

**Balancing the Risks of Corrective
Surgery: The political economy of
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of the New Economic Policy in
Malaysia**

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Abstract

This paper examines some of the political problems surrounding the implementation of policies to rectify horizontal inequalities through an examination of probably the most successful such programme followed in a developing country, the New Economic Policy (NEP) in Malaysia. Policymakers attempting to redress such inequalities are faced with a dilemma, as such policies themselves run the risk of alienating the economically dominant group, which may undermine any positive effects of redistribution. The chapter argued that whilst redistributive policies of the NEP were generally tolerated by the Chinese 'losers' during a period of high economic growth, the mid-1980s recession drove home Chinese grievances at their loss of economic dominance. The particularly patronistic structure of the Malaysian state, itself largely a product of the NEP, compounded this as the recession intensified factionalism within the regime, contributing to a spiral of ethnic mobilization that brought the country to the brink of ethnic conflict in late 1987, averted only through a Draconian crackdown. The paper concludes that the Malaysian experience gives strong weight to the intuitive claim that the rectification of horizontal inequalities is best conducted under conditions of relatively high growth, such that even the economics 'losers' still make absolute, if not relative, gains.

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The existence of significant 'horizontal inequalities' (Stewart 2000a; Stewart 2002), or 'relative deprivation' (Gurr 1993), between ethnic, religious or cultural groups is increasingly being seen as a potential source of communal violence in multicultural countries. In such contexts, policies to rebalance economic distribution are being promoted as an integral aspect of long-run conflict prevention policies (Stewart, 2000b). Yet policymakers attempting to redress such inequalities are faced with a dilemma, as such policies themselves run the risk of alienating the economically dominant group, which may undermine any positive effects of redistribution. In Sri Lanka, for instance, '[a]ction to reduce some privileges in education and employment enjoyed by Sri Lankan Tamils... was itself among the causes of conflict' (Stewart 2000b: 258).

Malaysia's record since 1970 under the aegis of its redistributory New Economic Policy (NEP) is thus often held up as exemplary, having achieved exceptional economic growth and a dramatic reduction in poverty, while simultaneously redressing existing horizontal inequalities and avoiding significant inter-communal violence. As Donald Horowitz (1989) notes, at the time of independence, Malaysia (Malaya) was often viewed as a considerably more unstable country than Sri Lanka (Ceylon); the reverse has proved true. The Malaysian experience of redistribution has not been entirely problem free, however. This paper takes a closer look at the performance and problems associated with horizontal redistribution in Malaysia with the intention of identifying obstacles and challenges that need to be addressed in the development of similar futures policies, both in Malaysia and elsewhere.

Figure 1: Measures of horizontal income inequality, 1970-2002

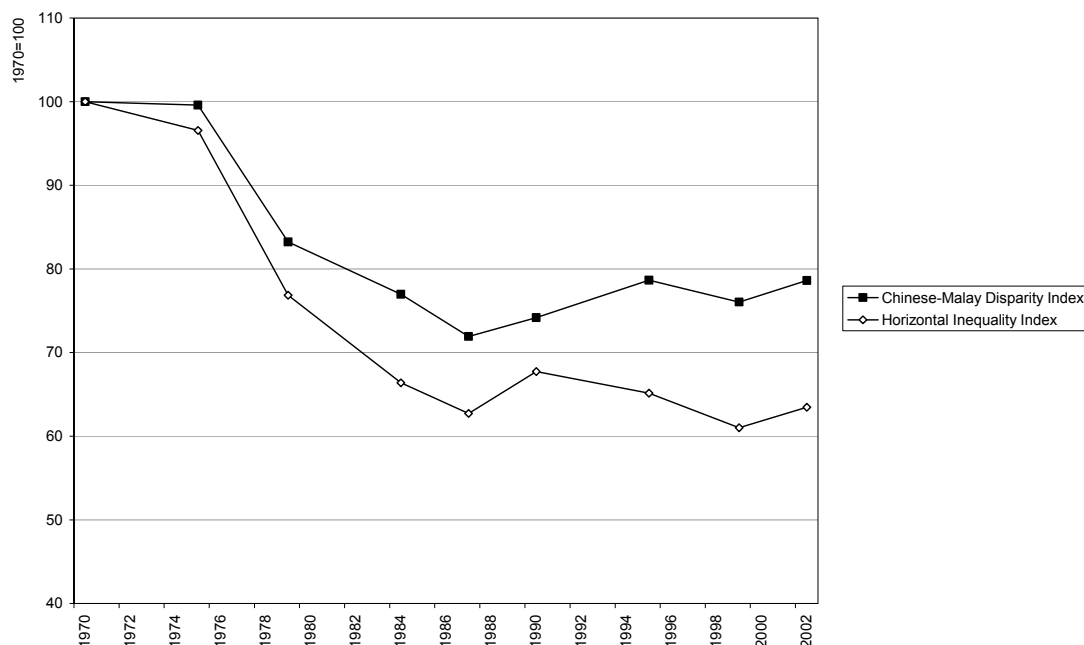


Figure 1 shows two measures of horizontal inequality in Malaysia over the period since the inception of the NEP, both indexed to 1970. The first measure, a simple unweighted ratio of Chinese to Malay average household incomes, dropped significantly for a decade from the mid-1970s, before picking up again in more recent times; in absolute terms, Chinese household had a mean income 2.3 times higher than Malay households in 1970, reaching its low-point of 1.6 times in 1987, rising again to 1.8 in 2002. The second measure, a population-weighted standard deviation of group incomes from the national mean (cf. Stewart, Brown, and Mancini 2005), shows a initially similar trajectory, dropping quickly until 1987, but broadly level since – this difference largely accounted for by the relatively faster growth of the Malay population, which kept the overall measure down even as Chinese (and Indian) incomes increased relatively quicker.

Clearly, then, the main period in which the NEP was forcefully pursued, from the passing of the Industrial Coordination Act in 1974 until the NEP was ‘held in abeyance’ in the mid-1980s, accompanied by high growth rates until 1985, saw a drastic decline in horizontal inequality in Malaysia, although disparities remained significant. Despite annual growth rates in excess of 10 per cent for much of the 1990s, the period since the mid-1980s has seen horizontal inequality at best plateau out, at worst increase slightly. Why, then, did the Malaysian government move back from a policy that had been so effective in reducing ethnic inequalities?

