

**Privatized Statism and Ethnic Capitalism in Malaysia**

by

Andrew Chinpeng Ho

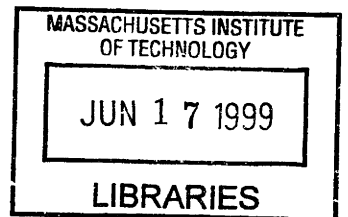
Doctor of Medicine, University of Malaysia, 1989  
Master of Private and Public Management, Yale University, 1993

SUBMITTED TO THE DEPARTMENT OF POLITICAL SCIENCE  
IN PARTIAL FULFILLMENT OF THE REQUIREMENTS FOR THE DEGREE  
OF  
DOCTOR OF PHILOSOPHY IN POLITICAL SCIENCE  
AT  
THE MASSACHUSETTS INSTITUTE OF TECHNOLOGY

JUNE 1999

© 1999 Massachusetts Institute of Technology  
All rights reserved

**ARCHIVES**



Signature of author \_\_\_\_\_

Department of Political Science  
April 30, 1999

Certified by \_\_\_\_\_

Richard J. Samuels  
Ford International Professor of Political Science  
Thesis Supervisor

Accepted by \_\_\_\_\_

Barry R. Posen  
Professor of Political Science  
Chair, Graduate Program Committee

# **Privatized Statism and Ethnic Capitalism in Malaysia**

by

Andrew Chinpeng Ho

Submitted to the Department of Political Science  
On April 30, 1999 in Partial Fulfillment of the Requirements for the Degree of  
Doctor of Philosophy in Political Science

## **ABSTRACT**

Theories of the developmental state assume astute bureaucratic interventionism protected from organized societal interests by authoritarian regimes; close bureaucracy-business ties supposedly facilitate prescient policy-making. In Malaysia, the bureaucracy did feature prominently in developmental policy-making, in an alliance with the political leadership in the seventies. Legitimated by a state ideology of ethnicity, this alliance created a Malay middle class through a legal, open, and centralized system of rents distribution to the Malay majority. In addition, ethnic quotas ensured extensive Malay participation in Corporate Malaysia and in the largest state-owned enterprise program outside the centrally-planned economies. This process also began the atrophy of ethnic Chinese capital. From the mid-eighties, through a carefully targeted program of privatization that divested state- and party-holdings of equity to co-ethnic proxies, the political leadership insinuated itself into the market. In the process, it sidelined the bureaucracy, forming an alliance with a consolidated Malay big business class instead. While proxies legally own these privatized entities, ultimate control inheres with the political leadership. However, day-to-day corporate life is not subject to the politician's micro-management. Thus, the political leadership has been able to bypass bureaucratic structures without relinquishing its control of the economy. While the bureaucracy prefers more regulation, policy controls, and state planning, the politician-businessman alliance is determined to negotiate these constraints. Because these corporations are subject to market discipline, this "privatized statism" tracks market structural changes; the ethnic capitalism so wrought has proven robust despite expectations of an enervating cronyist dissipation of rents. Mainstream developmentalist perspectives fail to anticipate the creation of an ethnic bourgeoisie, the intentional withering of a contending ethnic fraction of domestic capital and, crucially, the bureaucracy's role-inversion. Bureaucratic capacity cannot be assumed to define fully state power. To explain how the state structures domestic markets, state capacity must be characterized empirically by attending to historically determined coalitions and conflicts. Privatized statism also suggests a new mix of property regimes, and implies that each system of economic arrangements is historically constructed with resources and within contexts bequeathed from the past. But that endeavor is always constrained by politics; that is, markets are shaped by considerations of, not only, economic efficiency but, also, political power.

*Thesis Supervisor:* Richard J. Samuels

*Title:* Ford International Professor of Political Science

# CONTENTS

<b>Abstract</b>	2
<b>Acknowledgments</b>	5
<b>A Note to the Reader</b>	7
<b>Chapter One: Privatized Statism and Ethnic Capitalism in Malaysia, 1969-1999</b>	10
<i>I. Why Malaysia?</i>	
<i>II. The State's Role in Structuring Domestic Markets</i>	
<i>( a ) The Developmental State--Meaning &amp; Background</i>	
<i>( b ) Theoretic Considerations</i>	
<i>( c ) Historical Perspectives</i>	
<i>III. Privatized Statism &amp; A Durable Ethnic Capitalism</i>	
<i>IV. Methodology</i>	
<i>V. Previewing the Chapters</i>	
<i>Conclusion</i>	
<b>Chapter Two: The NEP Discourse of Ethnic Capitalism--Inverting Dependencies</b>	67
<i>I. UMNO's Legitimacy Problem &amp; its Ethnic Solution</i>	
<i>II. The 1969 Elections &amp; the Demise of Consociationalism</i>	
<i>III. Implementing the NEP--The ICA Initiative</i>	
<i>IV. Centralized Collection &amp; Distribution of Rents--The PNB/ASN Strategy</i>	
<i>V. Inverting UMNO's Dependency on Ethnic Chinese Capital--The Fleet Strategy</i>	
<i>VI. The NEP's Denouement</i>	
<i>Conclusion</i>	
<b>Chapter Three: Privatization as Insinuation of the State into Markets</b>	109
<i>I. The Economic Logic of Privatization</i>	
<i>II. A Political Logic of Privatization</i>	
<i>III. Privatization as Insinuation of the State into Markets</i>	
<i>Case 1: The Renong Privatization Rescue of Fleet &amp; Hatibudi</i>	
<i>Case 2: MRCB &amp; The Anwar Faction's MBO of TV3 &amp; NSTP</i>	
<i>IV. How Secure the Corporate Holdings?</i>	
<i>V. The Economic &amp; Political Impacts of Privatization</i>	
<i>Conclusion</i>	

*Contents (contd)*

**Chapter Four: Financial Policy & the Construction of an Ethnic Capitalism** 159

- I. *The Economics & Politics of Financial Interventionism*
  - ( a ) *Economic considerations*
  - ( b ) *Political considerations*
- II. *Financial Sector Structure in Malaysia*
- III. *Exploiting Banks & Financial Institutions*
  - ( a ) *Extracting seigniorage from the banking sector*
  - ( b ) *Directing preferential bank credit to specific interest groups*
  - ( c ) *Suppressing ethnic Chinese capital in banking*
- IV. *The Stock Market As An Instrument of State Power*
  - ( a ) *How the KLSE was used to create and consolidate a Malay business class*
  - ( b ) *The stock market bubble in the nineties*
  - ( c ) *The impact of employing stock markets on growth in developing countries*
- V. *Suppressing Bonds and Derivatives Markets to Support Malay Capitalism*
- VI. *The Politics of Malaysia's Financial Policy*
- Conclusion*

**Chapter Five: Privatized Statism--The Malaysian Model** 216

**Bibliography** 224

**List of Figures**

- 1.1 **The Argument** 63
- 2.1 **The PNB/ASN Strategy** 88
- 3.1 **How UMNO proxies benefit themselves** 121
- 3.2 **The Renong re-organization and cash-raising exercise** 133
- 3.3 **The MRCB deal** 136

**List of Tables**

- 1.1 **The state in domestic markets** 32
- 4.1 **Types of financial institutions in Malaysia** 166

## Acknowledgments

Any modest effort to acknowledge one's intellectual and institutional debts is endangered by inadvertent omissions. Many people were exceedingly gracious with their time and assistance. With apologies in advance to any of these individuals I neglect, I cannot fail to extend special appreciation to those who were most generous with their time, energy, resources, and--most important of all--their ideas. In this regard, to three *mensch*, thanks for your help of that excellent species invariably given with patience and generosity despite your obviously busy schedules. Only you who read my drafts know how significantly this imperfect thesis has benefited from your suggestions and revisions.

Special acknowledgment is due to my thesis supervisor, Dick Samuels, who straightened out my thinking at several junctures over the last two years. To him I owe a special intellectual debt. I will never be able to repay him for the perspicacious critiques of my repeated drafts and for the innumerable improvements he suggested. Many ideas developed in this thesis virtually germinated in discussions with Dick. He was always generous with his time, ideas and insights. He gave me the finest encouragement, enthusiastic counsel, and constructive criticism. He consistently made sure the thesis was readable but did not douse my drafts with red ink. He always made me feel I owned the piece, not him, and he kept me on schedule. He modeled "best academic practice" for me, and if I should turn out to be an uninspired and uninspiring academic--or no academic at all--the fault must surely be, irrevocably and solely, mine. I wish for every graduate student everywhere a supervisor as intellectually impeccable and irenically wise as mine. Thanks, Dick.

Next, I also want to express special thanks to David Woodruff and Zhiyuan Cui for serving untiringly on my thesis committee. David was in Russia during the second year of my dissertation doing his own fieldwork. While he was in Cambridge, we had several discussions, and he constantly urged me to develop arguments that were more sinewy, politically speaking.

We continued to keep in touch electronically. For his conscientiously detailed and painstakingly sharp readings of my drafts--as well as the wholehearted willingness to do so while officially on leave--I am most grateful and appreciative. But most of all, I want to thank David for teaching me to be meticulously ethical in regard to details. Thanks, David.

Zhiyuan also offered perceptive critiques and pointed me to paths less often treaded, literatures less often perused, and ideas less often plumbed. He constantly kept my eye on the theoretic endeavor, and consistently urged me to probe for deeper meanings in the complexity of social life. If I do this imperfectly hereinafter, the deficiencies are mine alone. I was also Zhiyuan's RA/TA, but he most graciously left me to my own tasks thus providing the in-kind emoluments so necessary for writing: time and space, peace and quiet. Thanks, Zhiyuan.

Thanks are also due to what must indubitably be the world's best department of political science. For its collegial atmosphere, and for its liberality in financial support the five years I have been privileged to spend at MIT, I am much obliged. Special thanks to Santina Tonelli, Janet Sahlstrom, and Paula Kreutzer at Headquarters for always going beyond the call of duty. Wherever I am going, I hope I will get to work with an equally great bunch of people. To my professors at Yale, especially David Apter, Alex Wendt, and Bill Foltz who encouraged me in my academic pursuits, let me also record my gratitude here. To Beth Rosenson, my fellow-traveler, thanks for commiserating. To Kenny, Mabel, John, and Tiffany, thanks for being my family in North Quincy--you unfailingly fleshed out the notion of "Families We Choose" for me. I will never be able to repay your kindness. Finally, to the bone of my bones, and flesh of my flesh--Josephine, Ken, and Jean--because we are one in His Spirit, I do not need to inscribe here my inexpressible gratitude and appreciation for your love and support. But, above all, this thesis is dedicated to Him who is able to provide exceeding abundantly, above and beyond what we ask for or dream about, pressed down, shaken together, and overflowing. To the Name that is above all names, to Whom every knee shall bow, and every tongue confess, *Maranatha!*

*Cambridge, Massachusetts*

## A Note to the Reader

**On titles and names:** References in the mass media and in the academic literature on Malaysia to dignitaries such as the Prime Minister Mahathir Mohamad are always formalized as Datuk Seri Dr. Mahathir Mahamad, for example, used repetitively. The Datuk Seri title is bestowed upon individuals for meritorious service. Sultans are referred to as Tuanku and their children as Tunku. (Tengku is a modern spelling.) The highest dignity that can be conferred--and only by the King on recommendation of the Prime Minister--is Tun, which is limited to 25 living persons. Governors of the four states without hereditary rulers--Penang, Malacca, Sabah and Sarawak--are made Tun at the first vacancy. Each of the thirteen state awards titles of various levels of honor as does the federal government. It is within the prerogative of the nine sultans to grant titles, though they often rely on advice from the executive councils of the state assembly.

There are a number of classes in each order, often carrying obscure titles, but Tan Sri (Puan Sri for wives of Tan Sri) and Dato (Datin for wives of Dato) are the most common. Generally Tan Sri (also Tan Seri) is the more eminent, but there are certain classes of Dato that outrank it. Dato is sometimes seen as Dato' or, in accordance with the reformed spelling rules, Datuk. Titles are conferred on deserving Malaysians of all ethnic origins. In the past, such honorees were invariably male, but more recent practice has involved conferring Dato, and Tan Sri, or their variants, on women recipients as more and more women reach high office in public service and the corporate sector as well. Once thus honored, the individual is thereafter always addressed as Dato or Tan Sri, as the case may be, instead of his (or her) name.

It may be assumed that all public figures who figure in my narrative are invariably so titled but, in the interests of brevity and clarity in the text, footnotes, and bibliography, I refer to such individuals by their personal names. I use first names in the case of Malays and Indians as they traditionally have no family names, individuals being named "son of" or "daughter of" so-and-so. Individuals of Chinese or other ethnicity using a similar nomenclature are referred to by their family names.

**On spelling:** Quotes from Malaysian sources written in English in the original generally use the British spelling which continues to be required in schools and is, therefore, widely used in the popular press, learned publications, and legal documents.

**On currency notations :**The Malaysian currency is the Ringgit Malaysia, currently abbreviated as RM. In older sources, the designation of the ringgit therein may well be M\$ (for Malaysian Dollar as it used to be called), or alternatively, MR\$ (Malaysian Ringgit), or even \$ in very old sources. When cited, I will adhere to the *RM* convention throughout. The approximate conversion rate to the US Dollar prevailing at the material time is included when necessary.





## CHAPTER ONE: Privatized Statism and Ethnic Capitalism in Malaysia, 1969-1999

---

This thesis characterizes the Malaysian political economy as a "privatized statism" which, at first glance, appears to be an oxymoron. I will demonstrate that, contrary to the standard model of the "developmental state," the Malaysian political leadership has insinuated itself into the market through a carefully targeted program of privatization using co-ethnic proxies. In the process, it has not only marginalized the previously dominant ethnic Chinese capital, but has, critically, also sidelined the public bureaucracy generally considered central to administrative guidance of the private sector by the developmental state. The Malaysian political leadership continues to direct markets not only through macro-economic policy but also by wielding these private sector firms it owns and controls elliptically through its co-ethnic proxies. Because these corporations attend to market discipline, and because there is little bureaucratic intrusiveness, this mode of interventionism does not distort or limit market competition; rather, it attends to market discipline and tracks changes in market structures. Importantly, this peculiar privatized, market-tracking state interventionism has constructed a durable ethnic capitalism; it raises important questions for the study of development, and for political economy, more generally. For instance, how can political elites use markets to create and consolidate an ethnic yet durable capitalism with minimal bureaucratic intrusion? How can these elites simultaneously divest state holdings and retain political control of markets? How does the creation, allocation, and deployment of ethnic rents by the state work through markets without bureaucratic guidance?

This chapter is organized as follows. Section I elaborates why Malaysia is an interesting case worth studying. In Section II, mainstream perspectives on state intervention in markets are discussed and found to be unable to explain Malaysia's peculiar model. A new framework is suggested and historical cases of privatized statism in different countries at different times are discussed. In Section III, privatized statism's manifestation in Malaysia is described where the ethnic capitalism it constructed using proxies has proven quite robust despite expectations it would lead to an enervating dissipation of rents. Research methodology is considered briefly in Section IV, and Section V previews the rest of the thesis.

## Section I. Why Malaysia?

The study of the economic transformation of a "successful" developing nation may provide insights into the development issues confronting developing countries. Malaysia is arguably one such story, and a particularly interesting case that has long exhibited the classic characteristics of economic dependence but which has been trying to reduce the limitations imposed by this dependence. This country has often been cited as the example *par excellence* of a society which, though having experienced deep imperial depredation, is in the process of breaking out of Third World status and commencing a journey of capitalist development. In more than 40 years of independence, this nation has seen only two years of negative economic growth, in 1985 and 1998. Indeed, for more than thirty years, from 1965 to 1997, its economic growth has been among the world's fastest, (on average, 4.4% on a GNP per capita basis).<sup>1</sup> It has had a per capita GDP far higher than any ASEAN nation, apart from Singapore. Along with industrialization (the share of industries in total production is over 30%, which is larger than the share of agriculture), a dramatic increase in exports was also evident in the 1970-1987 period. In fact, Malaysia was ranked sixteenth among all nations in terms of percentage growth of exports.<sup>2</sup> With growth, various social indicators of development have also improved, while significant progress has been made in overall poverty reduction as well.

The system of legal procedures and property rights inherited from the British colonial regime has been maintained fairly effectively by a judiciary that, even if somewhat shackled by the executive especially from the mid 1980s, remains proud of its circumscribed independence. Thus, legal, and predictable political foundations allow, within limits, the effective development of policies, and the rule of law in the marketplace. The private sector is relatively competitive with skilled labor available, a high level of domestic savings, and a relatively sophisticated financial sector capable of mobilizing these savings into risk capital (although it has not done this as well as it could have). Management ability and regionally specialized consultancy services

---

<sup>1</sup>Only a handful of developing countries achieved average annual rates of growth exceeding 4% between 1965 and 1990; see, World Bank, Council for Economic Planning and Development, *World Development Report* (New York: Oxford University Press, 1992). Between 1965 and 1980, the average growth rate of the GDP in Malaysia was 7.4%, while the growth over the last nine years have consistently been over 8%, and even more than 9% in some years.

are available while the state itself has adequate human resources too.

Malaysia's macroeconomic regime has been largely stable, and the economy relatively open in its capital orientation. Its trading regime has always been externally oriented and open although, by no means, any longer the colonial *laissez faire* system. Indeed, the advantages of its relatively low tariffs, its generous incentives to foreign investors, and its suppression of organized labor means that it has conceivably sustained a structurally competitive environment.

The society is heterogenous in its socio-cultural and ethnic structure as opposed to a more homogenous Thailand, or Taiwan.<sup>3</sup> The ethnic mix creates special problems of economic structure as well as political and social tensions. Its multicultural diversity focuses attention on the state as the terrain for political struggles. From independence right up to the early seventies, the state practiced (consociational) decision making through negotiations among elites (who claimed they were) acting as representatives of the major ethnic groups. With the NEP, the state has become more exclusively Malay.

The polity has been, formally speaking, a continuous democracy and has not witnessed any military ascent to power. The state has used its vast array of authoritarian powers to create a political environment that has undermined, but not completely eliminated, opposition. Despite various restrictions on civil and political rights, and legal as well as administrative discrimination against the ethnic Chinese, opposition political parties—which are invariably ethnically based like those in the governing coalition—are active. Malaysia's political system remains the most open as well as the most competitive and procedurally

(..continued)

<sup>2</sup> GATT, *International Trade 1987-88, vol. I*, (Geneva: GATT, 1988,) Table 1.3

<sup>3</sup> Colonial policies encouraged both natives and immigrants to view themselves as collective communities defined as "races." These included designating land reservations for the Malay, non-interference in matters pertaining to Islam and *adat* (customs) and an emphasis on education in the vernacular. Thus, within an overarching structure of colonial rule, the indigene/nonindigene divide emerged as a fundamental cleavage as distinct from a pluralist notion of categories based on races, viz., Malays, Chinese, Indian, Eurasian, and European. Stereotyping society to this very day as a confrontation between an economically dominant non-indigenous sector versus an economically weak indigenous sector effectively complicates the emergence of a class consciousness which would cut across ethnic lines and undermine UMNO's *raison d'etre*. The economic connotations of Malay special rights have encouraged the freezing of ethnic categories which, in truth, exist only because of being posited as oppositional economic categories, i.e., Malay versus non-Malay. The latter is not used with respect to foreign investors. That is, the terms are used within a national context to refer to two groups of residents. Wielding these categories, the putative impact of the "non-Malay" share of the national economy continues to be over-emphasized long after Corporate Malaysia has been dominated by the Malay elite.

democratic of all the ASEAN nations. Elections are free—but not fair. The electoral system is skewed to virtually guarantee victory for the dominant party, UMNO, or United Malay National Organization, and its allies. By relying primarily on the votes of heavily over-represented rural Malays, UMNO that has dominated the government for more than four decades, is thereby assured of a comfortable majority in parliament with a minimum expenditure of resources. (UMNO party elections, in contrast, are very expensive exercises in vote buying.)

The state is, by East Asian standards, relatively open to popular demands, if only those from the Malay segment which comprises 51% of the population. Such demands get articulated through elected Members of Parliament, and State Assemblymen especially those from the various political parties that make up the UMNO-dominated ruling coalition called *Barisan Nasional* (BN), meaning *National Front*. The legislature is dominated by UMNO's majority which has been consistently larger than two-thirds of the seats in the elected lower house. In fact, UMNO has a self-imposed goal of a two-thirds majority in parliament for the ruling coalition that is needed for constitutional amendments. The upper house of parliament is a "rubber stamp" body comprising appointed senators, mainly from the ranks of failed BN politicians.

UMNO's political strength further weakens subnational autonomy through its dominance at this level as well. All but one of the fourteen state governments in the Federation are UMNO-led whose state legislatures are expected to act within UMNO's guidelines. Although there are concurrent powers held by federal and state governments, the former has "preference." States are not explicitly involved in the constitutional amendment process, and individual states maintain authority only in religious and land matters. State governments depend upon federal largesse for budgetary resources. Unlike India, state governments cannot, in theory, be easily suspended. However, Article 150 of the Constitution allows the federal Parliament to declare an emergency at subnational levels; the law has invoked before to remove an oppositionist Catholic government in the East Malaysian state of Sarawak, and an oppositionist fundamentalist Islamic government in the West Malaysian state of Kelantan.

Although constitutionally a Federation, power has become concentrated in the executive. The Prime

Minister and his Cabinet are responsible to Parliament, but the Prime Minister has considerable powers although much of his ability to move the system depends upon a combination of his personality and capacity to placate his party constituency and member of the coalition. Although Members of Parliament are no longer immune from sedition charges, Parliament shows considerable life—but the overwhelming government majority, and a fractious Opposition combine to mean few surprises. Government backbenchers have long complained about their inability to influence policy. In the Mahathir years, there has been a shift of the locus of policymaking from the representative institutions to the executive branch. Within the political leadership, there has been a shift of power to the financial as opposed to the spending ministries. The bureaucracy has been marginalized from the mid-eighties. The only bureaus that play a role include the Economic Planning Unit (EPU), the Implementation and Coordination Unit, and the National Development Planning Committee which form the centralized economic policy making team in the Prime Minister's Department. They are subject to Mahathir's personalist intervention, which occurs quite frequently.

A very interesting feature is the remarkable expansion in the roles and functions of the political leadership in the last two decades. Its apparent ability to foster and direct capital accumulation directs attention to questions of state autonomy, the extent and limits of this autonomy, and the conditions under which the state can operate independently of societal pressures. This is all the more remarkable given that the factional state in Malaysia does not come close to approaching the combination of state autonomy, capacity and development commitment of the NICs. That is, the state is penetrated by networks of ethnic clientelist relations arranged along factional lines, and relies for its political backing on party and factional support, as in any representative system. However, the relative "weakness" of the state in these terms appears not to have been a serious obstacle to the rapid transformation of the economy over the last three decades.

From the early 1980s, UMNO went aggressively into big business as I will show in Chapter Three. Using proxies, trustees, and nominee companies, with pyramiding and interlocking directorates, complex mergers-and-acquisitions, reverse takeovers, management buy-outs, and so on, were executed. These maneuvers were carried out with cashless swaps and easy credit given UMNO's control of the banking and

financial sector. Several public assets including profitable state-owned enterprises were divested, and giant infrastructural projects awarded on lucrative terms and without competitive bidding to UMNO corporations often set up, or acquired, precisely for such purposes. Because of UMNO's extended period of domination of the state apparatus since independence in 1957, the distinction between party and state has become virtually meaningless. UMNO's corporate empire means that the state--or given the centralization of power within the state, the top political leadership itself--wields elliptical control over huge holdings of corporate assets.

UMNO is secure in office, and the triennial election for UMNO's top leadership that determines the national leadership is often more important than the general elections themselves. To win in UMNO party elections, candidates must respond to grassroots sentiment which means that leaders must portray themselves as communal leaders. Internal party elections have thus reinforced the pressures on politicians to play the ethnic card. Indeed, UMNO has promoted a myth of ethnic cleavages where subterranean racial conflicts simmer and threaten to erupt at any time so that UMNO is needed as protector of the Malays and guarantor of political stability mainly by being arbiter of economic activity.<sup>4</sup>

Of central importance in tying Malay voters to UMNO is the party's patronage network through which such incentives as commercial opportunities, licenses, subsidies, government jobs, preferential credit for low cost housing and other purposes, access to land, agricultural inputs, scholarships and civil service jobs are awarded to faithful party supporters and their offspring (who, incidentally, become UMNO members

---

<sup>4</sup> Electoral competition in Malaysia has not threatened regime stability but party competition provides the new nexus between elite aspirations and mass communal publics. In this interaction is the phenomenon of "ethnic or cultural heroism," i.e., the chauvinistic articulation of extreme positions in an attempt to outbid political competitors by making unrealistic promises to ethnic constituencies. In playing the role as protector of the Malay, UMNO has constantly invoked the bogeyman of the rapacious ethnic Chinese middleman, of Malays being reduced to an insignificant minority, or of losing their political pre-eminence. Simultaneously, elites continue to posit the Malays they claim to protect as being a weak and helpless people, incapable of standing on their own feet. This brand of ethnic politics has attracted many who aspire to hold office in the UMNO organization because of the lucrative returns of political office holding. This has caused party political campaigns to skyrocket in costs even for minor party posts. A vibrant democracy depends, of course, on active political participation and the availability of a self-renewing recruitment pool of activists. But self-seeking political entrepreneurs consistently increase public spending with pet projects and increasing corruption adding to the cost of government. Political entrepreneurs, unlike market entrepreneurs, do not bear financial risks. They desire to stay in office as long as possible, which is their incentive for policy and program initiation as distinct from need or appropriateness.

automatically at the age of eighteen.)<sup>5</sup> Finally, there is equity placement for the Malay masses through an investment holding company-cum-unit trust strategy that channels rents to every Malay adult as detailed in Chapter Two. The distribution of bountiful patronage to supporters ensures sufficient electoral support among the Malays that UMNO needs to continue winning most of the seats with a Malay majority.

The state has acquired the political ability to resist the penetration of special interests that cannot get organized under its repressive apparatus. The state is responsive only to pressures from Malay society channeled, in part, through the electoral system and, in part, through UMNO's party structures, especially pressures from Malay big business. It is far less responsive to non-Malay electoral pressures. While Malay voters are promised, and provided, substantial material benefits, the state's "ethnic bypass" approach means that few concessions can be offered to the ethnic Chinese voters. When offered, these are largely symbolic, the costs of which are not material, but political. (Examples are Chinese lion dances receiving official approval or Chinese costume dramas being permitted on state-owned TV stations after the obligatory public expressions of misgivings over what may be construed as public promotion of non-Malay culture. These are the non-trivial instances.)

Where the electorate is aware that campaign procedures are manipulated and that gerry-mandering occurs, and when the law does not provide a level playing field but rather distorts the process strongly in favor of UMNO incumbents, regime legitimacy in the eyes of the non-Malay segment of the population is wholly suspect. Voters may realize that they do little other than rotate members of an established elite as Mosca and Michels figured out a century ago. Still, to the extent the electoral process legitimates a political system and its ruling class, it serves to domesticate citizens more effectively by making them complicit in their own domination. Moreover, elections in Malaysia are not necessarily completely meaningless because

---

<sup>5</sup> On paper, UMNO still looks like a hierarchical, disciplined, and ideologically coherent party. Central control in UMNO, however, is now racked by factionalism such that discipline is conflicted, and the party's ethno-religious ideology is a melange of buzzwords and mantras without consistent effect on action. There are practically no UMNO divisions (which correspond roughly to electoral districts) that do not have two or more competing patrons and their clients aligned to various national leaders who are, in turn, aligned to either the Prime Minister, or the Deputy Prime Minister. What looks like a highly autonomous authoritarian state is, in fact, an amalgam of competing factions organized along clientelist lines, responsive to the major sectors of Malay society, especially Malay big business.



they may have a political effect beyond their predictable outcomes of winners and losers. That is, while secure elites may not worry much about the general elections, they do have to heed them as impressive samples of public opinion.<sup>6</sup>

The Malay elite has gradually assume a form that may be approaching a meritocracy of sorts (like Thailand's) with the old aristocracy, apart from the ceremonial sultans but not excluding their children, now melding into business roles, while the middle class is trending towards a propertied *bourgeoisie* (like the Philippines). Like the NICs, there is a fairly high degree of mutual understanding between business and key ministers as well as the economically more enlightened leaders of the main political parties. There is reasonable professionalism and threshold technical competence among the economic bureaucracy. However, it is hard to identify a distinct group of technocrats in Malaysia; from the mid-eighties, the bureaucracy has been increasingly sidelined in development planning. There has never been a strong *dirigiste* tradition (like Indonesia's). In fact, the NEP was primarily redistributive, first of income, then of capital, and not efficiency maximizing. The state is also not committed to either lean government or *laissez faire* as such. To the extent its policies of privatization, liberalization, and deregulation operate within constraints set by the NEP, ethnic cleavages will remain politically salient, and political considerations will attenuate the private sector's management of commercial risk.

Because of system openness, ethnic Chinese capitalists subjected to excessive pressures from the bureaucracy have been able to resort to political channels—political parties representing ethnic Chinese in the past, and clientelist links with the UMNO patrimonial machine in the Mahathir years—to somewhat limit squeeze and outright corruption, an intractable problem in several similarly authoritarian systems. Economic nationalism directed against the ethnic Chinese or foreign ownership of corporate equity has been amazingly muted despite UMNO's politics of ethnicity. One likely reason is that the post-colonial economy has never been really seriously under stress, the momentum of growth since the 1950s providing sufficient revenue to fulfill the demands of Malay special rights. Malaysia has never been under the same pressures as a Korea, or

---

<sup>6</sup> Harold Crouch, "Malaysia: Do Elections Make a Difference?" in R.H. Taylor, (ed.), *The Politics of Elections in*

a Taiwan, to maximize industrial growth to earn foreign exchange, or to mobilize support for a developmentalist ideology. Its traditional agricultural exports, supplemented by the discovery of high grade petroleum in the 1970s have, heretofore, expanded adequately to meet various exigencies. Political leaders are aware that it would be foolhardy to promote overly racist policies that may ravage business structures including those in which they themselves through proxies, family members, and clients may well have personal stakes.<sup>7</sup> The more prudent Malay leaders are cognizant of the fact that it is politically unnecessary, and economically unfruitful, to use state power against efficient Chinese capital too flagrantly. Conversely, ethnic Chinese know that, for the sake of social harmony, they have to abide with discriminatory ethnic policies which prioritize efficiency considerations lower than ethnic ones the Malay majority has been led to regard as just and equitable.

## **Section II: The State's Role in Structuring Domestic Markets**

States may abstain from, meddle with, or participate in firms and markets. A much-rehearsed debate is often posed between two alternatives—state abstinence or intervention. On the one hand, the state may abstain from markets, a position promoted by adherents of neoclassical orthodoxy.<sup>8</sup> On the other hand, the state may meddle with markets; paradigmatically the “developmental state” offers “administrative guidance” to the private sector, the Japanese MITI having long been posed as the exemplar *par excellence* of this guidance. Still, there is an emergent, if qualified, consensus that the state is necessary for markets to function properly, if only to secure property rights and enforce contracts. A

(..continued)

*Southeast Asia* (New York: Cambridge University Press, 1996,) 114-35.

<sup>7</sup> By reinforcing Malay versus non-Malay categories, the NEP was, in fact, UMNO's new integrating mechanism for Malays. Since the Malays—where ethnic communities are regarded as interest groups—do not have to pay the appropriate prices for government goods and services, there is always the escalation of demand with free riding and rent seeking by well placed segments of society. With accommodative political leadership and interethnic coalition building now attenuated, government policies and spending lead to avid comparisons and calculations made with respect to relative ethnic gains and losses. The dichotomy also serves to focus attention away from the fact that the state has enriched individual Malay elites. Even as interethnic income and wealth gaps continue to close because of disproportionate gains by Malay elites, perceptions of relative deprivation have increased.

<sup>8</sup> Or, as neoclassical proponents argue, getting the macroeconomic basics right; see, World Bank, *The East Asian Miracle: Economic Growth and Public Policy*, (Geneva: World Bank, 1994). There was no shortage of unfavorable critiques of *Miracle*, e.g., Albert Fishlow, et. al., *Miracle or Design? Lessons from the East Asian Experience*,

fundamental question that remains is how to minimize the economic upheavals inherent in the gyrations of market forces where there is private control of the economy. Developmentalism suggests a solution in the public control of the economy to facilitate its expansion. However, the efficacy of state interventionism remains disputed.

In sub-section (a) below, I review briefly the literature on the “developmental state” that, in general, conflates bureaucratic capacity with state power. The possibility of a developmental state where the political leadership--instead of the bureaucracy--leads intervention in markets, and does so in such a way that complies with market forces and tracks changes in market structure through the use of private sector corporations, is not countenanced in the literature. In subsection (b), using the Malaysian case as an instance of this mode of state intervention, I address its theoretic implications through an interlocution with an exemplar of mainstream developmental perspectives. Finally, in subsection (c), historical cases that evidence some of the characteristics of this mode of state interventionism are reviewed.

**(a) *The Developmental State: Meaning and Background:*** The implicit idea of a developmental state may be traced back to Friederich List who argued that less developed countries can “accomplish the economical (*sic*) development of the nation and... prepare it for admission into the universal society of the future...only by means of the interposition of the power of the State.”<sup>9</sup> It has been argued that, from the 1930s, this idea was at the heart of imperial policy with regard to colonial welfare.<sup>10</sup> By the sixties, Gerschenkron’s argument for the need of the state in late development had been adopted by development economics and policymakers.<sup>11</sup> The centrality of the bureaucracy to state intervention in markets was a theme in Fred Rigg’s seminal work on the “bureaucratic polity” in Thailand.<sup>12</sup> Huntington also came near

(..continued)

(Washington, DC: Overseas Development Council).

<sup>9</sup> Friedrich List, 1885, *The National System of Political Economy*, translated by Sampson S. Lloyd (New York: A.M.Kelley,) 175, 178.

<sup>10</sup> JM Lee, *Colonial Development and Good Government*, (Oxford: Clarendon Press, 1967).

<sup>11</sup> A. Gerschenkron, *Economic Backwardness in Historical Perspective*, (Cambridge: Harvard University Press, 1962).

<sup>12</sup> Fred Riggs, *Thailand: The Modernization of a Bureaucratic Polity*, (Honolulu: East-West Center Press, 1966).

to articulating the concept of the developmental state when, writing in 1968, he opined that it was critical to development to concentrate power in a “bureaucratic polity” to smash those “social forces, interests, customs and institutions” that had held back development by opposing modernization.<sup>13</sup> Meanwhile, Myrdal introduced the soft/hard state debate; others, beginning with O’Donnell, built on it with the “bureaucratic authoritarianism” perspective.<sup>14</sup> Similarly, writing in 1978 about Indonesia, Jackson found that “power and participation in national decisions are limited...to the officer corps and the highest levels of the bureaucracy.”<sup>15</sup> Conditions for the emergence of states that could intervene to effect development were explored but nowhere was the term “developmental state” used nor its structural characteristics investigated.<sup>16</sup> Even “bringing the state back in” did not engage the political determinants of state autonomy and capacity fully.<sup>17</sup> Next, came the strong/weak state debate, but there was still a failure to articulate the position that while institutional structures of such states were developmentally impelled, their developmental objectives were politically driven, that is, that politics centralized state power and concentrated state capacity to enable the state to achieve its developmental objectives.<sup>18</sup> As a result, successful and unsuccessful developmental states could not be theoretically differentiated, and anti-statism theorists denounced all developmentalism as doomed for failure.<sup>19</sup>

The term ‘developmental state’ first appeared in Chalmers Johnson’s work on Japan, where

---

<sup>13</sup> Samuel Huntington, *Political Order in Changing Societies*, (New Haven: Yale University Press, 1968,) 141, 142.

<sup>14</sup> G. Myrdal, *Asian Drama: An Inquiry into the Poverty of Nations*, 3 vols. (New York: Pantheon, 1968); Myrdal, “The Soft State in Underdeveloped Countries,” in P. Streeten (ed) *Unfashionable Economics: Essays in Honour of Lord Balogh*, (London: Weidenfeld & Nicolson, 1970); G O’Donnell, *Modernization and Bureaucratic-Authoritarianism: Studies in South American Politics*, (Berkeley: University of California Press, 1973).

<sup>15</sup> KD Jackson, “Bureaucratic Polity: A Theoretical Framework for the Analysis of Power and Communications in Indonesia,” in KD Jackson and Lucian Pye (eds) *Political Power and Communications in Indonesia*, (Berkeley: University of California Press, 1978,) 3.

<sup>16</sup> Ellen Kay Trimberger, *Revolution from Above: Military Bureaucrats in Japan, Turkey, Egypt and Peru*, (New Brunswick, NJ: Transactional Books, 1978) 4; A. James Gregor, *Italian Fascism and Developmental Dictatorships*, (Princeton: Princeton University Press, 1979,) 304, depicting Italian fascism as a “developmental regime” where the state was “a centralizing, integrative and managerial agency.”

<sup>17</sup> Peter Evans, D Rueschemeyer, and T Skocpol, *Bringing the State Back In*, (New York: Cambridge University Press, 1985).

<sup>18</sup> J Migdal, “Strong States, Weak States: Power and Accommodation” in Myron Weiner and Samuel Huntington (eds), *Understanding Political Development*, (Boston: Little, Brown, and Co., 1987); Migdal, *Strong Societies or Weak States: State-Society Relations and State Capacities in the Third World*, (Princeton: Princeton University Press, 1988).

attempts were first made to conceptualize it.<sup>20</sup> Differentiating the “plan rational” developmental state from the Soviet-style “plan ideological” state and the “regulatory orientation” of market liberal and social democratic states was its intimacy with markets. This was achieved by an elite bureaucracy, paradigmatically, the Japanese Ministry of International Trade and Industry (MITI) that presciently offered “administrative guidance” to firms and markets. For Johnson, there was a consensus on policy goals as determined by the bureaucracy rather than the political/legislative elite. However, Richard Samuels, *op cit.*, methodically picked apart this portrayal of a prescient MITI to sketch a more realistic picture of the Japanese bureaucracy brought down to size by the politics of reciprocal consent.<sup>21</sup> (*see below*). There have been other variations<sup>22</sup> of this idea of the developmental state<sup>22</sup> as well as attempts to extend theorizing about it.<sup>23</sup> Most of these studies were focused on Northeast Asia, and there were some non-culturalist claims that the developmental state might be *sui generis* to the region due to “its unique historical circumstances.”<sup>24</sup> Accompanying the emergence of the second-tier NICs, there is also a growing literature on Southeast Asia.<sup>25</sup>

(..continued)

<sup>19</sup> D. Lal, *The Poverty of Development Economics*, (London: Institute of Economic Affairs, 1983).

<sup>20</sup> Chalmers Johnson, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*, (Stanford: Stanford University Press, 1982).

<sup>21</sup> Richard Samuels, *The Business of the Japanese State: Energy Markets in Comparative and Historical Perspectives*, (Ithaca: Cornell University Press, 1987); hereinafter, referred to as BOJS.

<sup>22</sup> Peter Evans, “Transnational Linkages and the Economic Role of the State: An Analysis of Developing and Industrialized Nations in the Post-World War II Period,” in Evans *et al.* (eds), 1985; Gordon White and Robert Wade, *Developmental States in East Asia*, (Brighton, UK: Institute of Development Studies, 1985); R. Dore, *Flexible Rigidities: Industrial Policy and Structural Adjustment in the Japanese Economy, 1970-1980*, (Stanford: Stanford University Press, 1986); Chalmers Johnson, “Political Institutions and Economic Performance: The Government-Business Relations in Japan, South Korea, and Taiwan,” in F Deyo (ed) *The Political Economy of the New Asian Industrialism*, (Ithaca: Cornell University Press, 1987) Deyo, 1987; L. Jones and I. Sakong, *Government, Business, and Entrepreneurship in Economic Development: The Korean Case*, (Cambridge, MA.: Harvard University Press, 1980); G White (ed) *Developmental States in East Asia* (London: Macmillan, 1988); R Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, (Princeton: Princeton University Press, 1990); D Okimoto, *Between MITI and the Market: Japanese Industrial Policy for High Technology*, (Stanford: Stanford University Press, 1989).

<sup>23</sup> LL Burmesiter, “Warfare, Welfare, and State Autonomy: Structural Roots of the South Korean Developmental State,” 1 *Pacific Focus*, 1986: 121-46; P Evans, “Predatory, Developmental and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State,” 4 *Sociological Forum*, 1989: 561-87; Z Onis, “The Logic of the Developmental State,” *Comparative Politics*, October 1991: 109-26.

<sup>24</sup> Onis, *op cit.*, 13. Japanese academics talk about the “flying geese” pattern of the geographical spreading out of East Asian industrialization from Japan.

<sup>25</sup> C Lee and S Naya, “Trade in East Asian Development with Comparative Reference to Southeast Asian Experience,” 38 *Economic Development and Cultural Change*, 1988: 123-152; G Rodan, *The Political Economy of*

Generally, the literature that posits the state as an engine of growth identifies ties between the bureaucracy and big business as being central to the evolution of the state, the polity, and to capitalism itself. These political-economic linkages are seen as having smashed disabling conditions that have, hitherto, impeded business growth by creating the economic and ideological environment that spread acceptance of capitalist development among the elite. What is determinative in development is not necessarily the extent of state intervention but its quality. As such, an elite bureaucracy is assumed, close bureaucracy-big business cooperation in the policy-making process is crucial, while an authoritarian system shields the bureaucracy from organized societal interests. While most developmentalist states in East Asia have largely jettisoned their SOE programs, they continue to be distinguished, at least in the literature, by effective state interventionism where elite bureaucracies remain central. The close bureaucracy-business ties thought to militate for effective policymaking are conceived by some to transform the state into a quasi-internal organization that operates like an “internal capital market,” much like a firm.<sup>26</sup>

This notion emphasizes that policymakers exercise influence over the private sector through the financial system (mainly banks) much as corporate headquarters of a firm exerts control over corporate divisions through an internal apportioning of resources. It is claimed that the developmental state is an analogue of what Oliver Williamson calls “hierarchies,” or internal organizations, of which the firm is the prime example. Hierarchies stand in contrast to markets as an alternative institutional mode of organizing the exchange of goods and services, and emerge in response to “market failures.”<sup>27</sup> As hierarchies/firms grow in

(..continued)

*Singapore's Industrialization: Nation State and International Capital*, (London: Macmillan, 1989); Ruth McVey, “The Materialization of the Southeast Asian Entrepreneur,” in Ruth McVey (ed) *Southeast Asian Capitalists*, (Ithaca: Cornell University Press, 1993,) 17; G Hawes and H Liu, “Explaining the Dynamics of the Southeast Asian Political Economy: State, Society and the Search for Economic Growth,” 45 *World Politics*, 1993: 629-60.

<sup>26</sup>Wade, *op. cit.*; Lee, *op. cit.*; J Zysman, *op. cit.*

<sup>27</sup>Here, the term *market failures* specifically means that markets are not efficient in organizing certain transactions because of *ex-ante* and *ex-post* costs of negotiating, implementing, and enforcing contracts. That is, not market failures in the familiar sense of monopoly imperfections and externalities. Firms emerge to internalize transactions when doing so lowers the costs of organizing and transacting business. *Transaction costs* are said to stem from *bounded rationality*—that individual agents have a determinate capacity to understand and predict all possible contingencies given the ineluctable nature of human neural hardwiring—and from *opportunism*—that parties to any contract tend to exploit asymmetries in information to their own advantage; see, Oliver Williamson, *Markets and*

size through a process of internalization of transactions, professional managers are employed by owners of the firm. Consequently, a separation of ownership and control of the firm arises. Managerial opportunism in pursuing personal goals may mean profits are not maximized for the firm. Firms respond, Oliver Williamson argued, by forming the most efficient organizational structure, viz., a multi-divisional structure, or the M-form firm. Here, corporate headquarters oversees operational divisions, allocating resources to divisions on the basis of high-yield use. This "internal capital market" role of corporate headquarters is supported by control machinery (such as regular internal audits) and incentive mechanisms (such as promotions and bonuses.)

Symmetrically, in a developing nation with underdeveloped capital markets, the state may regulate the financial sector to allocate capital efficiently to targeted sectors. A centralized policymaking bureaucracy, shielded from societal interests by an authoritarian regime, plays the role of corporate headquarters, while business groups are the equivalent of corporate divisions.<sup>28</sup> The analogue of the firm's internal audit is the tax audit in the corporate sector. The bureaucracy's control and incentive machinery, like that in an M-form firm, allows policymakers to maintain control over the corporate sector, ensuring adherence to state-articulated goals. In its role as an internal capital market, the developmental state allocates funds to key corporate clients, in effect, offering subsidized credit to targeted firms or business groups conditioned on performance standards, such as export targets. However, Williamson's central propositions have been shown to be empirically non-robust.<sup>29</sup> Since there is no clear evidence that M-form firms are the most efficient organizational forms for large firms, the claim that the East Asia state is analogically efficient also lacks support. Since it is assumed that state interventionism requires the bureaucracy's whole repertoire of

(..continued)

*Hierarchies: Analysis and Antitrust Implications*, (New York: The Free Press, 1975); also, Oliver Williamson, *The Economic Institutions of Capitalism*, (New York: Free Press, 1985).

<sup>28</sup> In terms of institutional realities, this notion of the developmental state as an efficient internal capital market may have been applicable, at most, to South Korea., and then only in the seventies when its bureaucracy tried to wield financial policy to allocate credit and foreign exchange preferentially to targeted sectors and firms. From the eighties, financial deregulation began to take root in Korea too. (The Taiwan case is debatable with Wade, *op. cit.*, arguing for, and Park, *op. cit.*, against.)

<sup>29</sup> see, C Hill, "Oliver Williamson and the M-Form Firm: A Critical Review," XIX *Journal of Economic Issues* 1985: 731-49; also, Hill, "Internal Capital Market Controls and Financial Performance in Multidivisional Firms," XXXVII *The Journal of Industrial Economic*, 1988: 72-83.

administrative tools for policy implementation, monitoring, and enforcement, nowhere in the literature is it ever asked if the political leadership—instead of the bureaucracy—may be an alternate fulcrum of developmental interventionism. This was so despite the fact that there have been reports of some shift in the balance of influence over development policy from the bureaucracy to the political or legislative elites in some nations.<sup>30</sup> But nowhere did the process go as far as it did in Malaysia.<sup>31</sup>

In the following sub-section, by specifically engaging BJOS, *op cit.*, I show how privatized statism in Malaysia disconfirms and modifies its mainstream model on the origins and contours of the capacities of the developmental state. First, I find its classification of state interventions cannot accommodate privatized statism because its framework assumes bureaucratic involvement. Next, I explain why the BOJS typology of how states structure domestic markets cannot explain the circumstances under which interventionism distorts/limits/tracks markets. I modify its typology to explain the different modes of state-market interactions. Then, I contrast privatized statism in Malaysia with the BOJS characterization of Japanese politics of reciprocal consent in state interventionism. Finally, I outline some theoretic lessons.

*(b) Theoretic considerations:* There are different ways in which the state may be more and less intrusive. BOJS proposed modeling the ways in which states intervene in domestic markets as being either "market displacing" or "market conforming."<sup>32</sup> BOJS is concerned about the origins and contours of the capacities of the developmental state with respect to the question why a Japanese state that faced so many resource constraints did not participate directly in the market despite a pervasive regulatory presence. The answer was not a MITI so well informed it chose policies that anticipate and conform to market demands so that the market represented a policy instrument that could be wielded more effectively by indirect, rather than direct, means. In fact, the story is about attenuated bureaucratic power such that Japanese bureaucrats have to

---

<sup>30</sup> M Muramatsu and FS Krauss, "Bureaucrats and Politicians in Policy Making: The Case of Japan," 78 *American Political Science Review*, 1984: 126-46; Alice Amsden, "The State and Taiwan's Economic Development," in Evans, et al, 1985; L Picard, *The Politics of Development in Botswana: A Model for Success*, (Boulder, CO: Lynne Rienner, 1987); Robert Wade, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, (Princeton: Princeton University Press, 1990).

<sup>31</sup> Zakaria Ahmad reported this shift in Malaysia but did not follow through on its implications; see Zakaria Ahmad, "Malaysia: Quasi Democracy in a Divided Society," in L Diamond et al (eds) *Democracy in Developing Countries*:



negotiate with big business over jurisdiction and control of markets all the time.<sup>33</sup> In the development of Japanese commerce and industry, powerful and stable private actors had emerged that could check and limit market-distorting bureaucratic intrusiveness. As such, bureaucratic interventions that succeeded were those that fortified the positions of existing firms, and “conformed” to markets in the sense of confirming/reaffirming existing market structures that were far from free markets, thus preserving inefficient firms along with efficient ones. Rather than one-off bailouts by the state as guarantor in times of crisis, commercial risk was permanently socialized. In Japan, the political constraints of a durably institutionalized, iterative process required the bureaucracy to carve out continually a transactional/negotiated consensus with a powerful business class. This “reciprocal consent” in which jurisdiction and control are mutually constrained and perpetually being adjusted defines state-market relationships in Japan.

(i) *The BOJS classification of state interventionism:* If the state is competing with the private sector, it is said to displace the market in this mainstream model. The paradigm case is the SOE that competes with its material or financial products. Conversely, state sponsored cartels and state management of competition exemplify market-conforming interventionism where the state helps the private sector by supplying factors or assuring the supply of capital. The state may produce goods, or provide banking services, or both. As such, states may be rivals, partners, creditors, or guarantors of private firms in particular sectors of the economy. Different states at various times have intervened in these roles displacing, or conforming to shifting markets. The market conforming variety is more often negotiated with private actors through a process of “reciprocal consent,” but both are instruments of a developmental state.

SOEs compete unfairly, and private actors may be discouraged from venturing into the particular market niche even if there are no intentional barriers to entry. Their soft budget constraints and attenuated property rights means an intra-firm lack of efficiency incentives. And, as off-budget agencies, SOEs do not have to abide by the dictates of market discipline, but apparently suffer no consequences (up to certain

(..continued)

*Vol 3--Asia*, (Boulder, CO: Lynne Rienner, 1989).

<sup>32</sup> BOJS, 10-13.

<sup>33</sup> By jurisdiction is meant “the territory over which authority can be exercised,” and by control is meant “the

political strainpoints), clearly distorting inter-firm competition. The nature of their involvement in the market, depending on the diverse objectives for which SOEs are set up, generally put any competing private sector firms at a distinct disadvantage.<sup>34</sup> SOEs may even create new markets such as auto manufacturing but, frequently, this occurs in a developing country that has no comparative advantage in the particular sector concerned. Here, there are no pre-existing firms or markets that get displaced as such. Instead, SOEs distort what would otherwise be freer markets, everything else being equal.<sup>35</sup> As such, it might be more accurate to call this category of interventionism market distorting.

State-managed competition and cartels may well prevent “fratricidal hypercompetition” but these competition-retarding strategies limit the development of complete and competitive markets. They do conform to the interests of powerful market players but not to what would otherwise be competitive markets. Thus, this form of intervention limit the emergence of competition. In Japan, the MITI gets jurisdiction over cartelized markets and, in return, reaffirms the abbreviated competition, while domestic firms enjoy control of those markets protected from the full blast of market forces. These private firms encourage this sort of interventionism that allow them to legally limit production, allocate markets, control prices and collude in sales. The legitimating of these cartels is justified on a faithlessness “in the salutary effects of the free market” the state shares with business. That is, a state that does not trust markets intervenes to reaffirm cartelized market structures. However, a system of “cartels, trusts, control and other non-Smithian initiatives” can hardly be described as complying with unencumbered market forces if this is, in fact, implied in “market-conforming.” Such initiatives reproduce privileged market segments and reconfirm the *status quo* which beneficiary firms, of course, welcome. Indeed, BOJS describes the Japanese state as “fundamentally conservative.” (262)

---

(..continued)

exercise of that authority.” BOJs, 8.

<sup>34</sup> SOEs were set up by many developmental states in the early seventies with several aims including equity considerations (redistribution of income, job creation, regional development), infrastructural development and other similarly lumpy investments, etc. Other objectives included: the collection of monopoly rents especially on minerals, filling in for a deficient private sector, taking over failed private enterprises, countering capitalist monopolies, nationalizing foreign enterprises, strengthening economic sovereignty especially *vis-a-vis* multinational corporations, and building national strength through the defence sector.

Japan's export sectors, honed by global competition, were famously successful internationally, but these sectors had to subsidize its weak domestic sectors where markets were truncated and competition hobbled. Here, imports would have provided much-needed competition. Because exporters paid high prices for their domestic inputs, they, in effect, subsidized inefficient suppliers. By the late eighties, the burden was beginning to become unbearable. As a result, efficient Japanese exporters increasingly invested offshore, which included Malaysia, and this led to a hollowing out of efficient sectors so that the productivity of the entire economy sank to the level of the stagnant domestic sectors. (Meanwhile, an asset and stock market bubble in the late eighties fueled the hubris of the Japanese Miracle.) By January 1990, however, Japan's current economic crisis had begun; about a decade of no- or low-growth later, there was still no resolution in sight.<sup>36</sup> With "managed competition," inefficiencies had remained. In the catch-up phase of economic development when markets were incomplete and uncompetitive, infant industries might, indeed, have found it impossible to acquire the economies of size and scale as well the learning-by-doing efficiencies without protection. By the seventies, however, the Japanese economy had matured enough so that there were no more infant industries needing that sort of initial push. The continuing "management of competition" did not eliminate inefficiencies. Instead, the growth of markets was limited so that sheltered firms remained uncompetitive.

(ii) *Privatized statism not accommodated in the BOJS framework:* In a small, open country that is well integrated into the global economy and dependent on trade and foreign investment, markets are effectively complete and competitive. As an economy becomes more open, state capacity to direct structural change becomes circumscribed by its dependence on foreign capital. Under these conditions, is there a way for state-facilitated forced-march capitalist rationalization to be effected (for political reasons) such that it is compliant with market discipline and not hamstrung by an ever expanding and intrusive bureaucracy? Conceptually, an alternative lies in state participation in markets and firms, specifically, state control, with/without

(..continued)

<sup>35</sup> By freer or more competitive markets, I do not assume that markets are neutral or natural. Of course, political choices are embedded in the institutions that govern the market.

<sup>36</sup> Richard Katz, Japan, *The System that Soured: The Rise and Fall of the Japanese Economic Miracle*, (Armonk,

direct/indirect ownership, of corporate equity in private firms in strategic sectors of the domestic economy. Where a business-friendly political leadership—instead of bureaucrats—takes the lead, the problem of an ever expanding and intrusive bureaucracy may be obviated. This form of state participation in private sector firms and market institutions such as the stock market may be overt or covert, active or passive. This state control with/without ownership of equity in private sector corporations which makes it a market participant may come about by way of privatization of SOEs, or through open market/negotiated purchases of corporate equity in private sector corporations, whether directly through state investment holding companies or indirectly through proxies/trustees/nominees, whether openly acknowledged, or vehemently denied. The indirect manner of state ownership begotten under the guise of liberalization and privatization remains necessary in the interests of international credit ratings and sovereign credit risk which do depend to a large extent on a country's reputation as an open economy where there is little government interference and where market forces matter. This equity can be wielded by the state to achieve its political, economic, and social objectives and agendas. However, in this "privatized statism," market discipline is something even the state has to weigh carefully if tempted to meddle in the corporate governance of private sector firms in which it controls equity. A stark reminder of that discipline is a stock's price nosedive in a sell-off when investors express a vote of no-confidence if state intervention proceeds contrary to purely commercial considerations.

In Malaysia, strong market-sustaining institutions were bequeathed by the departing British, but growth predicated on ethnic Chinese capital gave rise to an urban counter-elite, largely from this fraction of capital. The Malay political leadership's solution to this challenge was to institutionalize Malay ownership and control of Corporate Malaysia. What better way to fulfill this self-imposed *raison d'être* than by its own (elliptical) ownership and control of the most important equity through co-ethnic proxies? The privatized statism in Malaysia appears, in fact, to be the only extant form of state interventionism that can comply with market forces and track structural changes in the market because, first, the commercial units involved are themselves (made up of equity in) private sector corporations. Thus, this mode of interventionism may be

(..continued)  
NY: ME Sharpe, 1998).

called market-tracking. A second reason is the problem of an ever expanding and intrusive bureaucracy has been solved. To the extent bureaucrats are held in check, there is less policy control, less planning, and fewer regulations that curtail competition, to that extent corporations can compete in unencumbered markets. True, there may be cut-throat competition such as that now evident in the de-regulated and privatized telecommunications sector in Malaysia where there are too many telephony providers for its small market, but the impending market shake-out will decide winners and losers.

One may feel compelled to conclude at this juncture that this seems to be a straightforward reaffirmation of neoclassical orthodoxy, that markets function best when the state gets out of the way. Still, this may be insufficiently accurate given that it is a specific organ of the state—the bureaucracy—that is actively culpable in both market-distorting and market-truncating interventionisms. Perhaps, it might be more precise to say that firms are free to compete when the bureaucracy gets out of the way, all else being equal. This seems almost self-evident for the bureaucracy prefers more regulation, more state planning, and more policy control. Increasing intensity of bureaucratic intrusion in markets is associated with increasing technical and organizational complexity, and, presumably, decreasing flexibility in policy response. The use of different economic instruments creates concrete institutional interests within the bureaucracy that seek to perpetuate and expand policies from which they benefit. Where the scope of such institutionalized interests in the bureaucracy widens, there will be increasing rigidity to restructuring. Although the literature on state capacity emphasizes the number and range of instruments at the command of the bureaucracy, “flexibility” in policy response may be more important.<sup>37</sup> Thus, in contrast, if the political leadership is business-friendly, and able to hold the bureaucracy effectively in check, whether the state abstains completely from market involvement (*laissez faire*), or participates explicitly/surreptitiously through control of equity in private sector firms, with/without ownership of that equity (privatized statism), then markets in an open economy will have the unencumbered opportunity to work their near-pareto optimal magic, thus militating for stronger firms and a more competitive economy, all else being equal.

