Back to the Future? Malaysian Lessons from the 1970s

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"if a leader seeks to maintain his position through making popular decisions, the national interest can be jeopardised. In leading a multiracial society, the principle behind every decision must be the promotion of the national interest, and not the fulfilment of the needs of just one group." *Tun Hussein Onn*

Contemporary conventional wisdom has not been kind to Malaysian government leadership in the 1970s. The period is often depicted as a period of unfortunate, but necessary political compromises to address the events of May 1969. These include the emphasis on rural and regional development as well as increased state intervention and public sector growth during this period. While acknowledging the public policy errors and excesses of the period, the lecture will highlight how the period laid the foundations for subsequent Malaysian progress, much of which has been undermined since.

After independence in 1957, Malaya, and then Malaysia achieved impressive growth, considerable infrastructure development, some economic diversification, and improved social services. Government intervention also grew from the 1950s. Development policies, government regulation, plan allocations as well as implementation reflected the changing nature, role, and orientation of the government, as well as politically influential business interests.

The changing nature of the state has influenced government interventions, but certain features have been common to all phases of Malaysian development after independence. Early development planning from the 1950s reflected the interests and priorities of the late colonial government as the post-colonial Alliance government's development strategy reflected the interests and political compromise it represented. The early post-Merdeka government British business interests in Malaya, but also enabled predominantly Chinese local businesses to strengthen their position. The Tunku government pursued a basically laissez faire development strategy, with limited government interference to secure electoral support, promote economic diversification and facilitate wealth accumulation. Economic diversification, including manufacturing, sought to reduce colonial era over-reliance on primary production.

Thus, post-colonial governments actively sought to promote industrialization from the outset. Early industrialization efforts from the late 1950s favoured import-substitution, through government intervention including tariff protection, infrastructure provision, tax exemptions, financing facilities and other incentives. Unlike many governments' use of state-owned enterprises or encouragement of national investments, the strategy encouraged foreign investors to set up production, assembly and packaging plants in the country.

Proclaimed in 1970 after the post-election race riots of May 1969, the New Economic Policy (NEP) sought 'national unity' through massive economic redistribution programmes to achieve its twin prongs of 'poverty eradication', i.e. ensuring no households earn less than the poverty line income, and 'restructuring society' to achieve greater inter-ethnic economic parity, especially in occupations and corporate wealth ownership, between the predominantly Malay Bumiputeras (indigenes) and the mainly ethnic Chinese non-Bumiputeras, to 'eliminate the identification of race with economic function'.

The government encouraged export-oriented industries from the early 1970s. Incentives shifted from import-substituting to export-oriented manufacturing. The government opened free trade zones (FTZs) from 1972 for export processing activities. Malaysia's export-oriented industrialization was consistent with the emerging new international division of labour, with transnational enterprises globally relocating various production, assembly and testing processes to secure locations offering lower wage and other production costs.

Policies in the 1970s saw partial abandonment of laissez faire policies, with greater government intervention in public resource allocation as well as public sector ownership and control of enterprises. The period saw rapid growth of the public sector and increasing government intervention invoking the NEP. The role of the Malaysian government was thus redefined. Especially during the heyday of the NEP in the 1970s, the bureaucracy in Malaysia enjoyed considerably more 'autonomy' from vested business interests. But increasingly, interventions reflected a preoccupation with inter-ethnic redistribution rather than other policy objectives.

Malaysia's 1975 Industrial Coordination Act failed to serve as an effective instrument of investment and technology promotion, instead associating such interventions in Malaysia with inter-ethnic redistribution. Hence, government industrial policy interventions have been quite different from industrial policy in the first-tier East Asian NIEs, where such policies prioritized international competitiveness for new industrial activities. Not surprisingly, most predominantly ethnic Chinese domestic private manufacturing enterprises became wary, if not quietly opposed to Malaysian government interventions generally. Thus, the ICA was probably primarily responsible for the following decade of capital flight and decline in private domestic investments.