Typically, it is argued that the severe economic recession that hit Malaysia in 1985 forced the administration of prime minister Mahathir Mohamad (1981-2003) into the realization that some degree of modernization and privatization at the expense of the interventionist NEP was necessary for the economy to recover and continue its previous upward trajectory (e.g. Khoo 1992). Not disputing the validity of this argument, this paper instead focuses on the political dynamics of the period, arguing that the confluence of economic recession together with the impacts of the NEP on the non-Malay, particularly the Chinese, communities and the factional structure of the BN coalition confluenced into a spiralling process of ethnic politics that, by late 1987, threatened to break out into violence.

The paper is organized into four main sections as follows. Sections 1 and 2 provide the political economy context of the mid-1980s focusing, respectively, on the policies of ethnic redistribution undertaken by the Malaysian state and on responses to this redistribution from the Chinese community. Section 3 analyses the impact of the economic recession and the process of ethnicization identified above. Finally and by way of conclusion, Section 4 offers a brief comparison of these events with the more recent recession that impacted the country after the currency crisis of 1997.

1. Horizontal redistribution in Malaysia: Context and overview

Since 1970, economic redistribution along ethnic lines has been both a major economic objective of the Malaysian state and a major plank in its legitimising discourse. When Malaya gained independence from the British in 1957, it was shackled by a colonial legacy of the ‘ethnic division of labour’, whereby the native Malay community had been left to remain in its traditional occupation of rural subsistence farming, whilst mainly Chinese and Indian immigrants were brought in to staff the colonial administration and to work the tin mines, rubber plantations, and other economic enterprises (e.g. Abraham 1997; Brown 1997; Kratoska 1982). By the mid-twentieth century, the Malay community was severely economically disadvantaged, with the domestic economy dominated in particular by the Chinese. Even the Malay’s numerical dominance in their perceived *Tanah Melayu* (Malay Lands) was under threat. Negotiations for independence, both with the erstwhile

colonial masters and between the major ethnic groups of the new nation, thus centred on a medley of contentious issues including the degree of citizenship rights extended to the immigrant communities and the position of Islam and the hereditary Malay Rulers in the constitution (Lee and Heng 2000; Stockwell 1979). The resulting formula was a federal system with (from the Malay perspective) fairly generous citizenship rights for the non-Malays balanced against 'special rights' for the Malays and the notorious independence 'bargain' of 'Politics for the Malays, Economy for the Chinese' (Case 1996). This system found its political form in the Alliance coalition, a triumvirate of three ethnic parties representing the major communities in the country: The United Malays National Organization (UMNO), the Malayan (later Malaysian) Chinese Association (MCA) and the Malayan (later Malaysian) Indian Congress (MIC).

By the late 1960s, many Malays were increasingly dissatisfied with their side of the bargain, a dissatisfaction expressed by the new breed of Malay *ultras* rising through the ranks of UMNO, and voiced most publicly in two Bumiputera Economic Congresses held during the decade. After the May 1969 general election descended into ethnic rioting in which more than a hundred people were killed, a state of emergency was declared and parliament suspended. The prime minister and 'father of independence' Tunku Abdul Rahman was eased out of power and replaced by Tun Abdul Razak, who was more sympathetic to the *ultras*' concerns. The Alliance was expanded through the cooptation of most of the major opposition parties, and in 1974 renamed the *Barisan Nasional* (BN – National Front).

Razak's administration argued that the root causes of the riots had been the economic discrepancies left over from the colonial period and allowed to fester under Abdul Rahman's consociationalist *laissez-faire* government. In 1970, the government moved to resolve these issues through the promulgation of a new policy strategy, the New Economic Policy. The NEP had two stated objectives: the complete eradication of poverty, and the eradication of the association between ethnic group and economic role. Ostensibly, the beneficiaries of redistribution were to be all *bumiputera* (lit. 'sons of the soil'), a term which encompasses the Malays, but also the indigenous tribes of East Malaysia and some other smaller groups, including the peninsular Orang Asli tribes. In reality, however, it heralded a new era of state interventionism and Malay chauvinism; in the words of Alasdair Bowie, it represented 'a form of Third World economic nationalism [in which] the principal antagonist was not foreign but rather domestic [i.e. the Chinese]' (Bowie 1994: 171). Ambitious twenty-year targets were set for the NEP through the first Outline Perspective Plan, including a reduction in the overall poverty rate from 49 per cent in 1969 to 16 per cent and 30 per cent *bumiputera* ownership of corporate wealth. Ethnic quotas were introduced for the distribution of new share offers, enrolment in public universities and employment in major corporations.

After an initial capital flight, it is generally argued that Malaysia's Chinese community essentially acquiesced to the NEP, recognising its political importance and developing strategies to defend their capital dominance (Heng 1992; Heng 1998). In the late 1970s, the Malaysian Chinese Association (MCA), the senior Chinese party within the BN coalition, was instrumental in the formation of Multi-Purpose Holdings Berhad (MPHB), a large conglomerate aimed at consolidating Chinese capital. At similar, smaller, conglomerate Maica Holdings was set up by the Malaysian Indian Congress, also a BN component. At a lower level of economic activity, number of Deposit-Taking Cooperatives (DTCs) were set up, again often linked to the MCA, to channel and protect the resources of less well-off Chinese. 'Ali Baba' arrangements also became commonplace, where an often politically-linked Malay entrepreneur would become in effect a silent partner in a business arrangement with a Chinese

counterpart, providing the benefits of *bumiputera* status but little involved in the running of the business.

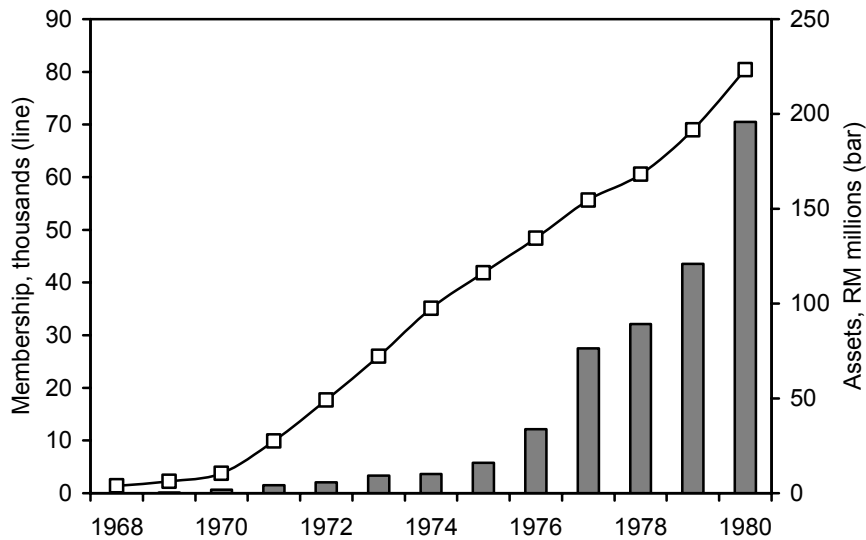
Although set to run until 1990, the NEP was 'held in abeyance' in the mid 1980s by the administration of Prime Minister Mahathir Mohamad, who replaced it with a policy of industrialisation and economic liberalisation (Jomo, Khoo, and Chang 1995; Khoo 1992). After 1990, the NEP was officially replaced first by the National Development Policy (NDP, 1991-2000) and then the National Vision Policy (NVP, 2001-2010), which promoted broader developmentalist agenda. Horizontal economic restructuring remains an important objective, however, although this is increasingly expressed in terms of corporate involvement rather than poverty eradication. The latest (eighth) of the country's Five Year Plans that set more specific policy objective and targets stated that 'emphasis will continue to be given on *[sic]* increasing effective Bumiputera ownership and participation in the corporate sector, improving Bumiputera participation in high-income occupations, strengthening the development of the BCIC [Bumiputera Commercial and Industrial Community], narrowing income inequality and eradicating poverty' (Malaysia 2001: 55).

