence, it could be said that a tentative conclusion can be drawn that such allegations actually revealed the uncertainty about protection and the underlying biased perception against Chinese capital. The accusations cannot be justified on solid grounds. Ironically, the Malay

\(^{30}\) Chung-Hua Institution of Economic Research, p.157, 
\(^{31}\) Ibid., pp.400-01. 
\(^{32}\) Trade News, August 9, 1994; February 14, 1995, Taipei. (Chinese)
business community actually resented the initial government’s efforts to attract Taiwanese investments and made an appeal to ethnic and cultural affinity. They failed to appreciate that the inflow of Taiwanese investment actually carried with it redistributive means as far as employment was concerned. To a large extent, the NEP championed the bumiputera economic challenge to non-Malays, particularly Chinese, which actually led to the creation of these biases and perceptions. Based on these biases, the allegations only served to deepen Malays’ mistrust towards local Chinese.

Conclusion

The most significant policy change during the recession was the relaxation in equity ownership prescribed by the NEP. The government counted on economic growth to solve some of the political dilemmas that derived directly and indirectly from the implementation of the NEP. In time when Malay unity was put to test, the government sought to harness Malay constituent support for its survival. It took pains to adopt a new policy approach to appease the Malay business community on the one hand and to generate growth for the economic well-being of the country on the other. Nevertheless, it was carefully designed to avoid any protests from the Malay community that would undermine the government’s legitimacy. In response to the various favourable investment incentives and the relaxation of equity regulations, FDI accelerated with great speed. Although FDI was greatly encouraged, it was received with some reservations especially within the Malay business community towards certain sources, namely Taiwan. Since the implementation of the NEP, the Malay mentality was inculcated to improve their economic position in relation to non-Malays, Chinese in specific. Allegations derived from the Malay perceptions which were based on ethnic suspicion that Taiwanese investment
would revive local Chinese capital only functioned to reinforce mutual distrust between the Malays and Chinese. Worried about the impact that diminishing state patronage and rising competition from foreign investors would have on them, the Malay business community thus pressed for the continuance of the NEP after 1990 which is discussed in the next chapter.
Chapter Four

Growth With Distribution

This chapter analyzes the interrelationship between politics and economic planning in the formulation of a new economic development policy after 1990. It explores the Malaysian government's response to the potential of an emerging 'Greater Chinese Economic Sphere' and the 'Southward Policy' of Taiwan in the early 1990s. The chapter is to pinpoint Malay concerns in continuing Malay advancement in the economic sphere through redistributive economic strategies.

Post-NEP Economic Policy: Growth or Distribution

The twenty-year period of the Outline Perspective Plan (OPP) for the NEP came to an end in 1990. During 1989, all quarters expressed concerns about what policies would replace the NEP when it expired. This was further complicated by the ruling BN ability to win the pending 1990 general elections.

The NEP Record

By looking at available official statistics on NEP implementation, one tends to conclude that OPP targets were largely achieved. The OPP projected a reduction in the official poverty rate from 49 per cent in 1970 to 16 per cent in 1990. The actual overall incidence of poverty in Malaysia dropped from 20.7 per cent in 1984 to 19.3 per cent in 1987. If considered on a per capita basis, the rate declined from 13.7 per cent in 1984 to 12.4 per cent in 1987. Hence, many believed that the OPP target of 16 per cent appeared to have been reached.\(^1\) However,

\[^1\] *Mid-Term Review of the Fifth Malaysia Plan*, p.47.
the government only emphasized the poverty reduction record in proportional terms where only a small proportion of the total number of households that significant reductions were achieved. The number of poor urban households actually increased from 86,000 in 1970 to almost 100,000 in 1983 and in 1987 the figure was still 81,000.²

Employment restructuring, in general, was accomplished. The bumiputera share of employment in each of the seven major occupations roughly reflected their share of the population which amounted to about 56 per cent.³ (Table 4)

Table 3 Malaysia: Distribution of Total Employment by Occupation and Ethnic Group, 1988 (%)