However, the pragmatic role of government in relation to palm oil refining was another matter. As rubber prices stayed low in the 1960s, plantation owners began diversifying to oil palm. The Malaysian government encouraged palm oil refining from the mid-1970s, but also needed to counter European common market tariff escalation with countervailing export duties to which the Europeans responded with even steeper tariff escalation. Realizing their dilemma, the Malaysian authorities sought alternative markets, and developed 'barter trade' in countries with foreign exchange constraints, first with India, then the Soviet Union, Pakistan and China, among others. Meanwhile, Malaysian palm oil refining rapidly became the most efficient and cost-effective in the world, thanks to economies of both scale and scope as Malaysian refineries focussed on palm oil and palm kernel oil. However, this achievement came at tremendous environmental cost, with the officially proclaimed 'death' of about 40 rivers, but this was at least partially ameliorated by enforcement of the 1974 Environmental Quality Act which later inspired a chapter in the *Third Malaysia Plan, 1976-1980*.

Tun Razak even sought to promote tripartism, and a less adversarial, if not quasi-corporatist industrial relations with organized labour. During the 1960s and 1970s, there were several government efforts to position itself as a neutral arbiter standing above and mediating between management and labour. An early attempt at tripartism (among employers, employees and the Government) — was embodied in the Code for Industrial Harmony in the 1970s. Except during the 1970s, the government has generally favoured the state and employers, e.g., in amending the labour laws.

Establishment of the Social Security Organization (SOCSO) in 1969 — to compensate victims of industrial accidents regardless of responsibility — absolved employers of responsibility for accident compensation even if they had been negligent in ensuring occupational safety at the workplace. With compensation payments kept low, SOCSO became an additional source of cheap finance for the government. With the eligibility wage ceiling increased several times, SOCSO coverage has grown over the decades.

Most amendments to labour laws have been at the expense of workers' rights. Labour laws inherited from the 1950s were amended in late 1969, to more effectively control employees in labour-intensive, export-oriented industries, e.g. by strengthening the Registrar of Trade Unions' discretionary powers, allowing previously prohibited night shift work for women, further restricting the right to strike and limiting trade union activities and rights.

Relatively few employees, mainly in the public, plantation and manufacturing sectors, were unionized, with workers in the free trade zones largely un-unionized until the late 1980s. There has not been minimum wage legislation in Malaysia until recently, set at low levels, and often evaded by the casualization of industrial relations with the large and still growing presence of foreign workers. The Malaysian Industrial Development Authority (MIDA) was even known in the 1970s to assure prospective investors in pioneer industries of safeguards against 'unreasonable demands' from unions during their first five years of existence, or for 'any such extended period'.

The ambiguity of the 1970s ended with the harsh government reaction, led by the then Deputy Prime Minister, to the protracted Malaysian Airlines System (MAS) industrial dispute of 1978-79. Unlike the efforts in the early and mid-1970s to promote tripartism and other reforms to co-opt 'moderate' trade union leaders with the semblance of a new social contract for labour, he further limited workers' political and legal rights while providing some economic benefits from the buoyant circumstances then prevailing.

Macro-financial management

Following scandals involving several new private banks in the early post-Merdeka years, the authorities bailed out several banks by nationalizing them. Several banking licences had been issued to politically well-connected Sino-Malayan bankers in the 1950s and early 1960s before the establishment of Bank Bumiputera in 1965 following the first Bumiputera Economic Congress. The authorities required all Malaysian banks to serve some limited government priorities, including lending requirements to Bumiputeras and for manufacturing. While the latter was later withdrawn, it reminds us of how banking policy can promote investments in the real economy – in contrast to the lending portfolios of commercial banks today.

While the Finance Minister from the 1960s continued into the early 1970s, macroeconomic policy became more counter-cyclical. Similar counter-cyclical fiscal responses were evident when growth faltered in 1974, and again following the Volcker-induced international slowdown in the early 1980s. In response to the collapse of private investment following the traumatic events of May 1969, the government increased public investment and undertook various initiatives to induce private investments, especially from abroad, to catalyze growth. Meanwhile, the new leadership undertook various initiatives to consolidate rural support for the ruling coalition including more rural development initiatives.

