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PRIVATISATION AND CAPITAL ACCUMULATION IN MALAYSIA

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PRIVATISATION AND CAPITAL ACCUMULATION IN MALAYSIA

Malaysia's privatisation programme needs to be seen as part of the government's strategy for capital accumulation and growth. This process, first initiated under the New Economic Policy (NEP), centres on the redistribution of resources to the Malay community through the restructuring of employment and ownership of share capital in the corporate sector, and aimed at creating a Bumiputera commercial and industrial community (BCIC). Under the NEP, the state actively acquired and held, in trust, shares on behalf of the Malay community, while nurturing a Malay business class through loans, subsidies, employment and training. The NEP can be viewed as part of the government's redistributive programme, whereby the expansion of the public sector was to increase the Malay share of capital until such time when private Malay capital accumulation could take over. Privatisation represented the formal transfer of these resources to a Malay capitalist class and greatly accelerated this redistribution process. The ultimate aim of the NEP and privatisation was the creation of a viable Malay capitalist class (while not disregarding non-Malay or foreign investment) which could contribute to economic growth, although growth was a prerequisite for redistribution in the first place.

Given that the Malaysian state has been highly interventionist and broadly developmental in nature, successful policy depends on the ability to make informed decisions and to successfully coordinate public and private decision making to elicit the desired behaviour (Felker 1993: 87). Successful policy can be judged by whether state and business elites institutionalised market augmenting policies, and whether state subsidies created an innovative, competitive class of manufacturers, or a politically dependent, protected class of rentier capitalists (Lubeck 1992). However, coordinating public and private decisions is politically problematic due to conflicting goals, motivations and pressures (Felker 1993: 87). The efficiency of privatisation depends on the capacity of the state, not only in selecting and monitoring candidates, but also in enforcing discipline. These are, in turn, affected by the availability of information, quality of state institutions (e.g. regulatory framework), and political constraints (i.e. distribution of power in society).

How were candidates selected? Did the state have sufficient information to choose the right candidates and monitor their performance? It will be argued that the selection of privatisation candidates could not have been (and was not) based solely on economic criteria, given the highly political (redistributive) nature of capital accumulation and development in Malaysia. Where political considerations are arguably as important, asymmetric information only tells half the story. Similarly, it is also debatable whether the existence of appropriate institutions would have ensured policy success in the context of a politicised redistributive process and hence, political constraints. On the other hand, there is sufficient evidence to suggest that the Malaysian government was, in fact, aware of the failure of the NEP and privatisation in producing a class of successful capitalists. Why then was it unable to discipline this group?

The ability of the state to act (i.e. enforce discipline) depends not just on its access to information, but also its political capacity to do so. State capacity is, in turn, determined by the state's reach (its connections with productive groups) and institutional endowments, but is also constrained by the nature of power relations (i.e. the balance of power) between the state and society, specifically segments of the capitalist class the state has identified for its development project. Largely as a result of its colonial legacy and ethnic political considerations, the Malaysian state had to engage the (aspiring) Malay middle and intermediate classes in the process of capital accumulation. Under the NEP, the allocation of rents to this group was channeled along racial lines (which also coincidentally, but not entirely, coincided with class divisions). This centralised patron-client relationship, however, began to change over time as emerging (and arguably, increasingly impatient) Malay businessmen (often in collusion with Chinese capitalists) began pushing for redistribution independent of the state. This shift in the balance of power was reflected in the increased factionalisation of the Malay capitalist class over time, and affected the ability of the state to enforce discipline on non-performing capitalists. The nature of this relationship – specifically the ability of segments of the capitalist class, not only to influence government decisions, but also to resist attempts to discipline them – can explain why privatisation was unsuccessful in meeting official objectives.

In particular, it will be argued that pressure from a growing Malay middle class was an important factor in the introduction of privatisation, while the changing, increasingly fragmented composition of this middle class led to the development of independent patron-client networks, allowing it to resist state attempts at enforcing discipline. The task is to trace the emergence of the Malay middle and capitalist classes, their influence on government policy, and attempts by the state to enforce discipline. What evidence is there of increasing factionalisation? How has increasing factionalisation affected the coherence of government policy, in particular the pattern of privatisation? Who are the beneficiaries and what are their relationships to the political elite? How has this affected the ability of the state to enforce discipline?

EXPLAINING POLICY FAILURE

The lack of transparency and proper guidelines in the selection process is widely regarded as a major reason for the failure of privatisation. Selection is usually seen to have been based on personal connections (i.e. cronyism), or primarily motivated by ethnic, rather than purely economic considerations, where relations between state and business are not forged through industrial policy, but through an inter-ethnic settlement in managing politics and the economy (Woo-Cummings 1999: 19). Arguments explaining policy failure have tended to examine the effects of ethnic-redistribution political pressures under the NEP (e.g. Jesudason 1989; Bowie 1990), or the result of capture of state-created economic opportunities by a bureaucratic-capitalist elite (e.g. Mehmet 1986; Jomo 1986; Bowie 1994, cited in Felker 1993: 83). Although there are two separate arguments involved, there is generally little distinction between arguments of ethnic preference and crony capitalism, and their effects on state policy.

NEP and 'Crony Capitalism'

The increase in state intervention under the NEP in favour of ethnic redistribution, for example, has been associated with a dramatic increase in the scope of patronage and rent-seeking, which has in turn undermined economic policy. Special opportunities and substantial assistance enabled a small group of Malay rich with strong political links to consolidate their position (Tan 1982: 331). Increased government intervention was seen to serve the interests of the governing class, 'self-aggrandising, politically influential rentiers' and the politically well-connected seeking to transform themselves into members of the bourgeoisie, albeit of a rentier rather than an entrepreneurial type (Jomo and Gomez 2000: 289; Jomo 1993: 7-8, cited in Searle 1999: 95). This class of 'statist capitalists' used the state apparatus to pursue self-interests, leading to corruption and waste (Jomo 1986: 266-269, cited in Searle 1999). Politicians who sat on SEDC boards pushed for projects that would extend their patronage and enhance their political fortunes, paying little attention to economic feasibility and viability (Jesudason 1989: 99).

Two mechanisms critical for the rapid ascent of the Malay bourgeoisie were access – from strong connections and political links – to enormous funds from the banking system (especially state-controlled and state-owned banks), and state regulatory power, which enabled Malays to buy cheap shares using borrowed money as a key to capital accumulation (Jesudason 1989: 105). NEP licenses, contracts and concessions contributed to the rapid growth of Malay businessmen and allowed UMNO to provide benefits to its supporters and strengthen party loyalty (Crouch 1992: 27; Khoo KJ 1992). This resulted in political loyalty becoming a more important criteria than technical competence (Jesudason 1989: 78)[1]. UMNO's role as trustee enlarged the Malay corporate stake which served the interests of a select group and entrenched patronage and money politics (Gomez 1990, cited in Searle 1999: 16). The system of trusteeship, and the control of savings and tax revenues, were also directly responsible for the concentrated pattern of wealth accumulation and resulted in a cartel of 'distributional coalitions' (military, religious, aristocratic, bureaucratic and political) (Mehmet 1988: 95, 135-136). The mushrooming of patronage networks in UMNO (Chandra 1979 and Mehmet 1986, cited in Gomez and Jomo 1997: 25) saw political patronage perpetuating rent-seeking activities (Gomez and Jomo 1997: 6, 9) and a 'subsidy mentality' among many Malays. The NEP strengthened patrimonialism, and the vulnerability of SOEs to patron-client influences led to a dependency on government by Malay businessmen while limiting the capacity of some SOEs to create a "genuine class of Bumiputra traders" (Gale 1981: 202-203, cited in Searle 1999).

Ethnic Redistribution

Many government policies aimed at raising the business strength of Malays – relative to Chinese businesses and the government's economic goals – were infused with strong ethno-political considerations (Jomo and Hamilton-Hart 2001: 75). The urgency to expand (and desire to bypass the Chinese business sector) often meant that state agencies were not interested in building up an indigenous technological capacity, preferring easy access to foreign partners and technology (Jesudason 1989: 85, 92, 199). The often preferred alignment of the Malay-dominated state elite with foreign – rather than local Chinese –

capital in exchange for directorships, joint-ventures, and other passive, essentially rentier rewards, and "often acting as a comprador bourgeoisie in relation to foreign capital while jealously seeking to control indigenous Chinese business growth" highlight the ethnic competition and cultural differences at the root of the Malaysian economy's structural weaknesses (Lubeck 1992: 184; Applebaum and Henderson 1992: 117). Consultation between state and business was neglected in favour of political bargains – 'money politics' – that merely benefited unproductive rentiers beholden to a political patronage system legitimated by the ethnic political settlement and thus hostile to open market competition (Gomez 1990, 1991, cited in Lubeck 1992: 181). Inter-ethnic economic differences and redistribution were thus seen to compromise the efficacy of state intervention for late industrialisation and undermine a developmental and industrially progressive state role (Jomo and Tan 1999: 239, 243, 291).

