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INDUSTRIAL DEVELOPMENT AND EQUITY DISTRIBUTION IN MALAYSIAN MANUFACTURING: INSTITUTIONAL PERSPECTIVES

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Abstract

This paper offers an institutional economic analysis of industrial development and equity distribution in Malaysia, with particular reference to the shift in Malaysia's redistribution regime in the mid-1980s. The regime gravitated from manufacturing licensing toward a more liberalised investment environment. I set out an institutional framework for political-economic analysis, which significantly incorporates concepts of legal institutions and the role of the state, with emphasis on those that are more relevant to the Malaysian context. An overview of Malaysian investment policy is presented, taking note of trends in equity distribution. This is followed by analysis of the mid-1980s investment liberalisation measures, with reference to: (1) the increased emphasis on industrial development, instead of equity redistribution, in the manufacturing sector, and (2) the concomitant shift from a redistribution-centred to a growth-centred development policy in the wider institutional economic framework. I examine empirical data, mainly comprising equity distribution of approved manufacturing licenses, and analyse the motivations for and implications of the shift in redistribution regime. This paper concludes with discussion of the continuing dynamics of and tensions between distributive and productive activities in the Malaysian economy.

A FUNDAMENTAL DUALITY: INDUSTRIAL DEVELOPMENT AND EQUITY DISTRIBUTION

The manufacturing sector in Malaysia has, since the mid-1970s, straddled dual objectives of industrial development and equity redistribution. Investment policies have operated within an over-arching mantle of economic growth and income redistribution. In the broader economy and polity, this conflation of growth and redistribution policies has continually predicated the design and performance of development policies. The framework for investment in the NEP era has consistently counterposed incentives that induce manufacturing investment against conditions that attempt to align ownership of those investments with income redistribution targets. Although these dual objectives do not always mutually negate each other, there is an enduring tension between redistribution-centred and growth-centred policies. This duality is manifest, at the next level, in the tension between the objectives of ownership and control of capital. Ownership of capital, in the context of the NEP, has been pursued for the acquisition of equity as a source of income. However, ownership does not guarantee control; capitalists are not all entrepreneurs.

This paper focuses on the shift in Malaysia's redistribution regime, specifically, the diminishment of manufacturing licensing as an apparatus for transferring equity. Our discussion is grounded in the industrial development-equity distribution and ownership-control dualities. The manufacturing sector was designated as a core vehicle of growth and socio-economic restructuring from the early 1970s; hence, a large portion of policies related to investment incentives have been committed to this sector[1] The opportunities for redistribution of equity and cultivation of entrepreneurs were also tremendous in manufacturing establishments.

We observe the process of investment liberalisation which began in the mid-1980s and gathered momentum in the 1990s, from the perspective of underlying shifts in ownership and control of capital, which took place primarily along ethnic lines. Fundamentally, national policy orientation also shifted, from a more state interventionist and explicit communal redistributive agenda to a more pro-growth, individual-centred approach. These reorientations were articulated saliently in the Sixth Malaysia Plan (1991-95), National Development Policy (1991-2000), and the Vision 2020 manifesto[2] The transition from the explicit redistribution priorities and practices of the NEP to the implicit projections of its successor, the NDP, is not clearcut and straightforward. Among other objectives that are less explicit in the NDP is the absence of a specific target for redistribution of income, especially the proportion of share capital in Bumiputera hands. Still, the scaling back in equity acquisition through state intervention in manufacturing investment is far from a negation of the over-arching redistributive thrust of the NEP. Indeed, while manufacturing licensing waned in significance as a channel for redistributing equity, privatisation filled this gap.

The overall policy shift to a growth-centred framework continues to grapple with the dual goals of industrial development and equity redistribution, and does not signify a complete leaning toward a non-interventionist, open market orientation. Some measure of investment liberalisation has undeniably taken place[3] However, the process has necessarily been more complex than uni-dimensional approaches can handle competently, hence our approach to the term liberalisation needs to be multi-dimensional – especially, integrating institutional and political factors into economic analysis. The implications on the tension between productive and redistributive economic activities are also complex, for Malaysia has attained a relatively high level of both.

This paper is organised as follows. Section II presents the theoretical and conceptual framework of this paper. I pay close attention to institutional factors that induce or limit investment, particularly legal institutions, state roles, and politico-economic bargaining relations. Section III surveys the evolution of investment policy, highlighting the beginnings of openness to export-oriented manufacturing and foreign direct investment, the contentions than later emerged when equity redistribution policies were promulgated. This historical overview sets the stage for an outline and evaluation of the liberalisation measures of the mid-1980s. Section IV then analyses the shift in redistribution regime, with reference to the reasons and outcomes of investment policy liberalisation. Section V concludes this paper, and discusses implications on the continuing dualities.

FRAMEWORK OF ANALYSIS

Our framework attributes primary importance to legal institutions and the state as constituents and agents of economic policy. The relationship between policy and its determinants is dynamic, and the causality mutual. Although policies are set by particular groups with particular interests, the impact of those policies on those influential parties induces further amendments. The efficacy of policy in attaining its set objectives also has bearing on continuing formulations – this feedback element is especially pertinent, considering the pragmatism of policy-making in Malaysia. The institutional dimensions most pertinent to this paper are:

1. the position and role of legal institutions,
2. the constraints national development objectives (in particular, NEP objectives) place on the formulation and implementation of more specific policies (such as investment or industry),
3. the motive and scope of the state in deploying its apparatus, including legal institutions, to balance the varied and often contradicting aims of development policy.

Some conceptualisation of legal institutions in the economy is necessary as groundwork. Legal institutions are central to the structure and functioning of investment coordination and market regulation. Laws can be enacted and enforced to align manufacturing activity to broader national developmental goals. Legal systems, in contrast, are commonly perceived as having a disinterested and intermediary position in an economy. This understanding of the nature and role of legal systems has been conceived in influential economic literature largely from observation of Western European, or Anglo-American, free market paradigms. However, the use of legal institutions for developmental goals in the post-World War Two era, especially in less developed countries, invites a different approach to issues of market governance. In particular, the interventionist policies in East Asia have highlighted an alternative view of legal institutions that recognises the possibility of employing legal institutions in the economic realm, to discriminate, promote and/or coordinate investment activities (Jayasuriya 1996 and 2000)[4].

The case for an East Asian model of legal institutions, although still in conceptual gestation, alerts us to the risk of looking parochially through lenses of the Western European-based paradigm, which tends to see legal institutions as ideologically impartial and politically neutral. In relative terms, East Asia's, and Malaysia's legal systems, have exceeded the roles of arbiter and overseer, to those of planner and controller. Jayasuriya (1996: 368-369) proposes a framework for analysing legal systems, in which the East Asian "public legal regime" emphasises performance of public duties, as opposed to the Western European "private legal regime" which stresses distribution of rights and entitlements[5] It follows that, in the East Asian paradigm, legal institutions play more of a policy implementing role, whereas in the Western European paradigm they serve mainly in a conflict resolving capacity. These contrasts are useful, and serve as one part of the groundwork laid for this paper. Issues related to the causality between politico-economic system and legal system – i.e. which causes the other – should not detain us here, important as these issues are.

As a further step, the framework being built here also accounts for varying levels of state intervention through legal institutions. This stratification draws on North's (1990: 47) instructive formulation of the 'formal constraints' of an economy, which he delineates as a hierarchy with three levels: political (judicial) rules, economic rules, and contracts[6]. While North's typology is more functional, the approach here defines these levels with reference to the scope of influence over policy. At the first level, political rules define the structure and role of the policy. At the next level, economic rules prescribe or guide the decisions and actions of policy-makers and economic agents. The tenets of the New Economic Policy –

poverty reduction (premised on economic growth) and social restructuring (in effect, ethnic income redistribution) – provide the over-arching framework within which more specific rules – i.e. contracts – are written. For instance, the seminal Malaysia Plans, written at five-year intervals, can be conceptualised as economic rules, within which contracts are written. The Acts of Parliament that administer investment policy are also situated in this long-term framework. The nominal constituents of these laws – i.e. the specific investment incentives and restrictions – embody the frame within which contracts are written and transacted.

An important consequence of this stratification of legal institutions is the speed at which they can be amended or rescinded. At the level at which contracts are written, changes can naturally be made more quickly. The nominal constituents of investment incentives and conditions, such as the maximum tax break, can be amended in accordance with shifts in policy priorities in the wider political economy. These changes can be brought about through pronouncement by the Ministry of Trade and Industry or stipulation in the Annual Federal Budget, or other means, while the over-arching national development creed, be it the NDP or Vision 2020, remains essentially unchanged.

The more ideological – and less legal –aspect of these all-pervading national development programmes operates with a high degree of tacit understanding, as well as exercise of discretion. In the case of the NEP, its basis as a programme for restructuring economy and society is not enshrined in the Federal Constitution, but these fundamentals are acknowledged as inexorable parameters, and are hence impossible to isolate from the socio-economic milieu. Emerging from this is a juxtaposition of specified and unspecified regulations – such as the target of 30 percent Bumiputera shareholdings versus the Industrial Coordination Act mandate to "ensure orderly development and growth of industries" (Ho 1988: 230). Amid changes to the emphasis of specific policies from the NEP to the NDP, the less specified and implicit goals of the NDP, in particular of Bumiputera capitalist development, have not been abrogated. The essential difference in the new regime is found in intensified emphasis on growth, and not distribution, as the bottom line of national development. Accordingly, this heightens the emphasis on entrepreneurship and efficiency.