<table>
<thead>
<tr>
<th>Occupation</th>
<th>Bumiputera</th>
<th>Chinese</th>
<th>Indian</th>
<th>Others</th>
</tr>
</thead>
<tbody>
<tr>
<td>Professional, Technical</td>
<td>55.6</td>
<td>30.8</td>
<td>11.5</td>
<td>2.1</td>
</tr>
<tr>
<td>Administrative, managerial</td>
<td>28.4</td>
<td>66.0</td>
<td>4.6</td>
<td>1.0</td>
</tr>
<tr>
<td>Clerical</td>
<td>55.1</td>
<td>35.6</td>
<td>8.8</td>
<td>0.5</td>
</tr>
<tr>
<td>Sales</td>
<td>36.5</td>
<td>57.5</td>
<td>5.9</td>
<td>0.1</td>
</tr>
<tr>
<td>Service</td>
<td>58.7</td>
<td>30.2</td>
<td>9.9</td>
<td>1.2</td>
</tr>
<tr>
<td>Agricultural</td>
<td>75.8</td>
<td>16.6</td>
<td>7.2</td>
<td>0.4</td>
</tr>
<tr>
<td>Production</td>
<td>45.9</td>
<td>42.8</td>
<td>10.8</td>
<td>0.5</td>
</tr>
<tr>
<td>Total</td>
<td>56.9</td>
<td>33.7</td>
<td>8.7</td>
<td>0.7</td>
</tr>
</tbody>
</table>

Source: Mid-Term Review of the Fifth Malaysia Plan.

Although bumiputera were still under-represented in sales, administrative and managerial positions, the promotion of bumiputera small- and medium-size enterprises, as recommended by the IMP, was well underway.⁴ In contrast, there was no serious commitment to increase Chinese participation in government services and agricultural sectors.⁵

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³ Ibid., p.66, table 3-10.
⁵ According to the 1980s census, more than 80 per cent of all government executive officers are Malay compared with their 48 per cent estimates share of the total population. Malays hold 96 per cent of the total land given under the Federal Land Development Authority (FELDA). *Far Eastern Economic Review*, 25 September, 1986, p.76-77.
In terms of the ownership of corporate wealth, the bumiputera share was recorded at 19.4 per cent in 1988. In fact, bumiputera share ownership was believed to be much higher than recorded in the official data because racially unidentified nominee companies were counted exclusively as belonging to non-bumiputera Malaysians. It was argued that if the shares held by these nominee companies were set aside, bumiputera share at par value would rise to 22 per cent. Some even argued that bumiputera share ownership in mining, banking and financial sectors had already surpassed 30 per cent by as early as 1983.

UMNO finally won the court-case and re-registered as the New UMNO in 1988. At the same time, Razaleigh successfully forged a united, though uneasy, opposition front to present an alternative to the Malaysian electorate for the first time. The new opposition alliance enjoyed substantial Malay votes that had traditionally supported UMNO. Considerable erosion of support for the ruling BN as evident in the by-election setbacks from mid-1988 until the general elections in October 1990, cast doubts about the political as well as economic future of the country. In this light, the BN had to count on non-Malay votes, Chinese in particular, in constituency with Malay majority.

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6 Mid-Term Review of the Fifth Malaysia Plan, p.70.  
In late 1988, Mahathir announced the establishment of the National Economic Consultative Council (NECC) to consolidate political support under the combined pressures of the declining support for BN, ethnic tensions since the mass arrests, criticism of the government’s assault on the judiciary, and open dissent by the BN’s second largest component party, the Malaysian Chinese Association (MCA). The NECC, which came into operation on 19 January 1989, comprised 150 members from all quarters and was equally divided between bumiputera and non-bumiputera members. The NECC was responsible to the government to recommend a national economic policy for the period after 1990. The establishment of the NECC was intended to enhance ‘the government’s credibility and legitimacy after the political and economic crises from the mid-1980s.’

Debate over The Post-NEP Policy

Divergent opinions about future economic policy were often divided along ethnic lines. In general, Malays hoped that the NEP would continue, and they worried about the economic imbalance that might eventually threaten their political dominance. Non-Malays, Chinese in particular, however, hoped for better economic opportunities and an end to ethnic

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12 MCA’s president, Dr. Ling Liong Sik had pressed for the establishment of the Council and then left the country for six weeks in late 1988 as a desperate gesture to get Mahathir and UMNO leadership to make certain concessions which Ling hoped would salvage the credibility of the MCA and his leadership.

