Economic Growth, Environment and Privatisation

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Essays by

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Third Holder of the Tun Hussein Onn Chair

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Malaysian Economic Growth and Equity in the 1970s

The change of government following the May 1969 third general election and the ensuing 13 May race riots began a new chapter in public policy with major consequences for Malaysian economic growth and distribution as well social, cultural and political transformation. The 1970s here will be used to refer to the period after May 1969, especially after Tun Razak Hussein became Malaysia's second prime minister and the New Economic Policy (NEP) began with the Second Malaysia Plan for 1971-1975. Following his untimely death in early 1976, his deputy and finance minister, the late Tun Hussein Onn took over and largely pursued policies initiated by Razak until he voluntarily stepped down in mid-1981 in favour of his Deputy, Tun Dr Mahathir Mohamad.

Malaysia's economic performance in the 1970s offers several important lessons from an earlier period relevant to contemporary economic options and policy debate. The 1970s' period in Malaysian history is often portrayed and seen as one of forced compromise following the traumatic events of May 1969. The implication is that in the interest of political and social peace, economic priorities – implying growth and development – were compromised.

On the contrary, it is very important to recognise the very significant achievements during this period, both in terms of economic growth as well as social progress. After a brief background and review of the 1970s, the period will be put into broader perspective. The two prime ministers, Tun Razak and Tun Hussein, have been unfairly criticised for the increased government intervention and significant expansion of the public sector during the 1970s.

Before the 1970s

Independence or *Merdeka* in 1957 led by the Alliance coalition involved an agreement with the British to secure formal, legal and political independence while protecting acquired property rights from the colonial period, especially in the form of foreign investment in general, and British investment in particular. British Malaya had an Emergency from 1948 to 1960 so that the British would not have to declare war, in order for insurance coverage and payments to plantation and other owners in this country to proceed as if in peacetime.

Incentives for foreign direct investment were extended. Post-colonial efforts to try to diversify the economy involved incentivising import, substituting industrialisation to produce, process and package manufactured goods previously made and imported from abroad. The 1960s was also a period characterised by low rubber prices after the Korean War boom early in the previous decade. This encouraged powerful plantation interests to switch to oil palm cultivation instead.

From the late 1950s, initially for counterinsurgency purposes, and subsequently for other political purposes as well, there was a strong emphasis on rural development. Two of the most popular politicians of the late 1950s and early 1960s were Tun Razak, associated with rural development and the Federal Land Development Authority (Felda), and his rival, Aziz Ishak, the first Minister of Agriculture and Cooperatives, later detained under the Internal Security Act after leaving the United Malays National Organisation (UMNO) to form a radical nationalist party, the *Parti Perhimpunan Kebangsaan* or National Convention Party.

The year 1963 saw the establishment of the Malaysian common market, initially involving Singapore. But it remained a relatively small common market, not much greater than the Malayan market, and hence did not provide a much needed boost to economic expansion through import substitution industrialisation. As a consequence, during the 1960s, unemployment and inequality went up. But regardless of actual trends, much of this was perceived through ethnic lenses. For many Malays, it was Chinese merchants who were responsible for continued Malay poverty. Meanwhile, the lack of progress for most Chinese was due to the Malay-dominated government. As a consequence, especially after the suppression of the Malayan left, ostensibly because of its association with Sukarno's opposition to the formation of Malaysia in 1963, and some other aspirations of the regional left during the mid-1960s, Malaysian politics has been dominated by rival ethno-populisms.

As a consequence, much more explicitly ethnic appeals and divisions became the "only game in town". This provided the background to the events of the mid- and late 1960s. The first Bumiputera Economic Congress was convened in 1965, with the establishment of Bank Bumiputera following shortly thereafter; a number of other affirmative action initiatives also began from the mid-1960s. Nonetheless, such reforms were probably "too little too late" and were not able to avert the political mobilisation, which resulted in the electoral results of May 1969 when half the population voted against the ruling Alliance coalition, including almost half the Malay population. Thus, although it has become commonplace to refer to the divide as essentially ethnic, it was not a straightforward ethnic divide of non-Malay opposition to and Malay support for the Alliance. The majority of non-Malays and almost half the Malays voted against it.

The New Economic Policy

The 1970s saw a very fundamental change in the nature and role of the government. Tun Razak, who had taken over leadership of the government, sought to broaden the political basis for continued governance of the country. He tried to do so through a number of measures, including bringing in new coalition partners from the opposition in the 1969 elections, by working with the Gerakan leader, Penang Chief Minister Dr Lim Chong Eu and PAS leader, Kelantan Mentri Besar Dato' Asri Muda, to eventually forge the Barisan Nasional coalition.

The NEP was announced in 1970s, making a strong commitment to greater inter-ethnic affirmative action as well as eliminating poverty. In particular, given the primarily rural location of the poor then, there was a very strong emphasis on more rural development efforts. The inability of the import-substituting industries of the 1960s to continue growing and creating many jobs led to a switch to export oriented industrialisation.

Not relying on the domestic market by producing for export was expected to earn more foreign exchange and to create more jobs. The two biggest manufacturing subsectors which emerged were electronic and electrical industries as well as textiles and garments. Interestingly, most of the new jobs created – especially in garments and electronic assembly – employed women. Thus, the role of women was fundamentally transformed by transformations of the 1970s, and this continues to affect Malaysian society to this day, but has not been the subject of much analysis.

After Tun Hussein took over from Tun Tan Siew Sin as finance minister, Malaysia became more explicitly Keynesian and less obsessed with maintaining annual budgetary balance. When rubber and other prices fell in 1974, for example, the government undertook what can be termed "counter-cyclical spending" to overcome the effects of the economic downturn. Later, while prime minister in 1980-1981, he supported a similar effort by then Finance Minister Tengku Razaleigh after US Federal Reserve chair Paul Volcker induced an international economic recession by sharply raising interest rates to deal with persistently high inflation.

In recent decades, it has become fashionable, in the Anglophone West and among Malaysians similarly oriented, to criticise public spending as necessarily inefficient and wasteful. Instead, various alternatives have been proposed, typically citing efficiency, rather than equity considerations. It is true that much Malaysian public spending leaves a lot to be desired, but it is useful to contrast the national experience with public expenditure on health versus education in this regard. Until the mid-1980s, Malaysia did rather well with health spending, with health indicators among the best in Asia. For decades now, the Malaysian government has spent more on education than most other governments in the region, but the outcomes have been much more modest. Most would agree that it has not gotten as much "value for money" from the expenditure on education in contrast to health.

In the colonial period as well as the in 1960s, public sector investments were largely limited to needed infrastructure and essential services although more developmental reform initiatives began from the 1950s in the counter-insurgency effort to win the "hearts and minds" of the population of Britain's most economically valuable colony. The ensuing transformation of the Malaysian economy and society involved significant public sector expansion.

Discovery of petroleum off the East Coast of Peninsular Malaysia provided considerable additional revenue right after the increase of oil prices from 1973. The government had more budgetary resources to spend, providing greater "fiscal space". This enabled not only more government spending, but also greater investments by the public sector and the proliferation of state-owned enterprises (SOEs), often ill-conceived, poorly developed or badly run. In 1975, the Industrial Coordination Act (ICA) was passed by parliament, partly driven by ministerial political ambitions to secure an advantage in the election of UMNO vice presidents. The ICA greatly enhanced government control of the manufacturing sector, resulting in massive capital flight.

Economic development and transformation

In this neo-liberal age, it is often presumed that the Malaysian economy grew fastest during the 1960s, after independence, but before state intervention, the economy grew under the NEP. Malaysian economic performance has been very susceptible to changes in the global economy as indicated in Chart 1. But Malaysian economic vulnerability has changed over time. Earlier, vulnerability to commodity prices was very important, but more recently, different patterns of demand for manufactured outputs have been more significant. For Mahathir enthusiasts, there is the widespread presumption of rapid growth under his leadership, at least before the 1997-1998 Asian financial crisis. Undoubtedly, there was rapid growth for a decade from the late 1980s under his leadership, but when considered against his entire 22 year tenure from mid-1981, it looks much less impressive as he engendered some of the major problems which undermined the record of his tenure. Especially since the 1990s, the Malaysian economy has become more vulnerable to movements on the capital account, as during the 1997-1998 crisis.

Malaysian economic growth performance was quite strong for about a decade before the 1997-1998 crisis. But it has never really recovered since the crisis. Since 1998, Malaysian economic growth has averaged about five percent. But on a per capita basis, it may be much lower as the contribution of foreign labour is not considered in official statistics. Needless to say, growth in the two decades since the 1997-1998 crisis appears to be about half the per capita average of over six percent in the decade before the crisis. Importantly, private investment has gone down dramatically since the crisis. Most attribute this to the collapse of foreign direct investment (FDI). FDI was never really all that high and has remained more or less at the same level since the mid-1990s, which is before and after the 1997-1998 crisis.

Many commentators on emerging markets and other developing countries are under the illusion that foreign investment leads and domestic investment follows. On the contrary, the bulk of the evidence suggests otherwise, which is domestic investment leads and foreign investment follows except, of course, where foreign investment has monopolised (exclusive) access to markets or technology. Clearly, domestic investor confidence fell significantly after the 1997-1998 crisis.

The collapse in private investment has been partially compensated for by increased government spending. Government spending has gone up, both in terms of government consumption as well as investment. Higher Malaysian government expenditure has been made possible by a constant fiscal deficit since 1998, which has been propping up economic growth. So, the relatively modest 5+ percent post-crisis growth rate – in contrast to the 8+ percent earlier – has been largely due to greater government spending. This consistent support for growth has been made possible only because of revenue streams associated with oil wealth, but depressed oil prices from late 2014 have posed new fiscal challenges.

A temporary increase in government spending during a downturn is desirable from a counter-cyclical point of view, but the Malaysian government fiscal policy has not been consistently counter-cyclical. Of course, deficit funded development expenditure can also be defended, but much of the increased expenditure has been for consumption, especially government consumption, rather than for investment, let alone productive investment. However, public sector borrowing from abroad (especially China) may have contributed to significant investments in infrastructure while generating a range of new related problems.

The decade of highest growth for the Malaysian economy since independence turns out to be the 1970s, under Tun Razak and Tun Hussein. Contrary to the widespread presumption that it was an interlude from otherwise impressive growth due to a necessary political compromise following May 1969, the 1970s was actually a period of high growth despite the vicissitudes due to international developments as well as the adverse consequences of "own goals", such as the 1975 Industrial Coordination Act (ICA), which appears to have deterred domestic private manufacturing investments.

Table 1: Malaysia: National Income, 1970, 1975, 1981

	1970	1975	1981
GNP (RM million)	11,644	21,606	55,602
National Income (RM million)	9,732	17,936	45,505
Population ('000)	10,877	11,868	14,128
Real GDP (RM million)	-	29,550	47,602
National Income per Capita (RM)	895	1,511	3,221

Sources: Bank Negara Malaysia, Quarterly Bulletin, various issues; Malaysia, Economic Report, various issues; Malaysia Institute of Economic Research.

Table 1 shows the rapid increase in output growth and national income under the leadership of Tun Razak and Tun Hussein. National income almost doubled between 1970 and 1975 and rose more than 150 percent in the following six years with corresponding increases in per capita income as population growth declined slowly. As real GDP or output increases were more modest, the income increases were undoubtedly boosted by higher commodity prices, particularly benefiting farmers while wage earners benefited from the declining unemployment and higher productivity.

Sectoral breakdown of GDP growth in Malaysia shows the beginning of the relative decline of primary production, both agriculture and mining, and a big increase in manufacturing growth. There was a big growth in manufacturing employment during the 1970s and for another decade from the late 1980s, with a corresponding decline in agriculture's share. The big expansion began in the 1970s, although the doubling of the number working in manufacturing was partly because of the low base at the end of the 1960s. However, manufacturing employment growth has slowed considerably in the last two decades since the 1997-1998 Asian financial crisis despite the massive national currency.

Table 2: Malaysia: Growth by Sector, 1965-1985 (% p.a.)

	1965-70*	1971-75	1976-80	1981-85
Agriculture, forestry and fishing	6.3	4.8	3.9	3.4
Mining and quarrying	1.1	0.4	8.9	6.0
Manufacturing	9.9	11.6	13.5	4.6
Construction	4.1	6.6	12.6	8.1
Electricity, gas and utility	8.1	9.8	10.2	9.1
Transport, storage and communications	3.0	13.0	9.6	8.4
Wholesale and retail trade, hotels and restaurants	3.2	6.3	8.2	7.0
Finance, insurance, real estate and business services	5.4	7.2	8.0	7.2
Government services	5.2	10.1	9.0	9.8
Other services	4.7	9.3	6.6	5.1
GDP at purchasers' price	5.5	7.1	8.6	5.8

* For Peninsular Malaysia only.

Note: GDP in 1965 prices for 1965-70; GDP in 1970 prices for 1971-80; GDP in 1987 prices for 1981-85.

In terms of structural change or sectoral transformation, manufacturing and services, which now contribute almost four-fifths of the total output, only contributed about half of the total output in 1970. Malaysia saw a dramatic transformation of its economy in terms of the rapid growth of manufacturing in the 1970s. Services' share also grew rapidly while agriculture's share declined although it continued to grow rapidly in absolute terms, before slowing down from the 1990s. In 1957, over 90 percent of Malaya's population lived in rural areas and has since moved to work in the mainly urban manufacturing and service activities, which grew more rapidly in the 1970s.