The importance of state-market relations underscores a premise of this paper, i.e. that the state is not independent of society and economy in setting policy and legislation; it operates within constraints and opportunities of the socio-economic milieu. A simplistic notion of disinterested state is too far from reality to be of analytical use. Chang and Rowthorn (1995: 36-40) assert that the state, in its capacity as agent of economic change, can play a meaningful role in providing ‘vision’ and not just co-ordinating a move to a higher equilibrium. This idea is obviously born of the East Asian Newly-Industrialised Country (NIC) experience and experiment with the developmental state, but is also highly applicable to Malaysia. A proviso needs to be appended here, i.e. that the benefit of providing a ‘vision’ is contingent on the efficacy of the state in using national economic focus to supersede certain sacrifices, be it economic freedom, labour suppression or redistributive policies. It also depends to an extent on the viability of the state practising *ex ante* promotion of activities, which to a significant extent hinges on the economy’s position vis-à-vis the technology frontier. Economies in the ‘catch-up’ phases of development have clearer guidelines to follow, for they have opportunity to emulate successful models (Khan 2000: 73 and Okuno-Fujiwara 1996: 398).

Our focus on the presence and influence of legislative incentives for investment, such as tax breaks, only comprises one part of the investment incentive system. This form of intervention, on its own, stipulates conditions for investment, but leaves the decision-making primarily to market players. At another level, the state also directly intervenes to channel credit and allocate capital. Malaysia has substantially undertaken this type of intervention, often in discretionary fashion, in the effort to redistribute equity. The line between growth-promoting policies and income-redistributing policies is sometimes obscure, for the two can be complementary. However, once the possibility exists for some sections of the economy to gain from redistributive effort, a network of competition for an distribution of rents inevitably emerges, which in aggregate can either lead to an increase in output or wastage of resources.

It is helpful, therefore, to integrate a framework of the political economy of patron-client relations into our analysis, to account for distributive pressures and patronage factors, specifically the relations that influence incentives for investment and behaviour of commercial interests. This is particularly interesting in the Malaysian context, where rent-seeking has been used within a socio-political milieu that has permitted a ‘bargain’ between different parties, which has played a paramount role in redressing disparities while not severely undermining production. In simplified terms, ethnic groups have traded economic stability for political power, with Chinese enterprise procuring rents and privileges from the

Malay elite in exchange for conditions that allow business to function and prosper (Khan 2000: 74). The capital issued in a manufacturing license, therefore, is effectively both a rent for redistribution and for learning. The latter, as a rent with the intention of acquiring new technology and knowledge, is invariably more difficult to administer effectively, all the more with redistributive pressures. Our framework, therefore, has been tailored with the duality theme as its thread. The process of allocating capital to Bumiputera individuals plays a dual transfer role, i.e. of wealth as well as of control over resources and a stake in decision-making. Policy has endeavoured to feed and groom the holders of capital into both capitalists and entrepreneurs. The tension between these objectives, we shall see, underlies the policies of industrial coordination and equity redistribution.

GROWTH AND REDISTRIBUTION: THE INSTITUTIONAL FRAMEWORK

To reasonably understand the importance and implication of industrial development equity redistribution, it is necessary to briefly trace the historical path of institutional development in investment framework. Legal institutions of investment have two historical landmarks: The Industrial Coordination Act (1975) and the Promotion of Investments Act (1986)[7]. These legislations serve as useful coordinates for tracing developments in the institutional framework, and in state-market relations.

Intervention for Redistribution: The Industrial Coordination Act and Heavy Industries Programme

The Investment Coordination Act (ICA) was passed in 1975, with a mandate to assimilate manufacturing into the mainstream of the New Economic Policy. The industrial sector had already been entrusted to play a central role in economic growth and social restructuring at the advent of the NEP in 1971. In the middle of the 1970s, the sector's redistributive role was augmented, motivated by assertions that the transfer of equity ownership to Bumiputera hands was not progressing as far as desired. The principal official objective of the ICA, however, was to coordinate an "orderly development of the manufacturing sector".

The Industrial Coordination Act introduced a licensing requirement to manufacturing activity in Malaysia. Every manufacturing project worth at least RM100,000 in share capital and employing 25 or more employees had to apply for a manufacturing license from the Ministry of Trade and Industry. To have their licenses approved, firms had to comply with new equity ownership conditions. Malaysian firms had to offer at least 30 percent of their equity to

Bumiputera interests. Foreign firms had to offer at least 70 percent to Malaysians, 30 percent of which had to go to Bumiputera individuals or agencies. Export-based firms, which were dominated by foreign interests, were permitted to hold up to 100 percent equity, provided they fulfil export (80 percent) and local content requirements.

The ICA was an aberration to a hitherto much less interventionist manufacturing investment system. The preceding core investment policy, the Investment Incentives Act (IIA) 1968, introduced incentives for manufacturing activity, particularly export-based operations, but did not intervene far into market activity. With enactment of the ICA, the balance of growth- and distribution-driven policies leaned heavily toward the latter. The tension between the objectives and measures of the IIA and the ICA correlates with the duality of industrialisation and redistribution. This tension persisted, because IIA-based incentives continued to be granted, while the ICA was introduced and enforced. The impacts of the ICA, it must be noted, were not uniform. A large proportion of foreign-owned, export-oriented manufacturing projects were exempt from the equity requirement. At the same time, numerous Chinese businesses, many of them family-owned, resisted and resented the sudden intrusion into their self-built enterprises[8].

The state, thus, assumed a more central and highly interventionist role in the manufacturing sector[9]. The government even more directly intervened in industry with the initiation of the heavy industrialisation programme in the early 1980s. This paper focuses on private investment, but public investment is relevant insofar as it impinged on the private sector – recognising that the public and private do intersect to a considerable degree. Although Malaysia's heavy industrialisation was a programme dictated by the government – or, to be accurate, by Prime Minister Mahathir – one of its central purposes was to involve and nurture Bumiputera entrepreneurs in the private sector, in addition to the official goal of diversifying Malaysia's industrial base.

This was accomplished through collaboration with Japanese corporations in joint ventures, through funding primarily from Japanese bank loans. The appearance of 'ethnic by-pass' – circumvention of Chinese capital and capability – lent itself to ill-feeling that Chinese business was again being shunned (Jomo and Gomez 1996: 356-357). However, an important aspect of heavy industrialisation is that new activity and capacity was being generated. Extant non-Bumiputera did not have to relinquish share holdings. Still, business-government tension was not completely allayed, because much domestic Chinese capital and capability was excluded from the heavy industrialisation project, with one specific instance being the exclusion of non-Bumiputera automobile assemblers – mostly joint-ventures with foreign auto makers – from potential sub-contracting opportunities (Jesudason 1989: 160-161 and Bowie 1991: 135). This was a precursor to liberalisation efforts, as we will see in Section IV.

Liberalisation: Promotion of Investments Act

The mid-1980s was a watershed. Various equity conditions of the Investment Coordination Act (ICA) were amended in 1985, easing full foreign ownership and excluding more Malaysian companies from the licensing requirement altogether. A more liberalised investment environment was instituted with the enactment of the Promotion of Investment Act (PIA) of 1986, which effectively subsumed the Investment Incentives Act (IIA). Amendments were made to both the ICA and IIA, i.e. changes took place on both the equity redistribution and the industrial development fronts.

The threshold of firm size for application of license from the Ministry of International Trade and Industry (MITI) was raised[10]. As a result, a drastically larger pool of manufacturing projects were exempted from applying for licenses under the ICA, and hence from abiding by equity requirements.

Concurrently, incentives for foreign-owned, export-geared manufacturing and allowances for foreign-ownership were expanded. Incentives were refurbished – though not rebuilt as a new structure – of which three stand out. First, the prior tax holiday period for projects granted pioneer status was fixed at five years, but could now be extended to ten years for certain promoted products or activities[11]. Second, applications for expansion of projects will be granted automatic approval, provided they export at least 80 percent. Third, a most consequential ICA-related amendment was the new rule allowing enterprises that exported 50 percent or more of their products to be 100 percent foreign owned. Previously, this liberty of ownership had been offered to firms exporting at least 80 percent. However, export orientation is not the only means of exemption from equity conditions. Companies whose capital exceed RM50 million or that employ more than 350 full-time Malaysians need export at least 50 percent of production to be allowed to hold as much equity as they desire. In cases where foreign ownership was less than 100 percent, the balance of share ownership "*should* conform to New Economic Policy rulings", with a suggestive addendum that "such rulings would be applied *without undue rigidity*"(*MIDA Annual Report 1986*: 22, italics added).