---

<sup>37</sup> G Ikenberry, *Reasons of State: Oil, Politics, and the Capacities of American Government*, (Ithaca: Cornell

(iii) *The BOJS framework cannot accommodate privatized statism:* Applied to Malaysia, the BOJS' classification of market-conforming and market-displacing interventionism breaks down because it under-specifies by assuming definitive bureaucratic power in all forms of state interventionism and, then, conflates bureaucratic power with state power by assuming that bureaucratic power defines completely the contours of state capacity, at least in so far interventionism is concerned. For example, BOJS says, "State and private actors have clashed often....so have businessmen and so have bureaucrats among themselves." (286) Or, "state and markets belong to businessmen and bureaucrats alike; state power and private power frequently enhance each other." (286) The parallelism is clear. Even though BOJS focuses specifically on the *attenuation* of bureaucratic power in the politics of reciprocal consent, and although empirical questions are addressed without obscuring politics, theoretic analysis remains focused, nonetheless, on the bureaucracy to the exclusion of the political leadership.

What is market-displacing or-conforming in the BOJS typology is conditioned on whether the state owns/controls equity in firms concerned, or not. (The state owns and controls equity in SOEs but does not own or control equity in cartels.) Because market displacement/conformance is taken as the extent of state interventionism in the typology, the extent of ownership/control of equity is made to proxy for the extent of state intrusiveness that is, by assumption, bureaucratic intrusiveness.<sup>38</sup> Thus, the vertical axis in the BOJS' two-by-two typology (13) that is bureaucratic intrusiveness really stands for extent of state ownership/control of equity in firms. But, I argued above, the bureaucracy is intrusive in markets anyway in both forms of interventions because they lead to distortion or limitation of market competition, respectively. That is, even where the bureaucracy is not directly involved in corporate management of individual *firms* as it does in SOEs, it remains *market* intrusive when it protects, legalizes, and reproduces cartelized market structures because, in doing so, it openly helps retard the emergence of freer competition.

---

(..continued)

University Press, 1988,) 206.

<sup>38</sup> BOJS points out, rightly, that control is more important, that state ownership means different things in different settings. In many cases of ownership, the private/public divide is not at all clear and, consequently, state ownership--a political decision--is no guide to state autonomy or state capacity. Thus, state interventions in the gray area between the ideal types of public and private deserve our immediate attention. (BOJS, 10.)

The horizontal axis in the BOJS typology is the nature of state intervention as defined by the type of equity owned/controlled, or not. The typology therefore pits an ordinal quality in the vertical axis (*extent* of ownership) against a cardinal quantity (*type* of ownership—either producer or banker). This means, in effect, this is a 2-column bar chart where each column is divided at the waist into two halves. This is actually a pictorial representation of a classification of state roles that runs into problems because the state can be both producer and banker (horizontally) (13) as well as partner and rival (vertically) (293; endnote 34). This typology cannot tell us under what circumstances—with respect to degree of state intrusiveness and the degree of state ownership/control of equity, for example—that state interventionism is distorting, or limiting, or tracking of markets, or if markets are free.

Given that privatized statism in Malaysia is defined by a unique un-bundling of the state, (*see* below), I argue that to identify and explain the state's role in structuring domestic markets, it is necessary to disaggregate state power to see whether it is the political leadership—rather than the bureaucracy—that is attempting to organize their economies with businessmen. The advantage of this approach is that politics is explicit; it is explicit about how state control of productive resources and financing are derived from political choice. It permits one to be explicit about how political conflict and competition in the past lead ultimately to the way state interventionism is organized in the present.

*(iv)The BOJS framework renovated:* If state interventionism is re-specified by the degree of bureaucratic intrusiveness, and by the extent of state control of corporate equity, with or without ownership, then government-business relations may be sorted out into the following basic forms. Where politicians are not actively involved, there may be a high degree of bureaucratic intrusiveness or meddling. This could be either the market distorting variety (such as SOEs) or the market truncating form (such as cartels and managed competition) where the state controls a lot, or a little, of equity, respectively. Or, there may be a low degree of bureaucratic intrusiveness—there is abstinence of the bureaucracy—presumably because of active sequestering by the political leadership. This could occur in a *laissez faire* system where markets are free and the state, *ipso facto*, owns/controls no corporate equity of any sort, or in a market-tracking

privatized statism where a business-friendly political leadership owns/controls/wields holdings of equity in private sector corporations, explicitly or surreptitiously. (Table 1.1 below lists and distinguishes the types of state interventions I catalog above. From this point onwards, I focus on the pro-ethnic market-tracking interventionism in privatized statism.)

**Table 1.1**                      **The state in domestic markets**

<i>Degree of bureaucratic intrusiveness</i>	<i>Extent of state control of corporate equity with/without ownership</i>	
	<i>High</i>	<i>Low</i>
<i>High (Meddling)</i>	market distorting (e.g., SOEs)	market limiting (e.g., cartels)
<i>Low (Abstinence)</i>	market tracking (e.g., privatized statism)	free markets (e.g., laissez faire --pre-NEP)

Using this modification, state interventionism in Malaysia from the early seventies through the early eighties was certainly of the market distorting variety. In a ruling coalition with the bureaucracy, the political leadership installed a huge SOE program. This greatly increased the involvement of the bureaucracy in the economy although it was ill prepared to meet its requirements especially with a heavy industry push in autos, steel, fertilizers, and cement. There was lax management, poor accountability, and inefficient use of resources. Public debt ballooned out of control.<sup>39</sup> From the mid-eighties, the SOE program was rolled back in an ethnically targeted privatization program—and with it, the bureaucracy was sidelined. At this point, the market displacing/conforming dichotomy based implicitly on bureaucratic power breaks down. For the political leadership began to intervene progressively in a new way that both

<sup>39</sup> Mavis Puthuchery, "The Administrative Elite," in Zakaria Ahmad (ed), *Government and Politics of Malaysia*, (Singapore: Oxford University Press, 1987,) 107, 117.



attended to market forces and tracked structural changes in the market. State ownership of equity was divested to the private sector only to be re-couped through co-ethnic proxies.

To describe this kind of state ownership and intervention as “market displacing” would be inaccurate as these corporations were, for the most part, compliant with market discipline. Since there was also no obvious promotion of cartelization, markets could grow according to the forces of supply and demand. In fact, in the aggregate, these diversified conglomerates constructed a large-enterprise economy. As such, they may be said to have augmented the market in size and scope. These UMNO firms had to compete with other firms without the luxury of soft budget constraints that SOEs were lavished with as off-budget agencies, or the protection that “state managed competition” would have afforded. Accordingly, these corporations were not debilitated by efficiency dis-incentives endemic to SOEs and cartels. True, many were bailed out by the state in the Crisis, yet this predicament arose not because they were fundamentally inefficient, lumbering conglomerates, but because of a specific weakness in Malaysian capital markets that is also endemic in the rest of East Asia. This was the nature of projects many of them had undertaken frequently at the behest of the state—namely, privatized infrastructure “mega” projects—that were characterized by delayed revenue streams coupled tightly to short-term funding dispensed by system of project financing that is bank- and stock-market dominated. That is, these firms suffered from a funding-revenues mismatch, not some foundational inefficiency, a business risk that was not manageable in the absence of mature capital markets for derivatives.

*(v) Contrasting Reciprocal Consent with Privatized Statism:* Although Malaysia is so richly endowed with natural resources, the Malaysian state—once a purveyor of SOEs—is now, in its latest epiphany, a direct if surreptitious commercial participant. State interventionism in an open economy is constrained by international economic forces—FDI and portfolio fund capital—to the degree the nation remains dependent on foreign capital. Domestically, however, the political leadership does not quite have to negotiate for concessions from business. After all, it created Malay big business, and retains control of the biggest firms through its proxies. Here, there is no parallel to the Japanese scenario of business relinquishing

jurisdiction over markets to the bureaucracy in return for maintaining control over those markets. Instead, the political leadership has both jurisdiction and control over firms and markets while big business does its will by doing what it is supposed to do best, that is, business itself. The breadth and stability of this political-business coalition is fundamental to the system's success; there are no serious incidents of local interests attempting to frustrate the centralized leadership. By and large, there are no shifting compacts between state and business in Malaysia. There is no equivalent to the Japanese condition of "permanent negotiations for the distribution of private and public power" as patron-client relations--though corporatized--remain clear: whenever the political leadership leads when it has to, and business follows then; otherwise, business is free to do business freely most of the time. While the state can decide market structures through its economic policies and direct involvement in corporate strategies of UMNO firms, state and market choices alike pay heed to the voice of market discipline.

UMNO firms are the access points that permit the Malaysian state to intervene in the market at any time. In other words, these UMNO firms are the specific institutions that organize the critical interactions between state and economy. The leadership prefers these firms to comply with market discipline rather than use policies to protect such firms because competitive pressures conduce to a more resilient Malay bourgeoisie, one of its avowed objectives in setting up an ethnic capitalism. In virtue of being a participant-competitor--its corporations compete in the marketplace subject to all its vagaries, gyrations, and uncertainties--this form of state interventionism tracks shifting market structures accurately. In virtue of this market-tracking interventionism, Malaysian firms and markets have been largely competitive. Because these shifts are continual in a small, open economy, the Malaysian state remains pervasive in the economy. But corporate management does not find this market-tracking state interventionism burdensome. After all, while legal ownership of equity in these privatized entities rests in the hands of co-ethnic businessmen proxies of state elites, control still ultimately redounds to the political leadership. More importantly, while corporate fates are inextricably politicized, day-to-day corporate management is certainly not hamstrung by the politician's micro-management. Corporate managers enjoy

many degrees of freedom and may function for long periods with hardly any political input, especially when things are going well. In fact, after the Renong restructuring (*see* Chapter Three), the state has been at great pains to stress how identifiably UMNO-owned or -linked corporations are really private sector firms not endowed with any special privileges. True, they historically had close ties to the political leadership, it is acknowledged, but they are now private corporations that have to fend for themselves in the marketplace, it is also asserted. Correlatively, Malay big business is successful enough now to stress that Malay entrepreneurs compete and succeed on their own merits, and not in virtue of any privilege their ethnicity might bring.

The autonomy of corporate management is to a large degree operationally assumed. A fitting analogy might be that if an UMNO proxy is the CEO of a diversified conglomerate, the political leadership plays the equivalent role of the Chairman of the Board of Directors of several such conglomerates. In this role as the contingent monitor, the political leadership coordinates strategic decisions across conglomerates, speaks with one voice and controls its intervention in corporate management when it needs to. The state intervenes in corporate management only when it becomes necessary to save the firm in an economic crisis or to solve some disruptive political exigency “in the national interest” (such as that exemplified in the MBO of Renong’s NSTP and TV3 to placate the Anwar faction; *see* Chapter Three, Section III). Unlike the politics of reciprocal consent in Japan, private sector corporations in Malaysia are not continually seeking to de-link state aid from state control: public and private preferences do not diverge in these firms. Both share in the ownership and control of these firms, and both share in the same vision of a national interest, ethnically defined, that can be achieved in the market.

The undifferentiated developmentalist model usually assumes a bureaucracy that interacts and negotiates with business over its policies. In Malaysia, the political leadership does not have to bother with the intermediation of the bureaucracy any longer, and neither does Malay big business. Civil servants remain across changes in political leadership; they consequently have longer time horizons, and,

presumably, different behavioral motivations. In contrast, politicians and businessmen have shorter time horizons--their corporations must succeed commercially in the present time if both are to survive in an open economy, the political leadership having tied its fortunes to the success of a Malay bourgeoisie of rising expectations. While the leadership certainly owns and controls firms and banks through its proxies, other fractions of capital--ethnic Chinese and foreign capital with the requisite Malay partners--may also compete in the same sector. In contrast to BOJS, the nature of state holdings makes little difference to the way they are wielded in Malaysia. Whatever the holdings, whether they be in production or in banks, the state may intervene as a rival in one sense--but it competes against other firms in a fair way, refereed by market forces. UMNO-owned and UMNO-linked financial institutions may also function as creditors, but for the most part these do so cognizant of market discipline as many are public listed corporations where corporate management is answerable to other investors too. The state is also a partner with other investors--to the extent that its public listed corporations have widely dispersed ownership among retail investors as well as other institutional investors. Finally, the state still stands as a guarantor in "permanent receivership" for all banks in the system regardless of ownership--whether Malay, ethnic Chinese, or foreign capital.

Tactically, this privatized statism means that the political leadership may now "evade some or all of the controls applicable to government agencies, funds, officers, and employees."<sup>40</sup> It shifted public assets, first, away from parliamentary oversight as well as bureaucratic intrusion and transferred them into party overview, and then, with privatization, relocated them from party overview into the political leadership's personal supervision. The incentives for this mode of interventionism were strategic as well. The NEP was, in fact, justified by the claim that a dozen years of free markets had not been allocatively efficient with regard to ethnic distribution of wealth and occupation. Proclaiming a state ideology of ethnicity furnished UMNO with a tool to re-establish its legitimacy that was under serious challenge by

---

<sup>40</sup> Harold Seidman, "Government Sponsored Enterprise in the United States," in Bruce Smith (ed), *The New Political Economy: The Public Use of the Private Sector*, (New York: Wiley, 1975,) 94; as quoted in Samuels.

an emergent urban, ethnic Chinese counter-elite from the mid-sixties, evident in the 1969 electoral debacle for UMNO. “Racial” justice was UMNO’s rallying cry and has since served to legitimate its rule.

(vi) *Some theoretic issues:* Because it consolidated the Malay business class through an ethnic privatization, the political leadership is *primum inter pares* in its new alliance with Malay business. However, this is not necessarily the permanent balance of power in the alliance, simply that this is the present reality. As the more equal partner, it has been able to prevent capture by even special interest groups within that fraction of capital, and is able to deploy the equity to achieve its political purposes. Cases where businessmen proxies contend with the political leadership over the ownership and control of these firms have been few and far in between. Changes in ownership may actually be more revealing about factional in-fighting within the political leadership. That is, the genesis of various organizational forms of the ownership and control of equity may be more instructive about political infighting within the UMNO political leadership. Still, although there might be the occasional factional fight at the top, the underlying premise that all owe allegiance to UMNO and the Malay race remains uncontested.

In Japan, reciprocal consent translates into a “perpetual negotiation (of) the identity and autonomy of the state.” (10) In Malaysia, state and market are not the two ends of a seesaw, one rising and falling in opposite direction to the other. Here is a cautionary flag to uncomplicated notions about state autonomy and capacity. It is not that control is mutually constrained. Neither is this a story about state strength. I do not imply that state pervasiveness in the market in privatized statism is a direct, or general, measure of state capacity: these state programs for market control and intervention can become transformed, over time, by politics. By identifying the theoretic shortcomings in conflating bureaucratic power with state capacity, we learn an important lesson: if the state can be unbundled, then notions of state autonomy and state strength must be correctly disaggregated into its component parts and precisely attributed in their historical specificities. The privatized statism perspective suggests the need for caution in applying models of state-society relations that are not sufficiently attentive to the separable power of the political leadership *vis-à-vis* the bureaucracy on the one hand, and business on the other. Moving

beyond “Who Governs,” I address the “How” and the “For Whom” to characterize more clearly how state and markets interact in Malaysia. The theoretic lesson is that state capacity must be characterized empirically, that we need to attend to historically determined coalitions and conflicts which, given their tactical and strategic motivations, are more important than “past attributions or current snapshots” of state capacity *per se* for explaining the ways in which states intervene in markets.

In sum, it is necessary to disaggregate the state as a social entity in order to recognize the different institutional interests and organizational cultures whose competing and conflicting relations produce “public policy.” Conversely, it is also necessary to recognize that the competitive fortunes of firms are not settled only by how well they compete with each other in terms of price and quality but also what strategic alliances they have. This is the point of entry of the political leadership. This nexus represents a complex division of labor between normally state and market institutions; what matters most is not their designations but whether tasks are performed properly by one or the other, or best of all, by the two in flexible symbiosis.

*(vii) Conclusion:* To reiterate, statist ideas about state led growth widely accepted in the comparative literature on state and markets are almost always characterized by an unquestioned assumption of definitive bureaucratic power. In Malaysia, however, the political leadership preferred ownership and control of equity to regulation because the former afforded greater flexibility, while regulatory intervention by the bureaucracy would compromise its authority. By successfully sidelining the bureaucracy, the leadership was able to check its involvement that would have militated for more market distortion and truncation. One possible reason was to obviate extensive negotiations in privatization that bureaucratic practices and procedures would have required. Besides, the bureaucracy was associated with the NEP’s failed SOE program (or could have blame for the failure attributed to it). Be that as it may, it was not in the political leadership’s interests to inherit institutional traditions or preferences for particular forms of intervention that would have hobbled the implementation of its ethnic privatization program.

By creating a Malay *bourgeoisie* through the NEP, and consolidating it through an ethnic privatization, politicians have been able to bypass state structures without relinquishing their control of the economy nor distort or truncate markets. The state is now able to direct development not only through macro-economic policy but also by wielding these private sector corporations in market-tracking ways to serve its political objectives, without the ministrations of an intrusive bureaucracy. The undifferentiated developmentalist perspective fails, however, to account for this inversion in the role of the bureaucracy in Malaysian statism. Because the unbundling of the state was not anticipated, the unreformed theoretic framework does not differentiate bureaucratic power from that of the political leadership. Accordingly, it assumes bureaucratic intrusiveness as being determinative of state intervention in all cases. Applied to the Malaysian scenario, its explanatory value is reduced to mistakenly trying to determine if this was market displacing or market conforming interventionism when, in fact, there is no bureaucratic intrusiveness to militate for such debilitation of markets.

(c) *Historical perspectives:* Privatized statism appears to be the only extant form of state interventionism that can comply with market discipline and track market structural changes. Although the story is not often recounted, several nations in diverse contexts and different settings have actually pursued some version of privatized statism before. There is a rich historical vein of antecedents, although in no other case has there ever been an ethnic focus and the use of proxies such as that in Malaysia. In fact, the public listed corporation itself was a creation of the state in the eighteenth century. William Roy argues that when the big corporation as we know it emerged in the United States, it did not arise out of Chandlerian considerations of efficiency. Alfred Chandler, Jr. had argued that the corporation assumed its now familiar mode of organization because it increased “throughput” of production, got products to the market faster, and then became large.<sup>41</sup> Contrary to that suggestion, Roy argues that the public listed corporation began “as a quasi-public agency created by (some American) states to perform public

---

<sup>41</sup> Alfred Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business*, (Cambridge: Harvard University Press, 1977).

services” such as building turnpikes, bridges and canals where markets would not support them. The public corporation arose as a quasi-state activity when states forged the earliest business corporations as an organizational means of mobilizing private resources to serve collective or state interests, and to perform tasks beyond the ability of existing organizational forms. These sub-national governments vested the public corporation with special privileges such as limited liability, perpetual life, and parceled-out ownership. The corporation was “a delegation of sovereign powers to serve the public interest (and) the enumeration of powers in a charter, the creation of boards of directors, and the election of officers” ensured its public accountability. (76) Indeed, the state was, in every sense, a shareholder—hence, the *public* limited company.

Through its charter policy, joint ownership of mixed corporations, public works program, and regulation of economic activities, the state government took a leading rather than quiescent role in the development of these public corporations. Of course, there were varying degrees of state involvement due to individual contexts in the different states.<sup>42</sup> For example, in his definitive study of the Pennsylvania state government’s role in the founding of public corporations, Louis Hartz describes an extensive creating and supporting of corporations by the state from 1793 (when it chartered the Bank of Pennsylvania and subscribed to \$1 million of its shares) until 1857 when a constitutional convention forbade such state investment in business corporations.<sup>43</sup> These investments, which eventually exceeded \$6 million, were aimed primarily at stimulating economic growth, but they undoubtedly also provided welcome revenue for the state government.<sup>44</sup> In the same period, the New York state government set up a public corporation to build the Erie Canal. The most successful of public works in the nineteenth century, the Canal sparked off a “canal mania,” or a wave of incorporation of similar public firms by state governments throughout the United States for infrastructure projects.

---

<sup>42</sup>Ernest Boggart, *Internal Improvements and State Debt in Ohio: An Essay in Economic History*, (New York: Longmans, Green & Co, 1924); John Cadman, Jr., *The Corporation in New Jersey: Business and Politics, 1791-1875*, (Cambridge: Harvard University Press, 1949).

<sup>43</sup>Louis Hartz, *Economic Policy and Democratic Thought, 1776-1860*, (Chicago: Quadrangle Books, 1968).

<sup>44</sup>Stuart Bruchey, “The Changing Economic Order,” in Alfred Chandler, Jr., Stuart Bruchey, and Louis Galambos,



At this juncture, there were no attempts by any party to question the role of government investments in these public corporations on the basis of inefficiency, legitimacy, or anything else. In fact, Hartz reports a fervent movement of religious dimensions by the mid 1820s to promote state ownership of public corporations. The legitimacy of this endeavor was taken for granted. (131) If there were any disputes over government involvement in a specific corporation, contestations turned not on legitimacy, or even efficiency, but rather on who would benefit. And both sides to the specific debate would stress public benefit and both sides would be equally unambiguous in being against private enrichment. At this point, the notion of private and public domains as being clearly distinguished from each other had not quite yet gelled into the form some now assume to be naturally inevitable.

The Main Line in Pennsylvania—an engineering marvel of its day—was a canal the state government had built to link up Pittsburgh and Philadelphia directly, but it soon fell into commercial trouble. The unforeseen development of the railroad rendered the Line obsolete within a decade of its completion in the 1830s. With a new logic—utilitarianism—ascendant, the commercial failure of the Main Line triggered a debate on government ownership of public corporations that focused, for the first time, on efficiency concerns. In fact, the fiscal crises of the 1830s and 1840s came to be interpreted in terms of the inefficiency, and consequent failure, of public ventures although these fiscal crises were, really, the first depressions of international finance. In addition, the rise of Jacksonian democracy with its distinctive anti-state brand of anti-corporations meant that, by the 1840s, there was already a movement to sell off public corporations. The successful sale to private interests of what was the world's largest corporation, a viable Pennsylvania Railroad, made it easy to sell off the Main Line.

This creation of public corporations as extensions of the state and their politically driven privatization show that it was not some inevitable, natural shedding of government restraints on free markets. In the early part of the nineteenth century, private ownership and control of corporations was hardly viewed as inevitable. The commonest corporations—road and water transportation companies—

(..continued)

*The Changing Economic Order*, (New York: Harcourt, Brace and World, 1968).

were entirely public. Only the late entrant, the railroad company, was born privately owned in many cases. “What sealed the doom of the public corporation,” Roy concludes, “was how effectively the advocates of *laissez-faire* used the depression and stock market crashes of 1837 and 1857 to make the case against government economic activity...Failing state enterprises were effectively used by opponents (although these enterprises were created to serve a general public service rather than make a profit) to legislatively limit state investment and supervision.” (74, 72) After 1837, nearly all state constitutional conventions had erected barriers that permanently sealed the public sector off from the private corporations, and many states divested off their corporate securities, often at a loss. By the 1850s, what had been a novel sentiment—the separation of politics and economics—was becoming received wisdom. In this manner, the corporation was transformed over a relatively short period of time from “an extension of state power into the quintessence of private property, a sanctuary from governmental authority.” (xiv)

This construction of a corporate sector was also giving impetus to the development in tandem of a financial sector. There was a steady, joint evolution of public corporations and the securities markets.<sup>45</sup> In fact, Wall Street—that very symbol of private enterprise and *laissez faire*’s anti-government sentiments—emerged to handle issues of securities by state governments and quasi-governmental corporations. It was precisely the active role of these state governments and quasi-governmental corporations in issuing securities—and buying securities, mainly in transportation and public utilities—that led to the creation and consolidation of Wall Street institutions.

By the early 1790s, there was already a thriving securities market where speculation in securities, such as they existed, consisted primarily in the buying of government bonds, and selling them at a profit. Public securities remained, at the century’s end, the principal stock market commodity.<sup>46</sup> Trading was largely the preserve of a few wealthy individuals in a number of large cities. The Buttonwood Agreement, signed in 1792, between twenty four New York brokers and merchants, to give one another

---

<sup>45</sup>Walter Werner & Steven Smith, *Wall Street*, (New York: Columbia University Press, 1991).

<sup>46</sup>Joseph Davis, *Essays in the Earlier History of American Corporations*, 2 vols., (Cambridge: Harvard University Press, 1917); vol 2, p 294.

preference in selling public securities, soon lapsed but laid the foundation of the New York Stock & Exchange Board, the forerunner of today's New York Stock Exchange.<sup>47</sup> This New York bourse was the direct capital market that financed the "canal mania" of the early nineteenth century already alluded to. For example, the New York state government issued \$7 million in canal bonds between 1817 and 1825 which were "sold by underwriters and bought by individuals and towns close to the canals, by banks, and by European investors."<sup>48</sup> While customers and securities traders nurtured the growing market, corporations and governments issued securities to raise funds on the bourse. The growing volume of transactions led to specialization among traders: one group contracted for government debt issues, the other concentrated on trading markets.

Because securities were readily convertible to cash, regularly traded shares came to be regarded primarily as tradeable financial assets. Accordingly, most shareholders evinced little interest in actual corporate management. Because securities markets caused a dispersion in the ownership of equity, actual corporate management and control of that equity came to rest in the hands of the top managers of these public corporations. That is, as nominal ownership became dispersed, control became concentrated since ownership of smaller and smaller proportions of equity was enough to exert control of enterprise. In this manner, securities markets were crucial to the maturation of the corporate form. Corporate control operated increasingly through the institutional structures of corporate capitalism, viz., the stock market, brokerage houses, investment banks and, even, the financial press, not the institutional structures of publicly accountable government.<sup>49</sup> In contrast to Galbraith's stress on the independence of the mature corporation from capital markets--as if its option of not going to the market for funds meant that it was free from market constraints--markets remained critical to its development by providing investors constantly updated measures of its value.<sup>50</sup>

---

<sup>47</sup> Davis, *ibid.*

<sup>48</sup> Werner and Smith, *ibid.*

<sup>49</sup> Roy, *ibid.*, 270, 271

<sup>50</sup> John Kenneth Galbraith, *The New Industrial State*, 3d ed., (New York: Mentor, 1978) 75. Others have recognized more fully the impact of financial markets on corporations; see, William Baumol, *The Stock Market and Economic*

Let us turn now to the market-tracking mode of state participation in markets in the sense I posed above. From the early 1980s, the Malaysian state made deft use of a government investments holding company strategy to centralize the collection of rents. Uniquely, a mutual fund element was appended to centrally collect disproportionately nominal investments from the Malay masses, and centrally distribute guaranteed supernormal gains to these investors. Unsurprisingly, this created a huge pool of goodwill towards the Malay state among the Malay masses. Surprisingly, there were American precedents for this approach, at least for the first segment of it. Although President Clinton's proposal in early 1999 for the federal government to invest in securities was greeted with dismay by those who feared an increasing encroachment of government in markets, state governments in the United States had actively invested in private sector securities even as recently as the Golden Age of Capitalism itself.

As a result of rising balances in state treasuries in the United States from the 1950s, at least eighteen states engaged in commercial investments, the largest of such investors being the state governments of New Jersey, Wisconsin, and Minnesota. These activities were carried out by centralized investment boards such as the Division of Investment in the Department of the Treasury set up in New Jersey in 1950, or the State of Wisconsin Investment Board set up in 1951. Such boards had encompassing controls over all cash flows and, wide investment discretionary powers given to their professionally trained investment personnel.<sup>51</sup> They were not attached or answerable to any group with funds to invest. Instead, they were constituted as separate entities within their respective state government bureaucracies. Specifically, only the investment function was centralized, not the complete administration of the various permanent, retirement, and operating funds. While the idea of investing state funds was hardly new—by 1925, the primitive practice of holding public funds out of circulation

(..continued)

*Efficiency* (New York: Fordham University Press, 1935); also, Thorstein Veblen, *The Theory of Business Enterprise*, (New York: Scribners, 1904); and, Adolf Berle and Gardiner Means, *The Modern Corporation and Private Property*, 2d ed., (New York: Harcourt, Brace & World, 1968) bk.4

<sup>51</sup> Miles Tommeraaen, *State Centralized Investment Process—Structure, Controls, and Operations*, (Lincoln: University of Nebraska Studies, 1966).

had ended<sup>52</sup>—the concept of a centralized process was novel. This process of centralization of the investment function where the state investment board was a distinct agency with control of funds, and where there was use of professional investment personnel for whom making state investments was their single responsibility, transcended a mere investment committee acting in an advisory capacity to various state agencies with funds to invest. The process meant economies of scale, and consolidated what were many smaller balances that would otherwise have appeared too small to invest. The process also enabled specialization in the bureaucracy, reduced duplication of paperwork in the handling of state investments, and assured constant oversight of what might have otherwise been part-time investing activity by bureaucrats bogged down with other responsibilities. Generally, these boards tended to shift from government to non-government securities, and diversify their portfolios to garner higher returns.

Any impression that state creation/ownership/use of market institutions was a preserve of the American states in their recent past would be erroneous for there were similar developments elsewhere in the OECD. For example, as is well known, a huge nationalization program after World War II transformed the British state into a shareholder in steel, railways, coal, and electricity. This endowed the state with ownership and control of such entities without the benefit of an increased income since profits, if any, were more than offset by interest payments on the national debt issued for nationalization.<sup>53</sup> What was less well known was the substantial involvement of the government directly in private sector firms themselves.

Over the years, the state had become involved in industry and commerce, not only by grants and aid, etc., but actually through purchase of corporate equity. This had not come about primarily because of some ideological commitment for there had been no prior philosophical discussion as to its merits or demerits. Rather, state purchase of corporate equity had occurred out of necessity as the state responded pragmatically to specific exigencies. These purchases by the British state were justified with *ad hoc* arguments couched in terms of defense and security concerns, for instance, with British Petroleum and

---

<sup>52</sup> Martin Faust, *The Custody of State Funds*, (New York: National Institute of Public Administration, 1925,) 6-7

Rolls-Royce; the maintenance of employment in shipping and computers facing foreign subsidized competition; the alleviation of social distress in the depression in the case of the Land Settlement Association; and so on. The range of the state's shareholding activities prior to the Thatcher program of privatization was wide but, with the exception of Rolls-Royce that was acquired in a blaze of publicity, there was little general knowledge of its extent.<sup>54</sup> In contrast to the American practice of centralized investment boards, the very *ad hoc* manner in which this type of ownership had developed in Britain over the years meant that there were no systematic arrangements for the control of these equity holdings. Lines of accountability were never made obvious. Neither was the extent of the government's obligations to company creditors in the event of collapse nor those of government appointed directors especially in those corporations with direct state equity.

On the Continent, there was also state ownership of private sector corporate equity in Sweden and Italy, among others, during the Golden Age. The Swedish state owned publicly listed equity in wines and spirits, air transport, ship building and iron ore mining in addition to the conventional state undertakings in the utilities. Its program came under unified ministerial authority. In Italy, besides conventional state undertakings in railways and posts, there were several state investment holding companies. Of these, the two most important were *Instituto per la Ricostruzione Industriale* that controlled more than a hundred firms in banking, mining, shipbuilding, merchant shipping, chemicals, air transport, civil engineering, turnpike construction, autos, and radio/television; and, *Ente Nazionale Idrocarburi* that controlled firms in petroleum, natural gas, and nuclear energy.<sup>55</sup> These state investment holding companies also came under unified ministerial control, and although the firms under these umbrellas raised part of their capital on the open market, and did compete with other firms, they also received interest-free loans from the state. Most of these firms attended to the profit motive but they also engaged in socially motivated operations, especially in terms of regional development. However, there was no organized distribution of

(..continued)

<sup>53</sup> James Meade, *Liberty, Equality and Efficiency*, (New York: New York University Press, 1993,) 95.

<sup>54</sup> Merlyn Rees, *The Public Sector in the Mixed Economy*, (New York: Harper & Row, 1973).

<sup>55</sup> David Coombes, *Business or Politics*, (London: Allen & Unwin, 1971,) especially chs. 10 & 11.

rents to some ethnic segment of the populace.

In more recent memory and closer to home, China's restructuring of its huge SOE program also led to state ownership of private sector corporate equity. A "corporatization" experiment from 1995 transformed one hundred of its medium size and large industrial SOEs into publicly listed firms on the stock exchanges that had been founded in Shanghai and Shenzhen a few years earlier. Ownership of the corporate equity so created was allocated to (a) the national and sub-national levels of government, (b) other listed companies, non-bank financial institutions, and other social institutions, as well as (c) individuals.<sup>56</sup> However, only the last category of shares is tradeable. The joint residual control arising from the substantial proportion of corporate equity that is mandated to stay in state hands means, however, that corporate management may still be subject to political intervention.

Finally, in its defense against twin speculative attacks on the Hong Kong stock exchange and its dollar's peg to the greenback in late 1998, the Hong Kong government was compelled to purchase substantial amounts of equity in several of the largest publicly listed corporations on the domestic bourse. This poses a serious conundrum for the *laissez faire* government, but it is expected that the equity will eventually be re-sold to the private sector when market conditions become more propitious for doing so.

Given these antecedents, the Malaysian state's creation, ownership, and wielding of private sector firms as well as its use of investment holding companies, seem less and less unusual. Still, in none of these cases was there the construction of an ethnic crony capitalism, one durable across crises, to boot.<sup>57</sup>

---

<sup>56</sup> World Bank, *China's Management of Enterprise Assets: The State as Shareholder*, (Washington DC: World Bank, 1997,) 4; also, Zhiyuan Cui, "The Economic Role of the State; A Theoretical Survey with Reference to China," in United Nations, *The China 1998 Report*, forthcoming.

<sup>57</sup>cf. Stephan Haggard suggests that the question today is "no longer why the region succeeded but why it had fallen so far so fast." He asserts that "the weakness of prudential regulation" is now a central analytic theme, and predicts that, consequently, "systems of corporate governance are also likely to change...with overhaul of the large, highly diversified industrial conglomerates" in Korea, Indonesia, and Malaysia. (16). This argument disregards the fact that the Mundell-Fleming theorem holds only if there are no capital controls. Malaysia's spectacular growth in the nineties came from increased factor input of portfolio capital. Symmetrically, it has been able to limit the impact of the Crisis by re-imposing capital controls and pegging the ringgit at a discount to regional currencies. So while international capital would not be returning any time soon, it meant that Keynesian reflation using its huge domestic savings has been effective in kept the crony capitalism intact, and the political leadership in power. *Pace* Haggard,

In no case did the political leadership use privatization to consolidate a business class of co-ethnic proxies and, in the process, build up a large-enterprise economy it continued to control through these proxies, crucially, with little bureaucratic intrusion. For, with success, the political leadership rejected its developmental association with the bureaucracy and, instead, formed an alliance with the Malay big business class it had created with the aid of the bureaucracy. The state now directs economic development not only through macroeconomic policy but also by wielding these firms which are the most important ones in the most crucial sectors. To reiterate, in none of the instances reviewed did the political leadership reject its developmental association with the bureaucracy once there was a strong business class, however created. It is precisely this unbundling of the state subsequent to the successful creation and consolidation of a co-ethnic business class that is uniquely true in the Malaysian case. In addition, there is no parallel in which one particular fraction of capital—the ethnic Chinese—was purposely allowed to wither away. With that, there was an inversion of relations of dependency between that fraction of capital and the Malay state, the latter gaining the upper hand. Finally, in none of the cases above was there distribution of proceeds from centralized state investment activities to the masses (through a state-run mutual fund) that garnered the state a lot of goodwill among its recipients, the Malay majority. Moreover, because the process was centralized and executed openly and legally with party and state structures, it de-linked political payoffs from corruption. In this manner, the structure of property rights in Malaysia did not ossify as it did in so many other Third World nations with interlocking patron-client networks. As such, reasonably rational allocation of resources was possible and respectable economic growth ensued. This strategy was justified by a state ideology of ethnicity which also laid the foundations for an ethnic privatization from the mid eighties. In the next section, I describe how a market-tracking privatized statism in Malaysia came about and how it constructed a durable ethnic capitalism.

(..continued)

prospects for system reform are dim; see, Stephan Haggard, "The Role of Government in Economic Development: The Debate from East Asia," *American Political Science Association-Comparative Politics Newsletter*, Winter 1999: 14-16; see Chapter Four, fn. 8.



### **Section III: Privatized Statism & A Durable Ethnic Capitalism**

This is the story of a differentiated developmentalist model. First, I describe in subsection (a) how privatized statism in Malaysia came about. Next, I discuss in subsection (b) why the ethnic economic system it has constructed is durable. I touch briefly on the impact of ethnic policies on growth, how in one sense, there has been growth in spite of them, and yet in another sense, because of those very policies.

**(a) *Privatized Statism:*** The observation that the state insinuated itself in the market by a well targeted program of ethnic privatization, as detailed in Chapter Three, is key because the process solidified a radical re-alignment in the politics-bureaucracy-business configuration of power relationships in Malaysia. Specifically, privatization accelerated the declining influence of the Malay bureaucracy that had, in fact, been dominant in the policy process during the earlier phase of the NEP, the origins and development of which are detailed in Chapter Two. The ethnic nature of the privatization itself was also legitimated by the NEP. By consolidating the Malay business class, privatization also reinforced the ascendancy of the Malay economic elite. Ironically, the emergence of that elite had to do precisely with the bureaucracy working in cooperation with the politicians to nurture its creation and development. The actual shift in the locus of power from an association between Malay politicians and bureaucrats at the start of the NEP to an alliance between Malay politicians and businessman at the end of the period maps well onto the privatization process.

Upper echelon politicians in the sixties and the early seventies had close ties with the top bureaucrats who were generally of aristocratic breeding, a result of British colonial policy of training a junior civil service comprised of Malay males from that strata of society to maintain the appearance of native participation in the administration. (Technically, the nation was never a British colony for, officially, the colonial rulers acted merely as “advisers” to the traditional sultanates in the Malay states.) This politician-bureaucrat alliance launched the NEP under Abdul Razak, the second Prime Minister after independence, to ensure support of the Malay masses. Facilitated by a marked increase in government revenues in the seventies, especially from newly discovered, high grade petroleum, the NEP fostered an

enlarged, more aggressive, and more direct role of the bureaucrats in the economy.<sup>58</sup> This strengthening of bureaucratic control of the economy also saw increasing uncertainty in the private sector, especially within ethnic Chinese capital—still the dominant fraction of domestic capital at this juncture—and a general decrease in economic efficiency.

In order to implement Razak's NEP, many of the most capable bureaucrats were transferred from the regular civil service to manage a plethora of newly formed statutory bodies and SOEs which radically enhanced the economic opportunities available to the emergent Malay middle class. Forced restructuring of big ethnic Chinese firms, and of MNCs, to achieve the NEP's mandatory 30% Malay quota of corporate equity ownership and of employment in managerial positions, as well as UMNO's growing corporate empire also provided real private sector opportunities for an emerging Malay business class. In the seventies, during the Razak administration, Malay professional groups were co-opted by the political and bureaucratic leadership, and received rapid advancement in their opportunities and remuneration. At the national level, several prominent Malay businessmen spawned by NEP opportunities soon began to discover that, while the bureaucracy helped suppress ethnic Chinese capital that might otherwise compete against them, their interests often conflicted with those of the bureaucracy. Meanwhile, UMNO grassroots leadership was changing as well with small businessmen steadily displacing the *penghulus* (hamlet chiefs) and schoolteachers who used to comprise the local leadership from the days of the struggle for Independence.

Mahathir became Prime Minister in July 1981. By the early eighties, a fundamental change in Malay society had occurred with the ascendancy of the new economic elite, and the unabashed migration of scions of the nine royal households as well as the aristocratic and bureaucratic elite into business to exploit NEP opportunities for themselves.<sup>59</sup> By the mid-eighties, there was already a sizeable group of

---

<sup>58</sup> Evers says there was "runaway bureaucratization" in Malaysia (and Indonesia) in the seventies. For example, the number of government employees in Malaysia grew by several hundred thousands, or about 90% in the period; see, Hans-Dieter Evers, "The Bureaucratization of Southeast Asia," *XXV Society for Comparative Study of Society and History*, 1987: 666-685.

<sup>59</sup>This was epitomized by the ascendance of commoner Mahathir Mohamad who had no MCS ties at all over KuLi, a

established Malay businessmen not beholden to ethnic Chinese capital.<sup>60</sup> The downturn in the international economy in the mid-eighties legitimated the political leadership's introduction of privatization, deregulation, and liberalization to free market forces, reduce government spending, trim the bureaucracy, and, unofficially, suspend the NEP. Thus, about a-decade-and-a-half of the NEP had to pass before the Malaysian version of privatization could be promoted in the interests of Malay business. Any earlier, and ethnic Chinese capital would have, directly or indirectly, appropriated the benefits. At the right moment, then, privatization provided the impetus to consolidate the Malay bourgeoisie significantly.

Using public resources and its control over the regulatory apparatus to found a corporate empire for itself, UMNO built up party holdings of huge conglomerates for itself and fed them with lucrative privatization projects. In this way, huge holdings of corporate assets were created by the Malay political leadership, owned elliptically through proxies, trustees, and nominee companies. (Because of UMNO's prolonged domination of the state over forty years, there is virtually no difference between party and state.) That is, the state's huge holdings of corporate equity were divested to co-ethnic proxies/cronies, thus creating a coterie of Malay captains of industry through whom the political leadership continued to simultaneously retain control of markets. Webs of pyramiding and interlocking directorates concealed the ultimate ownership and control of these conglomerates that include the largest corporations in the country. As the embodiment of Malay success in Corporate Malaysia, tremendous personal gains both in material terms as well as social standing accrued to these tycoons the state created.<sup>61</sup>

The immediate beneficiaries of the privatization, deregulation, and liberalization were, of course, these successful businessmen, but also included foreign capital. Malay business elites clearly gained from

(..continued)

wealthy prince, as UMNO leader and Prime Minister. In fact, Mahathir openly expressed disdain for the MCS and went to work on the bureaucracy immediately. For example, to this day, civil servants are required to wear name tags as well as clock in and out of work. To this day, Mahathir explicitly declares himself a friend of business—"My cronies"--and surrounds himself with businessmen.

<sup>60</sup>James Jesudasson, *Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia*, (Singapore: Oxford University Press, 1989.)

<sup>61</sup>For a listing of these individuals who came into (proxy) ownership of huge portions of the domestic economy, see Edmund Gomez, "Electoral Funding of General, State and Party Elections in Malaysia," 26 *Journal of Contemporary Asia*, 1996: 81-99; also, Gomez, *The 1995 Malaysian General Elections: A Report and Commentary*, (Singapore: Institute of Southeast Asian Studies).

a more open economy which was, however, contrary to the preferences of the bureaucracy that desired more regulation, more policy controls, as well as more planning and guidance of the economy. In contrast, the business elite stressed the negotiability of these constraints. By the latter half of the eighties, the Malay political elite had come to view the Malay business elite as the most dynamic element in its society. The relative strength of the Malay business elite was such that, when offered suitable opportunities, competent bureaucrats shifted over to business rather than remain in the administrative service. Meanwhile, capable new Malay entrants to the workforce also favored opportunities in business in contrast to former times when employment in the MCS held the prospects of the highest social status for aspiring Malay men.

Prior to the NEP, the political leadership had insulated the bureaucracy from demands of individual businessmen. Once the institutional barriers were broken down, and once it came to be regarded as legitimate to allocate public resources for private benefit, politicians became more concerned with constraining bureaucratic power that might impede the functioning of these linkages. As mutually beneficial linkages were forged between politicians and businessmen, one significant outcome of the NEP's successes was to marginalize the regulators. By the start of the nineties, bureaucratic power in contemporary Malaysia had become wholly derivative of its political masters and was no longer characterized by the autonomy it had once enjoyed. This was so despite the bureaucracy's demonstrably high level of sophistication, and the continuity of state structures in Malaysia in contrast to most ASEAN nations. Of course, the bureaucracy was far from homogenous. The EPU technocrats in the Prime Minister's Department embraced neoclassical orthodoxy thus enhancing their stature in Mahathir's eyes often at the expense of the rest of the bureaucracy. Economic policymaking became centralized in the EPU directly under Mahathir, but other government departments were routinely over-ridden in policy initiation and implementation.<sup>62</sup>

---

<sup>62</sup> Hilton Root misses this point completely in arguing that it was "Malaysia's will to grow" that "prevented the politicization of the bureaucracy" in Malaysia; see Hilton Root, *Small Countries, Big Lessons: Governance and the Rise of East Asia*, (Hong Kong: Oxford University Press, 1996,) 65-89.

At the cusp, the politician-businessman alliance was clearly ascendant. In many cases, these were the same individuals, the archetypical Malay tycoon-politician being Daim Zainuddin, Mahathir's closest confidant whom he appointed UMNO Treasurer and MOF, twice. In any case, many of the linkages between key individuals in politics and those in business were clearly known, and openly so described in the press with nary a denial to the contrary. This close alignment put state regulators in the bureaucracy on the defensive who came to be effectively bypassed on most development policy issues.<sup>63</sup>

Thus, by the early nineties, a large and confident Malay business class, backed by the politicians, that could challenge the regulators, and win, had arrived. There is a reciprocal relationship between the Malay economic elite and political elite where the latter provides a favorable policy environment for business, while the former supplies funding for electoral contests. Should this leadership ever be rejected by society through the electoral process—an extremely unlikely prospect—the awesome economic power it commands through its proxies would still render it a political force any government of the day would have to reckon with. That is, UMNO's corporate empire is a formidable insurance against its loss of political power.

However, there is nothing necessarily inevitable or permanent about this realignment of power relationships since it was founded and depends on increasing prosperity. A faltering economy could cause the Malay business class such relative immiseration that this key group may press the politicians for a re-emphasis on communal priorities. This would require the re-imposition of bureaucratic controls, which may not help the Malay business elite this time around, but could revitalize the bureaucracy and, certainly, hurt the emaciated ethnic Chinese capital further.

---

<sup>63</sup>Because the SOE strategy had bolstered the public service tradition in Malaysia, privatization involved a redefinition of the public interest and a re-orientation of the concept of public service. This became posed as a question of differentiating and balancing social criteria and commercial criteria, not one of sacrificing one for the other. Since the notion of public interest is ambiguous and politically expedient, privatization uncoupled or disentangled the objective of commercial viability from that of social responsibility in order that it might be possible to preferentially emphasize the former. The state's social responsibility became redefined as formalized monitoring of big business and ensuring its compliance but the new regulatory authorities were shorn of any real power to pursue the big firms.

(b) *Ethnic Capitalism*: Reciprocal ties between state and capital in many developing countries, and their social interactions in networks, are not institutionalized, but personalized. The political structure would be one of an aggregation of these networks bound together by the exchange of material benefits for political support. Frequently, these dense exchange relations among policymakers and their cronies facilitate collusion and may degenerate into super-cartels, aimed like all cartels, at protecting their members. Often, there is rampant factionalism as well as corruption at the highest levels. Such a system bases its authority on its distributive capacity, and its arrangements have been known to result in either monopoly or dissipation of resources through rent seeking.

The unreformed construal of crony capitalism stresses government failures where officials select investment projects based on which firms or business groups will benefit, thus distorting economic incentives to invest rationally in productive activities. In this perspective, social waste causing interventions, once created, are seen as not easily withdrawn; government imposed regulations, policies, legislation and initiatives introduced in response to rent seeking by cronies translate into corruption that undermines economic development.<sup>64</sup> However, the political economic problem—as opposed to the moral problem—is not corruption *per se* but which political structures so conflicted with these transfers can generate economic growth despite the corruption.<sup>65</sup>

A crony capitalism using co-ethnic proxies has certainly been constructed by the privatized statism in Malaysia.<sup>66</sup> However, economic growth has been quite robust both “despite” ethnic redistribution, and also “because” of it in the following sense.<sup>67</sup> Ethnic policies were aimed at securing political support from the Malay masses as well as the economic elite. With regard to the former, in the early NEP period, SOEs were important for Malay employment especially at administrative, technical and managerial levels, but the

---

<sup>64</sup> *see*, for example, K Y Chong, “Trade and External relations,” in E K Fisk & Osman Rani (eds) *The Political Economy of Malaysia*, (Kuala Lumpur: Oxford University Press, 1982).

<sup>65</sup> Michael Johnston, “The Political Consequences of Corruption: A Reassessment,” *Comparative Politics*, 1986: 459-477.

<sup>66</sup> *see*, for example, K S Jomo, “Malaysia Bails Out Its Cronies Again,” *Asian Wall Street Journal*, Op-Ed, January 7, 1999.

<sup>67</sup> I thank David Woodruff for making this distinction.

huge government spending in a grossly inefficient program was deleterious. Growth did come but simply from increased factor input of capital. There was crowding out of the private sector.<sup>68</sup> The open, legal, and centralized collection and distribution of rents through the PNB/ASN scheme meant that political payoffs were delinked from corruption, thus preventing ossifying patron-client pyramids from developing.<sup>69</sup> Consequently, resource allocation was reasonably efficient as there were no sclerosed regimes of property rights. With its market-liberal type preconditions, growth was thus possible *in spite* of the ethnic re-distribution.

Importantly, while Malay big capital had not yet arrived in the early years of the NEP, the state's efforts in support of Malays also meant an active suppression of entrepreneurial ethnic Chinese capital and, to that extent, growth must have been hampered.<sup>70</sup> There was promotion of foreign capital to countervail ethnic Chinese businessmen, such investments providing employment for Malays who were migrating from rural areas to the cities at this time, and accounting largely for manufacturing exports.<sup>71</sup> Of course, Malaysia's natural resources buoyed up growth accounting for a large part of the country's export earnings, and were

---

<sup>68</sup> A measure of the efficiency in the utilization of capital, ICOR (incremental capital-output ratio), identifies where capital has been effectively used and if government expenditure and investment has crowded out private investment. The average annual ICOR increased from 3.65 (for 1971-1980) to 7.21% (for 1981-1985). For the same periods, the public sector's figures increased from 6.75 to 15.51% while, in contrast, the private sector's figures only increased from 2.27% to 3.87%. The high public sector figures--and rising external debt--came from inefficient SOEs which comprised a third of total national economic activities, especially the capital-intensive investments in several off-budget, non-financial SOEs involved in Mahathir's heavy industry push; see Kamal Salih and Zainal A. Yusof, "Overview of the New Economic Policy and Framework for the Post-1990 Economic Policy," 24 *Malaysian Management Review*, 1991: 22. The writers were economists from a government-sponsored think tank, the Malaysian Institute of Economic Research (MIER). Kamal Salih who secured his PhD from the Wharton School, is now himself an UMNO proxy running a huge UMNO conglomerate.

<sup>69</sup> In terms of per capita GDP, incomes doubled in the 1971-1976 period, and then again in the 1976-1981 period, but remained stagnant until the end of the eighties; Kamal and Zainal, *op cit.*, 25.

<sup>70</sup> A proxy measure is as follows. Citing an unpublished World Bank study done with the EPU and supplied to the MIER, Kamal and Zainal, *op. cit.*, (22), found that there had been a drop in the contribution to growth of national output from "the third factor," i.e., technology, entrepreneurship, innovation and efficiency: from 28% in 1970-1975 to 13.7% in 1975-1980 to *minus* 21.1% in 1980-1985. In contrast, third factor contribution to national growth of output in the NICs exceeded 60 %.

<sup>71</sup> Specifically, the burdensome ICA was implemented from May 1, 1976 (see Chapter Two, Section Three). Domestic private investment (mainly ethnic Chinese in the period under consideration) declined precipitously: while average annual increase was 7.2% for 1971-1975, real private capital formation fell 3.6% in 1975 and 4% in 1976 against the government's projection of 10%. Foreign investment also suffered because of apprehension of the MITI's sweeping powers under the ICA to impose any condition "as he might think fit" on manufacturing licenses. Foreign investors had already been unsettled by the Petroleum Development Act, 1974, that had forced Esso to sell 30% of their Malaysian operations to Petronas including voting rights; see, Milne and Mauzy, *op cit.*, 349-50. After

important sources of rents as well. (see Chapter Two, Section VI). In other words, growth could have been even better—the growth in the period it came largely from public spending.<sup>72</sup> Thus, while Malaysia was ranked second in Asia behind only Japan in the late fifties and early sixties, it had been overtaken in the World Bank's rankings, by the early eighties, by the four East Asian NICs. Still, there was enough growth so that it was still far ahead of many other developing nations. In 1981, Malaysia ranked thirteenth out of 128 countries in terms of per capita GNP growth rates.<sup>73</sup>

On the other hand, ethnic clientelistic policies that won Malay elite support also enabled growth because these clients functioned as co-ethnic proxies for the political leadership that directs development instead of the bureaucracy. These individuals were tried and tested, loyal proxies handpicked to manage UMNO's huge corporate holdings. The leadership and its proxies share the same vision as well as jurisdiction and control of firms and markets. Of course, these individuals grew fabulously wealthy too but, in the main, that wealth was held in trusteeship for UMNO; while they could obviously enjoy the power and the prestige, eventual control of equity still rested with the political leadership.

The political leadership and the economic elite have substantial agreement on an agenda of economic development. Since there is personal control of extraordinary stakes by a few persons, fostering collective interests in maintaining consensus and secrecy, and excluding outsiders has not been difficult. But because the extraordinary stakes did not lend themselves to repeated exchange, personal loyalty and kinship ties replaced constant reminders of self interest and obligation to overcome internal instabilities and produced a close-knit elite substratum. In Malaysia, the political leadership is not a kleptocracy working in cahoots with businessmen co-conspirators to relentlessly benefit all involved at the expense of the nation. It controls a huge corporate empire through these co-ethnic proxies within which information costs are lowered because of

(..continued)

the ICA was relaxed for foreign capital, FDI increased tremendously.

<sup>72</sup> Compared to the NICs and Thailand, the Malaysian economy experienced a lower rate of economic growth during the NEP period when the average rate was 6.49% per annum. "The GDP growth rate declined from an annual average of 7-8% in the seventies to 4.5% in the eighties...For the twenty years, government expenditure was the driving force behind national economic performance. (It) contributed almost 28% to the GDP growth in the period...The second important source of growth during the first decade of the NEP in the seventies was the increase in commodity prices, especially oil;" Kamal and Zainal, *op. cit.*, 14.



close ties between politicians and businessmen. The network of long term ties has a variety of formal and informal institutional arrangements of cooperation. The ruling elite and big capitalists frequently share a common background in terms of school and college where “old boys” ties may be the basis for developing informal, but binding, links among these key players.<sup>74</sup> In Malaysia, ties that bind are those between big business and politicians, not bureaucrats. There is certainly a network consisting of very close personal ties with extremely frequent social and formal interaction and communication between the Prime Minister and his trusted economics czar, Daim Zainuddin, on one hand, and the coterie of captains of industry they have personally created (using the NEP’s ethnic quotas and privatization), on the other. Here, policymaking need not always be linear or unidirectional where business invariably obeys the dictates of a rigid state. That is, state preferences do not always have to prevail over business: policymaking may include negotiation and compromise because the political leadership is willing to listen to its proxies who are the ones in the market regarding what policies best serve their firms and markets.

This structural interdependence of stable long-term, non-formal, hierarchical relationships permits information sharing in the politician-businessman alliance. That is, direct sharing of information that would otherwise have to be done indirectly through market mechanisms. These arrangements lower information costs in economic policy making: the Malay business community develops rational expectations for a high degree of policy continuity and predictability on which economic viability of investment depends. Also, the multifaceted exchange relations reduce the incentive of those involved to withhold information from each other and for short-term opportunism. Policy implementation is thus facilitated. By the same token, political

(..continued)

<sup>73</sup> World Bank, *World Development Report, 1982*; (New York: Oxford University Press, 1982,) 8.

<sup>74</sup> In many East Asian nations, these informal ties may be institutionalized to varying degrees in discussion councils, as in Korea, or by employing top civil servants as directors of large firms when they retire, as in Japan; see, A Whitehill, *Japanese Management: Tradition and Transition*, (London: Routledge, 1990). While the captains of industry in Malaysia do share many old school ties with policymakers (e.g., Halim Saad, proxy owner of UMNO’s main giant conglomerate, Renong, went to the Malay College of Kuala Kangsar, or MCKK, The Eton of the East, set up by the British, and was trained as an accountant in a British university—indeed, the Renong headquarters also houses the MCKK Old Boys Association), many do not share these ties. Yahya Ahmad who was the proxy owner of Proton, the national auto maker and thirteen other listed corporations including a regional airline and hundreds of companies, was Anwar Ibrahim’s classmate at MCKK. Importantly, Mahathir himself never made it to MCKK and went to university in Singapore, while Anwar Ibrahim did go to MCKK but was a Malay studies major in a local university. Daim Zainuddin did not go to MCKK too but was trained as a lawyer in London.

imperatives in business remain and the corporate sector can be made to function like an arm of the state.

These business-government ties do not translate into Olsonian distributional coalitions engaging in zero sum activities. Rather, the state may be seen as an encompassing ethnic organization whose societal output is immense because of its weight in the economy. There are greater gains for such an encompassing organization and, given its ethnic calculus, it has the incentive to attach primacy to Malay societal interests and adopt such policies aligned to those interests. The Malaysian case suggests that state-created rents are not necessarily dissipated away just because there are rent seeking activities. Some possible reasons include the following. Unequal access to the political leadership translates into unequal opportunities for rent seeking. In Malaysia, the political leadership handpicks recipients for divestments and public works contracts with a "first come, first served" privatization policy. If the actual transfer of wealth itself is not wasted, if only rent seeking activities *per se* dissipate resources, then the estimation of the loss of social surplus may be exaggerated. The rents themselves may be seen as capital accumulation that can lead to investment in new productive activities. Of course, such businesses are not generally associated with higher value-adding production that comes from acquiring better technology. Instead, they (are frequently seen to) prefer speculative investments that promise surer and faster returns. These businesses are also seen as being more interested in obtaining cheaper access to high quality international products rather than fund research in, and development of, indigenous products. Yet, the "reality constraints" of project-specific resources mean that even such business arrangements must commit some project-specific resources in virtue of which "functional space" is created that may promote growth of project-related skills within firms, and generate private pressures to expand a project in beneficial ways. Moreover, these businessmen have every interest in trying to maximize available rents and profits and, therefore, may be as eager as the genuine entrepreneur to promote efficiency in their operations.