Table 3: Malaysia: Balance of Payments, 1965-1985 (RM million)

<table>
<tr><th></th><th>1965</th><th>1970</th><th>1975</th><th>1980</th><th>1985</th></tr>
<tr><td>Merchandise account</td><td>521</td><td>1,067</td><td>724</td><td>5,238</td><td>8,883</td></tr>
<tr><td>Exports</td><td></td><td>5,020</td><td>9,057</td><td>28,013</td><td>37,576</td></tr>
<tr><td>Imports</td><td></td><td>3,953</td><td>8,333</td><td>22,775</td><td>28,693</td></tr>
<tr><td>Services account</td><td>-86</td><td>-507</td><td>-983</td><td>-3,993</td><td>-4,957</td></tr>
<tr><td>Freight and insurance</td><td>-162</td><td>-325</td><td>-621</td><td>-1,781</td><td>-1,852</td></tr>
<tr><td>Other transportation</td><td>-16</td><td>-</td><td>-</td><td>-56</td><td>64</td></tr>
<tr><td>Travel[a]</td><td>-80</td><td>-105</td><td>-105</td><td>-885</td><td>-1,332</td></tr>
<tr><td>Government transactions</td><td>225</td><td rowspan="2">-77</td><td rowspan="2">-257</td><td>-7</td><td>-31</td></tr>
<tr><td>Other services</td><td>-53</td><td>-1,264</td><td>-1,806</td></tr>
<tr><td>Investment income</td><td>-255</td><td>-355</td><td>-727</td><td>-1,820</td><td>-5,434</td></tr>
<tr><td>Transfers</td><td>-58</td><td>-180</td><td>-79</td><td>-45</td><td>-14</td></tr>
<tr><td>Current account</td><td>122</td><td>25</td><td>-1,065</td><td>-620</td><td>-1,522</td></tr>
<tr><td>(% of GNP)</td><td>(1.4)</td><td>(0.2)</td><td>(-4.9)</td><td>(-1.2)</td><td>(-2.1)</td></tr>
<tr><td>Financial account</td><td>324</td><td>303</td><td>1,565</td><td>3,115</td><td>5,099</td></tr>
<tr><td>Official capital</td><td>174</td><td>20</td><td>869</td><td>180</td><td>2,504</td></tr>
<tr><td>Corporate investment</td><td>150</td><td>283</td><td>696</td><td>2,935</td><td>2,595</td></tr>
<tr><td>Errors and omission</td><td>-235</td><td>-260</td><td>-329</td><td>-1,493</td><td>-368</td></tr>
<tr><td>Overall balance</td><td>211</td><td>68</td><td>171</td><td>1,002</td><td>3,209</td></tr>
<tr><td>(% of GNP)</td><td>(2.4)</td><td>(0.6)</td><td>(0.8)</td><td>(1.9)</td><td>(4.5)</td></tr>
</table>

* Data are reorganised in consideration of changes in the format used by Bank Negara Malaysia.

[a] Includes education for 1985.

Sources: Bank Negara Malaysia, *Monthly Statistical Bulletin*, various issues; Ministry of Finance, Malaysia, *Economic Report*, various issues.

Rapid growth in the 1970s had important implications for external trade, as can be seen in Table 3, which reflects changes in its balance of payments over the two decades around the 1970s. While its merchandise exports grew rapidly, partly offset by rising imports, including manufacturing components for export-processing free trade zones (FTZs), the merchandise account surplus was offset by the fast-growing services account deficit. As Table 4 shows, primary commodity export growth accounted for much of the trade surplus. Owing to the FTZ incentives for foreign firms to practice transfer pricing, declared import and export prices probably overstated the value added in the Malaysian economy; foreign subsidiaries' payments for salaries, supplies and services are probably better measures of value addition as can be seen in input-output analysis.

Table 4: Malaysia: Commodity Exports, 1970-1980

Commodity	1970	1975	1980	Average Annual Growth Rate, 1971-1980 (%)
Crude Petroleum				
Volume ('000 tonnes)	4,696.2	3,794.5	11,226.9	9.1
Unit value ($/tonne)	43.1	226.9	597.6	30.1
Value ($ million)	202.6	861.0	6,709.1	41.9
*Palm oil**				
Volume ('000 tonnes)	401.9	1,160.6	2,258.2	18.8
Unit value ($/tonne)	657.5	1,136.9	1,152.7	5.8
Value (% million)	264.3	1,319.5	2,603.1	25.7
Rubber				
Volume ('000 tonnes)	1,345.4	1,456.9	1,525.7	1.3
Unit value (sen/kg)	128.1	138.8	302.7	9.0
Value ($ million)	1,723.7	2,025.6	4,618.03	10.4
Sawlogs				
Volume ('000 tonnes)	1,345.4	1,456.9	15,156.2	5.5
Unit value ($/cu. m.)	-260	138.8	-1,493	9.0

Value ($ million)	1,723.7	2,052.6	4,618.03	10.4
Tin				
Volume ('000 tonnes)	91.9	77.9	69.5	-2.8
Unit value ($/tonne)	10,938.7	15,473.9	36,049.0	12.7
Value ($ million)	1,005.6	1,206.1	2,505.3	9.6
Sawn-timber				
Volume ('000 tonnes)	1,392.9	1,883.5	3,245.2	8.8
Unit value ($/cu. m.)	147.7	233.9	414.2	10.9
Value ($ million)	205.8	440.6	1,344.1	20.6
Manufacturers				
Value ($ million)	615.0	1,786.0	6,269.8	26.1
Total gross commodity exports				
Value ($ million)	5,163.1	9,230.9	28,171.6	18.5

Note: *includes processed palm oil.

Sources: Bank Negara Malaysia, *Annual Report 1986, 1987*; Bank Negara Malaysia, *Quarterly Bulletin*, Vol. 1, No. 3, December 1988.

Table 5 shows public debt growing rapidly from mid-1975 after the discovery of offshore petroleum off the east coast of Peninsular Malaysia, the establishment of Petronas and the economic recession in that year. Thus, fiscal strategy changed, especially from the mid-1970s when Tun Hussein was finance minister, departing from the more conservative balanced budgets of the previous decade associated with his predecessor. As the public debt was growing rapidly, foreign debt's share of the total public debt rose from a quarter in 1975 to a third in 1981 when Tun Hussein stepped down as prime minister.

This analysis of Malaysia's economic development and transformation focuses on growth and distribution in the 1970s, the critical first decade of the NEP. This was reflected in changing employment patterns, including its changing sectoral distribution as in Table 6. The first decade of the NEP, under the leadership of Tun Razak and Tun Hussein, saw rapid and extensive structural transformation. This transformation has been very significant, especially in terms of the share of services (Khong and Jomo, 2010).

Table 5: Malaysia: Public Debt, 1975-1981 (RM million)

Year	*1965*		*1970*		*1975*	
	Domestic Debt		External Debt		Total Public Debt	
	Amount (%)	Annual Increase (%)	Amount (%)	Annual Increase (%)	Amount	Annual Increase (%)
1975	8,927 (75)		3,013 (25)		11,940	
1976	10,573 (71)	1,646 (18)	4,312 (29)	1,299 (43)	14,855	2,945 (25)
1977	12,709 (73)	2,136 (20)	4,740 (27)	428 (10)	17,449	2,564 (17)
1978	14,074 (72)	1,365 (11)	5,439 (28)	699 (15)	19,513	2,064 (20)
1979	16,744 (72)	2,670 (19)	6,636 (28)	1,197 (22)	23,380	3,867 (20)
1980	19,206 (72)	2,462 (15)	7,264 (28)	628 (9)	26,470	3,090 (13)
1981	29,929 (67)	3,723 (19)	11,231 (33)	3,967 (55)	34,170	7,700 (29)

Sources: *Economic Report 1987/88*, Table 8.6; Bank Negara Malaysia, *Annual Report, 1987*, Table 4.1.

Employment statistics also suggest dramatic changes since Malayan independence, with a major increase in wage employment among Malays and other Bumiputeras as well as Chinese, with a corresponding decline of unpaid family workers as well as own account workers, which are the self-employed. The number of wage earning Malaysians among those working has also significantly increased.

Table 6: Employment by Sector, 1970, 1982 (%)

Year	1970	1982
Agriculture, forestry, livestock and fishing	53.5	31.2
Mining and quarrying	2.6	1.0
Manufacturing	8.7	15.5
Construction	2.7	7.2
Services	32.5	45.1

Source: Department of Statistics Malaysia.

Unemployment rates declined from eight percent in 1970 to 6.7 percent in 1975 and 5.6 percent in 1980. From 1980, the US Federal Reserve Chair Paul Volcker sought to rein in US inflation by raising the interest rate to 26 percent, effectively bringing the world economy to a standstill from 1981. But growth and unemployment in Malaysia was less adversely affected as the government initially engaged in deficit financing to fund a counter-cyclical fiscal strategy. After a growth slowdown during the mid-1980s, there has been low unemployment despite growing reliance on foreign labour.

It was a period of rapid growth with redistribution, long before the recent appreciation of the need for greater equity in the West, particularly over the last half decade. Interest in growing inequity grew following the 2008 financial crisis and subsequent protracted recession resulting in the re-emerging consensus that lower inequality and progressive income redistribution are not inimical to high growth after several decades of Thatcherite Washington Consensus faith to the contrary. To be sure, this was recognised in the 1930s and during the post-World War II Golden Age, but the counter-revolution against Keynesian and development economics from the 1980s subsumed this in subsequent decades.

The second half of the 1970s saw the highest average growth for any half-decade Malaysia Plan period of 8.6 percent from 1976 to 1980. The only other comparable period of high growth in Malaysia was during the first half of the 1990s, from the late 1980s until the 1997 Asian financial crisis, which saw growth averaging eight percent.

The rising yen, from 1985 to 1995, gave rise to the Japanese *endaka*, or "high yen" period. Due to the strong yen and Korean won, as well as full employment, there was a big shift of industries from these Northeast Asian countries to China and Southeast Asia, especially to Malaysia and Thailand. Meanwhile, the ringgit, baht and rupiah had been deliberately depreciated during the mid-1980s, further lowering production costs to foreign investors. In contrast, growth averaging 8.6 percent from 1976 through 1980 was largely due to domestic factors, not favourable international circumstances.

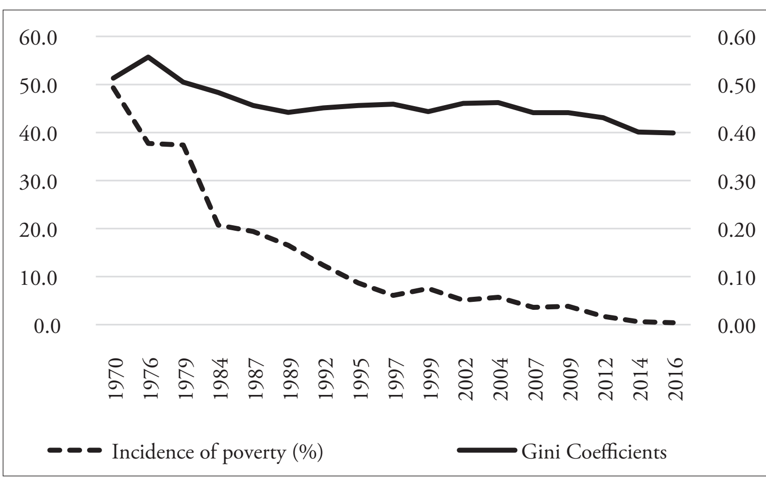
The official poverty rate has also fallen. The expansion of public investments during this period helped accelerate the huge reduction of poverty during the 1970s. Between 1970 and 1984, poverty declined from 49.3 to 20.7 percent. As Table 7 shows, the significant improvements in general living standards was not confined to urban areas, but also the countryside.

Table 7: Poverty Rate, 1970-1984 (%)

	1970*	1984
Total	49.3	20.7
Rural	58.6	27.3
Urban	24.6	8.5

*Peninsular Malaysia only.
Source: Department of Statistics Malaysia.

Figure 2: Poverty Rate, Gini Ratio, 1970-2016



Source: Department of Statistics Malaysia.

However, as Figure 2 shows, official Malaysian data suggest not only a decline of poverty, but also of overall inequality, not just of inter-ethnic disparities. Average gross household incomes have significantly increased for all ethnic groups, including the bottom 40 percent of the population, as Table 8 shows, although the increase in average incomes has been greatest for the top fifth of households. The Gini coefficients suggest that household income inequality rose during the 1970s, but declined thereafter. Meanwhile, between 1970 and 1984, Bumiputera inequality[1] came down from 51 to 46 percent, while overall inequality went down much more from 58 to 48 percent. Thus, overall inequality came down faster than Bumiputera inequality in this period which also saw the beginning of big increases in the numbers of Malay professionals and senior officials.

Table 8: Mean Gross Household Incomes by Income Grouping, 1970-1984

Year	*Top 20%*	*Middle 40%*	*Bottom 40%*
1970	3,111	914	322
1979	4,781	1,411	512
1984	5,610	1,058	663

Source: Department of Statistics Malaysia.

Table 8 also suggests decreasing overall income disparities, but this may be due to the coverage provided by official statistics. As Table 9 shows, except for 1976, perhaps due to the nature of the source of the data used, the changes were quite modest during these early NEP years. As the presence and share of foreign labour in the Malaysian economy have grown very significantly since the 1980s, and they – especially the many more undocumented foreign workers in agriculture, construction and services – are not covered by official statistics, measures of inequality in Malaysia have been greatly affected by excluding this sizeable "underclass" of undocumented foreign workers from official statistics.

Table 9: Peninsular Malaysia: Household Income Shares by Income Group, 1970-1984

Total	1970	1973	1976	1979	1984
Top 20%	55.9	53.7	61.9	54.7	53.2
Middle 40%	32.5	34.0	27.8	34.4	34.0
Bottom 40%	11.6	12.3	10.3	10.9	12.8

Sources: Malaysia Plan documents; Ikemoto, 1985; Jomo and Ishak, 1986.

[1] The Gini coefficient is the most widely used measure of equality and inequality. A Gini coefficient of zero means absolute equality. If all of us have the same income, our group would have Gini coefficient of zero. If only one has all the income and others have nothing, a Gini coefficient of one signifies total inequality. The higher the inequality, the higher the Gini coefficient.

Meanwhile, most countries in the West, the former Soviet Union, China and most developing countries have experienced rising inequality over the same period. Only Northern Europe and Northeast Asian countries (South Korea and Japan) appear to have maintained low inequality, while some countries in South America saw declines in inequality in the first decade of the new century after decades of rising inequality.

What does all this mean in terms of inter-ethnic economic disparities, which Malaysians have been obsessed with? There has been an apparent reduction in inter-ethnic income disparities over the last four decades, especially during the 1970s and 1980s. As Table 10 shows, in 1970, average Chinese income was 2.3 times average the Bumiputera income. By 1984, it was down to 1.76 from 2.3 in 1970, suggesting a significant decline in inter-ethnic average income disparities.