It is critical to note that the eased foreign-ownership rules were stipulated to apply from 1 January 1986 until 31 December 1990. These specific liberalisation measures of ownership incentives and extension of investment benefits were at the time of implementation were clearly enunciated, and understood to be subject to change after five years. As the title of the Act indicates, the measures were to promote, more than deregulate, the volume and direction of investment capital. Nevertheless, the rapid relaxation of foreign ownership regulations testifies to a broad-based commitment to attract investment. Malaysia's form of liberalisation was not so much located in the neo-classical dimension of reduced price distortion; indeed, with respect to FDI there was an expansion of fiscal incentives[12].

Hence, the more consequential liberalisation measures were not generic shifts toward a more *laissez faire* system. Rather, they were alterations in the distinctly Malaysian domain of ICA regulations. More Malaysian companies became exempt from applying for a manufacturing license under the ICA. It became easier for foreign manufacturers to operate without having to comply with equity requirements. The rapid rise in amount and average scale of manufacturing projects after the transition roughly in 1986-87 affirms that the liberalisation measures attained their main short or medium term goal of attracting FDI, which consequently raised the average capital-intensity of approved manufacturing projects (see Table 1). However, in the latter half of the 1990s, the proportion of approved projects that received incentives diminished.

In the longer term, with the launch of the Industrial Master Plan (IMP) in 1986, Malaysia embarked on a more integrated path to industrial development. This had implications for the redistribution regime. The IMP was an extensive outline and an influential document, and was scheduled to run its course from 1986 to 1995. It made recommendations for deepening Malaysia's industrial structure, and laid out criticisms of the existing industrial system. Although the IMP was mostly concerned with the structure, linkages and dynamics of industry, it also addressed the manufacturing licensing system. IMP authors recommended that the NEP targets would be better achieved through fiscal incentives than legislation. At ground level, the IMP contended that the function of the ICA could be justified for the purpose of socio-economic objectives, but state intervention in "production capacity control is hardly justifiable" (Chee 1987: 76 and 145). Hence, the contradictions of investment incentives and disincentives of coordination – including its distortionary impact on the 'free market' – came to be expressed more volubly in politically influential circles.

The state's commitment to liberalisation still continued to blend with its embedded interventionist tendencies. Some of the intervention took on different forms, again in line with the more integrated approach raised by the IMP, much of which was widely acknowledged in policy circles as well. In the Fifth and Sixth Malaysia Plans (1986-90 and 1991-95), policy orientation expressly shifted toward more reliance on markets and the private sector for industrial development[13]. In accordance with this national shift, corporate taxes were reduced in 1988[14]. In 1991, when the bundle of extra generous incentives of 1986 had finished its round, the conditions of the main incentives were scaled down[15].

Table 1. Allocation of Manufacturing Licenses, 1975-97 (RM million and percentage).

	1975	1976	1977	1978	1979	1980	1981	1982	1983	1984	1985	1986
All projects:												
Number	461	425	400	428	484	460	613	481	498	749	625	447
Proposed called up capital	564.5	458.5	357.9	480.2	1,254.7	752.9	1,709.1	1,921.5	1,280.3	1,213.4	1,823.7	1,878.8
Average per approval	*1.2*	*1.1*	*0.9*	*1.1*	*2.6*	*1.6*	*2.8*	*4.0*	*2.6*	*1.6*	*2.9*	*4.2*
To Malaysian	**409.2**	**344.4**	**250.0**	**302.4**	**759.1**	**504.7**	**1,213.8**	**1,393.9**	**951.2**	**938.0**	**1,498.8**	**1,354.3**
% Total	72.5	75.1	69.9	63.0	60.5	67.0	71.0	72.5	74.3	77.3	82.2	72.1
To Bumiputera	**236.2**	**184.8**	**150.7**	**160.0**	**578.8**	**304.1**	**761.2**	**1,081.9**	**607.5**	**515.4**	**992.8**	**707.0**
% Total	41.8	40.3	42.1	33.3	46.1	40.4	44.5	56.3	47.4	42.5	54.4	37.6
Indivs. and trust funds												
% Total												
Public corporations												
% Total												
To non-Bumiputera	**173.0**	**159.6**	**99.3**	**142.4**	**180.3**	**200.6**	**452.6**	**312.0**	**343.7**	**422.6**	**506.0**	**647.3**
% Total	30.6	34.8	27.7	29.7	14.4	26.6	26.5	16.2	26.8	34.8	27.7	34.5
To foreign equity	**155.3**	**114.1**	**107.9**	**177.8**	**495.6**	**248.2**	**495.3**	**527.6**	**329.1**	**275.4**	**324.9**	**524.5**
% Total	27.5	24.9	30.1	37.0	39.5	33.0	29.0	27.5	25.7	22.7	17.8	27.9
Bumiputera projects:												
Number	81	99	87	82	69	83	143	133	132	237	181	123
Proposed called up capital	164.1	143.1	107.1	85.6	691.8	202.7	559.0	1,067.0	555.6	401.8	856.4	413.2
Average per approval	*2.03*	*1.45*	*1.23*	*1.04*	*10.03*	*2.44*	*3.91*	*8.02*	*4.21*	*1.70*	*4.73*	*3.36*
		92.5	**78.2**	**62.8**								

To Bumiputera	**110.0**				**450.3**	**160.9**	**420.2**	**807.6**	**374.4**	**292.2**	**757.0**	**300.0**
% Total Bumiputera projs.	67.0	64.6	73.0	73.4	65.1	79.4	75.2	75.7	67.4	72.7	88.4	72.6
To non-Bumiputera	**19.0**	**24.3**	**8.2**	**10.0**	**7.0**	**8.1**	**41.8**	**41.5**	**65.9**	**58.2**	**41.3**	**37.8**
% Total Bumiputera projs.	11.6	17.0	7.7	11.7	1.0	4.0	7.5	3.9	11.9	14.5	4.8	9.1
To foreign equity	**35.1**	**26.3**	**20.7**	**12.8**	**234.5**	**33.7**	**97.0**	**217.9**	**115.2**	**51.4**	**58.1**	**75.4**
% Total Bumiputera projs.	21.4	18.4	19.3	15.0	33.9	16.6	17.4	20.4	20.7	12.8	6.8	18.2

Table 1 (cont'd)

	1987	1988	1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
All projects:													
Number	332	732	792	906	973	874	686	870	898	782	759	844	725
Proposed called up capital	1,529.3	3,469.7	4,603.4	9,679.1	9,679.0	8,662.6	4,851.4	7,788.6	6,524.1	12,184.9	8,185.1	6,886.1	3,162.8
Average per approval	*4.6*	*4.7*	*5.8*	*10.7*	*9.9*	*9.9*	*7.1*	*9.0*	*7.3*	*15.6*	*10.8*	*8.2*	*4.4*
To Malaysian	**778.6**	**1,459.2**	**1,202.2**	**3,451.1**	**3,605.6**	**2,802.3**	**2,408.1**	**3,678.7**	**3,331.3**	**5,972.3**	**4,471.4**	**3,945.9**	**1,200.1**
% Total	50.9	42.1	26.1	35.7	37.3	32.3	49.6	47.2	51.1	49.0	54.6	57.3	37.9
To Bumiputera	**450.3**	**822.6**	**637.8**	**1,928.7**	**2,359.4**	**1,832.8**	**1,094.2**	**2,019.7**	**1,615.1**	**1,686.7**	**2,562.7**	**2,569.0**	**497.2**
% Total	29.4	23.7	13.9	19.9	24.4	21.2	22.6	25.9	24.8	13.8	31.3	37.3	15.7
Indivs. and trust funds		**418.7**	**451.1**	**1,593.3**	**1,490.2**	**810.5**	**1,059.5**	**1,436.9**	**1,548.0**	**1,586.9**	**1,991.7**	**1,484.7**	**291.1**
% Total		12.1	9.8	16.5	15.4	9.4	21.8	18.4	23.7	13.0	24.3	21.6	9.2
Public corporations		**403.9**	**186.7**	**335.4**	**869.2**	**1,022.3**	**34.7**	**582.8**	**67.1**	**99.8**	**571.0**	**1,084.3**	**206.1**
% Total		11.6	4.1	3.5	9.0	11.8	0.7	7.5	1.0	0.8	7.0	15.7	6.5
To non-Bumiputera	**328.3**	**636.6**	**624.4**	**1,522.4**	**1,246.2**	**975.5**	**1,313.9**	**1,659.0**	**1,716.2**	**4,285.6**	**1,908.7**	**1,376.9**	**702.9**
% Total	21.5	18.3	13.6	15.7	12.9	11.3	27.1	21.3	26.3	35.2	23.3	20.0	22.2
To foreign equity	**750.7**	**2,010.5**	**3,401.2**	**6,228.0**	**6,073.4**	**5,854.3**	**2,443.3**	**4,109.9**	**3,192.8**	**6,212.6**	**3,713.7**	**2,940.2**	**1,962.7**
% Total	49.1	57.9	73.9	64.3	62.7	67.6	50.4	52.8	48.9	51.0	45.4	42.7	62.1
Bumiputera projects:													
Number	42	75	32	57	63	62	54	67	91	n.a.	n.a.	n.a.	n.a.