At this juncture, the market distorting/limiting/tracking trichotomy of state interventionism *vis-à-vis* state abstinence suggested in Section II needs to be qualified further. In all three modes of state

interventionism, markets are less than free compared to the theoretic ideal. In the Malaysian case, however, within the ethnic rules of the game, corporations are indeed free to compete so that state interventionism tracks markets rather than distort or truncate them. What was different in the Malaysian case was that, after the failed SOE program, this new form of state ownership was used not as a source of employment to garner broad political support which the state had, anyway, secured through a state investments holding company-cum-unit trust strategy (*see* Chapter Two) but for building narrow political support among the Malay elite, that is, to construct a bourgeoisie with real property rights and an interest in growth.<sup>75</sup>

Ethnic capitalism has flourished. With the ethnic constraints in place, there has been impressive growth but it has been overly reliant on external capital as well as imported technology. It is accompanied by a shallowness and dependence of its economic structures. Much of what passes for entrepreneurship in Malaysia—by both Malay and ethnic Chinese capital—consists of portfolio investment activities and other speculative ones in property and construction, rather than long term investment in industrial production or in R&D. There is a serious lack in technological capacity outside of the tertiary sector and light manufacturing. Foreign capital promoted to countervail ethnic Chinese capital has resulted in a dualistic economy where export processing zones of foreign MNCs with the highest technology in the country are sequestered from, and have no backward linkages with, the rest of the economy. These export processing zones account for the bulk of the nation's manufacturing exports, which now exceed agriculture's contribution to the GNP—hence the country's continuing dependence on (relatively footloose) foreign capital.<sup>76</sup> From the early nineties, real wages have risen twice as fast as labor productivity while inflation, foreign debt, and the current account deficit ballooned, and export growth rates declined even before the Crisis.

---

<sup>75</sup> UMNO's legitimacy lies in well distributed benefits of high growth rates, at least, as measured by the UNDP's Human Development Index, a combined measure of national income, life expectancy, and educational attainment. Malaysia ranks, at 51, in the upper third of 160 countries; *see*, UNDP, *Human Development Report*, (New York: Oxford University Press, 1992).

<sup>76</sup> Rajah Rasiah, *Foreign Capital and Industrialization in Malaysia*, (New York: St Martin's Press, 1995).

In short, some ethnic policies retarded growth, others enabled growth. But overall, it would seem logical to argue that if there were no ethnic constraints, growth would have been faster and industrialization deeper, especially after the bureaucracy was sidelined. Entrepreneurial ethnic Chinese capital that is now suppressed, and therefore to be found in more liquid investments, would be free to compete. Free markets are the most efficient, economically speaking. But politics does matter, and social equity, however construed, also matters. These institutionalized forms of ethnic state interventionism—even when they do change and are re-named and re-invested with different powers—will provide continuities in the distribution of both capital and productive resources because the die has been cast. As long as Malaysia is realistic about its ability to upgrade its industries to catch-up with world-class best practices, as long as it is contented to remain behind the curve, absorb technologies and industries the advanced economies have moved past, but whose products and services are still required somewhere in the world, these policies may continue to afford sufficient growth so that redistribution continues to hold up social tranquillity and political stability.

In sum, there has been an ingenious institutional tinkering on the part of the political leadership to renovate a system in which its patronage power is continually renewed and deepened. In the transition towards the modern state, there was an enlarged social and economic role for the state compared to its *laissez faire* origins. As its activities proliferated, as they increased in scope and intensity, and as the state assumed greater authority and responsibility for social controls and wealth distribution, clientelist linkages became more collectivized and party-directed. There has been a reshaping of clientelism as a means of extending political, economic, and social controls by an elaboration of new mechanisms for an exercise of authority, and the processing of demands without forfeiting political, economic, and social authority. Ethnic corporate forms of clientelism have taken shape. The importance of acknowledging cronyism in the model is that it restores the relevance of primordial elements including ethnicity, religion, and language. Essentially, privatized statism saw the creation of corporate forms of ethnic clientelism, on the effectiveness of which

rests the fate of those who would govern.

As the functions required for governance expanded, the political leadership has become the ultimate patron. It was in this manner that the political leadership created and consolidated an ethnic capitalism in Malaysia that appears to function well with minimal bureaucratic intrusion. Having rejected its developmental association with the bureaucracy, the political leadership formed a new alliance with the Malay business class. This unbundling of the state is unique. While the political leadership still directs development efforts, it does so now through its control of the levers of macroeconomic policy, and by wielding the resources of these huge private corporations, all without the ministrations of a cloying bureaucracy. In the rest of this thesis, I account for how this “privatized statism” constructed and consolidated the robust ethnic capitalism which now obtains in Malaysia.

#### **Section IV. Methodology**

This study uses a more heuristic, inductive approach rather than a technical, deductive method of models, hypotheses and tests. Case studies serve to elicit an alternative pattern in government-business ties rather than refute existing explanations or subject such notions to decisive tests. Each case study is presented with “within case” research objectives; that is, each case will be used to illustrate causal relationships between variables within its own research objectives.

I develop an analysis based on *ex post* “process-tracing.” High information barriers have been thrown up intentionally to render scrutiny by outsiders so difficult it is well nigh impossible to assert dogmatically that political elite *X* controls corporation *Y* through proxy *Z*. However, a substantive process tracing will likely elicit these patterns with a reasonable degree of certitude. To deal with a dearth of hard data I resort, first, to any available statistical evidence especially when considerations are strictly economic rather than political. For the latter, there are usually no statistics and often no directly observable information about the ties between patrons and clients, or the connections among interest groups, political pressures, and policy makers. For these, I rely mainly on softer data from interviews with participants and observers,

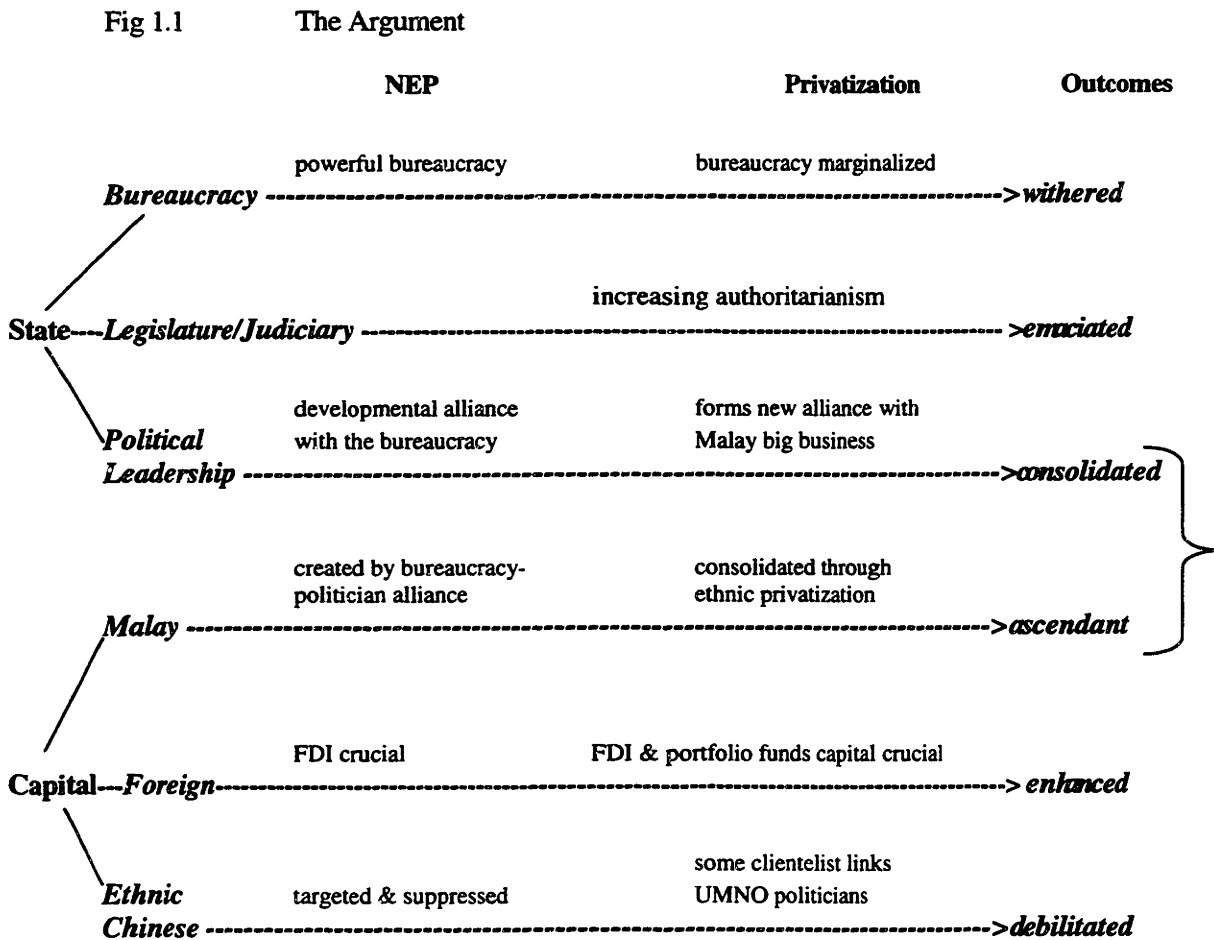
contemporaneous and retrospective market and political commentary, journalistic accounts, and scholarly studies. The primary sources of empirical data for the study were, therefore, interviews with state officials, active and retired politicians as well as business executives and industry representatives. (Many employed by government and industry were assured that their responses were not for attribution, so I have not cited interviews too widely.)

For economic interests, I also made extensive use of business advisory publications tracing changes in the business environment and investment climate. It was necessary to supplement these with publicly available company reports, and records of interviews in business magazines to cull information on company strategies and business personalities. I also interviewed domestic investors and foreign portfolio fund managers. Economic data from the government ministries, where available, were taken at face value. For policy elites, I also gathered material from published comments, interviews with these decision makers, and government documents and studies. Cabinet Ministers are wont to reveal important insider knowledge on economic strategies especially those concerning privatized entities and UMNO corporations. These are reported in the dailies and may not be otherwise found elsewhere in government documents, or party publications. Extensive use was made of local and regional newspapers, especially the vernacular dailies, as well as political magazines and party newsletters in the Malay language for current and historical information on government policies, policy pronouncements, and general statistics. A lot of my evidence thus came from the public discourse recorded in newspapers and political newsmagazines.

Finally, because firms are the entities that initiate economic change and bear economic risks, my focus is sometimes firm specific. That is, sometimes explaining microlevel variation, i.e., differences between firms of the same nationality or ethnicity, may require a substantive explication of the economic origins of specific firms, the personalities of founders and chief executives, and their links to political elites. My focus is not primarily personalistic or organizational theoretic. Rather, by looking at recipients and allocators, I examine how policies deployed by the state in a developing nation bring about structural changes.

**Section V. Previewing the chapters**

The state has wielded various economic policies to create and consolidate a Malay *bourgeoisie*. Malay big business now forms an alliance with the political leadership while the bureaucracy has been sidelined and allowed to wither away. The prosperity of this state-created Malay *bourgeoisie* justifies the state ideology of ethnic prosperity in a self-fulfilling manner and, hence, legitimates its rule. Ominously, the inverse in bad economic times may be equally true. (Fig. 1.1)



Chapter Two reviews the NEP deployed after the post-election race riots of 1969 that provided a neat solution to the Malay state's clientelist and, thus, legitimacy problem in the face of the rise of an urban, largely ethnic Chinese counter-elite. The NEP story lays down the background to how an ethnic privatization became possible in the eighties. The NEP's language of ethnic deprivation and lost patrimony mapped onto the bipolar dimension of the problem where ethnic Chinese formed the domestic capitalist class whereas the impoverished intermediate classes were Malays whom the emerging middle class organized through UMNO. Special rights for Malays legitimated the state's erection of an open, legal system that centralized both the extraction of rents (from ethnic Chinese capital and Malaysia's abundant natural resources) as well as their distribution to the Malay masses through an investment holding company-unit trust strategy. This strategy prevented the development of decentralized and interlocking clientelistic pyramids that would have led to structural sclerosis such as those on the Indian subcontinent that are associated with slow growth. In the name of acting as trustees for Malays, UMNO used public funds to finance its own investment holding company strategy that transferred public resources out of parliamentary scrutiny into party oversight and, importantly, eliminated--and eventually inverted--its dependence on ethnic Chinese capital for party funds. The NEP saw the creation of a Malay bourgeoisie through the efforts of the politician-bureaucrat alliance.

Chapter Three examines the core of the "privatized statism" strategy. Prior to privatization, Malaysia had the largest public sector in the world outside of the centrally planned economies. A Thatcher-like divestiture of state holdings might have threatened a reversal of the ethnic gains made under the NEP. But Malaysian politicians developed an ethnic privatization, divesting public assets at low prices to hand-picked Malay individuals acting as proxies for, or to nominee companies linked to, UMNO itself. Exploiting its domination of the state apparatus and the regulatory agencies, the UMNO corporate empire grew very rapidly through mergers and acquisitions and leveraged buyouts using state-directed bank credit, cheap equity capital, and cashless swaps. The empire was, however, hidden behind high information barriers constructed by pyramiding using proxies and nominee companies and interlocking directorates. Because



of UMNO's prolonged domination of the state, there is virtually no difference between UMNO and the state. As such it might be said that the state had insinuated itself into the market. Thus, privatization led to the fudging, not rolling back, of the frontiers of the state. While legal ownership of equity in privatized entities rests in the private hands of co-ethnic proxies of state elites, control still inheres with political elites themselves. While day-to-day corporate management is certainly not subject to the politician's micro-management, corporate fates are inherently politicized. Malay big business became consolidated through privatization, the bureaucracy was sidelined and allowed to wither, and the political leadership formed a new alliance with the Malay business class. In this manner, the political leadership is now able to bypass state structures without relinquishing its control of the economy.

Chapter Four discusses financial policy as a handmaiden to the state's ethnic capitalist development plan. While banks continued to be promoted for *seigniorage* and to direct preferential credit to the Malay masses and the Malay business class, the state also promoted surging stock markets. The stock market was a central tool in engendering spectacular growth in size and value of UMNO-owned or UMNO-linked corporations. The state lifted capital controls to supply the Malay bourgeoisie with cheap equity capital from OECD portfolio funds which engendered spectacular financial gains in a speculative bourse. The state also promoted primary bond markets for its own issues of government securities but retarded the development of markets for private bonds and derivatives. These markets, crucial for commercial risk management, were retarded in an effort to maintain some control over the corporate and financial sectors as well as a modicum of monetary autonomy. Because these markets remained infantile, the system of bank and stock market project funding resulted in a disastrous disconnect between (short term) debt maturity and (delayed) future revenue flows from huge infrastructure projects doled out to UMNO-owned or UMNO-linked firms in the private sector. This became evident in the Asian Crisis from July 1997. But the political leadership was able to override MOF opposition to the imposition of capital controls as a solution to the Crisis the leadership blamed on international currency speculators. These were imposed from September 1998 and, behind the walls erected, Keynesian reflation stabilized

the system.

Finally, a concluding Chapter Five revisits the market-tracking interventionism in Malaysia's privatized ethnic statism, and recapitulates why this perspective explains the political economy of Malaysia better than the undifferentiated developmental state perspective, or unreformed crony capitalism models.

## **Conclusion**

In this chapter, I identified a mode of state interventionism that has been largely forgotten in the literature where the state owns, controls, and wields corporate equity of private sector firms in ways that are subject to market discipline. I termed this a market-tracking form of state interventionism where there is state participation in firms and markets. This differs from market-distorting interventions (such as SOEs) and from market-truncating state interventionism (such as cartels, and state managed competition). I suggest a new framework of state interventionism that can accommodate privatized statism. In Malaysia, because the bureaucracy has been sidelined, the political leadership is able to deploy these commercial units through co-ethnic proxy businessmen in market-tracking ways when it has to, all without the bureaucracy's ministrations. Its unique ethnic and centralized character has enabled growth where run-of-the-mill personalistic clientelism would not have, but has also encumbered growth and technological deepening given that much effort has been directed towards ethnic capital accumulation through corporate maneuvers and portfolio speculation by Malay capital. Targeted ethnic Chinese capital, understandably, prefers to stay in liquid investments rather than long-term, value-adding industrial production. Finally, potentially footloose foreign capital sequestered within export-processing zones for decades continues to dominate manufacturing especially for exports without developing significant backward linkages that would deepen domestic industry.

## CHAPTER TWO: The NEP Discourse of Ethnic Capitalism--Inverting Dependencies

---

In Malaysia, a fragmented society that is also fortuitously resource-rich, the political elite has focused on redistribution to generate goodwill and legitimacy for its rule. As a nation dependent on trade and foreign investment, it is also constrained by forces in the international political economy. Malaysia is an exporter of high quality (low sulfur) petroleum and natural gas as well as 65% of the world's palm oil, 45% of its natural rubber, and 27% of its tin. However, it is also afflicted with serious ethnic cleavages: Malays form a small majority (51%) of the population while ethnic Chinese (25.4%) and ethnic East Indians (9%) comprise the main minority groups.<sup>1</sup> After ethnic riots in May 1969, a state initiative, the *New Economic Policy* (NEP), began a program of ethnic redistribution in favor of the Malay majority.

The NEP was officially to be in force for two decades with the twin aims of eliminating “the identification of economic function with race (and) the eradication of poverty regardless of race.”<sup>2</sup> In implementation, the second thrust was largely ignored. Instead, state elites belonging to the United Malay National Organization (UMNO), the Malay party that dominated the coalition called the Alliance, wielded the NEP's discourse of ethnicity to solve two problems they confronted. First, the NEP offered state elites a way to re-establish the legitimacy of their continued rule after the electorate had rejected the Alliance's consociational “bargain” in place since independence from Britain in 1957. The NEP justified a system that centralized both the collection as well as the distribution of rents to the Malay majority through an investment holding company/unit trust strategy. Secondly, the NEP also offered state elites a way to overcome UMNO's own dependency on ethnic Chinese capital that had traditionally funded the Malay party through the Malayan Chinese Association (MCA), UMNO's partner in the Alliance

---

<sup>1</sup> *Malaysia Year Book*, 1999 (latest official estimates)

<sup>2</sup> The NEP was formally presented in the Second Malaysia Plan, 1971-1975. Its goals were elaborated in the Midterm Review of the Plan, and quantified in the Third Malaysia Plan, 1976-1980. It was then further formalized in the (first) twenty year Outline Perspective Plan, 1971-1990.

government. In this instance, the NEP was used to justify the transfer of public resources away from parliamentary scrutiny into UMNO's coffers and party oversight. This laid the foundations of UMNO's enormous corporate empire. (The other partner in the ruling Alliance was the pinweight Malayan Indian Congress, or MIC, that represented the interests of ethnic Indians, mainly those from its professional segment.)

Typically, the direction of influence is from the economy to the polity, with powerful economic interests seeking to shape political decision making. In Malaysia, the direction of influence was the reverse: political power was used to create a capitalist class. Specifically, the first decade of the NEP saw the development of a large-scale corporatized capitalist sector dominated by public spending that crowded out private investment.<sup>3</sup> However, there was vigorous economic growth averaging 7.8% in the seventies largely as a result of favorable terms of trade, (notably, a windfall in petrodollars.) and foreign direct investment (FDI). With the global recession of the mid-eighties, there was a sharp scaling back of public sector spending and, eventually, the suspension of the NEP.

In this chapter, the legitimacy problem faced by state elites in the first decade of Malaysian independence is outlined in Section I. The rise of an urban counter-elite that became evident in the 1969 elections is recounted in Section II while Section III focuses on the political processes that shaped the NEP leading to ethnic restructuring that was first applied to the manufacturing sector by way of the Industrial Coordination Act (ICA) initiative. Next, there was restructuring of the corporate sector by way of the state's PNB/ASN investment holding company/unit trust strategy that centralized the collecting and distributing of rents to the Malay masses. This is considered in Section IV. How UMNO used the NEP to lay the foundations of its corporate empire to overcome its dependency on ethnic Chinese capital is sketched in Section V. The NEP's denouement in the recessionary mid-eighties is discussed in Section VI. An

---

<sup>3</sup> Mah-hui Lim, "Contradictions in the development of Malay capital: State, accumulation and legitimation," 15 *Journal of Contemporary Asia*, 1985: 37-63

assessment of the NEP's political economic impact is offered in Section VII while the conclusion summarizes the main points elucidated in this chapter.

### **Section I: UMNO's legitimacy problem and its ethnic solution**

At independence in 1957, ownership and control of the economy was largely in non-Malay hands, principally British, and ethnic Chinese interests. In 1970, up to 63% of corporate equity were still in foreign hands, chiefly British "agency houses," which dominated plantations and mining that were still the "commanding heights" of the economy, while over 30% were held by ethnic Chinese, mainly in trade and services.<sup>4</sup> For the first ten years of independence, economic development was premised on the continuation of the colonial laissez faire approach. The constitutionally enshrined Malay special rights remained outside the main policy framework and, in practice, amounted to little.

Government development efforts were two-fold. First, industrial development was promoted through various support schemes and incentives to provide employment and reduce dependence on the export of commodities. The main beneficiary was the non-Malay urban sector—the Minister of Finance (MOF) and the Minister of Trade and Industry (MTI) had always been ethnic Chinese elites from the MCA. Secondly, the promotion of subsistence agriculture through rural development programs that largely benefited the Malay rural sector. Conversely, the Minister of Rural Development and the Minister of Agriculture had always been UMNO politicians. UMNO was, at its origins, largely a farmers-and-vernacular-schoolmasters' party dependent on ethnic Chinese capital for party funds.

For historical reasons, the Malay middle class was concentrated in the civil service. In British Malaya, the colonial Malayan Civil Service (MCS) held a pre-eminent position in federal policy making (as it did in British India). The colonial masters had decided to give Malays

---

<sup>4</sup> Economic Planning Unit, *Outline Perspective Plan*, (Kuala Lumpur: Government of Malaysia, 1973) 31.

special preference in public service, opening up the elite MCS to Malays to promote the myth that power was being shared with the Malay elite.<sup>5</sup> An Eton of the East, the Malay College of Kuala Kangsar (MCKK), was set up to educate sons of the Malay aristocracy for a Malay Administrative Service (MAS), a junior partner meant to be eventually promoted to the MCS. (Even to this day, Malay political and economic elites almost invariably have MCKK roots--with the notable exception of Mahathir, the current Prime Minister.) The set-up was predicated on the notion that the British rulers had a special responsibility for the Malays whose Sultans had agreed to British intervention in the first place. Thus, although the British held real decision making power, there was a façade of Malay power by maintaining the structure of traditional Malay rule.

In this way, the Malay middle class came to be concentrated in the civil service and the Malay political elite emerging in the post-World War II period was primarily drawn from this segment. A close relationship thus developed between the Malay bureaucracy and UMNO. When the party succeeded in establishing a Malay-dominated coalition government at independence, Malay privileges in public employment were maintained and augmented. A Malay dominated administration came to work in lockstep with a Malay dominated political structure.

The main channel for social mobility for the small but growing Malay middle class was this government bureaucracy. However, though there was a growing bureaucracy in the first decade of independence during which UMNO President, Tunku Abdul Rahman, was Prime Minister, public service salaries could not keep pace with those in the private sector. Moreover, any growth of the bureaucracy was finite. The demands of this middle class, articulated through UMNO itself, became increasingly insistent.

---

<sup>5</sup>see, Khasnor Johan, *The Emergence of the Modern Malay Administrative State*, (Singapore: Oxford University Press, 1984); also, Kim-wah Yeo, "The Grooming of an Elite: Malay Administrators in the Federated Malay States, 1903-1941," 14 *Journal of Southeast Asian Studies*, 1984: 287-319

Within UMNO, a tussle between the Minister of Agriculture and the Minister of Rural Development for succession to the office of the Prime Minister had also begun. The latter, Abdul Razak, had control over the Ministry of Works (whose Minister was the President of the MIC, the junior partner in the Alliance, and sole ethnic Indian in the Cabinet). This enabled Razak to establish a patrimonial network with minor works projects such as the provision of schools, electricity, piped water, tarred roads, community centers, maternal and child health clinics, drainage and irrigation facilities, mosques and so on, thus extending and deepening his political base.<sup>6</sup> By the early sixties, Razak had won the fight so that, by the Second Malaya Plan (1961-1965), the budgetary allocation to his ministry was as much as that to the MTI.<sup>7</sup>

By the mid-sixties, it had become clear to the Razak faction that to satisfy the increasing demands of the emergent Malay middle class and improve Malay welfare, efforts would have to be made to increase Malay participation in commerce and industry. It was also felt that the optimal way to do this was through state intervention as an integral part of national development efforts rather than as an ancillary program appended onto the main policy framework. However, in Tunku's Cabinet, moves to promote Malay participation in commerce and industry were opposed by the MCA Ministers representing the interests of big business owned by the ethnic Chinese. Given Tunku's careful attention to the delicate balance of power within the Alliance Cabinet, Razak knew that his involvement in efforts to promote Malay participation in commerce and industry would be construed as a direct challenge to the Prime Minister. He resorted, instead, to a Malay pressure group outside the party, a weak Associated Malay Chambers of Commerce of Malaysia, set up in 1960, but so poorly funded it could not even afford a permanent secretariat.

---

<sup>6</sup> RS Milne, "The Politics of Malaysia's New Economic Policy," 49 *Pacific Affairs*, 1976: 235-261

<sup>7</sup> The Malaysian Deputy Prime Minister is an anointed heir or crown prince of sorts in contrast to its largely nominal or meaningless role in Britain, Canada, Australia, New Zealand or India where DPMs are hardly known to the outside while also enjoying little influence at home as DPM per se; see, Kadir Jasin, "Unique Position of Malaysia's DPM," *New Sunday Times*, January 17, 1998.

Razak encouraged and channeled funds to the Chamber to organize the First Bumiputra Economic Congress (FBEC) in 1965 to demand for state intervention to alleviate Malay poverty. (The term *Bumiputra*—Sons of the Soil—was chosen instead of *Malay* precisely because it did not yet carry any political connotations as it was officially used only for Bornean natives.) There was yet another problem in that state intervention in the economy smacked of “socialism,” anathema to the Tunku regime whose legitimacy rested on a strident anti-communism. (Under Tunku, there were free and fair elections except for the exclusion of the CPM, or Communist Party of Malaya, he had outlawed at independence. The CPM, whose membership was mainly ethnic Chinese, retreated to the jungles to wage a guerilla war that lasted into the mid-eighties.) Accordingly, the FBEC’s recommendations were couched in terms of emulating Meiji economic policies that sought to “transform the Samurai class into modern capitalists where the state started pioneering factories which were sold to private buyers as soon as these state-created enterprises became viable...often at 15-30% of their actual cost and at favorable terms of delayed payments.”<sup>8</sup> At the FBEC’s closing session, Razak accepted its recommendations in his capacity as Deputy Prime Minister (DPM). However, between 1965 and the Second Bumiputra Economic Congress in 1968 that came up with largely similar demands, little was implemented.

The Razak faction began to voice its dissatisfaction with Tunku’s leadership but, initially, it was typically only in the indirect or elliptical and deferential manner that is said to be the norm in ascriptive Malay culture. However, with the rise of a young “Ultra” wing of the faction led by commoners, Mahathir Mohamad and Musa Hitam, (who would become the first of Mahathir’s four DPMs), the demands became increasingly strident and confrontational. (It is often noted that these individuals had not been educated at the MCKK and British universities.) The debacle at the polls in May 1969, and riots that erupted thereafter leading to the suspension

---

<sup>8</sup> The Associated Malay Chambers of Commerce of Malaysia, “Participation of Bumiputra in Industry,” July 1965, p 15, *First Bumiputra Economic Congress*, Kuala Lumpur. (my translation)



of Parliament, presented the Razak faction the opportunity to ease Tunku out of power as UMNO President and Prime Minister. Declaration of Emergency rule saw the nation run by a National Operations Council (NOC) headed by Razak as Director of Operations. Mahathir and Musa, whom Tunku had had sacked from UMNO, were rehabilitated and elevated to Assistant Ministers by Razak who became PM when Tunku resigned in 1971. With the instauration of the NEP, the FBEC's recommendations became official policy. But why did the riots evoked such a sea change in Malaysian politics?

## **Section II: The 1969 Elections and the demise of consociationalism**

The latter half of the sixties saw the emergence of an urban, non-Malay counter-elite that threatened to disarticulate the political dominance of the ruling rural-based Malay elite as evidenced in the 1969 polls. In this sense, the NEP was a response by the Malay elite to that challenge. At independence, the economy was heavily reliant on the export of primary commodities but the nation had many advantages over most resource-rich post-colonial nations. Malaya, the crown jewel of the British Empire, was the world's largest producer of natural rubber and tin. Not surprisingly, then, it had been left with a well-developed infrastructure, one of the best education systems in the region, and a functioning public administration.<sup>9</sup>

The constitutional "bargain" struck at independence saw the new Alliance coalition government continuing the colonial *laissez faire* policy. This militated against state interventionism. The ruling coalition was composed of Malay "administrators," on the one hand, with ethnic Chinese businessmen and ethnic Indian professionals, on the other. In the bargain, ethnic Chinese (represented by the MCA) and ethnic Indians (represented by the MIC) recognized the primacy of Malay political rule (represented by UMNO) with special rights and privileges for Malays in return for full citizenship and a voice in the government for the ethnic

---

<sup>9</sup> World Bank, *World Development Report 1955*: 275-300

Chinese and Indians. There was also an implicit understanding that the urban business interests dominated by ethnic Chinese would be spared interference by the state dominated by Malays as long as former did not challenge the latter.

While this *modus vivendi* obtained, Malaysia was considered one of the most politically developed of the new nations.<sup>10</sup> More-or-less well organized political parties as well as independents competed freely for electoral support in 1955 for a small majority of the Colonial Legislative Council, and for the fully elected House of Representatives in 1959, 1964, and 1969. (The Senate is a rubber stamp institution consisting of nominated individuals, mostly failed politicians from the government side.) In 1955, the political issue was the drive for independence while the 1959 campaign focused on the integration of the ethnic Chinese including the issue of Chinese language education. "Confrontation" with Indonesia dominated the 1964 polls but the 1969 elections gave rise to no pressing economic or political issue of note. In the apparent tranquility, there were no harbingers of the violence that would follow.

The 1969 electioneering was typically closely monitored from the center by party headquarters. When the results were in, the Alliance had actually scored (what by British parliamentary standards was) a handsome majority although its representation was reduced by 23 out of the 103 seats decided compared to its previous 89 out of 104 seats in 1964. However, it did lose its two-thirds majority needed for constitutional amendments.<sup>11</sup> Moreover, every Opposition party gained seats at the Alliance's expense. Importantly, the Democratic Action Party (DAP), nominally multi-ethnic but predominantly ethnic Chinese in its membership, rose to Opposition leadership in parliament, displacing the Malay and rural-based Pan-Malaysian Islamic Party (PAS) whose President had been Opposition Leader since 1955.<sup>12</sup> (The DAP was an off-shoot of

---

<sup>10</sup> G Almond & J S Coleman (eds) *The Politics of Developing Areas*; p542; Table 4; also, EE Hagan, "A Framework for Analysing Economic and Political Change" in RE Moshen et al *Development of the Emerging Countries* (1962) pp 3-6, Table 1.1

<sup>11</sup> source: Election Commission of Malaysia, Archives; see, also, Simon Barraclough, "The Dynamics of Coercion in the Malaysian Political Process," 19 *Modern Asian Studies*, 1985: 797-822.

<sup>12</sup> NJ Funston, "The Origins of Parti Islam Se Malaysia," *Journal of Southeast Asian Studies*, 1981:58-73

Singapore's ruling party, the PAP, or People's Action Party, that had carried out its fractious "Malaysian Malaysia" campaign in 1964 before Tunku expelled Singapore with its Chinese majority from Malaysia in 1965 for allegedly threatening the delicate ethnic balance in the Federation.)

In the most urbanized and industrialized west coast states of Selangor, Perak, Negri Sembilan, Malacca and Penang, the Alliance's previously unassailable parliamentary representation was routed. In the absence of overwhelming national issues, large segments of the urbanized states (read: Chinese) indicated they preferred less Malay-oriented policies to those of the incumbents. The 1969 elections marked a turning point in Malaysia's political development. Clearly, a strong swing of voter sentiment away from the Alliance had apparently occurred had between 1964 and 1969. For the first time, the proportion of the popular vote polled by the Alliance came in below 50%, falling 10 percentage points to 49.1% only. Thus, for the first time, a bare majority of the electorate rejected the Alliance's strategy for ethnic compromise. In contrast, all opposition parties opposed to continued Malay political predominance experienced substantive gains in their share of the popular vote. Significantly, every opposition party obtained an absolute majority in the constituencies it contested. As a group, Cabinet Ministers fared poorly—three lost while five, including the Prime Minister (UMNO President) and the MOF (MCA President), only survived with narrow majorities. Moreover, while UMNO's bloc of Malay Members of Parliament (MPs) was reduced in size, the MCA's representation dropped even more dramatically so as to comprise only a minority of the representation of ethnic Chinese in the Lower House. The Opposition even placed more ethnic Indians in Parliament than the MIC.

State legislative assembly elections held simultaneously resembled the national distribution of party support closely. The Alliance's hold of ten out of eleven state governments since 1961 withered. While PAS retained Kelantan state, the opposition Gerakan Party gained in the predominantly Chinese Penang Island. The Alliance lost its majority in the economically

most important states of Selangor and Perak to the combined Opposition. The incumbents could no longer claim undisputed aggregation of communal interests of the three main ethnic groups. The effective voter appeal of the Opposition posed a severe challenge to the principle of Malay political predominance underlying the rule of the Alliance elites.

How did voter attention in 1969 apparently come to focus on ethnic cleavages? In contrast to previous campaigns, genuine debate over issues of policy was relatively muted because the Alliance had imposed strict controls on the mass media under the guise of preventing Communist “subversion” which effectively stifled opportunity for genuine political debate. In addition, there had been pre-election arrests and detention without trial of radical politicians under the ISA that further dampened Opposition ability or willingness to challenge prevailing policies. The enforced sterility in political debate had the effect of shifting the focus of the campaign by default to ethnic grievances.<sup>13</sup>

By 1969, not only were urban areas predominantly populated by ethnic Chinese but urban drift among non-Malays had also left the countryside primarily Malay.<sup>14</sup> Five of the six most urbanized constituencies went to the non-Malay Opposition while rural areas still voted overwhelmingly Malay—UMNO with 53 seats and PAS with eleven. From independence, rural constituencies had been deliberately over-represented to assure the continued Malay political dominance. For example, in 1959, while Malays comprised 49% of the population, they won 64% of the seats. Yet, the figures were largely unchanged a decade later although there had been a dramatic increase in political participation of the progressively enfranchised ethnic Chinese.

---

<sup>13</sup> see, Kit-Siang Lim, *Time Bombs of Malaysia*, (Kuala Lumpur: DAP: 1978); Kit-Siang Lim, Secretary-General of the DAP, and Opposition Leader since 1969; also, “The King’s Birthday Address,” June 5, 1969, *The Straits Times* (English Translation). On the history of long-standing Sino-Malay enmity, see, Boon-Kheng Cheah, “Sino-Malay Conflicts in Malaya, 1945-46: Communist Vendetta and Islamic Resistance,” *12 Journal of Southeast Asian Studies*, 1985: 108-117.

<sup>14</sup> R.S. Milne & Diane Mauzy, *Politics and Government in Malaysia*, (Singapore: Institute for Southeast Asian Studies, 1978). Ethnic considerations in constituency delineation predated the NEP; see, KJ Ratnam & RS Milne, *The Malaysian Parliamentary Election of 1964*, (Singapore: University of Malaya Press, 1967,) 63-66.

The original 1948 Federation Agreement hammered out by the British had put in place a highly centralized administrative unity with a federal façade and political hegemony accorded to the Malays with special provisions to secure the special position of the traditional Malay ruling class. But the extension of the franchise to ethnic Chinese stage by stage meant that, by 1969, ethnic voting power was virtually proportional to population. Opposition success in key states in 1969 thus marked the emergence of a potent counter-elite as well as a federal reality thus undermining the implicit constitutional order.

When the implications of the electoral outcomes had sunk in, bloody ethnic riots erupted three days after the polls ended. The government's helplessness before the Malay rioters—while the armed forces and the police stood idly by—showed that there was no operative Alliance government to take charge of the rapidly deteriorating situation. This was a crisis of political leadership with the failure at the crunch to display non-partisan consensus on ultimate national values vital for the health of any parliamentary system. Mahathir and the “Ultras” agitated for a more exclusively Malay government. The growing polarization of ethnic policies meant that, in the summer of 1969, the Alliance was only an UMNO shadow of its former inter-ethnic accommodating self. An Emergency was declared and Malaysia came under a National Operations Council headed by DPM Razak for 18 months. Tunku was eased out, and Parliament reconvened in February 1971 with Razak as the new PM. The NEP was declared and constitutional amendments passed to remove from public discussion four “sensitive issues,” viz., Malay special rights, the special status of Malay as the sole national language, the sovereignty of the Malay Sultans, and citizenship issues.

### **Section III: Implementing the NEP—The ICA initiative**

To implement the NEP, Razak formed a Department of National Unity (DNU) under the Prime Minister's Department because its Economic Planning Unit (EPU) was still headed by an ethnic Chinese and staffed with non-Malay economists associated with precisely the economic

policies that were now discredited. But it was unclear to the DNU itself how UMNO's political objective of satisfying the emerging Malay middle class would be given an economic façade the NEP itself implied. The solution came from Just Faaland of Harvard University who had been meeting with the DNU in secret to prepare a draft paper justifying UMNO's political objectives in terms of the eradication of poverty for the broader goals of social equity and national unity. (A Ford Foundation study with similar terms of reference done on the basis of a "lightning visit" soon after May 13 by Harvard's Samuel Huntington, MIT's Myron Weiner, and Boston University's Manning Nash and Nathan Glazer had been rejected by the government.<sup>15</sup>) Faaland's arguments that became the justification for the NEP called for state intervention to bring about intrasectoral and intersectoral reforms to achieve a redistribution that would be more representative of Malay pre-eminence. Intrasectoral reforms were aimed at ensuring that Malay income in all sectors would be raised while intersectoral reforms were meant to assure that Malay ownership and control of equity would be relocated between sectors. Faaland also persuaded DNU officials that a timeframe for achieving determinate targets, however unrealistic, would be useful as a yardstick to measure the policy's success. An arbitrary target not based on any realistic appraisal of 30% ownership and control of corporate equity within 20 years was accepted.

All NEP decisions came to be made by a small group around the PM without Cabinet deliberation because, the policy having been passed by the Legislature, these decisions were construed as being merely part of the implementation process. Moreover, Razak had formed an enlarged "national unity" coalition government of 14 parties called the National Front or *Barisan Nasional* (BN) which meant the dilution of the MCA's bargaining power. MCA's approval that used to be sought in all economic policy making in the Tunku's cabinets began to be effectively sidelined.

---

<sup>15</sup> Donald Snodgrass, *Inequality and Economic Development in Malaysia*, (Kuala Lumpur: Oxford University Press, 1980)

In practice, the NEP's second objective of poverty alleviation regardless of "race"—which would have benefited the poor, including the non-Malay poor—was largely ignored. Moreover, despite repeated assurances that no group would be discriminated against in the NEP's implementation, no machinery was ever created to ensure this. The process, in fact, came to be widely viewed by ethnic Chinese as discriminating against them, beginning in earnest in 1975 with the passage of the onerous Industrial Coordination Act (ICA).

According to Faaland, the state's failure to set specific numerical targets was why the 1971-1975 period was quiescent, and he made sure this was rectified in 1973 in the *Outline Perspective Plan* that set forth the ownership formula of (30: 40: 30) percent of the corporate equity for (Malays: Other Citizens: Foreigners) in that order.<sup>16</sup> I argue that the NEP's relatively light impact from 1971 to 1975 was primarily because policy implementation processes were not yet institutionalized. That is, a restructuring mechanism was required which did not exist until the ICA was passed in 1975. And, the delay in passing the Act came largely from effective opposition by the MOF—still the MCA President from Tunku's regime but who continued to enjoy Razak's confidence. The MOF's success in this regard was also facilitated by the continued presence of strategically placed ethnic Chinese bureaucrats who were still running the EPU and the MOF.<sup>17</sup> The ICA legislation was bandied around unsuccessfully until the MOF resigned because of ill health. Tengku "KuLi" Razaleigh then became the first Malay MOF and the ICA was passed.

With the passage of the ICA, it became mandatory for all manufacturing enterprise above a certain size to require a manufacturing license. The application for such a license at the MTI required the submission of detailed information about the applicant's business and manufacturing activities. Licensing was carried out on a product-by-product basis where manufacturing of any

---

<sup>16</sup> Just Faaland, J.R. Parkinson, & Rais Saniman, *Growth and Ethnic Inequality: Malaysia's New Economic Policy*, (London: St. Martin's Press, 1990,) 75-76

<sup>17</sup> Heng, 1996, *op cit.*

product other than that specified in the licence had to be approved all over again. In addition, any decision to suspend or terminate the manufacturing of a product specified in the license and any transfer or sale of the license had to be approved as well. The licensing officer was also empowered to add any condition or offer any exemption. The issuance of a license to such a firm was conditioned on its compliance with the 30% quota of Malay participation not only in its capital structure but also in employment at all levels especially the managerial as well as the appointment of Malay firms as distributors.

The ICA effectively targeted the individual firm as its unit of control. In practice, ethnic Chinese firms were impacted. Conversely, its implementation vis-à-vis foreign capital was tied to the Investment Incentives Act (1968) with which the state sought to displace ethnic Chinese capital by promoting foreign participation in joint ventures with Malay capital. Compliant foreign firms were exempted from the 40% ceiling on foreign shareholding especially in export-oriented industries, those in heavy industries, and those requiring state-of-the-art technologies. Because of very lucrative advantages offered, there was an influx of FDI especially to export-processing zones in free trade zones (FTZs) and licensed manufacturing warehouses (LMWs).<sup>18</sup>

Nevertheless, in response to protests by domestic capitalists, and capital flight in the 1975 downturn, the ICA was progressively amended in 1977 and 1979 to increase the size of the manufacturing firm that would come under the Act's purview. An exhaustive search of the dockets at the Industrial Court of Malaysia shows that no legal suit has ever been brought in connection with the ICA. Perhaps, this was because of its one virtue, namely, simplicity such that its regulations were too simple for anyone to be sure what was actually required in the individual case. (In contrast, India's Industries Development and Regulation Act, 1956, that similarly

---

<sup>18</sup> Peter Warr, "Malaysia's Industrial Enclaves: Benefits and Costs," 25 *The Developing Economies*, 1987: 30-55.



required industrial licensing was a very detailed piece of legislation and, correspondingly, the subject of extensive legislation.<sup>19)</sup>

The ICA was most aggressively promoted between 1975 and 1985. It resulted in Malays dominating the share of capital involved in state-approved projects during the period. Specifically, overall rates of Malay participation consistently exceeded 40% except for 33.3% in 1978. In fact, Malay share exceeded 50% in 1980 (with 56.5%) and 1985 (with 54.4%).<sup>20</sup> Malay-majority projects accounted for more than two-thirds of all state-approved projects in the period and were generally large enterprises in terms of capitalization (exceeding RM2.5 million or about \$1 million). Similarly, Malay share of overall manufacturing enterprises in that period exceeded two-thirds of the total.<sup>21</sup>

In contrast, ethnic Chinese capital participation in these projects was consistently low and failed to reach even 30% in some years. Between 1977 and 1982, that rate was even lower than foreign capital. Moreover, from 1977, all projects with capitalizations less than RM500,000 were exempted from the ICA's Malay quotas, but by the same token, such projects carried out by ethnic Chinese had a low aggregate macroeconomic significance. Still, although Malay share in the manufacturing sector reached very high figures between 1975 and 1985, manufacturing *per se* was not yet dominant in the economy. The very dramatic increase in overall Malay corporate equity ownership recorded in the period actually came more from the PNB/ASN strategy.

#### **Section IV: Centralized collection and distribution of rents—The PNB/ASN strategy**

While the state began a huge program of state-owned enterprises (SOEs) in various sectors to offer Malays immediate access to managerial positions, forced restructuring in

---

<sup>19</sup> I thank my childhood friend, SY Sar, Partner, Shearn Delamore Associates, for this point specifically, and for her *pro bono* legal advice on the manuscript, especially Chapters Two through Four.

<sup>20</sup> source: Malaysian Industrial Development Authority, *Annual Reports*, various years 1975-1985

<sup>21</sup> source: Department of Statistics of Malaysia, *Industrial Surveys: Construction, Manufacturing, Mining and Stone Quarrying*, various years, 1975-1985.

manufacturing and in other sectors largely transferred corporate equity to government investment holding companies. These had been set up by the state to hold the assets “in trust” for Malays, the first of which was The National Corporation (Perbadanan Nasional Bhd) or Pernas, set up in 1969 by the MOF, and controlled by the Treasury’s investment arm, *MOF Inc.* Pernas was used to acquire major publicly listed companies (plc) through open market purchase but was not particularly active until 1975 when KuLi became the first Malay MOF. He then began to use Pernas to acquire substantial stakes in major Malaysian companies. During the first half of the seventies, Pernas sought to set up joint ventures with Japanese, American and European companies, but from the latter half of the seventies, it began to emphasize acquiring stock in existing foreign firms operating in the primary sector in Malaysian.

Among the colonial jewels in the crown of imperial Britain, none was more lustrous than Malaya. Merchant adventurers had flocked to the peninsula in the seventeenth century planting vast tracts of its rich plains and hill slopes with rubber and sifting its soil for tin. The names of the early planters—Sime, Darby, Guthrie, Harrisons, Crosfield—eventually became household words as plantations flourished, joint stock companies were floated in London, and investors grew wealthy on the peninsula’s resources. Many of these British concerns turned into conglomerates with companies spanning numerous sectors including trade, large scale agriculture, mining, manufacturing, real estate, insurance, finance, and maritime shipping.<sup>22</sup> Pernas’s first acquisition of significant equity in such firms was of the British-controlled plantation-based conglomerate, Sime Darby, the largest firm in Southeast Asia. Other notable Pernas acquisitions of substantial equity that subsequently occurred included London Tin Corporation (renamed Malaysian Mining Corporation, or MMC Bhd), the world’s largest tin mining concern, Goodyear Bhd, Highlands and Lowlands Bhd, Island and Peninsula Bhd, and so

---

<sup>22</sup> J.H. Drabble & PJ Drake, “The British Agency Houses in Malaysia: Survival in a Changing World,” 12 *Journal of Southeast Asian Studies*, 1981: 297-328

on.<sup>23</sup> Although Pernas was increasingly profitable with its control of so many lucrative assets, its success could at best offer only vicarious delight to the Malay masses. Two government unit trusts had failed because too many Malays, on securing the at-par set-aside shares chose to realize short-term capital gains on the back of market prices, invariably surging above par. Indeed, although government investment holding companies and other minor Malay trust agencies averaged 39% annual growth between 1971 and 1980, individual Malay share of total Malay-held equity dropped from 60% in 1970 to 34% in 1980.<sup>24</sup> A new strategy to acquire and transfer equity to the Malays became urgent as it became increasingly clear that corporate holdings were not being transferred quickly enough to achieve the 30% figure by 1990.

The beginnings of the marginalization of the bureaucracy:-

*PNB*: If Pernas had been set up as a passive state investment house to hold “ownership-in-trust” of equity for the Malays, the National Equity Corporation (or *Permodalan Nasional Bhd*) or PNB,) was established in 1979 to bring about wider distribution of corporate equity to individual Malays while also ensuring that equity remained in Malay hands. In practice, PNB set up a wholly owned subsidiary, the National Trust Agency (ASN), as a mutual fund or “unit trust” to carry this out. While Pernas had been under the MOF, PNB’s Board of Directors (BOD) and its Executive Chairman reported directly to the PM. Mahathir’s brother-in-law ran PNB right up to his death in late 1998. Technically, Parliament voted huge grants and no-interest loans to the Malay Investment Foundation Bhd (YPB) that was headed by the PM and whose BOD comprised UMNO Ministers. YPB formulated policy guidelines to promote Malay ownership and control of corporate equity while PNB was formed as its operating arm. PNB’s corporate takeovers and equity acquisitions were financed by the sales of petroleum and natural gas, resources not yet discovered in the days of British Malaya. The Petroleum Development Act (PDA) passed in 1974

---

<sup>23</sup> Keiko Saruwatari, “Malaysia’s Localization Policy and its Impact on British-owned Enterprises,” 29 *The Developing Economies*, 1991:371-386

<sup>24</sup> Gordon Means, *Malaysian Politics: The Second Generation*, (Singapore: Oxford University Press, 1991,) 69-70.

ensured that Malaysia's newly discovered oil resources would be at the state's disposal. PNB served to evaluate, select, and invest in companies and, then, hold on to such shares until they were virtually foolproof before transferring them to ASN, its wholly-owned subsidiary.

Pernas was compelled to transfer 20 of its best listed equity holdings, including Sime Darby and MMC, to PNB for a nominal sum of RM300 million although their market value was in excess of RM1 billion at the time.<sup>25</sup> Forty other trusts, government agencies, and SOEs including MARA, UDA, Peremba, as well as the various state economic development corporations (SEDCs) were also made to transfer their best equity holdings at cost to PNB giving it an instant portfolio of companies. Moreover, in all new flotations and major restructuring schemes involving local corporations to ensure 30% Malay share, PNB had the first right of refusal of these equity allocations that came through the MITI and MOF. Such shares were acquired at the nominal value of RM1 per share. (When privatization began in the eighties, substantial blocs of shares were always reserved for PNB.) These transfers and cheap buys gave PNB immediate and hefty profits on paper. PNB (and ASN) have, otherwise, displayed a conservative approach, preferring to let existing management of profitable concerns remain with few operational changes. There has been little interference with investment decisions except with dividend issues that directly affect ASN payout prospects.

In the beginning, the PNB portfolio was heavily weighted in favor of plantations because it was used to bring home the huge plantation-based conglomerates listed on the London Stock Exchange that were still in British hands, and in control of Malaysia's commodities sector. (The two nations have historically maintained very significant trade and other links.) This move also meshed with Mahathir's nationalist *Buy British Last* campaign triggered by the Thatcher administration's raising of college tuition for foreigners from non-European Community countries in 1981. (The Malaysian contingent of students in Great Britain has always been the

---

<sup>25</sup> Malaysian Business January 5, 1991

largest in its international student body, but it was probably no coincidence that Mahathir had just become Prime Minister and was eager to differentiate himself from previous PMs who had all been educated in, and non-confrontational towards, Britain. In contrast, Mahathir had not only not been schooled at the MCKK but had also received university education in Singapore. Moreover, he was known to have been bitter at the colonial authorities who had refused him a scholarship to study law in the United Kingdom.<sup>26</sup>)

In its first foray on an overseas bourse, PNB made its (in)famous “dawn raid” on the LSE, a swift and furious share buying spree when the bourse first opened for trading in the morning. By the end of the trading day, 26% of Guthrie plc, a huge British plantation-based conglomerate with long standing ties to Southeast Asia, had been acquired by PNB to add to the 25% it had already received from Pernas. After the dawn raid, the LSE moved quickly to change its takeover rules that had held for two centuries on the Mother of all Bourses—but never before had an ex-colony recovered its national assets on the stock exchange instead of outright appropriation. The new rules made takeovers more difficult as board directors would, henceforth, have to get a look over uninvited takeover bids and advise shareholders accordingly. Specifically, no more than 5% of the shares in an LSE-listed firm may henceforth change hands in a single week if such purchases took one shareholder’s equity to 15% of total outstanding shares. The Guthrie acquisition was also motivated by the fact that Gurthrie plc had sold its 73% holdings in Guthrie Bhd listed on the Stock Exchange of Singapore to Multi-Purpose Holdings (MPH). UMNO was piqued because MPH was the investment holdings company set up by the MCA as the flagbearer of MCA’s conglomeratization response to the NEP, the ethnic Chinese party urging its constituents to pool their resources for this purpose in preference to the traditional family business approach. (In 1981, MCA was not yet as cowed as it is today.) Gurthrie plc had done so to fund its purchase of Page Airways, an American air charter company that, Mahathir

---

<sup>26</sup> Boo-Tiek Khoo, *Paradoxes of Mahathirism: An Intellectual Biography*, (Kuala Lumpur: Oxford University Press, 1995).

argued, offered no synergies in Gurthrie's portfolio and, therefore, implied sinister motives. Guthrie plc was subsequently stripped of its plantation holdings (mainly in Malaysia) that were then transferred to Gurthie Berhad. What was left of Gurthrie's overseas operations were refloated in 1986 with PNB making capital gains of 1000% in the process. Thus Guthrie became the first MNC to be owned outright by Malay interests. (It was the second to come under the Malaysian government directly, the first being Sime Darby that Pemas wrested from the British through a combination of state-sponsored and ethnic Chinese Malaysian investors in 1978.)<sup>27</sup>

Subsequently, PNB resorted to negotiated deals as well as purchases through proxies and nominee companies to acquire LSE-listed firms including Harrisons and Crosfield, a plantation-based conglomerate of true colonial heritage with 80,000 hectares of rubber and oil palm estates in Malaysia, about as much as Guthrie's, followed by Dunlop with 12,000 hectares of plantations and a huge tire manufacturing subsidy in Kuala Lumpur. (Like Sime Darby, but unlike Guthrie, the initial Malaysian equity in Harrisons and Crosfield and that in Dunlop were not exclusively Malay.) Through Guthrie's plantation interests in Guthrie Berhad wholly owned by PNB and its 58.8% share in Harrisons and Crosfield, PNB became the owners of the two largest rubber and oil palm plantation companies in the world. Several tin mining MNCs on the LSE were also acquired including the huge Amalgamated Metal Corporation to add to MMC it had received from Pemas.

Over time, PNB developed strategic stakes in all major sectors of the economy including the financial sector. If foreign interests (mainly British) owned 52.2% of the banking sector while ethnic Chinese owned 24.3% in 1970, eight of the top ten banks had been acquired by Malay interests by 1986 when Malay ownership and control of banking had increased to about 70%.<sup>28</sup> PNB had progressively acquired Malayan Banking Bhd (MBB), the nation's largest

---

<sup>27</sup> Asiaweek October 15, 1981

<sup>28</sup> Pek-Koon Heng, "Chinese Responses to Malay Hegemony in Peninsular Malaysia, 1957-1996," 34 *Southeast Asian Studies*, 1996: 500-523

commercial bank, Bank Bumiputra Malaysia Bhd, state-owned and the second largest, Bank Pembangunan Bhd, and Kumpulan Kewangan Bhd among others. (UMNO corporations formed the other significant bloc of Malay owners.) Importantly, by fostering an oligopolistic banking sector, indirect dominance over other sectors was also assured. Moreover, because the banking sector was, by the early eighties, already 70% restructured in terms of Malay equity, regulatory changes were made to permit banks to buy equity of non-bank corporations to speed up restructuring. (see Chapter 4)

PNB has consistently aimed to acquire companies with commanding positions in the traditional heights of the economy including plantations, mining, finance, and, later, manufacturing. By 1983, a mere five years after its incorporation, PNB was already the largest holder of KLSE stocks with 470 million shares at a par value of RM305 million but whose market value was, at least, five times as much. PNB was therefore the bourse's largest institutional investor. At the same time, ASN was the second largest holder of KLSE stocks with RM222.6 million par value in stocks but whose market valuation was, at least, seven times more.<sup>29</sup>

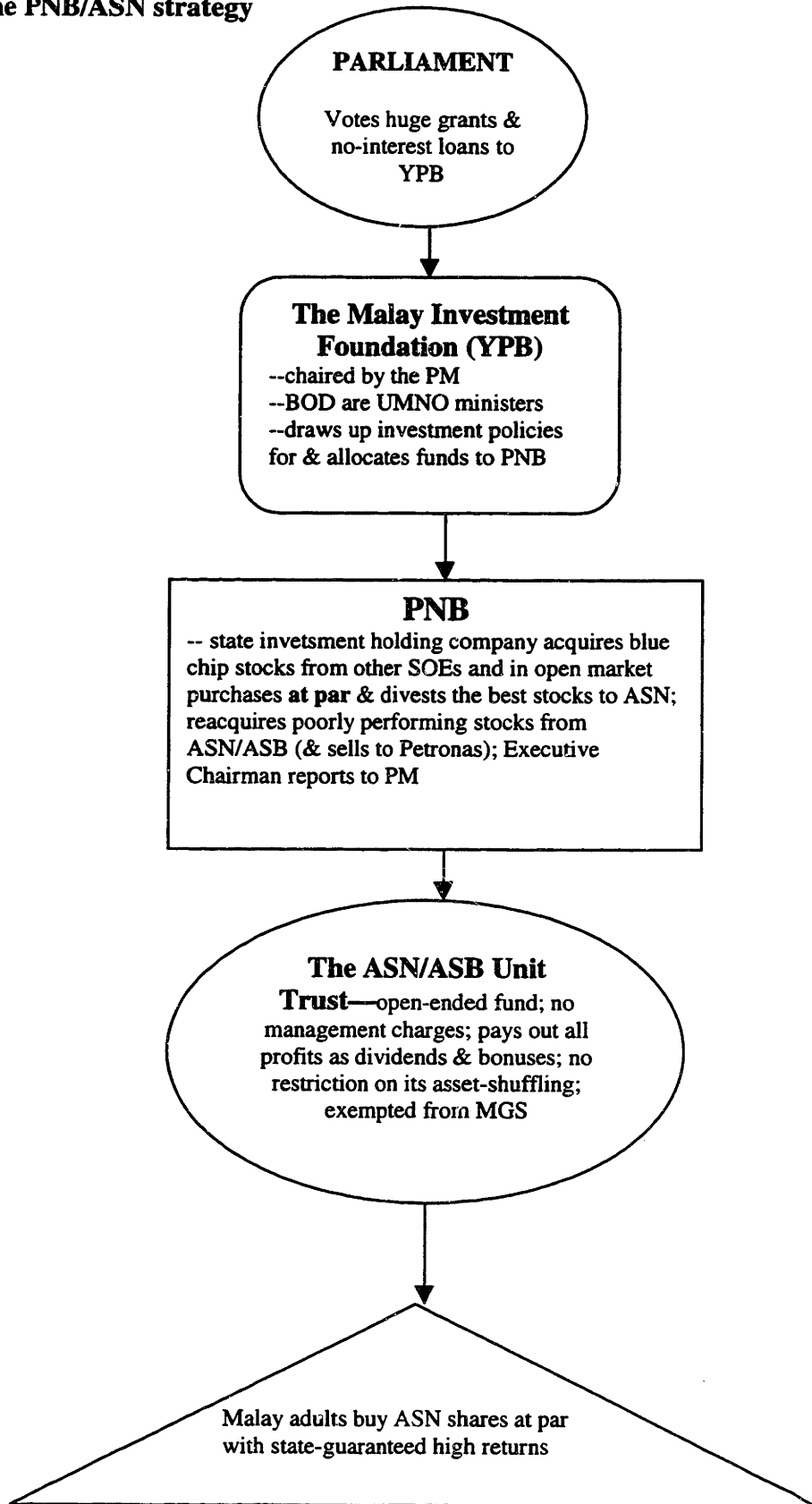
Over time, the weight of PNB's investments shifted towards manufacturing as the economy itself shifted in its emphasis. Still, a third of its portfolio is currently still in rubber, palm oil and cocoa while actual investment in purely manufacturing firms is well under 10% at any one time. By December 1993, PNB was in control of 26% of the financial sector, 26% of the hotel industry, 57% of manufacturing, 50% of plantations, 6% of the property sector, and 6% of the tin sector.<sup>30</sup>

---

<sup>29</sup> source: PNB & ASN, Annual Reports, 1979-1984

<sup>30</sup> *New Straits Times* June 8, 1994

**Fig 2.1 The PNB/ASN strategy**





*ASN*: The scheme to transfer to Malay individuals all that wealth centralized in PNB operated in the following manner. *ASN*, the only firm PNB may divest to, was run as a mutual fund with a difference. Because market conditions usually force prices of units up gradually, well-established unit trusts usually look to institutional buyers. By the same token, the average Malay investor would not be able to buy in. In contrast, *ASN* units were sold at RM1 per unit to adult Malay individuals, while institutions were not eligible. By selling at par and by requiring special set-asides in loan portfolios of commercial banks and finance companies for Malays at nominal interest rates, Malay adults were enabled to buy into *ASN*. The *ASN*'s high dividends and bonuses at year's end guaranteed by the state to be at least 10% meant that loan repayments were assured. By 1989, banks and finance companies had extended RM2.5 billion to eligible Malays for *ASN* investments.<sup>31</sup>

The *ASN* levied no management charges, kept no profits, and paid out all profits as dividend and bonus units. It was also obliged to buy back *ASN* units at par until the end of 1990 when *ASN* was floated (and replaced by a clone, the *ASB* scheme to last indefinitely, to which more than 75% of *ASN* investors migrated.) Buying and redeeming were done at post-offices found in the remotest nook of the country. A passbook system offered its unitholders tangible evidence of their individual equity holdings.