13 Among the 150 seats, forty-five seats were distributed to the BN parties, seven to the opposition parties, twelve from chambers of commerce, seven from trade unions, four from teachers’ organizations, two from finance and insurance, six from workers and social organizations, and three from farmers and fishermen. They were twenty-five bumiputera and twenty-six non-bumiputera members of political parties, twenty-one bumiputera and twenty non-bumiputera members of associations and chambers of commerce. BN parties nominated ‘individuals’ to make up the rest, most of whom were academics, intellectuals, or policy consultants to party leaders.

discrimination, especially in the form of quotas. They also worried that any changes would be instituted at their expense.

There were many advocates for the continuation of the NEP, including some top government officials.\textsuperscript{15} The Malay Chamber of Commerce simply assumed it should go on forever.\textsuperscript{16} But Malay aspirations did not stop at 30 per cent. The figure was pushed further amidst ethnic tensions. During the UMNO party general assembly held on 17-19 November 1989, the youth wing strongly proposed that equity ownership had actually discriminated against the bumiputera since they made up more than half the population and, consequently, proposed that the Malay corporate ownership target be based on the racial composition of the country.\textsuperscript{17}

On the other hand, Chinese views strongly opposed the continuance of the policy. MCA argued that, as a member of the Alliance, their support of the NEP in 1969-70 was based on the understanding that there would be no automatic extension. Rather, policies after 1990 should be posed on ‘merit and needs.’\textsuperscript{18} This was immediately met by provocative protests from Malays. The Malays accused the Chinese of challenging Malay political dominance and

\textsuperscript{15} As early as in mid-1985, Daim Zainuddin, the Finance Minister, announced that ‘the 1990 deadline was only a target date but the effort would have to be continued until the objectives were achieved’, \textit{Malaysian Digest}, April 30, 1985, p.8. In mid-1987, the Deputy Prime Minister in his address to the annual meeting of the Bumiputera Contractors Association proudly announced that the NEP bumiputera restructuring target would be raised from 30 per cent to 51 per cent. Jomo K.S., “Whither Malaysia’s New Economic Policy?” \textit{Pacific Affairs}, 63, 4(Winter1990/91), p.476.


warned them not to ‘play with fire.’\textsuperscript{19} Furthermore, opposition parties boycotted the NECC because their representatives were still under detention.\textsuperscript{20}

In the face of these open disputes, the Malaysian government was reluctant to release any NECC discussions or reports because it feared that this release might affect the 1990 election outcome. The Official Secret Acts was then invoked to cover all debate and all documents submitted to or produced by the NECC throughout its operations.\textsuperscript{21} Despite efforts to down-play the post-1990 policy issues, the government was bitterly criticized for its clandestine policy-making process.

In view of the implementation of the NEP and how it was perceived, the division of opinion was primarily ethnic in the form of wealth restructuring. The better-off bumiputera, especially the growing bumiputera business class who were in a position to benefit significantly from economic restructuring, demanded the continuation of the NEP, in one form or another. The increasing number of bumiputera businessmen rising to political prominence, as exemplified by former Finance Minister Daim Zainuddin, served as an implicit impetus for the policy’s continuation.

Furthermore, the government’s emphasis on export-oriented growth and privatization was geared towards ethnic redistribution. The Malaysian government welcomed foreign investments in export-oriented manufacturing because they provided jobs to Malaysians, particularly for Malays. As a result, Malays made up over 62 per cent of total manufacturing

\textsuperscript{19} The official mentioned is former Deputy Minister, Abdullah Ahamd. His speech was permitted to reprint in Malaysia which many speculated that the continuance of the NEP after 1990 was highly likely. \textit{Far Eastern Economic Review}, 25 September, 1986, p.77.


\textsuperscript{21} Ibid., p.196.
employment. The pursuit of privatization was to create and ensure the participation of bumiputra interests in the process. Finally, the existence of the NEP has important ideological implications for the Malays. Many poor Malay peasants regard with some pride the achievement of a few Malays in catching up with the non-Malays in the economic field—or, at least they can say that their fate is not entirely to serve other ethnic groups. The success of the NEP showed the world the feasibility of the policy and provided a justification for its continuation. Hence, given the symbolic status of the NEP, the most obvious strategy for demanding benefits was to press for the continuance of the NEP after 1990.