2. Chinese responses to the NEP

2.1. Responses from within: The Malaysian Chinese Association

Despite its pronounced support for the NEP as the largest Chinese party in the *Barisan Nasional* coalition, the MCA itself spear-headed a move in the 1970s to consolidate and corporatize Chinese business interests in the country in defence against the impacts of the policy. As Heng (1997: 271) notes, the MCA 'felt that Chinese enterprises were too small and under-capitalized to compete effectively with large state enterprises... which were aggressively acquiring assets on behalf of Malays'. The first prong of this defence mechanism was the establishment of Deposit-Taking Cooperatives, which acted as 'quasi-banks', taking deposits from investors – over 99 per cent of whom were Chinese, many from the poorer strata of society – and promising returns of up to 14 per cent. The Chinese cooperatives movement in fact predated the NEP, with the largest, *Koperatif Serbaganu Malaysia* (KSM), established by the MCA in 1968, largely in response to the aggressive demands of the Bumiputera Economic Congresses. It was only after 1970, however, that a renewed membership drive by the MCA saw the number of depositors take-off significantly, and only after the establishment of MPH in 1975 that the capital returns escalated significantly (see Figure 2). The 1970s also saw the creation of more Chinese cooperatives, many of them linked with particular MCA branches or divisions and, later on, with other Chinese parties in the BN. By the time of the recession in the mid-1980s, a total of 35 such deposit-taking cooperatives had been established, which had collected between them deposits estimated at RM4 billion (*Far Eastern Economic Review* [FEER], 28/08/1986). With some 588,000 individual depositors, one MCA leader estimated that around half of all Malaysian Chinese families had some investment in one of the cooperatives (FEER, 09/08/1987).

Figure 2: Development of KSM, 1968-1980



Source: Calculated from Gale (1985: 35)

While the cooperatives established strong economic links between the MCA and many ordinary Chinese families, it was Multi-Purpose Holdings Bhd. (MPHB) that was to be the flagship of the MCA's quest to defend Chinese capital against the NEP. Formed in 1975, a year after the passing of the Industrial Coordination Act, MPHB's ostensible purpose was, in words of MCA president Lee San Choon, to free Chinese businesses 'from the strait jacket that is their family business and organize themselves into larger combines to be run on a modern and efficient basis' (quoted in Gale 1985: 53). But the intention of MPHB to provide a shield against the NEP was clear; after the company's attempt to takeover one of the country's largest banks was blocked by the government, the UMNO Youth leader Suhaimi Kamaruddin spoke of 'a series of strategies carried out in secret to cripple the plans carried out by the Government to improve the economic standing of the Malays and other Bumiputera' (quoted in Gale 1985: 144). Established with initial funding from the MCA's cooperative arm KSM, which retained a controlling stake after floatation on the stock market, and under the dynamic directorship of a KSM director, Tan Koon Swan, MPHB embarked on an aggressive programme of corporate acquisitions. By 1984, the holding company had stakes in more than a hundred subsidiary and associated companies, many of them also listed on the Kuala Lumpur Stock Exchange, and was turning in regular healthy profits.

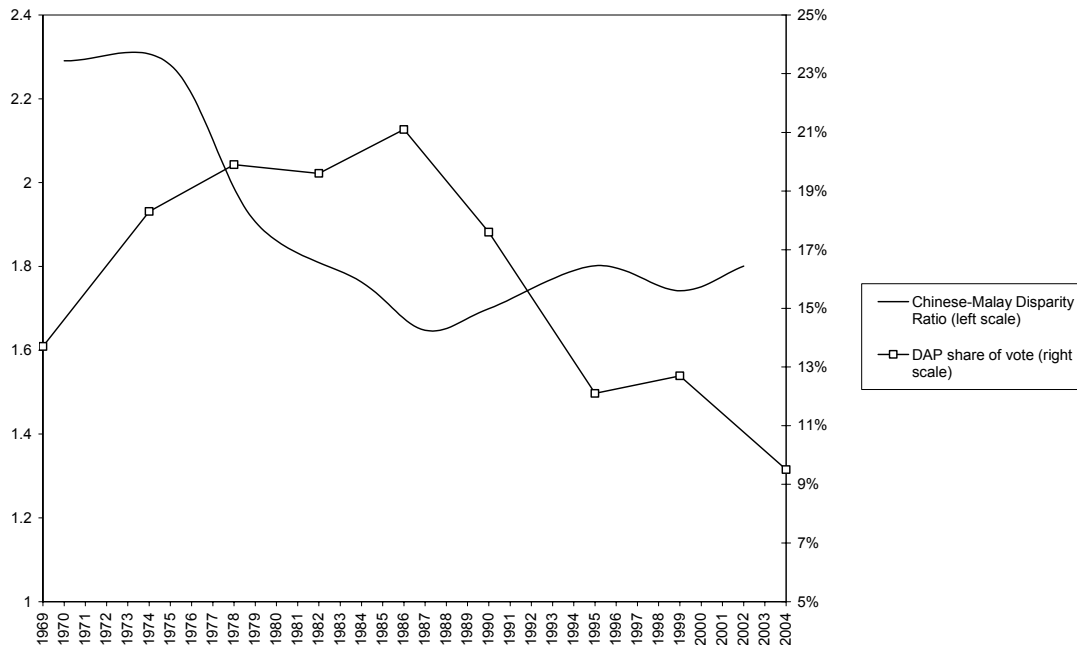
2.2. Responses from without: The Democratic Action Party

Responses to the NEP from the Chinese community beyond the BN coalition parties coalesced around the opposition Democratic Action Party (DAP), a nominally multi-ethnic but Chinese-dominated party that was formed as an off-shoot of the People's Action Party of Singapore. The DAP was the only major opposition party that refused to be co-opted into the Alliance/*Barisan Nasional* following the 1969 riots. Led by the fiery rhetoric of Lim Kit Siang, who remains the national chairman to date, the DAP was fiercely critical of the implementation of the NEP, which it claimed had lined the pockets of a few elite businessmen and politicians without addressing underlying issues.