Table 10: Peninsular Malaysia: Mean Monthly Household Incomes by Ethnic Group and Stratum, 1970-1984 (in constant 1978 prices)

	1970	1973	1976	1979	1984
All ethnic groups	423	502	566	669	792
Bumiputera (B)	276	335	380	475	616
Chinese (C)	632	739	866	906	1086
Indian (I)	478	565	592	730	791
Others	1304	1798	1395	1816	1775
Urban (U)	687	789	913	942	1114
Rural (R)	321	374	431	531	596
Disparity ratio (C/B)	2.3	2.21	2.28	1.91	1.76
Disparity ratio (I/B)	1.73	1.69	1.56	1.54	1.28
Disparity ratio (U/R)	2.14	2.11	2.12	1.77	1.87

Source: Malaysia Plan documents.

As Table 11 shows, NEP allocations for poverty eradication grew tremendously, especially under Tun Razak and Tun Hussein, from the Second Malaysia Plan (2MP, 1971-1975) to the Fourth Malaysia Plan (4MP, 1981-1985). Tun Hussein stepped down as Malaysia's third prime minister in mid-1981 after announcing the 4MP, which was significantly revised by his successor Tun Dr Mahathir. The total committed increased far more than inflation, from RM2.9 billion for the 2MP to RM9.0 billion for the Third Malaysia Plan (3MP, 1976-1980) and RM14.0 billion for the 4MP.

Table 11: Allocations for Poverty Eradication and Restructuring of Society under the 2MP (1971-1975), 3MP (1976-1980), 4MP (1981-1985)

Poverty	%	Restructuring	%	Overlapping[b]	%	Total	%
Second Malaysia Plan, 1971-1975[c]							
2,350.0	26.3	508.3	5.6	3.4	-	2,861.7	31.9
Third Malaysia Plan, 1976-1980[d]							
6,373.4	20.5	2,376.0	7.6	149.0	0.5	8,898.4	28.6
Fourth Malaysia Plan, 1981-1985[e]							
9,319.2	23.7	4,397.6	11.2	300.5	0.8	14,017.3	35.7

Notes:
[b] Programmes/projects contributing to both poverty eradication and restructuring.
[c] Based on the Federal Allocation of $8,950m for the 2MP.
[d] Based on the Federal Allocation of $31,147m for the 3MP.
[e] Based on the Federal Allocation of $839,330m for the 4MP.

Source: Malaysia Plan documents.

Table 12 shows poverty rates among those engaged in different economic activities by occupation and sector. Clearly, all these have much bearing on the likelihood of being poor, most evidently in agriculture, with poverty especially high among rice farmers, rubber smallholders, fishermen and coconut smallholders. However, the table suggests uneven progress over the period 1970-1984 with poverty continuing to be associated most with rice farmers and rubber smallholders. Clearly, progress also involved many moving out of occupations most associated with poverty to take on employment in other, presumably more remunerative, activities.

Table 12: Peninsular Malaysia: Incidence of Poverty by Economic Activity, 1970, 1976, 1984

Stratum	1970			1976			1984		
	Total households ('000)	Total poor households ('000)	Incidence of poverty (%)	Total households ('000)	Total poor households ('000)	Incidence of poverty (%)	Total households ('000)	Total poor households ('000)	Incidence of poverty (%)
Rural	1,203.4	705.9	58.7	1,400.8	669.6	47.8	1,629.4	400.0	24.7
Rubber smallholders	350.0	226.4	64.7	126.7	73.8	58.2	155.2	67.3	57.7
Padi farmers	140.0	123.4	88.1	187.9	150.9	80.3	116.6	80.3	116.6
Estate workers	148.4	59.4	40.0	-	-	-	81.3	16.0	19.7
Fishermen	38.4	28.1	73.2	28.0	17.6	62.7	34.3	9.5	27.7
Coconut smallholders	32.0	16.9	52.8	19.3	12.4	64.0	14.2	6.6	46.9
Other agriculture	144.1	128.2	89.0	528.4	275.4	52.1	464.2	158.8	34.2
Other industries	350.5	123.5	35.2	510.5	139.5	27.3	763.6	76.5	10.0
Urban	402.6	85.9	21.3	530.6	94.9	17.9	991.7	81.3	8.2
Agriculture	-	-	-	24.8	10.0	40.2	37.5	8.9	23.8
Mining	5.4	1.8	33.3	4.5	0.5	10.1	7.8	0.3	3.4
Manufacturing	84.0	19.7	23.5	55.3	9.5	17.1	132.3	11.3	8.5
Construction	19.5	5.9	30.2	34.7	6.1	17.7	86.6	5.3	6.1
Transport and Utilities	424.4	13.1	20.9	53.2	9.1	17.1	73.9	2.7	3.6
Trade and Services	253.3	45.4	18.1	9.0	33.7	13.9	472.7	21.9	4.6
Authorities not adequately defined	-	-	-	116.1	26.0	22.4	180.9	30.9	17.1
Total	1,606.0	791.8	49.3	1,931.4	764.4	39.6	2,621.1	483.3	18.4

Source: Malaysia Plan documents.

Table 13: Malaysia: Incidence of Poverty by State, 1970, 1976, 1984

State	1970			1976			1984		
	Total households	Total poor households	Incidence of poverty	Total households ('000)	Total poor households ('000)	Incidence of poverty (%)	Total households ('000)	Total poor households ('000)	Incidence of poverty (%)
Johor	1,158	520	45.7	268.1	77.8	29.0	365.8	44.5	12.2
Kedah	1,550	966	61.0	216.3	131.9	61.0	253.9	93.0	36.6
Kelantan	1,383	1,044	74.1	167.8	112.7	67.1	206.7	81.0	39.2
Melaka	291	131	34.7	85.8	27.8	32.4	95.1	15.1	15.8
Negeri Sembilan	494	241	50.5	106.0	35.0	33.0	132.8	17.3	13.0
Pahang	584	325	56.1	115.4	44.9	38.9	190.9	30.0	15.7
Pulau Pinang	405	209	52.7	150.1	48.6	32.4	204.2	27.4	13.4
Perak	1,501	833	52.2	340.7	146.4	43.0	400.2	81.1	20.5
Perlis	292	187	63.2	29.7	17.8	59.8	40.1	13.5	33.7
Selangor	672	287	42.7	211.4	48.3	22.9	359.2	31.0	8.6
Terengganu	558	380	65.1	100.6	60.7	60.3	129.9	37.6	28.9
Kuala Lumpur	-	-	-	139.4	12.5	9.0	242.1	11.8	4.9
Peninsular Malaysia	8,888	5,123	56.7	1,931.4	764.4	39.6	2,621.1	483.3	18.4
Sabah[1]	-	-	-	161.9	95.5	58.3	299.8	76.0	33.1
Sarawak	-	-	-	205.1	115.9	56.6	282.2	90.1	31.9

Note: [1]Includes Federal Territory of Labuan.

Sources: Sudhir Anand, *Inequality and Poverty in Malaysia: Measurement and Decomposition*, Table 5.3, 1983; *Fifth Malaysia Plan, 1986-1990*; *Mid-Term Review of the Fifth Malaysia Plan, 1986-1990*.

Table 13 shows changing poverty rates over the same period in different Malaysian states with poverty rates highest in Kelantan, Terengganu, Kedah and Perlis in Peninsular Malaysia in 1970. When data on Sabah and Sarawak for 1976 became available, it was clear that poverty was very high in the two Borneo states as well. The table suggests that poverty incidence in the peninsular fell from 56.7 percent in 1970 to 39.6 percent in 1976 to 18.4 percent in 1984. Between 1976 and 1984, the poverty rate fell from 58.3 percent to 33.1 percent in Sabah and from 56.5 percent to 31.9 percent in Sarawak. Table 14 shows the declining incidence of poverty among the major ethnic groups by region. Clearly, leaving aside "Others", poverty has been highest among the Bumiputera, followed by Indians.

Table 14: Malaysia: Incidence of Poverty by Ethnic Groups, 1976, 1984

	1976		1984	
	Total poor households ('000)	Incidence of poverty (%)	Total poor households ('000)	Incidence of poverty (%)
Peninsular Malaysia				
All ethnic groups	688.3	35.1	483.3	18.4
Bumiputera	519.4	46.4	388.8	25.8
Chinese	109.4	17.4	66.1	7.8
Indians	53.8	27.3	25.0	10.1
Others	5.7	33.8	3.4	22.0
Sabah				
All ethnic groups	83.9	51.2	76.0	33.1
Bumiputera	69.5	82.9	73.1	39.2
Chinese	4.8	5.7	2.4	6.2
Others	9.6	11.4	0.5	12.4
Sarawak				
All ethnic groups	1.73	1.69	1.56	1.54

Bumiputera	92.0	85.9	82.3	41.6
Chinese	15.0	14.0	7.7	9.3
Others	0.1	0.1	0.1	4.0
Disparity ratio (U/R)	2.14	2.11	2.12	1.77

Sources: *Fourth Malaysia Plan 1981-1985*; *Fifth Malaysia Plan 1986-1990*.

Table 15: Malaysia: Registered Professionals[1] by Ethnic Group, 1970-1983

	Bumiputera		Chinese		Indians		Others		Total
1970[2]	225	4.9%	2,793	61.0%	1,066	23.3%	492	10.8%	4,576
1975[3]	537	6.7%	5,131	64.1%	1,764	22.1%	572	7.1%	8,004
1979	1,237	11.0%	7,154	63.5%	2,375	21.1%	496	4.4%	11,262
1980	2,534	14.9%	10,812	63.5%	2,963	17.4%	708	4.2%	17,017
1983	4,496	18.9%	14,933	62.9%	3,638	15.3%	699	2.9%	23,766

Notes:
[1] Architects, accountants, engineers, dentists, doctors, veterinary surgeons, surveyors, lawyers.
[2] Excluding surveyors and lawyers.
[3] Excluding surveyors.

Source: Malaysian plan documents.

Society restructuring efforts have seen significant changes in employment and occupational distribution by ethnicity. Inter-ethnic disparities have greatly declined in most occupations. One exception is agriculture, where the Bumiputeras are more dominant than ever. Meanwhile, the proportion of ethnic Indians in agriculture, even plantations, has also declined greatly. The rapid rise of trained Bumiputera professionals between 1970 and 1983 and the relative decline of Indians and Others is reflected in Table 15.

The main bone of contention in Malaysian political economy public discourse has been over wealth ownership by ethnicity. Much of the increase in the share of Bumiputera capital was achieved during the 1970s, from 1.5 percent in 1969 to 15.6 percent in 1982. The share has risen more slowly and inconsistently since, implying that the big increase was during the 1970s. Previously much of this was held for the Bumiputera community in trust. The establishment of Permodalan Nasional Berhad (PNB) and Amanah Saham Nasional (ASN) was an important prelude to the subsequent privatisation of such community assets.

Table 16: Malaysia: Ownership of Share Capital (at par value) of Limited Companies, 1969, 1975, 1982

Ownership Group	1969 %					1975 %				1982 %	
Malaysian residents		37.9					46.7				65.3
Bumiputera individuals and trust agencies		1.5					9.2				15.6
Bumiputera individuals		1.0					3.6				7.5
Trust Agencies		0.5					5.6				8.1
Other Malaysian residents		59.6					37.5				49.7
Chinese		22.8					-				33.4
Indians		0.9					-				0.9
Foreign residents	2,909.8	62.1	3,377.1	63.4	4,051.3	8,037.2	53.3	13,927.0	42.9	16,970	34.7
Total (RM million)	3,286.0		5,329.2		6,546.1	15,064.4		32,420.4		48,873.8	

Source: Malaysia Plan documents.

The shares held by foreigners went down dramatically in the 1970s, from 62.1 percent in 1969 to 34.7 percent in 1982, especially following government purchases of stock in British agency houses, plantation and mining companies, which were then listed on the Malaysian bourse. It has gone up again to over 40 percent after the Asian financial crisis in 1997-1998 and may well have gone up further over the last decade with the availability of easy, cheap credit, thanks to unconventional monetary policies, such as "quantitative easing" since the beginning of this decade.

Bumiputera share ownership has undoubtedly increased significantly since the 1970s, but is understated by using par values rather than market values, which are also changing constantly. As better stock has been acquired by foreigners and the state, the market value of their shares may be higher than suggested by par values, as claimed by some studies. Especially following privatisation from the mid-1980s, there has been a rise in the share of individual Bumiputera wealth. Despite the emergence of Bumiputera wealth owners, it remains unclear to what extent they have successfully gone beyond capturing rents to become more entrepreneurial.

In the 1970s, high growth was accompanied by some redistribution. There are still concerns with redistribution today, with quite different priorities from the redistribution of the 1970s. Redistribution continues today, but increasingly benefits a relatively small number who benefit from the opportunities offered by privatisation. Regardless of intent and priorities, however, linking the question of redistribution and equity to ethnic politics has reinforced “ethno-populism”, with related clientelism now deeply embedded in Malaysian politics. Related to this are various types of corruption, with the resultant short-termism especially problematic for sustained development prospects. This is problematic for the nation today as well as for the future. In the 1970s, there was a strong shared sense of the national interest and the public purpose. Contrast that with the patronage widespread today, providing “jobs for the boys”, and so on.

Finance has been expected to serve the real economy. In the 1970s, the authorities demanded that a certain amount of credit had to go to manufacturing to encourage the sector’s growth. This requirement has since been dropped as finance became more dominant, as lending becoming less supportive of the development of the real economy, with lending for housing, for example, more than ample. Part of the reason why the world economy slowed down from 2009 was because the preceding US housing bubble was facilitated by generous bank lending. When the bubble burst, it was not only the lending banks who were in trouble, but also the various financial institutions throughout the world, which had invested in various derivative debt instruments, such as collateralised debt swaps (CDSs), often in extended pyramid-like arrangements.

Now, things are very different. There is still a very big emphasis on foreign investments in Malaysia, with the figure for foreign portfolio investments in the Malaysian stock market probably now well over 40 percent, up from 38 percent in 2008. Historically, state-owned or public enterprises were set up in Malaysia mainly because government departments were not well suited or unable to undertake certain responsibilities in terms of infrastructure and service provision. Such arguments may still be relevant today, some may never have been relevant in the first place, while some may have been relevant before, but are no longer relevant today.