**Growth with Distribution**

Despite some friendly gestures and election promises made by government official to the Chinese community, the government was determined not to be affected by the dispute. With the BN in firm control of all NECC proceedings, the final report of the council, *DEPAN*, or the Economic Policy for National Development was released in February 1990. It proposed a new economic policy but retained ethnic preferences through the so-called ‘growth with distribution’ approach. This was deliberately made to maximize public acceptance. Although the new emphasis of the post-NEP policy was clearly on growth, modernization and industrialization, the commitment to redistribution remained. The report encouraged private limited companies to go public so that the investment opportunities for bumiputera would

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22 As at 31st December, 1992, total manufacturing employment stood at 735,326 out of which 460,463 were bumiputera. Source: MIDA.


24 *Second Outline Perspective Plan*, p.3-5, *The Sixth Malaysia Plan*, p.3.
increase. This clearly demonstrated that inter-ethnic distribution was not de-emphasized but subsumed by the greater emphasis on growth. Growth enabled redistribution to take place.

It could also be argued that the adoption of this policy was partly a response to foreign influence. Huge foreign borrowings in the early 1980s and the more recent rapidly increasing FDI rendered the Malaysian economy and government economic-policy formulation far more vulnerable to foreign influence. For example, Malaysia’s debt servicing problem in the mid-1980s led to the adoption of a tighter fiscal policy under pressure of the IMF and the World Bank which could seriously affect the country’s international credit and investment rating. In the face of increasing foreign investment since 1988, the Malaysian government was prone to perpetuate a regime favourable for FDI, especially in export-oriented manufacturing. In this light, the Federal Constitution and the National Land Code were amended to allow foreign ownership of real property. Therefore, it was in the interest of the government to emphasize growth to maximize profits derived from foreign investment. It was clear that decisions about future economic policies were not going to be decided by the interests or needs of the masses, but were more likely to reflect the interests and desires of those in power and wielding influence.

The ruling BN won the 1990 general elections by a narrow margin, only 52 per cent of the total votes cast, but secured 127 out of the 180 parliament seats. The victory was seen as

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an indication that the new economic policy had popular support. As the economy was growing at over 8 per cent annually and with the help of the extensive and still forthcoming foreign investment, the government confidently proceeded on its new course.

**New Challenges**

At the beginning of the 1990s, three important national policies ranging from the medium to the long-term were introduced: Vision 2020, the National Development Policy which replaced the NEP, and the Sixth Malaysia Plan. These policies will certainly have a significant impact on the future development of the country. Prime Minister Mahathir announced the grandiose Vision 2020 in his inauguration speech for the National Business Council (NBC) on 28 February 1991. The speech, entitled 'Malaysia: The Way Forward', brought light to a new national objective of achieving 'fully developed country' status by the year 2020. The long awaited post-1990 economic policy, the National Development Policy (NDP), with a ten-year Second Outline Perspective Plan (OPP2) for 1991-2000 was announced in mid-1991. This was followed by the announcement of the Sixth Malaysia Plan (6MP), 1991-1995. New policies, however, in a new era, entail new challenges.

*Vision 2020: Fully Developed Nation*

Vision 2020 crystallizes Malaysia’s ambitious target to become a fully developed nation by the year 2020 in every sense of the word: socio-economically, technologically, politically and from the ethical and spiritual viewpoints. It identifies nine challenges that will have to be successfully addressed:
1. a united, peaceful, integrated and harmonious ‘Malaysian Nation’;
2. a secure, confident, respected and robust society committed to excellence;
3. a mature, consensual and exemplary democracy;
4. a fully moral society with citizens strongly imbued with spiritual values and the highest ethical standards;
5. a culturally, ethically and religiously diverse, liberal, tolerant and unified society;
6. a scientific, progressive, innovating and forward-looking society;
7. a caring society with a family-based welfare system;
8. an ‘economically just’ society with inter-ethnic economic parity; and
9. a ‘fully competitive, dynamic, robust, resilient and prosperous’ economy.29