The underlying argument of ethnic explanations is that the goal of increasing (ethnic) economic control constrains the maximisation of economic growth and the pursuit of rational economic policies (see e.g. Jesudason 1989). The preoccupation with inter-ethnic economic redistribution was one reason why there were no learning rents in the first place as rents under the NEP were primarily conceived for redistribution, driven by the ethnic imperative of increasing economic 'group capacity'[2]. Because capital accumulation was channeled to serve political and ethnic imperatives (where "political elites were rewarded precisely for breaking the rules of market rationality"), the result was an inefficient and fragile Malay bourgeoisie (Jesudason 1989: 99-100). Here, economic efficiency considerations faded in significance because it served to strengthen UMNO hegemony, underwritten by the state's considerable resources. The government failed to recognise and check the underlying economic problems of the NEP due to: competing rationalities (state patronage to increase political support); weakness of the private sector in disciplining the state; and state optimism buoyed by oil revenues (Jesudason 1989: 196-198). The failure of state policies to create "a self-confident Malay bourgeoisie" by the 1980s was said to be due to the failure of Malays to develop the Weberian equivalent of a rational approach to accumulation; and the very nature of state policies toward Malay business development, which included easy and cheap access to funds and cheap shares. Here, the government was not cognisant of the problem, and those who were aware were unwilling to implement changes which might adversely affect their interests. The state was also not very constrained by social forces and hence able to ignore 'rational' economic pressures.

Privatisation

Little changed with privatisation. Even though privatisation is said to provide incentives for efficiency and the design of efficient incentives through clearer designation of property rights[3], it was driven by similar considerations to those for direct state intervention in the 1970s under the NEP. Just as public enterprises can create opportunities for patronage and excessive rent-seeking, privatisation too can give significant political advantage. Privatisation may offer lucrative jobs for politicians or bureaucrats, or a means of buying votes or rewarding friends (Hood 1994, cited in Cook 1997: 57) and the desire to promote crony capitalism can also be a motivation for divestiture (Killick and Commander 1988: 1472, cited in Cook and Minogue 1990).

This appears to have been the case in Malaysia, where privatisation increased rent-seeking and money politics to secure positions in UMNO, which in turn facilitated access to rents (Gomez 1991a). The allocation of major privatisations tended to favour a relatively small group of Malays, which the government argued were selected on the basis of their ability to manage large projects. The emergence of this group of Malay businessmen, who benefited disproportionately from privatisation, led to allegations of cronyism and lack of transparency, where the "granting of projects to Bumiputra and to interests close to the ruling coalition (in particular UMNO) has become a common feature of the implementation of privatisation in Malaysia" (Barraclough 2000: 355; Ho 1988: 252; Jomo 1990: 77). Private interests were seen to be working hand in hand with the politically powerful to dominate financially lucrative rentier activities in what has been described as 'cronyistic privatisation' (Rasiah 1998: 368; Rasiah 2001: 58). Patterns in bidding for contracts in the early 1990s suggested the existence of formal and informal collusion (e.g. cartel-like agreements) among bidders, with some companies enjoying special influence and privileged information to bid successfully (Jomo 1994: 81). This was compounded by the absence of an open tender system as a result of a 'first come, first served' policy, which allowed the government to select beneficiaries on the basis of political and personal connections (Jomo 1994: 80), while consistent share underpricing with the increasing allocation of new privatised shares since early 1991 further encouraged the belief that privatisation was primarily a means of rent capture under government auspices and patronage to aggrandise politically influential beneficiaries (Jomo 1994: 77, 81).

Here, the awarding of contracts to those with political connections led to patronage, rent-seeking and corruption. Productive efficiency was sacrificed as the principal beneficiaries of privatisation were not competent enough to manage the enterprises or projects because their selection was not based on strict economic managerial competence criteria. Cronyism insulated many ventures from market competition, while their apparently unlimited access to finance and the speed with which this new breed of Malay businessmen acquired assets undermined the possible disciplining experience of business management and 'learning by doing' (Gomez and Jomo 1997: 27, 51). There was little evidence that privatisation strengthened domestic capital accumulation in export-oriented manufacturing, technological upgrading or other needed changes (Jomo 1994: 83-85; Gomez and Jomo 1997: 9), while rapid growth allowed crony ventures to flourish after 1986 without immediate debilitating consequences (Rasiah 2001: 52). There was also official acknowledgment that most of the economic rents secured through privatisation were not efficiently deployed through productive investments to significantly accelerate industrialisation or to consolidate genuine Bumiputera entrepreneurship (Jomo 1994: 84; Rasiah 2001: 83).

Instead, "changing forms of crony rentierism" and a conglomerate style of growth[4] meant that captured rents were reinvested in the protected domestic economy (unproductive property and real estate sectors, construction, finance and other investments with a short-term horizon) when rents associated with tariffs fell following deregulation in the 1990s (Jomo 1994: 84; Rasiah 2001: 83; Rasiah and Ishak 2001: 63)[5]. The speculative and unproductive nature of this form of diversification can be gauged from increased bank lending to the property sector[6] and for share purchases, instead of manufacturing, agriculture and mining[7] (Chin and Jomo 2000: 315-6, 322; Jomo and Gomez 2000: 291, 315). As a result, the Malay bourgeoisie was largely limited to finance, property and construction, and generally dependent on state patronage (Lubeck 1990: 182-183, 189), with a significant section of the newly created managerial class hardly showing entrepreneurship (given the absence of risk-bearing with several such ventures enjoying state guarantees of domestic market control) (Rasiah 1998: 268). This was acknowledged by the prime minister, who emphasised the need to "improve the resilience of the Bumiputra to enable them to sustain their corporate equity holdings and not succumb to divestment for short-term profits or when the country is faced with an economic crisis" (Malaysia 2001a).

Selection and Monitoring

Was the government mistaken in its choice of candidates? Was it aware of the problems which arose? Although Malaysia's development project was defined by ethnic redistribution to aid Malay capital accumulation, in many ways, state policies mirrored the East Asian developmental states. On a broad level, since 1970, the state redistributed agricultural land (e.g. through FELDA); controlled finance; generated and implemented national economic plans (e.g Outline Perspective Plans, five year Malaysia Plans, Industrial Master Plans); manipulated private access to resources (e.g. through tax breaks and learning rents); coordinated individual business efforts (e.g. through Malaysia Incorporated and the Malaysian Business Council); targeted specific industrial projects and assisted particular industries (e.g. HICOM); insulated the domestic economy from competition and excessive foreign capital penetration; improved productivity; and promoted exports and technological acquisition (largely by encouraging foreign investment). Like South Korea in the 1970s and 1980s, the Malaysian government sought to encourage development by offering a variety of state supports to an emerging (ethnically determined) capitalist class to lead accumulation efforts[8].

The design of state policies for long-term growth and industrialisation suggests that far from being irrational, the state had a clear developmental agenda. Based on government statements, the state was also well aware that future ethnic redistribution was contingent on economic growth[9]. It is then unclear why the government would choose to jeopardise economic performance by allocating resources to (unproductive) cronies when the stakes are too high in terms of government objectives and credibility (Mahathir 1998a: 29)[10].

There were certainly institutional weaknesses in the privatisation process which the Privatisation Master Plan (PMP) later sought to address, namely the lack of clear guidelines on activities to be privatised and the proper role of the state; lack of assessment of optimum modes of privatisation; inadequate criteria for selection of candidates; absence of criteria to screen SOEs to determine suitability for privatisation; and lack of transparency in decisionmaking. However, it is debatable whether solving these issues would have guaranteed the success of privatisation in the context of resistance to change and other political considerations (Ismail and Osman 1991: 114-115, 127). In the political context, it was important that selected candidates not only met ethnic and economic requirements, but were also loyal to the government (and in particular, to UMNO) and trustworthy. With these criteria, such a process cannot be transparent and the government was aware that the selection of Bumiputera candidates was quite risky, with no guarantee of success. It required careful assessment of track records, credit ratings, and intent: “They must not be the kind of people who would sell their shares for quick gains” (Mahathir 1998a: 29). Nonetheless, the government believed it had made the correct choice in its selection of candidates for privatisation. Mahathir consistently defended this choice by arguing that successful candidates “had already proven their ability to run big operations” (*New Straits Times* 27/11/95; Mahathir 1998a: 28) and were already rich, successful businessmen (Mahathir 1998b: 24). The emergence of leading Bumiputera businessmen running conglomerates comparable to large non-Bumiputera corporations was supposed to indicate their ability to improve the performance of companies to be privatised (Mahathir 1998a: 28-29).

More crucially, the choice of candidates reflected the nature of the selection process, which entailed more than just overcoming asymmetric (economic) information. Not only were the main privatisation beneficiaries closely connected to the government, if not UMNO, but the nature of privatisation also reflected Mahathir’s preference for an unbalanced, concentrated pattern of growth, over which the government exercised close supervision and guidance, unsurprisingly similar to the South Korean experience in the 1960s. This was consistent with the prime minister’s views that the redistribution project, though along ethnic lines, was not designed to reduce intra-ethnic inequalities: “The NEP ... was not concerned with making all the bumiputeras earn equally, or share equally the wealth distributed amongst them” (Mahathir 1998a: 33). This meant that shares or contracts could not be distributed equally, simply because “the amount was never enough to make any difference to the millions of bumiputeras who would have been considered eligible purely because they were bumiputeras”; furthermore, “the capacity of every bumiputera to acquire the shares was not equal” (Mahathir 1998a: 33). In short, for Mahathir, the NEP sought to establish equity between races and not between classes of people (Mahathir 1998a), being designed to create in the Bumiputera community the same proportion of low income, middle income and high income groups as in the non-Bumiputera communities (Mahathir 1998a: 34). What this meant in practice was a policy favouring wealthy businessmen which, by not destroying the natural desire for wealth, could exploit “those who have the acumen to accumulate wealth” to contribute to industry and commerce, providing employment and government revenue (Mahathir 1986: 11). Furthermore, by breaking into the formerly exclusive circle of big businessmen, Malay tycoons were seen to have changed the pattern of commerce previously favouring non-Malays, and by doing so, they “performed a function which is nationally important and of some value to the economic position of Malays” by boosting the Malay ego and thus, ostensibly diminishing the threat of inter-ethnic civil strife. For Mahathir then, it was therefore necessary to enrich a few Malays so that all Malays would feel better off (Mahathir 1970: 44-5). Underlying this was the prerequisite of growth: the NEP was not about simply taking the wealth from the rich and redistributing this equitably, but rather, “redistribution was based on growing the economic cake” (Mahathir 1998c: 103).