Proposed called up capital	308.7	588.6	110.7	260.3	783.5	271.3	507.4	610.3	919.4	n.a.	n.a.	n.a.	n.a.
Average per approval	*7.35*	*7.85*	*3.46*	*4.57*	*12.44*	*4.38*	*9.40*	*9.11*	*10.10*	n.a.	n.a.	n.a.	n.a.
To Bumiputera	**252.7**	**495.4**	**63.6**	**218.4**	**505.9**	**249.3**	**398.3**	**407.1**	**610.0**	n.a.	n.a.	n.a.	n.a.
% Total Bumiputera projs.	81.9	84.2	57.5	83.9	64.6	91.9	78.5	66.7	66.3	n.a.	n.a.	n.a.	n.a.
To non-Bumiputera	**45.3**	**19.1**	**17.8**	**16.6**	**25.8**	**11.4**	**21.9**	**78.7**	**179.8**	n.a.	n.a.	n.a.	n.a.
% Total Bumiputera projs.	14.7	3.2	16.1	6.4	3.3	4.2	4.3	12.9	19.6				
To foreign equity	**10.7**	**74.1**	**29.3**	**25.3**	**251.8**	**10.6**	**86.1**	**124.5**	**129.6**	n.a.	n.a.	n.a.	n.a.
% Total Bumiputera projs.	3.5	12.6	26.5	9.7	32.1	3.9	17.0	20.4	14.1	n.a.	n.a.	n.a.	n.a.

Sources: Yasuda 1991, Table 3, pp. 340-341, and *MIDA Annual Report*, various years.

Trajectory of Manufacturing Licensing

A trajectory of manufacturing investment and equity distribution can be mapped from Table 1. From 1975 until 1986, the trend-lines – principally, of biases in distribution and capital intensity – vividly paint the NEP picture. The bulk of shares of approved projects went to Malaysian interests, within which Bumiputera interests were the main beneficiaries. Capital intensity of Bumiputera projects (where Bumiputera ownership exceeds 50 percent) also consistently exceeded the total average. The redistribution to Bumiputera and away from Chinese and foreign ownership, while tapping mainly foreign sources of technology, is shown to be immense indeed. The larger share of capital of foreigners than Chinese within Bumiputera projects also reflects the reliance on foreign sources of technology (Yasuda 1991: 344).

The trend from 1986 is equally vivid. Bumiputera ownership drastically fell, while foreign equity increased its share. The annual volume of capital inflow, and average capital intensity escalated, the former from RM524.5 million in 1986 to an apex of RM6,228 million in 1990, the latter from RM3.36 million per project in 1986 to its peak of RM12.44 million per project in 1991.

Returning momentarily to our theoretical framework, before advancing to the analyses in Section IV, it is worth highlighting how this section's overview of the liberalisation measures has pointed out the inter-relationship between state and market that impinges on the institutional framework of investment. The impact of redistributive measures on economic performance is crucial, for it determines to a large extent the efficacy and sustainability of the redistribution effort. Malaysia's intervention has been distortionary in the sense of "interfering" with market initiatives and directives, i.e. by statutorily determining promoted products, *ex ante*, and subsidising cost through fiscal incentives. Arbitrary, heavy-handed state action has not been practised – although the extent of discretionary power vested in MITI would be expected to induce predatory state behaviour. An indication of this is the high rate of manufacturing license approval, i.e. 87 percent from 1980 to 1997 (BNM *Monthly Statistical Review*, Table VI.11). Systematically, the existence of a list of promoted activities pre-selects the pool of applicants for incentives. Hence, the exercise of *dirigiste* capacity – with the exception of the early heavy industrialisation years – has been manifest more significantly in 'indicative' measures such as this setting of the list of promoted industries than in 'authoritative' measures such as full state-led and state-run enterprise. The sensitive nature of redistribution efforts as well, has made the government tread carefully and tactfully when intervening.

In the earlier years of heightened discontent toward the ICA, much of the protest centred on the discretionary power in the Minister of Industry's hands, especially the power to change decision in mid-stream, thereby forcing firms to incur huge costs or switch business strategy (Jesudason 1989: 137 and Ho 1988: 232-234). Various measures have been taken to foster better communication and a more amicable investment climate[16]. There has been no need for heavy-handed and arbitrary decisions because conditions and incentives are quite clearly specified. Projects that have complied with Bumiputera participation commonly get approval without hassle (Adam and Cavendish 1995: 33). This gradual stabilisation of manufacturing licensing, and corresponding scaling down of direct intervention, are crucial pre-conditions to the liberalisation measures of the mid-1980s, to which we now turn.

THE POLITICAL ECONOMY OF INDUSTRIAL DEVELOPMENT AND EQUITY REDISTRIBUTION

This section analyses the motivations for the shift in Malaysia's redistribution regime, and its implications on ownership and control in the manufacturing sector. Our discussion follows three stages, each building on the previous one. First, I consider the inter-relationship between short-term and long-term policy setting. The early phase of liberalisation coincided with measures to lift the economy out of recession. In the longer term – and for more deep-seated reasons than economic recovery – there was a shift in the over-arching policy framework, from a redistribution-centred to growth-centred national approach to economic development, with increased emphasis on entrepreneurship and favour towards large-scale capitalists. Accordingly, the balance of the duality tilted more toward industrial development. Following from this, in the second segment I consider the differential impacts of investment liberalisation on ownership of capital and control over manufacturing activity. In the third part, I situate the manufacturing sector in the Malaysian economy as a whole, to account for crucial economy-wide developments – especially privatisation – that make this shift in the redistribution regime financially viable.

Recovery of Economy and Reformulation of Development Policy

During the recessionary years of the early to mid-1980s, Malaysia's GDP, capital formation, and manufacturing output grew slowly, or contracted. The downturn was confirmed in 1985, when the following growth rates were registered: -8.6 percent (private fixed capital formation), -10.4 percent (public fixed capital formation), -6.9 percent (manufacturing output), for overall 1.0 percent shrinkage in GDP (see Appendix Table 3). Thus, pressure and impetus mounted to induce a growth spurt in manufacturing. This recovery depended on the private sector, owing primarily to heavy public debt that had been incurred. However, domestic sources were inadequate to generate a capital infusion that could stimulate economic activity (Okamoto 1994: 464). By coincidence or providence, favourable external circumstances supplied a large part of the desired injection of investment. The appreciation of Japanese, Korean and Taiwanese currency, and consequent mass relocation of manufacturing operations to lower cost regions, provided a pivotal push factor, which combined with the various pull factors outlined in Section III[17].

The purpose of mentioning the interplay of push and pull factors is to be circumspect against overestimating the impact of enhancement of investment incentives in the Promotion of Investments Act of 1986. Furthermore, the dismantling of impediments, as much as the raising of incentives, can induce investment inflows (McClure 1999: 337). To be sure, supply of foreign direct investment increased at the same time that Malaysia became a more alluring destination for such capital flows. However, a multitude of factors were at work. Most importantly, FDI flowed in to capture gains from Malaysia's consolidated growth potential, which, in turn, drew strength from the growth-oriented strategy. This thesis is sustained empirically by the continual – indeed, increasing – influx of FDI in spite of the scaling back of incentives after 1991.

Our concern is with shifts in the institutional framework, and in this respect, the openness to foreign capital was not drastically new. Foreign investment has long been welcome in Malaysia, as a source of capital and technology, as well as a counterbalance against Chinese capital. Hence, although incentives were stepped up to draw new investment, the system of coordinating investment was not altered fundamentally, as reflected in the continuing preponderance of favoured high-technology and capital-intensive sectors. Effort was made, more significantly in the 1990s, to absorb these advanced technologies, or facilitate technology transfer, and enhance linkages with domestic industry. Our focus on the mid-1980s redistribution regime shift, however, fixes eyes on developments in manufacturing licensing as a channel for equity redistribution. The willingness to relinquish previously cherished ownership and control of equity in manufacturing testifies to a fundamental – and highly politically driven – shift in policy regime. A vital shorter-term objective – recovery from recession – harmonised with this fundamental shift, and is evinced by the five-year lifeterm (1986-91) for the enhanced investment incentives.

The raising of the ceiling for exemption from ICA licensing had greater implication on domestic than foreign manufacturing interests, and indicates that part of the strategy for economic recovery was counting on domestic capital. The vast increase of small and medium scale industries, mostly Chinese owned and operated, that did not have to relinquish equity to Bumiputera interests is highly indicative of a major shift in policy orientation[18]. These changes unambiguously signal the turning away from manufacturing licensing as a mechanism for equity redistribution, which must derive from the over-arching change in national policy orientation alluded to earlier in this paper. One aspect of this shift is an increase in the private sector's role in manufacturing – in the wake of heavy industrialisation and concentrated state-owned enterprise efforts. Beginning in the mid-1980s, policy documents articulated a different tenor to the NEP-objectives. Another aspect of this shift was the heightened attention paid to the creation of a "strong and viable Bumiputera Commercial and Industrial Community (BCIC)" (Malaysia 1991: 148-149). It was also asserted that Malay capitalist dependence on state protection and subsidies would be reduced, and self-reliance encouraged (Khoo 1992: 50-51).