Related to this strong shared sense of the public interest and the public purpose is a strong sense of responsibility, which prevailed in the 1970s. The kind of checks and balances for leaders like Tun Razak and Tun Hussein were those associated with the rule of law, not banks, perhaps because they were trained as lawyers. For example, after Tun Hussein became prime minister, he proceeded to prosecute the Bank Rakyat case instead of seeking a convenient political compromise. This was meant to be exemplary, to deter abuse and breach of trust by those in positions of power and authority. Unfortunately, such priorities are largely lost now, and the converse has become the case as political office is increasingly sought for the associated rentier opportunities available.

The preceding review suggests several priorities for reconsideration: an emphasis on the real economy, rather than finance; on pragmatism, not dogma; on national interest, rather than sub-national, especially ethnic interests; on the public interest, rather than narrow group or sectarian interests; on accountability, for which transparency is needed. In this connection, it is also important to remember that Malaysia has committed itself to trying to achieve the SDGs.

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2

From Environment to Sustainable Development

Within half a decade of the 1972 United Nations (UN) Conference on the Environment (Stockholm Conference), Malaysia had passed the Environmental Quality Act of 1974 and, in 1975, introduced a chapter on the environment in the Third Malaysia Plan (1976-1980). Under Tun Hussein Onn's Prime Ministership, Malaysia quickly went beyond mere rhetorical professions of commitment to sustainability and environment, to concrete policies and actions.

Since then, we have come a long way. At the 1992 Earth Summit in Rio de Janeiro, Brazil, further commitments were made to sustainable development. Two decades later, following the Rio+20 Conference in 2012, Sustainable Development Goals (SDGs) were unanimously embraced by the membership of UN in 2015.

Sustainable Development Goals

There are 17 SDGs and they are:

1. End poverty in all its forms everywhere;
2. End hunger, achieve food security and improved nutrition and promote sustainable agriculture;
3. Ensure healthy lives and promote well-being for all at all ages;
4. Ensure inclusive and equitable quality education and promote life-long learning opportunities for all;
5. Achieve gender equality and empower all women and girls;
6. Ensure availability and sustainable management of water and sanitation for all;

7. Ensure access to affordable, reliable, sustainable and modern energy for all;
8. Promote sustained, inclusive, sustainable economic growth, full and productive employment and decent work for all;
9. Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation;
10. Reduce inequality within and among countries;
11. Make cities and human settlements inclusive, safe, resilient and sustainable;
12. Ensure sustainable consumption and production patterns;
13. Take urgent action to combat climate change and its impacts;
14. Conserve and sustainably use oceans, seas and marine resources for sustainable development;
15. Protect and promote sustainable use of terrestrial ecosystems, sustainably manage forests, halt and reverse land degradation and biodiversity loss;
16. Promote peaceful and inclusive societies for sustainable development, provide access to justice for all and build effective, accountable and inclusive institutions at all levels; and
17. Strengthen the means of implementation and revitalise the Global Partnership for Sustainable Development.

The 17 SDGs have often been criticised for being too long and unwieldy, but then, internationally negotiated commitments rarely come out very neatly. Unlike the Millennium Development Goals (MDGs), the SDGs were internationally negotiated, and hence more legitimate, with countries having a greater sense of commitment to the SDGs. The MDGs were prepared by a committee within the UN Secretariat, which took the Millennium Declaration, also drafted by the Secretariat, as its starting point. It was not internationally negotiated. International agreements are much more difficult to achieve, but are essential for making human progress. As we look around the world today, multilateralism is greatly threatened. Powerful countries are turning to unilateralism and bilateralism to achieve their ends, undermining the multilateral system and even their own plurilateral arrangements in the process. It is essential for countries to renew commitment to the multilateral order in these difficult times.

At the same time, we have seen a number of important developments that threaten the now almost universal commitment to sustainable development. In 2015, two developments are especially relevant to consider.

First, the July 2015 Third International Conference on Financing for Development (FfD) held in Addis Ababa, Ethiopia, failed to make serious commitments on the means of implementation for the SDGs, most notably to significantly enhance international cooperation on taxation. Then, in December of the same year, the Conference of Parties (CoP) of the UN Framework Convention on Climate Change (UNFCCC), otherwise known as the Paris Agreement, only achieved voluntary commitments. The two are quite crucial for the achievement of the SDGs.

The Paris Agreement thus ineffectively replaced the Kyoto Protocol, which the United States (US) was not a signatory to. Most informed observers would agree that neither the 1997 Kyoto Protocol nor the 2015 Paris Agreement were adequate to meeting the challenges of climate change. It is important to consider this seriously.

In addressing climate change and the challenges it raises, it is useful to distinguish between climate action and climate justice. The commitment to climate action, particularly by Western economies, is certainly commendable. But often climate action treats all countries equally without recognising inequalities and disparities among countries. It inadvertently results not only in new inequalities, but also in uneven progress, owing to different capacities to endeavour to reach identical targets.

For example, a commitment to cutting down energy use has very different implications in poor countries and rich countries. That is why climate action without recognising the need for sustainable development implies a cruel trade-off that often comes up with seemingly fair solutions, such as raising the carbon price. Instead, many people, like former Irish President Mary Robinson, have been advocating climate justice, which recognises the requirements of sustainable development.

The Khazanah Research Institute has studied three important issues affecting Malaysia, but this is not on the radar of many people.

Genetically modified organisms

The first of these is genetically modified organisms or popularly known as GMOs. Genetic modification takes place all the time and can happen quite naturally, for example, when orchid growers crossbreed different species in their gardens. Genetic engineering (GE) is a more specific type of genetic modification. This typically involves the artificial introduction of external organic matter, such as alien bacteria, thus effectively creating new organisms.

There has been a great deal of debate in the West on the desirability of genetic engineering given potentially serious safety concerns. In pharmacological trials, there is an appropriate time lag to monitor the after-effects of the introduction of new medicines in line with the precautionary principle. One would imagine that the same caution would be applied to GMOs. There is also the danger that GMOs that have what is popularly called a "terminator gene" may render non-GMO plants in neighbouring fields sterile through cross-pollination.

The main arguments for GMOs and GE are that the world's population will grow to around nine million by 2050 and thus productivity of food production needs to be raised and that GMOs will reduce the fertilisers and pesticides needed in production.

There are reasons to be cautious about these arguments. First, possibly over a billion people in the world go hungry not just because they cannot produce enough food for themselves or they do not have the means to buy what they need in the market. The determinants are not simply economic. Dietary changes over the past half-century have changed the type of food needed. Urbanisation, long commuting times to and from work, and lifestyle changes, induced by advertising, peer pressure and new norms, mean there is a preference for convenience foods.

Second, a New York Times article[1] published last year summarised a great deal of information about maize and wheat production. Contrary to the hype, it found that there is actually very little evidence that productivity increases in the US, where the use of

[1] "Broken Promises of Genetically Modified Crops", *The New York Times*, 29 October 2016, https://www.nytimes.com/interactive/2016/10/30/business/gmo-crops-pesticides.html.

GMOs are widespread, are significantly higher than Europe, where less controversial means of raising productivity are used.

Third, and more fundamentally, US farmers planting GE organisms are now more reliant on agrochemicals and not less. The evidence contradicts the claims of GE proponents who continue to argue that GE reduces farmers' costly reliance on agrochemicals to raise productivity. Despite the irrefutable evidence to the contrary, advocacy of GE continues unaffected.

Anti-microbial resistance

Second, with respect to animals as a food source, there is the danger of anti-microbial resistance (AMR) or the decreasing efficacy of antibiotics. Animals carry many bacteria as part of their microbiomes, most of which are not only necessary for bodily functions, but also benign in terms of not causing morbidity. However, all bacteria, benign or malignant, are adversely affected by the use of antibiotics.

Many bacteria also defensively mutate when exposed to antibiotics intended to eliminate them. As a consequence, new bacteria that are more resistant to existing antibiotics may emerge, some of which may be malignant. The typical medical response is to use stronger antibiotics, but these have adverse side effects. Antibiotics that can be effectively deployed against new bacteria may also not exist as no new antibiotics have been discovered in the last three decades.

Excessive use of antibiotics in aquaculture, poultry farming and livestock breeding has similar biochemical and health effects and consequently on the products that we eat, such as meat and dairy products. The US Department of Agriculture (USDA) has estimated that the use of antibiotics is more than four times that of USDA recommended levels. As the US is the world's largest food exporter by far, this has health consequences well beyond its borders. In other societies, such numbers are often unknown or doubted because there is little effective, transparent and hence credible monitoring.

Jim O'Neill was the Chair of Goldman Sachs Asset Management in 2001 when he coined the abbreviation BRICS to refer to Brazil, Russia, India, China and later, South Africa. In July 2014, he was asked by the United Kingdom Prime Minister to assess the threat posed by growing AMR. His report[2] has largely been corroborated by the three main international agencies working on this issue, namely the World Health Organization (WHO), the Food and Agriculture Organization (FAO), and the Paris-based World Organization for Animal Health (OIC). They estimate that about 700,000 people die every year due to AMR. This number is expected to go up exponentially to about ten million by mid-century or in slightly over three decades.

We are going to have serious problems with the declining efficacy of antibiotics as the number of antibiotics available is very limited and there has not been any new group of antibiotics available since the 1980s. As most are not subject to strong intellectual property rights, they are cheaply available. Farmers and others are quite happy to use them liberally because of their presumed prophylactic effects in preventing diseases. Some even believe that they serve as growth hormones, enhancing the animals' body mass. Although they are not growth hormones, by temporarily preserving the health of the animals, they may appear to have growth enhancing effects.

Malaysia's shrimp trade scam

A rather sordid tale of the international shrimp trade involving Malaysia came to light in 2016. Malaysia reportedly exported about 20,000 tonnes of shrimp to the US between 2006 and 2015. Malaysian shrimp output was 32,000 tonnes while consumption in Malaysia was around 18,000 tonnes. Another 12,000 tonnes went to Singapore, presumably for consumption there, leaving only 2,000 tonnes for exports.

Yet the US imported 20,000 tonnes from Malaysia. Where did the remaining 18,000 tonnes come from? They actually did not come from Malaysia, but probably from China and Thailand, which were on the US Customs and Border Protection's Watchlist, requiring 100 percent checks on all shrimp imports. Then Malaysia too was added to the Watchlist and only then did the Ministry of Health in Malaysia take over responsibility for certification of shrimp exports.

[2] *Review on Antimicrobial Resistance*, https://amr-review.org/.

According to a Bloomberg investigative story[3], an official of a chamber of commerce basically signed off on export declarations without checking and perhaps for a small reward. The story further claimed that the exports were by companies with addresses that could not possibly be exporting shrimp. The huge increase in declared shrimp exports from Malaysia was therefore fictitious.

One consequence of this deception is the reputational damage done to Malaysian food exports more generally, not just shrimp exports. Once damaged, reputation is difficult to recover, especially if we are not seen as being serious about food safety.

Sugar

Third, in the mid-1960s, three researchers in Harvard University's Public Health Nutrition Department received funding from the (then) Sugar Research Foundation (SRF). They included the Chairman of the Department and another colleague, who later drafted the first-ever USDA dietary guidelines for Americans. The researchers were diligent in consulting the SRF to make sure that their results were satisfactory to the sponsors. Their research finding was that sugar had no relationship to cardiovascular disease, something that has since been contradicted by a large body of evidence.

The researchers instead pointed to saturated fats as the culprit. This triggered a half-century obsession with cholesterol and the spectacular boom in cholesterol-reducing pharmaceutical drugs, notably statins. Statins contain very small amounts of tin so Malaysia, as a producer of tin, did not really benefit. It did not help when the US released its tin stockpiles and brought the tin price down, killing the mining industry here. The large pharmaceutical companies, however, made a great deal of money from statin production. The latest US dietary guidelines are now silent on the once great threat of saturated fats. The general consensus now is that we have been misled on saturated fats, although there is still great disagreement on its full implications.

In the second half of 2015, the head of research at Coca-Cola was let go because she had been funding researchers to attend academic

[3] https://www.bloomberg.com/news/features/2016-12-15/how-antibiotic-tainted-seafood-from-china-ends-up-on-your-table.

conferences to promote the message that "you can eat or drink anything you want as long as you exercise". Former US First Lady Michelle Obama was quite successful in the first term of her husband's presidency in reducing childhood obesity, but before the end of his first term, when her husband was seeking corporate support for his re-election, the food companies offered to join her "Move It" campaign. The campaign then had two dimensions, namely improving diets and exercising. With increased corporate support, the campaign focused on exercise.

The story of research being compromised is worrying. The three Harvard researchers got a princely sum of US$6,800 from the SRF and that was enough to make them feel accountable to their sponsors. We cannot afford to be sceptical of all Harvard or scientific research, but the story is indeed worrying. This is why researchers, especially in the scientific community and working on medical health, are now obliged to declare all their interests when they publish in the best journals.

The stakes are high. The McKinsey Global Institute published a report in November 2014, on the eve of the Second International Conference on Nutrition (ICN2), organised in Rome by the WHO. It reported that the costs due to obesity were third, only to civil conflicts and smoking. Conflicts cost about US$2.1 trillion, while smoking and obesity both cost about US$2 trillion.

Malnutrition involves not only hunger, but also excessive consumption resulting in obesity and diet related non-communicable diseases and micronutrient deficiencies, namely shortages of minerals, vitamins and trace elements. The issues are complicated, but much of the calculated costs are related to overweight and obesity. Malaysia has the unfortunate distinction of being first in Asia in terms of the share of the overweight and obese, as well as the incidence of diabetes.

Climate change

Moving on to climate change, the current international near consensus is to try to reduce the increase in temperature to no more than 2 degrees Celsius for this century. There is no consensus on this because many researchers argue that 1.5 degrees would be all that the planet can take. This includes people like James Hansen, a former top scientist at the National Aeronautics and Space Administration (NASA), who insists on 1.5 degrees rather than 2 degrees Celsius. There is a small group, however, no more than three percent of scientists, who take the view that all climate change is due to astrophysical developments, such as the increased incidence of solar flares, sunspots and so on.