This reveals a clear perspective on the problems of political stability, excess demand[11] and capital accumulation, not least the need to allocate resources to the capitalists most likely to succeed within this context. In short, Malaysia’s privatisation programme was characterised by a general inter-ethnic redistribution necessary for political stability, and within this, a disproportionate transfer to a relatively small group of Malays in order to promote capital accumulation. But the transfer of resources to selected individuals for both capital accumulation (economic growth) and redistribution (political stability) was also politically circumscribed. This meant that not only was it important that selected candidates were competent enough to take over and manage privatised entities or projects given the economic imperative of growth, it was also important that those entrusted with economic resources could be trusted to carry out the state’s economic project (which entailed the state directing investment to strategic sectors by contracting out privatisation projects). As political loyalty was arguably as important a criterion as ability, it was not surprising then that the main privatisation beneficiaries were connected to UMNO[12] leaders and had served apprenticeships in NEP institutions, e.g. Fima and Peremba, then headed by Mahathir and Daim Zainuddin respectively before their appointments as prime minister and finance minister.

While privatisation in the abstract does not involve what is vaguely termed ‘cronyism’, the underlying political and economic conditions for the acceptance and implementation of privatisation in Malaysia seem to have necessarily involved such relations. Similarly, asymmetric information as an explanation for policy failure fails to consider the economic and political context of privatisation in Malaysia, where the choice of candidates was principally determined by political rather than economic criteria. This is as much due to the nature of ethnic politics, as to the political culture. UMNO's growing independence from Chinese capital[13] was inevitable to ensure its political hegemony. Sometimes successful privatisation applicants were acknowledged proxies for the ruling party. The ability of the government to select the right candidates based on the availability of (economic) information only provides part of the explanation, and does not account for the actual final outcome. In any case, it is questionable whether asymmetric information played a part in policy failure, especially when the government was cognisant of problems (Jomo and Gomez 2000: 300). The issue, rather, is whether the government was able to effectively monitor candidates.

While the Malaysian state, like the East Asian developmental states, was able to promote new Malay capitalists, and to direct investment into selected industries, it was unable to ensure good performance. Despite widespread acknowledgement of the failure of the NEP to improve competitiveness and create a class of successful independent Malay capitalists, the state retained inefficient protection policies and continued to support uncompetitive Malay businessmen. Whereas South Korea and Taiwan offered conditional subsidies in the 1960s and 1970s[14] (Amsden 1989; Wade 1990; Chang 1991; all cited in Rasiah and Ishak 2001), Malaysia offered monopoly rents and increased protection irrespective of productive capabilities and without performance conditions (Rasiah and Ishak 2001: 63; Alavi 1998)[15] The absence of complementary disciplinary mechanisms – including weak monitoring and enforcement – allowed unsuccessful firms to waste rents for too long (Rasiah 2001: 59, 62)[16]. As a result, selective state intervention was of much poorer quality and considerably less effective, with little in common with Taiwan and South Korea. The continued dependence of crony capitalists on subsidies and bail-outs following privatisation suggests that the state's promotion of capital accumulation continued to fail.

Concerns were expressed repeatedly in two Malaysia Plans in the 1970s regarding efficiency losses due to protection, and the need to ensure that tariffs and tax concessions contributed to efficiency and international competitiveness, but protectionist policies were instead further strengthened (Alavi 1998: 262). Even if the state was constrained by asymmetric information (i.e. the government was unaware of problems), this does not explain why poor policies persisted. In fact, despite tacit admission of its failings, the Mahathir government found it politically difficult to abandon the NEP even after 1990, instead replacing it with the National Development Policy (NDP) in 1991, which retained the same redistributive commitments. Similar problems arose with privatisation, where even if the government was able to promote capital accumulation by correctly selecting and supporting capitalists, and directing investment into strategic sectors (through contracting out development projects), it was unable to ensure good performance in the long run, leading to repeated bail-outs and eventual renationalisation. Clearly then, in view of the government's awareness of such problems, the state was obviously constrained by factors other than asymmetric information. We need then to look at the forces behind state policy, in particular, the motivations behind privatisation.

What Motivated Privatisation?

The motivation behind privatisation is generally seen to be fiscal and/or ideological. In Malaysia, the decision to privatise was certainly driven by economic (fiscal pressures and public sector inefficiency) as well as ideological considerations (Mahathir's longstanding personal preference for private enterprise [Mahathir 1986; Jomo 1993]). There was also growing dissatisfaction with public sector performance and a change in attitudes about the role of the private sector, which served to bring privatisation into the mainstream (Ismail and Osman 1991: 6). Furthermore, given the underlying difficulties with the NEP as a redistribution policy, privatisation attempted to address inefficiencies and the constraints on growth, modernisation and industrialisation imposed by the NEP (Malaysia 1983) by shifting power away from the bureaucracy (Leigh 1992; Felker 1993). More importantly, privatisation's dual objectives of growth and redistribution were based on the belief that public enterprises should only be temporary vehicles for creating a Bumiputera property-owning class and that the nascent NEP-era Malay business class was ready to benefit from liberalisation. By 1983, the government believed there was a sufficient supply of Malay managers and entrepreneurs to reap the benefits of privatisation. Privatisation thus aimed to accelerate the accumulation of Malay wealth through transfers to an emerging class of Malay businessmen. The preference for privatisation was not simply based on neo-liberal ideology, but rather on ethnic and political considerations. Behind this was the mounting pressure from the growing Malay middle and capitalist classes.

Public Sector Problems

Economic crisis has changed the nature of the groups resisting reforms, and the recession in the early 1980s arguably generated an environment conducive to radical policy change in the hope of quick recovery (Jomo 1993: 22). The fiscal crisis can be seen to have either pushed or helped the government introduce privatisation, given the political leadership's preference for liberalisation, and the unsustainability of the NEP's public sector expansion (Jomo 1993: 3). Privatisation was introduced when Malaysia was faced with fiscal and debt problems, which were exacerbated by the global recession in the early 1980s. It is said to have been motivated mainly by financial (i.e. general shortfalls of public funds) and economic efficiency concerns (Gouri *et al*. 1991). Certainly, the public sector had expanded into one of the largest in developing countries by the late 1970s ostensibly to meet NEP redistribution and employment targets. Between 1970 and 1983, the bureaucracy grew fourfold (from 139,476 to 521,818 employees), public sector expenditure increased over tenfold (from RM3.3bn to RM35.4bn in 1982), and SOEs increased from 109 to over 1,000 in 1980 (Khoo BT 1995: 129-130). The expansion of the public sector was such that even federal government officials were uncertain how many public enterprises had been established in the early 1980s, not just at federal and state levels, but also by various statutory bodies, regional development agencies and similar public sector bodies. By 1983, two-thirds of government expenditure were spent on 27 of the largest public enterprises (Khoo KJ 1992: 52). In 1984, the Ministry of Public Enterprises could only report annual returns for 269 of the 900 public enterprises, whose accumulated losses came to RM137.3m (Supian 1988: 120; Kamal and Zainal 1989: 22). Public sector borrowings, including loans from domestic agencies, increased from RM26.5bn (1980) to RM100.6bn (1986). By 1987, half of the 1,148 enterprises, mostly subsidiaries and associated companies of state enterprises, were still loss-making, involving a net loss of RM1.9bn (Jomo 1989: 89), and public enterprises accounted for more than a third of the public sector's outstanding debt and more than 30 percent of total debt servicing[17]. The economic burden of this large, financially-draining public sector became unsustainable with the global recession in the 1980s, with falling oil prices (1982-1986), the collapse of the tin market in 1985, and declining prices of other major exports after 1984 (Gomez and Jomo 1997: 77), which substantially increased the budget deficit[18]. By 1986, public debt accounted for 86 per cent of the country's external debt. Under pressure to implement fiscal austerity measures as well as economic reform, the government offered financially weak public enterprises three options of closure, rehabilitation or privatisation (Gomez 1994: 14).