The *ASN*'s unitholder gained in one of two ways depending on gains of the original portfolio, viz., the degree of capital appreciation of units, and the state-guaranteed annual dividends and bonuses. In the *ASN*, each unit equalled one share. While the price at a later date would not necessarily be the same at the time of launch for most unit trusts, on the *ASN*, however, whether the shareholder bought units in 1980 or 1989, she would still have paid only RM1 per unit. This fixed price prevented investors from selling their units for short term gains

---

<sup>31</sup> Bank Negara Malaysia, *Annual Report 1990*.

compared to other unit trusts. For an initial RM10, every investor was rewarded with another 90 units as immediate dividends.

PNB began to transfer to ASN from 1979 its most profitable stakes in blue chips including Sime Darby, MMC, Kentucky Fried Chicken Bhd, Rothmans of Pall Mall, Malayan Tobacco Company, and so on. The ASN's charter obliged it to pay a minimum of 10% dividends and bonus annually in shares only. To maximize profits on their books, there was a constant re-shuffling of PNB and ASN portfolios by the trading of shares among PNB and ASN themselves and their subsidiaries. This ploy generated huge capital gains through revaluation of firms bought cheaply earlier thus ensuring hefty dividends and bonuses including even a 13% payout in the 1986 recession. No other unit trust was allowed to do likewise. Moreover, losses in ASN's portfolio were moved out by transferring the shares in companies concerned back to PNB. The most well known instance revealed in Parliament under Opposition questioning involved losses incurred by ASN's 86.7% stake in Bank Bumiputra whose Hong Kong-based deposit-taking subsidiary, BMF, was saddled with \$1 billion in doubtful loans to three property-related firms involved in speculative activities. ASN's equity in the bank was transferred back to PNB that, thereby, absorbed the former's losses in this instance. Subsequently, PNB "sold" that equity to Petronas, the state-owned unlisted petroleum and gas concern, thus removing any politically sensitive losses from ASN itself.<sup>32</sup>

The ASN was not subject to several other regulations that applied to unit trusts. Because most unit trusts were not permitted to exceed a certain size, the only way for them to expand was to set up a new fund. However, these sister funds were not allowed to reshuffle their assets among themselves or borrow or lend among their companies, strategies that lent themselves to the kind of spectacular growth or capital gains seen with ASN. The ASN was, in contrast, open-ended. Except for the ASN, all unit trusts were only allowed to buy trustee stocks (blue chips),

---

<sup>32</sup> Asiaweek, September 15, 1990

approved bonds or fixed (time) deposits with banks, and no more than 10% of total funds may be invested in a particular company. All other fund managers were also required to invest large sums in the low-yield Malaysian Government Securities, except ASN. Even the giant state-owned pension fund EPF, to which contributions are compulsory, has only 2% of its funds in corporate equity because of statutory constraints on its portfolio. (*see* Chapter Four) Although the ASN was only a third of the EPF in size, it was free to invest in equities. As countercyclical players on the KLSE with their mammoth war chests, both PNB and ASN profit from downturns such as the October 1987 and the July 1997 crashes. PNB and ASN were exempt from corporate taxes, initially for ten years, up to 1990. Subsequently, the tax exemptions were extended indefinitely. Finally, while the EPF and Petronas were used to support the KLSE Composite Index when necessary (by buying index-linked shares) or to bail out troubled SOEs or indebted UMNO corporations, PNB and ASN were free from such pressures given their powerful constituency of about half the Malay population.

In terms of reach, by the end of its first year, ASN had more than 841,000 unitholders who garnered 20% in returns. Rates of 17 to 18% were given in subsequent years. By 1985, there were close to two million ASN investors with a five-fold increase in net investments from the initial RM374.8 million to RM1.7 billion. By 1988, there were 2.3 million Malays or about 44% of the eligible Malay population in the scheme. By 1990, while the coverage had remained about the same, ASN unitholder investments had risen to RM6.2 billion.<sup>33</sup>

A closer look at the distribution showed that, after the first five years of the scheme, 65% of all ASN investors possessed only 100 units each. That is, about two-thirds of all ASN investors made only the initial RM10 investment with no follow-up investments thereafter. Conversely, 10% had invested RM25,000 or more each. Importantly, in 1990, only 1.3% of ASN

---

<sup>33</sup> source: ASN Annual Reports, various years

investors owned 75% in aggregate out of the total of 6.2 billion units.<sup>34</sup> Equity distribution with the ASN was therefore skewed.

During the tenure of the ASN scheme till January 1990 when the ASN was floated, the annual return always exceeded the guaranteed 10% handsomely. In the first year alone, the cumulative rate paid was 20%. The generous distribution of profits—not least the publicity blitz surrounding their annual announcements—has earned UMNO plenty of goodwill among the Malay populations. It is no coincidence that Mahathir has never failed to personally declare ASN's (and ASB's) yearly payouts which is a media event with much fanfare and publicity. ASN yields, however, have trended down. If the first half of the eighties saw returns of 17-20%, returns hovered at 13-14% in the second half of the decade. Still the lowest return of 13% exceeded the best fixed deposit rates at commercial banks of about 10% in the period. After 1990, the market based ASN, without the benefit of asset transfers at par failed to return as much as the KLSE itself even during the boom years of the nineties. For example, in 1993, the KLSE composite index rose 101.53% but the ASN managed only 74.55%. In 1998, the ASN managed only 8% returns.<sup>35</sup>

Clearly PNB/ASN's early growth could not be sustained, having come primarily from transfer of assets with no net wealth created in the process. By the late eighties, few ready made assets remained to be transferred. In fact, no such transfer occurred from 1986 except for one SOE, Cement Manufacturers (Sarawak) Bhd, in 1988. Most new initial public offerings of shares of new listings on the KLSE were tiny relative to PNB/ASN's sizes except for the privatization of the national telecommunications and national electricity utilities in the nineties. (The two utilities remain the two largest firms on the KLSE in terms of capitalization.) Given their portfolios and sizes that mirrored the Malaysian economy, PNB/ASN could not continue to offer returns that outstripped the country's GNP growth. One strategy adopted was to invest overseas. However,

---

<sup>34</sup> S Jayasakaran, "By Popular Demand," *Malaysian Business*, January 1-15, 1990: 6

<sup>35</sup> source: *ASN Annual Reports*, various years.

there was a self-imposed limit of 10% of total assets invested offshore so as not to “upset the arithmetic of Malay participation” in the domestic economy.<sup>36</sup>

In 1990, the ASN was converted to variable daily quotations as required by its charter. To change its trust deed would have required the approval of a third of its unitholders, about a million individuals. The high transaction costs of such an exercise meant that starting a clone was a much easier way to perpetuate the centralization of collection and distribution of rents the ASN scheme represented. Rural Malays were also said to be unreceptive to the notion of their savings being subject to KLSE gyrations. Thus the ASB clone was started. (ASB was started a year ahead of the end of the old-format ASN to help especially rural unitholders get used to the idea of the ASB as ASN’s replacement.)

There was probably another equally important consideration. At changeover from ASN to ASB in 1991, unitholders would get a windfall in holdings. It turns out that 1991 was an election year in which the Mahathir regime would face its first real challenge from KuLi’s faction that had formed the first Malay opposition party with a national following and a war chest to match. (A prince of Kelantan state, KuLi was also fabulously wealthy. His party formed a loose coalition with the mainly Chinese DAP and the mainly Malay Islamic opposition, PAS, thus holding out the tantalizing promise of a two-party system in the offing.) The windfall to ASN investors came about as follows. ASN unitholders who chose to convert their ASN units to ASB ones after January 3, 1991 received first, the dividends and bonuses for 1990; secondly, they benefited from ASN’s anticipated price increase on the KLS; finally, and most importantly, they received Section 11 bonus units. (Section 11 of the ASN’s charter allowed fund managers to issue bonus units if ASN units exceeded RM1 in value.) The total number of units after that date was then multiplied at the prevailing market price. In this way, the amount converted came to a

---

<sup>36</sup> Pauline Almeida. “Interview with PNB Executive Chairman: What’s Up, Dato’”, at PNB?” *Malaysian Business*, January 1-15, 1990: 13

greatly inflated number of ASB units. Banks were also prohibited from deducting repayments on loans taken to buy ASN/ASB units that year.

The ASB is run like the ASN of old with a higher limit of RM100,000 per individual and a junior account for 12 to 18 year olds, both moves which favored richer Malays thus skewing the equity distribution even further. The average return on the ASB from 1990 to 1998 was 12.75%, with a high of 14% in its first year, but always exceeding 12% except in 1997, the year the Asian Crisis began (with 11.5%.) and in recessionary 1998 (with 10.5%).<sup>37</sup>

While PNB/ASN was the NEP's flagship, there were several other Malay investment, manufacturing, and trading companies started by the state with public money. If only two out of 47 SOEs specifically served Malay interests in 1964, fully 59 out of 103 new SOEs emerging in the following decade existed solely to promote Malay economic interests. These fell into four categories. First, portfolio investment agencies like PNB. Secondly, trading corporations with significant equity in other companies such as Pernas. Thirdly, Malay public enterprises that provided concessionary services, infrastructure, training or financing including MARA (Council of Trust for Malays) or Bank Bumiputra. Fourthly, state-level economic development corporations formed for all the above purposes but with a regional focus. Still, it was the PNB with its ASN and ASB that generated a great pool of goodwill among the Malay masses for UMNO. By 1988, Malay individuals accounted for 67% of total Malay ownership of equity, a dramatic reversal in a short time.<sup>38</sup> The other significant bloc of Malay equity holders was made up of UMNO corporations.

---

<sup>37</sup> Stephanie Rajendran, "Payouts for ASB," *New Straits Times*, Dec 11, 1998: 1

<sup>38</sup> *Asiaweek*, "Vanguard of a Nation's Wealth," May 24, 1991: 29,

## Section V: Inverting UMNO's dependency on Chinese capital—The Fleet strategy

If PNB/ASN was the investment holding company strategy for the Malay masses, Fleet Holdings was its twin created to serve UMNO's interests. Note that the bureaucracy was also sequestered from this set of initiatives. Fleet, set up as UMNO's first investment holdings company under KuLi as UMNO Treasurer, functioned as a passive investment vehicle for the acquisition of existing entities (much like Pernas that was also run by KuLi) with little involvement in the day-to-day management of its acquired corporations. In contrast, Mahathir (who was MTT) preferred "organic growth" of Malay corporations. When he became PM in 1981, Mahathir moved quickly to change the way Fleet was run.<sup>39</sup> Daim Zainuddin, one of Mahathir's few trusted aides, was named UMNO Treasurer replacing KuLi in 1982.

Daim proceeded to shed Fleet's passivity and led it through a series of mergers and acquisitions that had doubled its size by the end of the eighties.<sup>40</sup> The acquisitions were effected by a torrent of share swaps and rights issues. Intra-group sales and asset shuffling among its various listed firms created a tangled web of companies. Using a holding company strategy, Daim created a multi-layered structure of companies for UMNO. In this structure, the various directors of a holding company used a system of pyramiding that involved owning a majority of the stock of one corporation which, in turn, held a majority of the stock of another, a process which was repeated a number of times. This was a convenient way of acquiring control of corporations without involving the reputation of the holding company, its creditors or minority

---

<sup>39</sup> Mahathir had been expelled from UMNO in 1969 by Tunku but re-admitted after Tunku's resignation as PM. He was appointed a Senator and director of FIMA, a food processing SOE owned by *MOF Inc.* In his capacity as director—he remained FIMA director until 1981 when he became PM—and later as its Executive Chairman, Mahathir garnered experience in the use of networks and legal processes for the acquisition of companies under the NEP. For example, in that capacity, he acquired for FIMA a British plc, Metal Box. This sort of experience must have made him aware of the possibilities for greater control of corporate wealth by the Malays. Hence, Fleet's new direction when he became PM in 1981.

<sup>40</sup> Daim has explicitly declared that Fleet was really created to reduce UMNO's financial dependence on its "non-Malay supporters," (read: ethnic Chinese); see Doug Tsuroka, "Fleet's Stormy Voyage," *Asiaweek*, July 5, 1990: 52; also, Pek-Khoo Heng, *Chinese Politics in Malaysia: A History of the Malaysian Chinese Association*, (Singapore: Oxford University Press, 1988). What was left unsaid was that Fleet was also set up to acquire control of the mass media since it was better to control the press from below rather than rely on strict top-down censorship.

interests. It conferred simultaneously the advantage of centralized control and decentralized administration, i.e., consistent overall policies with the flexibility of specific strategies in subsidiaries. The holding company was also better positioned as an investment vehicle to obtain external funding compared to its smaller subsidiaries. Moreover, the holding company was not responsible for its subsidiaries. On the other hand, when a firm saddled with accumulated losses was acquired as a subsidiary, its losses could be carried forward for income tax abatement for the holding company. Finally, when the need arose to delink a specific subsidiary, it was easily achieved by share transfers. Most importantly for UMNO, the strategy could be used to conceal the identity of the real shareholders especially where trustees, proxies, or nominee companies were used.<sup>41</sup>

Through pyramiding, the directors of a holding company acquired the power to appoint one or more directors to the board of acquired firms. This made possible inter-firm transactions including the routing of profitable businesses to some other firm in the group, and the concealment of losses or the creation of non-existent deficits.<sup>42</sup> Yoshihara calls this mode of operation "paper entrepreneurship," i.e., the pursuit of opportunities for mergers and acquisitions, restructurings, and leveraged buy-outs in which actual production and services are frequently

---

<sup>41</sup> Nominee companies hold stocks of other companies keeping the real investor anonymous. Most nominee stocks do not reflect true ownership patterns even when they are not being used by politicians to conceal their investments because they can also arise out of loans. For instance, banks place stocks pledged as collateral under nominee companies; stocks registered by stock brokerages to cover the deposits of their remisers are held in nominee companies; big clients of stock brokerages, in return for margin financing, also place share deposits in nominee companies of the brokers; institutional investors appoint merchant banks to invest for them and their transactions are carried out through the nominees of the advising body. In any case, the presence of nominees fudges the true ownership of shares. Officially, when the government tallies up equity holdings, nominee companies are classified as "other Malaysian" meaning non-Malay when most of them are, in fact, Malay owned. For example, a 1990 study showed that 205 of the combined total of the top twenty shareholders of fifteen publicly listed firms linked to UMNO were nominee companies. Most of these nominees controlled significant equity holdings in excess of 50%, the figure being frequently 60-70% of equity in the plcs, subsidiaries, and associated firms. At the start of the NEP period, a survey of the corporate sector showed that the share of nominee and locally controlled companies was minuscule. As the corporate sector burgeoned, nominee and locally controlled companies also proliferated. By 1990, UMNO's total value of corporate equity in nominee hands were about RM4 billion of which RM2 billion were listed stocks comprising 2% of the KLSE capitalization.

<sup>42</sup> Adolf Berle & Gardiner Means, *The Modern Corporate and Private Property*, (New York: Macmillan, 1932,) 183.



sacrificed for other activities which turn in a quicker profit.<sup>43</sup> Minority shareholders run the risk of the holding company withholding dividends, manipulating interfirm transactions, giving loans to one another without adequate collateral, restricting the activities and earning power of one firm for the benefit of the group as a whole.<sup>44</sup>

Fleet was formed ostensibly to acquire the *Straits Times Press* (STP) from its Singaporean owners because of allegations that Singapore, which had a predominantly ethnic Chinese population, was still meddling in Malay politics through its control of Malaysia's leading English language daily. (Singapore had been sacked from the Federation of Malaysia in 1965.) The UMNO acquisition was financed with a RM32 million loan from state-owned *Bank Bumiputra Malaysia Berhad* (BBMB) of which KuLi was also Chairman. The real motive for Fleet's creation was to reduce UMNO's dependence for funding by ethnic Chinese capital that had hitherto been channeled through the MCA, an arrangement dating from the 1955 pre-independence Legislative Council elections that UMNO had won handily in a coalition with the MCA.<sup>45</sup>

Since 1961, UMNO had held unquoted shares in *Utusan Melayu Press sdn. bhd.*, (the suffix standing for *sendirian berhad* or Malay for *private limited company*), that published the Malay language daily most widely read among rural Malays.<sup>46</sup> Thus, by the early seventies, UMNO had already dominated the country's leading print media. In 1974, Fleet also acquired a bank, later renamed the Bank of Commerce (BOC) but after this acquisition, public information on Fleet became no longer available because it had secured *private exempt status* which meant

---

<sup>43</sup> Kunio Yoshihara, *The Chinese in Southeast Asia and Ersatzcapitalism*, (Kuala Lumpur: Oxford University Press) 8

<sup>44</sup> Mei-Ling Sieh, *Ownership and Control of Malaysia's Manufacturing Corporations*, (Kuala Lumpur: UMCB Publications) 1982: 145-52.

<sup>45</sup> Daim Zainuddin admitted to this years later after the Renong deal; see, Doug Tsuruoka, "We've nothing to hide," *Far East Economic Review*, July 5, 1990.

<sup>46</sup> N.J. Funston, *Malay Politics in Malaysia: A Study of UMNO and Parti Islam*, (Kuala Lumpur: Heinemann, 1980) 188.

that it did not have to submit financial returns to the Registrar of Companies (ROC). In 1985, Fleet's sole shareholder was a firm, *Nominees Bumiputra sdn. bhd.*, controlled by state-owned Bank Bumiputra even though only individuals and not companies were allowed by law to own shares in private exempt companies.<sup>47</sup> KuLi built up Fleet mainly by re-investing earnings in the renamed New Straits Times Press (NSTP). The Fleet conglomerate included the following plcs.<sup>48</sup>

**NSTP:** During KuLi's time at Fleet's helm, NSTP's growth came from acquisitions related to the publishing industry. With Daim, it started a conglomerate style of growth instead. For example, it acquired Faber Group stock from Daim himself,<sup>49</sup> a 20% shares in Bank of Commerce, 49.9% of TV3, and all of American Malaysian Insurance. In the Renong deal, its highly profitable stake in TV3 was sold to Renong.

**STMB:** Fleet secured the first license to run a private TV station in 1983, introduced by Mahathir as a "privatization" project. Fleet owned 40% while UMNO's Utusan Melayu owned 20%, Daim 10% as well as another proxy, Syed Kechik, (who also co-owned D&C Bank with Daim) with 20 percent. Its lively fare compared to government TV made it a powerful advertiser earner. Yet, by 1986, Fleet, Daim, and Syed Kechik had divested their TV3 stakes although Utusan retained 10% of its shares. In fact, 49.9% of TV3 equity was acquired by NSTP in which Fleet still held 56% equity.

**BOC:** The bank was acquired from its ethnic Chinese owners and a NSTP director was appointed its CEO. It then acquired a merchant bank, Sanwa Bank, from state-owned Bank Pertanian, and renamed it Commerce International Merchant Bank (CIMB). BOC also acquired ailing United Asian Bank Bhd. (UAB) through an equity swap after the Central Bank had poured RM363

---

<sup>47</sup> "Fleet's Stormy Voyage," *FEER* July 5, 1990: 52

<sup>48</sup> source: Registrar of Companies, Archives

<sup>49</sup> *Far East Economic Review*, October 8, 1987

million into UAB for 79% equity. The central bank's equity in UAB was sold to BOC without open bidding at an undisclosed price.

**Hume:** Fleet acquired Hume from a Chinese conglomerate, Hong Leong Bhd., that has wide connections with UMNO politicians. UMNO holds equity in many of its other firms such as Mycom Bhd involved in the gaming industry of which the chairman was a son of the DPM, Ghaffar Baba, in the late eighties.

**Faber:** A group of companies involved in hotel, construction, and property development, Faber was acquired from its ethnic Chinese owners when its entire special NEP issue of shares for Malays was awarded to Fleet by the Minister of Trade and Industry. Daim himself had a personal stake in Faber. He then used Faber to acquire two of his indebted companies involved in property and housing. The sector crashed in the 1985 recession and Faber was heavily in debts. Fleet hived off its Faber equity to a private limited company to exclude its debts from an impending restructuring, the Renong deal. (*see* Chapter Three)

Under Daim, several corporations acquired under KuLi were spun off in a series of share swaps to Fleet's subsidiary, New Straits Times Press (NSTP). Daim rapidly expanded Fleet's portfolio, snapping up several listed firms including Faber Merlin, the country's largest hotel chain and a major property developer, TV3, the first private television station, Cold Storage, a foods concern, Bank of Commerce, and American Malaysian Insurance. Fleet's whole structure would eventually fall prey to high debt and poor management. In many cases, the firms involved in the equity churning were linked to Daim's family and such assets were purchased overvalued or shares offered undervalued.<sup>50</sup> Although Daim other UMNO proxies made huge profits from Fleet's dealings,<sup>51</sup> by 1985, Fleet's liabilities had accumulated to exceed its assets by RM222 million. At least one off-budget agency and one SOE—Urban Development Authority (UDA)

---

<sup>50</sup> *see*, for example, "A Sense of Mission--and Missing Shares," *FEER*, September 3, 1987; also, Gomez, 1990, *ibid.*, 52.

<sup>51</sup> *see*, for example, "Peremba offshoot feels bite," *FEER* September 3, 1987

and Peremba Bhd—were used to try to bail out Fleet. Still, by 1990, its gross accumulated liabilities had risen to about RM600-650 million. (In the following chapter, I show how Daim used an ethnic privatization that not only saved Fleet but also extended UMNO's corporate empire.)

The SOE program, the PNB/ASN scheme, and the Fleet strategy were justified largely on the grounds of "trusteeship," i.e., the putting of faith in the hands of an individual or organization to advance a certain policy or duty.<sup>52</sup> In this sense, PNB/ASN directors and management were government trustees while Daim and his proxies were UMNO trustees for the Malays. Trusteeship was tied up with the concept of loyalty.<sup>53</sup> Since the mid-seventies, there has been a strong correlation between being a Malay director in a Top 100 listed company and having an UMNO political affiliation or civil service background.<sup>54</sup> Appointments as trustees were rewards for loyalty to UMNO. In the role of trustees, these individuals have remained dependent on the state to ensure business success with protection from market competition and access to concessions, licenses, monopoly rights, government subsidies, approvals for corporate takeovers, etc. In these relationships, business and politics were not divergent interests but partners. The fusion of the political and economic elite concentrated corporate wealth in the hands of an elite minority.<sup>55</sup> And, as the extent of state and party control over economic resources increased, the bases of power of those in control of the state expanded.

---

<sup>52</sup> Ozay Mehmet, *Development in Malaysia: Poverty, Wealth and Trusteeship*, (London: Croom Helm, 1986).

<sup>53</sup> Chandra Muzaffar, *Some Dominant Concepts and Dissenting Ideas on Malay Rule and Malay Society from Malacca to the Colonial and Merdeka Periods*, unpublished doctoral dissertation, University of Singapore, 1977: 185.

<sup>54</sup> Mah-hui Lim, *Ownership and Control of the One Hundred Largest Corporations in Malaysia*, (Kuala Lumpur: Oxford University Press, 1981); based on author's doctoral dissertation, University of Pittsburgh.

<sup>55</sup> *Far East Economic Review* April 13, 1979

## Section VI: The NEP's Denouement

Between 1965 and 1973, Malaysia's GNP grew at average annual rate of 6.7% as Malaysia emerged as one of Asia's most successful agriculture-based economy. After the NEP was introduced, despite the crowding out of domestic entrepreneurial capital, the rate accelerated to 7.3% between 1973 and 1983. This was primarily because Malaysia had become a net exporter of crude petroleum while also being buoyed by the expanding output of electronic components from its export processing zones (EPZs) where FDI flourished, and manufacturing expanded into a key pillar of the economy. From the end of 1984, however, the global recession began to be felt in Malaysia with falling prices of palm oil, rubber, tin, timber, cocoa and pepper as well as lower crude oil production and a drop in demand for electronic components and textiles.

The period right up to 1981 had seen real disposable incomes rise faster than GNP financed by the boom in oil production and sustained gain in terms of trade. From the early eighties, however, private spending and private investment trended down while public investment escalated.<sup>56</sup> While revenues had been falling, public consumption continued to rise, accounting for more than two-thirds of total consumption while even export receipts for petroleum and natural gas declined.

By 1983, however, there had been a net reduction of poverty of only 74,200 households or only 9.4% over 13 years, a poor performance given that the period had seen rapid economic growth. It was recognized that economic and revenue circumstances that had prevailed in the decade up to 1981 that underwrote the huge expansion of the public sector had fundamentally changed.<sup>57</sup> Although non-oil private investment had done quite well in the early eighties, it had

---

<sup>56</sup> see Economic Planning Unit, *Mid Term Review, Fourth Malaysia Plan*, (Kuala Lumpur: Government Printers, 1984). Although there had been a period of stability in the relative size of the public sector in the late 1970s, this was partly because of buoyant commodity prices boosting the private sector and partly because of the huge rise in oil industry investment which was counted as private sector and, in fact, accounted for a quarter of all "private" investment.

<sup>57</sup> see October 1983, Budget speech in Parliament by the MOF.

been too concentrated in property and construction. These non-tradeables had grown as a consequence of rising incomes generated by oil and favorable terms of trade, and were drivers of growth. While manufacturing exports had grown spectacularly, they were dominated by foreign-owned electronics assembly and textiles in EPZs with little backward linkages to the domestic economy. The risk/reward ratio in these new capital-intensive industries in which Malaysia had no comparative advantage was not as attractive as commerce that Malaysia had traditionally offered. (The potentially footloose ethnic Chinese capital had historically focused on liquid investments rather than long term productive capacity.)

The more difficult economic environment with slower export growth and adverse terms of trade, an overly large government sector as well as educational, manufacturing and agricultural distortions led to the introduction of a structural adjustment program as advocated by the Bretton Woods institutions. The state began to scale down the public sector. Heretofore, restructuring had been achieved through the acquisition of existing assets or direct private sector stimulation by state funded institutions including Pemas, PNB/ASN, UDA, MARA, etc. But now the state recognized that development spending had to be slashed given a growing debt burden, an increasing proportion of which was funded overseas. The implications of slower growth and a winding down of the public sector for NEP objectives became inescapable. The state began to argue that private sector would be expected to do more, and faster, in terms of investments and growth if NEP restructuring was to achieve its targets. Growth would receive as much priority as equity while employment generation would be stressed as much as restructuring.<sup>58</sup>

---

<sup>58</sup> In the mid-eighties, the state established a *Central Information Collection Unit* run by PNB itself. The extent of public sector losses may be gleaned from its 1987 data which revealed that 1148 SOEs, their subsidiaries and associated companies had a net loss of RM1.9 billion. Of these, some 562 firms had losses totalling RM 7.4 billion while 446 had profits of RM5.6 billion, with the remainder inactive or closing down. Total public sector investment in the 1148 firms came to RM15.3 billion which was 71% of their total paid-up capital of RM21.5 billion. The state held at least half of the equity in 813 of these firms; see *Southeast Asia Digest*, July 21, 1989.

Thus, by 1985, NEP rules were beginning to be relaxed. For example, foreign equity investments up to 80% were allowed in export oriented industries to encourage inflow of funds. The ICA's provisions were also relaxed. To signal the change in policy direction to foreign investors and to domestic ethnic Chinese capital, the state resorted to two foreign channels. First, in February 1986, a UNIDO-led study, the *Industrial Master Plan* (IMP), was released in incomplete form. In preparation since July 1983, only 14 out of 22 volumes of the IMP were published by the Malaysian government. The withheld portions included a highly critical analysis of the NEP within the framework of industrial progress. However, summaries of the withheld portions were released—but solely by UNIDO—and suggested that there was a case for introducing some degree of relaxation of NEP requirements.

Next, in a televised interview on Australian Broadcasting Corporation TV aired on May 28, 1986, Mahathir announced that the NEP would be “held in abeyance, more or less, except in areas where there is growth.” He went on to qualify the qualifier that “At the moment, there is no growth. So, we have decided we will not go ahead with the kind of restructuring we had planned for...We have to concentrate on growth.” Mahathir repeated the announcement in the United States on a trade promotion trip there. Liberal incentives for FDI were introduced. For example, first-time foreign investors were to be allowed 100% equity; the 30% Malay shareholding requirement was also waived for manufacturing enterprises including those manufacturing for the domestic market. Mahathir's statement was, however, not circulated in the English or Malay language media but, pointedly, appeared in one local Chinese language daily.<sup>59</sup> There were Malay fears that the new policy direction would see a reversal of NEP gains, and the dominance of foreign capital in manufacturing, at least, was in fact enhanced, further subordinating the state and Malay capital. This public de-emphasis of ethnic quotas from the latter part of the eighties

---

<sup>59</sup> Suhaini Aznam, “Malays marking time: Mahathir temporarily suspends the NEP,” *Asiaweek*, June 1, 1986: 17-18

was to shade into a new strategy called “privatization.” The state’s claim that it would be able to fold the new policy neatly into the old is examined in the next chapter.

An interesting footnote to the NEP is that the state seemed to have intentionally misled all concerned—including the Malay masses—by suggesting a serious shortfall with Malay share of corporate wealth, standing at 18% in 1985, and rising to only 19.8% by 1990, the official end of the NEP. Presumably, the state did not wish to be disabled from perpetuating its ethnic ideology. There are reasons to suspect that Malay ownership and control of equity had, in fact, exceeded the 30% quota by 1988. First, federal and state-level government share ownership other than Malay trust agencies had not appeared in the official tables of ownership of share capital in private limited companies since 1969. A fuller picture of wealth distribution should consider ownership of these private limited companies. Secondly, although not officially acknowledged, the official figure (which encompassed only publicly listed companies) excluded Malay shares owned by nominee companies whose true owners used to obscure their identities. All such shares were considered by the state to belong exclusively to “other Malaysians” and foreign residents when, in fact, it was common knowledge that they were more likely to be owned by Malays, especially politicians, who wished to fudge their business interests. Thirdly, these statistics considered only nominal share values. Since Malay and foreign share ownership were concentrated in larger and more successful corporations, it was likely that the actual market value of shares held by non-Malay citizens was proportionally less than the latter’s nominal share in percentage terms. Conversely, Malay and foreign wealth ownership must have been considerably higher. As such, it seems very likely that when the policy was beginning to be relaxed in 1985, the 30% target was probably very close to being achieved.<sup>60</sup> Correlatively, when non-corporate

---

<sup>60</sup> For example, by December 1988, Malays were in control of 29.4%, non-Malay citizens 41.9% , and foreigners 28.7% of KLSE equity by nominal value; *see* KLSE Annual Handbook, 1989. But using market value with closing prices on the KLSE on March 1, 1989, it has been shown that Malays already owned 34.5%, other Malaysians 33.3%, while foreigners were in control of 32.2% of that equity; *see* Chan-Onn Fong, *The Malaysian economic Challenge in the 1990s: Transformation for Growth*, (Singapore: Longman,



wealth is considered—that is, when other tangible assets of foreign branches and subsidiaries such as real property and agricultural land which do not figure in such calculations are included—foreign-owned wealth and wealth generating capacity in Malaysia is seriously underestimated by government statistics. In addition, despite its apparently sizeable share of corporate equity, ethnic Chinese capital today has little control over the financial sector and the commanding heights of the economy, namely, international trade and primary commodities. These, of course, have been taken over from British interests by the state for distribution to Malay interests. It should also be noted that there is no way of independently verifying the comparability of data over time in terms of methods of measurement since they are not publicly available.

## **Conclusion**

In the early sixties, the emergent Malay middle class was beginning to organize to demand for a larger share of the economic pie. The state, in allocating and stabilizing new property rights and institutions as a new class was emerging, faced a situation fraught with tremendous incentives to contest such allocations given their long term implications. To be legitimate, this apportionment had to be done openly but could not sideline the large populist Malay alliance mobilized in the anti-colonial struggle. A determinate supply of goods but an unlimited demand meant that the allocation was inevitably going to be unfair. Emerging middle classes began to contest the claims of existing privileged classes of property owners. A solution lay in side-payments but, unless they were legally and openly organized, corruption would ensue. This meant the need for a legitimating ideology. As it happened, the rise of an urban-based, ethnic Chinese counter-elite, evident in the 1969 Elections, was an assault on the constitutional ethnic “bargain” set in place at Independence. This paved the way for a state ideology of ethnicity. That is, the 1969 riots provided the Malay elite with an opportunity and rationale to

---

1989). Professor Fong was the Dean of the Faculty of Economics, University of Malaya, and head of the MCA think tank at that time. The following year he was appointed as Deputy Education Minister in which

push that ethnic ideology; the coincidence of ethnic and class identities permitted the organization of a system of centralized payoffs to the Malays legitimated by that state ideology. The political elite centralized the demands of the emerging Malay middle class and arranged the transfer of rents--their payoffs--centrally. In this way, payoffs were delinked from corruption and, as a result, decentralized, interlocking patron-client networks did not develop.<sup>61</sup> Consequently, there was reasonably rational allocation of resources with respectable economic growth rates during that period, helped fortuitously by Malaysia's abundant natural resources, including the timely discovery of high grade petroleum in the seventies.

During the early phase of the NEP, ethnic Chinese and foreign capital had to work with the bureaucracy to develop their corporate assets. By the mid-eighties, the bureaucracy had been sidelined, and ethnic Chinese capital found itself marginalized and having to work with, and through, Malay political leaders and their proxies to attain their corporate goals. The once inter-elite cooperation that existed had dissipated, the ethnic Chinese were increasingly marginalized, and ethnic Chinese businessmen found themselves at the mercy of Malay politicians.<sup>62</sup> It has been suggested that the impact of colonial power in Malaya was one of consolidation. That is, the colonial power's effected a structural change but one that was a phenomenon of essential continuity. It was a process of interaction with external forces that renewed--rather than replaced important existing structures in Malay society.<sup>63</sup> The NEP effected a similar change-of-the-consolidating kind in the sense that the structural situation in present day Malaysia arose from the NEP's institutionalization of the security of the political leadership in a modern setting that not only replicated, but also augmented colonial oligopolistic ownership structures albeit with a new, Malay, owners.

---

post he remains to this day.

<sup>61</sup> Mushtaq Khan, *Clientelism, Corruption and Capitalist Development: An Analysis of State Intervention With Special Reference to Bangladesh*, Unpublished doctoral dissertation, University of Cambridge, 1989.

<sup>62</sup> Mah-hui Lim, "The Ownership and Control of Large Corporations in Malaysia: The Role of Chinese Businessmen," in Linda Lim & LA Gosling (eds), *The Chinese in Southeast Asia*, (Singapore: Maruzen Asia, 1983).

The *New Economic Policy* was a state ideology of ethnic rights introduced in Malaysia in the seventies for ethnic redistribution. It effectively increased state elites' economic base of power with a huge program of SOEs and a push to acquire corporate equity through open market as well as negotiated purchases of strategic shares in private sector companies. The latter was achieved using state-owned investments holding companies as well as UMNO corporations set up to explicitly hold equity "in trust" for Malays. Both were financed with public monies. The NEP thus began a process that transferred policy making power as well as the state's holdings of corporate equity and, consequently, economic patronage from the ruling coalition to UMNO. It removed from parliamentary scrutiny the involvement of government in business which came more and more under party oversight.

Initially, the two main groups that benefited were the bureaucrats and the politicians. UMNO elites protected the bureaucrats from public criticism concerning their unfair and discriminatory decisionmaking while the bureaucracy provided economic justification for NEP decisions that served the interests of its political masters and carried out their policies that ensured the political leadership stayed in office. Bureaucrats, especially those from the ministries of finance, public enterprises, and trade and industry, had ample opportunity to take over and run firms set up by the state, giving rise to a new class of businessmen. Symmetrically, the creation of UMNO firms resulted in party leaders and their supporters benefiting. These channels of preferential access existed informally and conferred a particularly invaluable edge in an information-controlled society. Thus, the NEP increased the patronage power of the political leadership who also decided whom the recipients in ethnic restructuring exercises involving private sector corporations would be. This gave rise to the beginnings of a Malay business elite that would become fabulously rich under the ethnic privatization policy which we examine in the

---

<sup>63</sup> Khasnor Ibrahim, *ibid.*

following chapter. If the UMNO of old was rooted in a traditional world of Malay peasantry and village politics, and run by teachers and country doctors, the emerging UMNO was firmly urban based with a membership that was increasingly populated by more professionals trained in the West, more comfortable in the emergent corporate scene. Because of UMNO's prolonged domination of the state apparatus, there was now little difference between UMNO and the state, not least in terms of whom the political leadership was. The post-1969 reformulation of the ethnic "bargain" between Malays and ethnic Chinese at Independence translated inexorably into a more exclusivist Malay state. With this issue of ethnic dominance "settled," the main confrontation in Malaysia became one within the Malay community itself.

### **CHAPTER THREE: Privatization as insinuation of the state into markets**

---

By the early eighties, UMNO's focus had shifted from passive stock investments to an aggressive program of mergers-and-acquisitions, takeovers, and reverse takeovers. A privatization policy working hand-in-glove with party control over the regulatory agencies and the financial sector saw the divestment of SOEs, and other public assets such as utilities without open and competitive bidding. It also involved the transfer of UMNO's corporate interests to hand picked Malay businessmen who had acted openly as trustees for UMNO in the first decade of the NEP but, now, as proxies for the political leadership. With this strategy, UMNO's assets, acquired using public monies in the first instance, were eventually transposed from party oversight to the personal control of the political leadership, albeit through its co-ethnic proxies. In Malaysia, privatization did not roll back the frontiers of the state but fudged them instead. Privatization offered the state political cover to insinuate itself into the market: it apparently divested public assets to the private sector but, in truth, did not lose control of those assets. In fact, through co-ethnic proxies, the political leadership acquired operational control over strategic firms in critical sectors of the economy. Hence "privatized statism" was market-tracking . Because these proxies were high profile Malay corporate "movers and shakers," the political leadership could claim that privatization folded seamlessly into the NEP, thus promoting ethnic advancement.

This chapter is organized as follows. First, the economic rationale for, and political logic of, privatization are reviewed in Section I and section II respectively. Next, in Section III, I describe the material foundations of Malaysia's ethnic privatized statism. I show how UMNO's colossal empire of corporate holdings was constructed and divested to proxies, thus consolidating the Malay business class. The story is told in two main parts, viz., first, the Renong story that, in turn, requires an explanation of the Fleet-and-Hatibudi saga; and, second, the MRCB deal. Then,

in Section IV, I assess, first, how vulnerable for the political leadership these corporate holdings are, given it does not have direct ownership and control; and, second, how vulnerable to market competition these corporations are. Finally, in Section V, the economic and political impacts of privatization on Malaysian society and polity are considered.

### **Section I: The economic logic of privatization**

The spread of privatization policies was a striking feature of the global economy in the eighties when several countries embarked on privatization programs regardless of political regime or level of development. Empirically, though, concrete cases of divestiture relative to the scale of programs envisaged have been quite limited in developing countries.<sup>1</sup>

Economic analysis is well suited to the task of finding an optimal way of achieving a more efficient mix of services and providers, which is usually posited as the main motivation in privatization programs all over the world. Were the ends of privatization indisputably allocative in nature, economic analysis would provide the most appropriate approach. Privatization would then be a policy that seeks to make institutional adjustments so that services can be moved from where they are less efficiently provided by some specific combination of for-profits, non-profits, and public organizations to a state where they are more efficiently provided by some other combination of these organizations. These institutional forms fail to achieve economic efficiency when there is either market failure or government failure.

*Market failure:* This obtains where the market departs from pareto optimality when there are either externalities or market imperfections.<sup>2</sup> The former comprise costs or benefits that cannot be appropriated for trade and thus cannot be captured by the pricing mechanism. The latter arise

---

<sup>1</sup> RS Milne, "The Politics of Privatization in the ASEAN States," 7 *ASEAN Economic Bulletin*, 1991: 322-33; Milne, "Privatization in the ASEAN States: Who Gets What, Why, and With What Effect?" 65 *Pacific Affairs*, 1992: 7-29; Colin Kirkpatrick, "Some Background Observations on Privatisation," in VV Ramanadham (ed.), *Privatisation in Developing Countries*, (London: Routledge, 1993).

<sup>2</sup> Francis Bator, "The Anatomy of Market Failure," *Quarterly Journal of Economics*, 1958: 351-79.

from both imperfect information and market instabilities (such as panics) that prevent producers or consumers from exercising choice competently as well as risks that set up high barriers to entry (such as huge capital costs and regulatory requirements).<sup>3</sup>

The solutions to market failures include collective or government provision of services, regulation of private providers, or the use of non-profit organizations (NPOs) especially where there is “contract failure” due to problematic consumer information or competence.<sup>4</sup> Though not precluded from generating profits, NPOs are under a “non-distribution constraint” because their charters prevent distribution of profits to persons in control who therefore have disincentives to exploit consumers. However, such disincentives also render NPOs less likely to keep costs down which therefore tend to grow less efficient over time.

*Government failure:* The typical argument for government provision is that capitalists acting out of self interests as economic maximizers tend to provide an inappropriate level or quality of service at inflated costs.<sup>5</sup> However, there can also be government failure where government supply is inefficient because of either new inefficiencies created by government action, or constraints on government.<sup>6</sup> While these reasons may suggest that NPOs will be most appropriate under certain circumstances, all non-market organizations tend to expand beyond efficient size and suffer from information and incentive problems as they do. Where there is

---

<sup>3</sup> John Vickers & George Yarrow, *Privatization: An Economic Analysis*, (Cambridge: MIT Press, 1988).

<sup>4</sup> Henry Hansman, “The Role of Nonprofit Enterprises,” *Yale Law Journal*, 1989: 835-901.

<sup>5</sup> Neil Gilbert, *Capitalism and the Welfare State: Dilemmas of Social Benevolence*, (New Haven: Yale University Press, 1983).

<sup>6</sup> New inefficiencies created by government initiatives include internalities (or manifestations of private goals of individuals in public organizations); redundant and rising costs (from internalities, politicians pursuing unrealistic and conflicting goals; difficulty in measuring and monitoring output of public agencies; difficulty in terminating programs that are no longer useful); and, derived internalities (or unintended side effects of government intervention in market processes such as economic losses from tariffs.) Constraints on government, on the other hand, can arise from the requirement for a uniform level of services as well as universal provision (which means that non-typical needs are not attended to and experimentation disallowed); the need to attend to the majority’s conception of the public good (so that only key voters are fully satisfied); the short termism of politicians (so that long term consequences of public policy are neglected); informational deficits in the government; and, the bureaucratic size of government organizations such that they are difficult to approach and access for many; see, Charles Wolf, “A Theory of Nonmarket Failure: Framework for Implementation Analysis,” *Journal of Law and Economics*, 1979: 107-139; also, James Douglas, *Why Charity*, (Beverly Hills, CA.: Sage, 1983).

market failure, it may be necessary for government to deliver but where there is government failure as well, it may be better for government provision through contractual arrangements with the private sector third-party providers. Long practiced in the United States (and largely the form of privatization in Malaysia now), this permits adaptation of local services to local community needs and may be cost effective where there are diseconomies of scale.<sup>7</sup> However, this contracting-out may be hobbled by the small numbers problem when there are few bidders by default or design. There may be few effective traders in a market either initially or after rounds of bidding for contracts have reduced bidders to outsiders and incumbents.<sup>8</sup> Under these conditions, internal organization or delivery of services by the government in-house may be preferable to curb opportunism.

## **Section II: A political logic of privatization**

The case for privatization on narrow economic grounds is often spurious because, for all its economic concerns, privatization has to do with what is properly public and what private, and is therefore inherently political. Thus, while economic analysis starts from the assumption that property rights are exogenously and clearly defined, existing property rights are the outcomes of previous social bargaining and are constantly being contested in politics. The delineation of property rights is not independent of what the members of society believe to be legitimate and are willing to accept, and what is accepted as being legitimate depends on the politics of the collectivity concerned. (Consider child labor, for example.)

A valid political argument for privatization though rarely articulated is that privatization would not be required if there were an ideally functioning state that imposed suitably tight budget constraints and actively promoted competition where required thereby achieving the efficiency

---

<sup>7</sup> Lester Saloman, *Partners in Public Service: Towards a Theory of Government-NonProfit Relations*, (The Urban Institute, 1985).

<sup>8</sup> Oliver Williamson, *Markets and Hierarchies*, (New York, NY: The Free Press, 1975).



gains supposedly associated with privatization. But such a state does not exist. In fact, in practice, the state often shields SOEs from competition and subsidize their inefficiencies. Given the inadequacies of the state, privatization, it may be the second best solution.

Because privatization programs are initiated by state elites in response to externally generated pressures and not the outcome of social forces, their effective implementation will require more than the commitment of state elites especially in parliamentary democracies. Empirically, though, privatization has been found to be limited as a tool to construct winning electoral coalitions in developing countries.<sup>9</sup> Political considerations other than electoral calculations may matter even more in privatization in developing countries. First, if policy is, at least, in part, about the ends of the state, it may be inappropriate to think about privatization in terms of optimal solutions or economic efficiency to the extent economic analysis assumes settled ends. Instead, questions about the ends of the state—which are, by definition, political—involving conflicts over values, power, and social relationships may be more relevant.<sup>10</sup> If certain ends beyond efficiency are at stake in the state’s efforts to restructure the provision of public goods and services, then one’s analysis must attend to what strategic contribution privatization makes to those ends in what is fundamentally a political struggle. That is, the ends of a privatization program in a developing country can be more far reaching than the economic ends

---

<sup>9</sup> As such, some pro-privatization coalition is required that may be constructed out of industrial and financial conglomerates (that are supportive as long as public assets are divested below their free market prices), and the retail stock market investor (who benefits from the flotation of public assets if priced low enough). The principal losers are SOE managers and employees (who can be coerced or otherwise bought off) as well as segments of the population that actually benefit from subsidized government services but who face collective action problems. For example, in Malaysia, affected state employees were induced to support privatization by the prospects of improved remuneration and medium-term employment guarantees. More importantly, it was a labor force frustrated by real wage erosion from inflation since a civil service wage freeze from 1980, and a lack of upward mobility in an employment structure based largely on educational credentials; see, Ziya Onis, “Privatization and the logic of coalition building: A comparative analysis of state divestiture in Turkey and the United Kingdom,” 24 *Comparative Political Studies*, 1991: 231-253.

<sup>10</sup> see, Max Weber, “Objectivity in Social Science,” in Edward Shils and Henry Finch (eds. & trans.), *On the Methodology of the Social Sciences*, (Glencoe, Ill: The Free Press,) 1949: 56-57. Weber argues that “the distinctive characteristic of a problem of social policy is indeed the fact it cannot be resolved merely on the basis of purely technical considerations which already assumed settled ends. Normative standards of

that obtain in efficiency minded reforms such as those in the United States or Sweden. Secondly, privatization, of course, does impact where the frontiers of the state are inscribed. Those frontiers are in no sense permanent for they can change as concerns and functions are constituted politically to fall within or without the domain of the public. That political constitution both reflects and impinges upon the strengths of competing interest groups within the polity. In turn, the allocation/reallocation—or distribution—of political power is impacted by changing boundaries of the state.

Privatization impinges upon the balance of political power, social goods, and cultural values because public and private spheres afford different opportunities for individual and collective choice so that to move something from the public to the private or vice versa is to move the issue away or into the domain of public discourse. Battles over whether a set of problems is properly public or private typically calls forth a combination of material interests and ideological commitments. These concerns are not otiose because they determine what evaluative criteria—whether more inclusive or more exclusive—are applied to specific privatization proposals.

Privatization may be construed as an agenda setting strategy that seeks to achieve control over how the issues of conflict are defined; control over the choice of battlefields critically determines victory or defeat.<sup>11</sup> It is not a policy end but a terrain where conflicts over the state's ends are fought. For example, state elites generally posit privatization as a technical or administrative concern rather than a matter encompassing the distribution of material benefits and symbolic capital. The reason for doing so is that it narrows the scope of conflict by limiting the discourse to “experts” and to non-political questions of “better management” or “efficiency.” It specifies policy ends by default and conceals the “non-technical” issues which are contentious social policy objectives with respect to material benefits and political power. This strategy also

---

value can and must be the objects of dispute in a discussion of a problem of social policy because the problem lies in the domain of general cultural values.”

<sup>11</sup> Roger Cobb & Charles Elder, *Participation in American Politics: The Dynamics of Coalition Building*, (Baltimore: Johns Hopkins University Press, 1983).

enables policy elites to avoid legislative scrutiny that may well lead to a broader examination of its scope of concerns. It allows indirect policy making through what are basically alterations in bureaucratic structures or discretionary bureaucratic practices in policy implementation. Such moves are less visible than formal policy changes effected through legislative processes.<sup>12</sup> In this manner, privatization allows social policy to be altered without subjecting policy provisions to free ranging political debate. In the same manner, posing privatization as a question of the size of government (“trimming the fat,” etc.) implicitly serves to limit discussion bureaucratic failure.

All these concerns may have been important in the Malaysian context, but the distinguishing feature was that state elites wedded privatization to ethnic interests. The privatization process worked hand-in-glove with UMNO’s many corporate dealings, first, taking state owned assets out of the public domain (and, therefore, from Parliamentary scrutiny) and placing them in party coffers. Next, by legally severing explicitly acknowledged party-business ties—a move necessitated by the unexpected outcome of a legal suit arising from a factional dispute that saw UMNO declared an “unlawful” society—these assets were then transferred from party oversight to be placed in the hands of a number of Malay businessmen proxying for state elites of the ruling faction.

### **Section III: Privatization as insinuation of the state into markets**

In Malaysia, there was a wide disparity between the stated aims of the privatization policy and the manner in which it was carried out. There has only been a relatively modest transfer of equity ownership to the private sector. As such, the state continues to play a huge role in the ownership and control of assets that have only been partially sold. New boards of directors that replaced career bureaucrats are typically made up of individuals with strong links to UMNO.

---

<sup>12</sup>cf. Evelyn Brodtkin, *The False Promise of Administrative Reform: Implementing Quality Control in Welfare*, (Philadelphia: Temple University Press, 1986).

When the role of the state's Golden Share is included, it is clear that public share issues have done little to transfer control of privatized entities to the private sector.<sup>13</sup>

What is less obvious is how privatization has enabled state elites to strengthen their factional bases, build strong party machines, and stave off any political challenge from within or without. Even before privatization, as indicated in Chapter Two, UMNO had begun to own cooperatives, first, and investment holding companies, later, to promote party finances and, putatively, to protect the ethnic wealth of its stakeholders. The profits from these enterprises were used to fund party elections that were progressively more and more expensive as party members further and further down the pyramid had to be bought off with material rewards in return for their votes.<sup>14</sup> But it was privatization that enabled state elites to build up power bases for themselves on the back of UMNO's domination of the state apparatus. Operating without conflict-of-interest rules, there were large, lucrative privatization contracts with the government, and divestment of SOEs at below-market prices to party-owned and party-backed private sector corporations without open bidding. As such, these corporations typically reaped huge profits as favored beneficiaries of the government's increasingly aggressive development programs. Privatization projects transformed UMNO in less than a decade from a passive investor to a huge and active corporate player while its proxies also stood to gain personally from rampant insider trading.<sup>15</sup>

We have already detailed the Fleet story in Chapter Two. Fleet was UMNO's first investment vehicle. UMNO Treasurer and the first Malay MOF, Tengku "KuLi" Razaleigh, had

---

<sup>13</sup>A. Aziz A. Rahman, "Privatisation in Malaysia," in VV Ramanadham, *ibid.*; also, Rahman, "Privatization in Malaysia: Some Observations of the Divested SOEs," in Hara Fujio (ed), *Formation and Restructuring of Business Groups in Malaysia*, (Tokyo: Institute of Developing Economies, 1993).

<sup>14</sup> Edmund Gomez, "Electoral Funding of General, State and Party Elections in Malaysia," *26 Journal of Contemporary Asia*, 1996: 81-99.

<sup>15</sup> Mahathir has been noted to say that "In trying to redress the imbalance, it will be necessary...to bring out more Malay entrepreneurs..and make Malay millionaires, if you like, so that the number of Malays who are rich equals the number of Chinese who are rich." *Quoted in, Ozay Mehmet, Development in Malaysia: Poverty, Wealth and Trusteeship*, (INSAN: Kuala Lumpur, 1988).

set up several state investments holding corporations including Pernas before setting up Fleet.<sup>16</sup> All were passive investment firms that grew flushed with dividends flowing from their manifold shares in major blue-chip Malaysian, Singaporean, and British public listed companies. By the end of KuLi's stewardship in 1982, through this mode of passive investments, profit-making Fleet had acquired substantial holdings in 23 corporations in banking, insurance, telecommunications in addition to publishing.

Mahathir who had become Prime Minister in 1981 had different plans for Fleet which he wanted to be a model for Malays of dynamic corporate management by Malays. KuLi's successor as UMNO Treasurer and MOF, Daim Zainuddin, therefore turned Fleet into an aggressive market player.<sup>17</sup> A Mahathir confidant, Daim took over from KuLi when the latter lost in his 1981 bid for UMNO Deputy President against Mahathir's choice for Deputy Prime Minister, Musa Hitam. Trustees on the BODs of UMNO corporations who had been appointed by KuLi were replaced by Daim's appointees. UMNO's control over the financial sector was exploited to fund Fleet's new program of aggressive M&As, TOs, and RTOs. Fleet's highly leveraged mode of acquisitions saw it grow rapidly into a huge and diversified conglomerate.

As UMNO Treasurer, Daim's method of financing the party's acquisition of corporate assets stood in stark contrast to his image as a properly fastidious MOF. One of his first acts as MOF was to reduce government borrowings to roughly half their 1982 levels. By 1987, he had slashed public spending to 9.7% of GNP compared to 22% in 1982. He had progressively reduced foreign debt to RM41.8 billion by 1989 compared to more than RM50 billion in 1984 at the start of privatization which he pushed through. He also pressed Mahathir to relax some of the NEP's tenets to allow more participation by ethnic Chinese and foreign capital during the recession of the mid-eighties. These changes encouraged a surge in FDI which helped fuel

---

<sup>16</sup> For many years before the 1987 UMNO crisis, Malaysian and foreign newspapers had routinely referred to Fleet as UMNO's investment arm without ever being challenged.

<sup>17</sup> AWSJ August 9, 1982.