Unfortunately, the efforts that the international community have made so far are not up to the challenges. The Paris Agreement is essentially voluntary and not really binding, contrary to the impression given by the Trump administration. The two decades old Kyoto Protocol, to which most countries other than the US signed, was not a voluntary agreement, but even that has not been met. Many developed countries have not met most of the Protocol's key targets.

Use of modern energy is essential to improve human welfare. There is a very strong correlation between per capita energy consumption and human development (Figure 1), as well as between economic growth and carbon emissions. However, some countries have less carbon emissions relative to their peers. For example, Hong Kong has much less carbon emissions than Singapore, while Japan and Switzerland have much less carbon emissions than the US, Australia and the Gulf economies.

The economic damage from the failure to control climate change is expected to be more than double for developing rather than developed countries. We urgently need to increase the use of renewable energy to mitigate global warming. Renewable energy can take many forms. The most widely used are solar and wind turbine energy, but there are others, including nuclear energy, which does not generate greenhouse gases, but raises other concerns.

In order to accelerate the transition to renewable energy, we need an investment-led approach; leaving it to the market is not going to work. This was seen between 2008 and 2009 when carbon markets collapsed. Unfortunately, a great deal of advocacy for carbon markets continues and they are presented as the only solution. What we also need is front loading, which is an adequately funded big push effort as soon as possible. When this argument was made in 2009, in anticipation of the Copenhagen Conference of Parties (CoP), the argument was dismissed as unrealistic and unfeasible because the unit cost of renewable energy would not go down as fast as was projected.

With the benefit of hindsight, it is clear that the UN was wrong. Unit costs of some forms of renewable energy, in fact, went down much faster (key findings of Lazard's *Levelized Cost of Energy Analysis 10.0* in December 2016 and Figure 2) than predicted in the 2009 *World Economic and Social Survey*. Carbon markets have also failed to generate the finance to bring about the massive investments in renewable energy generation needed to mitigate climate change and meet the growing demand for electricity, including from almost a quarter of the world's population who have limited or no access to modern energy (Figure 3).

China was criticised during the last decade for its heavy reliance on coal energy and, in anticipation of the 2009 Copenhagen CoP, it introduced incentives to promote renewable energy. It was very successful in dramatically reducing the cost of wind as well as solar power. Within three years, renewable energy unit costs were well below what had been anticipated and China became the most competitive producer of both solar panels and wind turbines. Instead of welcoming this, the West blocked imports of China's turbines and solar panels on the grounds of quality and for having received government subsidies. Solar panels from Malaysia were also blocked on the same grounds until 2016 as a US inducement to support the Trans-Pacific Partnership Agreement (TPPA). At the Honolulu meeting, Malaysia was taken off the blacklist and solar panel imports from Malaysia were allowed.

In short, producers of renewable energy have achieved considerable progress by capitalising on learning economies and economies of scale. What is basically needed are much more significant transfers of both finance as well as technology, which are available, to make it achievable.

In the past, renewable energy was much more expensive than non-renewables, but the gap today has gone down. The main reason that renewable energy is more expensive today is because the price of oil went down tremendously from the end of 2014. More upfront investments in the short term will reduce investment needs in the longer term as seen in Figure 4.

An increase in upfront investments now will result in a considerable reduction in the need for investments in the longer term. While this makes a lot of sense, it is not going to come about simply by leaving things to the market.

The path forward is quite clear. We need not only a big push in renewable energy, but also specific policies to promote it. Brazil and Cuba have done this by making bio-ethanol from sugarcane. The US has had a strong policy since 2006 to make bio-ethanol fuel from maize, while Europe has eschewed bio-ethanols in favour of biodiesel. Rather than moving decisively, however, we have a situation where we do not have the kind of progress needed.

To summarise, we need to address climate change while improving living standards for all. The way to do so is to promote the use of renewable energy to mitigate global warming. Markets are not going to do this on their own. We need mechanisms not only to develop renewable energy, but also transfer technologies affordably, especially to the poor, despite existing intellectual property rules. All this needs to be done while addressing challenges of adaptation to global warming.

Palm oil

Given the European choice of biodiesel and that palm oil is the cheapest vegetable oil, the research and development (R&D) effort for biodiesel from palm oil has been surprisingly modest. Oil palm cultivation is controversial in the world today and Malaysia has been heavily criticised for it. The situation could be turned around if Malaysia could prove its commitment to sustainable development by providing renewable energies. Indonesia is now producing 60 percent more than what Malaysia is producing. Besides Thailand, West Africa is increasing production. Malaysian palm oil companies are well placed to contribute to this.

Malaysia became the most efficient refiner of palm oil for reasons of scale as well as scope, augmenting its incomes from oil palm cultivation. By focusing exclusively on refining palm oil and palm kernel oil, Malaysian refineries became highly specialised, productive and competitive whereas European refineries typically switched, depending on season, among sunflower seed oil, rapeseed oil and so on. None of this would have been achieved if not for government intervention. It is important to recognise this because the dominant neo-liberal ideology maintains that governments always distort otherwise optimal market outcomes.

Before this, one unsung achievement of Malaysian economic development in this period is the story of palm oil. Malaysia had been producing palm oil from before the World War II, mainly on a Belgian-owned plantation. But with persistently low rubber prices from the 1960s, other plantation companies increasingly diversified their portfolios by switching from rubber to oil palm, usually when replanting old rubber trees well past their prime. Factories crushed the outer fibre and the kernel pulp, sending crude palm oil for refining abroad. The 1970s saw strong promotion of palm oil refining, which is the truly Malaysian industrialisation success story. When Tun Razak was Prime Minister and Tun Hussein was Finance Minister, several plantation and tin mining companies, previously listed on the London Stock Exchange, were bought by Malaysian government interests and relisted on the Malaysian bourse.

After US President Richard Nixon brought an end to the post-World War II Bretton Woods System in September 1971, many countries faced new foreign exchange problems and this was soon exacerbated by the Organization of the Petroleum Exporting Countries (OPEC) oil price hikes of 1973-1974 and 1978-1979. Malaysia made barter trade deals with countries with large populations and vegetable oil markets to export refined palm oil to them in return for buying their goods for resale or consumption. Refined palm oil and palm oil consumer products were first exported in large quantities to India and then to the former Soviet Union, Pakistan and China, all countries with large populations. Palm oil had other advantages, such as its appeal to housewives in China because it does not quickly soot up their kitchen ceilings.

In the mid-1970s, Malaysia tried to counteract the effect of European common market policies, which deterred Malaysian refining of palm oil through what economists call "tariff escalation": the more refined the oil, the higher the European import tariffs. Refined palm oil exports from Malaysia were thus effectively discouraged unless the playing field was levelled. In an attempt to do so, the Malaysian government introduced export duties on crude palm oil. The effect of the export duties on crude palm oil was to counteract the effect of tariff escalation by Europe to discourage refining abroad. But the European response was to further increase tariff escalation. It became clear that any Malaysian initiative would be countered by a European response and the Malaysian government would not get very far with its countervailing strategy.

Most Malaysian engineers were previously engaged in refinery maintenance and servicing even if they were well trained and qualified. Despite their limited experience, when new opportunities were presented in the 1970s, Malaysian engineers quickly learned by doing and were able to compete with Europeans and Americans. Within a decade, Malaysia became the most efficient palm oil refiner in the world, augmenting the benefits of oil palm cultivation.

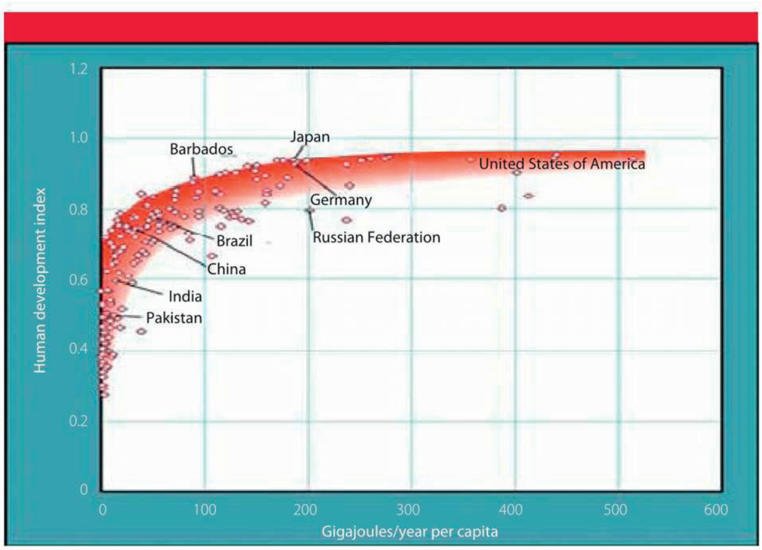
The commitment to promote palm oil refining would not have emerged without the government helping producers to overcome the obstacles of producing for foreign markets. Individual plantation companies would have been unlikely to take such initiatives for fear that their rivals would free-ride on them and that they would be unable to secure or monopolise first-mover advantages. Precisely for this reason, it is necessary for the government to step in to overcome such collective action problems.

As an aside, there is another twist to the story of Malaysian palm oil refining success. The effluents from these palm oil factories went into Malaysian rivers and within a short period, about 40 rivers were declared "dead" because of the adverse effects on aquatic life. The 1974 Environmental Quality Act thus became very important. The Third Malaysian Plan, 1976-1980 had an unexpected emphasis on the environment for those times. Since then, Malaysia has come a long way of course, committing itself in 2015 to the internationally negotiated SDGs.

Of all the vegetable oils currently commercially cultivated, palm oil is the most economic and environmentally least damaging by far. It is more economic than the others in terms of the land-output ratio and requires the lowest unit costs. It also requires the least agro-chemicals, both fertilisers as well as pesticides, including herbicides, except for coconut oil.

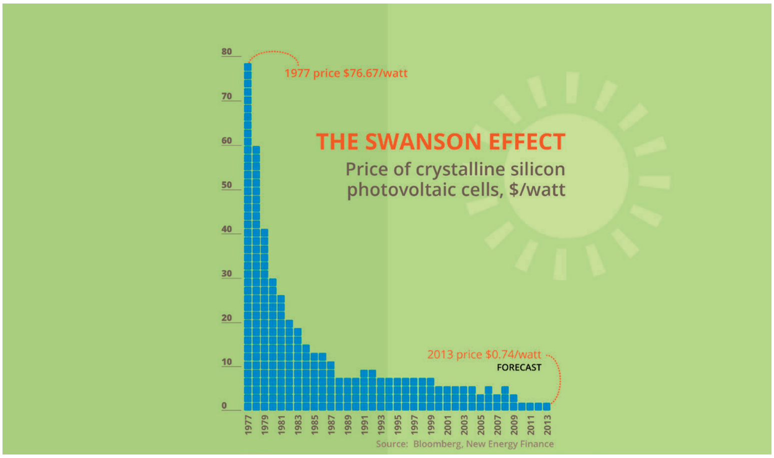
The challenges of sustainable development involve not only problems, but also opportunities for the country and for the future of humanity. With regards to climate change alone, it has been estimated that annual damages as a share of GDP in the year 2100 will be almost 1 percent in the US, about 2 percent in other OECD countries and over 4 percent in the rest of the world. Non-economic damages are expected to account for about half of such damages with economic damages accounting for less while catastrophic damages will account for about a tenth.

Figure 1: Per Capita Energy Consumption and Human Development, Selected Countries



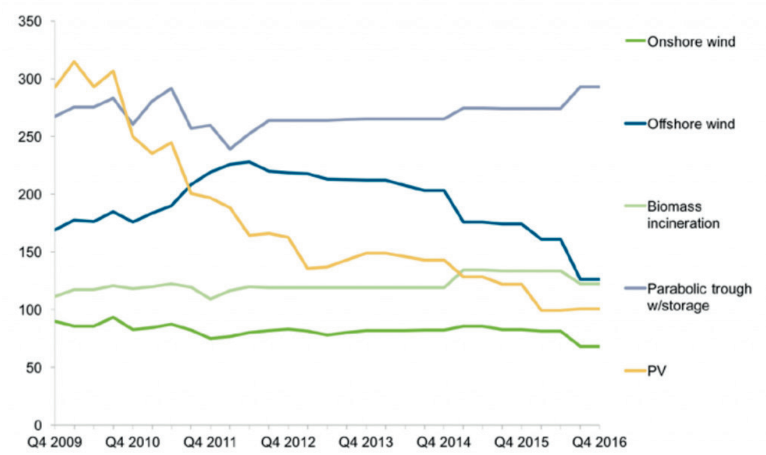
Source: United Nations, *World Economic and Social Survey 2009: Promoting Development, Saving the Planet*, Figure II.5, 2009.

Figure 2: Price of Photovoltaic Cells Required for Solar Panels, 1977-2013



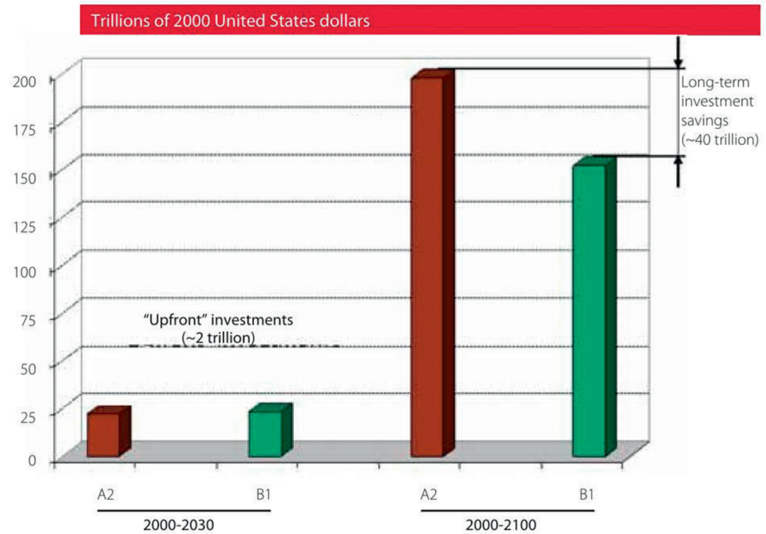
Source: Bloomberg, New Energy Finance, https://understandsolar.com/cost-of-solar/.