Public enterprise performance was hampered by ambiguous criteria and multiple, often contradictory and unclear objectives (e.g. redistribution and employment generation versus efficiency); a lack of coordination among different levels (state and federal, municipal and regional, and between ministries); a serious shortage of competent and experienced Bumiputera managerial expertise; and the absence of proper guidelines for selecting and monitoring management performance (Puthucheary 1984: 226). Directorships were not usually based on management ability and experience, but instead on political and bureaucratic considerations (Ismail and Osman 1991: 81), and led to the emergence of self-aggrandising rentier managers, rather than disciplined, competent and entrepreneurial administrators (Gomez 1994; Jomo 1995; Gomez and Jomo 1997). There was a tendency for SOEs to operate on highly geared ratios (supported by easy access to loans), and as a result of easy credit, there was often inadequate pre-investment planning and a tendency to engage in a wide range of activities without first developing expertise (Puthucheary 1984: 224-226). Government bail-outs and protection from market forces bred complacency, and resulted in a bloated bureaucracy, inferior services, major inefficiencies, low productivity, limited innovation and high costs (Ismail and Osman 1991: 90, 102; Gomez and Jomo 1997; Felker 1993). The high cost of government bail-outs included Bank Rakyat's RM65m loss in 1976, and Bumiputra Malaysia Finance's RM2.5b loss in 1983 (Ismail and Osman 1991: 88; also see e.g. Daim 1990: 32). The emphasis on redistribution was seen to have created distortions for the efficient functioning of SOEs, subsequently adversely affecting both efficiency and distributive equity (Gouri *et al.* 1991: 31). According to the first Industrial Master Plan, 1986-1995 (Malaysia 1986), NEP restructuring efforts adversely affected industrialisation (Jomo and Tan 1999: 291) and was cited by foreign investors as the most serious disincentive to invest in the country in a survey of American investors (Schlossstein 1991: 237).

However, there was little statistical correlation between the increasing size of the public sector and the rate of growth; although the NEP did not have a strong positive effect on growth, there is even less statistical evidence that it retarded growth (Ismail and Osman 1991: 28). Furthermore, despite the difficulties in assessing SOE performance – given their multiple objectives – compared to private enterprises in similar sectors, the profitability of the public sector was generally lower, though not always, as in the case of the construction sector (Ismail and Osman 1991: 82). In light of its role to 'restructure' the economy, since private investors were reluctant to do so, public sector employment has been said to not have been overly large (Ismail and Osman 1991: 57). There are further doubts as to whether excessive public sector expenditure has been the main motive for privatisation. For example, the government was also 'forced' to spend RM2.4m monthly in 1986 in 'allowances' for unemployed Malay graduates (mainly government scholarship holders) as a short-term measure to reduce massive graduate unemployment; the scheme was extended after its six month time frame at a cost of RM1.6bn a month (Siti and Zaini 1989: 270). But available data suggests that public sector growth was more due to public sector expenditure rather than public sector employment or remuneration (Ismail and Osman 1991: 49). Ironically, privatisation was introduced at about the time the government launched its ambitious heavy industrialisation programme with the creation of the Heavy Industries Corporation of Malaysia (HICOM) in 1980 at a cost of RM3.8bn, despite the financial constraints facing the public sector[19].

Besides fiscal considerations, other problems with the NEP may also have led to the introduction of privatisation. Despite major problems with the SOEs, the NEP greatly increased public sector employment and engendered a widespread 'subsidy mentality' among Bumiputeras, e.g. with businesses dependent upon government largesse (Kamal Salih 1989, cited in Felker 1993: 89). Despite being nurtured on easy credit, reserved corporate shares, business licenses, government contracts and other forms of preferential treatment, Malay businessmen did not fulfill the NEP's objective of a class of competitive Malay entrepreneurs, but instead displayed a 'dole', 'subsidy' or 'get-rich-quick' mentality (Khoo BT 1995: 127). The NEP instead made it possible for Malay contractors, lawyers and businessmen – who continued to depend on the government – to survive (Mahathir, cited in Khoo BT 1995: 128). Malay businessmen relied on state contracts, were highly geared on loans, and dependent on Bumiputera share allotments under the NEP, leading to heavy debt, if not bankruptcy (Mahathir, cited in Khoo BT 1995: 138). By the end of the NEP's expiry date in December 1990, its quantitative and qualitative targets had not been fully achieved; Bumiputeras (individuals and agencies) only owned about 20 per cent of the corporate sector[20] and mainly remained in lower end of economic activities. Ultimately, the NEP failed to produce many credible Malay entrepreneurs, or the same number of Malay big entrepreneurs as in the non-Malay community (Anwar 1989: 36; Mahathir 1998). The NEP was thus presented as the obstacle to the creation of an independent Malay capitalist class while privatisation also promised improved efficiency through market discipline.

Ideology

Ideologically, Mahathir displayed a disdain for the NEP's 'soft' policy environment which had led to Malay dependency on the state. Personally, he preferred the incentive structures associated with private enterprise and emphasised that the NEP was only conceived as a temporary measure until Malays were capable enough to take over assets held in trust by state agencies. However, Malaysia's privatisation programme has not been premised on an inherent belief in the superiority of market forces, but rather designed as a means to overcome problems thrown up by the NEP in the process of redistribution, capital accumulation and growth. As such, he was not interested in entirely abandoning state support for selected businessmen, or continued state intervention for that matter. The framing of the privatisation programme in the context of ethnic redistribution reflected these concerns. Not only was privatisation to be implemented within the context of the NEP (Malaysia 1985; Galal *et al.* 1994: 301), but privatised entities were also considered "jointly owned by the government and private companies, although legally they belong to the private companies for the duration of the concession" (Mahathir 1998c: 105). This enabled the government to privatise state assets to individual Malays, while continuing to intervene in the economy. This intervention went well beyond the 're-regulation' seen as a necessary part of privatisation (see e.g. Kay and Vickers 1988).

Hence, rather than deregulation, privatisation was accompanied by an increase in state intervention and direct participation in industry (e.g. HICOM), as the state sought to exercise close supervision and guidance to ensure that both growth and redistribution targets were met. In cases of selective deregulation, these generally avoided directly encroaching on ostensibly Malay interests, with privatisation not undoing socio-economic policies and institutions geared towards ethnic redistribution (Jomo 1990: 478; Jomo 1994: 20). The state also continued to direct investment into strategic sectors, for example, by sub-contracting out privatised development projects. Privatisation thus became not only consistent with the NEP's redistributive agenda, which required continued state intervention in aid of Malay capital accumulation (and thus, sought to accelerate this process), but also enabled the government to oversee economic activity: growth was thus re-emphasised as the precondition for redistribution. As such, the government was more prepared to forego ethnic redistributive considerations if at the cost of economic performance, as illustrated by the dismissal in 1988 of the Malay executives of a large state-owned steel industry project in favour of foreign and non-Malay managers[21], and the 1986 easing of ICA restrictions on Bumiputera equity (Felker 1998: 92). Overall then, the nature of Malaysia's continued state intervention, as well as non-Malay beneficiaries of privatisation, indicate that privatisation was not motivated by an ideological faith in markets, but rather, in the efficiency ostensibly promised by private control.

What then was wrong with the redistributive arrangements under the NEP?

Changing Political Dynamics: The Malay Middle Class

Policy change needs to be considered in its specific political context. While underlying conditions must be conducive for policy change, there may also be economic problems which the government was previously unable to overcome. The 1997-98 economic crisis created an environment conducive to radical policy change, but the reason for this was not entirely economic. For while the NEP had a mixed record in creating successful Malay capitalists, it had increased the size of the Malay middle class, including SOE managers with a vested interest in the public sector and NEP subsidies, whom the federal government had difficulties controlling. For example, SOEs were able to operate somewhat independently of federal control by borrowing with federal government guarantees, instead of relying exclusively on public expenditure. As a result, the public deficit remained high, even after steps were taken to reduce government expenditure after 1983 (Ismail and Osman 1991: 15), including attempts to discipline SOEs[22]. The expansion of the public sector thus raised management and supervisory problems for the government as SOE managers entrenched themselves and resisted attempts to discipline them. The emergence of Malay business interests with considerable political influence made it especially difficult to change the policies (e.g. to restructure tariffs or to withdraw financial support) that had permitted them to come into existence and entrench their interests, thus, the government was no longer as free to act before (Bruton 1992: 314).

However, the economic and political crisis and subsequent fiscal austerity however imperiled many bureaucratically-controlled enterprises and led to the bankruptcies of Malay firms dependent on government contracts and soft loans. This allowed the government to rein in the state enterprise sector and to streamline regulation, and, through dialogue with business with its 'Malaysia Incorporated' policy, to discipline the bureaucracy, particularly in economic regulation, to better serve private business interests (Felker 1993: 93-4). The government was increasingly unwilling to subsidise widely, instead favouring indirect incentives, due to an unwillingness to channel new amounts of money through the bureaucracy and a mistrust of entrepreneurial capabilities given the 'subsidy mentality' (Felker 1993). The privatisation and 'Malaysia Incorporated' policies called for greater government/business coordination in order to engage the private sector in pursuing industrial upgrading goals. The political leadership sought to build links with big businesses to secure cooperation. Privatisation provided a means for the government to shift power away from the general bureaucracy by centralising power and authority in economic policy-making (in the Prime Minister's Department's, Economic Planning Unit [EPU] and more recently, to the National Economic Action Council), and legitimising links between political and select business leaders (Leigh 1992, cited in Felker 1993: 93; Felker 1999: 107). By focusing more narrowly on publicly-allocated growth opportunities among a select group of entrepreneurs, through the management of key government-linked projects, the government also hoped to overcome distributional constraints and inefficiencies (Felker 1993: 110).