The Malaysian government perceives Vision 2020 as its third socio-political contract30 towards establishing a united Malaysian Nation which transcends ethnic boundaries without undermining ethnic identity.31 Since the 1970s, there is little evidence that the state has been committed to forging unity among Malaysians as its primary goal. The NEP narrowly interpreted its overriding goal of national unity in terms of improved inter-ethnic relations: the closing of the income gap between different ethnic groups, especially between Malays and Chinese. In fact, inter-ethnic relations deteriorated during NEP implementation and racial confrontation mounted in the October 1987 mass arrests. While the announcement of a united Malaysian Nation appears attractive, prevalent ethnic discrimination against non-bumiputera in educational, cultural and economic areas raise serious doubts regarding the possibility that the goal will be appropriately translated into policy and practice.32

Vision 2020 outlines an attractive picture of rapid growth and industrialization in exchange for materialistic gains. All three policies project an average rate of growth at 7 per

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30 The first socio-political contract was the ethnic bargain where non-Malay recognized the Malay political dominance and ‘special rights’ in exchange for citizenship and economic rights whereas the second one was the government’s commitment to ‘correct inter-ethnic imbalance’ as proscribed by the NEP.
cent in the next three decades. It is envisaged that the new challenges will be overcome in a context of rapid growth. This clearly shows a shift of priority and emphasis from distribution to growth and industrialization. However, the emphasis on rapid growth similar to that during the 1970s raises the question of whether Mahathir’s various economic policies in the early 1980s ended in failure.

The eighth challenge serves as an example that the Vision continues to emphasize redistribution. ‘Economic justice’ may be interpreted as a legitimating provision to provide opportunities for Malays to achieve inter-ethnic parity. Moreover, privatization and the creation of a bumiputera commercial and industrial community are reiterated in the policy. In view of the prevailing rent-seeking behaviour cutting across all ethnic lines, whether or not the efforts to forge a bumiputera capitalist class will be successful remain to be seen.

The OPP2 and the 6MP are largely instruments to implement Vision 2020. They claimed to maintain much of the basic NEP commitments: alleviation of hard-core and relative poverty; increased employment; the rapid development of a bumiputera commercial and industrial community; a greater role for the private sector to achieve restructuring through growth; and human resources development to achieve growth and distributional objectives. The Malaysian government will continue to foster the inflows of foreign investment and ensure the maximization of its net benefits in order to diversify export markets, increase export

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34 “The eighth challenge ensuring an economically just society...Such society cannot be in place so long as there is indetification of race with economic function, and the identification of economic backwardness with race...If we want to built an equitable society then we must accept some affirmative action...we must ensure the healthy development of a viable and robust bumiputera commercial and industrial community. ” quote from Mahathir, *Malaysia: The Way Forward*, p.13-14.
earnings, create industrial linkages, provide jobs, and quicken technology transfer. Emphasis now was given to more sophisticated technology and high value-added manufacturing investment. This was made as part of the post-1990 foreign investment regulations. In terms of bumiputera share ownership, the NDP’s goal remains 30 per cent but no time frame is set as target date. Nevertheless, many Malays tend to regard this provision as a major concession to the Chinese because they did not push for the percentage which they argued is their rightful claim.

In sum, the three policies essentially maintain the status quo. While redistribution remains on the agenda, the focus is mainly on consolidating and strengthening a Malay capitalist class. In this light, the government has painted an all too rosy picture of a developed nation by the year 2020, a nation where reduced ethnic relations is replaced by rapid economic growth.

Muslim versus Chinese

The Vision 2020 agenda generated two sets of responses within the Malay community. A Malaysian Islamic party, Parti Islam SeMalaysia (PAS), strongly criticized the policy direction on the ground that the government is leading Malaysian Muslims towards a secular state vision with an emphasis on material returns which will eventually erode the Muslims’ faith. Malay intellectuals were more cautious regarding the objective of establishing a ‘Malaysian Nation’. They feared that, if achieved, there will be a Malay identity crisis. The broad notion of a

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‘Malaysian Nation’ may blur the distinctiveness of ethnic Malays in cultural sense.\textsuperscript{39} A loss of Malay identification with economic achievements made thus far would be unacceptable.