This greater thrust for the cultivation of a Malay capitalist elite carried much baggage. It may be argued that state-capitalist relations changed, from the more general pursuit of Bumiputera interests to more personalised and direct relations between capitalists and leading political figures[19]. In the aftermath of the power struggles of the mid-1980s in the United Malays National Organisation (UMNO), the victors consolidated the primacy of large capitalists under the party elite's protection (Khoo 1992: 62-70)[20].

Ownership of Capital, Control of Industry

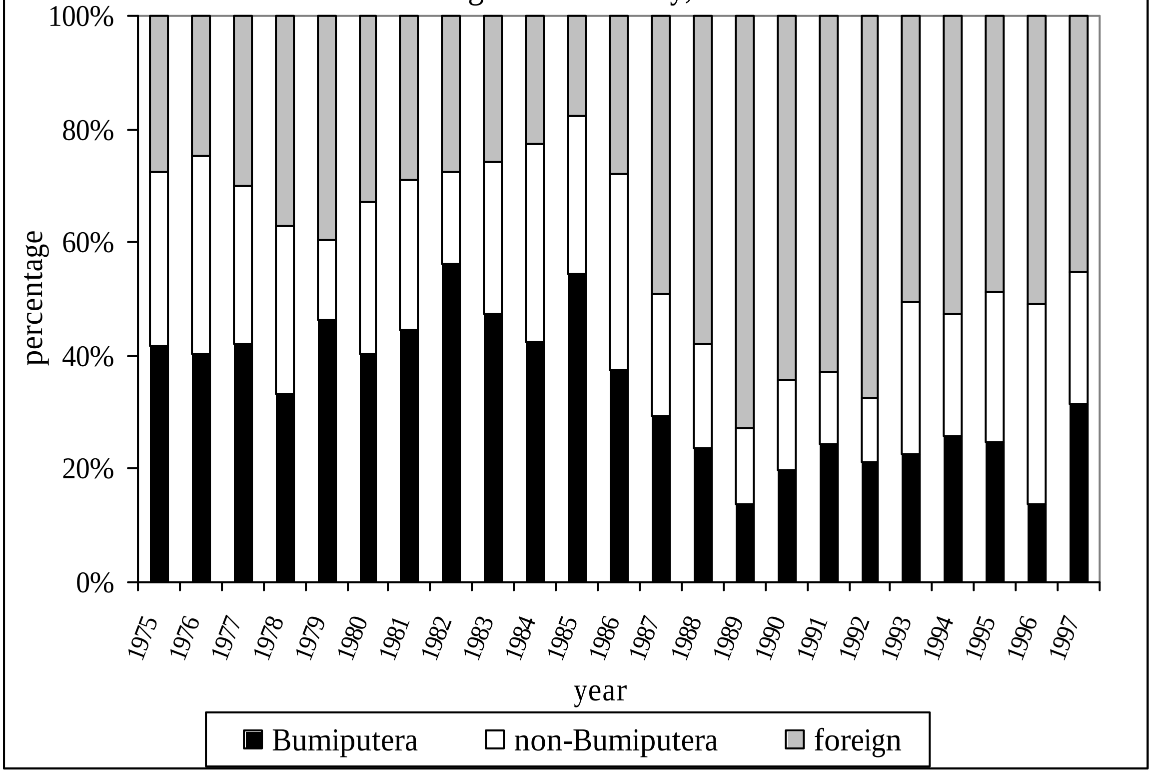
Amid the protest against the ICA, large amounts of capital took flight. One source estimates the outflow to be US$12 billion from 1975 to 1984, more than half of which is believed to be Chinese-owned (Morgan Guaranty, cited in Gomez 1999: 70). Yet, a substantial amount remained in Malaysia, and a sizeable amount flowed in. The capital that stayed in Malaysia accommodated the ICA strictures. An important underlying factor is the observation that Chinese businesses have not greatly benefited from, nor extensively sought, pro-active incentives, although they have desired to be left to run on their own. Investment inducements have, particularly since the late 1960s, tended to court foreign capital. Therefore, it is difficult to maintain that the ICA completely undermined a conducive environment for Chinese business, for there were few privileges that were actually rescinded. The fact that manufacturing is not the only mainstay of Chinese business activity is also a critical factor. Chinese businesses are heavily engaged in retail, wholesale, and other services (Jesudason 1989: 147 and Yasuda 1991: 343). Nonetheless, every instance of liberalisation of ICA rules benefits Chinese capital.

Chinese and foreign companies that accommodated ICA equity requirements released, respectively, the minimum 30 percent to Bumiputera or 70 percent to Malaysian investors. Managerial position, of course, is much more difficult to cede. Nonetheless, it was often not difficult to establish some rapprochement, for there was also a lack of experience and sometimes interest of Bumiputera associates to participate in management. Beneficiaries of ICA-redistributed shares – usually bought at heavy discount – often sold their lot for quick profit (Gomez 1999: 17). Hence, Chinese and foreign manufacturers engaged Bumiputera directorships, effectively without relinquishment of executive or managerial power to these appointees. In addition, statutory unit trust funds often stepped in to fill a dearth of Malay individual and household savings. The need for recourse to these pooled funds suggests that the number of Malay individuals placed in influential shareholding positions fell below expectations (Bowie 1991: 103-4 and 109). The endeavour to promote both Bumiputera ownership and control over manufacturing capital through heavy industrialisation turned out to be unsustainable, a situation that was exacerbated by the misfortune of a contemporaneous global economic slump.

The mid-1980s liberalisation, therefore, must be seen in the context of these realities: first, the dynamics of the entrepreneurial development and capital acquisition duality; second, the failure of preceding attempts to reach these objectives, through ICA licensing and heavy industrialisation. These investigations find empirical support from manufacturing licensing data.

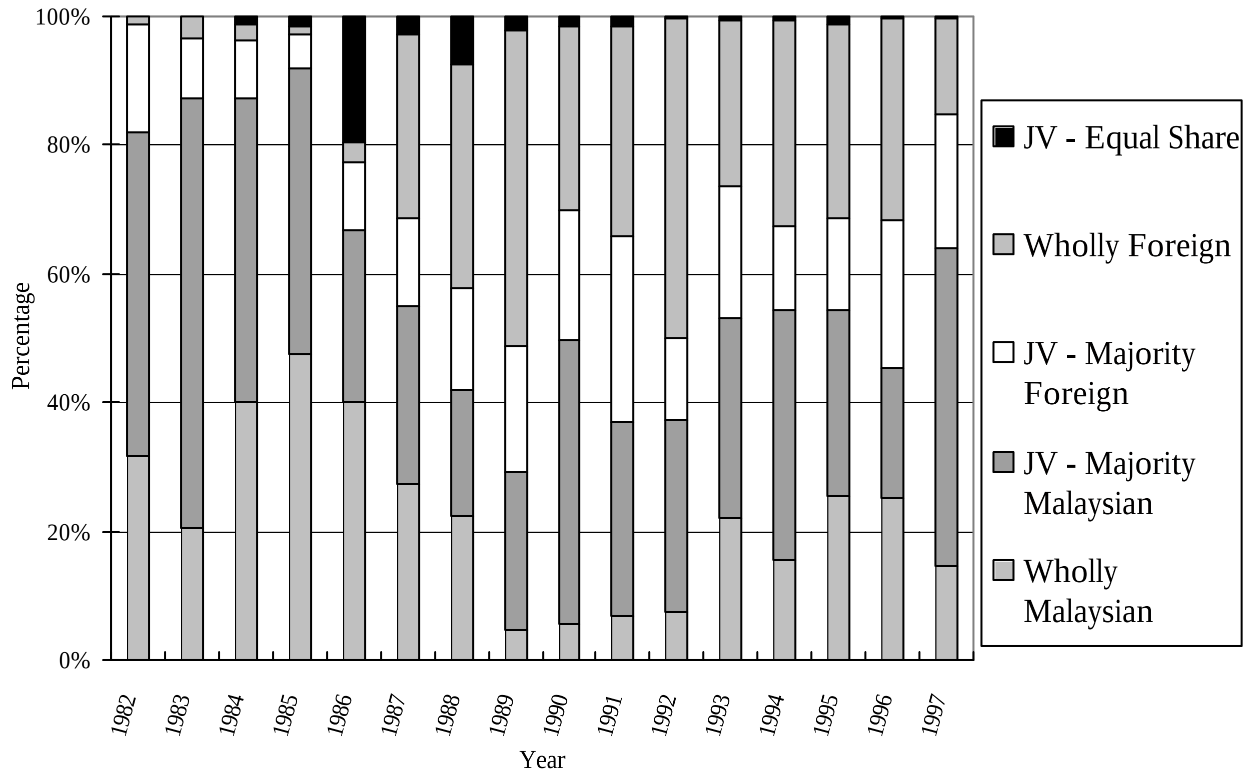
The following data delineates the allocation of equity of approved manufacturing projects, according to different categories. Figure 1, plotted from data in Table 1, shows the distribution of capital ownership. Foreign interests rapidly increased their share from 1985, while both Bumiputera and non-Bumiputera portions decreased. In Figure 2, we note that the proportion of fully Malaysian-owned projects and Malaysian-majority joint-ventures (JVs) plummeted from 1985, in terms both the number of projects approved and the proportion of these projects in total capital investment.