However, if the success of policy change depends on whether this is consistent with the balance of forces in society (see Khan 2000), then privatisation obviously has the support of certain groups poised to benefit. While privatisation attempted to overcome problems related to a powerful, entrenched SOE bureaucratic managerial class, produced by the NEP, the same policy also transformed the new Malay middle class.

Privatisation was premised on the government's belief that there was a sufficient supply of Malay managers and entrepreneurs to reap the benefits of privatisation (see e.g. Khoo BT 1995: 134). But if the introduction of privatisation was facilitated by the emergence and support of a group of potential beneficiaries, it is also reasonable to expect this group to push for such a policy change. Changes in the balance of power – in this case, the emergence of private Malay capitalists – supported the push for privatisation. Rather than the changing nature of the 'communal settlement' (Bowie 1991)[23], the evidence suggests that changes within the Malay middle class played an important part in the introduction of both the NEP and its apparent negation through privatisation. Ethnic explanations invariably simplify class analysis (and the changing composition of Malay society) and the economic policy making process.

In reality, the NEP and privatisation were shaped by a variety of political factors, not least the emergence of a Malay middle class which, after "sharing in the significant increase in the middle and upper income groups" increasingly advocated greater state intervention on behalf of Malay businesses (Tan 1982: 124). Since privatisation sought to overcome problems associated with the NEP, the emergence of the Malay middle class provides a useful starting point for analysing the political settlement and how this affected state policy. The definition of the middle class is, of course, problematic (e.g. see Jomo 1999c), and most of the literature on state policies in favour of the Malay middle class treats this group as homogeneous. The Malay middle class has been loosely defined to refer to an 'intermediate class' (i.e. located between labour and big business) of small, businessmen, white collar professionals, civil servants and middle income groups. Given the state's active engagement in the creation of Malay middle and capitalist classes and their relatively recent emergence, it is useful to view them as the principal beneficiaries of state policies.

One early attempt to classify Malay society in this way examined the (changing) class composition of Malay politicians in parliament in terms of a 'social class index' – 'medium' (not affluent, but with some education, usually teachers, religious figures, lower civil servants), 'high' (no title, but well educated and relatively affluent, usually children of estate owners, rubber planters, and civil servants), 'very high' (traditional aristocracy, but not in the line of direct descent for inherited privilege), and 'highest' (royal title and wealth; sultans, offspring and siblings) (Neuman 1971: 112). The most interesting aspect of this analysis is the steady increase in 'middle' social status legislators from 10 per cent in 1955 to 42 per cent in 1964, outnumbering those from the 'high' category. This group included teachers (increased from 20 per cent to 33 per cent in the same period, and who were only second in social status to government officials; 80 per cent of the Federation of Malay Teachers Associations belonged to UMNO), Malay businessmen, and junior civil servants (fourfold increase) (Neuman 1970: 115, 212, 218, 237-238; Clarke 1964, cited in Neuman 1971: 229).

Even though Malay businessmen in parliament were small in absolute terms, numbers were high relative to their proportion in Malay society (Neuman 1971: 211). This shift in the balance of power in favour of this 'quasi-modern occupational sector – Malay vernacular teachers, former government clerks, local party cadre and small businessmen. (Neuman 1971: 264) – influenced state policy and eventually the decision to introduce the NEP.

The Malay Middle Class and the NEP

The NEP is generally viewed as a policy response to the 'race riots' in May 1969 following the dismal electoral performance of the ruling Alliance coalition in the general elections that year. Underlying the policy was a general consensus that the nature of post-Independence Malaysia – in particular, the Alliance agreement guaranteeing Malay political hegemony in return for Chinese 'economic freedom' – had produced few changes for Malays who remained poorly represented in most high income segments of the modern economy. Policies during 1957-1970 were said to have "failed to correct the delicate situation and instead accentuated further the inequality and poverty problems along racial lines" (Aris 1977: 13). Implemented by 'administocrats' (the Malay political elite of the 1960s and 1970s), the NEP aimed "to safeguard and promote the political and economic power of the Malay community" (Searle 1999: 12).

However, changes over a 10 year period before 1970 (as opposed to single year data[24]) show that the Malay middle class grew faster than for the other races, and "Malays had been able to benefit as much in sharing in the significant increase in the middle- and upper-income groups" a decade after Independence (Tan 1982: 124-5, 325). Between 1957 and 1970, Malays enjoyed the highest household income increases (Snodgrass, cited in Ho 1988: 106). This should not be entirely surprising considering state attempts to develop a Malay industrial and commercial bourgeoisie through protection (i.e. quotas on business licenses, employment and education), assistance (credit, training, business premises), and acquisition (Malay corporate ownership) (Lim 1985: 41, 49). Importantly, racial differences accounted for only 8.6 per cent of total income inequality (Tan 1982: 336; also see Anand 1983).

From its small base, Malay equity increased from two to 6 per cent in seven years (Tan 1982: 178-179). Not surprisingly, Malay middle and business classes were most vocal in demands for government intervention in favour of Malays (Tan 1982: 332). In fact, agitation for increased state intervention did not come from the lower income groups, but from the small but expanding Malay middle class (Toh and Jomo 1981, cited in Puthucheary 1984: 218). Malay middle class impatience can be attributed to the group's higher expectations and aspirations having achieved tangible and significant benefits. For this group, the stakes were highest (Tan 1982: 334-335). Rising economic expectations of the Malay middle class by the late 1960s were coupled with mounting frustration over the modest changes in ownership and control of the economy since 1957[25] (Gomez and Jomo 1997: 21). The inability of the civil service to continue absorbing the emerging university middle class also meant greater interest in private commerce (Jomo 1990: 470). The 1969 race riots has also be seen as a product of class frustrations within the Malay community, with roots in intra-Malay class conflict (Stenson, cited in Ho 1988: 147).

The growing influence of the Malay middle class in the 1960s was evident in Malay business lobbies which led to the first Bumiputra Economic Congress (BEC) in 1965, followed by a second BEC in 1968, both demanding a more active state role in support of Malay accelerated business expansion (Searle 1999: 36). The organisational capacity of the Malay bourgeoisie was strengthened with the establishment of the Associated Malay Chambers of Commerce[26] (Lim 1985: 44), and the Malay business community began to exert pressure through such bodies (e.g. the Kuala Lumpur Petty Traders Association) and UMNO[27] (Jesudason 1989: 65; Ho 1988: 273), even issuing a warning that unless Malays were given a stake in the economy, there would be no guarantee of peace and security (Lim 1985: 44). (The confinement of Malay rioting to the capital suggests that the May 13 incident may well have been largely a reflection of urban (especially middle class) Malay discontent.) This group sought state intervention, including the establishment of enterprises to be later sold to private individuals (Puthucheary 1984: 218-219; Lim 1985: 44). Demands made at the first BEC led to the establishment of Bank Bumiputera to provide Malays with credit facilities, and the reorganisation of the Rural Industrial Development Authority (RIDA) in the form of MARA (the Council of Trust for Indigenous People).

Demands for more direct state action in the second BEC were finally met after the ruling coalition's failure to secure a two-thirds parliamentary majority in the 1969 election. This electoral blow was seen as a threat to Malay rights, and the race riots which followed provided the impetus – a "policy window" – for more direct state involvement to address inter-ethnic inequalities – considered necessary for political stability, and which could not have been implemented earlier as UMNO did not have the political strength and financial independence (Ho 1988: 85-86). Pressure for greater state intervention in favour of Malays was thus evident even before the 1969 race riots, as seen in the mounting criticisms of the first prime minister and the 'Old Guard' (conservatives)[28] by the 'Young Turks' and 'Ultras'[29] who wished to expand state capitalism further to create a strictly Malay bourgeoisie, who eventually managed to "tip the balance of class forces in its favour" following the ruling coalition's poor performance in the 1969 elections (Hua 1983: 145, 147; Jomo 1990: 470). Support for greater state intervention also came from Malay-medium school teachers and students who wanted Malay as the sole medium of instruction so as not to be disadvantaged in higher education and government employment[30] (Goh 1971: 31).

The NEP can thus be seen as a response to ethno-nationalist pressure from the aspiring Malay middle class who successfully linked their claims to the racial riots (Shamsul 1986, cited in Lubeck 180). Many programmes to support Malay capitalists were essentially extensions of pre-NEP policies (Shamsul 1986: 192)[31]. The introduction of the NEP, and the main beneficiaries of these policies, reflect the growing influence of the emerging Malay middle class in shaping government policy. Given that pressure for the NEP came from the Malay middle and business class – the rising Bumiputera elite including civil servants and professionals – it was not surprising that the bulk of NEP redistribution was captured by this group, the elite of whom have been variously described as 'bureaucratic capitalists', 'bureaucratic bourgeoisie'[32], a 'hegemonic fraction of Bumiputera capital' (Ho 1988: 246), the 'Malay bourgeoisie' and its 'bureaucratic class' (Shamsul 1986: 193), 'statist capitalists' and 'bureaucrats and technocrat-politicians'.