On the back of this critique, the DAP enjoyed a drastic rise in support throughout the early NEP period, mostly from Chinese voters, capturing over 20 per cent of the

national vote in the 1986 election. Indeed, as Figure 3 shows, throughout the post-1969 period, the performance of the DAP has been strongly (and inversely) related to the relative income advantage of the Chinese over the Malay community, the one rising as the other falls.

Figure 3: Performance of DAP against Chinese-Malay income ratio, 1969-2004



The DAP was also actively campaigning with Chinese civil society for amelioration of the impacts of the NEP, particularly in the field of education. Even before the 1969 riots, the large and influential Chinese educationalist *Dongjiaozong* organizations had lobbied for the creation of a Chinese-language private university, dubbed the Merdeka University. Such was the support for the move within the community that even the MCA initially expressed support, although later promoting the idea of a private English-language tertiary college as a compromise, which was accepted by the government with the creation of the Tunku Abdul Rahman College under the aegis of the MCA. *Dongjiaozong* and the DAP, however, continued to press the Merdeka University cause after the inception of the NEP. A legal challenge was mounted to challenge the government's right to block the proposal but successive courts ruled in favour of the government on the basis of the Universities and University Colleges Act, part of the first tranche of NEP legislation, which specifically stated that all universities must be government funded (Freedman 2001).

3. Economic crisis, ethnic politics and the end of the NEP

In last quarter of 1987, government supporters and critics alike realized that the country was on the brink of potential ethnic violence such as had not been seen since 1969. Decisive but draconian action by the government – the notorious 'Operation Lalang' that saw the detention without trial of over a hundred politicians, unionists and NGO activists, a complete ban on public demonstrations and the withdrawal of publishing licenses for a number of national newspapers and magazines – averted the clashes that appeared imminent. This section will argue that the rapid deterioration in ethnic relations at the time was the outcome of a cycle of 'ethnic outbidding' (cf. Horowitz 1985; Rabushka and Shepsle 1972) driven by confluence of the economic pressures of the recession of the previous years, which had intensified economic and redistributive grievances felt by the non-Malay,

particularly Chinese, community, and the existence of heightened factionalism within the BN coalition (itself intensified by the economic collapse), which allowed the political space for these grievances to be expressed.

3.1. Background to the Recession: Factionalism in the *Barisan Nasional*

In understanding the dynamics of recession, inequality and ethnic politics in the mid-1980s, we must begin with an analysis of the factional structure of the *Barisan Nasional* regime. Although its public face is very much one of unity of purpose and consensus building, the coalition is rife with factionalism between and within the coalition parties. Intra-party tensions are often between parties of a similar ethnic make-up, jostling to take centre-stage as the main representative of that community: such tensions led to the quick departure of the Malay-based *Partai Islam seMalaysia* (PAS – Pan-Malaysian Islamic Party) after it was co-opted into the coalition following the 1969 riots; similar tensions between the MCA and the *Gerakan Rakyat Malaysia* (GERAKAN – Malaysian People’s Movement Party), another Chinese-based coalition partner have been on-going for decades.

In the early 1980s, however, internal factional struggles arose within the largest two parties in the coalition, UMNO and the MCA, which had vital implications for the way the recession impacted the ethnicization of politics. The first of these splits to become public was within the MCA. In 1983, MCA president Lee San Choon abruptly retired from office, shortly after ousting his deputy and replacing him with his own protégé, Neo Yee Pan. Neo was not popular within the party, however, and was soon challenged by a faction headed by Tan Koon Swan, who accused him of creating ‘phantom’ party members to boost his standing (FEER, 08/03/1984). As we have seen, Tan was a key figure in the Chinese response to the NEP, and was thus highly popular, both as the managing director of MPHB, the Chinese conglomerate designed to protect capital from the NEP, and as a successful entrepreneur in his own right.

The intense and protracted nature of the dispute, the details of which need not detain us here, soon dragged in the other BN parties. UMNO leaders expressed concern that the factional struggle would drag down support for the coalition, whilst leaders of GERAKAN sought to capitalise on the MCA’s woes to boost its own standing in the BN. In 1984, Deputy Prime Minister and UMNO deputy president Musa Hitam even suggested that the MCA should consider ‘opting out’ of the coalition temporarily until its internal problems were solved (FEER, 27/12/1984). At around the same time, the Malay opposition party PAS approached the MCA to ‘explain its aims’, an indication that senior PAS members felt that tensions between UMNO and the MCA were high enough that PAS might be able to tempt the MCA out of the BN (*New Straits Times* [NST], 15/10/1984).

The dispute came to a head at the November 1985 party elections, when Tan officially challenged Neo for the party presidency. The delegates voted overwhelmingly for Tan, and the party split appeared settled. Just days after Tan won the presidency, however, Pan-Electric – a major Singapore-based listed company of which he was a director – went into bankruptcy amidst allegations of share price manipulation, prompting a collapse on both the Singapore and the Malaysian stock exchanges. Criminal Breach of Trust charges were lined up against Tan in Singapore but, in an apparent arrangement with the Malaysian government, he was not prosecuted until after the 1986 general election. Shortly after the election, Tan was found guilty and imprisoned in Singapore, relinquishing control of the party to his deputy, Ling Leong Sik. Ling, a staunch supporter of Tan during the crisis, picked another Tan stalwart, Lee Kim Sai as his new deputy.