Public sector

Malaysia's public sector was among the largest in the world outside most of the previously 'communist' economies, with over 1,100 SOEs at its peak in the mid-1980s. By the late 1980s, as the privatization programme began in earnest, SOE output accounted for about a quarter of GDP. The overall SOE debt-equity ratio of 180% was significantly higher than the average private sector ratio. The government was criticized for its 'soft budget constraints' for extending easy and cheap credit to SOEs without demanding improved accountability and performance.

The generally poor SOE performance was obscured by high profits for PETRONAS and its subsidiaries whose surplus was 5% of GDP in 1982 when oil prices were no longer high. The SOE sector imposed a considerable burden on public resources and, if not for petroleum revenues, the financial burden would have been greater. Approximately 40-45% of all SOEs were unprofitable through the 1980s, with most drawing on taxpayers' funds. SOEs were allowed to survive when market discipline required closure and reallocation of resources. So-called 'social' or NEP – i.e. ethnic redistributive – objectives were often invoked to excuse neglecting efficiency and accountability. Coordination problems have also been serious.

Monitoring and evaluation of SOE performance were virtually non-existent until the mid-1980s. As the larger enterprises developed in size and influence, they often became less answerable to external monitoring, let alone supervision. Non-financial public enterprises (NFPEs) – previously known as off-budget agencies (OBAs) – proved particularly problematic, as they were not subject to normal government budgetary constraints.

While acknowledging poor and inefficient management of many, if not most Malaysian SOEs, the key question is whether such inefficiencies are inevitable consequences of public ownership, which cannot be overcome except through privatization. The much better performance of most SOEs in neighbouring Singapore, or of Malaysia's historically well-run Petronas, underscore this point. Less politicized and ethnic criteria for recruitment, appointment, promotion and accountability, as well as greater SOE autonomy, transparency and organizational flexibility could radically improve SOE performance.

If the performance of Malaysian SOEs has primarily been due to the nature, interests and capabilities of those in charge, rather than an inevitable consequence of public ownership *per se*, then privatization itself cannot and will not overcome the problems of Malaysian SOEs. Also, while privatization may improve enterprise profitability for the private owners concerned, such changes may not benefit the public or consumers, or worse, be at their expense.

Since a significant portion of such activities are public monopolies, privatization will hand over such monopoly powers to private interests likely to use them to maximize profits. The privatization of public services has burdened the public, especially as charges for privatized services are raised. Private interests are only interested in profitable or potentially lucrative activities and enterprises, leaving the government with unprofitable and less profitable activities that will consequently worsen overall public-sector performance, resulting in the claim of inevitable SOE or public sector inefficiency becoming a self-fulfilling prophecy.

Malaysia's privatization programme thus reversed the NEP's expansion of the public sector despite official insistence that the program would contribute to NEP objectives, referring mainly to inter-ethnic wealth redistribution. Whereas the *Third Malaysia Plan, 1976-1980* had envisaged that the Malay share would be held through government established trust agencies, on behalf of the entire community, privatization has accelerated private accumulation, especially by the politically influential, at the expense of the community as a whole, especially its poorer members.

The sovereign debt crises of the early 1980s forced many developing countries to seek support from the International Monetary Fund and the World Bank. These Bretton Woods' institutions blamed developing countries' problems on excessive state intervention, poor macroeconomic management, SOE inefficiencies, national food security and import substitution industrialization policies. Hence, the Washington Consensus policy prescriptions of liberalization, deregulation and privatization. Privatization was supposed to accelerate growth, improve efficiency and productivity, shrink the public sector, and reduce the government's role.

Unlike many other developing countries forced to accept privatization as a condition for support from the World Bank or which embraced privatization because they were constrained by fiscal and debt constraints, Malaysia chose to do so in the mid-1980s after rapid SOE expansion to promote heavy industrialization, increasing public sector employment before the mid-1982 general election and collapse of primary commodity export prices after the Volcker-induced international recession from 1980.