Malaysia's economic recovery. The GDP which had contracted 1.1% in 1985 began growing and growth reached 9.4% in 1990.<sup>18</sup>

As UMNO Treasurer, however, Daim wielded UMNO's control over the state's regulatory oversight of the financial and corporate sectors to shepherd Fleet through complicated maneuvers that grew the firm rapidly but eventually encumbered it with a serious debt burden. Because of its rapid expansion, there was also inadequate attention to the management of its acquired corporations. With the recession, Fleet found itself in dire straits.<sup>19</sup> After the 1985 recession, Daim resorted increasingly to cashless share swaps as an inexpensive way to raise funds and to take over companies.<sup>20</sup>

In 1985, UMNO set up a new vehicle, Hatibudi—a Malay neologism which roughly means *a heart for good deeds*—for a second beginning, determined not to repeat Fleet's mistakes. The NEP's sets-asides for Malay ownership of equity—a constitutional amendment made it seditious to question Malay "special rights"—made it simple for UMNO corporations, nominee companies, trustees, proxies, and family members of state elites to buy into a host of local corporations.<sup>21</sup> In addition, the party's enduring domination of the state apparatus ensured a steady flow of "privatization" contracts for such firms. Using the privatization mantra as justification, Daim doled out lucrative public works contracts and divested public assets to Hatibudi corporations. There was also a methodical effort to either sweep the last major independent businesses owned or controlled by ethnic Chinese into an alliance with UMNO corporations or proxies, or take them over completely.<sup>22</sup>

---

<sup>18</sup> Jomo KS, "Wither Malaysia's New Economic Policy," 63 *Pacific Affairs*, 1991: 469-99.

<sup>19</sup> Nick Seaward, "Fleet Group sails into heavy weather," *Far East Economic Review*, September 03, 1987: 58-59.

<sup>20</sup> Edmund Gomez, 1990, *ibid.*, 37-43

<sup>21</sup> "Stocks for the Privileged? An allocations furor puts UMNO on the defensive: Rafidah gave names," *Asiaweek*, Nov 30, 1994, pp. 38; also, Murray Hiebert, "The Privileged Few: A string of court cases and scandals provides a rare insight into how political patronage is dispensed in Malaysia--and who benefits from it," *FEER* July 6, 1995 pp. 14-15.

<sup>22</sup> Pek-Khoo Heng, "The Chinese Business Elite of Malaysia," in McVey, 1992, *ibid.*

Daim's distinctive *modus operandi* wielding privatization in lockstep with UMNO's control over the FIC and CIC was as follows. (The CIC was used to justify pricing equity involved in these corporate maneuvers at huge premia or discounts as the deal may require. The extra-legal FIC under the Prime Minister's Department exempted corporations involved from various regulatory requirements.) First, a financially unsound and sluggish publicly listed company (plc) would be taken over to serve as UMNO's vehicle for expansion. An un-distressed UMNO plc engages in a share swap with the new vehicle at inflated prices of its shares vis-à-vis those of the firm being acquired, usually with no cash changing hands. The deal results in the undistressed plc acquiring control of huge equity shares in the weak plc and establishing majority control in the latter. Whittling down the acquiring plc's huge shares in the acquired plc's through their sale in the open market just enough so that the former retains control over the latter's core assets raises cash. New shares in the acquired plc, now with a better asset base, are then issued for sale to its existing minority shareholders, again so that it is just sufficient to ensure UMNO retains control of the concern.

Retail investors in the rumor-driven KLSE snap up these issues knowing that the rejuvenated plc is a "political blue-chip" that promises astronomical premia in the near future. The funds raised by these strategems are used to not only narrow the burden incurred in taking over the weak plc but also to wipe out the debt of some other UMNO company that is acquired by the now cash-rich vehicle through another cashless equity swap. The overall entity that emerges is now even larger but debt-free and is plied with several lucrative privatization contracts. As a result, its stock rapidly appreciates in price, which allows it to go on an acquisition spree, pledging its shares, those of its operating companies, and shares of companies to be acquired as collateral for project funding and for loans to finance its M&As. In this manner, the conglomerate bloats up very quickly. (I revisit stock market politics in detail in Chapter Four.)

The key to carrying these deals through is UMNO's control over the extralegal FIC and its Panel on Takeovers and Mergers, the CIC (or its successor, the Securities Commission), the

KLSE, and the ROC. These levers mean that UMNO can ride roughshod over the interests of minority shareholders. (In Malaysia, shareholder democracy is a myth and minority interests have precious little to say under the Companies Act, a little known fact among retail investors. I discuss this in some detail in Section V below.) The masking of corporate ownership and control behind a wall of complex maneuvers and convoluted share swaps, trustees, nominee companies, and proxies makes unraveling the skein of party holdings very tricky at best. The strategy shields the extent of corporate wealth state elites now control and also obscures the great extent of the skewed distribution of wealth.<sup>23</sup>

Moreover, because the CIC required new shares to be issued at a substantial discount from market prices, listed companies became vehicles used by UMNO proxies, invariably majority shareholders and directors of these firms, to use for costless and profitable mergers-and-acquisitions on the basis of swaps under boom conditions. This was how it was done. Assuming a publicly listed corporation called plc A, whose shares are being actively traded on the stock exchange, wants to acquire a piece of property Z from party B in exchange for A shares although B is not actually interested in retaining ownership and control of equity in A. First, the two parties agree to set the price of the property Z above its market price. The substantial difference insures the sellers against unfavorable share price movements. Party B makes a prior agreement with the majority shareholders and directors of plc A to sell back to the latter A shares at par which is the price of its rights issue the CIC authorizes. These Malay majority shareholders and directors acquire preferential bank credit to re-purchase these shares using the shares to be re-purchased as collateral. Banks acquiesce because these individuals need only sell a portion of these new shares at market price in a surging bourse and the capital gains would be sufficient to repay the bank loans. Thus, these individuals increase their equity holdings in A without placing any of their personal resources at risk, while firm A acquires property Z. This is a popular maneuver used by UMNO corporations and their collaborators who

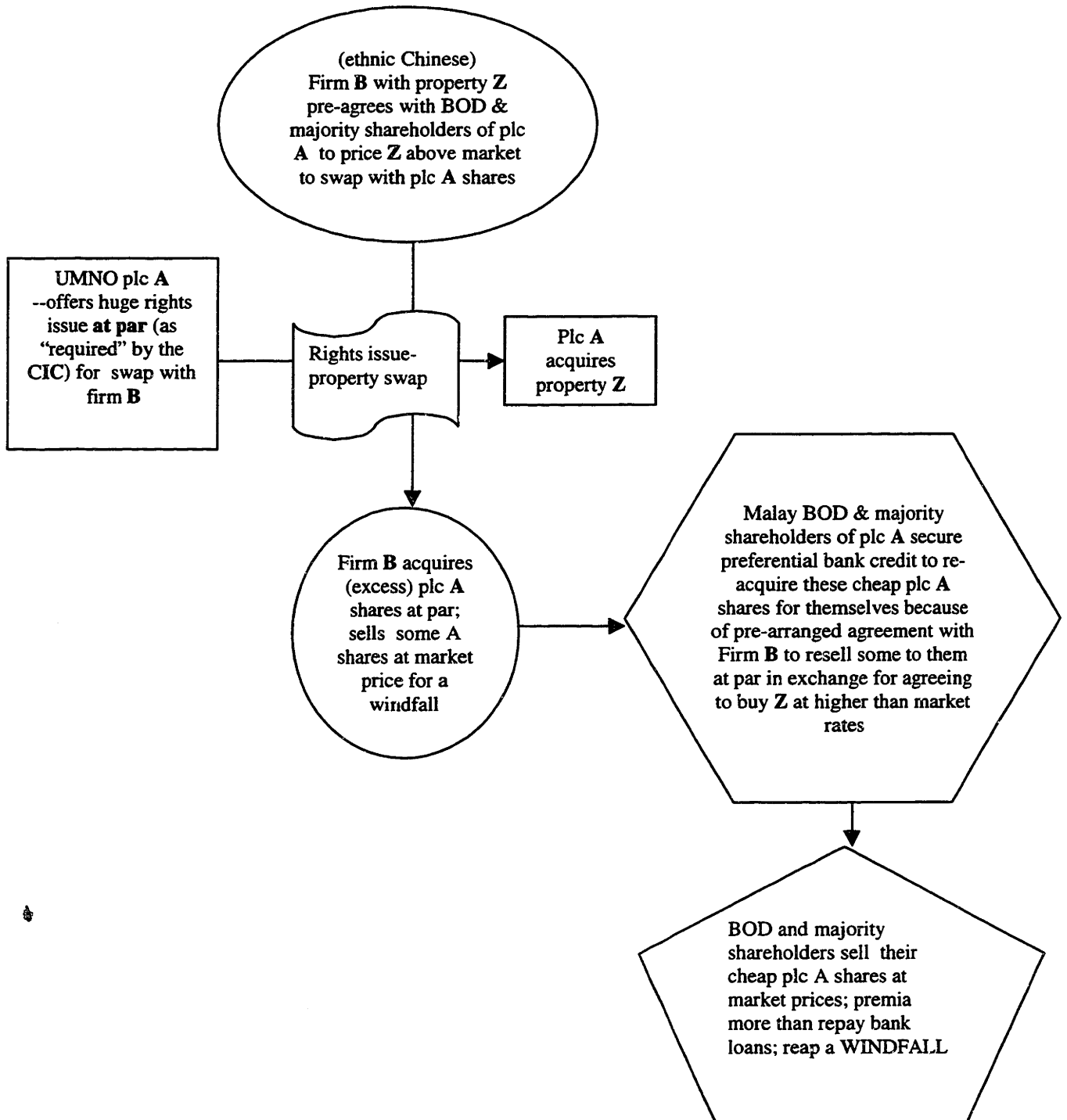
---

<sup>23</sup> Meiling Sieh-Lee, "The Transformation of Malaysian Business Groups," in McVey, 1992, *ibid*.



are, not infrequently, ethnic Chinese firms with clientelist ties to UMNO. The obvious way to prevent these insider schemes would be to minimize the differential between issue price and market price. The CIC's response, instead, was to issue broad guidelines on what would be deemed permissible acquisitions through such swaps. Speculative activity naturally flourished. (Fig. 3.1)

**Fig 3.1 How UMNO Proxies profit themselves**



Institutional barriers have been erected that increase the information costs of delineating ownership and control of plcs. An amendment to the Securities Industry (Amended) Act, 1988, (Section 99B), requires the Chief Executive and Directors of a plc, their spouse, children, and parents to file details of their interests in the securities of the corporation concern, however minuscule the holdings. (In contrast, Section 69D of the Companies Act 1965 defines substantial interests as not less than 5% of the issued shares of a corporation at which level the person holding such shares in a plc must declare his or her interests.) Why would non-significant holdings have to be declared? After all, there are many ways to evade this requirement. The pro forma is very tedious to fill out—well nigh impossible were it not for electronic calculators—and even worse to peruse. It has been suggested that non-significant holdings have to be declared because whatever the limit set, each affected member of the family would then elect to hold shares just below the limit. If the family were large, total share holdings would be very substantial and still not contravene the rule. (Most Malay families are large as a matter of religious conviction while most Chinese families are comparatively smaller so the law must impact Malays more which supposedly absolves the state of any suspicion of bias.) Yet the obvious solution, whatever the threshold, is to make the Chief Executive or Director concerned personally liable for the aggregate holdings even if no individual family member holds securities in excess of the threshold. After all, he or she is in the best position to ascertain if the aggregate limit has been exceeded. I suggest that the requirement simply serves to raise the transaction costs for anyone trying to ascertain ownership and control of enterprise in Malaysia.

### **Case studies**

UMNO's corporate empire such as it exists today was acquired largely through privatization during Daim's tenure as MOF. Although UMNO has several other conglomerates, the story of how the political leadership parlayed privatization into a corporate empire for itself has two main parts. The first element was the Renong restructuring in 1990 which, in turn,

requires an explication of the antecedent Fleet-Hatibudi saga. The Fleet-Hatibudi saga explains how state elites divested public assets to the ruling party thus removing them from Parliamentary oversight and placing them into the hands of party elites. The Renong restructuring, in turn, removed these assets from party oversight and transferred them into the personal fiefdoms of the political leadership through proxies. The political leadership could henceforth declare publicly that the party/government had severed all ties to business. The second case involves an UMNO faction's management buyout of a portion of Renong, specifically, its media conglomerates TV3 and NSTP, using a public listed vehicle, MRCB.

### **Case 1: The Renong Privatization Rescue of Fleet & Hatibudi**

Although the Renong restructuring took place in 1990, the watershed year was actually 1987. In that year's triennial party elections, the most bitter in its 30 year history, Mahathir narrowly defeated KuLi (761 to 718) to retain party presidency and, therefore, the office of Prime Minister. Mahathir's running mate, the DPM, Ghafar Baba, also won over former DPM and KuLi's running mate, Musa Hitam, for the deputy presidency and, therefore, the office of DPM, by an equally slim margin (739-699). There was probably ballot box stuffing as there were 30 unregistered UMNO branches.<sup>24</sup> On the grounds there were delegates to the general assembly (who vote at the party polls) from these illegal branches, KuLi's faction brought suit to declare party elections null and void. In February 1988, the Kuala Lumpur High Court unexpectedly declared UMNO itself an "unlawful" organization in virtue of these illegal branches. Since the parent body was "unlawful," the legality of the elections did not require a specific ruling. This paved the way, after the initial shock, for the Mahathir faction to form a new party he called New UMNO reverting, later on to just UMNO. KuLi's faction appealed the High Court verdict to the

---

<sup>24</sup> Diane Mauzy, "Malaysia in 1987: Decline of the Malay Way," *XXVIII Asian Survey*, 1988: 215; also, Shamsul A.B., *The Battle Royal: The UMNO Elections of 1987*, *South East Asian Affairs*, (Singapore: Institute of Southeast Asian Studies, 1988).

Supreme Court. The chief justice (called the Lord President) who was to have presided over the appeal was suspended along with five other Supreme Court justices under trumped-up charges. Mahathir had publicly attacked the chief justice for alleged bias in the UMNO case and other cases involving the government. On the day his dismissal became effective, a new chief justice who proved to be a very compliant one (and who was never recognized by the Bar Council up to his retirement on grounds that he had presided over the tribunal that sacked the chief justice although he was himself next in line for the position) heard the appeal.<sup>25</sup> That is, despite the conflict of interest involved, the acting chief justice accepted the appointment to head the tribunal deliberating on the charges against the suspended chief justice.

The Supreme Court upheld the High Court's verdict that "as a result of the existence of the unlawful branches, the main body (UMNO) had also been rendered unlawful. However, it rejected the High Court ruling that as UMNO was illegal at the time of the 1987 elections, those elected in the previous party polls in 1984 continued to be lawful in which case "the obvious remedy was for office bearers elected in 1984 to hold fresh elections at all levels (of UMNO) after obtaining the necessary approval of the unapproved branches from the Registrar of Societies."<sup>26</sup> Had the appeal been upheld, Mahathir's publicly declared aim of excluding KuLi's dissidents from New UMNO would have been thwarted. More importantly, had it been upheld that the 1984 Supreme Council was still valid, its office bearers supporting KuLi would have the right under UMNO's constitution to call a party general assembly and new party polls whereas Mahathir's faction would not have been able to do so since it was legally constituted as a new party, New UMNO.

Under the Societies Act, all property of an illegal organization was forfeited to the Registrar of Societies "for disposal in such a manner as he may see fit."<sup>27</sup> The legal status of

---

<sup>25</sup> KS Nathan, "Malaysia in 1988: The Politics of Survival," XXVIII *Asian Survey*, 1989: 130.

<sup>26</sup> *Asiaweek*, October 16, 1987: 19-20

<sup>27</sup> *New Straits Times*, July 7, 1988: 1

UMNO's corporate empire became a vexing problem for both factions, neither presumably willing for political and financial expediency to sacrifice billions of ringgit worth of assets accumulated painstakingly. At the time, most UMNO corporate assets were grouped under Fleet Holdings and Hatibudi. These together with UMNO's imposing headquarters, the Putra World Trade Center (PWTC), were supposedly handed over to the Official Assignee (OA) in February 1988.

The OA, it was learned much later, had sold the very profitable Hatibudi to Hatibudi Nominees, a holding company set up by the same individuals who had controlled Hatibudi before the 1987 crisis, viz., Halim Saad and Annuar Othman., both Daim's proxies. When Renong took over Hatibudi Nominees, the latter did not have 25 million UEM shares listed among its assets taken over by the OA. (It was suspected that the Mahathir faction had sold these off to fill its coffers for an expected tussle with the KuLi faction in the impending general elections.<sup>28</sup>) The non-disclosure of the movement of such a substantial number of publicly listed shares was in serious violation of KLSE rules. Yet, by September 1990, the necessary approvals from the FIC, CIC and the Central Bank had been secured for the Renong restructuring with minor conditions attached.

Thus, in 1990, almost all of UMNO's assets were brought under a little known publicly listed property company, Renong Bhd.; one individual, Halim Saad, had acquired all of UMNO's controlling shares in some of Malaysia's largest corporations in exchange for agreeing to pay off Fleet's debts of about RM600 million. (In fact, Halim paid off less than RM30 million to acquire Fleet Holdings and all its firms) Halim Saad was appointed Executive Chairman since he held a 17.7% personal stake in Renong.<sup>29</sup> Together with Renong shares owned by Fleet, UMNO effectively controlled Renong whose other directors and significant shareholders were also UMNO proxies. The notion that UMNO's corporate empire had been bought by one individual

---

<sup>28</sup> Edmund Gomez, *Money Politics in the Barisan Nasional*, (Kuala Lumpur: Forum Enterprise, 1991).

<sup>29</sup> *New Straits Times*, November 3, 1990.

was greeted with widespread disbelief. Even UMNO members wondered how the party's sprawling corporate assets so carefully assembled over so many years could have been acquired by one person in exchange for paying off corporate debts which were a mere fraction of their potential asset value.

Renong had been incorporated in Britain and was taken over by ethnic Chinese interests in Malaysia in 1981, went public in 1983 as an investment holding company with subsidiaries in property development, but performed badly so that, by late 1989, it was weak enough to be susceptible to a takeover. What the Renong restructuring amounted to was a reverse takeover of Renong by UMNO's Fleet and Hatibudi Nominees which turned over their entire paid-up capital to Renong in return for control of Renong, absorbing a total of RM1.04 billion in new Renong shares issued to finance the cashless transaction. (Another RM186 million of Renong shares were also offered to Hatibudi's cash cow, UEM.) This was the largest takeover in Malaysian corporate history. Yet it was effected with almost no cash outlays.<sup>30</sup>

Subsequently, the Renong holdings of both Fleet and Hatibudi were reduced to 50% to raise money for shareholders to pay down Fleet's current liabilities of RM600-650 million at the time. The sale of 440 million Renong shares at RM1 per share to existing shareholders removed RM440 million in debt, boosted its capital by 90% to 1.34 billion shares with a market capitalization of RM6.7 billion and put RM1.2 billion in unencumbered funds as well as very promising assets at UMNO's disposal.<sup>31</sup> Thus, the exercise increased the asset value of UMNO's corporations by merging the highly leveraged and indebted Fleet with the far healthier Hatibudi and its UEM. It was, in effect, a re-organization and cash-raising exercise that put a new face on old practices. With the restructuring completed, Renong controlled the country's largest construction firm, UEM, which was the contractor and 30-year concessionaire for the RM57

---

<sup>30</sup> Sally Cheong, *Corporate Groupings in (sic) the KLSE*, (Petaling Jaya: Modern Law Publishers, 1990).

<sup>31</sup> Sally Cheong, *Bumiputera Controlled Companies in (sic) the KLSE*, 2d. ed., (Petaling Jaya: Corporate Research Services, 1993).

billion, 870 kilometer tolled North South Expressway (NSE) running from the Thai border in the north to the Singaporean one in the south. This extremely lucrative B-O-O “privatization” contract had been awarded to UEM under questionable circumstances.<sup>32</sup>

UEM’s toll rights alone were enough to ensure a steady flow of cash for a generation. Its projected toll revenues for the whole concession period till 2018AD were cumulatively worth about RM77-82 billion according to Renong but in excess of RM100 billion according to analysts I spoke to. Eventually, Renong was to acquire a virtual monopoly over toll collection on almost every highway (except for a short stretch in a predominantly Chinese suburb of Kuala Lumpur that was managed by Metromac Corp., also owned by Halim Saad.<sup>33</sup> The high toll charges when first imposed there sparked violent protests in which an Opposition MP was jailed under the ISA. Because of the controversy, UEM decided not to proceed with its announced plan to acquire Metromac as well.) All in all, in 1990, seven other firms in the Renong stable held RM1.57 billion in related contracts from the NSE project. UEM itself had its own cement, quarrying, construction and steel fabrication companies acting as contractors or suppliers for the NSE project. Several other services traditionally provided by the state were also contracted out to Renong firms. For example, UEM also headed a consortium that was awarded the right to take over the RM1 billion a year running of the government’s medical supplies department including the manufacture of generic drugs and the distribution of healthcare products to state run hospitals and clinics.<sup>34</sup>

Importantly, this exercise meant that UMNO had centralized its control over all major dailies in English, Malay and Chinese as well as the nation’s only private TV station. With its share price appreciating rapidly, Renong went on an acquisition spree. In addition to NSTP, the largest publishing and media company; STMB, running the nation’s most popular TV station;

---

<sup>32</sup> Kit S Lim, *The \$62 Billion North-South Highway Scandal*, (Kuala Lumpur: DAP, 1987).

<sup>33</sup> *Investors’ Digest*, May-June 1994.

<sup>34</sup> *Asian Wall Street Journal*, Dec 11-12, 1998.

and, Bank of Commerce, the fifth largest bank, by 1993, Renong had taken over the following firms: Hume Industries, a giant construction materials producer; Faber Merlin, the largest hotel chain; Cement Industries of Malaysia, the largest cement manufacturer; and, Time Engineering with a subsidiary owning the second telecommunications network. In 1993, its listed subsidiaries and affiliates accounted for nearly 5% of the RM92 billion capitalization of the KLSE.<sup>35</sup>

Renong's sustained success at landing privatization projects was its trademark characteristic, and the longstanding lack of a convincing explanation of how UMNO's old assets migrated from the party to Daim's associates left suspicions about the true ownership of Renong that have lingered to this day. By 1995, Renong had at least RM13 billion in privatization contracts on its order books.<sup>36</sup> With the deal sealed, UMNO could technically disavow ownership of its companies while still being in control of, and drawing financial resources from, its firms. Daim declared that UMNO had ceased to be active in business as its corporate assets had been surrendered to the OA in 1988, first, and then bought outright by Halim Saad's Renong Berhad in 1990.<sup>37</sup> In effect, the political leadership had been handed on a platter a way to retain ownership and control of party corporate assets while legally divorced from them. Importantly, it also nullified KuLi's efforts to claim the old UMNO's assets.

KuLi publicly questioned the legality of Halim Saad's purchase since ownership of UMNO assets was still uncertain. According to KuLi, a court order was required before the OA could sell UMNO's assets after which the sale had to be made public. A bid for the assets was then required and the OA obliged to accept the best bid.<sup>38</sup> Yet the OA had not obtained such a court order. Moreover, the takeover of Fleet Group was not negotiated through the OA's office but directly with Fleet Holdings. This implied that Fleet Holdings and, therefore, Fleet Group,

---

<sup>35</sup> Sally Cheong, *Changes in Ownership of KLSE Companies*, (Petaling Jaya: Corporate Research Services, 1995).

<sup>36</sup> *Far East Economic Review*, "Its Our Pleasure," January 19, 1995.

<sup>37</sup> Doug Tsuruoka, "Interview with Daim Zainuddin: We've nothing to hide," *Far East Economic Review*, July 5, 1990: 50

<sup>38</sup> *Sin Chew Jit Poh*, May 3, 1990 (a Chinese language daily)



had already been sold by the OA but the identity of the party that obtained ownership of Fleet Holdings before the Renong deal was never disclosed.<sup>39</sup> In fact, the records of Fleet Holdings, and Fleet Group do not indicate they were ever held by the OA at all.

In October 1990, some leaders of KuLi's faction filed suit to declare the Renong RTO unlawful but by January 1992, the suit had been dropped. KuLi claimed the suit "would have been futile." A more important reason was probably because while he had become the first Malay opposition leader with a national following, it was he who had created Fleet in the first place and pioneered UMNO's involvement in business to raise cash for the party. As such, he had reason to fear that he would also be seen as being culpable for Fleet's misfortunes. State-owned Bank Bumiputra and state-controlled Malayan Banking that had financed the RM400 million UMNO Headquarters project had sued New UMNO to auction off the complex and the prime land on which it was erected. The action proved to have been motivated not primarily to recover their monies but to discredit KuLi, the project's prime mover and to block KuLi's attempts to recover the property that was also in the OA's hands. In December 1988, the two banks obtained a court order for an auction but did not proceed with it. In fact, the suit was dropped in August 1991 by which time the KuLi faction was already in disarray over defections to New UMNO.

Because UEM is crucial to the Renong empire, I devote some attention to it below.

- **Fleet Holdings**

This was the distressed portion of the UMNO empire before the Renong deal. The plcs under Fleet included NSTP, STMB, BOC, Hume Industries, and Faber. (see Chapter Two)

- **Hatibudi sdn bhd & UEM**

This was the cash rich part of the UMNO empire and its story is mainly about one of its plcs, UEM. The Hatibudi story is about UMNO's concerted effort to corner the construction market

---

<sup>39</sup> *Asian Wall Street Journal*, May 3, 1990

and keep rents accruing from government projects within the slew of its UEM-related companies. UMNO's ownership of Hatibudi was inadvertently revealed in Parliament in July 1987. In response to Opposition queries about the award of the NSE project to UEM, the Works Minister admitted that UEM was owned by Hatibudi whose Board of Trustees comprised UMNO's top leaders including Mahathir; Ghafar Baba, the DPM; Sanusi Junid, the Agriculture Minister; and, Daim, the MOF.<sup>40</sup> In a subsequent suit brought by the Opposition to stop UEM's NSE deal, Halim Saad also admitted in a court affidavit that he held Hatibudi shares "in trust for the ultimate beneficial owner, UMNO." Mahathir defiantly defended the deal on the grounds that UMNO needed funds to pay off its grandiose PWTC headquarters project.<sup>41</sup>

*UEM:* In keeping with Daim's modus operandi, UEM, a weak plc was acquired to serve as Hatibudi's vehicle of growth through government patronage. Originally United Engineers (UE), it was ultimately owned by Singapore's Overseas Chinese Banking Corporation (OCBC). UE went into the red in 1981 and its debts were already RM90 million in 1985 when discussions for the acquisition with the Singaporean parties began. During these discussions, it was made clear that Malaysian government and statutory-board contracts would be channeled into UE through Hatibudi.<sup>42</sup> Debt for equity swaps were arranged between UE and Hatibudi for the acquisition of the former in March 1985. Immediately, the new entity, UEM, started receiving several government contracts under Mahathir's "privatization" policy. (The MOF was responsible for tender decisions while the AG who should investigate and prosecute malpractices as well as prepare Government contractual agreements was also answerable to the PM.)<sup>43</sup>

In August 1985, UEM proposed its "privatization" plan to complete the remaining 500km of the 904km NSE six months before the tender was even advertised. When bids were opened,

---

<sup>40</sup> *The Star* July 10, 1987

<sup>41</sup> *The Star*, August 29, 1987

<sup>42</sup> *AWSJ*, January 18, 1988

<sup>43</sup> *AWSJ*, January 28, 1988

UEM was unable to provide the most competitive bid (by a difference of a few billion ringgit) regarding construction costs, the financial burden on the government, toll rates, the period of toll collection, and the total in tolls expected. Other bidders were given less time to prepare their tenders compared to UEM whose tender details are now no longer available under the amended Official Secrets Act.<sup>44</sup>

The Opposition pointed out in Parliament that UEM stood to profit without having to front a single cent because of a \$295 million pre-completion loan from the government during construction and a \$374 million post-completion loan payable during operations over ten years. These were in addition to toll collections. Prior to the NSE project, not only was UEM virtually insolvent--its counter having been suspended for some years--but it also had never built any roads as well. As such, it was heavily dependent on foreign partners including *Mitsui* of Japan, *Societe Francaise de Dragages et de Travaux Publics* of France, and *Taylor Wood* of Britain. UEM was guaranteed minimum traffic volume and toll collections for 17 years and the state would compensate it for any shortfalls in toll collections even though privatization was justified on the grounds that private entrepreneurs, not government, would bear the risks of investment. UEM secured a private monopoly but the deal, in fact, increased the financial burden on the state that also agreed to advance soft credit facilities to UEM of RM750 million. The Malaysian Highway Authority (MHA) handed over to UEM its highways that it had built for RM3.32 billion and UEM began to charge higher tolls on these roads immediately while the government continued to pay off the remaining RM1.6 billion incurred by the MHA in their construction. Finally, UEM was to be exempted from various taxes worth RM2.65 billion in foregone revenues to the state.

Despite the high profile court case over the NSE, which UEM won on appeal to the Supreme Court, UEM continued to receive other major privatization contracts but, now, without open bidding. A common feature in all these projects was UEM's lack of relevant experience or

---

<sup>44</sup> Nick Seaward, "UMNO's Money Machine," *Far East Economic Review*, October 6, 1988: 66-67.

expertise. In effect, UEM was a front for foreign companies, collecting handsome commissions for its ability to win contracts unopposed. These included project management consultancy for the expansion of a giant processing plant and export terminal for natural gas; a 392- hectare land reclamation project for the Penang state government,<sup>45</sup> the RM400 million National Sports Complex, the government medical supplies project,<sup>46</sup> and a new international airport for US\$4 billion. UEM quickly became the “political bluechip” of a resurgent KLSE. The rapid rise of its stock price allowed it to acquire controlling stakes in more companies and joint ventures by swapping its appreciating shares for those of companies being acquired.

For example, UEM acquired the Perlis state government’s profitable majority stake in Cement Industries of Malaysia Bhd. (CIMA) through an equity swap on terms unfavorable to CIMA’s minority share holders. A CIMA subsidiary was then appointed the sole supplier of cement for the NSE project.<sup>47</sup> Similarly, UEM acquired Time Engineering Bhd, a failing plc, through a share swap. Time Engineering was then awarded a RM5 million contract to maintain the NSE toll equipment, the B-O-O contract to build a RM1.7 billion Second Link (a tolled road and bridge link) to Singapore, and sole rights to develop adjoining property including a RM2.4 billion port near Singapore.<sup>48</sup> In 1990, Time acquired 49% in Celcom, a private telecommunications company that would later become the first cellular company with a 6 year monopoly.<sup>49</sup>

---

<sup>45</sup> *The Star*, February 12, 1990

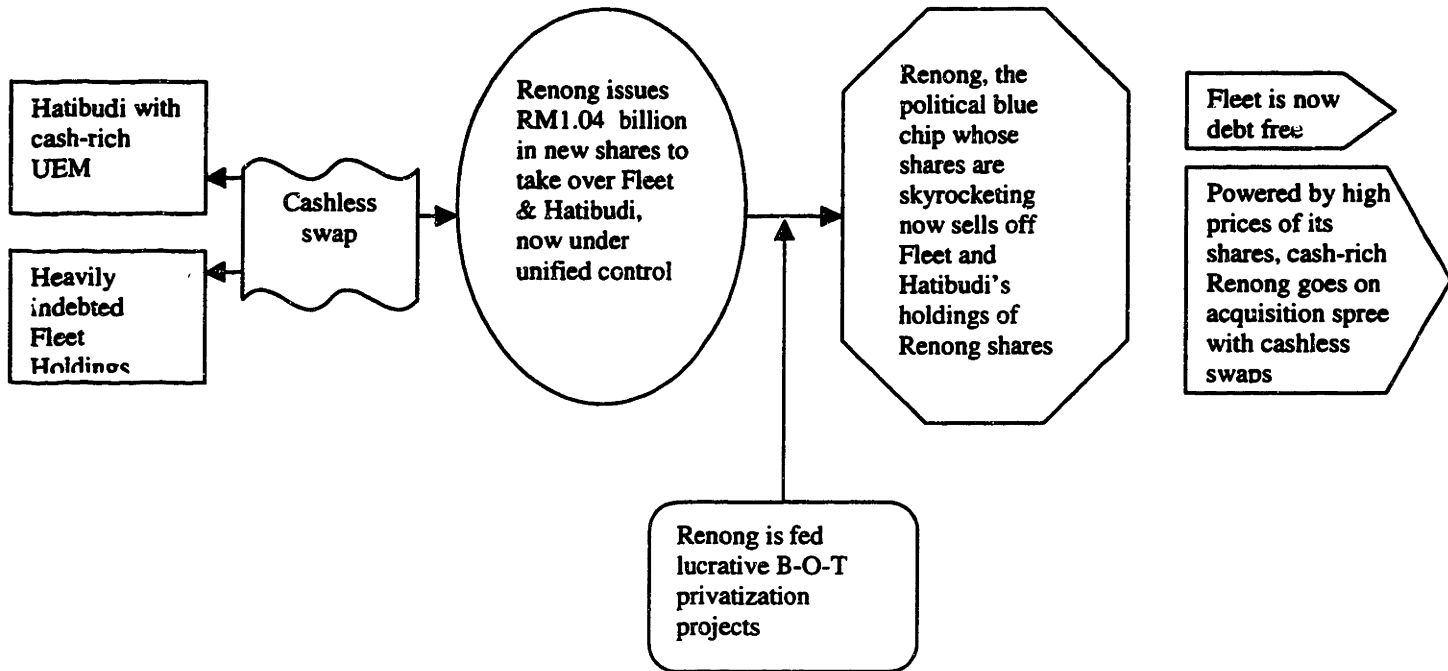
<sup>46</sup> *New Straits Times*, May 20, 1993

<sup>47</sup> *The Star*, September 4, 1991

<sup>48</sup> *The Star*, April 25, 1991

<sup>49</sup> Doug Tsuruoka, “Malaysia’s Leading Party Fills Up Its Election Coffers,” *Far East Economic Review*, July 5, 1990: 48-50.

**Fig 3.2 The Renong re-organization & cash-raising exercise**



**Case 2: MRCB & The Anwar Faction's MBO of TV3 & NSTP**

Anwar's rise up the party hierarchy, replacing Daim as MOF in 1991 and Ghafar Baba as DPM in 1993, meant that his faction was looking to strengthen its own base by acquiring some of UMNO's corporate assets. Anwar was openly feuding with Daim, who although out of the Cabinet on his own free will was well placed as UMNO Treasurer, to continue running many aspects of the nation's business as *de facto* economics czar. Factional jockeying centered on Renong's lucrative media firms, NSTP and TV3. A management reshuffling in 1991 brought the two media concerns under Halim Saad who interfered with operational management and editorial content, even sacking its Managing Director, a key executive linked to Anwar. When Anwar

became MOF that year, he began to openly criticize Halim Saad's stewardship of Renong and had him investigated for possible securities violations.<sup>50</sup> In turn, Daim, once a political ally of Anwar, began to openly criticize, in print, Anwar's handling of the economy.<sup>51</sup>

In 1993, a significant shuffling of Renong assets signaled that "peace had broken out" when Daim allowed a management buyout (MBO) of Renong-controlled NSTP and TV3 which led to the largest privately owned media groups in East Asia. In the MBO, four NSTP executives allied to Anwar set up Realmild sdn bhd., a small private company with no asset base, to acquire 48.01% of NSTP and 43.22% of TV3 for RM800 million. A noteworthy fact was that the NSTP and TV3 stocks were purchased at above-market prices. In by now a familiar fashion, the executives used a troubled plc, Malaysian Resources Corporation Berhad (MRCB) as their vehicle for the MBO. In early 1993, MRCB was a troubled publicly listed developer and investment holding company controlled by Hong Leong, an ethnic Chinese conglomerate linked to Anwar, that had itself purchased MRCB through open market purchases barely four months before the MBO.<sup>52</sup> In Realmild's MBO of NSTP and TV3, and its reverse takeover of MRCB, financing came from bank loans, a bonds issue, and a new issue of 275 million MRCB shares that diluted Hong Leong's equity which therefore relinquished control of MRCB. Heavy Industries of Malaysia Bhd (HICOM) which had not been privatized yet, whose majority shareholder was MOF Inc, the MOF's holding company, also took up 20% in MRCB. Thus, in effect, Hong Leong had placed its resources at Anwar's disposal to facilitate the MBO.<sup>53</sup>

Because Realmild's acquisition exceeded the 33.3% trigger in both NSTP and TV3, it was required by law to make a general offer (GO) to the minority shareholders in both plcs at the higher-than-market price it had paid for the rest of the equity. An FIC waiver of the GO requirement sidelined minority interests but signaled Mahathir's approval of the MBO. With the

---

<sup>50</sup> *The Star*, February 22, 1993. The results of the probe were never disclosed.

<sup>51</sup> *FEER*, June 15, 1993.

<sup>52</sup> *New Straits Times*, June 25, 1993

<sup>53</sup> *FEER*, July 14, 1994

deal consummated, the four executives came into legal ownership of five major plcs including, significantly, financial institutions since NSTP owned 20% of Commerce Asset Holdings Bhd (CAH), and BOC Bhd, while TV3 had significant equity in First Malaysian Property Trust Bhd. NSTP would then acquire a stake in the futures exchange, KLOFFE, set up by a consortium that also included Renong, and Hong Leong's Zalik Securities.<sup>54</sup> (Since Renong also held 20% in CAH as well, it was clear that Halim Saad—if he were no proxy—must have been loathed to part with his NSTP equity but he acquiesced to the MOF.) Anwar was eager to bring under his control TV3 and, also, NSTP with its English, Malay, and Chinese dailies in preparation for his (successful) run that year for UMNO deputy president and, therefore, DPM.

MRCB was soon whipped up by stockbrokers into the latest “political blue chip” and, indeed, it began to “win” privatization projects in areas it had no experience or expertise. First came the right to privatize electricity generation with licenses for two independent power production (IPP) projects with guaranteed purchases by Tenaga, the national electricity utility, for many years at prices higher than Tenaga's own cost of generation.<sup>55</sup> MRCB also received the main slice of a lucrative RM7 billion B-O-T contract to upgrade the national electricity grid. Then, it was awarded a 20-year telephony concession for a personal communication network funded with “non-recourse financing” based not on collateral but on projected cash flows with very generous grace periods.<sup>56</sup> It was also authorized to place, lay, carry or maintain any wire, cable or post for the purpose of telecommunications. In addition, MRCB was awarded rights to build a massive railway and mass transit hub in downtown Kuala Lumpur. In 1996, MRCB also acquired RHB Bhd, the nation's second largest financial conglomerate with its own bank, finance company, securities stock brokerage, and insurance. In 1996, RHB Bank would acquire two other banks to become the second largest in the country after state-controlled Maybank.<sup>57</sup>

---

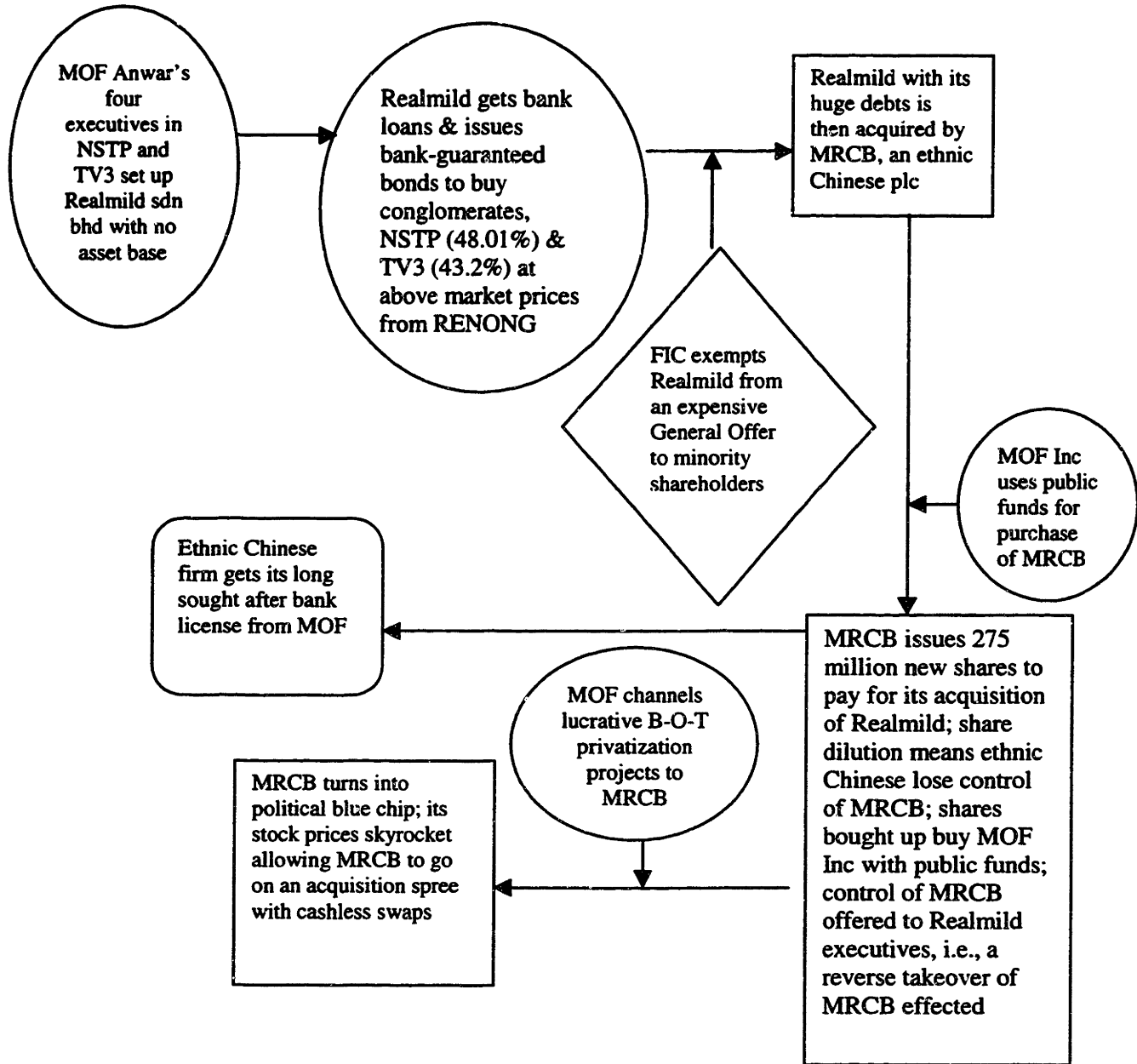
<sup>54</sup> *Asian Wall Street Journal*, November 12, 1993

<sup>55</sup> *The Star*, July 03, 1993

<sup>56</sup> *Far East Economic Review*, July 15, 1994

<sup>57</sup> *New Straits Times*, September 13, 1996

**Fig 3.3 The MRCB deal--How costless and profitable UMNO MBOs are executed**



**Section IV: How secure the corporate holdings?**

The Renong deal legally extricated most of old UMNO's assets from the OA and placed them out of the reach of KuLi's faction. It increased the assets' market value, gave the ruling



faction a tidier, consolidated, debt-free group of assets, and permitted the political leadership to declare that the party had gotten out of business, to boot. The MRCB deal laid a strong foundation for the Anwar faction upon which to build up its own corporate assets. In all cases, because the links were personalistic, it was not clear if the political leadership was effectively in control of the assets. How vulnerable are these assets? First, there was the danger of opportunistic behavior on the part of the proxies. At the extreme, what, if anything, could political elites do if proxies ever decided to dispose off the assets as their own? Secondly, even if proxy loyalty is unquestioned, are these individuals competent enough to manage these far-flung, widely-diversified corporate empires from a business perspective. Moreover, corporate management is susceptible to political interference in operational matters including disruptive factional fights.

(i) With regard to the first question, as far as is publicly known, there have been but two “test cases” where proxies behaved as if UMNO assets were their own, as they indeed legally are. (Halim Saad’s divorce in 1995 did not affect the control of Renong assets although his wife, Noraini Zolkifli, held substantial equity in the conglomerate from the day the Renong deal was consummated. They collectively held at least RM2.4 billion worth of corporate stock.<sup>58</sup> Basically, the divorce proceedings have been indefinitely held up in the Muslim courts that have sole jurisdiction over family law for Malays and are not subject to other institutional checks or balances.) In the first known case, a Daim associate, Samsuddin Abu Hassan, actually tried to dispose off UMNO assets as his own on a number of occasions. The second case involved the ruling faction’s attempts to coerce an Anwar proxy to relinquish his majority holdings in, and corporate management of, MRCB after Anwar was sacked and jailed in late 1998.

---

<sup>58</sup> Sally Cheong, 1993, *ibid*.

(a) In the first test case, Samsudin Abu Hassan who had controlling stakes in an UMNO conglomerate created by privatizing an off-budget agency, Peremba Bhd which controlled four plcs, and at least thirty three property based companies with very substantial land banks.<sup>59</sup> When its hotels and property development focus started declining in growth, it acquired a controlling stake in a weak plc, Landmarks, which was then plied with privatization contracts such as a RM1 billion IPP project, a portion of the Light Rail Transit system for Kuala Lumpur, etc. Landmarks was meant to be used as a vehicle for health care privatization projects<sup>60</sup> but Samsudin incurred the MOF's ire when he initiated talks with Bank Bumiputra to privatize the state-owned bank as an individual investor, and without the Central Bank's clearance.

First, BAFIA (the Banking and Financial Institutions Act) required any party seeking 20% or more of a financial institution to first obtain the central bank's clearance. Second, Anwar had already announced plans to divest BBMB to his proxies in MRCB.<sup>61</sup> Moreover, BBMB was a perennially sensitive subject with the state, and within UMNO, because of its distinction as a Malay bank that was a textbook case of mismanagement and fraud but which comes directly under the Prime Minister. It is run by a board of directors whose Chairman is directly answerable to the Prime Minister, while the Chairman of the giant state investment arm, PNB, that has the controlling stake in BBMB is also directly answerable to the Prime Minister. Of course, Samsudin failed.

Next, Samsudin sold "his" stakes in a Peremba plc, Granite Bhd, again without MOF blessings, to an ethnic Chinese businessman linked to Mahathir (who would also get the controversial multi-billion dollar Bakun Dam project, a *bete noir* to environmentalists world-wide).<sup>62</sup> As Mahathir's standard bearer to educate black nations on how to wield ethnic policies like the NEP, Landmarks invested in South Africa. (There was a similar initiative in Fiji.)

---

<sup>59</sup> Nick Seaward, "Peremba offshoot feels the bite," *Far East Economic Review*, September 03, 1987: 62-63

<sup>60</sup> *Malaysian Business*, October 16, 1993

<sup>61</sup> *Malaysian Business*, March 16, 1994

<sup>62</sup> *New Straits Times*, August 16, 1994

Samsudin acquired a controlling share in Boland Bank, the third largest bank in South Africa, as well as a 70-hectare industrial and commercial development near Johannesburg. All his South African operations however had no black input at all. Next, after two acrimonious divorces from his Malay wives, Samsudin married a blond South African “exotic dancer” and *Penthouse Pet*, an “issue” that was even discussed in the Cabinet.<sup>63</sup> Shunned by the Malay elite thereafter, he declared publicly that he would, henceforth, reside permanently in Johannesburg. But as he was already heavily indebted, he tried to sell “his” Landmarks stakes to an ethnic Chinese businessman-cum-politician, Joseph Chong, from the Gerakan, a small party in the ruling coalition.<sup>64</sup> Because Landmarks held large land banks and prestigious hotel operations, UMNO elites were miffed at the prospect of these passing into Chinese hands. Challenged on various technicalities, Samsudin went to court to assert his ownership of Landmarks and won.<sup>65</sup> As Joseph Chong decided not to exercise his option to buy, Samsudin then approached another ethnic Chinese businessman, John Soh, thought to proxy the MCA, the ethnic Chinese party in the ruling coalition. After paying for part of the purchase, John Soh came under intense pressure from the Securities Commission (that had replaced the CIC) to abort the deal but, on appeal to Mahathir, was permitted to proceed with the purchase. However, to make the sale palatable to Malays, a senior UMNO leader (a former Chief Minister of Perlis state) was brought into the deal as Soh’s partner. With Samsudin out of the way, Landmarks also fell out of favor, and health care privatization projects went instead to Tongkah Holdings Bhd, controlled by Mahathir’s second son.<sup>66</sup> This case shows that a proxy may, indeed, be able to dispose UMNO corporate assets held in his name, but UMNO’s control over the state apparatus can be wielded to ensure its re-acquisition of control over at least a portion of those assets.

---

<sup>63</sup> Doug Tsuruoka, “Who Gets What: Politics-as-usual Drives Malaysian Privatization,” *FEER*, May 5, 1994

<sup>64</sup> *The Star*, August 18, 1994

<sup>65</sup> *Investor’s Digest*, May-June, 1994

<sup>66</sup> Sally Cheong, 1995, *ibid*.

(b) The second test case involved the MRCB group. When Mahathir purged Anwar from the party in 1998, MRCB held 48% equity in NSTP with five newspapers; 43% in TV3 (but Daim's proxies had also set up two other private TV stations); 39% in Malakoff Bhd, the largest IPP; 27% in RHB, by now, the largest integrated financial services group; and, 64% in KL Sentral, a huge integrated railway hub in the city center. Anwar alleged from prison that MRCB was held in trust for UMNO, the first time a senior (ex)UMNO leader had disputed Daim's frequent boast that UMNO had gotten out of business completely.<sup>67</sup> Ahmad Nazri, a close Anwar ally, owned 80% of Realmild sdn bhd that owned 27.12% of MRCB making his 21.7% the largest shareholder in MRCB. Because of MRCB's rapid expansion, by 1997, it was already indebted to the tune of RM1.2 billion. NSTP and TV3, once cash cows, were suffering from rising debts and falling advertising revenues. RHB, its financial arm, was heavily weighted down with non-performing loans in the Crisis. Correspondingly, Realmild's debts grew to about RM800 million having borrowed heavily to buy new MRCB stock to maintain its controlling stake.

In December 1997, Ahmad Nazri had written two articles, one critical of the privatization program and the other of Mahathir's penchant for huge projects. In June 1998, TV3 and NSTP provided extensive coverage to Anwar's allies who had begun a media campaign to impugn Mahathir's rule as one of "nepotism, cronyism, and corruption." Ahmad Nazri was sacked as editor of *Berita Harian*, the middle class Malay's daily, and pressured to sell "his" MRCB stakes to Renong. Neither side could agree on how to settle Realmild's debt but it was clear UMNO would have to rescue its corporate assets in some fashion.<sup>68</sup> This case demonstrates that while UMNO might have to pay off proxies to reacquire its assets when there is factional in-fighting, because proxies are themselves burdened with huge debts precisely as a result of their high

---

<sup>67</sup> *AWSJ* Nov 30, 1998

<sup>68</sup> For example, the government moved to bail out RHB Bank even as Ahmad Nazri was being pressured. See, May Chen, "Tan Sri Rashid Announces Rescue Package for RHB," *AWSJ* December 1, 1998: 3

personal stakes in these highly leveraged corporations, the political leadership appears to be able to keep them under a tight leash.

(ii) With respect to the second question regarding the market vulnerability of these assets, the leadership faced a stark choice in 1998 between saving its conglomerates and rescuing a banking sector (a significant portion of which was also in UMNO hands) that were both in serious trouble simultaneously. (A healthy banking sector was necessary to rejuvenate the economy.) These corporations proved to be vulnerable despite—or because of—their gargantuan sizes. MRCB's corporate problems in the Asian crisis were, by no means, unique. Its bulkier sibling, Renong, faced similar, if weightier, problems. The Renong empire had been built basically on the back of a privatization bonanza Malaysian-style and little else which left Renong with an inventory of big-ticket ventures with long payback periods, many linked to a fragile property sector. By late 1997, it was already RM4.12 billion in debt with another \$800 million in dollar denominated debt.<sup>69</sup> Importantly, there were cost overruns due to lack of management oversight and managerial incompetence. With progressively lower prices for its stock that had dropped six-fold (and those of its operating companies as well) in a “bombed-out” stock market, deflated value of its property holdings, a bank credit squeeze (because of Anwar's “virtual IMF” approach to the Crisis,) a devalued ringgit, and excessive foreign exchange pressures in the form of put options coming due, Renong could not meet growing financial obligations to see partially completed projects to completion and service its debts.

In November 1997, UEM was used to bail out its parent by purchasing 32.6% equity in Renong from Halim Saad through eight nominee companies at RM3.24 per share (although its

---

<sup>69</sup> Ominously, there was even more debt that Renong had issued that was off-balance sheet. In late 1997, for example, when its officially listed debt was \$1.2 billion, analysts I spoke to all concurred that, at a minimum, it exceeded \$2 billion in reality. *See, also*, James Holloway, “Renong has \$85.3 million Loss in First Half,” *AWSJ* March 16, 1998.

stock was trading at only RM1.80 per share) for RM2.34 billion. This meant that UEM shareholders suffered an immediate paper loss of RM1.04 billion. The FIC exempted UEM from having to make a mandatory general offer to Renong's minority shareholders that would have cost UEM another RM1.6 billion. The market decried the deal and the KLSE crashed. (UEM and Renong shares themselves fell 48% and 38% respectively before their trading was suspended.)<sup>70</sup>

If UEM holdings of Renong came to exceed 51%, Renong would have had to divest its stake in UEM because Malaysian corporate law stipulates that a subsidiary—a firm owned more than 51% by another firm—cannot hold majority shares in its parent company. But UMNO was not about to give away UEM to just anyone. In addition, Malaysian corporate law requires a firm be de-listed if the proportion of its shares held by public investors fell below 10 percent. Thus, Renong was in danger of being de-listed if UEM made a general offer, and de-listing would complicate Renong's \$400 million 10-year convertible Eurobonds it had issued to fund its large infrastructure projects with the promise that when they fell due, they could be converted into Renong shares. De-listing, instead, would push bondholders to demand early redemption that would financially cripple Renong. Hence, the FIC waiver.<sup>71</sup>

UEM, however, failed to make timely public disclosure of the waiver, (that is, within 14 days of the information becoming available to it.) Moreover, the waiver was conditioned on UEM having effectively less than 50% of Renong, but three parties acting in concert after the deal—UEM (32.6%), Halim Saad (23.4%), and Renong shareholder, Time Engineering (21%)—held 76.9% in Renong. Under intense pressure from the Opposition in Parliament, the MOF publicly revoked the FIC waiver, declaring that the deal would be investigated. A few weeks later, UEM announced it had secured a second waiver from the FIC. Acknowledging UEM's violations in the case, the FIC nevertheless re-instated the waiver was on grounds of “national

---

<sup>70</sup> *Harakah*, March 31, 1998 (Newspaper of Parti Islam, the main Malay opposition party. )

<sup>71</sup> *The Rocket*, April 02, 1998 (Newsletter of the DAP, the main ethnic Chinese opposition party.)

interest.” Two conditions were imposed. First, Halim Saad was to reimburse UEM’s unspecified “holding costs” for the stock, presumably interest payments on the RM2 billion loan UEM had taken out for the purchase. Second, Halim Saad was to give UEM a put option with the “unconditional and irrevocable” right to require him to buy the entire amount of UEM’s newly purchase Renong shares at the same price UEM paid for them in 1997 (RM3.24). This was supposed to assure that UEM shareholders that they did not suffer any losses on the Renong investment. (It was, however, highly questionable whether Halim Saad would be able to muster the resources in 2 years time to buy back the Renong shares if required by UEM.) Still, the put option would not apply should Renong be voluntarily or otherwise wound up before March 1, 2000. Halim Saad also obtained another FIC waiver exempting him personally from having to make a general offer for all Renong stock in 2000AD should the put option be exercised which would raise his personal stake from the present 23.3% to 55.8% thus breaching the 33% trigger for a mandatory general offer.<sup>72</sup>

The government’s flip-flops on the issue decimated the KLSE’s reputation especially with foreign portfolio fund managers whose investments were crucial to the bourse’s health. These fund managers abandoned the KLSE in droves. After the second waiver was announced, and trading in UEM and Renong shares resumed, both stocks lost 30% in the first minute. (That is, they opened “limit-down” or the 30% maximum fall in a share price allowed in a single trading session, morning or afternoon). Both stocks were suspended again immediately marking the first time in KLSE history for any stock to be re-quoted only to be swiftly re-suspended within the hour. At this point, Mahathir declared that the government would buy into the market to support Malaysian corporations. Eventually, capital controls were imposed with closure of the financial sector.<sup>73</sup>

---

<sup>72</sup> AWSJ, April 8, 1998

<sup>73</sup> AWSJ, April 10, 1998

Subsequently, the state approved a Renong plan to use its toll-road operator, PLUS Bhd, a UEM affiliate, to issued \$2.24 billion in bonds (banks will have to buy up) to help repay Renong and UEM debt in exchange for which Renong and UEM would sell undisclosed assets to PLUS. (Renong's debt had grown to account for more than 5% of total loans in the banking system.) PLUS would repay the bonds with revenues from its toll roads—using future earnings to repay current debt—as well as its future tax payments the state will forego (about \$1.2 billion). In addition, the state wrote-off a RM824 million soft loan for Renong's second causeway project, a bridge to Singapore but Renong was allowed to keep the 42 square miles of land around the Malaysian end of the bridge (about 27,000 acres of prime land) it had received as payment for building the bridge. Finally, the state extended Renong's North-South highway toll concession beyond the contractual cut-off date.<sup>74</sup>

#### **Section V: The economic and political impacts of privatization**

(i) *The economic impact of privatization:* Despite the fact that the Malaysian government appropriated the terminologies of British privatization, the two programs were fundamentally different on two counts. First, the British program trumpeted a “people’s capitalism” that enlarged the constituency for privatization by offering tangible benefits to many. In contrast, the Malaysian government relied on abstract appeals resting largely on grounds of “national interest” —to prevent a repeat of ethnic conflict over national wealth. Privatization would serve the national interest because it would deepen the Malay business class which would not just own but also control the corporate sector.