The denouement of the factional struggle within UMNO came at the party elections of 1987, but the roots of the contest can be traced back to the administration of Mahathir's predecessor Hussein Onn. Although perceived as an honest and sincere politician with a distinguished pedigree (his father was UMNO founder Onn Jaafar), Hussein lacked a substantial support base of his own within the party, and thus also lacked an obvious choice of deputy.¹ Hussein's initial choice was apparently the powerful but unpopular home minister Ghazali Shafie. Ghazali, however, lacked a senior post within UMNO, and Hussein was thus given an ultimatum by the party's three elected vice presidents that he must choose one of them. The three were Ghafar Baba, Tengku Razaleigh Hamzah and Mahathir Mohamad. Hussein selected Mahathir, who was politically closest to him, but also the most junior of the three. Ghafar promptly resigned from the cabinet and left frontline politics until the 1980s; Razaleigh was similarly disenchanted, though he retained his cabinet portfolio.²

In 1980, Hussein announced that he would be stepping down as prime minister, to be replaced by Mahathir. The transition took place during the party elections at the 1981 UMNO general assembly. In the context of an ordered and anointed transition from Hussein to Mahathir, there was never likely to be any challenge to Mahathir's position, but a contest did emerge for the deputy presidency of UMNO, and thus *de facto* the position of deputy prime minister. The two contenders were Musa Hitam, one of the 'young Turks' who had briefly been expelled from the government along with Mahathir, and Razaleigh. The contest was the first election for the deputy presidency, and with both candidates popular within the party, Mahathir remained officially neutral about who his preferred deputy would be. It has been suggested, however, that Hussein's public support for Musa was the swaying factor which gave him a decisive but less than over-whelming victory over Razaleigh (Means 1991: 82). Undaunted, Razaleigh again challenged Musa at the next party elections in 1984. The contest was bitter and expensive, marking the real entry of money politics into the party. By this time, the NEP had brought about a transformation of UMNO membership, with small businessmen replacing teachers and British-trained bureaucrats as its office bearers. For many of these businessmen, involvement in UMNO was an investment the same as any other, and one of the principle sources of return on this investment was factional patronage.³ In 1984, Razaleigh, a successful businessman was able to dispense considerably personal patronage to his supporters. In contrast, Musa, a career politician who had been an assistant minister in Tunku Abdul Rahman's cabinet, was a relative pauper in UMNO's top ranks.

Despite Razaleigh's financial advantage, however, Musa won the contest again by a slightly increased margin, in part due to the fact that this time around Mahathir was

¹ Hussein's father Onn Jaafar had left UMNO in the 1950s after a failed attempt to transform it into a multiracial party. Hussein, with a more chauvinistic ideological bent than his father, had assiduously resisted entering UMNO until the equally pro-Malay Razak replaced the more consociational Tunku Abdul Rahman.

² It has been alleged that Ghazali made use of his influence as Home Minister over the secret police ('Special Branch') to try and discredit Mahathir with purported link to the Singapore Communist underground. Syed Husin Ali, a professor and leader of the PSRM who was detained under the ISA for six years during the 1970s, alleged that special branch officers attempted to coerce him into admitting to being a 'middleman' between Mahathir (and Musa) and the Singapore communist underground. See Syed Husin Ali 1996.

³ One former UMNO office bearer I interviewed during fieldwork, who had been active in the party for more than a decade before leaving to join the opposition in 1999, was able to give me a breakdown of how much he (claimed to have) spent on buying his nomination to various posts and delegations, and explained his departure from UMNO as partly due to his support for Anwar, but also due to the party's failure to provide him with a 'big project', despite his investment.

openly supportive of him.⁴ In the aftermath of his victory, Musa privately demanded that Mahathir remove Razaleigh from his post as the powerful UMNO treasurer and from his ministerial position. Mahathir half complied, sacking Razaleigh from his party post, but keeping him in the cabinet, moving him from the Finance Ministry to Trade and Industry Secretary (*Asiaweek*, 16/03/1986). This move apparently disenchanted Musa even further, however, as he claimed that Razaleigh's new position would allow him even greater control of patronage networks (Crouch 1996). In February 1986, Musa Hitam abruptly resigned his position as Deputy Prime Minister, although retaining his post as Deputy President of UMNO. With party elections again due in April 1987 and Mahathir himself experiencing a drastic decline in popularity, some form of leadership challenge appeared imminent.

3.2. Impact of the Recession

The economic recession of the mid-1980s directly impacted both UMNO and the MCA but in very different ways, which ultimately contributed to the spiralling ethnicization of politics in 1987. In 1985, the market price for all Malaysia's main exports – petroleum, palm oil, rubber, sawlogs, tin and cocoa – collapsed, prompting a deep recession that lasted into 1987. As the redistributive grip of the NEP reached its peak and the recession bit in, the Chinese community was hit hardest, registering a 4.8 per cent drop in its average household income between 1984 and 1987, compared with slight *increase* of 1.9 per cent for the bumiputera community over the same period. For the first time, the declining incomes of the Chinese relative to the national average was accompanied by an absolute decline.

As we have seen, for the MCA, the recession came on the back of a very public factional dispute that had already hurt the party in the eyes of the Chinese community. The first indication that the recession was to deepen the party's woes came with the collapse of Pan-Electric after Tan's victory. Pan-Electric had clearly been in trouble before the MCA election, and Tan had pledged S\$40 million of his own money in an interest-free loan to help keep the company afloat, which he 'flouted' following his successful election – perhaps indicating a false belief that his political position as the head of the MCA would protect him from action by the Singapore government (MAS 2004: 25). There were further allegations that Tan used money from MPH in a last-ditch attempt to save Pan-Electric (Heng 1997: 272). Further problems for the MCA and Tan in particular were added as the recession – and, perhaps, Tan's misdemeanours – impacted the performance of MPH, which registered its first ever loss in 1985.

Despite his personal troubles, Tan – still popular with much of the MCA grassroots – remained at the head of the MCA and led it into the general election that was held in August 1986. Although the BN won the election comfortably, maintaining its usual two-thirds dominance of the parliament, Chinese support for the coalition haemorrhaged and the MCA performed disastrously. Table 1 shows the election results for the West Malaysia, broken down according to the proportion of Chinese voters in the constituency. While the relatively small size of the Chinese population and the historical bias of the electoral system towards rural Malay seats (cf. Lim 2003) meant that only a small proportion of West Malaysian seats – 24 out of 132 – had a Chinese majority, the BN nonetheless performed disastrously in these seats, winning only six of them, of which five were those with the smallest Chinese majority. In contrast, the BN virtually annihilated the Malay opposition party PAS (*Partai Islam seMalaysia*, or Pan-Malaysian Islamic Party), which won only one seat – Pengkalan

⁴ Also contesting was Harun Idris, a charismatic vice president who had briefly been imprisoned on corruption charges in the 1970s, before receiving a royal pardon. Harun surprised many, however, with his lack of support, garnering only a handful of votes.