Then and now

The contrast between the present and the past is instructive. While the official New Economic Model suggests that balanced economic development and structural transformation are to be prioritized, the widespread perception is that policy priorities are influenced by rentiers, with financial interests dominant. Not surprisingly, economic and political patronage or clientelism are widespread with 'jobs for the boys' a major consideration in procurement decisions, for example. As in so much of the world today, the dominance of finance has been at the expense of the real economy, with public policymakers more responsive to financial indicators and considerations, rather than the real economy. The prioritization of finance at the expense of the real economy has resulted in growing neglect of Malaysian investors in the real economy with corresponding privileges directed at foreign investors and financial investments instead.

Malaysia today contrasts sharply with the situation in the 1970s during the first decade of the New Economic Policy (NEP) under the prime ministership of Tun Abdul Razak and Tun Hussein Onn. Although this period is often viewed as period when economic policy was compromised by necessary political compromises following the events associated with May 1969. The general elections of May 1969 saw the ruling Alliance coalition lose the popular vote, including half the Malay vote in the peninsula. The preceding economic malaise and growing unemployment, due to the exhaustion of import-substituting industrialization favouring foreign investment, was seen primarily through ethnic lens after the elimination of the Socialist Front in the mid-1960s and the tensions generated by Singapore's secession from the expanded Malaysian federation. While non-Malays saw their problems as due to the Malay-led government, Malays were encouraged to blame their lot on Chinese economic dominance.

In contrast to this caricature, the 1970s, especially the second half of the decade, saw the most rapid growth ever compared to preceding and subsequent decades (the period from 1988 to 1997 saw more rapid growth largely due to the relocation of production from Japan and other Northeast Asian economies to China, Thailand, Indonesia and Malaysia). The decade also saw the most rapid NEP redistribution, not only in terms of poverty reduction, but also in terms of Bumiputera wealth accumulation. The transfer of Bumiputera share ownership from trust agencies to private individuals only happened in the 1980s, accelerated in the name of privatization. At the highest level, there was a strong sense of public purpose and commitment to creating conditions for 'national unity'. Although publicly owned, commercial banks were expected to serve the real economy, e.g., with required quotas for lending to Bumiputeras and manufacturing, thus seeking to accelerate industrialization.

Thus, well before the contemporary debate on the relationship between growth and redistribution, Malaysia in the 1970s underscored that the two were not inimical although much depends on the actual policies adopted and implemented. The vulnerability of many, though not all Malay and non-Malay rentiers to the 1997-1998 'Asian crisis' and the 2008-2009 global financial crisis underscores their tenuous bases. With ethno-populist patronage shaping politics and political discourse, its expression in terms of clientelism has proved to be economically debilitating. Consequently, much of Malaysian capitalism or business may be deemed economically wasteful, with corruption endemic and inclined to be short-termist, rather than progressive.

Lessons

If pressed to draw lessons from the 1970s, one would need to take into account much that has not been discussed so far. Besides acknowledging the compatibility of growth with redistribution, it is also important to compare instances of successful and unsuccessful public spending, e.g. the contrast between investments and results in health in contrast to education. Also very sobering is the fact that much policy was made on a pragmatic basis, rather than inspired by some pre-conceived dogma, ideology or grand theory imported from abroad or prescribed by the founts of conventional wisdom such as the World Bank. Thus, Malaysia was thankfully spared the still hegemonic Washington Consensus which dictated economic liberalization and privatization regardless of circumstance.

Driven as they were by a high sense of national public purpose, the two leaders presumed that others were similarly motivated, and that existing laws against graft, corruption and abuse were enough to prevent rot from setting in. With the benefit of hindsight, it is clear that institutional reforms must not only keep up with new challenges, but will need to anticipate further problems ahead in a fast changing world. Thus, besides keeping the real economy -- not finance -- foremost, it will be crucial to ensure adequate institutions to preserve and advance accountability.