Secondly, unlike the Thatcherite program, the Malaysian one was not primarily a case of strong ideological commitment to free markets. Rather, it was an authoritarian regime that was

---

<sup>74</sup> Lye-huat Toh, “Renong gets reprieve from debts,” *The Edge*, October 12, 1998: 6; KS Jomo, “Malaysia props up crony capitalists,” *AWSJ* December 21, 1998 (Op-Ed); Leslie Lopez, “Malaysia alters rescue proposal for Renong,” *AWSJ* January 8, 1999: 1



able to undertake a far reaching program with little opposition to its excessive underpricing of public assets and its recurring choice of a small coterie of politically linked recipients of divestiture. The political leadership's powers in Malaysia are fused with an overwhelming legislative majority combined with strong partisan discipline thus minimizing intra-governmental conflict. Cabinet members are seasoned politicians with years of parliamentary experience and close partisan ties make participation in policy making much less fluid.<sup>75</sup> Preferences among decision makers are accordingly less problematic, and with the bureaucracy progressively sidelined as well as limited access that most interest groups and other societal actors have to decision making centers, roles in Malaysia are less contested, links are tighter, and fewer actors have input into policy. Moreover, there has been an unrelenting and mostly successful assault by Mahathir on all alternative and potential sources of institutional power and political opposition including the Malay Sultans, the judiciary, the press, as well as the professoriate.<sup>76</sup> Centralization of power in Mahathir's hands over policy initiatives and all significant political institutions has blocked alternative sources of influence, participation, and group accommodation.<sup>77</sup>

Privatization began in 1984 with the sale of 51% equity and transfer of management of the country's main port to an Australian firm. By most accounts, it was a successful divestment in common with first privatization projects elsewhere which are valued mainly for their

---

<sup>75</sup> see, H.P.Lee, 1995, *op cit.* In Malaysia, there is little separation between the legislature and the executive. The ruling coalition controls about 80% of the 180 parliamentary seats of which 24 are currently occupied by Ministers and 30 by Deputy Ministers. Government back-benchers are timid knowing their candidacy in the next elections hinges entirely on the approval of party chiefs; see, also, *The Hansard, 1998: 4* (Official records of parliamentary proceedings in Malaysia.).

<sup>76</sup> Gordon Means, *op cit.*.

<sup>77</sup> For example, before January 1985, the evaluation of detailed feasibility studies for privatization projects was conducted by the Ministry involved. Since then, the Privatization Task Force (PTF) in the Prime Minister's Department has appointed *ad hoc* technical committees to do that evaluation. More importantly, the PTF is supposed to be the unit that issues a Letter of Exclusivity to the first party that suggests a privatization project to conduct a detailed feasibility study. However, when privatization involves mammoth projects such as the North-South Highway, the PTF is not the nerve center. These decisions, like all major political and policy decisions, have invariably been made by Mahathir with Daim Zainuddin, endorsed by the UMNO Supreme Council, and announced after the Council's late night meetings rather than the Cabinet's weekly Wednesday meetings.

demonstration effects. The main program soon got bogged down in the recession so that, by 1988, only five privatized projects had been listed on the KLSE.<sup>78</sup> Still, many small and medium size businesses, defined as firms of capitalization under RM1 million—owned by the state were sold directly to Malay individuals and companies. At least 287 such companies had been divested by 1989. Their selling prices were never made known.<sup>79</sup> In addition, the first private television station—owned by UMNO—had been allowed to break into the formerly state-run preserve of broadcasting. Increasingly, deregulation like this and that in electricity and telecommunications would become lumped together as privatization in Malaysian political discourse.

From 1984 to 1990, investors responded favorably to the public flotation of nine privatized entities mainly on account of their low initial price offerings (IPOs) although foreign subscribers were charged a price premium of 20-30% for these issues. Based on IPO prices, these listings added, on average, RM2 billion annually to the capitalization of the KLSE.<sup>80</sup> Progress speeded up with the mutually de-listing of KLSE and SES in January 1990. Within a year, KLSE capitalization had increased from RM100 billion to more than RM120 billion while average trades frequently exceeded 100 million shares daily.<sup>81</sup> Of course, the listings would not have succeeded had it not been for the fact that the country's economy that started surging from 1989 as investment capital including portfolio funds started flowing in from the OECD countries. The flotations also afforded domestic brokerages much experience in handling huge share issues. Indeed, privatization is frequently called upon to promote a virtuous cycle where divestiture of huge public assets contribute to the deepening of domestic capital markets which, in turn, will facilitate further divestitures.

---

<sup>78</sup> Pauline Almeida, "Going Nowhere Fast: Is Privatization a Good Thing or Bad?" *Malaysian Business*, Sept 15, 1989: 14-15.

<sup>79</sup> *New Straits Times*, July 8, 1989

<sup>80</sup> Jomo, 1995, *ibid*.

<sup>81</sup> *Asiaweek*, June 15, 1991

Off-budget agencies such as the giant retirement fund, EPF, the state-run Muslim pilgrims fund, LUTH, the armed forces provident fund, LTAT, the government's investment arms, Khazanah Holdings Berhad, and MOF Inc. bought up most of these IPOs. As such, the state still owns 75% of the electricity company, Tenaga Nasional Berhad, and 77% of the telephone company, Telekom Malaysia Berhad, the two largest entities on the KLSE. Still, it was significant that large numbers of individuals actually participated in the process in spite of their eventually marginal contribution to the overall total especially since asset sales were always partial anyway. Of course, IPOs were intentionally priced low to encourage over-subscription and so that immediate gains would accrue to Malay subscribers who were preferentially allocated IPO shares as well as low interest bank loans set aside for this very purpose (the interest on which could immediately be paid off many times over on listing of the stock concerned as a result of its price premium.)<sup>82</sup> These were middle class retail investors, Malay and Chinese, who stood to gain from the price premia. Over-subscription because of these price premia characterize all major privatization issues and the authorities took great pains to present over-subscription as a measure of the popularity of its privatization program. In this manner, the state was able to incorporate a significant segment of the middle class electorate in its privatization policy especially urban middle class Malays.<sup>83</sup> Thus, privatization did help to build a coalition in the electorate favorably disposed to what the state portrayed as its pro-market ideology.

However, the fiscal impact of privatization was substantially reduced due to the heavy underpricing of assets. Officially, anyway, revenue maximization was always a secondary objective. Moreover, although Malaysia has often been portrayed as the standard bearer of privatization in developing countries, the program's net impact on the relative balance of public

---

<sup>82</sup> Lance Brannan, "Bumiputera and public returns to balloting for new KLSE share issues," XXIX *Malaysian Journal of Economic Studies*, 1992: 13-20; also, K Paudyal, B Saadouni & RJ Briston, "Privatisation Initial Public Offerings in Malaysia: Initial Premium and Long-term Performance," 6 *Pacific Basin Finance Journal*, 1998: 20.

<sup>83</sup> Kin-woon Toh, *The Gerakan's Position on the New Development Policy from 1991*, (Penang: Gerakan Party Economic Research Bureau, 1990). Gerakan is a small party in the ruling coalition.

and private sectors has been minimal. This is ironic since the country has a strong economic base upon which genuine privatization that did not serve political objectives could have thrived. Privatization is said to have saved the government an annual RM5 billion in salaries and pensions. At the last count 92,700 employees have been taken off the payroll. There are also interest savings as well as opportunity cost savings for infrastructure projects carried out by the private sector of about RM 41 billion in all. The cumulative proceeds from all asset sales up to 1990 were very small, about RM437.6 million or less than 0.1% of GDP.<sup>84</sup> This is minuscule compared to the SOE sector output of 25% of GDP. Revenues from divestiture were cumulatively only 0.35% of the government's total revenues over the same period.

There was accumulating evidence that there had been some organizational re-orientation within these entities so that there might have been some productivity gains. In their review of the Malaysian experience, however, Goh and Jomo found that there was no clear trend of improved efficiency *pace* the property rights argument and no unambiguous evidence of improved consumer welfare. Where there were improved services, they found also increased consumer costs. To be sure, these firms were generally fast growing and profitable. However, the direction of causation probably ran from economic growth (due to increased input of factors of production) to privatization rather than the reverse given that increases in profitability during the go-go nineties were not confined to them but was generalized to the whole economy.<sup>85</sup> (Thus, for example, the national railway company was not on the privatization agenda until 1997 but had recorded substantial productivity improvements prior to its privatization in 1998. Ironically, Telekom continued to perform poorly in terms of productivity although privatized in 1985 but remained the surging KLSE's star performer.) Proponents may argue that the very momentum of privatization itself was indirectly instrumental in transforming the operational environment of the remaining state owned entities. However, it is also true that these firms certainly continued to

---

<sup>84</sup> Adam and Cavendish, *ibid.*

<sup>85</sup> Winnie Goh & K.S. Jomo, "Efficiency and Consumer Welfare," in Jomo, *ibid.*

receive special privileges such as incentives and soft loans from state-owned or state-controlled banking institutions.<sup>86</sup>

The state boasts, correctly, that privatization led to the deepening of capital markets in Malaysia: its nineteen listed privatized firms account for a third of the KLSE capitalization at any one time.<sup>87</sup> However, it is also true that capital resources that might otherwise have been invested into expanding productive capacity were, instead, diverted into acquisition and transfer of existing public assets. For example, Naidu argues that the privatization of infrastructure construction meant the long-term loss of revenues that were important for cross-subsidization of other public services. Furthermore, the state had actually performed commendably in the provision of infrastructure for economic growth that also reduced spatial inequalities prior to privatization.<sup>88</sup>

(ii) *The political impact of privatization in Malaysia:* Between 1983 and 1995, over a hundred SOEs were privatized while 96,756 public sector employees or 11.4% of the total public sector labor force were transferred to the private sector.<sup>89</sup> Most of the sales had been public issue of minority shares in state-owned companies such as the Malaysian Airlines (MAS) in 1985 and the Malaysian International Shipping Corporation (MISC) in 1987; placement of shares with institutional investors such as the sale of 5% of MAS stock to the Malay Sultanate of Brunei, or joint ventures with the private sector such as the establishment of its national auto maker, Proton, with 15% equity held by Mitsubishi Corporation and 15% by Mitsubishi Motors Corporation.<sup>90</sup> Along with the sale of state-owned assets, the privatization policy extended to allowing private companies to manage state assets and the awarding of exclusive rights to conceive and implement

---

<sup>86</sup>Fazilah Abdul Samad, *Performance of Group-affiliated Firms: A Study of Politically Affiliated Business Group (sic) in Malaysia*, unpublished doctoral dissertation, University of Rhode Island, 1996.

<sup>87</sup> See, KLSE Annual Handbook, various editions.

<sup>88</sup> G Naidu, "Infrastructure," in Jomo, 1995, *ibid*.

<sup>89</sup> Seventh Malaysia Plan, 1996-2000.

<sup>90</sup> KS Jomo, *Growth and Structural Change in the Malaysian Economy*, (London: MacMillan, 1990) 236-37.

new public works or services. Indeed, there were few asset sales after 1987. By this time, the privatization program had transmuted into mainly management buy-outs (MBOs) and the contracting-out of construction and management of giant infrastructure projects, called the B-O-O (Build-Operate-Own) or B-O-T (Build-Operate-Transfer) methods. The B-O-O/B-O-T program soon eclipsed the asset sales program. Often, companies offered to provide public utilities or services in exchange for prime land or, at least, rights to develop prime property owned by the state, or other commercial privileges not otherwise available to private business. The result was a cornucopia of infrastructure ventures awarded to UMNO-owned and UMNO-linked corporations including highways, bridges, dams, ports, railways, electricity generation plants, water works, solid waste disposal, sewage systems, and the trade-mark huge property development projects.

After the UEM disclosure in Parliament, the privatization program eschewed open competitive bidding, adopting as its main operating principle that prospective ventures were to be considered on a “first come, first serve” basis. On the surface, this meant that if private sector proponents of a privatization deal could present a proposal that the state deemed feasible and “in the national interest,” they were awarded the project. But since proposals were treated as confidential and since no competitive bidding was required, no information was disclosed about such projects until the state announced its approval. There was, therefore, little public debate on the commercial merits of such ventures. Mahathir brushed aside suggestions that Malaysia would benefit by opening projects to competition, arguing that the policy promoted private sector initiative and innovation besides cutting red tape, putting needed projects on track quickly and efficiently. Sheltered from public scrutiny, this process placed a premium on political access and influence. In practice, this meant pitching an idea directly to the Prime Minister, or the MOF, and winning their backing in advance. With the endorsement, the proposal was easily hustled through the bureaucracy. At this stage, the proposers would encourage market talk about the major privatization project their firms were about to win. In the rumor-driven KLSE, their shares would skyrocket in prices thus enabling them to fund the project. This mode of privatization worked in

an environment of cheap equity capital but, with a stock market crash, these firms that had invested in very long term assets were faced with costly capital and equally long repayment periods. In addition, there was quite intentionally the maintaining of obstacles to competition, the putting in place of mechanisms too weak to guard against anti-competitive behavior, or lax enforcement of laws and regulations where legal barriers to entry had been removed. Because adequate measures for competition and regulation of sectors concerned were not devised, short-term political advantage may have been won but long lasting gains in efficiency were lost.

As noted earlier, the process had been enabled by the fact that privatization was centrally directed by the EPU in the Prime Minister's Department, and power had been centralized in Mahathir's hands. Privatization did not lead to depoliticization of the Malaysian economy. By the late eighties, very substantial corporate equity had been captured by the political leadership and its proxies. By the early nineties, there was a big business-politician alliance, and the wealthiest businessmen in the nation were identifiably those most closely linked to Daim/Mahathir. Their political clout clouded the assessment of the economic viability of their projects, and the extent to which their businesses were subject to market discipline was not always evident.

Because privatization was also justified by and wedded to Mahathir's "Malaysia Inc" policy, there was the weaving of an intricate web of favors and obligations to and from companies involved in "national" projects. There was the parceling out of scores of subcontracts to smaller companies lower down the pyramids. Many of these contracts won by Malay businesses were, in turn, sub-contracted again to ethnic Chinese so that the development of Malay entrepreneurs, a stated aim of privatization, was not always facilitated. Control over these webs of corporate holdings may be seen as pyramids at the top of which are state elites responsible for decision making pertaining to UMNO's business concerns. This elite appoints trustees from the Malay economic elite who in turn appoint mainly Malay individuals as directors and top managers of UMNO corporations. Many of these individuals are high-profile corporate movers-

and-shakers who proxy for the party in webs of holding companies, nominee firms, interlocking directorates, and equity cross-holdings. Some of these individuals move seamlessly from the private sector to the public, even the Cabinet, after “disposing off” their stockholdings and directorships to other trustees and proxies.<sup>91</sup> Key management positions in UMNO corporations doled out to party functionaries allow them to use their positions for self enrichment at the expense of minority shareholders especially through unchecked insider trading.

The gross concentration of wealth and the limited accountability have been exacerbated by the increasingly personalistic and particularistic nature of business-politics ties since the mid-eighties. This unique politics-business nexus meant that, rather than getting the state out of the market, privatization in Malaysia was only a re-arrangement of economic and political power. The increasing strength and influence of politically linked Malay businessmen help perpetuate UMNO’s domination of the economy through a small number of firms and the coterie of individuals who control them. If UMNO should ever lose its domination of the state, its influence on politics would still be considerable. By spinning off UMNO’s assets so that party leaders are no longer accountable to party members for the manner in which UMNO assets are deployed, the faction with the largest concentration of the best corporate assets will prevail. Proxies have generally remained subservient to party leaders but business-political relations have become increasingly complex and particularistic reciprocity increasingly sophisticated. This means that patron-client structures within the party have become even more important than in the past. Competition between factions grew intense as the financial resources needed to ascend party hierarchy grew unmanageably huge.<sup>92</sup>

---

<sup>91</sup>For example. the ex-chief of UMNO Youth, an Anwar ally, was exposed to be “the director of 95 companies and shareholder of 24...Zahid holds shares worth millions of ringgit” in “Zahid’s name listed under 100 companies,” *New Straits Times*, December 3, 1998. Ex-UMNO Youth chief in Penang, Anwar’s base, was shown to be the shareholder in 14 firms and director in 44; see, “Rahim to dispose of entire stake in Abrar Group,” *NST*, Dec 8, 1998. Also, Anwar’s father was shown to be a shareholder in 24 companies and director in more than 50 firms. His younger brothers were similarly identified; see, “Anwar’s family members important corporate players,” *NST*, Dec 8, 1998.

<sup>92</sup> Gomez, 1996, *ibid*.



Perpetuation of this mode of political control over business encourages the development of many other similar groupings especially on a factional basis. This offsets the coalescing of political coalitions around other interests and goals antithetical to UMNO. Patronage networks continue to be developed by aspiring politicians, and privatization contracts continue to be doled out to businesses with close political ties. This also means that UMNO itself is no longer the general object of criticism regarding contentious ties between politics and business. Instead, individual leaders are the object of such criticisms.

How factional conflicts affect business will become increasingly important as in-fighting becomes more pronounced with diminishing resources especially after the most lucrative projects have been divested.<sup>93</sup> Of course, membership of factions may not be mutually exclusive as political and business realities shift. This uncertainty exacerbates the short termism in many of their business decisions and engenders speculative investment, corruption, and corporate mismanagement. Most of these companies do not have corporate strategies because they respond to politically channeled opportunities, not market challenges. They are widely diversified because their opportunistic mode of operation drives them. During their "successful" years when cheap equity capital was available, these firms did not upgrade to the next level of sophistication in terms of product development, clear brand franchises, and control over distribution channels,

---

<sup>93</sup> Notably, in October 1995, the state investment arm, Khazanah Holdings, divested without public tender its 32% stake in HICOM to a Daim ally, Yahya Ahmad, for RM1.72 billion. HICOM was a heavy-industry conglomerate capitalized at RM 7.5 billion with nine listed companies. Mahathir claimed that HICOM's selling price was 12% higher than the estimated value of the equity, but it would probably have fetched between US\$1.2 and \$1.6 billion in open bidding. The biggest privatization project in Malaysia at the time, Yahya became one of the biggest players in the Malaysian economy, as the HICOM equity included PROTON, the national auto maker; a bank; two stockbrokerages; huge land banks divested at the nominal value they had been held on the books. None of his personal wealth was pledged as collateral to raise the requisite financing since HICOM paid for its own acquisition by Yahya through a paper shuffling exercise that sacrificed the interests of its minority shareholders. Basically, HICOM paid inflated prices for Yahya's auto assemblers, ACM and USF, which put up excessively optimistic profit forecasts to justify their acquisition prices. The deal upset Anwar's faction that had targeted HICOM for divestment to his allies. Not only were there not too many profitable "mega" entities left to divest, but HICOM itself had so many plcs, each with its own high-flying subsidiaries. For example, HICOM also controlled 30% of EON, the distributor for PROTON cars, which owned/controlled 13 other firms, including EON Bank, and a stock brokerage; *see, Asiaweek*, November 17, 1995.

the very considerations management must attend to if a company is to control its own destiny. In short, these conglomerates do not have value added across their businesses.

As a result of this sort of privatization, there is a heightened importance of politics in the boardrooms of many of the most important firms in Malaysia. The most obvious inroad is through state representation on the board of directors either because the state continues to have majority or significant minority equity holdings, or because of the Golden Share provision in the Memoranda and Articles of Association of Tenaga, Telekom, Malaysian Airlines, MISC and other divested SOEs. This provision vests the state with special shareholder rights including veto power over any proposed alteration to key Articles, changes in substantial shareholdings and any proposal for mergers, acquisitions, or takeovers. The notion of good corporate governance implies that directors of a firm are obliged, by law, to act at all times in the best interests of the firm but this may mean that the state's role as public guardian or protector of the public's interests is compromised for commercial reasons. On the other hand, for state-nominated directors to do otherwise would be a legal breach of duty to the firm.

The British experience in this regard is one of general dissatisfaction with government nominated directors. In Malaysia, there has not been a single shareholder lawsuit against such directors but this may simply reflect ignorance about the difficulties of this role. (The very notion of corporate governance was not even a part of public discourse until well into the Asian Crisis when Anwar began deploying the term in his public but elliptical attacks against Mahathir.) Moreover, because of the centralization of power at party and national levels in the Executive, there is little protection of investments from arbitrary executive decisions. Since Mahathir's assault on the Judiciary from 1988, the capacity of the courts to provide any decision that will antagonize the state is highly doubtful.<sup>94</sup> Moreover, judicial review has not been resorted to for fear of jeopardizing access to other privatization projects.

---

<sup>94</sup> HP Lee, *Constitutional Conflicts in Contemporary Malaysia*, (Kuala Lumpur: Oxford University Press, 1995).

In addition, institutional barriers radically increase the transaction costs to minority shareholders who may wish to challenge board decisions in plcs such that most corporate management can ride roughshod over their minority shareholders. Legally, apart from the right to receive and have laid before her at the Annual General Meeting (AGM) the audited accounts, the Board of Directors' Report, and the Auditor's Report, approve the appointment of directors and their remuneration, and raise questions at such AGMs, the minority shareholder is also said to be entitled to protection of any other rights such as may be specified in the Companies Act. However, it is not even clear if shareholders actually have the right to reject audited accounts for Sections 169(1) and 170 as well as Article 46 in Table A refer merely to the "laying before" as opposed to seeking the approval of shareholders. With regard to putting a resolution before shareholders, there is a requirement that there should be a number of members representing not less than one-twentieth of the total voting rights of all members entitled to vote or that there be not less than 100 members holding an average of 500 shares each. Even if these conditions are met, the corporation must be given adequate notice under that Section, and a sum reasonably sufficient to meet the firm's costs relating to the requisition for such resolutions to be put before shareholders tendered. These incur impossibly high transaction costs for the retail investor which probably explains why, for example, the UEM bailout of Renong was "approved" at its AGM.

The biggest hidden surprise is that the Board of Directors is not even required to act in accordance with the wishes of shareholders and may even act against those wishes if, in doing so, the Directors are acting in the interests of the firm as a whole. While shareholders prosper with the firm, how they prosper in immediate pecuniary terms depends on the extent of dividends declared by the directors at their discretion supposedly at the best interests of the firm rather than the shareholder. In effect, although corporate governance is supposedly controlled by shareholders through their appointment of the Board, such control is virtually never exercised by the ordinary shareholder in Malaysia but by the controlling shareholders. FIC waivers generally benefit the latter while sacrificing the interests of the former. Because the FIC comes directly

under the Prime Minister and is not constituted through a formal statute, it is not open to challenge. That is, since there is no Act of law under which the FIC was constituted, there are no specific provisions against which its decisions can be questioned and interpreted in a court of law. In practice, the FIC's pronouncements are taken as the Prime Minister's word, which has become unassailable in the Mahathir years.<sup>95</sup>

To push through its privatization program, the state also resorted to increasingly authoritarian laws to sidestep obstacles as they emerged. For example, an amendment to the Official Secrets Act (OSA) to impose a mandatory minimum one year prison term for offenders was passed in December 1986 after it was learned that leaks had alerted the Opposition in Parliament to UEM's NSE deal. (The OSA, an anti-espionage legacy of pre-World War I Britain when defence information was at a premium was adopted in Malaysia in 1972. It had been amended by Mahathir in 1983 as a result of leaks to the Opposition about the first of Bank Bumiputra's billion-dollar scandals.) While the 1986 amendment appeared to have removed several categories from the schedule of possible secrets—federal-state relations, the economy, official tenders, and recommendations to the government—a Minister may add to the schedule by executive fiat. This represented excessive delegation of power to the executive by the legislature but was further compounded by the removal of judicial discretion in determining whether a document qualified to be labeled secret. (From the time Mahathir became PM, even before his assault on the Judiciary, judicial discretion as far as sentencing was concerned had eroded. For instance, drug trafficking, armed robbery and illegal possession of firearms carry mandatory death sentences under the ISA.)<sup>96</sup>

In 1991, after a resident-initiated court case had held up Renong's Second Link to Singapore project, the state pushed through a Land Acquisition (Amendment) Act putatively

---

<sup>95</sup> Kevin Hewison, Richard Robison, & Garry Rodan (eds), *Southeast Asia in the 1990s: Authoritarianism, Democracy and Capitalism*, (Sydney, Australia: Allen & Unwin, 1993).

<sup>96</sup> HP Lee, *ibid.*

because the state needed to avoid delays in implementing projects vital for industrialization and development. This act armed the state with sweeping authority to acquire whatever land it deems necessary for “economic development” and not just for “public purposes,” namely, roads, schools and hospitals as stipulated under an earlier law. The amendment made it difficult for individual landowners to seek redress in the courts, and landowner rights were reduced to mere legal quibbling over the quantum of compensation. In another departure, the acquired land may also be handed to third parties—“any person or corporation”—for development that need not necessarily be of the kind for which it was originally acquired. This meant that with active privatization, business could make huge profits at the expense of landowners because the state may now acquire land ostensibly for one purpose and then use it for the private gain of political elites themselves through their proxies, family members, or other favored individuals or corporations.<sup>97</sup>

## **Conclusion**

In Malaysia, privatization undoubtedly reduced the formal role of the public sector. However, it had not arisen out of some newly discovered commitment to neoclassical orthodoxy. Rather, it was used to further the political leadership’s promotion of an ethnic capitalism through the consolidation of the Malay business class. The process transmuted the form of the state’s involvement in business: privatization served to insinuate the state into the market where it now lies inextricably imbricated as a market participant. Ownership and control of these corporate assets lie concealed behind webs of corporate deals and stacks of informational barriers. Thus, although it removed from both parliamentary scrutiny and party oversight the ownership and control of these corporate assets, the process did not roll back the frontiers the state but, instead, increased the importance of politics in corporate governance. Having sidelined the bureaucracy,

---

<sup>97</sup> Diane Mauzy, “Malaysia: Malay Political Hegemony & Coercive Consociationalism,” in John McGarry & Brendan O’Leary (eds), *The Politics of Ethnic Conflict Regulation*, (London: Routledge, 1993).

**the political leadership formed a new alliance with Malay big business, and now wields not only macroeconomic policy but also firms and markets without the ministrations of the bureaucracy. In this manner, a privatized statism obtained in Malaysia.**

## **CHAPTER FOUR: Financial Policy in the Construction & Consolidation of an Ethnic Capitalism**

---

In Chapters Two and Three, I discussed the emergence of a privatized statism and its construction and consolidation of an ethnic capitalism that now obtains in Malaysia. In Chapter Two, I showed how a state ideology of ethnicity, the NEP, was justified and how it forged a Malay business class. Next, in Chapter Three, I discussed the subsequent ethnic privatization program that consolidated that Malay business class. In these endeavors, financial policy was an indispensable handmaiden.

This chapter on that policy is organized as follows. First, I discuss in Section I the economics and politics of financial interventionism, and I suggest why politics explains financial policy better than economics alone. The financial sector structure in Malaysia is briefly sketched in Section II. Next, I discuss how each component of the financial system was used in the construction and consolidation of an ethnic capitalism in Malaysia. I show in Section III how the state directs bank credit preferentially to its most important constituencies while marginalizing ethnic Chinese capital in banking. Because crossholdings were allowed, bank solvency became inextricably linked with the securities operations of their brokerage subsidiaries and, therefore, with stock market gyrations. Next, how the stock market was used to construct and consolidate a Malay bourgeoisie, and supply it with cheap equity capital is discussed in Section IV. Although the Malaysian state exploits financial institutions as captive markets for its huge issues of government securities--this is not unique to Malaysia although it is singular among East Asian states in its huge issues of government securities, it has retarded markets their trading as well as the issuing and trading of primary private debt securities (PDS), of asset securitization (or bank-issued secondary PDS), as well as markets for financial derivatives. This is discussed in Section V. Although these specific markets for long-term capital remain immature in Malaysia, they deserve attention because it was precisely this immaturity that led to a systemic banking crisis following the currency and stock market crash of 1997 that nearly

crippled the ethnic capitalism put together so carefully over three decades. Finally, the Malaysian politics of financial policy is examined in Section VI to explain this apparently incoherent mixture of policies.

### **Section I: The Economics and Politics of Financial Interventionism**

Just as money intermediates between the flow of goods, financial institutions intermediate between the flow of funds from economic units with financial surpluses to those with deficits. Different financial institutions cultivate particular financial specializations, achieving higher efficiency. A network of this intermediation reduces default risks, improves the liquidity and maturity structure of assets, and enables better information flows. In addition, financial institutions also have the capacity, working on a fractional reserve system, to create credit. That is, banks can increase investment by several times more than the savings they actually receive.

Financial interventionism is still the most common system worldwide.<sup>1</sup> It has been suggested that, in developing countries, the state intervenes in financial markets to compensate for incomplete markets.<sup>2</sup> The argument is that state regulation of the sector, especially bank-based financial systems under state control to guided industrial development, promotes public welfare, and that this has been amply vindicated by NIC growth. Yet, since the seventies, the literature on financial development has been dominated by arguments for liberalization, often blaming this interventionism for the debt crises of the eighties. Conversely, liberalization, it is said, will improve overall efficiency. Indeed, over the past decade or so, financial policies in both developed and developing countries have increasingly stressed market forces, while the World Bank has been actively fostering stock market development in developing countries.

---

<sup>1</sup> The World Bank, *World Development Report, 1989: Financial Systems and Development*, (New York: Oxford University Press, 1989.)

<sup>2</sup>For example, Edward Buffie, "Financial Repression, the New Structuralists and Stabilization Policy in Semi-Industrialized Economies," 14 *Journal of Developing Economics*, 1984: 305-22; T. Hellmann, K. Murdock, and J. Stiglitz, "Addressing Moral Hazards in Banking: Deposit Rate Control vs. Capital Requirements," mimeo, Stanford University, 1994.



(a) *Economic considerations:* If money and productive capital assets are, as James Tobin argues, substitutes, then for productive investment to occur, the return on capital must exceed that on money holdings.<sup>3</sup> As such the state should tax such holdings and retard the development of the financial sector. However, this justification for financial intervention is rejected if money and productive assets are, as Ronald McKinnon argues, complements rather than substitutes.<sup>4</sup> If so, growth in real money, accumulating capital, and deepening the financial system are necessary preconditions for productive investment to grow. As the state has no superior information about the rate of return to projects than the private sector, it should not be making decisions about the allocation of resources; repression arguably introduces inefficiencies into the financial system.

Proponents argue that financial intervention creates rents sufficient to induce banks to supply goods and services that may be under-provided in a competitive market. (Here, *rents* means returns in excess of those that would be generated in a competitive market, not income accruing to inelastically supplied factors of production.) By increasing the rate of return to bank intermediation, financial interventionism offers incentives to banks to strive to increase deposit rates and to monitor their portfolio of loans and investments to maximize their rates of return thus encouraging efficient portfolio allocation. Moreover, non-price competition may conduce to improvements in the quality of bank services. However, this strain of argument holds true only if financial interventionism is able to generate enough rents continually. This means that the state must (a) reduce price competition by raising barriers to entry; (b) restrict the ability of households for asset substitution out of bank deposits in response to interest rate caps including equity and debt markets; and, (c) render capital flight unattractive by imposing controls on capital flows across borders. Gold, as well as the informal sector, remains as a threat in this regard. The empirical evidence across countries is variable but,

---

<sup>3</sup>James Tobin, "Money and Economic Growth," 33 *Econometrica*, 1965: 671-84.

<sup>4</sup>Ronald McKinnon, *Money and Capital in Economic Development* (Washington D.C.: The Brookings Institution, 1973).

on balance, mildly against interventionism.<sup>5</sup> The variability probably stems from national differences in political institutions so that incentives and constraints on political elites to exploit the financial system differentially enable/disable them in this regard.

(b) *Political considerations*: The state wields financial policy to extract sufficient revenue to use to satisfy its politically significant constituencies without, where possible, explicitly raising direct or value added taxes. Well organized interest groups including banks and other financial institutions such as finance companies, brokerages, insurance companies, retirement and pension funds, deposit-taking cooperatives/savings-and-loans thrifts, etc. benefit directly from policies such as caps on interest and credit rates (which ensure profitable spreads). Powerful conglomerates in which banks have significant equity or which, alternately, own the banks themselves benefit from preferential credit allocation, while the costs in terms of losses in financial efficiency are diffused over the impacted public including savers and firms not receiving the state directed preferential allocation of credit.

Indirect taxation on banks and other financial institutions primarily in the form of asset restrictions such as liquidity asset requirements (LAR) that enable the state to extract seigniorage from the system. In a sense, the state gets seigniorage from statutory reserve requirements (SRR) but only because they are frozen and subject to the inflation tax, that is, these funds lose value when new money is printed.<sup>6</sup> (In

---

<sup>5</sup> e.g., Maxwell Fry, *Money, Interest, and Banking in Development*, (Baltimore: Johns Hopkins University Press, 1988) ch. 17, vs. Alice Amsden, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989,) ch. 6.

<sup>6</sup> SRR is the ratio of reserves to eligible liabilities, and has been a requirement since January 1959. It affects the level of loans a bank may legally support given the size of its reserves. A higher SRR reduces the amounts of deposits and loans a given level of bank reserves can support, and is therefore a restrictive or contractionary measure. Conversely, a lower SRR is an expansionary measure. In Malaysia, commercial and merchant banks as well as finance companies are required to maintain the statutory reserve as a specific percentage of their respective total deposit liabilities in a special account with the central bank which earns no interest. By effectively locking in some of the resources of a financial institution, the SRR affects not only its capacity to extend credit and accept deposits but also the cost of its funds since the central bank pays no interest on such funds. The central bank may also require different categories of banks to maintain varying ratios in accordance with their capitalization or geographical location, or both. Because SRR changes affect bank management and forward planning profoundly, *changes* to the SRR have been used infrequently except in inflationary or recessionary periods. Between 1959 when the central bank was first set up and 1968, the ratio was

Malaysia, there is also an additional 5% "withholding tax" on interest earned on all savings including time deposits.) More important are LARs that ensure placement of government securities and treasury bonds—defined by the state as liquid assets—at low interest. All things being equal, seigniorage is easier to extract from the banking system and more difficult from direct capital markets where funds pass directly from owners to final users without the intermediation of banks.<sup>7</sup>

To promote an oligopolistic banking sector in which banks are rewarded with supranormal profits while their small numbers make government control easier, the state can encourage consolidation in the sector through mergers and acquisitions, and limits competition by raising barriers (capital requirements, etc) to entry by domestic entrants and by forbidding the entry of foreign banks. Interest rate ceilings may be imposed—banks prefer ceilings on deposit rates but dislike loan rate caps but accept the latter with the former as a profitable spread is thereby assured. For the state, loan rate caps induce non-price rationing of funds so that credit allocation by lending institutions may occur on the basis of political connections rather than expected rates of return on projects. That is, interest rate caps and credit controls can be used to channel funds to favored groups and away from real or potential rivals.<sup>8</sup> Although the literature tends to focus on one aspect of state interventionism in the financial sector, i.e., how politicians use preferential credit as a policy instrument,<sup>9</sup> interest rate and credit controls can be used to create special interest groups<sup>10</sup> such as the state-created Malay bourgeoisie in Malaysia.

---

changed only twice. It was increased twice to control bank credit growth from 1968 to 1974, but was reduced several times in the 1985-86 and 1997-98 recessions to ease tight liquidity in the banking system and release funds for fresh lending in a bid to encourage reflationary investment and spending. (A cut of 1% in SRR currently frees about RM 4 billion into the system.) The SRR was reduced in five steps in 1998—an indication of the desperation of the Mahathir regime to increase liquidity in its attempts to reflate the economy out of the recession—down from 13.5% to 4% to increase liquidity, ease credit, and finance a bailout fund.

<sup>7</sup> Maxwell Fry, *Money, Interest, and Banking in Economic Development*, (Baltimore: Johns Hopkins University Press, 1988) 288-91.

<sup>8</sup> This argument was first made in John Zysman, *Governments, Markets and Growth: Financial Systems and the Politics of Industrial Change*, (Ithaca: Cornell University Press, 1984).

<sup>9</sup> see, for example, Stephen Haggard, Chung Lee and Sylvia Maxfield (eds) *The Politics of Finance in Developing Countries*, (Ithaca: Cornell University Press,) 1993.

<sup>10</sup> Samuel Peltzman, "Toward a More General Theory of Regulation," 19 *Journal of Law and Economics*, 1976: 211-40

I explain in Section VI below how politics, not economics, led to the lifting of capital controls in Malaysia. This permitted a deluge of portfolio funds from the OECD nations to supply cheap equity capital. Not only did this help the UMNO strategy for corporate growth but it also fueled a speculative frenzy that bestowed dizzying capital gains on the middle class retail investor in a surging stock market. However, portfolio substitution from bank credit to tradeable securities meant that stock market funds were used to change corporate capital structures where the proportion of equity capital and securitized debt increased relative to bank loans. Portfolio capital was supposed to be less vulnerable to external interest rate shocks than debt.<sup>11</sup> But they have been just as destabilizing—opening up the stock market to non-residents led to close links between two intrinsically volatile markets, the stock and currency markets. In the case of economic shocks, the two markets tend to interact in a negative feedback fashion, exacerbating macroeconomic instability and reducing long term growth.

## **Section II: Financial Sector Structure in Malaysia**

Until the late eighties, the financial sector in Malaysia was still largely dominated by its banks, and development was largely bank financed as direct capital markets were immature and because of institutional and individual familiarity with bank financing. From 1980 through 1986, an average of RM 7.2 billion were extended annually by banks, eight times more than the funds raised in its direct financial markets. From 1987 through 1992, however, the ratio of funds raised by banks to that by direct markets dropped precipitously.<sup>12</sup> (In 1992, direct markets raised 49.8% of total funds although this was anomalously high because of mammoth public issues of the national electric utility—RM 3.2 billion—and the national automaker—RM 800 million—in their privatization, as well as huge rights issues by the national airlines and several UMNO

---

<sup>11</sup> WIDER, "Foreign Portfolio Investment in Emerging Equity Markets," *Study Group Series No. 5*, (Helsinki: World Institute for Development Economics Research, United Nations University, 1990).

<sup>12</sup> Jaafar Ahmad, "Effectiveness of the Formal Financial Institutional Structures in Mobilising Savings," in Al Alim Ibrahim (ed) *Generating A National Savings Movement*, (Kuala Lumpur: Institute of Strategic and International Studies, 1992): 153-55.

corporations involved in "privatized" B-O-T infrastructure projects.) Still, financing from direct markets grew to about 35% of total financing in the 1990 to 1996 period in contrast to about 10% in the 1980 to 1986 period.<sup>13</sup>

Strong national savings have funded bank loans mainly through bank deposits; gross national savings have averaged about 30% of GNP from the second half of the eighties. Yet these were insufficient and, during the Asian miracle, Malaysia faced a savings-investment (S-I) gap grew steadily from 1990, and was already 10% of GNP in 1991. An S-I gap generally translates into current account deficits. From 1991 to 1997, the country incurred a current account deficit of more than RM 5.6 billion annually. Offshore portfolio funds in search of better returns were welcome, and these fueled the surging stock market but the extent of their involvement in the economy was not generally appreciated until their abrupt withdrawal in July 1997. In fact, these short term capital inflows were offsetting a negative balance of payments from 1994, but especially in 1996, to produce what even appeared to be a small surplus.<sup>14</sup>

In Malaysia, financial intermediaries are neatly divided in terms of their markets served, and financial services remained narrowly compartmentalized and protected.<sup>15</sup> This arrangement enhances the power wielded by the Ministry of Finance (MOF). In addition, as MOF Inc., it also wields significant market power in virtue of its ownership of majority shares and/or "golden shares" in privatized utilities and other monopolies and oligopolies including several UMNO conglomerates. The domestic banking system consists, first, of monetary institutions whose principal liabilities are generally accepted as money comprising the central bank called Bank Negara Malaysia (BNM) and commercial banks including the state-owned Islamic bank called Bank Islam. Secondly, there are non-monetary institutions which are closely linked to the monetary institutions and whose principal liabilities are generally accepted as near-money. These include

---

<sup>13</sup> Source: various issues of Bank Negara Malaysia monthly and quarterly statistical bulletins.

<sup>14</sup> source: Bank Negara Malaysia monthly and quarterly statistical bulletins, various issue.

<sup>15</sup> see, See-yan Lim, "Malaysian Financial Markets," in SG Rhee and RP Chang, (eds), *Pacific Basin Financial Markets Research, Volume III*, (Amsterdam: North Holland Publishers, 1992).

merchant banks, finance companies and discount houses that absorb excess liquidity in the inter-bank market and invest such funds in government paper. (Table 4.1)

**Table 4.1 Types of financial institutions in Malaysia**

	<i>Total</i>	<i>No. of branches</i>
<b>A. Monetary institutions</b>		
1. Bank Negara Malaysia		
2. Commercial banks --Domestic	20*	1478*
--Foreign	13	144
<b>B. Non-monetary institutions</b>		
1. Finance companies--Domestic	31*	1077*
--Foreign	8	67
2. Merchant banks	12	24
3. Discount houses	7	--
4. Factoring companies	19	--
5. Stock brokerages --Domestic		
Tier-One	10	--
Non-Tier One	58	--
-- Foreign	--	--

Commercial banks raise the funds for their operations mainly from deposits, a sizeable portion of which is retail based, (individuals and small-and-medium industries, or SMIs,) although deposits from institutions have been rising. Commercial banks have the largest capital bases of all capital market intermediaries in Malaysia but no offshore currency markets (which allow Malaysian firms to borrow in foreign currencies from Malaysian banks) are permitted except in the far-flung Federal Territory of Labuan Island, off Borneo. Less than 10% of total bank funds are raised offshore almost exclusively from the international inter-bank markets. There are 33 licensed commercial banks with a total of 1671 branches for a population of 21 million people. This number is far too large when we consider that England with a far larger economy has only four major banks following recent mergers and acquisitions. This overbanked situation—that is nevertheless dominated by the three biggest banks—arose in the laissez faire period which prevailed from independence in 1957 till the NEP affirmative action policy for the Malay majority was instituted in 1971. (There are another 48 foreign banks represented but not allowed to conduct commercial banking activities. From the start of the NEP, no new banking licenses have been granted to foreign banks

except in 1994 when the Bank of China was allowed to set up in the capital in return for a license in China for a Malaysian bank.)

There are also more than 39 finance companies with 1144 branches, many still family-owned belonging to ethnic Chinese. Their numbers are fluctuating as many are being forced by the state to merge with other finance companies or are be acquired by commercial banks in the aftermath of the Asian crisis. These institutions accept retail deposits and provide finance for hire purchase (installment credit), leasing transactions, and home mortgages.

Merchant banks in Malaysia fund their capital market activities--underwriting equity and dealing in government paper--with funds from institutions and wealthy individuals rather than the general public. These merchant banks rely almost wholly on domestic sources and thus have higher funding costs than commercial banks that can raise demand and retail deposits. There are 12 merchant banks with 24 branches.

Stock brokerages are the predominant dealers in equity in Malaysia. Except for the ten "Tier-One" brokerages which are all located in the country's capital city, highly capitalized and, without exception, part of a UMNO-owned or -linked or state-backed Malay financial or commercial conglomerate, secondary market activity rather than underwriting is their only source of income. The non-Tier One brokerages have smaller capital bases, are generally family-owned firms belonging to ethnic Chinese, and located outside of the capital city. Finally there are 7 discount houses which may invest short-term funds in treasury bills, Malaysian Government Securities, or MGS, bankers' acceptances, negotiable CDs, and private debt securities, or PDS. There are also 19 factoring companies that offer facilities for factoring recoverables.

### **Section III: How the state exploits banks and financial institutions**

#### *(a) Extracting seigniorage from the banking sector:*

*Liquid Assets Requirement (LAR):* This is the minimum liquidity requirement, or cash and securities requirement, defined in terms of total deposit liabilities. It has been required since November 1959, and

historically, has been 17% at its lowest. On the one hand, it safeguards bank liquidity, protects bank depositors, and helps control excessive expansion of bank credit. On the other hand, it immobilizes bank portfolios of government securities defined and therefore held as liquid assets, The state therefore uses it to channel an increasing volume of bank funds to finance its budget deficits. It has specifically been used to direct funds into the primary market in its low-yield Malaysian Government Securities (MGS) thus hampering the development of an active secondary market in MGS as well as that of private debt securities (PDS).

The LAR operates in the same manner as the SRR in that when the liquidity ratio is raised, the amount of deposits and loans a given supply of reserves can support is much less. Conversely, the impact is expansionary if the ratio is reduced. However, unlike SRR funds which are immobilized in the central bank and earn no interest, statutory LAR funds are immobilized in the banks themselves and do yield a return albeit at lower-than-market rates. In theory, it limits the scope for bank liquidation of short-dated liquid assets thereby restraining credit. By designating its long term MGS and Malaysian Treasury bills as liquid assets, banks are compelled to play a direct role in financing the state's activities. By increasing the LAR, the state channels more of bank resources into specified assets. (Besides MGS and T-bills, other instruments accepted as liquid assets include cash, money at call, inter-bank balances, bankers acceptances, negotiable certificates of deposit (CDs), and foreign liquid assets.) Not only have MGS and T-bills become the main form of liquid assets but, more importantly, bank holdings of cash and clearing balances are now kept to very low levels—the average figure was 6.0% at the end of the 1960s, 3.5% at the end of the 1970s, and already as low as 1.3% of eligible liabilities in 1988.

The LAR is fine-tuned by excluding savings deposits from the liquidity base in computing compliance with the ratio, and by requiring banks, insurance companies and retirement funds to maintain a minimum ratio of their eligible liabilities in Malaysian liquid assets. (The giant Employee Provident Fund (EPF) to which every worker and employer must contribute is a huge source of funds for the state in this



respect.) A half of this particular ratio must be held in primary liquid assets. These are defined as cash, balances with the central bank, money at call with discount houses in Malaysia, federal government T-bills, other federal and state government securities including Cagamas bonds (issued by the state-owned National Mortgage Corporation) with maturities of one year or less. All other liquid assets are designated as secondary liquid assets including federal and state government securities with maturities exceeding one year; bills discounted or purchased and bills receivable that are payable in Malaysia; and, bills re-discountable at the central bank including bankers' acceptances.

Another maneuver the state employs is double counting. Here, primary deposits mobilized by one segment of the financial community, say, commercial banks, are subject to a second round of LAR when such deposits are placed with another segment, say, merchant banks. Merchant banks, in addition, have to observe higher LARs. Until 1985, all financial institutions were required to maintain the minimum ratio on a daily basis, a very onerous requirement; from 1985, all have been allowed to average their LAR on a monthly basis.

The LAR renders financial institutions captive markets for government securities. Because of their low yield curves, a secondary market for bonds has not developed. As such, the central bank's open market operations (or the sale and purchase of government securities in open and organized markets to affect directly the reserves of banks, and thus the flow of bank credit and money) which is an effective policy tool in developed economies is, however, ineffectual in Malaysia. Whenever the central bank has sold on any significant scale to induce credit restraint, it has only resulted in an undue depression of security prices. Such transactions have always meant that the central bank is on the buying side only.

*(b) Directing preferential bank credit to specific interest groups:*

Central bank action on bank reserves affects the flow of deposits and credit. It is also empowered to regulate interest rates or the price of borrowed money. The main instruments used to effect preferential credit allocation thus include interest rate and credit controls.

*Interest rate regulation:* Interest rates may be established by the forces of supply of and demand for funds, but interest rates in Malaysia have not been very responsive to market forces because of market imperfections in the shape of state-imposed restrictive practices in pricing, operating requirements commercial banks are required to observe as members of what is essentially a cartel, the Association of Banks, in which there is a concentration of market power in the hands of a few big financial institutions that account for the bulk of funds and transactions (although there are far too many small cap banks for its small population).

Prior to 1978, the state set minimum lending rates for bank loans defined as "prime rates" for a bank's best customers, and "preferential rates" for advances to federal and state government including public agencies and advances against MGS, usually 1/2 - 1% below the prime rate. This "administered" interest rate regime impacted not only savings rates, as well as level and maturity structure of savings, but also helped promote an oligopolistic sector by limiting rate competition. Domestic banks could not and would not offer higher rates to attract deposits while foreign banks could not undercut domestic banks by offering unduly low lending rates. It also prevented volatility in interest rate differentials between Malaysia and the rest of the world thereby protecting the balance of payments from being significantly impacted by cross-border capital movements.

The state has always permitted lending rates of commercial banks to be generally high relative to their deposit interest rates to ensure a generous "spread" to cross-subsidize bank losses incurred in lending to the state and priority groups such as Malays, home mortgages, and small-and-medium size industries (SMIs) for which yields are fixed. Between 1959 and 1965, loan rates against property and equity were 6.5 - 8.0% per annum but no changes were ever made to the low interest rates on fixed term deposits while savings rates were raised only once from 2.5% to 3.0% in August 1965. Ceilings on interest rates for bank deposits of maturity more than 12 months were lifted in 1972, and those offered by finance companies in 1973, while the interest rate regime was "completely" liberalized in October 1978 after which banks were allowed to

determine interest rates for deposits and loans. However, the cap at 10% for all loans to Malays that had been instituted in 1976 continued to be enforced even after 1978 till the present day. Moreover, the banks have continued to apply preferential rates for loans to the government and statutory authorities. In addition, banks and finance companies align their rates to the base lending rate (BLR) charged by the two top banks. This offers a collusive anchor and, historically, the maximum differentials between the deposit rates of the two lead banks and other banks has been about 0.5% while that of finance companies has been about 1.5% even though they are allowed to freely determine their rates. In practice, the 3-month rate at which the central bank lends to banks is the key money market rate that indexes the Kuala Lumpur Interbank Offer Rate (KLIBOR) which is used by commercial banks to calculate their BLR. (Thus, in recessionary times, for example, if the desire is to pump more liquidity into the system, a monetary tool available to the central bank is a reduction in the 3-month money market rate, in which case the KLIBOR and, therefore, the BLR will fall in tandem. Moreover, the central bank computes the net lending margin as the difference between the weighted average lending rates and deposit rates with no adjustments made for penalty rates charged for NPLs. As such, the computed average lending rate is frequently distorted; banks and finance companies have historically been able to charge high penalty rates, the impact of which has been felt mainly by small businesses since politically connected clients generally secure loans to "reschedule" their loans in default.

*Preferential credit allocation:* The use of direct credit controls through the imposition of quantitative controls on credit extension by commercial banks and finance companies, and guidelines or "directives" from the central bank to affect the direction of bank lending serve to bypass market mechanisms and profoundly impact the management of bank assets especially their loan portfolios. Quantitative controls have been used sparingly in Malaysia; in fact, it has been used only once in 1974 to moderate inflationary pressures as bank credit rose by 53% in 1973. The loan growth caps at 20% and 25% for commercial banks and finance companies respectively were withdrawn in 1975 when inflationary pressures moderated and have not been used again since. Since then especially as bank credit helped fuel the surging markets in the 1990s,

the central bank's aversion to slowing down monetary aggregates and credit expansion, especially from 1994, had not passed unnoticed by the financial markets. Thus the vulnerability of the financial sector to speculative attacks in the stock and currency markets.)

Directing credit preferentially to favored sectors as a policy tool, on the other hand, has been wielded by the state with alacrity. Beginning in February 1975, commercial banks and finance companies were required to extend a minimum of 50% of their net increase in net credit during 1975 to Malays, for home purchases, and to manufacturing. From October 1976, commercial banks and finance companies were specifically required to direct a minimum of 20% of their increase in loans to the Malay community, 25% to manufacturing, 10% to agriculture, and 10% to individual home purchases. Banks that did not comply were penalized; such banks had to re-channel their funds to banks that did comply at a penalty rate of return determined by the central bank. Thereafter, lending guidelines were issued every year for each bank specifically to ensure compliance with the Malay quotas. From August 1979, instead of these guidelines based on the flow of new loans, financial institutions were required to extend a minimum proportion of their total loans to Malays, SMIs, and food production. From 1981, to further ensure that Malays continue to have ready access to credit at low costs, the central bank has issued annual lending guidelines. Through all this, a ceiling rate has always been prescribed by the central bank for loans to Malays not exceeding RM0.5 million. As a result, credit to Malays has increasingly become directed to its contractors and property developers as well as home purchases. Small Malay accounts have declined in importance while increasingly larger loan commitments to individual Malays are evident, reflecting the growing participation of the Malays in large scale projects.

Home purchasers as a group, but especially Malay home purchasers, have significantly receive preferential credit, home ownership being arguably an important consideration for a majority of the electorate in any procedural democracy. Before state intervention to direct credit in this way, the amount of bank credit in the 1950s and 1960s extended for home ownership was very limited. From October 1968, 50% of savings

in commercial banks had to be invested in home purchases by individuals and approved financial intermediaries (and in long-term MGS.) From October 1976, banks were required to extend at least 10% of their new loans yearly to individuals for home purchases, and a ceiling rate on small individual housing loans defined as a few points above the average BLR of the two lead banks. From 1982, commercial banks were required to finance the purchase of specific minimum units of low cost homes per year of which a specific proportion, always exceeding 50%, must be reserved for Malay individuals. Malays also receive a discount of 10% on sale prices and financing of up to 90% of the purchase price with longer repayment periods than non-Malays. (This direction of bank credit also serves the interest of the property and construction sector dominated by UMNO corporations, especially its giant construction and infrastructure developer Renong, and property conglomerate, UEM.)

In this connection, the state undertook to help banks cope with their required portfolio of loans to Malays for home purchases by introducing the only significant change in Malaysian bond markets which the state has been at pains to suppress (*see below*). The National Mortgage Corporation (Cagamas) was established to issue the first ever mortgage bonds in Malaysia in 1987 as a facility to primary lenders namely commercial banks and finance companies. The state itself is a very significant lender of home mortgage loans at nominal interest to its huge army of civil servants. Cagamas helps provide liquidity for what were previously illiquid portfolios of loans. These bonds help reduce the asset-liability mismatch of the financial institutions required to carry out origination and funding of residential mortgages. This securitization (*see below*) means that the function of origination is separated from financing, and the risks of financing the securities issued against the underlying mortgage loans is passed on to those most able and willing to assume the risk, invariably institutions and individuals with long term funds. Because they qualify as liquid assets and as "Prescribed Investments" each flotation have been oversubscribed many times over.

Malays are also recipients of special credit allocations to buy ASN and ASB shares (see Chapter 2) as well IPOs and rights issues. Finally, bank credit—in contrast to direct capital markets—can also be directed

to support 'national' ambitions in industries such as textiles, steel, shipbuilding, autos and electronics. Indeed, one of the allocative inefficiencies resulting from financial repression is supposed to be overly capital intensive and large scale production techniques as credit is allocated by the state at artificially low interest rates.<sup>16</sup>

(c) *Suppressing ethnic Chinese capital in the banking sector:*

By the 1940s, the ethnic Chinese had grown to half the population and remained so till the expulsion of Singapore from the Federation in 1963. Low birth rates and emigration in response to state policy of ethnic repression with the NEP from 1971 have caused the ethnic Chinese population to dwindle its present 25.6% of the total population. Historically, the banking system in Malaysia was dominated by British banks while domestic banks were small cap, family owned ones belonging to these ethnic Chinese. The state amended the Banking and Financial Institutions Act (BAFIA) in 1985, effectively targeting Chinese-owned banks, by limiting ownership by an individual to no more than 10% interest in a bank. In addition, any entity other than an individual was limited to 20% ownership on the grounds that the banking sector had become captive of a small number of owners who might extend credit to firms they own regardless of the credit worthiness of such firms, and thereby jeopardize savers' deposits. The equity of such banks also had to be restructured to comply with NEP quotas of a minimum of 30% Malay ownership of corporate equity, whether through "negotiated purchases" of the equity of non-listed banks, or through open market purchase of the equity of listed banks using public funds.

In 1989, the BAFIA was amended again to prohibit the acquisition or disposal of 5% or more of the shares of any locally incorporated bank without prior approval of the MOF. The correct ethnicity of the buyer of Malay equity is a *sine qua non*, which effectively prevents the dilution of Malay ownership of equity in the banking sector. The 1989 amendments also prohibited banks and finance companies from cross-holdings of shares among financial institutions thus effectively limiting the growth of small-cap, Chinese

---

<sup>16</sup> Fry, *ibid.*, 410-17.

financial institutions.<sup>17</sup> In this manner, Malay ownership of equity in and Malay control of the sector has supplanted that of the ethnic Chinese.

The state has tried on several occasions to compel the small cap ethnic Chinese-owned banks to merge with large Malay financial conglomerates. The rationale included the need for the over-banked sector to consolidate to achieve economies of scale and scope, given the prospects of international competition from a WTO financial liberalization pact to come into force in 2003. But substantial shareholders of small cap banks have held out. In 1994, the central bank instituted a two-tier regulatory system based on new capitalization requirements. Incentives were offered to banks to achieve Tier-1 status. In a *volte-face*, crossholdings were also permitted to enable banks to secure cheap equity capital in the surging KLSE as well. Banks then became characterized by a close integration with the securities business and a Tier-1 bank would typically own a Tier-1 brokerage too. Yet, at the end of 1998, only 18 commercial banks (or about half the total) had attained Tier-1 status, and even these had shareholder funds well below international standards.<sup>18</sup> Early in the Crisis, the state demanded that banks merge into five groups while finance companies were also to merge into five groups. By its well publicized deadline in 1998, the latter had merged into 8 groups but only one failing Malay bank agreed to be acquired by another owned by a prominent UMNO player even though the state had threatened not to extend aid (or bail out) non-compliant banks that failed.<sup>19</sup> That is, even though the banking sector faced an overall non-performing loans (NPLs) rate of about 30% and even though its recapitalization probably required about 25% of the GDP, the state's threat was less than credible because

---

<sup>17</sup> Mahathir has declared that "many non-Malay companies are now owned by Malays although the names of the companies continue to be non-Malay like several banks previously owned by non-Malays, and the big construction companies are owned by Malays...We can show (UMNO members) that actually many Malays have now bought over non Malay properties, non Malay companies, non Malay banks...They now belong to Malays." See, "Sale of stakes in Malay firms a temporary measure," *New Straits Times*, February 26, 1998.

<sup>18</sup> Out of 200 banks in Asia surveyed before the Crisis, Malaysian ones had the lowest Tier-1 capitalization. The typical Malaysian bank's average was US\$0.33 billion in contrast to Singapore's average of US\$3.01 billion; figures cited in Editorial, *Banker's Journal*, October 1997.