Figure 3: Global Trends in Renewable Energy Investment, 2009-2016



Source: Frankfurt School-UNEP Centre/Bloomberg New Energy Finance, *Global Trends in Renewable Energy Investment 2017*, Frankfurt, 2017.

Figure 4: Upfront Investments and Long-Term Investment Savings



Source: United Nations, *World Economic and Social Survey 2009: Promoting Development, Saving the Planet*, Figure II.7, 2009.

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3

Malaysian Privatisation: Private Property vs Public Interest

Privatisation advocates continue to make exaggerated claims about its virtues and ostensible contribution to economic competition, efficiency and growth. Its Malaysian proponents implicitly, if not explicitly, criticise Tun Hussein Onn's half decade tenure as Prime Minister when the public sector grew faster than ever before, or since. While Tun Hussein was firm in his actions against corruption, he also expected public servants and politicians to be honest, if not incorruptible. While this may seem naive in retrospect, it was certainly the ethos he inherited and expected of others in turn. Hence, there were few institutional checks, including monitoring and oversight, or balances, involving supervision or accountability. This paper critically reviews public sector expansion and privatisation in Malaysia.

Privatisation

Privatisation has been one of the pillars of the counter-revolution against development economics and government activism from the 1980s. Many developing countries were forced to accept privatisation as a condition for support from the World Bank while many other countries have embraced privatisation, often on the pretext of fiscal and debt constraints.

Privatisation usually refers to a change of status from public to private ownership or control. Strictly, privatisation only involves the transfer of 100 percent or a majority share of public or state-owned enterprise (SOE), or its assets, or an entity (government department, statutory body, government-owned company) previously, at least majority, owned by government, whether directly or indirectly.

Unfortunately, in the discussion which has developed in Malaysia and also globally over the last few decades, the term is used more loosely. For example, it may only involve minority private ownership after the corporatisation of an SOE, and the sale of a minority share of its stock.

It is sometimes also used to refer to the contracting out of government services to private contractors on behalf of the government, such as involving the issue of licenses to participate in activities previously undertaken by the government. The definition is sometimes so broad that it includes cases where private enterprises are awarded licences to participate in activities previously in the exclusive preserve of the public sector.

Background

The balance-of-payments problem arising from oil shocks in the 1970s and the US Federal Reserve interest rate hike precipitated the fiscal and debt crises of the early 1980s, especially in Latin America, Africa and Eastern Europe. The sovereign debt crises forced many countries to seek emergency financial support from the International Monetary Fund (IMF) and the World Bank (WB), jointly known as the Bretton Woods institutions (BWIs), both headquartered in the US capital of Washington, DC. The two BWIs have been the dominant international financial institutions (IFIs). The fiscal and debt crises, precipitated by the US Federal Reserve Bank's decision to raise interest rates sharply to stem inflation in the United States and internationally, were attributed to excessive government intervention, public sector expansion and SOE inefficiency.

In response, the IMF provided emergency credit facilities requiring stabilisation programmes focusing on price stabilisation to bring down inflation, later attributed to "deficit financing" due to "macroeconomic populism". Generally, WB worked closely with IMF to provide medium- and long-term credit on condition that the government concerned adopted structural adjustment programmes (SAPs) as well. The SAPs generally prescribed economic, especially trade and financial liberalisation, deregulation and privatisation.

Soon, privatisation became a standard requirement of SAPs. Thus, many governments of developing countries were forced to privatise by SAP loan conditions, but many other governments voluntarily adopted such policies as they became standard pillars of the emerging Washington Consensus associated with the BWIs and the US policy consensus of the Reagan years.

Privatisation and the Washington Consensus were preceded by the political counter-revolution associated with the election of Mrs Margaret Thatcher as the Prime Minister of the United Kingdom and Mr Ronald Reagan as the President of the United States. Earlier, US President Jimmy Carter had appointed Paul Volcker as Chairman of the US Federal Reserve in 1980. He presided over raising interest rates, which precipitated not only fiscal crises in many parts of the world, especially in Latin America and Africa, but also the international sovereign debt crises, which followed as interest rates shot up.

In this context, it was claimed sometimes with uneven and sparse evidence, that SOEs were inherently likely to be inefficient, corrupt, subject to abuse, and so on.

The motives of many involved in the preceding public sector expansion – enabled by high commodity prices and earnings as well as low real interest rates due to easy credit with the need to "recycle petro-dollars" – were often quite developmental and noble.

Changing policy

Looking back on the role of the public sector in Malaysia, it is useful to consider the nature of the changing political settlement in this connection. During the colonial period, the public sector grew primarily to provide infrastructure and services.

Malaysia's first Prime Minister Tunku Abdul Rahman adopted an essentially *laissez faire* approach. Nevertheless, there was some modest expansion of the public sector. For example, Malayan Industrial Development Finance (MIDF) and a number of other similar companies were created to facilitate early import-substituting industrialisation. From the mid-1960s, many state governments set up state economic development corporations (SEDCs) to enable state agricultural and industrial development. Following the first Bumiputera Economic Convention in 1965, private companies were set up to facilitate the Bumiputera economic empowerment. The establishment of Bank Bumiputera in 1965 and Perbadanan Nasional (Pernas) in 1968 were the most notable in this regard.

The 1970s are generally associated with the New Economic Policy (NEP). Leaders like Tun Razak, Tun Hussein and Tengku Razaleigh, his Finance Minister, saw public sector expansion as necessary to further the national and public interest, including poverty reduction, ethnic affirmative action and achieving national unity. Associated with, but distinct from, the NEP, was state-led, London stock market-based nationalisation. This sense of importance for the nation to take control of its destiny was initially associated with Tun Razak, and pursued strongly by his successor, Tun Hussein, after Tun Razak's untimely demise in January 1976. This involved further public sector or SOE growth. There was a strong presumption by national leaders of a shared sense of and commitment to a public mission requiring honesty, sincerity and dedication. Consequently, there was little recognition of the need for appropriate and adequate checks and balances in these early years despite revulsion of occasional instances of corruption and abuse of the public sector and SOEs. Hence, the 1970s was an era of rapid public sector growth, involving SOE expansion and proliferation.

Tun Dr Mahathir's tenure of over 22 years from mid-1981 was an era which might usefully be divided into three periods. The first period, from 1981 to about 1985-1986, saw him promoting his Look East Policy to grow, modernise and industrialise the economy by emulating Northeast Asia, especially Japan and South Korea. His emphasis on heavy industrialisation involved the Proton Malaysian car project and the establishment of Heavy Industries Corporation of Malaysia (HICOM) in 1978, when he was Minister of Trade and Industry, with capitalisation from the government.

His second period, inter alia, saw reversal of earlier public sector expansion, especially after he replaced his political rival, Tengku Razaleigh, with Tun Daim as the new Finance Minister from 1984. Shortly after announcing the Fourth Malaysia Plan for 1986-1990, he abandoned its thrust, and instead turned to economic, cultural and education liberalisation and accelerated privatisation. Unlike in many other countries, privatisation was not externally imposed as Malaysia had not gone heavily into debt, thanks to the availability of windfall earnings from additional petroleum production and export.

The third period saw another drastic change of course responding to the Asian financial crises of 1997-1998. The crises experienced by many privatised corporations saw an urgent need for their renationalisation, again on generally generous terms, with Danaharta and Danamodal playing crucial roles.

The regime of Tun Abdullah from 2004 saw his commitment to reorganise the SOEs differently with what has been called government-linked company (GLC) restructuring, largely undertaken by his second Finance Minister, Tan Sri Nor Mohamed Yakcop. GLC restructuring was quite different from the privatisation undertaken during the 1980s – many SOEs were turned over to private interests while others were corporatised, neither supervised nor overseen, but nonetheless expected to become much more efficient.

With such restructuring, GLCs were subjected to far more transparency and accountability than had been the case under privatisation, or even after being saved by Danamodal and Danaharta. Khazanah Nasional is the archetype of GLC restructuring, but other government-linked corporations and groupings have also been subjected to parallel reforms and changes.

In the more recent period, however, the New Economic Model's renewed promise of privatisation and the recent emphasis on infrastructure development involving private-public partnerships (PPPs) may have weakened the thrust of earlier GLC restructuring reforms.

Why state-owned enterprises?

There are many reasons and one should not generalise too readily, although some generalisations may be appropriate in particular contexts, over time or in particular places.

Historically, the private sector in many contexts has been unable or unwilling to affordably provide needed services. Hence, SOEs were created during the colonial period as the private sector was simply not rising to the challenge or gap. Establishment of government departments, statutory bodies or even government-owned private companies were deemed important, if not essential, for maintaining the status quo – to legitimise it, or to advance particular projects or powerful and influential interests. Such important matters could not just be left to the market or private interests. Analytically, these are sometimes portrayed as "market failures", although they are more accurately understood as failures of the private sector, which need to be recognised as such.

SOEs have also been established to advance national public policy priorities. Again, these emerge owing to what are seen as market failures for those who naively believe that markets will serve national public policy purposes. Libertarian economists do not recognise the existence of national public policies, often characterising those so claimed as actually subterfuges for advancing particular interests while presenting or even disguising them as being in the national interest. It is important to recognise such philosophical differences in perspectives as having profound implications for economic analysis and policy prescriptions. Often blanket assertions about subtle, even nuanced issues and situations tend to be obfuscated by such simplistic, often ideologically driven pronouncements.

Such considerations and arguments are still relevant in some, if not many instances and cases, but may no longer be relevant in others, and perhaps never relevant in yet other situations. Nevertheless, regardless of their original rationale, many SOEs have undoubtedly become problematic and often inefficient. Yet, privatisation is not and has never been a universal panacea to the myriad problems faced by SOEs.

Arguments for privatisation

Several arguments have been advanced to justify privatisation in Malaysia since the mid-1980s. Privatisation was advocated as an easy means to:

1. Reduce the financial and administrative burden of the government, particularly in undertaking and maintaining services and infrastructure;
2. Promote competition, improve efficiency and increase productivity in the delivery of public services;
3. Stimulate private entrepreneurship and investment and thus accelerate economic growth; and

4. Help reduce the presence and size of the public sector, with its monopolistic tendencies and bureaucratic support.

First, privatisation is supposed to reduce the financial and administrative burden of the government, particularly in providing services and infrastructure. The rapid expansion of the role of government and the public sector in the 1970s and early 1980s was increasingly seen as problematic. Thus, reducing the government's role and burden were seen as likely to be a popular government policy.

Second, privatisation was portrayed as a measure to promote competition, improve efficiency and increase productivity in service delivery. This belief was naive, confusing the issue of property rights with that of promoting competition. It was believed that privatisation would somehow encourage competition, not recognising that competition and property rights are distinct and not contingent issues. Associated with this was the presumption that competition would automatically result in efficiency as well as improved productivity, not recognising the economies of scale and scope in many instances.

Third, privatisation was expected to stimulate private entrepreneurship and investment. There is also a popular but naive belief that privatisation was going to stimulate private entrepreneurship when, in fact, the evidence is strong, not only in Malaysia but also elsewhere, that privatisation crowds out the likelihood of small and medium-sized enterprises actually emerging to fill the imagined void, which is supposed to exist following privatisation. Admittedly, there is scope for entrepreneurship with privatisation as new ways and ideas offered by the private sector are considered – or reconsidered – as the new privatised entity seeks to maximise the rents which can be secured with privatisation. However, the private purchase of previously public property does not augment real economic assets. Private funds are thus diverted and consequently diminished rather than augmented to take over previous SOEs. Hence, available private funds are less available for investing in the real economy, in new economic capacities and capabilities.

Fourth, privatisation was supposed to reduce public sector monopoly, but there is little evidence of significant erosion of the monopolies enjoyed by the privatised SOEs. Arguably, technological change and innovation, such as in telecommunications, were far more significant in eroding the privatised monopolies and reducing costs to consumers or customers than the change in property rights implied by privatisation.

From the 1980s, various studies purported to portray the public sector as a cesspool of abuse, inefficiency, incompetence and corruption. Books and articles with pejorative titles, such as "vampire state", "bureaucrats in business", and so on provided the justification for privatisation policies. Despite the caricature and exaggeration, there were always undoubted horror stories, which could be cited as supposedly representative examples. But similarly, by way of contrast, other experiences show that SOEs can be run quite efficiently, even on commercial bases, confounding the dire predictions of the prophets of public sector doom.

Causes of SOE inefficiency

Undoubtedly, the track record of SOEs is very mixed and often varies by sector and activity, with different governance and accountability arrangements. There is general recognition that many SOEs are quite inefficient and it is important to recognise and address such inefficiencies.

First, SOEs often suffer from unclear or sometimes even contradictory objectives, which can be problematic. Some SOEs may be expected to deliver to the entire population or to reduce spatial imbalances. Other SOEs may be expected to enhance growth or promote technological progress or generate jobs. Over-regulation inadvertently exacerbates such problems by imposing contradictory parameters.

To be sure, unclear and contradictory objectives, such as to simultaneously maximise sales revenue, address disparities and generate employment, often meant ambiguous performance criteria, which is open to abuse. Often, SOE failure on one criterion (such as cost efficiency) was justified on the grounds of fulfilling other objectives (such as employment generation). However, the ambiguity of objectives is not necessarily due to public or state ownership per se.

Second, the performance criteria for evaluating SOEs as well as privatisation are often ambiguous and related to contract specifications and enforcement. Similarly, SOE inefficiencies have often been justified by other public policy objectives, such as affirmative action, the NEP, and Bumiputera economic empowerment or employment generating considerations. Ineffective monitoring and poor transparency typically compromises SOE performance. Inadequate accountability requirements have been a major, growing and festering problem as the public sector grew by leaps and bounds, especially in the second half of the 1970s, ostensibly to achieve NEP objectives, which were very loosely and broadly interpreted.

Third, coordination problems have often been exacerbated by inter-ministerial, inter-agency or inter-departmental rivalries. Some consequences included ineffective monitoring, inadequate accountability, or alternatively, over-regulation. Moral hazard has also been a problem as SOE management's expected sustained financial support from the government attributed to weak fiscal discipline or soft budget constraints. In many former state-socialist countries, such as the Soviet Union and Yugoslavia, the existence of soft budget constraints is said to be the reason why SOEs continued to be generously financed regardless of performance.