Chepa, in the poor Malay-dominated state of Kelantan. As a component of the BN, the MCA won only 17 of the 32 seats it contested; UMNO won 82 out of 83. The election result contributed to deteriorating relations between UMNO and the MCA with the BN coalition; many within UMNO blamed the MCA for the poor performance, and comparisons were made to the 1969 election, when a similarly poor showing by the MCA had almost cost the Alliance its parliamentary dominance, as well as proving the spark point for the ethnic riots.

Table 1: Seats won and contested by major parties in West Malaysia, 1986

Proportion of Chinese voters	BN	DAP	PAS	Total
≤10.0%	25(26)	0(0)	1(25)	26
10.1-20.0%	18(18)	0(0)	0(17)	18
20.1-30.0%	27(27) ^a	0(8)	0(21)	27
30.1-40.0%	23(23) ^b	0(9)	0(17)	23
40.1-50.0%	13(14)	1(13)	0(9)	14
50.1-60.0%	6(9)	3(8)	0(7)	9
60.1-70.0%	0(6)	6(6)	0(0)	6
70.1-80.0%	0(4)	4(4)	0(0)	4
80.1-90.0%	0(5)	5(5)	0(0)	5
Total	112(132)	19(53)	1(96)	132

Notes: figure in brackets gives number of seats contested; a) seat of Sri Gading in Johor won by the BN without contention; b) seat of Parit Sulong in Johor won by the BN without contention

A week after the election – despite later accusation that the relevant authorities had been aware of the growing problem for six months – the central bank froze the assets of twenty-four of the Chinese Deposit-Taking Cooperatives, which had collected between them over RM500 million from almost six hundred thousand depositors. Originally promising returns of up to fourteen per cent, the cooperatives' assets had been virtually wiped out in the recession and, in some cases, through gross mismanagement – many of the cooperatives had lent money to their own directors on very soft terms and in one case highlighted by the influential Consumers Association of Penang, a cooperative director bought a piece of property privately and then sold it on to his cooperative at ten times the price he paid. As the government moved to wind up the cooperatives, depositors were faced with the prospect of receiving back barely one fifth of their investment. The government ruled out a rescue package, citing the poor economic climate (*Asiaweek*, 1/2/1989).

As part of the system of defence against the impacts of the NEP orchestrated by the MCA over the previous decade, many of the cooperatives had strong links with the party and, indeed, with MPHB – the largest of the frozen cooperatives, Koperasi Serbaguna Malaysia, controlled 222 million shares in MPHB. Faced with the loss of their life savings, many depositors held the MCA responsible for their predicament. Depositors held furious demonstrations demanding the MCA persuade the government to implement a ringgit-for-ringgit rescue package, even storming the home of the chairman of one of the cooperatives, and staging a number of 'sit-ins' at the headquarters of others and outside the MCA general assembly, provoking a near riot when a group of delegates attacked the demonstrators, accusing them of 'making the Chinese community lose face in front of the prime minister', who was attending the assembly (*FEER*, 27/11/1986). The government's refusal to back such a plan

was seen by some as a case of ethnic discrimination – in the 1970s, the government had bailed out Bank Rakyat, a cooperative bank with mainly Malay investors and had also rescued Bank Bumiputera from almost RM1 billion losses in the Hong Kong property market in a scandal that implicated high-ranking UMNO politicians, including the Trade and Industry Minister Razaleigh Hamzah.

By late 1986, then, the MCA's position as the representative of Chinese interests within the BN and Malaysian society more broadly was extremely shaky, largely due to the direct and indirect impacts of the economic recession, that had driven home the effects of the NEP redistribution. Yet the MCA's losses in the election had also seen its position within the BN coalition weaken considerably. The MCA was thus torn between its need to mend fences with its senior partner UMNO, but also to champion the woes of the Chinese community.

For UMNO, the effects of the recession played out slightly differently. As already mentioned, the NEP had transformed UMNO from a party of public sector employees into a vast patronage machine that spread down to the village level through the Village Development Committees (JKK – *Jawatankuasa Kemajuan Kampung*). The protraction of the factional struggle between Musa and Razaleigh had important implications in that it caused the dispute to spill over into a deep factional divide within UMNO, and even beyond into Malay society at all levels. As one commentator put it:

Before this any such division was only felt at the top but this time it went down to the grass roots... *Orang Musa* ('Musa's man') and *orang Razaleigh* ('Razaleigh's man') were not only labels but often became the 'key phrases' which opened or terminated a business or any other discussion, guaranteed or denied an individual getting a contract or a scholarship, and expedited or delayed an application for a job, a licence, or even the transfer of a teacher from an *ulu* ('remote') to an urban school and vice versa.

(Shamsul 1988: 172-3)

This deep factionalism within UMNO was aggravated by the economic collapse of the mid-1980s. The economic downturn was particularly felt by the Malay business class, where the effects of the recession were heightened by the *ersatz* nature of much Malay capital – based to a large extent on government patronage through the NEP and an associated flurry of mergers and acquisitions by new Malay conglomerates. By 1986, the UMNO-dominated government was finding it difficult to deliver 'development plums' to its rural Malay constituency (FEER, 02/01/1986). Small Malay businessmen, used to the frequent handout of development projects and preferential licenses, found their livelihoods severely affected both by the economic downturn and the concomitant contraction in government patronage. In such conditions, those businessmen who were also UMNO members started to pressurise their respective political patrons for further largesse, in turn heightening factionalism in the upper echelons of the party (see Case 1996 for an extended version of this argument). After Musa's resignation, it was clear that some form of challenge to Mahathir's presidency of the party was likely in the UMNO elections of April 1987. A surprise realignment of forces in the months preceding this saw Razaleigh and Musa, erstwhile arch-enemies, team-up to challenge, respectively, Mahathir and his candidate for deputy, Ghafar Baba. These two pairings of candidates for the top posts soon broadened into unofficial slates of candidates: Mahathir's Team A and Razaleigh's Team B. When the party election was held, the results demonstrated the deep divisions in the party. Mahathir and Ghafar both won,

but by the smallest of margins: Mahathir beat Razaleigh by less than three per cent of the votes cast; Ghafar's winning margin over Musa was even smaller and indeed less than the number of spoiled ballots. On the next rung down, two of the three elected vice presidencies went to Team A candidates, the other to Team B (*Asiaweek*, 03/05/1987).⁵ Team A candidates also won fifteen of the twenty-five seats available on the party's top decision-making body, the Supreme Council. As president-elect, however, Mahathir was entitled to appoint another ten council members, thus tightening his control over the party's hierarchy, despite his own wafer-thin majority. The struggle did not end there, however, as the Razaleigh team challenged the legitimacy of the UMNO elections in a court process that eventually led to the dissolution of the party and its reconstitution as UMNO Baru (New UMNO), firmly under Mahathir's control. Many of Razaleigh's supporters crossed the floor and formed a new opposition party, *Semangat '46* (Spirit of '46 – a reference to the year UMNO was founded).