But despite the influence of the Malay middle class on state policy leading to the NEP, and the close alliance between top Bumiputera politicians and bureaucrats with business, almost all businessmen were heavily dependent on the state, which remained in control (Ho 1988: 248). Almost all Malay businessmen, regardless of type[33], were either created by the state or at the least with crucial state support (Jomo 1993: 19), of which patronage and access to political power were key to wealth accumulation (Jesudason 1989: 105). Malay company directors were almost always royalty, politicians or prominent public servants (Tan 1982), with the Malay aristocracy and politicians overrepresented among Malay company directors, with representation mainly from UMNO[34] (Lim 1981: 55-61).

But rather than the “mushrooming of patronage networks” (Chandra 1979; Mehmet 1986, cited in Gomez and Jomo 1997: 25), the NEP was a highly centralised vehicle for wealth redistribution to Malays. This centralised allocation of rents ensured that NEP beneficiaries were beholden to the political leadership in UMNO for access to rents, and hence prevented the capture of state authority by rent-seeking and private-sector interest groups, or a quasi-class of bureaucratic-capitalist elites (Mehmet 1986, cited in Felker 1993: 90). Private business influence on economic policies was seen to be minimal during the 1970s and early 1980s. And contrary to the state being captured by private-sector interest groups, NEP beneficiaries were still beholden to the UMNO leadership with access to rents principally through the party (Felker 1998: 90-91). “Rather than signifying the domination of technocratic elements of the state by broad-based populist or pluralist political pressures emanating from society, the NEP was a coherent political and economic strategy, implemented by a unified party elite under a strong leadership involving the mobilisation of Malay middle class support through bureaucratic expansion and consolidating rural support” (Leong 1991, cited in Felker 1998: 90). The political consolidation of UMNO after the 1969 riots consolidated potentially competing Malay clientelist groups into a unified structure. This ‘centralised clientelism’ resulted in relatively low rent-seeking expenditure (Khan 2000: 99, 117)

What happened to change this? Why did the government replace the NEP with privatisation? Having established that political factors, namely the changing balance of power brought about by the emerging Malay middle classes, largely influenced the introduction and implementation of the NEP, it is useful to examine how this group developed and what effect this, in turn, had on state policy. Central to this was the way in which resources were allocated.

The Malay Middle Class and Privatisation

The NEP fostered a Malay middle class and entrepreneurial community through restructuring ownership through public enterprises, trust agencies and institutional savings funds, allocations of licenses and credit (Searle 1999: 60, 65) and education[35]. The most tangible benefit of the NEP was the creation of a large Malay middle class and the shift of the Malay population from predominantly agricultural occupations to more diversified activities (Jesudason 1989: 111). The Malay middle class more than doubled from 12.9 per cent to 27 percent between 1970 and 1990 (Crouch 1993: 142; cited in Searle 1999: 46) and, according to one estimate, increased by more than tenfold between 1970 and 1998 (Jomo 1999c: 131). The government achieved rapid progress in increasing Malay representation in eight prized professions[36] from barely 5 per cent in 1970 to 25 per cent in 1988 (Jomo 1990: 475, 498), although in some (Malay) quarters, this has been seen as insufficient (see e.g. Ismail and Osman 1991: 88; Zulkifly 1989: 169, 171). Increases in employment were fastest amongst in managerial posts[37], especially in the commercial and industrial sector, in line with the NEP's goal of greater Bumiputera participation at the management level (Ismail and Osman 1991: 37-40). The growth of a university-trained Malay middle class also increased business participation following the exhaustion of employment opportunities in the public sector (Jomo 1990). Corporate restructuring increased Malay share ownership from 1.5 per cent in 1969 to 19.4 percent in 1988, while individual share ownership among Malays increased to 67 per cent[38]. State efforts to control the 'commanding heights of the economy' (e.g. plantations and tin mines), driven by concerns with finding the quickest way to accumulate assets and control well-managed, profitable companies (and fueled by the rising influence of Malay nationalists) also created a new corps of state managers who have been centrally and powerfully involved in Malaysian corporate life (Jesudason 1989: 87, 97). The rapid increase in the number of Malay executive directors since the mid-1970s has meant that by the late 1980s, Malay executive directors – whether professionals or trustees – represented an important new element in strengthening the Bumiputera commercial and industrial community (Searle 1999: 86).

Despite its continued economic weakness and dependence on the state, the Malay business class was growing in organisation and influence, with its views often shared by the political leaders themselves (Jesudason 1989: 100-101). By the 1980s, the growing number of Malay businessmen fostered by the NEP had become increasingly important in the Malay political elite, the composition of which gradually changed from politicians and administocrats to a combination of politicians and businessmen (Leigh 1992: 119-120; cited in Searle 1999: 13). There were significantly more Bumiputera politicians active as businessmen (on their own and sometimes, ostensibly on UMNO's behalf) and Bumiputera businessmen active in politics with the NEP (Ho 1988: 243). This shift in power was also accompanied by changes in the occupational background and outlook of the elite (accelerated after Mahathir's assumption of leadership) and mirrored by the changing occupational background and disposition of UMNO leaders and grassroots members, with schoolteachers and other local leaders increasingly pushed aside by a new generation of businessmen and university-educated professionals produced by the NEP's education policy (Crouch 1992: 32; Searle 1999: 45-46). 'Middle class elements' were able to completely take over UMNO in the 1970s and certainly, by the early 1980s (Jomo 1999c: 146). By the time privatisation was introduced, there was already a large Malay middle class, including a younger, more professionally trained managerial cadre (or 'rentier-business cadre' [Jomo 1993: 25]) nurtured in NEP institutions in the 1970s and whose support was not only important for the introduction of and support for privatisation, but who also had to be accommodated (see e.g. Milne and Mauzy 1999: 45).

But the changing composition of the Malay middle class also led to increasing factionalisation and conflict, centred around the nature of redistributive policies between those who benefited from the state's participation in the economy and those who stood to benefit from its withdrawal. While the NEP "provided the social peace analogous to social democracy's dampening of class tensions, and was seen to have created the basis for economic growth and stability since 1971" (Searle 1999: 180), it also created divisions within the Malay community by the very nature of capital accumulation which widened intra-ethnic inequalities[39], and created winners and losers.

Here, it is more useful to understand crony capitalism and ethnic preference in terms of patronage and the dynamics of patron-client relations. Though this has been noted, and in more recent cases, explored in some detail (e.g. Gomez 1991a, 1994; Ho 1988), the impact of patron-client networks on state policy has not been examined in depth. Ho (1988: 243-244), for example, argues that the most important policy outcome of the NEP was the coalescence of a Bumiputera political-business class. Political bargains ('interlocked relationships') between Bumiputera politicians and bureaucrats consolidated a "horizontal class alliance", with important implications for policymaking. He is, however, more concerned with the impact of such pro-Bumiputera policies from an ethnic (non-Malay) perspective, rather than in exploring the nature and beneficiaries of such a 'coalescence'. For example, the emergence of patron-client networks transcending ethnic boundaries have been said to provide informal arrangements "to manage ethnic conflict and ameliorate some of the problematic aspects of official policy in regards to ethnic preferences" (Means 1986: 114). When denied official access to policymaking, Malay and Chinese businessmen have relied on personal access to political and bureaucratic leaders; the greater the role of the state in allocating resources, the greater the value of such patronage (Sieh 1992, cited in Felker 1999: 103). As such, patronage was not restricted to Malays. Chinese capitalists grew due to political patronage arising from close ties with powerful, often Malay, politicians (Gomez and Jomo 1997; Gomez 1999)[40]. The effects of patron-client networks on state policy, specifically privatisation and the ability of the state to discipline underperforming companies, is still poorly understood.

The NEP increased the scope of patronage tremendously (Crouch 1992; Khoo KJ 1992) and contributed to the rapid growth of Malay businessmen. As a result of UMNO's extensive patronage network – designed to strengthen loyalty (and later, instill party discipline through the threat of withdrawing loans) and foster the development of a new Malay business class – the emergence of Malay businessmen in the late 1970s and in the 1980s soon became an important force in UMNO's internal politics (Crouch 1992: 27, 32, 39). The NEP essentially changed the nature of patron-client relations (Shamsul 1986: 243-244): where elected members of parliament were previously political patrons (i.e. providing political support in return for economic benefits), the NEP greatly increased their control of the district development machinery, allowing them to distribute development benefits and thus purchase continued support. This reshaped internal politics in UMNO branches, increasing often bitter factional struggles for nomination and election including the rising outbreaks of violence at UMNO branch and division meetings after 1984. The rise of money politics at all UMNO levels was thus closely related to (if not a direct result of) the NEP (Shamsul 1986: 244), although factions were arguably already present at all levels of UMNO (Ahmad 1985: 92). Increasing contestation in UMNO general assemblies and widespread use of money politics suggests that the redistributive process became increasingly decentralised. As competition for resources intensified, the Malay middle classes grew more factionalised, leading to the development of patron-client networks independent of the state/central government, which in turn altered the balance of power.