There have often been poor accountability requirements and arrangements for SOEs as Permodalan Nasional Berhad's Central Information Collection Unit (CICU) learnt in the mid-1980s when it sought to catalogue existing public enterprises. Over-regulation has not been a solution as it is generally proved to be quite ineffective. The monopoly status and powers of SOEs are widely acknowledged to have been abused, but privatisation would simply transfer those powers to private hands.

Very often, inadequate managerial and technical skills and experience have weakened the performance of SOEs, especially in developing countries like Malaysia, where the problem has sometimes been exacerbated by considerations of ethnic privilege, legitimised in terms of the need for affirmative action. Often, SOE managements lacked adequate or relevant skills, but were constrained from addressing them expeditiously. Privatisation, however, does not automatically solve the problem of the lack of managerial skills. Similarly, the privatisation of SOEs, which are natural monopolies (such as public utilities), will not solve problems of inefficiency due to the monopolistic or monopsonistic nature of the industry or market.

The key remaining question is whether privatisation is an adequate or appropriate response to address and overcome the problems of the SOEs in the public sector.

Has privatisation improved efficiency?

Although there are cases where SOEs have been better run and deemed more efficient after privatisation, the overall record has not been even and consistent. As correlation is not causation, it is also important to ascertain why there have been improvements or otherwise. It is also important to remember that better run privatised SOEs in and of themselves do not necessarily serve the national or public interest better.

Undoubtedly, SOEs can generally be better run and most can become more efficient. But this is not always the case as some SOEs are indeed well run. Very few privatisation advocates would insist that most SOEs in neighbouring Singapore for instance, are poorly run. In Singapore and in some other countries, where SOEs are well-run, public ownership cannot be used as an excuse for poor governance, management or abuse, but precisely the inverse, whereby it becomes criminal to abuse SOEs under a manager's watch. As a matter of fact, the overall share of the economy controlled by the city-state is far greater than in Malaysia.

Hence, in different contexts, with appropriately strict supervision, SOEs can indeed be better run. Privatisation in itself will not solve managerial delegation problems, which is the principal-agent problem, as it is not a question of property rights per se. With SOEs, the principal is the state or the government while the agents are the managers and supervisors, who may or may not necessarily pursue the objectives intended by the principal. This is a problem faced by many organisations. It is even a problem of private enterprises or corporations, such as where the principal may not be able to exercise effective supervision or control over the agent.

Furthermore, many problems or inefficiencies are not necessarily due to public or state ownership. A much more nuanced understanding of the situations and issues involved is needed to analytically ascertain the causes of inefficiencies. The causes established may still prove to be the exception, rather than the rule, in the sense that many SOEs may well be inefficient. However, the reasons for their inefficiency are exceptionally, rather than typically, due to the fact of state or public ownership.

Also, natural monopolies (such as public utilities) are often deemed inefficient due to the monopolistic nature of the industry or market. The question then is whether the alternative, which is a private monopoly, is the superior solution, even under regulation to protect the public interest. The issue needs to be ascertained analytically and cannot be presumed *a priori*. If an industry is a natural monopoly, what does privatisation achieve? Often, it means transfer to private hands, which can be problematic for, if not dangerous to, the public interest.

Has privatisation benefitted the public and consumers?

Again, this has not consistently been the case. In most cases, there have been some beneficial outcomes, which have served to legitimise the privatisation. Nevertheless, the overall net welfare improvements have never been demonstrated in many cases, especially because they involve non-Pareto optimal outcomes, where not everyone is better off. Rather, some are better off while others are not, and possibly even worse off, or the costs of the partial gains have been high and have been negated by the overall costs of these gains, which may be diffused and less directly or even imperceptibly felt by the losers.

Since many SOEs are public monopolies, privatisation has typically transformed them into private monopolies, where opportunities to abuse market monopoly power, often seen in terms of firm competitive advantage, occur in order to maximise rents and profits. This may prove tempting and is often the private sector's yardstick or corporate criteria of success. Not surprisingly, private monopolies are more likely to abuse their market power to maximise rents or profits for themselves.

The privatisation of public services tends to burden the public, especially if charges are raised for privatised services, which may not improve with privatisation. In most cases, privatisation did not solve the problem of governments' fiscal deficits. Instead, governments lost vital revenue sources. Profitable SOEs were also sold in most cases as prospective private owners were only interested in securing profits.

Fiscal crises have often been exacerbated when new private owners used creative accounting to avoid tax and secure tax credits. Thus, in most cases, privatisation has been the problem and rarely the solution to the government's fiscal crisis or SOE problems.

Thus, privatisation often burdens the public in many different ways, depending on how such market power is deployed or abused. For instance, privatisation burdens the public even when charges are not reduced, but services are significantly and sustainably reduced. Often, instead of trying to provide a public good to all, many people are excluded because it is not considered commercially economic to deliver services to them. Consequently, privatisation may worsen overall enterprise performance. "Value for money" may go down, despite improvements used to justify higher user charges.

When privatisation also worsens the fiscal situation due to loss of revenue sources or tax evasions by new private owners, the government is often forced to cut essential public services. Options for cross-subsidisation to broaden reach are reduced as the government is usually left with the unprofitable activities whilst everything that is potentially profitable is acquired by the private sector.

Thus, privatisation of the profitable not only perpetuates the exclusion of the deserving, but also worsens overall public sector performance as it is encumbered with all remaining unprofitable obligations. One consequence is exacerbating poor public sector performance as it then becomes a self-fulfilling prophecy. To make matters worse, the public sector is then stuck with financing the unprofitable, thus effectively contributing to the privatisation prophecy.

For neo-liberals, SOEs are generally presumed to be inherently more likely to be inefficient. The most profitable and the potentially profitable are typically the first and most likely to be privatised. This scenario leaves the rest of the public sector even more inefficient, in turn justifying further privatisations. One variation of this rationale is that since the government is inherently inefficient and does not know how to run enterprises well, privatisation is needed. Another common argument is that since privatised SOEs are presumably more efficient and the government has certain obligations to its citizenry, it should subsidise privatised SOEs so that they can fulfil those very government obligations. Admittedly, such obligations may not involve direct payment transfers, but rather, further profitable concessions to the privatised former SOE, which may well make far more from these additional concessions than the actual cost of fulfilling government obligations.

Privatisation – enriching the politically connected few who secure lucrative rents – has increasingly sacrificed the national or public interest for private profit, which is very different, and rarely coincides with the former. They have generally benefitted, even when the mode of privatisation may not seem to obviously benefit them. Privatisation in many developing and transition economies has primarily enriched these few as the public interest has been sacrificed to such powerful private business interests. This has, in turn, exacerbated problems of corruption, patronage and other related problems.

For example, following Russian voucher privatisation and other Western recommended reforms, for which there was a limited domestic constituency then, within three years (1992-1994), the Russian economy had collapsed by half, and adult male life expectancy fell by six years. It was the greatest such recorded catastrophe in the last six millennia of recorded human history. Soon, a couple of dozen or so mainly young Russian oligarchs had taken over the commanding heights of the Russian economy, although many have since monetised their gains and taken them out to invest elsewhere. All this was celebrated as a great achievement in the Western media, but the actual record of what happened suggests the Russian public may have very different views of what happened.

Thus, the actual consequences of privatisation and its associated policies give much cause for concern.

Partial privatisation

In many instances, privatisation has only involved partial transfers of ownership. In some cases, such so-called privatisation actually involves corporatisation with only minority share ownership actually transferring to private hands, at least in the first instance, leaving majority ownership in public hands. And even if the government cedes majority ownership, it may still insist on a controlling "golden share" for itself. Thus, even though it may have less than half the stock of the company, it can effectively continue to be in control because of this golden share arrangement.

Such situations involve partial divestiture or divestment and are not really privatisations. The main rationale for such partial privatisations is to legally prevent or forestall the possibility of reversal of the corporatisation as there is no other rationale for this type of privatisation. However, there are actual instances which suggest that such seemingly irreversible privatisations have in fact been reversed with the government or a proxy buying back the stocks and taking the corporatised entity "private" again, which is renationalising it.

Adverse economic consequences

Privatisation has not provided the miracle cure for the problems (especially the inefficiencies) associated with the public sector. And the public interest has rarely been effectively served by private interests taking over public sector activities. More recently, growing concern over adverse consequences of privatisation has spawned research worldwide.

As a matter of fact, both the IMF and World Bank were aware of such likely adverse impacts of privatisation. For example, a 1999 IMF research paper acknowledged that privatisation "can lead to job losses, wage cuts and higher prices for consumers". Similarly, World Bank research on the experiences of Argentina, Bangladesh, Chile, Ghana, Malaysia, Mexico, Sri Lanka and Turkey in 1997 found large-scale employment losses when big SOEs were privatised.

Comparative data from the United States, the United Kingdom, Canada, Chile, Sweden, Russia, Poland, Ukraine, Bulgaria, China, Hong Kong, Malaysia, the Philippines, South Korea, Sri Lanka and Bangladesh for 1999-2004 found that privatisation disproportionately affected female workers. IMF and World Bank safety net or compensation proposals were either too costly for the public exchequer or too administratively burdensome for many developing countries.

Diverting private capital from productive new investments to buy over existing publicly held assets actually retard, rather than enhance, economic growth. This effectively involves significant diversion of potentially productive new investments as such resources are instead used to buy over existing assets. Instead of contributing to growth, this simply enables and facilitates changes of ownership.

Listing privatised SOEs on the stock market tends to subject them to short-termist managerial considerations, such as to maximise quarterly firm earnings performance. This, in turn, often serves to discourage new investments. Such a focus on quarterly earnings, for example, tends to marginalise the long-term interests of the enterprise itself, let alone the nation. Thus, stock market listing and responsiveness may mean the introduction, perpetuation and encouragement of a culture of short-termism. This is often inimical to the interests of corporate and national development more generally, let alone improvement of economic welfare more broadly.

Both evenly distributed as well as concentrated share ownership undermine corporate performance of the privatised enterprise, whereas SOE ownership may have and can overcome such collective action problems.

One set of problems is where the population has equal shares following privatisation, such as after what is called "voucher privatisation". When share ownership is distributed equally among the population, no one has any particular interest in ensuring the company is run well. Thus, public pressure to ensure the equitable distribution of share ownership (such as voucher privatisation) may inadvertently undermine pressures to improve corporate performance since each shareholder would then only have small equity stakes and would therefore be unlikely to incur the high costs of monitoring management and corporate performance.

The result is what is called a "collective action" problem as nobody takes much interest in the operations or functioning of the company. This exacerbates the "principal-agent" problem as no one has much incentive to properly monitor and take initiatives to improve the management of privatised enterprises as everyone has equal shares and hence modest stakes in the outcome.

The converse is where one has concentration of share ownership, such as the so-called Russian oligarchs. Concentrated share ownership also undermines corporate performance for other reasons. In the case of the Russian oligarchs, many moved to London after making huge fortunes and pushed up real estate prices there and in Moscow, which then gave rise to a range of other related problems.

Privatisation may postpone a fiscal crisis by temporarily reducing fiscal deficits with additional one-off revenue from the sale of public assets. However, in the long-term, the public sector would lose income from profitable SOEs and be stuck with financing and subsidising unprofitable ones. More resources would also be needed to finance government obligations previously cross-subsidised by public revenue streams.

As experience shows, the fiscal crisis may even deepen if the new owners of profitable SOEs avoid paying taxes with creative accounting or due to the typically generous terms of privatisation. For example, Sydney Airport paid no tax in the first 10 years after it was privatised even when it earned almost A$8 billion; instead, it received tax benefits of almost A$400 million!

This does not show up as government development expenditure or debt. Instead, it is hidden away as government-guaranteed debt, whether implicitly or explicitly, which accrue as "contingent liabilities". Thus, the government remains ultimately responsible. Problems arise when government ministers force SOEs to undertake projects or make investments or buy unneeded or unnecessarily costly equipment or services. Understandably, the government should remain responsible for the debt incurred, but such practices only ensure that privatisation will not improve enterprise performance.

Adverse public welfare impacts

Privatisation tends to be inegalitarian. Due to the macroeconomic consequences of privatisation, even if inadvertent, reduced investments in the real economy would have serious deflationary consequences in terms of less jobs, stagnant wages, or both. Diversion of available funds to buy existing assets would diminish resources available for expanding the real economy. Thus, by diverting private capital from productive new investments to privatise public sector assets, economic growth would be retarded rather than enhanced.

Privatisation gives priority to profit maximisation, typically at the expense of social welfare, equity and the public interest. In most instances, such priorities tend to reduce jobs, overtime work opportunities and real wages for employees besides imposing higher user fees or charges on customers or consumers. Privatisation, thus, tends to adversely affect the interests of public sector employees and the public, especially poorer consumers.

Costs of living have undoubtedly increased for all. One consequence of privatisation has been the dual provision of inferior services for the poor, and superior services for those who can afford more, and thus better. The implications of dual provision greatly vary and may well be appreciated by those who can afford costlier, but better, privatised services.

Long-term investments by the new private owners are narrowly focused on maximising short-term profits and may hence be minimised as a consequence. Preoccupation with profit-maximising commercial costing has generated a variety of problems. Services and utilities due to such economic costing have often become more inferior or expensive, such as water and electricity. The absence of additional subsidies to the private supply companies increases living costs, such as for water supply and electricity, especially in poorer, rural and more remote areas. Thankfully, technological change has reduced many telecommunication charges, which would otherwise have been much higher due to privatisation.

Privatisation was supposed to free market forces and encourage competition in the economy, but the new owners have an interest in retaining the SOE's competitive advantages, including monopoly positions. Hence, there has been widespread concern about: (i) formal and informal collusion, such as cartel-like agreements; (ii) collusion in bidding for procurement contracts and other such opportunities; and (iii) some interested parties enjoying special influence and privileged information.

Chairman of the Australian Competition and Consumer Commission (ACCC) Rod Sims, a strong supporter of privatisation for three decades, recently confessed that "he is on the verge of becoming a privatisation opponent" (*Sydney Morning Herald*, 27 July 2016). According to him, selling public assets has created unregulated monopolies that hurt productivity and damage the economy.