3.3. From Intra- to Inter-Party: UMNO vs. MCA and the demise of the NEP

We have seen, then, that the economic recession of the mid-1980s brought to crisis point transformations that the NEP had wrought in both the senior parties in the BN, threatening to undermine both the huge corporate empire associated with MCA and the patronage network that UMNO had developed. In the early stages of the recession, before the depth of the schism within UMNO had become clear, the MCA was being drawn by contradictory incentives, either to patch things up with UMNO and cement its place in government, or else to seek redemption from the Chinese community by airing their grievances over the NEP. For those within the MCA who felt that reasserting the party's position as the defender of Chinese interests was more important than a *rapprochement* with UMNO, the explosion of factionalism within the latter must have seemed like a God-send – with UMNO considerably weakened, no longer could it blame the MCA for the coalition's woes nor ignore the demands of the Chinese party.

The first indication that sections within the MCA was willing to push a harder line for the resolution of Chinese grievances came in November 1986, when the Selangor branch of the MCA, which was headed by the national deputy president and Labour Minister Lee Kim Sai, passed a resolution calling for the abolition of *bumiputera* status for the Malays and the East Malaysian natives. The resolution provoked an immediate backlash from UMNO members, who interpreted it as a demand for the end of the cherished Malay 'special rights'. Forty-six UMNO MPs wrote to Mahathir, asking him to sack Lee from the cabinet, who himself offered to resign. Whilst the rift was quickly patched over in public – the Selangor MCA withdrew the resolution and the Sultan of Selangor publicly reprimanded Lee and warned him not to question Malay special rights – many within UMNO remained unappeased, and it contributed to deteriorating relations between the parties, most notably in the virtual demonisation of Lee that was to arise later in 1987 (*Asiaweek*, 23/11/1986).

As the factional struggle within UMNO intensified, however, the MCA continued to assert its renewed relative strength within the coalition, particularly on the still unresolved issue of the frozen cooperatives and the extent of the rescue package that the government would offer. At the height of its own internal crisis, the MCA had been threatened with expulsion from the BN; in May 1987, it was the MCA's turn to threaten to leave the coalition should the government refuse to institute a ringgit-for-

⁵ The two Mahathir allies were Wan Mokhtar Ahmad and Anwar Ibrahim, who eventually rose to be deputy prime minister before falling out of Mahathir's favor and into prison; the Musa supporter was Abdullah Ahmad Badawi, who eventually found his way back into Mahathir's favor, and in 2003 succeeded him as premier.

ringgit rescue package. UMNO, still reeling from the Razaleigh-Mahathir showdown the previous month, could ill-afford to lose its major coalition party, and acceded to the plan. The issue, however, left the parties even further estranged than before; during the negotiations, UMNO Youth suggested that the MCA make good on its threat and leave the BN. Once again, it was Lee Kim Sai – the main player in the MCA’s proposals – who received the most condemnation, with several UMNO Youth leaders calling for his dismissal from the post of Labour Minister (FEER, 23/7/1987).

Tensions between the MCA and UMNO soon spilled over into broader ethnic tension with Malaysian society. Language and education issues – a political flashpoint since the days of the Malayan Union plan in the 1940s and, as we have seen in relation to the Merdeka University controversy, accentuated by the social programme of the NEP – proved to be the spark point for the escalation of tensions. The first round of protests came in August, when Universiti Malaya instituted a ruling limiting the use of Mandarin, Tamil and English in the teaching of elective subjects. The decision provoked demonstrations from non-Malay students, who interpreted the ruling as an attempt by the administration to boost the academic performance of the Malays compared to the other ethnic groups (NST, 02/08/1987). The ever-belligerent UMNO Youth soon waded into the controversy, criticising the demonstrators but doing nothing to prevent counter-demonstrations by students supportive of the university’s move (NST, 04/08/1987). As the protests continued, police were forced to keep the contending groups of demonstrators apart (NST, 18/08/1987). By October, the DAP had become involved in the protests and the police were making numerous arrests (NST, 10/10/1987).

The Universiti Malaya uproar was soon overshadowed, however, by a national level dispute, also concerning language and education, when the Education Minister Anwar Ibrahim announced the promotion of around ninety teachers who were not educated in Chinese-language schools to senior positions in government-supported Chinese-language primary schools. The promotions caused a storm of protest from the Chinese community, which saw the move as an attempt to ‘change the character of the Chinese schools’, and perhaps ultimately pave the way for their disestablishment (Tan 2000: 244). Although Anwar quickly backed down over the appointments, Chinese opposition parties and educationalist groups continued to protest, demanding the instant withdrawal of the appointees. Again, the Chinese parties in the BN were clearly pressurised by the protests into adopting a more chauvinistic position, for fear of losing ground to the DAP. In a sensational turn, the MCA and members from other Chinese parties in the BN, again led by Lee Kam Sai, thus joined a protest rally with the DAP and other Chinese-based opposition parties, calling for a boycott of the schools involved (NST, 12/10/1987). The boycott saw over thirty thousand children kept away from school by their parents (NST, 16/10/1987).

The cycle of protest was intensified by a series of counter-demonstrations organised by various groups with UMNO. On the same day as the MCA-DAP joint rally, some five hundred UMNO members also held a demonstration, but the primary target of their anger was their coalition partner the MCA, rather than the DAP; demonstrators burnt MCA flags and posters (NST, 12/10/1987). Subsequently, on October 17, UMNO Youth held a rally at a disused stadium in Kampung Baru, a large Malay district in Kuala Lumpur. The rally, attended by some six thousand people, was highly chauvinistic, and the target of the protesters wrath was against the government MCA rather than the opposition DAP. Banners called for the resignation and of Lee Kim Sai, and urged the MCA to ‘go to Hell’ (*pergi Jahanam*). Other banners expressed broader and often violent anti-Chinese sentiments: ‘May 13 has begun’, a reference to the ethnic riots of 1969, and ‘Soak [the kris] in Chinese blood’ (Malaysia 1988:

17).⁶ The UMNO Youth president, Najib Tun Razak, addressed the crowd, calling for Lee's resignation and demanding that the MCA acquiesce to government policy, or else leave the BN (*Asiaweek*, 20/10/1987).