On the one hand, the emerging Malay business class was heavily dependent on access to government patronage, and therefore tended to be an appendage to the government, rather than a significant check on its power. On the other hand, it also made a major contribution to the growing factional rivalries, which grew in importance in the 1980s, culminating in the 1987 UMNO leadership challenge. Policy disagreements between factions within UMNO "fanned the perpetual smoldering of fractional politics into an open party split" in 1987 (Khoo KJ 1992; Crouch 1992). The first group[41], represented large capitalists (owners as well as senior managers) who "had grown to the point where they were increasingly independent of state sponsorship and patronage" (Khoo KJ 1992: 62), sensed the opening of new business opportunities and favoured growth-oriented policies (Khoo BT 1995: 132; Searle 1999: 55). They viewed the NEP as imposing market distortions and obstructions to growth; for them, equity restructuring was meaningless without growth (Khoo KJ 1992: 62). The pro-'distribution' group[42] comprised small and medium Malay businessmen and the 'bureaucratic class'[43] who favoured continued state intervention to meet Malay equity targets. These were 'rentiers', concentrated primarily at the branch level of UMNO and within various Malay chambers of commerce, heavily dependent on access to patronage, and whose political influence was contained, partly by their 'dependence' on the one hand, and partly by the capacity of the leadership to 'divide and rule' on the other (Jomo 1993: 27)[44]. This group was most affected by the government's response to the 1980s' recession, which included the tightening of credit, austerity measures, the suspension, restructuring or shelving of SEDCs (Searle 1999: 65) and centralisation of assets[45]. They were also the most vocal in their complaints about patronage abuses and privatisation to allegedly favoured persons and the transfer of profitable enterprises to trust agencies directly under the prime minister's control (Khoo KJ 1992: 63).

In principle, privatisation provided a vehicle of distribution for big Malay entrepreneurs as well as individuals of lesser wealth who could 'get their share', thus relieving pressure on the state under the NEP to 'distribute' among the Malays, the resources, assets, and corporate wealth it had garnered and held 'in trust' for them (Khoo BT 1995: 134). In practice, while the NEP spelled a shift of power to technocrats and bureaucrats, deregulation and privatisation served to discipline them and curtail their powers. As such, privatisation was seen as a retreat from the promotion of Malay interests via expanding the state role, and was met with increasing resistance by the second group. Mahathir's eventual victory and control of UMNO owed much to the successful creation – under the NEP – of a 'Malay rentier-business cadre' who stood to benefit (disproportionately) from greater business opportunities following the state's retreat from direct production and whose support was crucial (Jomo 1993: 25; Felker 1993: 92).

But given the closeness of Mahathir's 1987 UMNO re-election (by a mere 43 out of over 1,000 votes), and even with Razaleigh eventually invited back into the party, deep divisions have persisted within UMNO, resurfacing in the sacking and jailing of Deputy Prime Minister Anwar Ibrahim and underlying the intra-ethnic nature of political conflict in the country[46]. Clearly then, the redistributive process has increasingly been contested. How did the state manage these increasing tensions? How did political conflict (and constraints) affect the nature of privatisation? Who were the main beneficiaries? How did this affect the state's ability to monitor and discipline them?

State Capacity: Managing Conflict and Factionalisation

There is a lack of consensus over whether the state was able to manage growing factional rivalries. On the one hand, it is argued that the Malaysian political arena became the battleground for different fractions of Malaysia's elite and middle classes – groups that could no longer be controlled (from the early 1970s), and hence brought under the shared consociational vision of the pre-NEP years before 1969 (Kahn and Loh 1992: 14-15). On the other hand, the Malaysian state displayed a considerable degree of autonomy (viz economic reforms in the 1980s) as "no group or class had developed sufficient political or economic coherence to subordinate the state to their interests" (Jomo 1993: 12, cited in Searle 1999: 55). NEP-era legacies in the organisation and interests of local groups meant that there were difficulties in mobilising consensus, as the business sector, weakened by ethnic divisions, had minimal influence on economic policy (Jesudason 1989: 137-147, cited in Felker 1999: 103).

While 'Malaysia Incorporated' involved 'smart partnerships' with the organised business sector (Mahathir 1998: 104), business' access to decision-making power remained lodged in narrow, informal elite networks (Felker 1999: 107). The political leadership was seen to have considerable autonomy in setting economic policies (Felker 1999: 99) as a result of the shift in the locus of power from politicians and administocrats to a combination of politicians and businessmen (culminating in the increased concentration of power in the political executive); and the fact that Malay businessmen consisted of individuals and groups whose independence and autonomy from the state varied, and did not yet constitute a class determined to further its common interests (Searle 1999: 54).

This is further supported by the growing hegemony of UMNO and the centralisation of power in executive hands (i.e. the Prime Minister's Department) under Mahathir (Jesudason 1989: 117-8, 127). This concentration of authority coincided with the changing balance of power, reflected in the changing composition of the Malay middle class who stood to gain from privatisation. The marked increase in the Prime Minister's authority, both in party and government, suggests that rather than influenced by patron-client networks, Mahathir was able to exert control – and, by definition, discipline – on Malay capitalists. The assumption of Mahathir as prime minister coincided with the emergence of an increasingly influential core of Malay businessmen and the concentration of power in a few key regulatory agencies directly under the Prime Minister's Department (Searle 1999: 45-46). As UMNO accumulated greater system-wide power, and power became more concentrated in the UMNO leadership, the party sought to assert greater control of the economic agenda by consolidating its hold over the key economic and technocratic agencies of government, specifically wresting control of the Ministries of Finance and of Trade and Industry from the Malaysian Chinese Association (MCA), and strengthening the Economic Planning Unit (EPU) (located in the Prime Minister's Department). Its leaders were able to influence the behaviour of the bureaucratic and technocratic organs of the state, placing only trusted or loyal personnel in key planning and decision-making positions, rather than those merely technically competent (Searle 1999: 43; Jesudason 1989: 78). What this meant though was that decision-making became increasingly centralised under the chief executive and concentrated in a few key bureaucratic and technocratic agencies (Searle 1999: 45)[47], bypassing key bureaucratic interests (Felker 1999: 102).

Mahathir's victory in intra-party struggles enabled him to strengthen his position by amending UMNO's constitution to increase the power of the president (Milne and Mauzy 1999: 45. 153), and served to hasten a political realignment, in which power was lodged in a coalition of political and business elites, including a cadre of Malay businessmen who had emerged through state-mediated patronage during the previous decade (Leigh 1992, cited in

Felker 1999: 102; Searle 1999: 47). Although there had already been some concentration of power with preceding prime ministers, there was a marked increase in the executive powers under Mahathir (see Milne and Mauzy 1999: 29; Khoo KJ 1992: 61), who saw the formulation of economic policies based on his own vision of industrialisation. He was able to impose his own views on economic policies, and besides a close circle of advisers – only a few of whom are in the Cabinet – kept his own counsel (Jesudason 1985: 117-118, 127)[48]. The EPU has had to defer to Mahathir on his selection of key projects – the 'Look East Policy', 'Malaysia Incorporated' and HICOM were all Mahathir policies which embraced private businessmen and the ethos of business (Jesudason 1985: 127; Searle 1999: 47; also see Khoo BT 1995: 119, 120). Alongside Mahathir's consolidation of power was UMNO's economic expansion, which not only provided the party with economic control, but also allowed it to centralise the allocation of resources and process of capital accumulation/class creation[49]. This merging of interests has meant that the emergence of a Malay capitalist class has also been closely related to the party (and, by extension, dependent on the government) and it is in the party's interest that resources are allocated efficiently.

But was this concentration of power in the political executive a reflection of strength or inability to enforce discipline? Increasing authoritarianism since 1987 is said to be the response on the part of the ruling elite to a fragmentation, which was a manifestation of the arrival of the middle class and their challenge to the cultural vision of the ruling elite (Kahn and Loh 1992: 14-15). If state capacity is the "ability to shape incentives through coordinated decision-making and elicit desired behaviours and not coercive power to forestall political challenges" (Mann 1991, cited in Felker 1998: 87), then this suggests that the Malaysian political leadership was unable to manage factional conflict and enforce discipline. What were the factors which prevented this? What constrained state capacity to implement policy? More importantly, given the prime minister's accumulation of power, why was he unable to act against non-performing capitalists? One explanation is the changing nature of rent allocation and patron-client networks.

Privatisation and Patron-Client Networks

If the NEP saw the emergence of independent patron-client networks, then privatisation greatly accelerated this process, as both Malay and non-Malay businessmen sought to secure economic concessions by cultivating their own patron-client relations. The actions of non-

Malay businessmen in seeking direct ties with members of the UMNO leadership (and in doing so, bypassing their respective ethnic component parties in the National Front) was a reflection of the new post-1969 shift in power, but also had deeper economic consequences.

The NEP's centralised clientelism "consolidated potentially competing Malay clientelist groups into a unified structure" (Khan 2000: 99). This allowed the state to distinguish between productive groups and those whose accommodation was necessary for political stability (i.e. the emerging Malay middle classes). In Malaysia's case, transfers by Chinese capitalists to politicians in the form of taxes and illegal extractions were centrally distributed through the political apparatus to UMNO members in return for learning and natural resource rents (Khan 2000: 99; Khan undated: 24). The result was relatively low rent-seeking expenditure and some transfer of resources to capitalists to accelerate primitive accumulation or the transition to higher technology industries.

The key point here is that political (redistributive) and economic (efficiency) requirements were kept separate. While rents were allocated in exchange for 'payoffs' or 'kickbacks' to the political leadership, the level of bribes indirectly correlated with the ability (i.e. economic efficiency) of the client. Increased factionalisation within UMNO meant that efficiency was no longer a criterion for securing rents as non-Malay capitalists could collude with Malay clients to push for such redistribution independent of the state. This may explain the number of non-Malay privatisation beneficiaries and why the state was unable or unwilling to discipline the beneficiaries despite evidence of their inability to perform or deliver.