Inequality in this country is said to have declined steadily over the decades. Part of the reason for this is because about five million undocumented foreign workers are largely excluded from official statistics. A more realistic and inclusive view including this foreign underclass would give a very different picture and inequality may have gone down less impressively, or may even have increased with their inclusion. Inclusion would also change the denominator for output and productivity measures.

Collusion and corruption

Despite misleading claims to the contrary, it is competition policy and not extending private property rights that can encourage competition. Not surprisingly then, privatisation has been accompanied by widespread evidence of collusion. Formal and more commonly, informal collusion appears rife. The collusion may sometimes be formal, where you have companies openly working together through cartel-like arrangements in which these are not prohibited.

Informal collusion is more likely among those involved in public or transparent bidding to provide privatised or contracted-out services. Collusion undermines the possibility of competitive pricing.

Transparent institutions and arrangements, such as public auctions and open bidding for contracts, have often been compromised by secret, informal collusion arrangements. It is also widely acknowledged that those with connections and insider information are better able to secure lucrative contracts and other business opportunities, giving rise to claims of "insider abuse".

Greater public transparency and accountability were expected to promote greater efficiency in achieving the public interest while limiting waste and borrowing. But contrary to claims by its proponents, privatisation does not enhance transparency and accountability or address corruption. Privatisation is rarely implemented on an arm's length basis, contributing to other problems, including rent-seeking and corruption.

Privatisation does not enhance efficiency except in so far as enhancing efficiency augments profits. It is also important to analytically distinguish the question of private or public ownership from the question of competition or market forces. The conflation of the two has worsened analytical confusion.

The public sector can be more efficiently run, as in Singapore, Israel and Scandinavia. The challenge is to ensure that the public sector is much better run. Greater public accountability and a more transparent public sector can ensure greater efficiency in achieving the public and national interest while limiting public sector waste and borrowing.

Throwing the baby out with the bathwater

The governance of many Malaysian SOEs has often been problematic, resulting in a great deal of inefficiency. Many believe that SOEs are necessarily inefficient, particularly in the Malaysian context. Undoubtedly, many had unclear, even contradictory objectives; performance criteria were often poor, with SOEs beset by the lack of appropriate managerial skills, coordination problems, poor monitoring and so on.

It is also often presumed that SOEs are subject to a soft budget constraint, meaning that money is readily made available to SOEs with little accountability expected. Ensuring greater transparency is fundamental to meaningful accountability. SOEs often enjoy monopolistic powers, which can be abused, and require appropriate checks and balances. The answer, in most instances, is not privatisation, although there are instances where privatisation may well be best.

Two examples from Britain and Hungary may be helpful. The most successful case of privatisation in the United Kingdom during the Thatcher period involved a company called National Freight. A Cambridge University study showed that it was successful precisely because it involved an Employee Stock Ownership Plan (ESOP). This basically meant that all the truck drivers and other staff co-owned National Freight and thus had a stake in making it a success.

There was a different situation in Hungary. After the invasion of Hungary in the mid-1950s, the state started getting involved in all kind of things, including running relatively small stores. Many were poorly run because of over-centralised control. After privatisation, they were more successfully run by the new owners who were previously the store managers.

Hence, there are circumstances where privatisation can result in a desirable outcome, but one cannot presume from citing a few such examples that privatisation is the answer to all problems of state ownership. Privatisation, however, has never been a universal panacea. This was part of the problem with the policy implemented from the mid-1980s, especially in the 1990s. One has to understand the specific nature of a problem; that is why the solution has to come from a careful examination of the state and the specific problems to overcome.

SOE reform often superior

SOE reform is often a superior option for a variety of reasons although there are no "one size fits all" circumstances and situations. There can be compelling cases for privatisation in some situations. Retail shops in Hungary were state-owned and successfully privatised to the managers of previously state-owned retail shops – they had a strong incentive to run their privatised retail shops much better.

Problems need to be analysed in context. It would be erroneous to presume that property rights is the problem. This has to be established and should not be assumed *a priori*. There may be other problems and those other problems are not going to go away without some means of resolving them. For an enterprise to be successful, there needs to be an appropriate system, culture and incentives for progress to be made. Following the privatisation of a particular SOE, desirable changes may take place resulting in improved performance and outcomes. But even this does not mean that privatisation per se was responsible for these improvements unless it is established that state ownership itself blocked the desired changes.

If improvements could have been achieved without privatisation, then a range of related issues needs to be examined before determining whether society is better off with privatisation. Correlation does not imply causation. In this connection, it is important to consider the kinds of organisational and managerial reforms, including incentive changes, which might be desirable to achieve superior outcomes. In other words, it is important not to assume that privatisation is the answer regardless of the question or the problem at hand.

But there are many other situations where privatisation is not the solution. In some cases, privatisation may well engender new problems and compound already difficult situations. In other words, privatisation or any other purported solution cannot be the answer without analysing the problems to be addressed.

After all, many SOEs were set up precisely because the private sector was believed to be unable or unwilling to provide certain services or goods. In many instances, the problem with an SOE is not due to ownership per se, but rather to the absence of explicit, feasible or achievable objectives, or even to the existence of too many, often contradictory goals. In other cases, the absence of managerial and organisational systems, such as flexibility and autonomy, and cultures supportive of such goals and objectives may be the key problem. In such cases, managerial and organisational reforms may well achieve the same objectives and goals, or even do better at a reduced cost and thus prove to be the superior option.

Many SOEs have undoubtedly proven to be problematic, often inefficient. However, privatisation has not proved to be the universal panacea for the myriad problems of the public sector it was touted to be. As such, the superior option cannot be presumed *a priori*, but should instead be the outcome of careful consideration of the roots of an organisation's malaise.

Public-private partnerships

After the failure and abuses of privatisation and the contracting-out of services from the 1980s, there was a period of renewed appreciation for the role of the state or government. This has since given way to the promotion of PPPs.

PPPs are essentially long-term contracts, underwritten by government guarantees, with which the private sector builds (and sometimes runs) major infrastructure projects or services traditionally provided by the state, such as hospitals, schools, roads, railways, water, sanitation and energy. PPPs are promoted by many governments in the Organisation for Economic Co-operation and Development (OECD) and some multilateral development banks (MDBs) – especially the World Bank – as the solution to the shortfall in the financing needed to achieve development, including the Sustainable Development Goals (SDGs).

Since the late 1990s, many countries have embraced PPPs for many areas ranging from healthcare and education to transport and infrastructure – with problematic consequences. They were less common in developing countries, but that is changing rapidly, with many countries in Asia, Latin America and Africa now passing enabling legislation and initiating PPP projects. Nevertheless, experiences with PPPs have been largely, although not exclusively negative, and very few PPPs have delivered results in the public interest. However, the recent period has seen tremendous enthusiasm for PPPs.

Undoubtedly, there has been some success with infrastructure PPPs, but these appear to have been due to the financing arrangements. Generally, PPPs for social services, such as for hospitals and schools, have much poorer records compared to some infrastructure projects.

One can have good financing arrangements, such as due to low interest rates, for a poor PPP project. There may be a need for additional financial resources in some situations to improve the efficiency of provision, but this does not come automatically. Nevertheless, private finance all over the world still accounts for a small share of financing of infrastructure. However, good financing arrangements will not save a poor PPP.

PPPs may often involve public financing for developing countries to sweeten the bid from an influential private company from the country concerned. "Blended finance", export financing and new ostensible aid arrangements have become means for governments to support such powerful corporations bid for PPP contracts abroad, especially in developing countries, with such arrangements justified and counted as overseas development assistance (ODA), or even North-South or South-South development cooperation.

PPPs often increase fees or charges for users of services. PPP contracts often undermine the public interest in other ways, including their rights, and the state's obligation to regulate in the public interest. PPPs can limit government capacity to enact new policies – such as strengthened environmental or social regulations – that might affect particular projects.

Undoubtedly, PPP contracts are typically complex. Negotiations are subject to commercial confidentiality, making it hard for civil society and parliamentarians to scrutinise them. This lack of transparency significantly increases the likelihood of corruption and undermines democratic accountability.

Hence, in many cases, PPPs are the most expensive financing option and hardly cost-effective compared to good government procurement. They cost governments – and citizens – significantly more in the long run than if the projects had been directly financed with government borrowing.

It is important to establish the circumstances required to make efficiency gains and to recognise the longer-term fiscal implications due to PPP-related contingent liabilities. Shifting public debt to government guaranteed debt does not really reduce government debt liabilities, but obscures accountability as it is taken off-budget and no longer subject to parliamentary, let alone public scrutiny.

Hence, PPPs are attractive because they can be hidden "off balance sheet" so they do not show up in budget and government debt figures, giving the illusion of "free money". Hence, despite claims to the contrary, PPPs are often riskier for governments than for the private companies involved, as the government may be required to step in and assume costs if things go wrong.

PPPs also undermine democracy and national sovereignty as contracts tend to be non-transparent and subject to unaccountable international adjudication due to investor-state dispute settlement (ISDS) commitments rather than national or international courts. Under World Bank-proposed PPP contracts, national governments can even be liable for losses due to strikes by workers.

PPPs are now an increasingly popular way to finance mega-infrastructure projects, but dams, highways, large-scale plantations, pipelines and energy or transport infrastructure can ruin habitats, displace communities and devastate natural resources. Typically, social and environmental legislation is weakened to create attractive business environments for PPPs. There are also a growing number of "dirty" energy PPPs, devastating the environment and undermining progressive environmental conservation efforts and exacerbating climate change. PPPs have also led to forced displacement, repression and other abuses of local communities and indigenous peoples.

Thus, PPPs tend to exacerbate inequality by enriching the wealthy who invest in and profit from PPP projects, thus accumulating even more wealth at the expense of others, especially the poor and the vulnerable. The more governments pay to private firms, the less they can spend on essential social services, such as universal social protection and healthcare. Hence, PPP experiences suggest not only higher financial costs, but also generally modest efficiency gains.

One alternative, of course, is government or public procurement. Generally, PPPs are much more expensive than government procurement despite government subsidised credit. With a competent government doing good work, government procurement can be efficient and low cost. Yet, international trade and investment agreements are eroding the rights of governments to pursue such alternatives in the national interest. With a competent government and an incorruptible civil service or competent accountable consultants doing good work, efficient government procurement has generally proved far more cost-effective than PPP alternatives. It is therefore important to try to establish why and under what circumstances gains can be achieved and when these are unlikely.

Strengthening governments to cope with PPPs

PPPs have emerged in recent years as the development "flavour of the decade" in place of aspects of the old Washington Consensus. Instead of replacing the role of government or consigning it to the garbage bin of history, corporations are increasingly using governments to advance their own interests through PPPs.

On the one hand, in a contemporary variant of previously condemned "tied aid", developed country governments have been persuaded to use their aid or ODA budgets to promote their own national – read corporate – interests, such as by providing "blended finance" on concessional terms to secure PPP contracts, or to otherwise advance the interests of such businesses.

On the other hand, aid-recipient governments have been encouraged to replace government procurement with PPP arrangements to undertake infrastructure and other projects despite the mixed records of PPPs, not least in developed countries themselves.

Hence, many developing countries have little choice but to deal with the active promotion of PPPs. Thus, to secure financing for needed infrastructure, they need strong institutional capacity to create, manage and evaluate PPPs. When presented with PPP proposals, governments need to have the capacity to critically evaluate these proposals and to make counter proposals when needed. It is therefore important for government institutional capacity to be enhanced to create, manage and evaluate PPP proposals.

Governments should be empowered and thus discouraged from presuming that they have no choice but to accept PPP proposals from the private sector. Most developing country governments cannot dodge the PPP bullet and need to be able to better deal with the challenge.

Strong institutional capacity to better cope with PPPs requires having a dedicated competent service loyal to government and public priorities and concerns to do the needed. But most low income and many middle income developing countries do not have the capacity, let alone the capabilities needed to be able to effectively evaluate and respond to such proposals. Hence, most developing countries need international technical support for the necessary accelerated capacity building.

Using private consultants to fill the gap in the interim before national capacities are sufficiently developed can be attractive in the short-term, but it is often forgotten that most such consultants tend to be mainly oriented to serving better paymasters from the private sector. Hence, strengthening public sector capacities to cope with PPP proposals is necessary and urgent. This may not be a major problem in some emerging market economies, which generally have more choice in such matters, but it is for many poorer developing countries.

ODA should therefore enable public sector capacity building, rather than give governments little choice. Instead of helping countries develop such capacities, ODA often gives developing country governments little choice but to accept some PPP proposals touted as superior.

As many governments may not be able to develop such a centralised capacity and mechanism to deal with very varied PPP proposals, one alternative is for them to work together to develop some kind of shared capacity.

However, relying on organisations committed to PPPs, such as MDBs or IFIs, raises different problems. So far, they have largely failed to credibly provide such capacities and mechanisms. They have also not enabled cooperation among developing countries to better cope with the PPP challenge, partly due to their current inclination to promote and enable PPPs as directed by their major shareholders.

Hence, there is an urgent need to consider and develop alternative arrangements. Government procurement, with sovereign debt if necessary, has been found to be generally much cheaper contrary to the misleading claims of PPP advocates.

Ensuring transparent competition among prospective PPP proposals would also help. Many PPP proposals have been approved and implemented without any real or meaningful transparency or competition despite a great deal of pious rhetoric by donor governments, IFIs and MDBs about the importance of and need for competition and transparency.

There are many contemporary examples that clearly suggest that the public interest would be well served by more transparent bidding. Also, it is important to make sure that PPPs are not abused with the government or public sector, and ultimately, the public, bearing the costs or taking the bulk of the risks while rents or profits mainly accrue to the private partner.

Internationally agreed guidelines would also help. International guidelines for PPPs need to be developed multilaterally through an inclusive multi-stakeholder process, perhaps through the United Nations Financing for Development process. Alternatively, United Nations Conference on Trade and Development (UNCTAD) in Geneva is well placed to work towards such guidelines which would go some way to levelling the playing field.

Such guidelines should endeavour to enhance developing countries' bargaining and negotiating positions, such as by ensuring competition through open bidding. Such guidelines should also seek to avoid the abuse of PPPs, including by ensuring that public money is not used to subsidise private risk and rents.

Responsible and accountable developed and developing country governments must work together to ensure that they are all better able to cope with this growing trend of state-sponsorship of private corporate expansion.

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