By the end of October 1987, then, ethnic tensions in the country were reaching critical levels. As news spread of a freak shooting incident when an army sergeant ran *amok* killing one Chinese and wounding another Chinese and a Malay in the Chow Kit area of Kuala Lumpur, the centre of the 1969 riots, many people rushed to stockpile food, fearing the outbreak of rioting. Increasing public attention was focussed on a mass rally planned for 1 November to celebrate UMNO's fortieth year, postponed since 1986 (the actual anniversary) and relocated from Johor (UMNO's birthplace) to Kuala Lumpur. Up to a half million Malays were expected to join the rally, in what was seen by many as a show of strength by Mahathir against the UMNO dissidents (*Asiaweek*, 06/11/1987). With ethnic tensions running high, however, it was feared that the rally would prove to be the spark point for fresh riots. In such a context, there was little doubt that the government needed to take action to calm sentiments and prevent an escalation of conflict.

In the mid-1980s, then, the economic recession intensified the ethnic grievances felt by the Chinese community at the effects of the NEP. Their major economic defence mechanisms – MPHB and the DTCS – collapsed and their relative autonomy within the education system appeared under further threat. At the same time, the recession also shook the patronage systems within the BN that fed the businessmen-politicians that were coming to dominate party membership. These factors fed into a cycle of ethnic mobilisation that, even in the eyes of government critics, threatened to spiral out of control. This cycle was brought to an abrupt halt by the 'Operation Lalang' crackdown, which effectively suppressed political and social dissent for years to come. In the 1990 general election, the UMNO splinter *Semangat '46* was able to forge a relatively united opposition front to contest against the BN, but with the economy returning to high growth, averaging over 6 per cent annual real GDP growth between 1988 and 1990, and Mahathir firmly in control of the government again, the opposition was unable even to achieve its lesser aim of denying the BN a two-thirds majority in parliament. Nonetheless, in winning over 46 per cent of the popular vote, the opposition registered its best performance since 1969 although in Malaysia's skewed electoral system this only translated into around 30 per cent of parliamentary seats.

4. Conclusions

The prime minister who presided over the events discussed here, Mahathir Mohamad, is a doctor by training, and likes to make medical allegories in his speeches. In a kind of semi-homage to his legacy, I will, by way of conclusion, make one of my own. Redressing horizontal inequalities in ethnically-divided societies can be seen as a kind of corrective surgery, where the short-run risks of infection and complications due to the surgery itself are considered worthwhile when weighed against the long-term risks of the *status quo*. In Malaysia, it appears that the stunning economic growth of the first fifteen years of the NEP acted as a kind of antibiotic, fending off any adverse effects of the surgery. For antibiotics to be effective, however, a full course must be taken. It was only when this antibiotic ran out in the mid 1980s that serious complications emerged.

Put in more prosaic language, this paper has argued that whilst redistributive policies of the NEP were generally tolerated by the 'losers' during a period of high economic

⁶ The *kris* is a ceremonial Malay dagger, which is also emblazoned on UMNO's party flag.

growth, the mid-1980s recession drove home Chinese grievances at their loss of economic dominance. The particularly patronistic structure of the Malaysian state, itself largely a product of the NEP, compounded this as the recession intensified factionalism within the regime, allowing the political space for such grievances to be expressed. In contrast, for most of the 1990s, high growth was accompanied by the gradual re-emergence of higher horizontal inequalities; this was also a period of unprecedented support for the BN regime and low societal protest.

Since 1987, the Malaysian regime has reduced its redistributive fervour and has replaced a 'discourse of ethnicism' with one of broader 'developmentalism' (Loh 2001; Loh 2002). 'Nation-building' has taken centre stage over Malay chauvinism and whilst preferential treatment of the bumiputera by the state has continued, the private sector has been allowed to develop alternatives for the non-Malay community, providing an 'escape valve' for discontent.⁷ Private education colleges, catering mainly for Chinese students, have been allowed to multiply, including the upgrading of the MCA-run Tunku Abdul Rahman College to a university (Lee 1999).

Redistributive policies continue to cause some interethnic tensions, however. Virtually every year, Chinese-market newspapers including the *Star*, owned by the MCA, publicise the cases of Chinese school leavers who achieve top results in their examinations but are nonetheless unable to find places in public universities due to the *bumiputera* quota system. The marginalisation of the urban Indian community is also increasingly troubling; the two largest incidents of interethnic violence in recent years, the Kampong Medan riot in the greater Kuala Lumpur urban area, and the Kampong Bahru Mosque clashes in Penang, both stemmed from Indian-Malay tensions (Loh 2003).

From a broad political perspective, however, this approach appears to be paying dividends for the BN. In 1998, the BN regime faced a crisis of remarkably similar dimensions to those in 1987. The financial crisis of the previous year had brought an abrupt and dramatic end to the decade of sustained high growth that had followed recovery from the recession of the mid-1980s. As previously, it was the Chinese community that was hardest hit economically, registering a 7.5 per cent drop in average household incomes between 1997 and 1999, compared with only 2.6 per cent for the Bumiputera community. As previously, the economic collapse also brought to a head a festering factional split in UMNO, this time between Mahathir and his deputy and anointed heir Anwar Ibrahim.

In September 1998, Mahathir sacked Anwar, who was later imprisoned on extremely dubious charges of corruption and sodomy. Anwar's dismissal provoked an outpouring of anti-government demonstrations and protests that gave birth to a *reformasi* (reform) movement, which dominated national politics for the following three years. The dynamics of this *reformasi* movement were overwhelmingly determined by the ethnic concerns of the Malay community; Chinese participation in the protest movement beyond a civil society elite was sparse, and in the 'reformasi election' of November 1999, Chinese support for the BN regime apparently increased beyond its already high levels in the previous election of 1995. Whilst it is beyond the scope of this paper to offer a thorough analysis of why the Chinese community responded so differently to the 1998 crisis than they did to the 1987 crisis, at least part of the explanation must lie in the changing dynamics of horizontal inequality. For the Chinese, the 1985 recession crisis came on the back of a decade of decreasing relative economic advantage over the rest of Malaysian society; in contrast, the 1997 recession came at the end of a decade in which this advantage had been

⁷ The analogy here is due to Khoo Kay Jin, pers. comm., August 2004.

substantially restored. In 1987, average Chinese household incomes stood at 33 per cent above the national average. By 1997, this had increased to 43 per cent, not far behind the 49 per cent advantage the community had held at the inception of the NEP in 1970. In such a context, the 1997 crisis may well have appeared to large sectors of the community simply as an expectable economic turn down to be weathered as part of the normal business cycle, rather than the 'last straw' that the 1985 downturn appeared to be.

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