Facing pressures from both sides, Mahathir addressed the Malay community at the New UMNO General Assembly held on November 8, 1991. He refuted the PAS accusations by claiming that capitalist practices were not incompatible with Islamic teachings. Muslims should be rewarded for their hard work in the current life, but not in the next one. He stressed that the success of Malays equates to the success of Muslims, and that successful Malay Muslims should in turn, retain Islamic values and practices.\textsuperscript{40} Most significant of all, Mahathir emphasized that in order for Muslims to establish themselves in an increasingly competitive world, the nation needs close co-operation between UMNO leaders and members to meet the challenges lying ahead. Therefore, a strong, disciplined and unified, well-structured UMNO is needed to achieve the objectives of Vision 2020. He argued that if Malays wish to become strong, the establishment of New Malays is essential. The New Malays, as Mahathir defines them, are those who possess a vision and a ‘strong culture.’ They are educated, honest, disciplined, trustworthy and efficient, and capable of meeting the challenge of global competition.\textsuperscript{41}

It was argued that the ‘New Malays’ should aspire to leading Malaysia into becoming an influential global nation equal to the United States, Israel, Japan, China and India. However, these aspirations were met with the emergence of the ‘Greater Chinese Economic Sphere’ in

\textsuperscript{40} Ibid., p.115-20.
\textsuperscript{41} Ibid., p.128.
the Asia Pacific Rim. The talk of a Chinese economic sphere has gathered momentum as a result of the massive capital inflows from the ethnic Chinese East Asian NICs, the growth of China as a potential regional economic power, and the recent ‘Southward Policy’ of Taiwan.

In response to this, the Malaysian government has sought to establish closer ties with Middle Eastern countries by increasing trade relations and investment in the region. Meanwhile, efforts are devoted not only to forge a business network based on the Muslim Brotherhood but also to create a model for success and prosperity for other Muslim countries. It is hoped that the ‘New Malays’ of Malaysia will be able to create a ‘New Malay Economic Sphere’ to withstand the Chinese economic sphere in the Asia Pacific region through cooperation with Islamic countries based on a shared Muslim Brotherhood. Within Malaysia, the New Malay entrepreneurial class and Malay corporations should proceed hand in hand with governments in Southeast Asian countries to promote regional transnational corporations in an effort to establish this ‘New Malay Economic Sphere’. The recent emergence of the growth triangles including the Northern Triangle, the Southern Triangle, and the Eastern Triangle within ASEAN can be seen in this light. At the same time, the Malaysian government is developing the Islamic financial system with functions similar to the conventional banking system. In addition, the Malaysian government has recently been promoting the Labuan International Offshore Financial Centre to attract financial investment from Muslim countries.

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43 Ibid.
44 The Northern Triangle is made up of Penang of Malaysia, Phuket Island of Thailand, and Medan in Sumatera, Indonesia while the Southern Triangle comprises Johor of Malaysia, Singapore, and Batam Island of Indonesia. The Eastern Triangle links Sabah of Malaysia, North Kalimantan of Indonesia and Philippines together.
It shows signs of a continued government agenda which relied on foreign investment to finance various development projects, this time with sources from the Middle East.

While the New Malay march confidently to ‘Vision 2020’, the question remains as to whether they are competent or prepared to meet global challenges. The fact that the majority of the ‘New Malay’ thrive on state protection cast doubts about their ability to survive in a highly turbulent and competitive international environment. Another problem facing the Malaysian government is whether it can successfully forge a solid inter-ethnic integration as a base of genuine state-capital alliance for further economic expansion.