Figure 1. Distribution of Equity of Approved Projects, According to Nationality, 1975-97



Source: MIDA *Annual Report*, various years.

Figure 2. Equity of Approved Projects, by Ownership, Percentage of Total, 1982-97

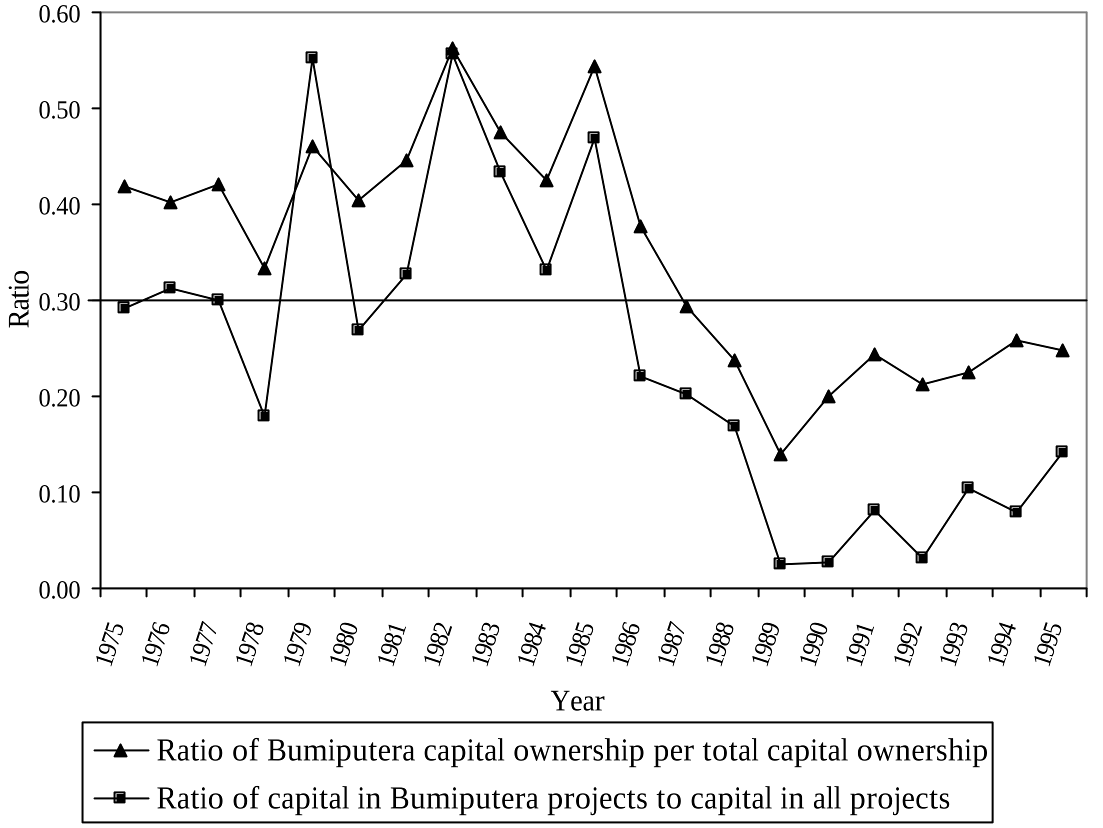


Juxtaposing Figure 2 against Figure 1, we can discern, at a further level, differentials in the decrease in Malaysian ownership and control of the manufacturing sector. The distribution of share capital according to nationality in Figure 1 indicates ownership, while distribution according to type of ownership in Figure 2 approximates the relative control of foreign and Malaysian interests. The two have moved in tandem. The proportion of capital accruing to wholly Malaysian-owned projects and Malaysian-majority JVs fell from 85.6 percent in 1985 to 29.2 percent in 1989. Over the same period, equity in Bumiputera and non-Bumiputera hands dropped from 82.2 percent to 26.1 percent. The influx of foreign capital raised the share of total equity of approved manufacturing projects going to foreign interests, from 17.8 percent in 1985 to 73.9 percent in 1989, while the corresponding share of wholly-owned foreign projects and foreign-majority JVs leapt from 6.7 percent in 1985 to 68.6 percent in 1990[21]. Importantly, in the 1980s period prior to liberalisation, most foreign capital was attached to joint venture projects that were majority-Malaysian owned. The more drastic change, therefore, took place in the handing over of control over manufacturing sector to foreign interests.

What were the implications on equity redistribution? To address this question, we must examine the data on Bumiputera equity allocation. Looking at Table 1 and Figure 1**,** we observe that until 1992, the allocation of new manufacturing equity, within Malaysia, had always been larger to Bumiputera interests. In 1993, 1995 and 1996, however, more equity was approved to non-Bumiputera hands. Moreover, not only did the *proportion* of equity issued to Bumiputera, but the *absolute* amount in a few years was also smaller than in the preceding year (1992, 1993, and 1995; See Table 1). The break in the trend of Bumiputera predominance in receiving share allocation, although not as drastic as the foreign capital inflow trend, is still clear enough to warrant further investigation.

To proceed further, we again consider differential impacts on ownership and control, in the context of Bumiputera capital within the economy. Figure 3 delineates the proportion of Bumiputera capital ownership in total capital ownership, as well as the proportion of capital in Bumiputera projects (51 percent or more Bumiputera) in total capital of approved projects. The upper line ('ownership ratio'), therefore, straightforwardly indicates percentage of capital in Bumiputera hands. The lower line ('control ratio') is a proxy for Bumiputera control of manufacturing.

Figure 3. Proportion of Bumiputera Equity in Total Manufacturing Equity, 1975-95



Sources: same as Table 1.

During the early ICA years, 1975-78, Bumiputera control was significantly lower than ownership, and hovered closely above or below the pivotal 0.30 mark[22]. The ownership ratio, accordingly, maintained above this mark. The period 1978-85 witnessed fluctuations in both these indicators. Importantly, the control ratio tended to reside above 0.30. Importantly, from 1982 to 1985 these ratios moved in closer tandem, reflecting the intensified effort to converge ownership and control in the economy, particularly in the heavy industries programme. From 1985, both indicators dropped rapidly, but the control ratio fell to much lower levels. In 1989, Bumiputera-controlled projects accounted for only 2 percent of total called-up capital. In 1990 and 1992, the corresponding figure registered a marginally higher 3 percent. The gulf between ownership and control widened again, especially between 1989 and 1992. Bumiputera ownership hovered around 20 to 25 percent, indicating that a significant amount of 'non-controlling' capital was still being transferred. In sum, the liberalisation measures were concomitant to a massive scaling down of Bumiputera control over the manufacturing sector.

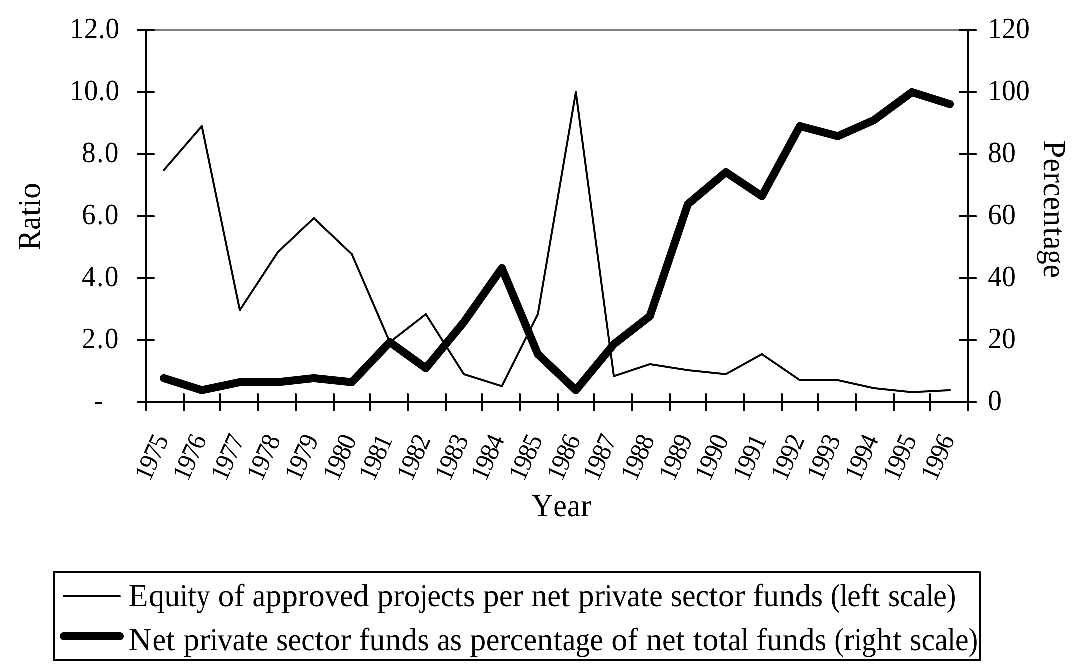
In this reconfiguring political economy, there were two key factors underlying these distributional developments. First, the structure of centralised investment coordination diminished in its ambit of transferring equity to the Bumiputera community as a whole. Access to lucrative contracts became highly dependent on patronage, inducing manufacturers (mainly Chinese) seeking licenses to offer equity and directorships to select Bumiputera politicians, in increasingly personalised circumstances (Gomez and Jomo 1997: 47). Second, the impacts of the higher priority placed in entrepreneurship became more palpable. The more stringent demands of the IMP-led post-1986 industrialisation programme began to exclude Bumiputeras who were inexperienced or not qualified, who might have been granted management positions in the previous regime. In two highly indicative instances, the Malay managers of two heavy industry mega-projects were replaced: in Proton (the automobile venture), by a Japanese; in Perwaja Steel, by a Chinese (Bowie 1991: 137-138).