<sup>19</sup> The solitary failing bank that agreed to be merged, Sime Bank, was directly owned by UMNO's earliest conglomerate, Sime Darby. (See Chapter Two) Sime Bank had been brought down by its securities subsidiary, Sime Securities, with its losses of RM1.8 billion. The acquiring bank was Malaysia's second largest—also UMNO-linked—which had been formed in 1996 when Rashid Hussain Bank acquired Kwong Yik Bank; *New Straits Times*, November 13, 1998.

much of bank ownership was by now in the hands of UMNO players.<sup>20</sup> Faced with public defeat by the banks, the state declared victory since finance companies had been compliant and averred that the deadline had really been meant for finance companies only, and not commercial banks.

Finally, because private bonds in Malaysia are issued with expensive bank guarantees (*vide infra*), defaults in these securities in the Crisis threatened to impact the banking system seriously. The guarantees were granted with collateral pledged to banks as consideration so that the guarantors, by substitution, became the issuer's creditors. The banks involved were thereby obliged to honor their commitments in the event of a default by the issuer. The banks were to pursue payment from the issuer while the noteholders were excluded from the queue of claims. About RM3 billion in private bonds matured in 1998, of which RM1.9 billion were guaranteed by banks, while another RM6.84 billion were due for redemption in 1999, of which RM4 billion were bank guaranteed. In the event, the state decided to protect not only those issuing corporations in default such as Renong but also the banks. Using ambiguities in the bankruptcy laws, it rendered null-and-void the banks' "unconditional and irrevocable" guarantees. In the event, no creditor or groups of creditors tried to enforce any bank guaranteed debt.

More fundamentally, the solvency of the banking system had become inextricably linked to the securities operations of its subsidiaries. As a result, instability in the whole financial system and the macroeconomy in the Crisis was amplified. The domestic economy became vulnerable to international macroeconomic fluctuations and capital flights. The Asian crisis—mainly a stock market and currency meltdown—translated into a systemic banking crisis thus jeopardizing long term growth.

#### **Section IV: The stock market as an instrument of state power**

Prior to liberalization, financial policy sought to promote a cartelized banking system; three British banks dominated 80% of the banking sector from independence until the early 1970s. These banks mobilized

---

<sup>20</sup> For example, *see*, "Asian banking headache may top Tequila hangover," *The Star*, August 17, 1998: 23.



savings from the agricultural sector as commodities were the main export earners in the pre-NEP period, and the biggest corporations were British "agency houses" that continued to occupy the "commanding heights" of the economy long after independence. Buying and selling of shares occurred first in 1870 and the first stockbroker's association was formed in 1927. The first public trading of shares occurred in May 1960, less than two months after the Malayan Stock Exchange was established. The small size of most domestic firms and a general lack of investor confidence as well as the state monopolization of direct financial markets through the issue of government securities relegated these markets to minor roles in the financial sector. With the end of currency interchangeability between Singapore and Malaysia in 1973, the KLSE was established. Up till very recent times, direct capital markets—stocks and bonds—played insignificant roles in financing development and the KLSE was not actively promoted by the MOF.

A key reason for the inertia arose from the historical oddity of KLSE's linkage with the Singapore Stock Exchange (SES). Although formally split in 1973, a full decade after the expulsion of Singapore from the Federation, it was not until January 1990 that the two stock exchanges were substantively separated. It was only at that time that all Singaporean stocks were delisted from the KLSE, and all Malaysian incorporated firms delisted from the SES. In 1990, half the SES listings were Malaysian firms which meant that the rupture impacted the SES more than the KLSE for which only 11% of its capitalization were Singaporean firms. To overcome its low trading volumes, the SES launched an over-the-counter (OTC) market called CLOB (Central Limit Order Booking) that the KLSE steadfastly refused to recognize. Yet these shares were not created out of thin air for all CLOB shares had mirror holdings on the KLSE as they were captured in the form of nominees who created a pool of shares for people to trade in. By 1997, CLOB was 25% of the SES capitalization and had a total of 130 stocks of which 113 are top quality Malaysian stocks, 5 European, and one each from Hong Kong, Manila and Jakarta.

Prior to CLOB, foreign brokers were compelled to trade through Malaysian brokers because foreign brokers were barred from becoming full-fledged KLSE members. The competence of Malaysian brokers was

questionable. Apart from introducing a daily netting settlement system for securities in 1990 to complement the daily netting of cash positions, the KLSE did not seek to actively improve its operations, and had an outdated delivery system. With the setting up of CLOB, foreign brokers began to trade in Malaysian stocks on the CLOB instead, the effect of which was to limit non-Singaporean foreign equity on the KLSE and hence its development. Malaysia wanted that trading for itself but its anger with CLOB's circumventing its ban on trading of KLSE stocks on the SES was soon forgotten. This was because, during the boom years from 1992, CLOB came to be seen as helping to bear some of the load from overburdened KLSE brokers. CLOB was decimated in September 1998 when Mahathir closed the financial system after the KLSE had lost 70% of its value in the Asian Crisis. (*see* Section VI)

(a) *How the KLSE was used to create and consolidate a Malay business class:*

Although slovenly compared to the Singaporeans, it did not mean that the state was uninterested in the KLSE. In fact, it had begun to use the KLSE to construct a Malay bourgeoisie from the early seventies. The Capital Issues Committee (CIC) was established in 1968 to approve listings and to supervise the quotations of shares and other securities by corporations applying for listing or that were already listed by the KLSE. The first law for the Malaysian securities industry, the Securities Industry Act (SIA), was passed in 1973, under which the KLSE was established as a company limited by guarantee as distinct from the KLSE-SES tie-up. The 1973 law provided legal authority to the ROC instead of the CIC to license brokerages and curb excessive speculation, insider trading, share rigging and other forms of market manipulation. In effect, the CIC functioned without legal standing to oversee the KLSE—and therefore, theoretically, could not be challenged in a court of law (until a new law was passed in 1983.)

The CIC was supposed to play a key role in protecting the interests of minority shareholders especially in schemes of corporate restructuring especially in mergers and acquisitions (M&As). However,

the CIC was in reality more important to the state as a tool to build a Malay business class through ethnic quotas to effectively increase Malay ownership of corporate equity. The main device was the CIC's conservative pricing policy—and that of its successor, the Security Commission (SC)—so that, in practice, issues were always priced below prevailing market prices. This made the underwriting of stock issues by merchant banks almost riskless. More importantly, it enabled Malays to acquire new shares—at least 30% of which had to be reserved for them—at very low cost. In addition, such acquisitions were almost exclusively carried out with cheap credit preferentially allocated to Malays by commercial banks at the state's behest. The Malay adult could purchase small units at par on the KLSE, or through the state-run ASN mutual fund—beginning with a RM10 purchase—with a guaranteed return above the prevailing loan rates. Because these purchases were made at post offices, and because purchases and dividends were recorded on a passbook, it was immediately familiar to, and held a resonance for, rural folks who had used the postal savings institution passbook system for decades so that coverage was immediate and nationwide. Given great publicity in the media, the notion that there was an on-going transfer of public wealth to many Malays through UMNO became widely believed although it was a minority—the urban, upper social class Malay—who actually bought a majority of these cheap shares. Even more significantly, because the CIC required new shares to be issued at a substantial discount from market prices, listed companies became vehicles for UMNO proxies who were majority shareholders and directors to use for costless and profitable M&As on the basis of swaps under boom conditions.

Up to the late 1980s, the economy was small, and the stock market capitalization was accordingly also small. Enabling electronic technology had not yet arrived, and transaction costs for new issues on the KLSE remained very high. This was because it was a fragmented process in which at least three separate agencies had to be consulted and their individual approval secured for each issue, namely, the CIC, the ROC, and the KLSE. An applicant had to approach the CIC for a listing, "wait several weeks for approval, then to

the KLSE, wait another several weeks, and finally to the ROC and more waiting."<sup>21</sup> The power to register and approve prospectuses for public offers resided with the ROC that also has the power of enforcement. If the listing came about as the result of a merger or acquisition, there was also the Panel on Takeovers and Mergers (PTM) to contend with. Finally, to this very day, it is the Foreign Investment Committee (FIC) in the Prime Minister's Department that actually has the sole prerogative of granting a general offer exemption on grounds of "national interest" so-called.

In the late 1980s, privatization was a major force in deepening the KLSE's capitalization. State owned enterprises, various utilities and huge infrastructure projects such as highways, urban transit systems and railways, auto manufacturing, airlines, shipping and ports, were divested at nominal prices and in a discretionary manner to UMNO corporations as well as hand picked Malay individuals and firms. All public issues under privatization reserved a portion for designated Malay institutions, another third of the primary issue had to go to Malay individuals, while most of the rest of the equity were directed to UMNO corporations, a fact never denied by the government. Privatization thus increased rather than curtailed Malay equity accumulation contrary to initial Malay fears. Usually some proportion of the equity of these gargantuan monopolies, say 15%, were sold on the KLSE to domestic and foreign investors. Although these amounted to huge sums of money, they were proportionally small enough to ensure that control of enterprise remained in Malay/UMNO hands. Still, minority equity held by non-Malay retail investors and foreign institutional investors were significant enough to offer the privatization (that transmuted public assets into private wealth) some measure of legitimacy.

A new regulatory agency, the Securities Commission (SC) was set up in 1993 to expedite equity issues. The SC supervises capital markets while the Central Bank continues to supervise the banking sector. Taking over the functions of the CIC and the PTM, the SC was supposed to regulate all matters relating to

---

<sup>21</sup> See, "An Interview with the Head of the Registrar of Companies: The Task at Hand," *Malaysian Business* June 16, 1998, 13.

securities and future contracts, takeovers and mergers, and unit trusts/mutual funds, streamline the approval process for listings as well as promote good corporate governance. It also licenses and supervises brokers and all other licensed exchanges, clearing houses and central depositories. Having consolidated the activities of the three main agencies, the SC has been able to carry out its regulatory functions reasonably well. That is, except, crucially, when UMNO corporations and well connected firms are involved, in which case exemptions may be offered at the expense of minority shareholders.<sup>22</sup>

Even with the setting up of the SC, the FIC (that has never been given legal standing and, therefore, cannot be challenged under any specific statute) is still very much alive and still grants a general offer exemption under Rule 34.2 of the Malaysian Takeover Code. Its exemption powers have been used on several occasions to enable cash-rich UMNO corporations to bail out UMNO corporations in trouble at the expense of minority shareholders, namely, the retail investor. The FIC is not subject to any set of clear or coherent criteria that is stipulated by statute.<sup>23</sup> Since its exercise of discretionary powers is not backed by legislative fiat, FIC decisions do not bear the legitimacy of legal authority, and are often justified in terms of "national interest."<sup>24</sup> Decisions by the FIC (or, for that matter, those of the CIC,) have never been challenged

---

<sup>22</sup>The SC Chairman has openly admitted to the validity of charges of "the lack of transparency (of the SC's own operations) and insufficiencies in the protection of investor interest...the cornerstone of any modern regulatory system." That is, the SC does not function as it should being vulnerable to political pressure; see, "Chairman's Statement," *Annual Report of the Securities Commission*, (Kuala Lumpur: Government of Malaysia, 1997) 1. The Chairman also referred in passing to the infamous and disastrous move by the Prime Minister, Mahathir Mohamad, in August 1997, to impose trading restrictions on designated stocks in his ill-advised attempt to flush out short-selling of these stocks during the KLSE crash. The SC Chairman, an ally of the MOF, averred that this had been done without consultation with the SC. The SC's lack of autonomy was made evident in the two infamous episodes involving UMNO firms where minority (shareholders) interests were sacrificed. (see following footnote)

<sup>23</sup>For example, in a move that took its minority shareholders by surprise, United Engineers Malaysia Bhd. (UEM)--a blue chip popular among foreign investors because it a linchpin of the UMNO "money machine"--paid a hefty premium in November 1997 for a stake in its debt-laden parent company, Renong Berhad, UMNO's investment arm. UMNO, the ultimate beneficiary of the sale, sold Renong stocks for an above market price in a RM2.34 billion transaction to UEM and after receiving special clearance from the FIC. Frightened that other healthy firms would suddenly take stakes in sickly cousins, investors dumped shares on the KLSE which plummeted further. Soon after that, FIC offered UMNO special exemption to repeat this maneuver, its cash-rich media giant, NSTP/TV3, rescuing its cash-strapped utilities concern, MRCB, at the expense of minority shareholders yet again.

<sup>24</sup>The SC has articulated its unease about this although it was not reported in the media and therefore not common knowledge. See, Securities Commission's Annual Report, 1997.

in a court of law. Precisely because they do not have legal authority, they have been able to function in ways beyond what were originally contemplated.

*(b) The stock market bubble in the nineties:*

By the early 1990s, stock markets in East Asia had begun to surge from huge portfolio flows. The region became attractive to portfolio funds given reduced concerns about its debt servicing, perceptions that its governments had put in place sound financial policies, and the relocation of labor intensive industry from Northeast Asia to Southeast Asia.<sup>25</sup> Also, enabling information technology was emerging. Despite relatively poor and declining rates of return on capital, Malaysia still attracted additional portfolio investment for two possible reasons. First, the cost of capital in the 1990s was low—institutional investors from OECD countries (mutual funds, pension funds, and life insurance companies) were seeking to diversify their portfolios while fund managers were afraid of losing out on the phenomenal gains in the region—and therefore the required rate of return on invested capital had fallen. These flows started because of artificially low (3%) U.S. federal funds rate of 1992-93, in particular, which arose from U.S. policy meant to enable US banks to repair their balance sheets following the 1990/91 recession. Malaysia and other southeast Asian nations did not need such low rates but, because the Ringgit was effectively pegged to the Dollar, domestic interest rates fell to a low of 6%, well below the perceived rate of return on capital in a fast growing economy. Perceived as good credit risk, a deluge of capital inundated Malaysia, generating overall balance of balance surpluses at the prevailing exchange rates. The process was enabled by the globalization of finance through electronic means. Liquidity and credit began to balloon, foreign currency reserves tripled from \$10.8 billion in early 1992 to \$27.2 billion by the end of 1993.<sup>26</sup> Secondly, corporations known to be UMNO-owned or UMNO-linked were often able to inject new assets through the on-going privatization program, and these attracted strong

---

<sup>25</sup> MS Khan & CM Reinhart, "Capital Flows in the APEC Region," *IMF Occasional Paper* # 122, 1995.

<sup>26</sup> Bank Negara Malaysia, *Monthly Statistical Bulletin*, January 1994.

market interest allowing funds to be raised so cheaply that unsurprisingly capital reserves were not effectively utilized.

Initially, the central bank sterilized the excess liquidity by issuing central bank debt in the domestic money market. It quickly became obvious that the Malay bourgeoisie (and ethnic Chinese investors) would benefit from the stock market euphoria. Capital controls were then completely lifted. In early 1994, the central bank's policy reversal led to soaring bank credit which even a tiger economy could not absorb productively thus promoting speculative activity on the KLSE and in real estate. This led to rivers of consumer imports and inflation. A second board was set up on the KLSE with less stringent listing requirements so that small capitalization corporations could also secure the cheap equity capital. In addition, an electronic, scripless clearing and settlement system for the KLSE called the Central Depository System (CDS) was set up in 1992 under a new Securities Industry Act (Central Depository), 1991, to expedite registry as well as the sales and purchase of shares. It replaced the practice of holding and moving physical scripts of quoted shares with a computerized book entry system, thus enabling stock brokerages to better manage related settlement flows.

In the bull run years of the 1990s, Malaysia experienced dramatic disintermediation of traditional bank deposits to the stock exchange.<sup>27</sup> Especially from 1992, stock market development has been very rapid in terms of the average daily volume of shares traded, as a proportion of the GDP, stock market capitalization as a proportion of total market capitalization, as well as the number of companies listed. However, the KLSE remains immature in terms of "thickness" of the market for, typically, most of the trading occurs in a small number of stocks. There are serious deficiencies in the availability of information with lax disclosure requirements regarding the performance and prospects of various shares as well as the transparency of transactions. The financial deepening the KLSE represents made it a major channel for institutional investors from developed economies as they sought to achieve portfolio diversification through country or regional

---

<sup>27</sup> Source: *Bankers' Journal*, November 1996.

funds. Up till the Crisis, there was considerable direct buying of shares by individuals and institutions from developed economies.

Aggressive bank lending as well as generous margin financing facilities provided by stock brokerages to politically linked speculators fed the euphoria. Individuals and corporations used bank credit to speculate in the stock market and were often allowed to pledge the shares to be purchased as collateral. For many such borrowers of revolving credit and short term advance facilities, their main sources of repayment funds came issuing shares in their companies. The whole scheme held up when the stock market was surging but falling share prices in the Asian crisis reduced the security cover of margin financing provided by stockbrokerages resulting in "force selling" when clients failed to meet margin calls. Moreover, high share prices meant that stocks were also frequently used to provide security cover for bond issues. Sharp drops in stock prices thus also meant that the security cover for bonds also fell below the amount required by KLSE rules. Such breaches in security covers constituted defaults if the corporation was not able to top-up the shortfall. Finally, high share prices also meant that the exercise of warrants had been a major source of funds to redeem the principal of bonds. The prices of warrants move in tandem with the prices of their underlying stocks. When the underlying share price fell, many such warrants were "out of money."

Apart from this, this direct capital market for short term funds remained closed to foreign securities companies which are still not allowed to play any significant role, most of which have only representative offices in Malaysia for the purposes of research and advising global investors. Foreign securities companies are still prohibited from incorporating start-up enterprises and must invest in an existing stock brokerage but cannot own more than 30% of the firm's equity (or up to 49% with the state's approval on a case-by-case basis.) Moreover, small cap domestic brokerages which are mainly family owned operations belonging to ethnic Chinese are still hamstrung. For these firms, which are generally not Tier-1 brokerages, secondary market activities are their only source of income. Trading in Malaysian equities for such firms is fairly sizeable relative to their capitalizations. Financing needs for their brokerage activities stem from both the



clearing and settlement process as well as the need to "warehouse" large orders typically from foreign investors who do not pay in advance because of the size of the order. (That is, to fill large orders, brokers have to buy the stocks demanded by the customer in batches here and there, warehousing them till the required amount is secured.) Whereas domestic retail investors are required to pay these brokers before they pay SCANS thus reducing the broker's exposure, clearing and settlement for foreign investors necessitate a three-day financing arrangement. This is because the custodian banks for these foreign investors will not release any funds to the broker until it receives the shares upon which the broker gets paid the following day. The check then takes yet another day to clear. These custodian banks, however, do not provide credit lines to cover the three-day exposure. Funding requirements for brokerage activities of this sort can be quite considerable which means that small cap, Chinese owned brokerages that have been around for a long time are very dependent on expensive short term bank financing and thus have little prospect of attaining to Tier-1 status. In January 1998, the KLSE imposed new measures to regulate borrowing levels of stock brokerages that impacted small cap operations disproportionately. Moreover, exposure to a single client and a single security were also drastically reduced for such firms, while only heavily capitalized operations were permitted to continue margin financing.

There is also a specific requirement that bank borrowings for brokerage activities must be collateralized with "trustee" or bluechip shares. To collateralize a margin loan to a customer who is not purchasing trustee shares, the stockbroker must produce trustee shares from somewhere. Both the small brokerages and their retail clients are least likely to have trustee shares in their inventories that can be pledged. This form of collateral is required each time the broker draws down on a bank funding facility making the search for trustee shares a perennial problem. In contrast, Tier-One brokerages which are usually part of some Malay/UMNO financial conglomerate have ready access to trustee shares. This is because commercial and merchant banks have been given a special dispensation to hold trustee shares of up to a maximum of 10% of a domestic bank's paid-up capital and reserves, or 10% of a foreign bank's working

funds (and ordinary shares of up to a maximum of 25% of a domestic bank's paid-up capital and reserves, or 25% of a foreign bank's working funds.)<sup>28</sup> Cross holdings of shares among financial institutions were not permitted until 1989 when commercial and merchant banks were allowed to invest in broader categories of shares largely because of the privatization of the national airlines (MAS) and the national shipping company (MISC).<sup>29</sup>

Given Malaysia's adoption of the new BIS adequacy standards which focus on credit risks associated with lending operations without addressing market risks, these onerous requirements mean that small cap stock brokerages are treated as high risks by most banks. Because of the great volatility in the stockbroker business, the return on capital during quiet periods may be low enough to further impair their perceived standing and hence cost of capital in other markets.

*(c) The impact of wielding stock markets on growth in developing nations:*

The view that liberalization leads to faster economic growth is not justified by the available evidence.<sup>30</sup> This record in the advanced economies notwithstanding, it has been argued that financial liberalization in developing nations, primarily stock market development, conduces to economic growth by increasing the rate and productivity of investments. It is also said that stock markets diversify systemic risk, and screen and monitor investments the individual investor will find too uneconomic to do. Finally, stock markets may also promote technical progress and entrepreneurship.<sup>31</sup> However, such analyses ignore the actual channels through which stock markets function, viz., prices, and takeovers, mechanisms that operate imperfectly even in well functioning bourses in the United States or Great

---

<sup>28</sup> *Investors' Digest*, July-August 1995

<sup>29</sup> *Malaysian Business*, Nov 15, 1989

<sup>30</sup> Sachs and Warner suggest that developing nations that are more open grow faster. However, openness here refers only to trade, not finance; see the exchange between Warner, Srinivasan, and Dornbush in the *General Discussion* in J Sachs & J Warner, "Economic Reform and the Process of Global Integration," 1 *Brookings Papers on Economic Activity* 1995: 1-95.

<sup>31</sup> A recent overview of the literature is M Pagano, "Financial Markets and Growth: An Overview," 37 *European Economic Review*, 1993: 613-22. It has been pointed out that most of these studies are Barro-type inter-county cross-section studies from which drawing causal inferences is suspect; see, P Arestis & P Demetriades, "Financial Development and Economic Growth: Assessing the Evidence," *The Economic Journal* 1997.

Britain. First, even where actual stock prices are efficient in a Tobin's "information arbitrage sense," there is so much noise due to fads and fancies that these prices are not efficient in the sense of reflecting fundamental value. Secondly, the takeover mechanism operates more based on corporation size than performance.<sup>32</sup> That is, the larger unprofitable firm is more likely to survive than a smaller efficient firm. In fact, the former can increase its likelihood of surviving by increasing its size further through the takeover mechanism itself.<sup>33</sup> Moreover, the way these mechanisms actually work leads to short-termism, lower rates of investment especially in firm-specific human capital and, perversely, rewards the financial engineer rather than the manager who creates new wealth through organic growth.<sup>34</sup> Finally, in Malaysia, the regulatory infrastructure is immature and suffers from political intervention while many firms do not have adequate capacities to collect and disseminate information, or may be so young their track records are simply not long enough for proper assessment. As such, there is much "noise" and volatility in such a bourse.<sup>35</sup> As Lord Keynes noted more than six decades ago, "When the capital development of a country becomes the byproduct of the activities of a casino, the job is likely to be ill-

---

<sup>32</sup> James Tobin, "On the Efficiency of the Financial System," *Lloyds Bank Review*, July 1984: 1-15.

<sup>33</sup> Ajit Singh, "Corporate Takeovers," in J Eatwell, M Milgate & P Newman (eds) *The New Palgrave Dictionary of Money and Finance*, (London: Macmillan, 1992.)

<sup>34</sup> It has not been stressed enough that the overall record of financial liberalization where it has gone the furthest, that is, in the advanced economies, is not encouraging although Wall Street, the multilateral international organizations, and orthodox economists embrace it. In fact, there is evidence to show that the uninspiring economic performance in the leading economies in recent years is causally linked to financial liberalization and the increasing integration of the capital markets that has occurred in those countries since the late seventies; see, Ajit Singh, "Liberalization and Globalisation: An unhealthy euphoria," *International Social Security Review*, 1996; also, "The stock market and economic development: Should developing countries encourage stock markets?" 4 *UNCTAD Review*, 1993. The level and the growth of economic activity in the eighties and nineties have not been sufficient to meet the needs of the people in these countries. The mass unemployment and stagnant or slow growing real wages—despite the supply side potentialities of the information technology revolution—constitute eloquent evidence of economic failure. In short, the experience of advanced economies where the process has gone the furthest over the last twenty years is uninspiring. A chief reason is that financial liberalization will conduce to a more efficient allocation of scarce capital resources and promote convergence in the sense of factor price equalization if and only if there are no coordination failures in the domestic and international markets; see, Joseph Stiglitz, "The Role of the State in Financial Markets," in World Bank, *Proceedings of the World Bank Annual Conference on Development Economics, 1993*, Washington D.C.

<sup>35</sup> Ronald Dore, "Financial Structure and the Longterm View," *Policy Studies*, 1985: 10-29.

done.”<sup>36</sup> A high degree of volatility renders stock prices useless as guides to resource allocation, raises cost of capital because risk averse savers and investors are discouraged, while risk averse firms may also be prevented from seeking a listing.

Not only has there been a tremendous increase in stock market activity but firms have been raising considerable capital on these bourses. Over 40% of the corporate growth of net assets in firms—that is, the long term capital employed in the firm—in Malaysia (and 4 other nations out of 9) in the 1980s were found in a study of the top 100 listed corporations in each country to have been financed by new share issues, and over 70% of that corporate growth was funded externally. This is surprising when we consider that corporations in advanced economies issue very little equity—even though their bourses are more efficient—being funded largely by retained earnings.<sup>37</sup>

In international financial flows, there remains a major problem regarding the maintaining of equilibrium in the balance of payments between countries. This problem has never been solved—except during the Bretton Woods period which was also the Golden Age of capitalism. On that basis, the very fast expansion of the stock market and the opening up of the capital account which have been the salient features of the financial liberalization process in Malaysia will, on balance, be more likely to hinder, rather than help, its industrialization and long term economic growth. That is, even if domestic policies are appropriate, the problem of international coordination failures is so serious; in the absence of adequate international cooperation, financial markets have come to dominate. Specifically, unfettered capital movements provide enormous scope for destabilizing speculation which, in turn, lead to high volatility of financial variables. This causes fluctuations in real variables such as investment, directly and indirectly. Investment is discouraged directly by the rising cost of capital because of the volatility of financial

---

<sup>36</sup> D Moggridge, *The Collected Writings of John Maynard Keynes, Vol 25*, (Cambridge: Cambridge University Press, 1980.) 159.

<sup>37</sup> Ajit Singh, “Comparative Markets and Economic Development: A Commentary on World Bank Analyses,” 2 *International Papers in Political Economy*, 1995.

variables. Moreover, the overall uncertainty in the economic environment and the greater fluctuations in the components of final demand negatively impact the corporate inducement to invest. Despite the rise in profits in the eighties and nineties and booming stock markets, the trend rate of growth of investment in industrialized nations since 1980 has been about half of what it was in the Golden Age. Financial deregulation has made aggregate demand unstable by increasing the volatility of consumption expenditures, exports and imports. Easier access to credit has enabled consumers to spend more freely, but their accumulated debt has made current expenditure more vulnerable to changes in interest rates. Export and import volatility have also increased due to sharp changes in competitiveness brought on by exchange rate fluctuations and swings in economic activity.<sup>38</sup>

#### **Section V: Suppressing bond and derivatives markets to support Malay capitalism**

Every act of borrowing generates a financial asset for the lender and a financial liability for the borrower. PDS are debt instruments issued by borrowers to their lenders. In effect, savers hold PDS and leave the task of investing to those who are more efficient as investors. A straight or conventional bond is one such debt instrument that normally pays a fixed amount of interest periodically as well as the face value (principal) of the bond at maturity. There are also floating rate bonds that pay variable interest determined relative to some changing index. Zero coupon or discount bonds do not pay periodic interest, while concols have no maturity.

A bond market provides medium- and long-term funds to both the public and private sectors. It allows the government to finance its development programs without relying solely on current revenues through the issue of government securities.<sup>39</sup> The central bank may also use government securities for its

---

<sup>38</sup> see UNCTAD, *Trade and Development, 1995* (Geneva).

<sup>39</sup> Government securities comprise Malaysian Government Securities (MGS) which are issued several times a year to finance its long-term expenditures, Treasury bonds which are issued weekly, biweekly, and monthly for the same purpose, and Cagamas bonds (issued by the state-owned National Mortgage Corporation). In addition, Government

open market operations, (issues mop up excess liquidity in the system, for example.) If there is active secondary trading in government securities, their yield serve as benchmarks for pricing PDS. For the private sector, bonds mobilize funds without diluting the current shareholders' control of the firm. For institutional investors such as insurance companies with long-term liabilities, bonds serve as medium- and long-term assets. By issuing convertible bonds, private sector firms can also secure cheaper funds than straight bonds.

A well developed derivatives (futures and options) market is absolutely necessary if a thriving secondary trading in bonds is to develop. A futures or options position can be established so that losses in value in a cash position resulting from price or interest rate movements can be offset by the gains obtained in the futures or options position. Futures and options are legally binding contracts made on the trading floor of an organized exchange. With the former, both parties are obligated to perform in accordance with the contractual terms, one to buy and the other to sell a specified amount of a particular commodity at a specified time and place in the future at an agreed price. With the latter, it is the buyer's right, not obligation, to exercise the option. The seller (or writer) for a premium makes an unconditional obligation to the buyer. For a call option, the writer commits to sell the underlying asset when the buyer exercises its right to call on the writer to sell it under the terms specified. For a put option, the buyer gains the right to put up to sell the underlying asset to the writer under the specified terms. Hedging is used by organizations to reduce their exposure in one market by taking offsetting exposure in another market. In the short run, it costs some money but in the long run, organizations that hedge will be more consistently profitable than organizations which do not hedge because of the former's lower credit margins and higher external credit ratings.

(a) *The captive base for government securities:* The investor base for government securities is a

---

Investment Certificates (GICs) which are dividend bearing instruments are issued annually by the central bank on behalf of the government to meet the needs of Islamic institutions including the state-run Bank Islam. Finally, the central bank also issues Registered Certificates which are interest bearing instruments not offered to the public but only for application by invitation. (As of December 1997, the total outstanding value on MGS was RM66.3 billion compared to RM21.5 billion of Cagamas bonds and RM47.5 billion of PDS

sizeable because it was made captive from the mid-eighties, viz., commercial banks, merchant banks, and finance companies because of the LAR. It includes the state-run Employee Provident Fund (EPF), a pension fund to which all Malaysian wage earners and their employers must contribute, other tax-exempt pension funds (which must hold 25% of their investible funds in MGS), discount houses, the National Savings Bank, or BSN, previously the Post Office Savings, the Social Security Organisation (Socso), and insurance companies (for which there are specific statutory investment portfolio requirements and limitations placed on the trading of their holdings of government bonds.) Because the market is captive, the yield on these bonds cannot reflect underlying market conditions. This captive base provides the state with cheap funds but also hinders the development of benchmarks for bonds. That is, an active secondary market for bonds is slow to develop since MGS coupon rates are perceived to be lower than market rates of return which, in turn, implies that there will be losses when selling MGS in the secondary market. Moreover, because its coupon rates are too low to attract investment from the non-captive segment of the market, MGS are perceived by individuals and by corporations as unattractive investments because of their relatively low yields and which generally lack liquidity.

The EPF and the commercial banks together account for more than 70% of all outstanding medium- to long-term government securities with the EPF accounting for more than 60% of that total since it is required by law to hold at least 70% of its total investible funds in government securities. EPF contributors were not permitted to withdraw their funds until they reach the age of fifty-five. From 1996, they have been permitted to use a small portion of their savings for home purchases or investment in specified property trusts. The EPF is the largest holder of government securities. Without alternative instruments available, the actual investment in MGS always exceeds 70 per cent. Given the preeminent position of the EPF, it remains well nigh impossible to set up other provident funds to compete with each other. As such, too much of the nation's investible funds are funneled into the EPF with its restricted portfolio structure, and is too conservative about non-government, non-bank investments. Moreover, it is vulnerable to use by the state for

unproductive purposes. Because the EPF remains under the MOF, there is a conflict of interests in this sense. To the extent the EPF is a provider of long-term funds, it is supposed to maximize their yield for its contributors while the MOF as a mobilizer of funds for the state is interested in minimizing the costs at which it secures long term funds. Historically, since MGS are held until maturity, the EPF is effectively a bottomless trough of very cheap funds for the state's ill fated attempts at manipulating the world tin market, in currency speculation, and in bailing out failing UMNO corporations. (The other off-budget agency that has been similarly used is Petronas, the National Petroleum Company.)

*(b) Suppressing markets for private debt securities:* There are a few types of bonds listed on the KLSE and they tend to be unsecured. First, there are conventional bonds. Second, there is loan stock or an unsecured security issued by a private firm in respect of a loan made by investors. (These would be called debentures in the USA.) If of the convertible variety, loan stocks carry the right to convert into ordinary shares at a specified price within a limited period. Third, there are debentures which are long term obligations secured by the company's fixed or floating assets. Finally, since 1990, there have also been bonds with warrants or bonds with transferable subscription rights (TSRs). Holders of these instruments have the right to subscribe to a specific number of ordinary shares of the issuing firm at the strike price over a finite period. Warrants and TSRs are stripped from the bonds and tradeable separately on the KLSE or over-the-counter market.

Straight bonds, debentures, loan stocks, warrants and TSRs are listed on the KLSE with a strong bias for stock-linked debt as opposed to straight debt. Except for these equity-linked bonds, relatively few conventional bonds are listed or traded on the KLSE. Since the late 1980s, bond markets in Malaysia have grown substantially; for example, direct markets for long term funds increased 57% from 1995 to to RM30.8 billion in 1996, of which long term bonds accounted for 46%, of the total or RM13.6 billion. Of the latter, Malaysian Government Securities (MGS) dominate with their captive base as a result of liquid asset requirements on commercial and merchant banks, finance companies, provident funds, and insurance



companies. This captive base holds, in the aggregate about 60% of all MGS issued and represents the main way the state secures long term funds at cheap rates. (In contrast, the Hong Kong and Singaporean bond markets are dominated by international bonds.) If MGS are excluded, the Malaysian bond market is small compared to equities. There is almost no trading of MGS on the KLSE and even listed PDS are not traded much. In fact, the state has retarded the issuing of primary PDS by corporations, secondary PDS by banks, as well as the secondary trading of both types of PDS. Still, private sector corporations are increasingly issuing PDS; this increased 140 fold from RM325 million in 1987 to RM45.2 billion in 1997. The market for financial derivatives have been suppressed even more.

In Malaysia, a market for corporate bonds exists but remains essentially a primary issue market of relatively short- term commercial paper (of maturity under five years). Bond offerings are mainly private placements such as commercial paper and promissory notes or equity-linked bonds offered at low interest rates because of the embedded stock option. There is little secondary trading in these PDS on the KLSE with only five bond funds in Malaysia with a total value of RM280 million at the end of 1997.<sup>40</sup> The main trading of these bonds does not take place on the KLSE but on the OTC market, which is also not very active. (No official figures for OTC trading are available.) It is the banking sector that continues to finance directly and indirectly almost all direct capital market activity. Commercial and merchant banks promote and underwrite all equity and all debt issues. Together, they are the predominant funding source for stock brokerage activities, and they comprise the bulk of the principal dealers in the only secondary bond markets (in MGS). In contrast, in many developed economies, the fixed income securities department can be as large as or larger than the equity part of the bourse.

It is true that there was little retail demand for bonds, probably because of the predominance of younger investors in Malaysia. Generally, older investors prefer to invest a heavier proportion of their funds

---

<sup>40</sup>*Statistical Bulletin, January 1998* (Kuala Lumpur: Bank Negara Malaysia).

in bonds than do younger investors since bonds do not keep up with inflation. Moreover, because bonds act as safe havens they generally fall with strength in equity markets, which was true for much of the nineties. Still, banks and other institutional investors have always demanded bonds as high quality fixed income securities for stable, long term income in contrast to volatile equity dividend flows. Banks, especially, are interested in bonds and derivatives to arbitrage their commercial risks especially the possibility of non-performing loans (NPLs) since there is a lot of lending on the basis of political ties rather than project rate of return considerations.

An emerging economy that is open is volatile because of its sensitivity to international capital inflows. With this implicit volatility, nations such as Malaysia should ideally access capital in such a way that repayments correlate with economic performance. That is, borrowers should borrow in such a way that they end up paying more when things are going well and less when things are going badly. However, the structure of domestic financial markets is such that changes in local expectations are immediately reflected in debt servicing costs. So when things were going well and inflation was under control, borrowing costs declined commensurately and immediately, and the borrower's financial position improved. However, with the Crisis, interest rate increases exceeded inflation so that the real cost of servicing debt became unbearable for borrowers especially when they were least able to absorb the higher costs. The portfolio of NPLs in domestic banks grew dramatically which destroyed the precarious banking system. That is, the inefficient structure of the domestic financial system ensured that the financial crisis was exacerbated by a collapse in purchasing power and investment at precisely the wrong time. In contrast, longer term fixed rate obligations (bonds) and derivatives to manage interest rate and exchanger rate risks would have prevented these impacts because longer term debt reduces refinancing risk. Moreover, inflation usually surges after a currency crisis so that the cost of fixed rate debt actually declines in real terms during the crisis instead of shooting up unmanageably. This would have provided some relief for producers and improved their capital structure. The real reduction in debt servicing would have reduced pressure on the economy.

During the boom years, market demand did exist for domestic long-term markets because investors wanted to lock in long term exchange and interest rates. This could have been either because they believed interest rates would decline in the future or because some investors, especially local pension funds and insurance companies, needed to be able to predict cash inflows. The state however did not heed market demand because during the miracle years, it thought that PDS would lock in excessively high rates. This belief seemed misguided. Because capital structures are the crucial transmission belt for external shocks, a high risk-premium—deep and liquid markets for primary and secondary PDS as well as financial derivatives—is the price to pay for safety for these markets improve credibility. Instead, Malaysia's short-term capital structure increased its risk premium; its risky term structure signaled a non-credible policy mix.

Primary PDS are important for large investors because these issues serve to pool smaller savings for their projects. However, this direct exchange of funds suffers from certain rigidities as in any barter system: primary PDS have greater default risks and lack liquidity because they are less readily accepted by other parties and therefore more difficult to convert into money before maturity. Quite often, there is also a mismatch between quantity and maturity of the funds required. In contrast, secondary PDS are financial instruments issued by the financial system and therefore carry less risk since financial institutions are presumably closely regulated and the issuers therefore enjoy good standing with the public. Secondary debt securities are therefore more liquid, or more easily accepted by others, and therefore easier to liquidate. They are also more divisible than PDS that are normally denominated in fixed and larger amounts. Banks in many developed economies have long used secondary PDS--the issuance of securities tied to pools of receivables or other financial claims--as a way of financing corporations without having such financing weigh down their balance sheets in the form of loans that have to be backed by costly share capital. Also known as asset securitization,, the funds required are raised through an issue of bonds while the corporation's cash flow backs the interest payments on the bonds. In fact, if banks so desire, they can use their own funds to purchase huge

slews of assets, or even whole companies especially if these are undervalued but have strong cash flows, and then repackage their assets as securities to be sold on the bond market to other investors.

These secondary PDS are more suitably dated as a source of bank financing and lower in cost than current financing alternatives in Malaysia. In fact, an important source of current financial problems in Malaysia can be traced to the extension of short term financing for projects with relatively long gestation periods. The income streams of these borrowing entities are in Ringgit while the financing obligations are to be met in Dollars. Thus, Malaysian banks are eager to promote secondary bond markets denominated in Ringgit. Such markets would increase the receipt of funds from a broader base of private investors especially the domestic institutional segment looking for more diverse investments. Sponsors of projects with relatively long gestation periods also support such markets because they would have to borrow less overseas, thus reducing their currency exchange risks. Bankers and sponsors of these projects also want to see a well-functioning derivatives market.

In sum, asset securitization would enable both financial institutions as well as corporations to raise funds at economic rates and conserve capital for use where it is best employed, and hedging would reduce their commercial risks. Yet despite a decade of rapid growth, high savings and almost no fiscal deficits, Malaysia managed to stumble into a huge liquidity crisis precisely because there were no robust domestic markets for bonds and derivatives. Instead, high private sector borrowing, mostly short term, and dollar denominated, was mismatched with non-liquid, long term assets such as real estate and infrastructure projects. By over-relying on banks financing and portfolio funds in the equity markets, Malaysian corporations borrowed too much, mainly in short term funds, so that once bank credit shrank and stock markets collapsed, portfolio fund managers could not diversify their Malaysian investments into bonds even if they did not want to leave. Thus, their only alternative was to withdraw their capital leading to a sharp liquidity shock. The Asian crisis highlighted the vulnerability of the Malaysian corporate and financial sectors to currency and interest rate risks.

Bankers are looking for ways to improve their own risk management and asset liability systems since the reality is that they will have to continue extending credit lines to some firms regardless of the commercial risks of doing so. Capital markets deepening with bonds and derivatives would cause banks to lose a large portion of their corporate market and income source—that is, traditional lending and fund mobilization activities. But the development of such markets would also lead to an increase in client demand for advice on risk management that would require relationship-based modes of operating. Banks would profit from providing such value added services in their advisory capacities. There would also be fee-based financial engineering and corporate restructuring services which they saw as technology based services (compared to traditional bank activities) and, therefore, more cost efficient and more profitable activities. Banks have been pressing the central bank for years now to set up an information gathering and dissemination system for information gathering and dissemination system for derivatives, MGS, and PDS to support both primary and secondary activities but to no avail.

I do not argue that bonds and derivatives make up a panacea that will substitute for good corporate governance and managerial accountability. But they would certainly help risk management as discussed above. Probably out of a desire to prevent arbitrage, the state has been ponderous in developing secondary markets for primary and secondary PDS, and those for financial derivatives which pose a direct threat to the state's ambition to direct and ration capital. Moreover, to develop these markets, the mobilizers of public funds including listed corporations as well as financial institutions will be required to disclose more about their affairs if investors are to be convinced that their interests will be protected. Full disclosure, free entry and free exit are deemed more efficient than restrictive licensing practices and the over-reliance on a government nanny to police players especially since UMNO is itself—even if only in an elliptical manner by way of labyrinthine arrangements—the biggest corporate player in the nation. Thus, bonds and derivatives may jeopardize UMNO's hold over the corporate sector since such markets demand greater transparency and more information disclosure than that which now obtains. In addition, to develop

derivatives would require some financial institutions to put up the risk capital and to develop the specialized skills to write futures and options to cover interest and currency exchange risks of their existing and prospective clients. The lack of specialized expertise and experience in financial engineering as well as the lack of risk capital means that foreign banks are likely to dominate. It is the foreign banks that are in the best position to venture into this field given their expertise and experience accumulated in the financial centers of the world, and it remains up to these institutions to take the lead. However, there is widespread skepticism among foreign investors about the state's sincerity in ensuring transparency and good governance in the country's financial and corporate sectors. In sum, unless the state takes the lead, these markets will be hard to develop.

There is a definite bias in the MOF organizational culture against derivatives (and not bonds *per se*) because these instruments allow huge positions to be taken with relatively little capital so that losses can be many times the capital. The attitude may be best summed up as "If you don't have a fiscal deficit, you don't borrow. If you don't borrow, you don't need to hedge." The fluctuating value of these instruments can lead to either profit or loss when engaged purely without any asset or liability to hedge. The fear was that instruments used to reduce risk, if employed wrongly, would significantly increase risks. If not handled properly, derivatives would open the door to a world of speculative activity Malaysian corporate managers may understand poorly. In sum, the greater volatility introduced into domestic financial markets would jeopardize state control over the system. Finally, a well-functioning derivatives market would effectively make it possible for market players to fix the price—or interest rate—at which money can be borrowed. This would undermine the effectiveness of state intervention in interest rates, its most potent policy tool in a financial system without capital controls.

The state has not responded with the same alacrity to put in place the legal and regulatory structures needed to develop a competitive environment for bonds and derivatives (as it has done with stocks). Primarily by maintaining low yields, illiquidity, and captive markets for its government securities, the state

has been able to retard the development of an active market for the secondary trading of government securities, primary and secondary PDS, as well as futures and options. Other measures that serve to retard these markets from developing include the following. The high transaction costs in the primary issuance of all forms of debt instruments have already been alluded to.

First, Malaysia is still far short of having a one-stop agency the SC was ostensibly supposed to represent. Multiple regulatory agencies not only decrease the effectiveness of supervision due to the segmented outlook of each agency but also hinder the issue of new PDS. The approval process for these issues remains tortuous: public offerings of private debt must be approved by the central bank, the SC, the FIC if there are foreign buyers, the ROC, the Licensing Officer for Securities and Futures Trading in the MOF, and the KLSE if the issuer is a listed company.

Moreover, the ROC requires the widespread circulation of a prospectus, a very expensive and time consuming undertaking because a thorough audit of the issuer is required. By the time the paper is ready, (historically, at least six months,) market conditions may have changed rendering the bond issue unattractive. Secondly, PDS issuers are required to buy expensive bank guarantees. Even blue chips are required to purchase expensive—usually 1.5-2.0% of the issue value—guarantees from banks whose credit quality may be equal or less than their own. Yet when UMNO corporations defaulted on their bonds in the Asian crisis, not only did the FIC offer exemptions to these issuers of PDS but it also rendered null-and-void what were supposedly "unconditional and irrevocable" bank guarantees for the redemption of these PDS. This has set back investor confidence in PDS in Malaysia for years. (It also impacted the credibility of Malaysian banks and the portfolios of local institutional investors. If bank guarantees on bonds are questionable, faith in other areas such as trade guarantees could be affected too.)

Thirdly, a commercial or merchant bank is not allowed to lend to any customer in excess of 30% of its capital funds. Since the purchase of PDS is considered credit to the PDS issuer, the amount purchased is limited to this "single customer limit." Finance companies are not allowed to invest in unsecured PDS as

well as bank-guaranteed ones, but they may acquire collateralized securities. Mutual funds and unit trusts are not permitted to buy bonds and derivatives. Only the Social Security Organization is allowed to buy listed PDS.

Fourth, there is the prohibition against selling securities short which translates into illiquidity. (Selling short is an agreement to deliver at a future date a security or asset which the seller does not own but hopes to buy later at a lower price.) In advanced economies, securities may be borrowed against the collateral cash, and repurchase agreements to borrow cash against collateral are also permitted thus creating a more liquid market in bonds. In Malaysia, this prohibition means that PDS markets lack liquidity—that is the ability of the holder to convert the security to cash easily, quickly and with little loss in value—but another main reason is simply an inadequate supply of the PDS themselves.

Fifth, banks and finance companies incur a “reserve cost” when they buy PDS thus increasing their cost of doing business. Banks and finance companies must observe an 8% risk-weighted capital ratio aside from the LAR and SRR. When a bank buys a PDS, these increase its total assets. Thus, it must increase its capital to meet the 8% minimum. PDS also increase a bank’s liabilities. Thus it has to increase its non-interest bearing (SRR) deposits with the central bank as well.

High transaction costs are also maintained on the secondary trading of all types of PDS. This is effected by the following requirements: high stamp duties; high clearing fees payable by both buyer and seller; high ROC fees for the issuance of certificates; a schedule of exorbitant brokerage fees; refusing to designate PDS as liquid assets that would satisfy LAR; refusing to allow PDS to be fully deductible from bank's Eligible Liability Base; and, restricting the investor base to a maximum of ten (exclusive of financial institutions) at any one time. The same captive market for MGS that comprises permitted investors for PDS are long term investors who do not trade their securities, whether MGS or PDS, actively. Potential market



makers must secure a dealer's license but the MOF has an ad hoc ceiling on new licenses. The official rationale for a restricted investor base is that because the prospectus requirement applies only to initial buyers, secondary buyers would have limited information to assess the institution.<sup>41</sup> Finally, some of the interest income from bonds is taxed.

In the deepening of debt markets, the role of rating agencies is crucial. Until 1990, there were no public rating agencies in Malaysia. Thus there was a statutory requirement for expensive bank guarantees for PDS issues to reduce the risks from information uncertainty about borrowers' credit worthiness thus increasing the cost of making a bond offering. Two rating agencies now exist but suffer from credibility problems because of their known susceptibility to political interference for better ratings for well connected firms. Moreover, "shopping around" for ratings and the withdrawal of unfavorable ratings are widely practiced. These agencies were disallowed until recently from providing an MGS index as a benchmark to measure risk-free government bond performance, an analytical tool fund managers need to create portfolios incorporating government bonds. In February 1998, the central bank decided to release the required data on government bond trading (basically, monthly returns of each security, plus coupons received, change in bond price and interest on coupons.) There is still no permission to develop a PDS index to measure corporate bond performance as this would require greater access to timely and accurate information on the trading of these bonds. As such, the rating agencies have not been able to alert bond investors of signs of economic problems.

Transaction costs also remain high because of the fragmenting of what are already small bourses, and the retarding of their introduction of new financial products (derivatives). The KLCE (Kuala Lumpur Commodity Exchange) had commissioned a study funded by the IMF on the setting up of a futures exchange under its management but after much public wrangling, the state gave ownership and control of KLOFFE

---

<sup>41</sup> See, Bank Negara Malaysia, *Guidelines on the Issue of Private Debt Securities*, undated.

(the Kuala Lumpur Options and Financial Futures Exchange) to a consortium (led by an UMNO corporation). It was finally set up in December 1995 but has been allowed to offer only one product, the KLCI futures or Kuala Lumpur Composite Index futures. The Malaysian Monetary Exchange (MME) was set up as yet another body to provide a medium for financial institutions to manage their exposure to interest rate and currency risks. Since its inception, however, the MME has been permitted to offer only one product, an interest rate futures contracts, the KLIBOR (Kuala Lumpur Interbank Offer Rates), for which the underlying asset is the 3-month interbank money market deposit. Repeated appeals by these exchanges and their clients to allow trading in short term bonds, short term interest rate contracts, rollover spot currency contracts on major or regional currencies, and futures on stock indices of other stock exchanges have been consistently refused. Most corporate clients of banks who do hedge their loan portfolios do so with OTC interest rate swaps but only a few domestic banks have the wherewithal and the expertise to offer their clients interest rate or currency swaps. Banks themselves were loath to have to turn to the inefficient exchanges to pass on some of the risks they assume. Thus most domestic banks are unable to deliver to clients the hedging instruments they want.

Institutional barriers between the different exchanges remain through restrictive licensing practices. Thus, while it is slightly easier for KLSE equity dealers to get a KLOFFE or MME or KLCE license, it is nearly impossible the other way around.<sup>42</sup> As such, investors are denied a common-broker, front-end system where brokers can see at one site stocks, bonds, futures and options. In addition, the clearing houses for securities and derivatives (the Securities Clearing Automated Network Services or SCANS, and the Malaysian Derivatives Clearing House respectively) are separated from each other and from their individual exchanges. This increases the operating costs for market makers through multiple iterations of documentation and less efficient use of the collateral of clearing members. Thus KLCE, KLOFFE and MME

---

<sup>42</sup> The KLCE was established in 1980 for futures trading in commodities but to this day only crude palm oil CPO) futures are traded. It has its own clearing house. It was brought under the SC only in April 1997.

have not been able to offer efficient services to their clients and therefore cannot attract more people to these markets. The systemic banking crisis—a consequence of the stocks and currency crisis—has led some MOF officials to publicly suggest that, as a first step, KLOFFE, MME, KLCE and KLSE be merged to lower transaction costs.

## **Section VI: The politics of Malaysia's financial policy**

The account above involves an apparently incoherent mix of policy instruments. On the one hand, the state actively promotes bank intermediation of the financial system. On the other hand, it also promotes bank disintermediation through direct financial markets for short term capital (equity or stock markets). The state monopolizes the primary direct financial markets for long term capital through its issues of MGS and Cagamas mortgage bonds. But it has also retarded, by omission or by commission, the development of all other direct capital markets for long term funds such as primary PDS, secondary PDS issued by financial institutions, secondary trading in all types of bonds, and markets in futures and options, or other derivatives.

We do know the following: the state promotes banking to extract seigniorage and to preferentially direct credit; it used the KLSE to construct an interest group and to maintain it with cheap equity; it uses most financial institutions such as the EPF and banks as captive markets for cheap long term funds in the form of government securities; it suppresses secondary trading in bonds to avoid scrutiny of UMNO corporations; finally, it retards derivatives to maintain its financial autonomy especially its control over interest rates as a policy tool. We also know that banks are rewarded with supernormal profits; the middle class benefited from the KLSE euphoria; corporations benefited from cheap equity capital; corporations also used the high prices of stocks to secure their bond issues and the exercise of warrants as the major source of redemption of the principal of bonds to borrow even more. But how did this policy admixture come about?

Although Malaysia has been described as an instance of successful policy reform towards financial liberalization, I argue it was not a planned, programmed policy reform. Its putative success was more the

result of a fortuitous conjuncture of specific economic and political considerations, and key personalities that necessitated certain measures be put together in piecemeal fashion to combat the recessions of the eighties while attending to its ethnic capitalism. Since the recovery from the recession of the mid-1980s, financial policy has evidenced incoherence and lack of long term perspective, which eventually contributed in large measure to the recession of the late-1990s. Finally, in September 1998, an abrupt policy *volte face* brought the financial system to practically total closure as the Prime Minister sacked the MOF. To see how these policy discontinuities and inconsistencies came about, one must attend to the wider political context of the recession in the mid-eighties which, in turn, originated in the ethnic politics the 1970s.

Ethnic quotas in every field were introduced with the NEP from 1971. This led to a bloating of the size of government and its expenditures, in particular its huge program of state-owned enterprises (SOEs), the largest in the world outside of the centrally planned economies of that era. While federal reserves in the 1970s remained sufficient due to receipts from taxes on primary commodities, the 1980-83 period saw a cyclical downturn in prices of Malaysia's export commodities. Petroleum profits helped keep the government's budget deficit from being even worse but that deficit still tripled from RM3.7 billion in 1979 to RM11.2 billion in 1982. Foreign borrowings quintupled from RM6.8 million in 1979 to RM3.4 billion in 1981, accounting for 45% of the country's total loans or 17.8% of GNP. While current account deficits in the 1970s had been ameliorated by net FDI, this proved insufficient in the early 1980s and the country came to depend on large external borrowings. The current account deficit rose from 1.1% of GNP in 1980 to 14% in 1982. The balance of payments told a similar tale as a result of a fall in exports and export prices. Whereas the global economy had started recovering in 1983, commodity prices did not recover in tandem. This led to a merchandise account deficit while servicing charges on Malaysia's huge debts worsened its service account.<sup>43</sup>

Yet KuLi, the politically ambitious MOF at the time repeatedly put off making the hard decisions necessary if government expenditure was to be downsized. He feared that such a move would cost him the

---

<sup>43</sup> Jomo KS, *Growth and Structural Change in the Malaysian Economy*, (London: Macmillan, 1990).

political base he had built up as architect of NEP structures especially the enhanced role of the public sector. In 1984, out of a sense of *lese majeste*, KuLi (who is a prince from the Kelantan state where the state government has traditionally been the Islamic opposition) made his second bid for UMNO deputy president having failed in his first bid for the same post in 1981. In 1979, KuLi had been passed over by the Prime Minister (PM) at the time, Hussein Onn, for promotion to deputy president and therefore Deputy Prime Minister (DPM) in favor of commoner Mahathir Mohamad. This in spite of the fact that KuLi was the most senior of three Vice Presidents VPs), traditionally the office holder to be promoted to deputy president. (Every PM and DPM until Mahathir had been of royal or aristocratic breeding.) When Hussein Onn resigned because of ill health in 1981 Mahathir became UMNO President and PM. In turn, Mahathir chose another commoner, Musa Hitam, for deputy president and DPM, sidelining KuLi yet again. Against Mahathir's expressed wishes, KuLi challenged Musa for deputy president that year but was defeated. Still, Mahathir kept KuLi on as MOF against Musa's wishes.

Downsizing the public sector would cost KuLi political support among UMNO members who were government employees. Just as importantly, it would also require promoting private capital which, at the time meant unshackling ethnic Chinese capital that KuLi had targeted with the repressive ICA, or Industrial Coordination Act, 1968. Doing this would seriously jeopardize his political support within the Malay community given the politics of ethnicity that underpins UMNO's legitimacy with Malays. In 1984, when KuLi lost his bid for UMNO deputy president a second time, he was "demoted" to the powerful position of Minister of Trade and Industry against Musa's wishes again. (Mahathir kept KuLi on as a counterweight to Musa's faction.)

KuLi's replacement as MOF was Daim Zainuddin, a Mahathir friend who hailed from the same *kampung* or village of birth, an important affective tie among Malays. Daim, a corporate mover-and-shaker and reluctant politician, turned out to be a fortuitous choice. Because he had no political ambitions, he was not beholden to grassroots support which allowed him to roll back many of KuLi's initiatives. Helped by an

unexpected global recovery, Daim proceeded to make the unpopular decisions, slashing government expenditure, and relaxing the ICA to accommodate Chinese capital. He lowered corporate and personal income taxes (which still benefits Daim personally to this day) and initiated a huge privatization program to divest profitable monopolies (without open bidding) to UMNO corporations and Malay individuals whom he hand-picked with Mahathir. Recipients of huge state contracts for such “privatized” infrastructure projects included unequivocally their family members as well. Thus heavy government spending under a different guise was used to reflate the economy. It was this ersatz-privatization that necessitated a deepening of the KLSE, the lifting of all capital controls, and the relaxation of rules about foreign equity participation.

From Malaysia's only year of negative growth in 1985 in 30 years of independence, GDP growth recovered to 5.2% in 1987 and reached 9.7% in 1990, Daim's last Budget year, when the current account deficit declined to 4.1 per cent. However, the federal budget deficit that had been declining in 1984 and 1985 started climbing up again in 1986 and 1987 because of Daim's reduction of personal and corporate taxes.<sup>44</sup> The very ambitious Anwar Ibrahim, a relative newcomer to UMNO who had raced up the ranks to become one of the three UMNO vice presidents was known to have had political differences with Daim over the apportioning of privatization goodies to his faction. When Daim resigned voluntarily in 1991 at the height of his power, Mahathir made Anwar the MOF. (Daim remained UMNO Treasurer to this day and was officially appointed as Economic Adviser to the Government mainly as a counterweight to Anwar, as events in 1988 would show.)