**Conclusion**

The NEP, a sweeping twenty-year affirmative-action programme to propel bumiputera into the economic mainstream vis-à-vis non-bumiputera, was primarily premised on growth. Based on the 1970s record economic growth and the expectation of continued foreign capital inflow, the Heavy-Industry policy in the early 1980s brought direct state intervention one step further in its attempts to correct economic imbalances in favour of the Malays. During the recession, this redistribution strategy ostensibly hoped to solve the historically persistent ethnic problems, but serious doubts about its feasibility remain. Despite its objective to cultivate national unity, the NEP’s approach to racial harmony, aiming to close the income gap between different ethnic groups has actually resulted in the deterioration of ethnic relations. This was worsened by the official categorization of the population into bumiputera and non-bumiputera that entrenched the segregation the Malaysian society. In contrast to the NEP’s objective to
correct economic inequality between different ethnic groups, the past twenty years of its implementation brought about a differentiated Malay community accompanied by widening intra-ethnic income gap.

Continued reliance on foreign investment, bypassing local, especially Chinese capital, has occurred at the expense of racial harmony. However, foreign investment was zealously encouraged during the 1985-86 recession. The fragile equilibrium of the NEP forced the government to relax equity regulations which had been imposed on industries at all levels for the sake of growth. To a certain extent, the relaxation was an implicit recognition of the various problems involved in NEP implementation. However, the change in policy approach continued to be mindful of Malay political perceptions. It primarily addressed the foreign sector in relation to foreign equity participation and paid only limited attention to the local Chinese business sector. The official decision to return to an emphasis on economic growth as stated in the Second Malaysia Plan implied that this was reached only after paying a high price.

Increased government pragmatism, including the promotion of privatization, benefited only a handful of politically well connected bumiputera businessmen. Malays in general, the small- and medium Malay businessmen in particular, called for continued state protection. Furthermore, the need to maintain legitimacy as the protector and facilitator of Malay interests, and to consolidate Malay constituent support inevitably assured the continuation of redistribution. The National Development Policy that replaced the NEP 1991 is actually a variation of the former which was made more acceptable to all Malaysians.
The post-1990 economic policy remained distributional in tone even though its emphasis has shifted to growth and industrialization. Gestures towards forging ethnic tolerance in the election year and the advocation of a Malaysian Nation, however, remain empty in view of how the NEP has been implemented in the past twenty years. Furthermore, the grand vision of the establishment of a united Malaysian Nation by the year 2020 was soon followed by a campaign to boost the concept of the New Malays and the idea that the New Malays concept is the core of the Malaysian Nation. With UMNO and the Malays' increasing ethnocentrism, coupled with continued redistribution, it is doubtful that genuine national unity can be successfully forged. Finally, the three major policies after 1990 put an emphasis on growth with distribution without taking into account non-Malay feelings and perceptions. In short, new nationalistic Malay formulas appear to be divisive and may serve as destabilizing factors in the future.
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Appendix 1

Construction Projects Secured by Japanese and Korean Companies

<table>
<thead>
<tr>
<th>Project Description</th>
<th>Contractor(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Daya Bumi</td>
<td>Takenaka Komuten &amp; Kumagai Gumi</td>
</tr>
<tr>
<td>UMNO Headquarters</td>
<td>Takenaka Komuten, Kumagai Gumi, Shimizu and Konsetsu</td>
</tr>
<tr>
<td>PermodalanNasional Berhad Headquarters</td>
<td>Shimizu Kensetsu</td>
</tr>
<tr>
<td>UBN/Shangrila Hotel</td>
<td>Taisei Kensetsu</td>
</tr>
<tr>
<td>Employees Provident Fund Headquarters</td>
<td>Taisei Kensetsu</td>
</tr>
<tr>
<td>PKNS Low-cost Housing</td>
<td>Hazamagumi, Taisei Kensetsu</td>
</tr>
<tr>
<td>Urban Development Authority Bukit Nanas</td>
<td>Taisei-Marubeni</td>
</tr>
<tr>
<td>Penang Bridge</td>
<td>Hyundai</td>
</tr>
<tr>
<td>Maybank 58-storey Headquarters</td>
<td>Keang Nam/DaeWoo Construction</td>
</tr>
<tr>
<td>Kenyir Dam</td>
<td>Hyundai</td>
</tr>
<tr>
<td>Sabah Natural Gas Project</td>
<td>Daelim</td>
</tr>
<tr>
<td>Prefabricated houses Pahang/KL housing parts</td>
<td>Samick</td>
</tr>
<tr>
<td>Resins project, Pahang</td>
<td>Young Dong</td>
</tr>
</tbody>
</table>