However, a sizeable number of Bumiputera entrepreneurs did prove their capability, and became prominent in the 1980s. Consequently, as opposed to the 1970s when non-controlling directors were quite common, more Bumiputera began to desire control over the companies in which they had equity interests (Gomez 1999: 17-18). These opportunities became curtailed in the manufacturing sector in the mid-1980s, in the wake of the influx of export-oriented and large scale investment, which was exempt from equity requirements. Hence, a larger proportion of manufacturing establishments also did not have to redistribute their equity. Thus, sights were set in other directions. In other words, the locus of Bumiputera capital acquisition shifted to other sectors and activities – specifically, privatisation and the stock market.

New Conduits for Equity Transfer

On the whole, the private sector increased its scope and depth, concurrent with liberalisation. Figure 4 shows the rapid rise of private sector funds as a proportion of total funds raised in the capital market, from 1986. More specific to the manufacturing sector, the ratio of equity of approved projects per total private sector funds is also graphed. This puts the distribution regime in the bigger picture, pointing out important public-private sectoral developments that have taken place. First, the public sector's dominant role in raising new capital – mostly bonds – of the period prior to 1986 reflects the limited the scope for private equity transfer to Bumiputera ownership through raising new funds. The policy choice to intervene in direct redistribution of existing equity clearly befits this context of underdeveloped capital markets. During this period, the amount of proposed equity of ICA-approved projects alone considerably exceeded new issues of shares. Second, the burgeoning role of the private sector in raising new capital concurs with diminishing dependence on the ICA as a means for Bumiputera capital acquisition.

Figure 4. Funds Raised in Capital Market



Source: MIDA *Annual Report*, various years, BNM *Monthly Statistical Bulletin*, Table V.11.

A core determinant of the rise of the private sector was the privatisation of state enterprise. Government desire for privatisation as a channel for equity transfer was expressed in various contexts, but few places as saliently as in the Sixth Malaysia Plan: "Privatisation of suitable public enterprises has been undertaken and will continue to be a vehicle to create opportunities for Bumiputera participation in industrial development" (Malaysia 1991: 148-149). The most favoured mode of privatisation was through sale of equity[23]. By June 1992, the public listing of thirteen privatised entities was worth RM201.1 billion, accounting for 28 percent of total market capitalisation (Gomez and Jomo 1997: 87).

The stock market boom of the 1990s allowed rapid wealth accumulation. Bumiputera capitalists who benefited from privatisation also exercised control over their portfolios, more than under the manufacturing licensing regime. The burgeoning of the Kuala Lumpur Stock

Exchange (KLSE) bridged the higher demand for Bumiputera control over capital. All KLSE indicators indicate the bountiful opportunity for acquisition in the bubble economy of the 1990s (Appendix Table 4). Turning from manufacturing for equity acquisition required growth in other newly-targeted sectors. Evidence in Table 2 below firmly corroborates this case. While manufacturing equity dominated the KLSE up to the late 1980s, accounting for up to 48 percent of total equity, the expansion of construction and financial services carved away this preponderance (Adam and Cavendish 1995: 34). From 1990 to 1996, the average annual proportion of new equity issues by major sectors were: manufacturing (28.2%), construction (14.9%), and financial services (26.6%).

Table 2. New equity issues by sector, percentage of total, 1990-97

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
Manufacturing	17.2	25.4	20.1	50.8	27.9	43.1	22.9	22.9	66.5	46.6	35.3
Construction	14.6	17.5	5.6	19.2	18.5	11.6	20.4	18.1	21.7	13.0	23.0
Financial services[1]	26.8	43.4	14.5	21.9	31.2	32.2	24.1	36.9	10.6	32.5	17.6
Services[2]	6.1	1.1	1.7	7.3	8.1	9.2	15.5	5.8	0.0	0.6	16.9
Other	35.3	12.6	58.1	0.8	14.2	3.9	17.1	16.3	1.2	7.3	7.2
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Bank Negara Malaysia *Monthly Statistical Bulletin*, Table V.12.
Notes: [1]Finance, Insurance, Real Estate and Business Services
[2]Wholesale, Retail Trade, Hotels and Restaurants

CONCLUSIONS

Synthesis

This paper has examined the industrial development and equity redistribution in Malaysia's redistribution regime, in the context of a shift in the redistribution regime. This process stems from a fundamental transition from a redistribution-centred to a growth-centred national development policy, which constitutes an over-arching ideological institution. Legal institutions, operating at other levels in the broad institutional framework, have conformed to this ideological shift, and enhanced investment incentives to draw foreign investment. The state has also narrowed the scope of its redistributive role in manufacturing, by exempting a larger proportion of (primarily domestic) manufacturing establishments from licensing requirements. These measures had a short-term objective of reviving an economy in recession, and the long-term objective of enhancing industrial and entrepreneurial development.

The data indicating changes in ownership and control patterns reveal differential outcomes to the allocation of equity of manufacturing projects in the wake of investment liberalisation. The declines in proportion of manufacturing capital issued to Malaysians, relative to foreigners, and to Bumiputera, relative non-Bumiputera, have been more significant in the ratios that indicate control over manufacturing than those that indicate ownership of equity. The domestic context is more relevant, for the drastic decrease in Bumiputera ownership of manufacturing equity testifies to scaling back of direct state intervention in industry and the rise of large capitalist and their personalised relations with politicians or the dominant political party, UMNO. The trend also reflects the declining significance of the manufacturing sector as channel for equity transfer. Indeed, redistribution of both ownership and control has diverted attention to other sectors, as the private sector has burgeoned, and the stock market boomed, substantially due to privatisation.

Continuing Duality

We now consider the dynamics of continuing duality in manufacturing, and the economy as a whole. As with all major regime shifts, Malaysia's shift in redistribution regime has come with consequences on industrial development. The full ramifications are too vast to be explored here. Nevertheless, the general impact of the unique bundle of liberalisation measures on manufacturing may be inferred from data on output and value-added (see Appendix Table 3). In 1981, 1984 and 1985, the manufacturing sector obviously performed poorly in terms of output and value-added. The recovery from 1986 onwards is also unambiguous. Liberalisation clearly played a significant role in facilitating capital accumulation. Importantly, the data reveals that over the longer time span manufacturing output and value-added grew steadily in most years, even in the wake of post-1975 ICA imposition.

The conventional dichotomy of redistributive versus productive activities, therefore, is not so distinct in the Malaysian context, although it is more applicable elsewhere among the less developed economies[24]. The maintenance of social and political stability in the first decade of the ICA was key to sustaining a substantial stream of foreign direct investment, as well as preventing complete capital flight. This stability partly derives from a unique bargaining structure in which offer of capital and/or company directorship from Chinese to Bumiputera parties. Critique of the redistribution regime of Malaysia, therefore, has to be tempered with acknowledgement of more wasteful, or harmful, consequences that could have transpired (Yasuda 1991: 348).

However, manufacturing investment could unquestionably have benefited more from better cooperation between the state and Chinese capital, which had the potential to enhance technological capabilities and consolidate Malaysia's industrial base (Jesudason 1989: 161). Chinese business strategies to circumvent ICA equity relinquishment, particularly by preventing expansion beyond the threshold of exemption, has surely precluded scale economies in many instances (Jesudason 1989: 149). Ownership of equity has not always meant control, and thus has not effectively cultivated Bumiputera entrepreneurship as intended. This, together with profiteering through sale of shares acquired at heavy discount, has rendered the transfer of learning rents ineffectual (Gomez and Jomo 1996: 369).

Preoccupation with equity redistribution – ownership of capital – has compromised industrial development. In the broader scope of national development, the potential for entrepreneurial development, skills acquisition and technological advance has been somewhat stifled by redistributive schemes. Control over capital is less easily gained and more effectively sustained than mandatory transfer of equity. It is still a desired goal of national development, but has been virtually abandoned in the manufacturing sector. In this regard, the rapid ceding of Malaysian – especially Bumiputera – control over manufacturing activities has been a mixed blessing. In likeness of the 1985-86 liberalisation measures, equity conditions were again dismantled, as a means to spur investment to recover from the 1997-98 financial crisis. This time, liberalisation took an even further step, with a complete annulment of export conditions. Effective 31 July 1998 to 31 December 2003, all manufacturing investments do not have to abide by equity requirements, irrespective of export levels.