Devoid of private sector experience or an education in business or economics, having majored in Malay Studies in college, Anwar basically continued Daim's pro-business policies and its stock market excesses. This was especially necessary since UMNO's younger members who had propelled him up the UMNO hierarchy belonged to the new Malay bourgeoisie and its *nouveau riche*. Getting ready to challenge the poorly educated seat warmer DPM, Ghaffar Baba, for deputy president, Anwar lowered personal and

---

<sup>44</sup> Jomo, 1990, *op cit*.

corporate taxes even further, reduced import duties on consumption goods, and raised the salaries of government employees.

Anwar also ordered the central bank to enter the currency market in a big way. In 1992 and 1993, Malaysia was among the world's most aggressive foreign exchange players, speculating internationally until September 1992 when it became one of its biggest victims, losing \$5.8 billion in the collapse of the British pound under an attack led by financier, George Soros. The central bank then drove down the value of the ringgit in late 1993 to make its currency trading losses, stated in U.S. dollars, appear smaller.<sup>45</sup> The action attracted the attention of speculators who began buying ringgit expecting the MOF to permit the ringgit to appreciate again after revealing these losses and stating the government's year end financial position. Instead, in early 1994, the central bank began lowering interest rates, first, in a bid to further weaken the ringgit and drive the speculators out. There was also a second consideration.

The inflow of American and European portfolio funds from 1992 had led to a ballooning of liquidity and credit; foreign reserves had tripled from \$10.8 billion in early 1992 to \$27.2 billion in December 1993. To mop up excess liquidity, the central bank started issuing central bank debt in the domestic money market, borrowing back (or sterilizing) the additional liquidity. In early 1994, Anwar ordered a policy reversal, letting banks lend money to the private sector that soared 31.6% in the 12 months ending in August 1995.<sup>46</sup> The excessive credit growth fostered strong economic growth but also rising real exchange rates and large current account deficits that were clearly unsustainable if the torrents of foreign money were to dry up or even slow down. Lower standards of credit screening rigor by banks led to overlooking of credit risks and a

---

<sup>45</sup>Michael Sun, "Bank Negara's Misadventure," *KLSE Investor's Digest*, April 1994:4-5; Doug Tsuruoka, "Vanishing Act," *Far East Economic Review*, March 31, 1994; Doug Tsuruoka, "Early Withdrawal: Malaysia looks for a new central-bank governor," *Far East Economic Review*, April 14, 1994: 70; S Jayasankaran, "On being accountable for the accounting: What after the exit of Bank Negara's buck-stopping governor?" *Malaysian Business*, April 16, 1994: 29-31; *Asiaweek*, "Revelations: Malaysia's \$6-Billion Fiasco—A Costly Lesson in Speculation for the Central Bank," October 26, 1994: 55.

<sup>46</sup>Bank Negara, monthly statistical bulletin, September 1995.

highly leveraged corporate sector.<sup>47</sup> Thus an era of easy credit began which helped get Malaysia into its financial and stock market crisis of 1997 and the recession of 1998. For the moment, there was great market euphoria and talk of "the new Malay." In late 1993, with Mahathir's implicit blessings, Anwar took on and won the deputy presidency and became DPM. As UMNO insiders put it to me regarding Anwar's successful run for DPM, "there were many, many debts to repay."<sup>48</sup> Besides, there was already talk of Anwar contemplating a challenge for the presidency itself.

Emblematic of Anwar's stewardship, the Second Board on the KLSE was set up on his watch. One of the world's best performing stock markets between 1995 and 1997, its small companies suddenly commanded billion dollar market capitalizations. Some Second Board counters traded for RM100, or more, in March 1997 just before the crash, a staggering testimony to the frenzy since no Malaysian or Singaporean main board stock has ever even come close to a triple digit price tag. Its small number of shares made it easy for syndicates to corner the market and thus manipulate prices. In the crash from July 1997, the Second Board lost 90% of its value not only because of rising interest rates, credit squeeze, rising bad debts, and a weakened currency but, most importantly, an absence of any real fundamentals. It had become one of the world's worst performers.

Anwar's tenure as MOF saw a growing current account deficit, initially brushed aside as investment in productive capacity but now largely recognized as largely spending in speculative, non-tradeable sectors especially real estate and prestige projects.<sup>49</sup> The current account deficit averaged 6.4% of nominal GDP from 1991 to 1996 largely because of a rising share of investment to GDP from 39% in 1993 to 46% in 1995 with very high import content of such investments averaging 32% in the 1993 through 1995 period. There

---

<sup>47</sup> Only 25% of Malaysian commercial bank lending went to productive purposes (manufacturing 22%, agriculture 2%, and mining 1%) with another 5% going to construction. That is, the remaining 70% went to consumption and purchase of stocks and real estate; *see*, Harakah, "Interview with Jomo KS: The Current Situation in Malaysia," March 15, 1999.

<sup>48</sup>It was rumored that Anwar's faction had spent huge amounts to win the UMNO deputy presidency; *FEER* November 18, 1993: "Never has money been spent on such a scale before in an UMNO election."

<sup>49</sup> *See*, for example, "When Growth is a Problem," *Asiaweek*, November 17, 1995: 56.



was a sharp build up of private sector borrowing from abroad—medium and long term debt grew from RM4.9 billion in 1990 to RM49.5 billion by mid 1997. In the 1990s, Malaysian banks borrowed extensively from abroad; there was an abrupt jump in net foreign liabilities of commercial banks from RM5.3 billion in 1995 to RM15.3 billion by mid 1997.<sup>50</sup> Immediate gains from the resort to short-term "hot" money downplayed the need to strengthen the financial system and the corporate sector. Instead of improvements to efficiency, growth in this period came primarily from augmenting input, a significant proportion of which (both capital and labor) was imported.

The use of capital from 1994 was increasingly inefficient as shown by a rising capital-input ratio, mainly due to increasing investments in capital-intensive projects with long gestation periods and underutilized capacity. Excessive credit expansion to the property sector grew above 30% for most of 1997 itself, amounting to 26% of total loans so that more than 5.8 million square feet of new office space would come on line by 1998 on top of the 5.6 million square feet already available in 1997. Even without the Crisis, the glut would have triggered a shake-out and dragged the economy down. Moreover, loans for the purchase of stocks and shares during the 1993 through 1997 period grew at an average of 35% annually.<sup>51</sup> In 1997, there were also rising cost pressures from wage increases as well as sharp declines in external terms of trade with a sharp drop from 1996 in prices of electronic products, Malaysia's main exports.

Overall, the rate of return on assets in both manufacturing and non-manufacturing sectors had declined steadily from 1991 with over-capacity and poor cash flows in telecommunications, property, infrastructure, transportation and certain subsectors in the manufacturing sector indicating market failure in allocating resources to the most productive use. The decline in terms of trade and the visibly extravagant overbuilding began to make investors nervous.

---

<sup>50</sup> Bank Negara, monthly statistical bulletin, various issues.

<sup>51</sup> S Jayasankaran, "Economic Monitor: Malaysia—Blunt Talk," *Far East Economic Review*, April 10, 1997.

The level of debt in Malaysia was very high by any international standard: the banking sector's loans and advances alone were 145% of nominal GDP at the end of 1997, and 160% of GDP by mid 1998 or about RM277 billion, one of the highest ratios in the world. (In contrast, the stock of bank credit to GDP in Mexico in 1994 was 50.7 per cent.) Credit to the private sector surged an average 29% per year during the 1995-1997 propelling corporate and household indebtedness to over 170% of GDP in 1997 from 125% in 1994.<sup>52</sup> The levels of debt engendered by Anwar's policies and accumulated on corporate and household balance sheets effectively propagated deflationary shocks from the asset markets to the banking system and the rest of the economy. The sharp recession in 1998 impaired corporate and bank balance sheets significantly even if bank lending slowed.

In sum, during Anwar's tenure as MOF, the state developed a "reputation" for loose monetary policy. Despite frequent pronouncements about the need to tighten monetary policy to prevent overheating, monetary base and credit grew unabated especially from 1994 right up to the end of 1997, well half a year into the Crisis. The MOF's aversion to raising interest rates sufficiently to slow down monetary aggregates and credit expansion had not passed unnoticed by the financial markets. In other words, the MOF developed a "reputation" for a low opt-out threshold. That is, the particularly high social costs of defending the Ringgit through higher interest rates in the form of high unemployment and insolvency given Malaysia's politics of ethnicity meant that the state would easily opt-out of raising interest rates to defend the Ringgit's unofficial peg to the Dollar.<sup>53</sup> The stock market bubble and the pervasive influence it had on the economy together with the high degree of leverage in the Malaysian corporate sector rendered the economy extremely vulnerable to any sustained period of high interest rates. Thus, any attempt to raise interest rates in response to speculative attacks was not going to impress the markets.

---

<sup>52</sup> *AWSJ*, February 3, 1998.

<sup>53</sup> Robert Barro, *Macroeconomic Policy*, (Cambridge: Harvard University Press, 1990).

By early 1997, even before the Crisis, fund managers had begun withdrawing their portfolio funds. (The economic scenario was essentially the same in Thailand. Currency speculators smelling blood tested the Thai baht's peg to the Dollar first. On July 2, 1997, the Thais capitulated after spending \$7 billion of their reserves on the spot currency market and committing \$23 billion to the forward markets to defend its peg. Within days, the contagion had spilled over to Malaysia and the rest of East Asia, quickly ending a decade of the East Asian miracle.)<sup>54</sup> Once the attack on the Ringgit began after the baht had collapsed, the sharp depreciation of the Ringgit, rising interest rates, and the collapse of the stock and bond markets transformed the initial crisis into a serious financial crisis with falling asset prices and insolvency among financial intermediaries and their debtors.

Daim was brought back into the Cabinet as Economics Minister or *de facto* MOF in mid 1998, and resorted to heroic reflationary spending and bailouts of UMNO corporations. Because the state eased credit, the risk was that it would foster the next financial bubble which would likely be followed by a bigger crash later. Global financial flows tend to discipline expansionary governments. Still, Daim acknowledged that there had been a fundamental funding mismatch in Malaysia's bank dominated system, compounded by its ineffective and non-credible market for long-term debt instruments. Its own savings had been invested in OECD markets in long term instruments, funds flowed back to Malaysia in the form of FDI, bank loans, and equity investment by portfolio funds that were largely footloose and short-term. This had translated into a short-term liquidity problem caused by commercial over-borrowing in short-term debt. Thus it was recognized that Malaysia needed to transform the wealth created by its high savings into powerful liquidity in its own markets without costly liquidation of its foreign assets.

---

<sup>54</sup>A Malaysian professor of finance argues that "Although only about 20% of daily market activity (are attributable to) foreign funds, the influence of (these) funds is more than their share of the volume of activity as they are generally considered as market leaders. Their presence is crucial to lending, credibility, and international standing which are important elements in raising future capital, locally and overseas." See, Mansor Isa, "Malaysian Capital Markets: Recent Development and Future Challenges," paper presented at the 5<sup>th</sup> Tun Abdul Razak Conference, Ohio University, Ohio, April 21-23, 1995.

The Crisis spawned the need for the government to raise vast sums of money to mend the banking system and reflate the economy. The economic woes also spurred a sharp rise in (attempts at) PDS issues as crippled local banks were unable/unwilling to offer credit to companies. The financial meltdown jolted the state to try to put in place the infrastructure needed for debt issuance. Thus, changes were instituted in the hope of developing a deep, liquid and mature debt market where the private and public sectors could borrow long to invest long to eliminate the maturity mismatch. These changes included reducing the inventory costs for market makers by exempting the holdings of MGS and PDS by commercial and merchant banks from SRR and LAR; allowing foreign fund managers to buy PDS regardless of their sources of Ringgit; introducing self registration for corporate bonds; and, promising to reduce the time taken to approve the issue of corporate bonds to three months or less. It was recognized that merger of the equities market with the futures exchange would lead to more efficient financial markets by creating a common electronic method for the trading and clearing of exchange-traded instruments. Malaysia is small fish in the stock-exchange pond; its market does not justify separate exchanges for equities and derivatives. Likely benefits included efficiencies in transaction clearing, lower costs for information technology, benefits of experienced executives from the separate exchanges working together instead of acting in rivalry. Cost savings also could accrue from the fact that many financial institutions are members of all the separate exchanges and must bear the capital costs of operating in these separate systems.

Steps were taken to begin the merger of the MME with the KLCE, and the KLOFFE with the KLSE. The KLSE even had a completely separate derivatives operation for the trading of warrants which could be easily merged with KLOFFE's operations. Moreover, the central bank's capping of interest rates had caused the tiny MME volumes to crumble. The MME was then permitted to introduce roll-over spot currency contracts on four major and three regional currencies. But concerns about counter-party credit quality and the illiquidity and volatility of the underlying debt and foreign exchange markets made these instruments prohibitively expensive which deterred trading. Eventually when capital and exchange controls were imposed

in September 1998, hedging by foreign participants ceased as they were no longer exposed to interest rate risks after halting their offshore lending-and-borrowing activities in ringgit. The market for these instruments thus collapsed. Daim then ordered foreign exchange controls to be eased solely for derivatives trading but to no avail. The one-product KLOFFE was sold to the KLSE by its owners, a consortium of cash-strapped UMNO companies headed by Renong.

Although some necessary changes were instituted, they came at the worst possible time and bore no fruit. The local currency bond market would not be ripe for foreign investors—whose support was crucial—until the economy had resumed growing and a free floating Ringgit had stabilized for a few years.<sup>55</sup> Moreover, for economies of scale and scope, what was really needed was an integrated Asian regional market for derivatives with its own clearing house so that stock brokerages in Asia could carry out derivatives trading for their clients without having to register with the exchange in each country.

With reflationary measures failing to work, Mahathir suddenly imposed capital controls in September 1998 after sacking the MOF and the central bank's top bureaucrats who had disagreed with the measure. Six months later, reflationary measures behind capital controls, together with a ringgit pegged lower than other regional currencies, seemed to have stabilized the economy.<sup>56</sup> This was unsurprising because only those governments and central banks that oversee open economies cannot simultaneously maintain the independence of their internal monetary policies, stabilize their exchange rates, and permit unrestricted capital inflows and outflows. For such governments, only two of these three policy goals can be achieved at any one time—this is the Mundell-Fleming impossibility theorem.<sup>57</sup> In contrast, behind

---

<sup>55</sup> These investors in Malaysian equities want to hold PDS from companies with debt that are less vulnerable to currency market zig zags. They used to profit when the local peg to the dollar meant they could hold Malaysian debt yielding between two and five percentage points more than US Treasury securities without any apparent foreign exchange risks.

<sup>56</sup> *The Star*, "Morgan Stanley: Controls timing just right," March 3, 1999.

<sup>57</sup> *see*, Robert Mundell, "The Monetary Dynamics of International Adjustment under Fixed and Floating Exchange Rates," 74 *Quarterly Journal of Economics*, 1960; and, J Marcus Fleming, "Domestic Financial Policies under Fixed and Floating Exchange Rates," 9 *IMF Staff Papers*, November 1962; for a clear exposition, *see* Benjamin Cohen, "The Triad and the Unholy Trinity: Lessons from the Pacific Region," in Richard Higgot et al., eds., *Pacific Economic Relations in the 1990s*, (London: Allen & Unwin, 1993).

capital controls, and a pegged currency, there is monetary autonomy and fiscal reflation will work as long as there are sufficient funds.

## **Conclusion**

A common theme in East Asian development in imitation of the Japanese model—articulated explicitly in Malaysia as Mahathir's *Look East Policy* from the 1980s—was to "turbocharge" growth by over-relying on bank financing. (Japan has 63% of its savings in banks, compared to 19% in the US and, even though Japan is the world's second largest economy, its financial markets are accordingly immature.) In Malaysia bank lending was 100% of GDP at the end of 1995 while bond markets stood at only 56% of GDP. Moreover, preferential credit allocation through banks for certain interest groups caused interest rates, or the price of funds, to vary across classes of borrowers for reasons other than equilibrium interest rates as determined by market forces. This did not help economic efficiency.

The stock exchange was a linchpin in the state's construction of a Malay bourgeoisie and a big-business economy. The CIC/FIC/ROC/KLSE axis was used to effect complex mergers and acquisitions, takeovers, and reverse takeovers through cashless share swaps, cheap equity capital, and preferential bank credit that bloated UMNO firms into huge conglomerates. The high volatility on the KLSE in an era of cheap capital in the nineties resulted from an immature regulatory infrastructure, and political intervention. Share prices in Malaysia have not been useful as a guide to resource allocation. Surging stock markets from the early 1990s led not to productive investment but to speculative activity. The opening up of stock markets to non-residents in the face of a fully open capital account led to close links developing between the stock and currency markets, two inherently unstable markets vulnerable to sudden withdrawal of portfolio funds. Because cross-holdings were permitted, the solvency of the banking system itself became inextricably linked to the operations of their

securities subsidiaries and, hence, the volatility on the KLSE. The state's monetary autonomy became circumscribed in a world of high capital mobility. The tasks of coordinating monetary base management, exchange rate and interest rates management, and fiscal policies became increasingly difficult.

## **CHAPTER FIVE: Privatized Statism--The Malaysian Model**

This thesis is about a new model of the developmental state where the political leadership, instead of the bureaucracy, spearheads governmental interventionism in which the state controls corporate equity of private sector firms, with or without ownership, and wields that equity in ways that do not distort or limit market forces. This "privatized statism" obviously differs from mainstream notions of interventions such as SOEs or state sponsored cartels where market forces cannot function freely. In Malaysia, contrary to the standard model of the developmental state, the political leadership has insinuated itself into the market through a carefully targeted program of privatization, divesting SOEs and party-owned corporations to co-ethnic proxies. In the process, it has not only marginalized the previously dominant ethnic Chinese capital, but also, critically, sidelined the public bureaucracy generally considered central to administrative guidance of the private sector by the developmental state. The political leadership continues to structure markets not only through macro-economic policy but also by wielding these huge conglomerates it owns and controls elliptically through its proxies. Because these corporations have to comply with market forces, and because there is little bureaucratic intrusiveness, this mode of interventionism tracks changes in market structures. This privatized, market-tracking state interventionism constructed a robust ethnic capitalism where its unique ethnic and centralized character has enabled growth where run-of-the-mill personalistic clientelism would not have had. However, it also encumbered technological deepening given that much effort has been directed towards ethnic capital accumulation through corporate maneuvers and portfolio speculation by Malay capital. Targeted ethnic Chinese capital is now withered and, understandably, prefers to stay in liquid investments rather than long-term, value-adding industrial production. Finally, potentially footloose foreign capital sequestered within export-processing zones for decades continues to dominate manufacturing, especially that for exports, without developing significant backward linkages that would deepen domestic industry.



In the early sixties, the emergent Malay middle class was beginning to organize to demand for a larger share of the economic pie. UMNO elites employed a state ideology of ethnicity to re-establish the legitimacy of their continued rule after the electoral debacle of 1969. The 1969 riots provided the Malay elite with an opportunity and rationale to push that ethnic ideology: the coincidence of ethnic and class identities permitted the organization of a system of centralized transfer of rents as payoffs to the Malays. In this way, payoffs were delinked from corruption. Consequently, decentralized and interlocking patron-client networks like those in India did not develop. Thus, there was reasonably rational allocation of resources within these constraints during that period. The first decade of the NEP also saw the development of a large-enterprise economy run fundamentally by public spending and run by Malays. Though this crowded out private investment, there was vigorous economic growth in the seventies with favorable terms of trade, notably, a windfall in petrodollars, and substantial FDI.

The NEP also offered state elites a way to overcome UMNO's own dependency on ethnic Chinese capital that had traditionally funded the Malay party. The NEP effectively increased state elites' economic base of power by initiating the process that transferred policy making and the state's holdings of corporate equity and, consequently, economic patronage from the ruling coalition to UMNO. It removed from parliamentary scrutiny the involvement of government in business that came more and more under party oversight. Initially, the two main groups that benefited were the bureaucrats and the politicians. UMNO elites protected the bureaucrats from public criticism concerning their unfair and discriminatory decisionmaking while the bureaucracy provided economic justification for NEP decisions that served the interests of its political masters and carried out their policies that ensured the political leadership stayed in office. Bureaucrats, especially those from the ministries of finance, public enterprises, and trade and industry, had ample opportunity to take over and run firms set up by the state, giving rise to a new class of businessmen. Symmetrically, the creation of UMNO firms resulted in party leaders and their supporters benefiting. By the early eighties, UMNO's focus had shifted

from passive stock investments to an aggressive program of mergers-and-acquisitions, takeovers, and reverse takeovers. These channels of preferential access existed informally and conferred a particularly invaluable edge in an information-controlled society. The political leadership also decided whom the recipients in ethnic restructuring exercises involving private sector corporations would be. This gave rise to the beginnings of a Malay business elite that would become fabulously rich under the ethnic privatization policy.

With the global recession of the mid-eighties, there was a sharp scaling back of public sector spending and, eventually, the unofficial suspension of the NEP. A privatization policy working hand-in-glove with party control over the regulatory agencies and the financial sector saw the divestment of SOEs, and other public assets such as utilities without open and competitive bidding to co-ethnic proxies of the leadership. There was simultaneously the transfer of UMNO's corporate interests to these hand picked Malay businessmen who had acted openly as trustees for UMNO in the first decade of the NEP but, now, as proxies for the leadership. With this strategy, UMNO's assets, acquired using public funds in the first instance, were eventually transposed from party oversight to the personal control of the political leadership, albeit by proxy.

Because of UMNO's prolonged domination of the state apparatus, there was now little difference between UMNO and the state, not least in terms of whom the political leadership was. In Malaysia, privatization did not roll back the frontiers of the state but fudged them instead. The rigged privatization offered the state political cover to insinuate itself into the market: it apparently divested public assets to the private sector but, in truth, did not lose control of those assets. In fact, through these proxies, the political leadership acquired operational control over strategic firms in critical sectors of the economy. This "privatized statism" attended to market discipline and tracked changes in market structures. Because these proxies were high profile Malay corporate "movers and shakers," the political leadership could claim that privatization folded seamlessly into the NEP, thus promoting ethnic advancement. The

bureaucracy was sidelined, and the political leadership formed a new alliance with Malay big business. In Malaysia, privatization undoubtedly reduced the formal role of the public sector. However, it was no manifestation of some newfound faith in neoclassical orthodoxy. Rather, privatization was used to further the political leadership's promotion of an ethnic capitalism through the consolidation of the Malay business class. The process transmuted the form of the state's involvement in business so that the state is now inextricably imbricated in the market as a participant. Ownership and control of these corporate assets now lie concealed behind webs of corporate deals and stacks of informational barriers. The process removed from both parliamentary scrutiny and party oversight the ownership and control of these corporate assets; it did not diminish the importance of politics in corporate governance.

In all these endeavors, financial policy was an indispensable handmaiden. In imitation of the Japanese model, growth was to be "turbocharged" using politically directed bank financing. In addition, the stock market was a linchpin in the state's construction of a Malay bourgeoisie and a big-business economy. UMNO used its control over the CIC/FIC/ROC/KLSE/BNM axis to enable its proxies to effect complex mergers and acquisitions, takeovers, and reverse takeovers through cashless share swaps, cheap equity capital, and preferential bank credit that bloated UMNO firms into huge conglomerates. With an immature regulatory infrastructure and political intervention, the KLSE was highly volatile especially with a deluge of OECD portfolio capital in the nineties. Under these conditions, share price was no guide for resource allocation. The opening up of the stock market to foreigners with Malaysia's fully opened capital account led to a linking up of the stock and currency markets, two inherently unstable markets susceptible to a withdrawal of foreign capital. Because cross-holdings had been permitted, the solvency of the Tier-1 banks became linked to their securities subsidiaries and, therefore, to KLSE volatility. These risks were exacerbated by the lack of mature and liquid markets for bonds and derivatives. Ultimately, the

state's monetary autonomy became circumscribed in a world of high capital mobility. In the Asian Crisis, capital controls were re-imposed in Malaysia to preserve its ethnic capitalism.

There is no parallel in the developmentalist literature where the bureaucracy is sidelined by the political leadership in development planning. Because the unbundling of the state was not anticipated, the unreformed theoretic framework does not differentiate bureaucratic power from that of the political leadership. The situation where one particular fraction of capital—the ethnic Chinese—was purposely allowed to wither away is also not anticipated in the developmentalist literature. With the ascendancy of Malay capital, and its close alliance with the political leadership, an inversion of relations of dependency between ethnic Chinese capital and the Malay state occurred, the latter gaining the upper hand. The post-1969 reformulation of the ethnic "bargain" translated into a more exclusivist Malay state. With this issue of ethnic dominance "settled," the main confrontation in Malaysia became one within the Malay community itself.

The developmentalist perspective assumes selective resource allocation to targeted sectors on the basis of economic considerations as the state sees them. But the state does not function, as some advocates claimed, like corporate headquarters perspicaciously allocating resources to its divisions on the basis of high-yield use, rewarding winners and chastising losers. Since ethnic ownership and control of corporate equity is the political leadership's rockbottom goal, resource allocation is directed towards maintaining that, and not necessarily best use or efficient performance. Thus, bank credit, for example, was preferentially channeled on the basis of persons and political ties to co-ethnic proxies and cronies without performance criteria being imposed on these recipient firms.

## **Conclusion**

Typically, the direction of influence is from the economy to the polity, with powerful economic interests seeking to shape political decision-making. In Malaysia, the direction of

influence was the reverse: state power was used to create and consolidate an ethnically-defined capitalist class. Statist ideas about state led growth widely accepted in the comparative literature on state and markets are almost always characterized by an unquestioned assumption of definitive bureaucratic power. Because the unreformed theoretic framework does not differentiate bureaucratic power from that of the political leadership, mainstream developmentalist perspectives fail, crucially, to anticipate the inversion in the bureaucracy's role. In Malaysia, the political leadership used a rigged privatization to consolidate a business class of co-ethnic proxies and, in the process, it marginalized the bureaucracy. Privatization deepened an ethnic capitalism the leadership continues to control, crucially, with little bureaucratic intrusion. Ascendant Malay capital came into a close alliance with the political leadership and an inversion of relations of dependency between ethnic Chinese capital and the Malay state occurred. Because it consolidated the Malay business class, the political leadership is *primum inter pares* in its new alliance with Malay business. As the more equal partner, the leadership has been able to prevent capture by even special interest groups within Malay capital, and employ that equity to achieve its political purposes. However, this is not necessarily the permanent balance of power in the alliance; quite simply, this is just the present reality.

Because the state can be un-bundled, the notion of state capacity must be correctly disaggregated into its component parts and precisely attributed in its historical specificity. The privatized statism perspective suggests the need for caution in applying models of state-society relations that are not sufficiently attentive to the separable power of the political leadership vis-à-vis the bureaucracy on the one hand, and business on the other. I do not imply that the state's surreptitious pervasiveness in this small, open economy is a direct, or general, measure of state capacity. Indeed, state programs for market control and intervention of any form can become transformed, over time, by politics. As such, to explain how governments intervene in markets, state capacity must be characterized empirically with respect to historically determined coalitions and conflicts. Given the tactical and strategic motivations of these coalitions, such a

characterization is more important than "past attributions or current snapshots" of state capacity. That is, it is necessary to dis-aggregate the state as an entity in historical process in order to recognize the different institutional interests and organizational cultures within it whose competing and conflicting relations produce "public policy."

State and market are not the two ends of a seesaw, one rising and falling in opposite direction to the other. In Malaysia, the political leadership preferred ownership and control of private equity to regulation because the former affords greater flexibility, while the latter--regulatory intervention by the bureaucracy--would compromise its authority. UMNO corporations, the point of entry of the state into markets, represent a complex division of labor between "normally" state and market institutions. Here, what is important is not their designations but whether tasks are performed properly by one, or the other, or by both in flexible symbiosis. Thus, privatized statism suggests a new mix of property regimes in which the large private sector corporation may be partly, if surreptitiously, owned by the state, and still functions, for all intents and purposes, like any other private sector firm subject to market discipline. Here, flexibility in the control of equity rather than top-down command-and-control by the state is the organizing principle; monitoring by the political leadership is contingent.

Thus, modern capitalism is not some natural condition that manifests itself uniformly and equally in any and every political or social context once state interventionism, conventionally understood, is dislodged. Each capitalist system of economic arrangements, or markets, is historically constructed through the forging of a legal, corporate, and financial system in which specific modes of exchange and cooperation become viable structures for economic activity. These structures are constructed using resources and within contexts bequeathed from the past but this endeavor is always constrained by politics and policies--or political power. That is, the logic of a specific capitalism is historically contingent: there are no "free" markets that function autonomous from the state. In short, markets are shaped by both the dynamics of economic efficiency as well as the realities of political power.



## Bibliography

### *Books, Book Chapters, & Articles*

- Abdul Aziz AR, "Privatisation in Malaysia," in VV Ramanadham, 1993.  
\_\_\_\_\_, "Privatization in Malaysia: Some Observations of Divested SOEs," in Hara Fujio, (ed.), *Formation and Restructuring of Business Groups in Malaysia*, (Tokyo: Institute of Developing Economies, 1993).
- Adam C, and William Cavendish, "Early Privatizations," in Jomo, 1991.
- Almond G, and James Coleman, (eds.), *The Politics of Developing Areas*, (Princeton: Princeton University Press, 1960).
- Amsden A, *Asia's Next Giant: South Korea and Late Industrialization* (New York: Oxford University Press, 1989).  
\_\_\_\_\_, "The State and Taiwan's Economic Development," in Evans, *et al*, 1985.
- Arestis P, and P Demetriades, "Financial Development and Economic Growth: Assessing the Evidence," 10 *The Economic Journal*, 1997.
- Asher RE, (ed.), *Development of the Emerging Countries*, (Washington, DC: Brookings Institution, 1962).
- Associated Malay Chambers of Commerce of Malaysia, "Participation of Bumiputra in Industry," July 1965, *First Bumiputra Economic Congress*, Kuala Lumpur.
- Bank Negara Malaysia, *Guidelines on the Issue of Financial Debt Securities*, n.d.
- Barracrough S, "The Dynamics of Coercion in the Malaysian Political Process," 19 *Modern Asian Studies*, 1985: 797-822.
- Barro R, *Macroeconomic Policy*, (Cambridge: Harvard University Press, 1990).
- Bator F, "The Anatomy of Market Failure," *Quarterly Journal of Economics*, 1958: 351-79.
- Baumol W, *The Stock Market and Economic Efficiency* (New York: Fordham University Press, 1965).
- Berle A and Gardiner Means, *The Modern Corporation and Private Property*, 2d ed., (New York: Harcourt, Brace & World, 1968).
- Boggart E, *Internal Improvements and State Debt in Ohio: An Essay in Economic History*, (New York: Longmans, Green & Co, 1924).
- Brannman L, "Bumiputera and Public Returns to Balloting for New KLSE Share Issues," XXIX *Malaysian Journal of Economic Studies*, 1992: 13-20.



- Brodkin E, *The False Promise of Administrative Reform: Implementing Quality Control in Welfare*, (Philadelphia: Temple University Press, 1986).
- Bruchey S, "The Changing Economic Order," in Chandler and Cadman, 1949.  
 \_\_\_\_\_, and Louis Galambos, *The Changing Economic Order*, (New York: Harcourt, Brace and World, 1968).
- Buffe E, "Financial Repression, the New Structuralists and Stabilization Policy in Semi-Industrialized Economies," 14 *Journal Of Developing Economies*, 1984: 305-22.
- Burmesiter LL, "Warfare, Welfare, and State Autonomy: Structural Roots of the South Korean Developmental State," 1 *Pacific Focus*, 1986: 121-46.
- Chandler A, *The Visible Hand: The Managerial Revolution in American Business*, (Cambridge: Harvard University Press, 1977).  
 \_\_\_\_\_, and John Cadman, Jr., *The Corporation in New Jersey: Business and Politics, 1791-1875*, (Cambridge: Harvard University Press, 1949).
- Chandra M, *Some Dominant Concepts and Dissenting Ideas on Malay Rule and Malay Society from Malacca to the Colonial and Merdeka Periods*, unpublished doctoral dissertation, University of Singapore, 1977.
- Cheah B, "Sino-Malay Conflicts in Malaya, 1945-46: Communist Vendetta and Islamic Resistance," 12 *Journal of Southeast Asian Studies*, 1985: 108-117.
- Cheong S, *Corporate Groupings in the KLSE*, (Petaling Jaya: Modern Law Publishers, 1990).  
 \_\_\_\_\_, *Bumiputera Controlled Companies in the KLSE*, 2d. ed., (Petaling Jaya: Corporate Research Services, 1993).  
 \_\_\_\_\_, *Changes in Ownership of KLSE Companies*, (Petaling Jaya: Corporate Research Services, 1995).
- Chong KY, "Trade and External Relations," in Fisk and Rani, 1982.
- Cobb R, and Charles Elder, *Participation in American Politics: The Dynamics of Coalition Building*, (Baltimore: Johns Hopkins University Press, 1983).
- Cohen B, "The Triad and the Unholy Trinity: Lessons from the Pacific Region," in Richard Higgot et al., 1993.
- Coombes D, *Business or Politics*, (London: Allen & Unwin, 1971).
- Crouch H, "Malaysia: Do Elections Make a Difference?" in R.H. Taylor, (ed.), *The Politics of Elections in Southeast Asia* (New York: Cambridge University Press, 1996,) 114-35.
- Cui Z, "The Economic Role of the State; A Theoretical Survey with Reference to China," in United Nations, *The China 1998 Report*, forthcoming.
- Davis J, *Essays in the Earlier History of American Corporations*, 2 vols., (Cambridge: Harvard University Press, 1917).
- Deyo F, (ed), *The Political Economy of the New Asian Industrialism*, (Ithaca: Cornell University

Press, 1987).

Dore R, *Flexible Rigidities: Industrial Policy and Structural Adjustment in the Japanese Economy, 1970-1980*, (Stanford: Stanford University Press, 1986).

Douglas J, *Why Charity*, (Beverly Hills, CA.: Sage, 1983).

Drabble JH, and PJ Drake, "The British Agency Houses in Malaysia: Survival in a Changing World," *12 Journal of Southeast Asian Studies*, 1981: 297-328.

Eatwell J, M Milgate, and P Newman, (eds.), *The New Palgrave Dictionary of Money and Finance*, (London: Macmillan, 1992).

Evans P, "Predatory, Developmental and Other Apparatuses: A Comparative Political Economy Perspective on the Third World State," *4 Sociological Forum*, 1989: 561-87.

\_\_\_\_\_, D Rueschemeyer, and T Skocpol, *Bringing the State Back In*, (New York: Cambridge University Press, 1985).

Evers H, "The Bureaucratization of Southeast Asia," *XXV Society for Comparative Study of Society and History*, 1987: 666-685.

Faaland J, JR Parkinson, and Rais Saniman, *Growth and Ethnic Inequality: Malaysia's New Economic Policy*, (London: St. Martin's Press, 1990).

Faust M, *The Custody of State Funds*, (New York: National Institute of Public Administration, 1925).

Fazilah, AS, *Performance of Group-affiliated Firms: A Study of Politically Affiliated Business Group (sic) in Malaysia*, unpublished doctoral dissertation, University of Rhode Island, 1996.

Fishlow A, Catherine Gwin, Stephan Haggard, Dani Rodrik, and Robert Wade, *Miracle or Design? Lessons from the East Asian Experience*, (Washington, DC: Overseas Development Council, 1994).

Fisk EK, and Osman Rani, (eds.), *The Political Economy of Malaysia*, (Kuala Lumpur: Oxford University Press, 1982).

Fleming JM, "Domestic Financial Policies under Fixed and Floating Exchange Rates," *9 IMF Staff Papers*, November 1962.

Fong CO, *The Malaysian Economic Challenge in the 1990s: Transformation for Growth*, (Singapore: Longman, 1989).

Fry M, *Money, Interest, and Banking in Development*, (Baltimore: Johns Hopkins University Press, 1988).

Funston NJ, *Malay Politics in Malaysia: A Study of UMNO and Parti Islam*, (Kuala Lumpur: Heinemann, 1980).

\_\_\_\_\_, "The Origins of Parti Islam Se Malaysia," *Journal of Southeast Asian Studies*, 1981:58-73.

Galbraith JK, *The New Industrial State*, 3d ed., (New York: Mentor, 1978).

GATT, *International Trade 1987-88, vol. I*, (Geneva: GATT, 1988).

Gereffi G, and D Wyman, (eds.), *Manufacturing Miracles: Paths of Industrialization in Latin America and East Asia*, (Princeton: Princeton University Press, 1990).

Gerschenkron A, *Economic Backwardness in Historical Perspective*, (Cambridge: Harvard University Press, 1962).

Gilbert N, *Capitalism and the Welfare State: Dilemmas of Social Benevolence*, (New Haven: Yale University Press, 1983).

Goh W, and Jomo KS, "Efficiency and Consumer Welfare," in Jomo, 1991.

Gomez ET, "Electoral Funding of General, State and Party Elections in Malaysia," 26 *Journal of Contemporary Asia*, 1996: 81-99.

\_\_\_\_\_, *The 1995 Malaysian General Elections: A Report and Commentary*, (Singapore: Institute of Southeast Asian Studies, 1996).

\_\_\_\_\_, *Money Politics in the Barisan Nasional*, (Kuala Lumpur: Forum Enterprise, 1991).

\_\_\_\_\_, *Corporate Business in Malaysia* (Brisbane, Australia: James Cook University Press, 1990).

Gregor AJ, *Italian Fascism and Developmental Dictatorships*, (Princeton: Princeton University Press, 1979).

Hagan EE, *A Framework for Analysing Economic and Political Change*, in Asher, 1962.

Haggard S, "The Role of Government in Economic Development: The Debate from East Asia," *American Political Science Association-Comparative Politics Newsletter*, Winter 1999: 14-16.

\_\_\_\_\_, Chang Lee, and Sylvia Maxfield, (eds.), *The Politics of Finance in Developing Countries*, (Ithaca: Cornell University Press, 1993).

Hansman H, "The Role of Nonprofit Enterprises," 98 *Yale Law Journal*, 1989: 835-901.

Hartz L, *Economic Policy and Democratic Thought, 1776-1860*, (Chicago: Quadrangle Books, 1968).

Hawes G, and H Liu, "Explaining the Dynamics of the Southeast Asian Political Economy: State, Society and the Search for Economic Growth," 45 *World Politics*, 1993: 629-60.

Heng PK, "Chinese Responses to Malay Hegemony in Peninsular Malaysia, 1957-1996," 34 *Southeast Asian Studies*, 1996: 500-523.

\_\_\_\_\_, "The Chinese Business Elite of Malaysia," in McVey, 1992.

Hewison K, Richard Robison, and Garry Rodan, (eds.), *Southeast Asia in the 1990s: Authoritarianism, Democracy and Capitalism*, (Sydney, Australia: Allen & Unwin, 1993).

Higgot R, Richard Leaver, and John Ravenhill, (eds.), *Pacific Economic Relations in the 1990s: Cooperation or Conflict*, (London: Allen & Unwin, 1993).

- Hill C, "Internal Capital Market Controls and Financial Performance in Multidivisional Firms," XXXVII *The Journal of Industrial Economic*, 1988: 72-83.
- \_\_\_\_\_, "Oliver Williamson and the M-Form Firm: A Critical Review," XIX *Journal of Economic Issues* 1985: 731-49.
- Hellman Y, K Murdock, and J Stiglitz, "Addressing Moral Hazards in Banking: Deposit Rate Controls vs. Capital Requirements," *mimeo*, Stanford University, 1994.
- Huntington S, *Political Order in Changing Societies*, (New Haven: Yale University Press, 1968).
- Ikenberry G, *Reasons of State: Oil, Politics, and the Capacities of American Government*, (Ithaca: Cornell University Press, 1988).
- Johnston M, "The Political Consequences of Corruption: A Reassessment," *Comparative Politics*, 1986: 459-477.
- Jomo KS, "Malaysia Bails Out Its Cronies Again," *Asian Wall Street Journal*, January 7, 1999.
- \_\_\_\_\_, (ed.), *Privatizing Malaysia: Rents, Rhetoric, Realities*, (Boulder, CO: Westview Press, 1991).
- \_\_\_\_\_, "Wither Malaysia's New Economic Policy," 63 *Pacific Affairs*, 1991: 469-99.
- \_\_\_\_\_, *Growth and Structural Change in the Malaysian Economy*, (London: Macmillan, 1990).
- Kamal S, and Zainal Y, "Overview of the New Economic Policy and Framework for the Post-1990 Economic Policy," 24 *Malaysian Management Review*, 1991: 13-61.
- Katz R, Japan, *The System that Soured: The Rise and Fall of the Japanese Economic Miracle*, (Armonk, NY: ME Sharpe, 1998).
- Khan MS, and CM Reinhart, "Capital Flows in the APEC Region," *IMF Occasional Paper # 122*, 1995.
- Khasnor J, *The Emergence of the Modern Malay Administrative State*, (Singapore: Oxford University Press, 1984).
- Khoo BT, *Paradoxes of Mahathirism: An Intellectual Biography*, (Kuala Lumpur: Oxford University Press, 1995).
- Kirkpatrick C, "Some Background Observations on Privatisation," in VV Ramanadham, 1993.
- Kornail J, "Resource-constrained versus Demand-constrained Systems," 47(4) *Econometrica*, 1979: 801-19.
- Krugman P, "Dutch Tulips and Emerging Markets," *Foreign Affairs* July/August 1995: 28-54.
- Kunio Y, *The Rise of Ersatz-Capitalism in Southeast Asia*, (Singapore: Oxford University Press, 1988).
- Jesudasson J, *Ethnicity and the Economy: The State, Chinese Business, and Multinationals in Malaysia*, (Singapore: Oxford University Press, 1989.)

Jackson KD, "Bureaucratic Polity: A Theoretical Framework for the Analysis of Power and Communications in Indonesia," in KD Jackson and Lucian Pye, (eds.), *Political Power and Communications in Indonesia*, (Berkeley: University of California Press, 1978).

Johnson C, "Political Institutions and Economic Performance: The Government-Business Relations in Japan, South Korea, and Taiwan," in F Deyo, 1987.

\_\_\_\_\_, *MITI and the Japanese Miracle: The Growth of Industrial Policy, 1925-1975*, (Stanford: Stanford University Press, 1982).

Jones L, and I Sakong, *Government, Business, and Entrepreneurship in Economic Development: The Korean Case*, (Cambridge, MA: Harvard University Press, 1980).

Lal D, *The Poverty of Development Economics*, (London: Institute of Economic Affairs, 1983).

Lee CH, "The Government Financial System, and Large Private Enterprises in the Economic Development of South Korea," *20 World Development*, 1992: 187-97.

\_\_\_\_\_, and S Naya, "Trade in East Asian Development with Comparative Reference to Southeast Asian Experience," *38 Economic Development and Cultural Change*, 1988: 123-152.

Lee HP, *Constitutional Conflicts in Contemporary Malaysia*, (Kuala Lumpur: Oxford University Press, 1995).

Lee JM, *Colonial Development and Good Government*, (Oxford: Clarendon Press, 1967).

List F, *The National System of Political Economy*, tr. Sampson S. Lloyd, (London: Longmans, Green, 1885).

Lim KS, *The \$62 Billion North-South Highway Scandal*, (Kuala Lumpur: DAP, 1987).

\_\_\_\_\_, *Time Bombs of Malaysia*, (Kuala Lumpur: DAP: 1978).

Lim L, and LA Gosling, (eds.), *The Chinese in Southeast Asia*, (Singapore: Maruzen Asia, 1983).

Lim MH, "Contradictions in the Development of Malay Capital: State, Accumulation and Legitimation," *15 Journal of Contemporary Asia*, 1985: 37-63.

\_\_\_\_\_, "The Ownership and Control of Large Corporations in Malaysia: The Role of Chinese Businessmen," in Lim and Gosling, 1983.

\_\_\_\_\_, *Ownership and Control of the One Hundred Largest Corporations in Malaysia*, (Kuala Lumpur: Oxford University Press, 1981).

Lim SY, "Malaysian Financial Markets," in SG Rhee and RP Chang (eds), *Pacific Basin Capital Markets Research, Vol III*, (Amsterdam: North Holland, 1992).

Mansor I, "Malaysian Capital Markets: Recent Developments and Future Challenges," paper presented at the *Fifth Tun Abdul Razak Conference*, Ohio University, April 21-23, 1995.

Mauzy D, "Malaysia in 1987: Decline of the Malay Way," *XXVIII Asian Survey*, 1988: 213-222.

\_\_\_\_\_, "Malaysia: Malay Political Hegemony & Coercive Consociationalism," in McGarry and O'Leary, 1993.

- McGarry J, and Brendan O'Leary, (eds.), *The Politics of Ethnic Conflict Regulation*, (London: Routledge, 1993).
- McKinnon R, *Money and Capital in Economic Development*, (Washington, DC: Brookings Institution, 1973).
- McVey R, "The Materialization of the Southeast Asian Entrepreneur," in Ruth McVey, 1992. \_\_\_\_\_, (ed.), *Southeast Asian Capitalists*, (Ithaca: Cornell University Press, 1992).
- Meade J, *Liberty, Equality and Efficiency*, (New York: New York University Press, 1993).
- Means G, *Malaysian Politics: The Second Generation*, (Singapore: Oxford University Press, 1991).
- Mehmet O, *Development in Malaysia: Poverty, Wealth and Trusteeship*, (London: Croom Helm, 1986).
- Migdal J, *Strong Societies or Weak States: State-Society Relations and State Capacities in the Third World*, (Princeton: Princeton University Press, 1988).  
\_\_\_\_\_, "Strong States, Weak States: Power and Accommodation" in M Weiner and S Huntington, (eds.), *Understanding Political Development*, (Boston: Little, Brown, and Co., 1987).
- Milne RS, "Privatization in the ASEAN States: Who Gets What, Why, and With What Effect?" *65 Pacific Affairs*, 1992: 7-29.  
\_\_\_\_\_, "The Politics of Privatization in the ASEAN States," *7 ASEAN Economic Bulletin*, 1991: 322-33.  
\_\_\_\_\_, and Diane Mauzy, *Politics and Government in Malaysia*, (Singapore: Institute for Southeast Asian Studies, 1978).  
\_\_\_\_\_, "The Politics of Malaysia's New Economic Policy," *49 Pacific Affairs*, 1976: 235-261.
- Moggridge D, *The Collected Writings of John Maynard Keynes, Vol 25*, (Cambridge: Cambridge University Press, 1980).
- Mundell R, "The Monetary Dynamics of International Adjustment under Fixed and Floating Exchange Rates," *74 Quarterly Journal of Economics*, 1960.
- Muramatsu M, and FS Krauss, "Bureaucrats and Politicians in Policy Making: The Case of Japan," *78 American Political Science Review*, 1984: 126-46.
- Mushtaq K, *Clientelism, Corruption and Capitalist Development: An Analysis of State Intervention With Special Reference to Bangladesh*, unpublished doctoral dissertation, University of Cambridge, 1989.
- Myrdal G, "The Soft State in Underdeveloped Countries," in P. Streeten (ed) *Unfashionable Economics: Essays in Honour of Lord Balogh*, (London: Weidenfeld & Nicolson, 1970).  
\_\_\_\_\_, *Asian Drama: An Inquiry into the Poverty of Nations*, 3 vols. (New York: Pantheon, 1968).
- Naidu, G, "Infrastructure," in Jomo, 1991.

- Nathan KS, "Malaysia in 1988: The Politics of Survival," *XXVIII Asian Survey*, 1989: 129-139.
- O'Donnell G, *Modernization and Bureaucratic-Authoritarianism: Studies in South American Politics*, (Berkeley: University of California Press, 1973).
- Okimoto D, *Between MITI and the Market: Japanese Industrial Policy for High Technology*, Stanford: Stanford University Press, 1989).
- Onis Z, "Privatization and the Logic of Coalition Building: A Comparative Analysis of State Divestiture in Turkey and the United Kingdom," *24 Comparative Political Studies*, 1991: 231-253.
- \_\_\_\_\_, "The Logic of the Developmental State," *24 Comparative Politics*, 1991: 109-26.
- Pagano M, "Financial Markets and Growth: An Overview," *37 European Economic Review*, 1993: 613-22.
- Paudyal K, B Saadouni and RJ Briston, "Privatization Initial Public Offerings in Malaysia: Initial Premium and Long-term Performance," *6 Pacific Basin Finance Journal*, 1998: 20-40.
- Pauly L, *Who Elected the Bankers: Surveillance and Control in the World Economy*, (Ithaca: Cornell University Press, 1997).
- Peltzman S, "Toward a More General Theory of Regulation," *19 Journal of Law and Economics*, 1976: 211-40.
- Picard L, *The Politics of Development in Botswana: A Model for Success*, (Boulder, CO: Lynne Rienner, 1987).
- Polanyi K, *The Great Transformation: The Political and Economic Origins of Our Time*, (Boston: Beacon Press, 1944).
- Puthuchery M, "The Administrative Elite," in Zakaria Ahmad, (ed.), *Government and Politics of Malaysia*, (Singapore: Oxford University Press, 1987).
- Ramanadham VV, (ed.), *Privatisation in Developing Countries*, (London: Routledge, 1993).
- Ratnam KJ, and RS Milne, *The Malaysian Parliamentary Election of 1964*, (Singapore: University of Malaya Press, 1967).
- Rajah R, *Foreign Capital and Industrialization in Malaysia*, (New York: St. Martin's Press, 1995).
- Rees M, *The Public Sector in the Mixed Economy*, (New York: Harper & Row, 1973).
- Riggs F, *Thailand: The Modernization of a Bureaucratic Polity*, (Honolulu: East-West Center Press, 1966).
- Rodan G, *The Political Economy of Singapore's Industrialization: Nation State and International Capital*, (London: Macmillan, 1989).

Root H, *Small Countries, Big Lessons: Governance and the Rise of East Asia*," (Hong Kong: Oxford University Press, 1996,) 65-89.

Sachs J, and J Warner, "Economic Reform and the Process of Global Integration," 1 *Brookings Papers on Economic Activity* 1995: 1-95.

Saloman L, *Partners in Public Service: Towards a Theory of Government-NonProfit Relations*, (Washington, DC: The Urban Institute, 1985).

Samuels R, *The Business of the Japanese State: Energy Markets in Comparative and Historical Perspectives*, (Ithaca: Cornell University Press, 1987).

Saruwatari K, "Malaysia's Localization Policy and its Impact on British-owned Enterprises," 29 *The Developing Economies*, 1991: 371-86.

Schonfield A, *Modern Capitalism*, (New York: Oxford University Press, 1969).

Securities Commission, *Annual Report*, (Kuala Lumpur: Government of Malaysia, 1997).

Seidman H, "Government Sponsored Enterprise in the United States," in Bruce Smith, 1975.

Shamsul AB, "The Battle Royal: The UMNO Elections of 1987," *South East Asian Affairs*, (Singapore: Institute of Southeast Asian Studies, 1988).

Sieh ML, "The Transformation of Malaysian Business Groups," in McVey, 1992.

\_\_\_\_\_, *Ownership and Control of Malaysia's Manufacturing Corporations*, (Kuala Lumpur: UMCB Publications) 1982: 145-52.

Singh A, "Liberalization and Globalisation: An Unhealthy Euphoria," *International Social Security Review*, 1996.

\_\_\_\_\_, "Comparative Markets and Economic Development: A Commentary on World Bank Analyses," 2 *International Papers in Political Economy*, 1995.

\_\_\_\_\_, "The Stock Market and Economic Development: Should developing countries encourage stock markets?" 4 *UNCTAD Review*, 1993.

\_\_\_\_\_, "Corporate Takeovers," in J Eatwell, *et al*, 1992.

Smith B, (ed.), *The New Political Economy: The Public Use of the Private Sector*, (New York: Wiley, 1975).

Snodgrass D, *Inequality and Economic Development in Malaysia*, (Kuala Lumpur: Oxford University Press, 1980).

Stiglitz J, "The Role of the State in Financial Markets," in *Proceedings of the World Bank Annual Conference on Development Economics*, (Washington, DC: World Bank, 1993).

Tobin J, "On the Efficiency of the Financial System," *Lloyds Bank Review*, July 1984: 1-15.

\_\_\_\_\_, "Money and Economic Growth," 33 *Econometrica* 1965: 67-84

Toh KW, *The Gerakan's Position on the New Development Policy from 1991*, (Penang: Gerakan Party Economic Research Bureau, 1990).



- Tommeraaen M, *State Centralized Investment Process—Structure, Controls, and Operations*, (Lincoln: University of Nebraska Studies, 1966).
- Trimberger EK, *Revolution from Above: Military Bureaucrats in Japan, Turkey, Egypt and Peru*, (New Brunswick, NJ: Transactional Books, 1978).
- UNCTAD, *Trade and Development, 1995* (Geneva, 1995).
- Veblen T, *The Theory of Business Enterprise*, (New York: Scribners, 1904).
- Vickers J, and George Yarrow, *Privatization: An Economic Analysis*, (Cambridge: MIT Press, 1988).
- Vogel E, *Japan as Number One*, (Cambridge, MA: Harvard University Press, 1979).
- Wade R, *Governing the Market: Economic Theory and the Role of Government in East Asian Industrialization*, (Princeton: Princeton University Press, 1990).
- Warr P, "Malaysia's Industrial Enclaves: Benefits and Costs," *25 The Developing Economies*, 1987: 30-55.
- Weber M, "Objectivity in Social Science," in Edward Shils and Henry Finch (eds., & trans.), *On the Methodology of the Social Sciences*, (Glencoe, Ill: The Free Press, 1949).
- Werner W and Steven Smith, *Wall Street*, (New York: Columbia University Press, 1991).
- White G, (ed.), *Developmental States in East Asia*, (London: Macmillan, 1988).
- Whitehill A, *Japanese Management: Tradition and Transition*, (London: Routledge, 1990).
- WIDER, "Foreign Portfolio Investment in Emerging Equity Markets," *Study Group Series No. 5*, (Helsinki: World Institute for Development Economics Research, United Nations University, 1990).
- Williamson O, *The Economic Institutions of Capitalism*, (New York: Free Press, 1985).
- \_\_\_\_\_, *Markets and Hierarchies: Analysis and Antitrust Implications*, (New York: The Free Press, 1975)
- Wolf C, "A Theory of Nonmarket Failure: Framework for Implementation Analysis," *Journal of Law and Economics*, 1979: 107-139.
- World Bank, *China's Management of Enterprise Assets: The State as Shareholder*, (Washington DC: World Bank, 1997).
- \_\_\_\_\_, *The East Asian Miracle: Economic Growth and Public Policy*, (Geneva: World Bank, 1994).
- \_\_\_\_\_, *World Development Report, 1992*, (New York: Oxford University Press, 1992).
- \_\_\_\_\_, *World Development Report, 1989: Financial Systems and Development*, (New York: Oxford University Press, 1989).
- \_\_\_\_\_, *World Development Report, 1955*, (New York: Oxford University Press, 1955).

Yeo KW, "The Grooming of an Elite: Malay Administrators in the Federated Malay States, 1903-1941," 14 *Journal of Southeast Asian Studies*, 1984: 287-319.

Zakaria A, "Malaysia: Quasi Democracy in a Divided Society," in L Diamond, *et al.*, (eds.), *Democracy in Developing Countries: Vol 3--Asia*, (Boulder, CO: Lynne Rienner, 1989).

Zysman J, *Governments, Markets and Growth: Financial Systems and the Politics of Industrial Change*, (Ithaca: Cornell University Press, 1984).

### ***Other Publications Cited***

*Asian Wall Street Journal*, The (published daily in Malaysia)

*Asiaweek* (independent weekly magazine published in Hong Kong)

*Berita Harian* (the middle class Malay's daily in the Malay language)

*Banker's Journal*, The (monthly publication of the Bankers' Association of Malaysia)

Bank Negara Malaysia, *Annual Report*, various issues

Bank Negara Malaysia, *Guidelines on the Issue of Financial Debt Securities*, n.d.

Bank Negara Malaysia, *Monthly Statistical Bulletin*, various issues

Bank Negara Malaysia, *Quarterly Bulletin*, various issues

*Edge*, The (a bi-weekly English language newsletter devoted to Malaysian corporate affairs)

*Far East Economic Review* (independent weekly magazine published in Hong Kong)

*Hansard*, The (the official record of parliamentary proceedings in Malaysia).

*Harakah* (Parti Islam's newsletter; limited, by law, to party members only)

*Investors' Digest*, The (the KLSE's publication)

*Malaysian Business* (bi-monthly business magazine controlled by UMNO's NSTP)

*New Straits Times*, The (major English language daily, generally seen as UMNO's mouthpiece)

*Rocket*, The (DAP's newsletter; limited, by law, to party members only)

*Sin Chew Jit Poh* (UMNO-owned Chinese language daily with the largest circulation)

*Star*, The (English language daily with the largest circulation; also controlled by UMNO)

*Sun*, The (English language tabloid; ultimate ownership cannot be ascertained )

*Utusan Malaysia* (the working class' Malay language daily; UMNO's first corporate asset)

# THESIS PROCESSING SLIP

FIXED FIELD: ill. \_\_\_\_\_ name \_\_\_\_\_

index \_\_\_\_\_ biblio \_\_\_\_\_

► COPIES: Archives Aero Dewey Eng Hum  
Lindgren Music Rotch Science

TITLE VARIES: ►  \_\_\_\_\_

NAME VARIES: ►  \_\_\_\_\_

IMPRINT: (COPYRIGHT) \_\_\_\_\_

► COLLATION: 23412

► ADD: DEGREE: \_\_\_\_\_ ► DEPT.: \_\_\_\_\_

SUPERVISORS: \_\_\_\_\_

NOTES:

cat'r:

date:

page:

► DEPT: PolSci

► 3192

► YEAR: 1999 ► DEGREE: Ph.D.

► NAME: Ho, Andrew Chinpeng