Notes

[1] A useful example is the threat of recalling loans to enforce party discipline. Here, it should be mentioned that such threats are not performance-related, and instead emphasise loyalty over competence (see Crouch 1992: 33).
[2] Jesudason distinguishes between Horowitz's notion of 'group worth' (psychological in construct) and 'group capacity' (a system-wide capacity).
[3] "The more completely rights over resources are allocated to the decision taker, the stronger are the incentives to use and preserve those resources efficiently" (Plane 1997: 357).
[4] Where the rentier constantly moves in order to capture available rentier opportunities regardless of previous experience or expertise.
[5] Here, diversification, rather than being a criterion of corporate success (see Searle 1999), is not necessarily an indication of improved economic performance.
[6] Loans could be obtained without proper procedures and were often given for speculative get-rich-quick schemes, rather than productive investments (Chin and Jomo 2001: 97; Gomez 1994: 9, cited in Chin and Jomo 2001; 95, 98). Loans for construction, housing and real estate increased from 21.6 per cent in 1977 to 35.9 per cent in 1988 (Chin and Jomo 2000: 315-6, 322).
[7] Loans to these sectors comprised barely a quarter of commercial bank loans (*ibid*).
[8] Even the shift to unproductive investments in property and shares paralleled the South Korean "double-edged strategy of accumulation" in the 1960s, which combined productive investment in export and import-substituting industries, and speculative investment and money lending in the curb market (Koo and Kim 128-130).
[9] "Without wealth you cannot distribute" (Daim 1990: 31); "If accelerated wealth creation is necessary before any distribution can be undertaken, then economic growth, and not redistribution, will be the premium" (Anwar 1987: 86).
[10] The potential loss or 'trade off' of opportunity "made the government not keen to provide opportunities to those who are inexperienced and unsuccessful although they are amongst political cronies who would certainly reciprocate through support for their leader" (Mahathir 1998b: 24).
[11] Although resources were strongly contested, the choice of candidates was limited by the relatively recent process of class creation, thereby restricting the pool of potential candidates who could take over privatised entities.
[12] Fazilah (1999) discusses the performance of politically-affiliated businesses in Malaysia.
[13] Through the Malaysian Chinese Association (MCA), which was the National Front's main source of funds.
[14] Where a high effective rate of protection on import substitutes was granted to domestic producers on condition that export targets were fulfilled (Hamilton 1986; Luedde-Neurath 1986; Pack and Westphal 1986; all cited in Alavi 1998: 263); export was the single yardstick for performance.
[15] For example, while high tariffs (cement) and quotas (steel) offered incentives for Malay entrepreneurship to evolve, the government avoided imposing standards and discipline (Rasiah and Ishak 2001: 74).
[16] This was illustrated by the problems of commercial viability facing most SOEs (and especially SEDCs) in the 1980s (Jesudason 1989: 98-100).
[17] Some 562 companies had losses totaling RM7.5bn, 446 had profits of RM5.6bn, and the remainder were inactive or winding up (Jomo 1989: 89; Jomo 1990: 186).
[18] From RM120m in 1981 to RM3.5bn in 1987.
[19] This increased public investment in commerce and industry from RM0.3bn (1978-80) to RM1.5bn (1984), or 9.6 per cent of GDP, and contributed to the rise of long-term external debt from under RM5bn (1980) to RM12.5bn (1982), equivalent to an increase from 10 per cent of GDP (market prices) in 1980 to 38 per cent in 1986 (Jomo and Edwards 1993). These heavy industry projects were uncompetitive internationally and suffered heavy losses due to the high cost of production and management, low capacity utilisation and few linkages (*Mid-Term Review of the Fifth Malaysia Plan*: 280). For example, the Perwaja steel plant and national car manufacturer Proton recorded heavy losses, the latter estimated at RM1.6bn for the first 10 years (Jomo and Edwards 1993).
[20] Often quoted figures of Malay share ownership are argued to have been erroneous and gross underestimations (Tan 1982: 339; Jomo and Gomez 2000: 293).
[21] The project also failed under the new management and was closed down in 2002 after over RM10 billion in publicly acknowledged losses by 1995.
[22] For example, when the government closed down two subsidiaries of the Johor Tenggara Development Authority (KEJORA) in 1981, following huge losses for several years; served notices to other SOEs to perform; and later ordered 41 subsidiaries of various SEDCs to shut down (Tan CK 1984: 189).
[23] Bowie argues that broad consensus (during 1957-1969) constrained state autonomy, leading to low state intervention. This was reflected in the choice of industrial strategy which emphasised the role of the market. A

medium level of 'communal settlement' (1970-1980) allowed the state greater autonomy to intervene in favour of the dominant community in power.

[24] As used by Searle (1999: 39) to show Malay underrepresentation in most economic sectors.

[25] The frustration of this group about making inroads into the modern sector was primarily directed at the Chinese (although the Chinese did not dominate the economy) and later, the UMNO-led Alliance government (Searle 1999: 40).

[26] Ethnic-Malay business associations largely represented the voice of medium-scale enterprises dependent on bureaucratic patronage (Felker 1999: 103).

[27] Many Malay businessmen were present or past high UMNO officials and top civil servants.

[28] Whose economic interests lay with private non-Malay and foreign capital.

[29] Which included Mahathir.

[30] Not coincidentally, UMNO's branch heads and committee members at the time of Independence were mainly teachers, who were regarded as Malay society's elite (Ahmad 1985: 90).

[31] In fact, the system of ethnic recruitment, which became the basis for quotas and privileged access by Malays to the higher administrative positions, was first introduced by the British for its Malay Administrative Service (Means 1986: 97).

[32] Drawn mainly from the ranks of politicians with business connections, businessmen with strong ties to those in politics or the bureaucracy, and present as well as former bureaucrats in control of SOEs (see Ho 1988: 246-247).

[33] Malay businessmen have been variously categorised as independently wealthy (e.g. aristocrats), government proxies or rentiers[1] (Tan 1982: 291); politicians or aristocrats or those with close connections to such people, and having used political connections and state patronage (Lim 1981; Lim 1983: 54); and figurehead capitalists, executive professional and executive-trustee directors, functional capitalists, bureaucrats-turned-businessmen or state-managers-turned-owners (a group who moved into business via the government's privatisation programme) (Searle 1999: 81).

[34] For example, in 1972, 13.2 per cent of Malaysian directors were politicians – a "very high percentage", given the small size of MPs. Furthermore, 26 per cent of Malay directors (rising to 50 per cent if we include civil servants) – compared to 6 per cent of non-Malay directors – had political backgrounds.

[35] Education was the single largest item in the government's budget, accounting for about half the budget (Jomo 1991: 475). This increased the proportion of Malay university students from 40.2 per cent in 1970 to 47.3 per cent in 1980.

[36] Doctors, lawyers, engineers, veterinary surgeons, dentists, accountants, surveyors, architects.

[37] 7,400 in 1971 to over 61,000 (1985) or and annual average of 16.6 per cent (Ismail and Osman 1991: 39).

[38] Though the figures have been said to be grossly underestimated (Jomo 1990: 476-7).

[39] Inter-racial income inequality was replaced by intra-ethnic inequality, particularly among the Malays, where mass poverty at the bottom was seen as necessary for income and wealth concentration at the top (Schlossstein 1991: 260). Tan (1982: 182) notes that "great concentration of wealth and control of corporations in the hands of a very small number of Malay individuals, analogous to the concentration in the case of non-Malays". Of the two million bumiputera investors in the National Unit Trust Scheme (ASN), less than two per cent managed to acquire shares above RM5,000 in 1990 (Ismail and Osman 1991: 89).

[40] Yoshihara (1988) describes disciplined Chinese capitalists 'contaminated' by the political networking and rent-seeking practiced by well-connected Malay political actors (cited in Lubeck 1990: 190).

[41] Mahathir (who oversees PNB) was identified with the (pro-'growth') technocrat group seeking tighter SOE controls and reducing SOE competition with Malay businessmen.

[42] Led by Razaleigh, who was also the first chairman of PERNAS, which had to transfer profitable enterprises to PNB.

[43] Which sought to transform itself into a new bureaucratic capitalist class through the NEP' (Jomo 1977; Lim and Canak 1981; Toh 1982; all cited in Jesudason 1989: 73).

[44] Protests against economic reform and liberalisation by this group led to resolutions at the Bumiputra National Economic Symposium (organised by the Malay Chamber of Commerce and Industry), calling on the government to establish a trust fund to prevent the forfeiture of property used as collateral for loans and 'changing the rules of the game if necessary' to make loans for Malays easier (Searle 1999: 53).

[45] In particular from PERNAS (once headed by Razaleigh) to PNB (which answered directly to Mahathir).

[46] The concern over "the division of Malays into factions" pattern towards this was noted by the second prime minister and Mahathir's predecessor, Huseein Onn, in 1990 (Schlossstein 1991: 270).

[47] As Minister of Trade and Industry in 1977, Mahathir was already the main director of economic policy, having the last word even with Daim playing a part (Milne and Mauzy 1999: 75).

[48] Also, see Milne and Mauzy 1999: 168-169.

[49] By the early 1990s, Mahathir's faction had, through proxies, regained most of UMNO's assets following the 1987 leadership struggle (Searle 1999: 110).

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