Foreign interests, therefore, continue to dominate manufacturing activity. From 1990 to 1999, 55.1% of equity in manufacturing was held in non-Malaysian hands, most of which was not drawn so much by incentives. This waning of explicit favour toward foreign investment may, directly or indirectly, provide a fillip for the cultivation of domestic industrial capacity. However, vital factors in further stimulating the manufacturing sector lies at a deeper root level, i.e. in overcoming acquisitive and under-productive behaviour. In terms of equity, proliferation of stock market speculation and short-termist profiteering, plus the non-competitive, cronyistic conduct of privatisation, have created a rentier elite in the private sector, of various ethnicities (Gomez and Jomo 1997: 98-99 and 177-179). In terms of bank loans, as shown in Table 3, the preponderance of loans for purchase of landed property, vehicles and securities, and the concomitant lack of investment in manufacturing, particularly among Bumiputera investors.

Table 3. Distribution of Bank Loans to Selected Sectors (percentage of total loans[1])
(as at 31 December 2000)

Sector	Bumiputera	Non-Bumiputera	Total
Manufacturing	7.2	18.9	15.0
Construction	11.7	7.8	8.4
Purchase of landed property	19.8	27.2	24.0
Purchase of transport vehicles	16.3	6.2	8.5
Purchase of securities	12.0	4.1	5.9

Note: [1]i.e. Bumiputera loans in each sector per total Bumiputera loans.
Sources: OPP3: Table 4-4, p. 95; author's calculations from BNM Monthly Statistical Bulletin, Table III.14.

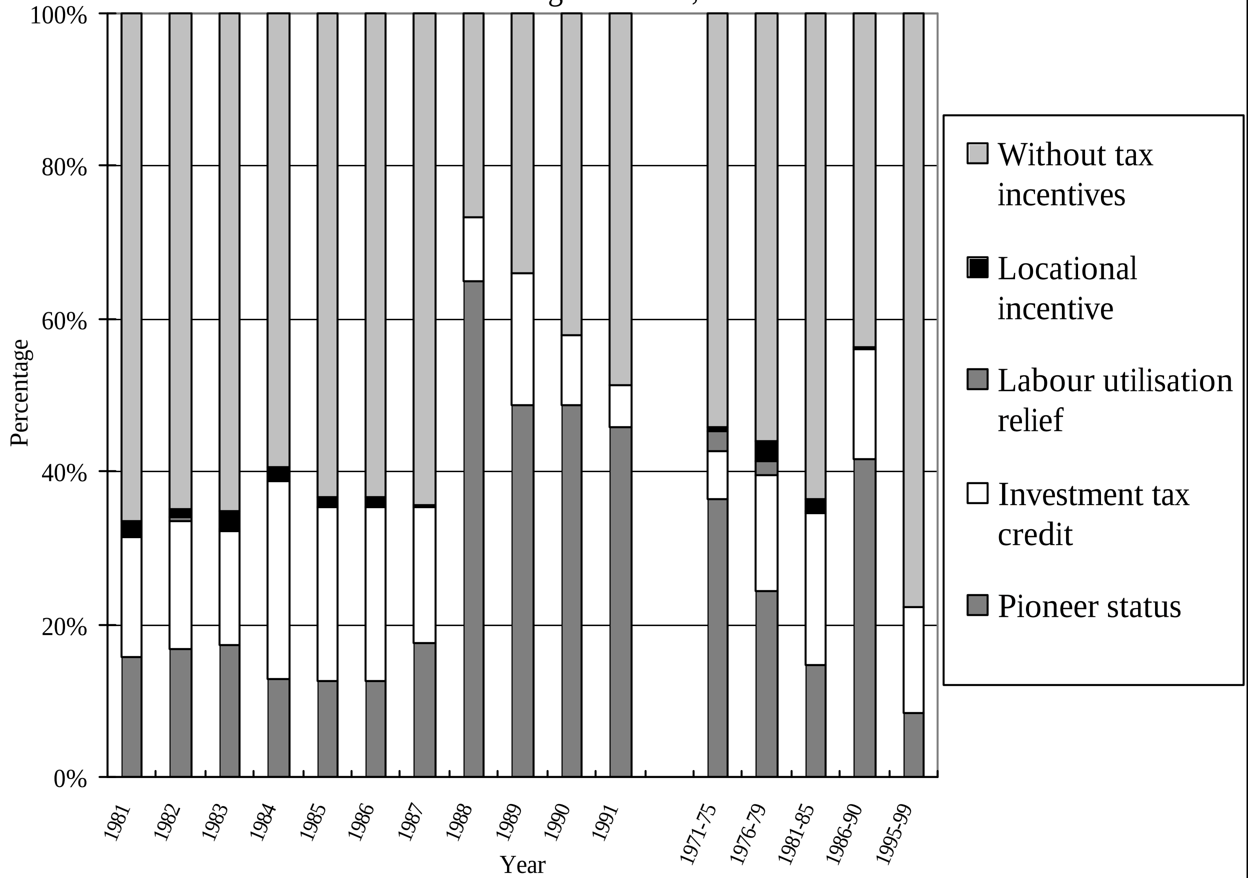
At the same time, with a balanced look, we may see early signs of a more integrated manufacturing sector. In recent years, less of preoccupation with redistribution, and with large-scale capital-intensive manufacturing, has facilitated a more holistic and integrated approach to industrial development. More institutions have been in place in recent years that attempt to foster linkages and learning. It has been noted that from the mid-1980s, rents have been increasingly tied to the development of domestic production capacity, rather than simply to investment and employment, as was the situation before the mid-1980s (Rasiah 1996: 166).

There is, of course, still a place for investment coordination in Malaysia. The manufacturing sector is still fragmented, and while still in catch-up phases technologically, the scope for a state coordinative role is still consequential. Efforts to develop linkages and consolidate SMIs has been implemented, some more substantively and faithfully than others[25]. Beginning in the late 1980s, the government moved to promote SMIs by granting incentives to companies exempt from ICA licensing (see Appendix Table 5). Although on paper this initiative is salutary, its implementation has not been encouraging, probably due to the political insignificance of these industries relative to other economic sectors that have, since the mid-1980s, taken over manufacturing's position at centre-stage of redistributive effort. The individualised patron-client networks that have grown in recent years and come to be dominated by rentier capitalists have, by drawing attention and resources to themselves, undermined the functioning of incentives in less capital-intensive, smaller-scale sectors. The relative lack of massive and unproductive rent-seeking within manufacturing, however, brightens the prospects for productive activity.

Appendix Table 1:
Chronology of Major Investment Incentives and Equity Requirements

Act/ Amendment	Investment Incentive • Projects eligible for incentives	Equity Requirement • Projects subject to requirements	Notable Precedent/Change
Investment Incentives Act 1968	Pioneer status • pioneer industry/activity		Potential tax relief (100%) period: 3-8 yrs.
	Investment tax credit • export, local content and/or located in development area		Emphasis on ITA minimum of 25%
Amendments 1971	Labour utilisation and location • employment of Malaysians, location in less developed area		
Industrial Coordination Act 1975		At least 30% to Bumiputera, 70% to Malaysian • RM100,000 equity, 25 employees	ICA licensing instituted
		Exemption (up to 100% foreign ownership allowed) • Export at least 80%	Openness to export-oriented foreign direct investment sustained
Amendment 1977		At least 30% to Bumiputera, 70% to Malaysian • RM250,000 equity, 25 employees	Increase in % domestic projects exempted from ICA licensing
Promotion of Investments Act 1986	Pioneer status • promoted activity, determined by Minister of Trade and Industry		Potential pioneer status tax relief period lengthened: 3-8 years to 5-10 years
	Investment tax allowance • conditions: export, VA, local content, location		Criteria for ITA expanded, emphasis on maximum of 100%
		At least 30% to Bumiputera, 70% to Malaysian • RM2.5 million equity, 75 employees	Increase in % domestic projects exempted from ICA licensing
		Exemption (up to 100% foreign ownership allowed) • export at least 50%, or high VA/capital expenditure	Relaxation of export condition permitting full foreign ownership
Amendments 1991	Pioneer status • same as above		Pioneer status tax relief period shortened: max. 10 to 5 yrs., no tax on 70% income (previously 100%)
	Investment tax allowance • same as above		Maximum ITA reduced from 100% to 60%
		Exemption (up to 100% foreign ownership allowed) • export at least 80%, or high VA/capital expenditure	Tightening of export condition permitting full foreign ownership

Appendix Figure 1. Project Approvals, According to Type of Incentive, Percentage of Total, 1981-99



Source: *MIDA Annual Report*, various years.

Appendix Table 2:
Criteria for the Investment Tax Allowance, 1987

Criteria	*Basis*	*Percentage ITA*	
Export	At least 50% and less than 80%	15%	15-30%
	More than 80%	30%	
Value-added[1]	At least 25%		20%
Local content	At least 50%		20%
Employment	At least 100 full-time paid Malaysian workers		15%
Location	Located in 'promoted industrial area'		15%
	Total		100%

Notes: [1] Value-added equals gross sales less raw materials costs,
[2] A manufacturing project is eligible for the ITA if it satisfies 30 percentage points of the conditions,
[3] Maximum ITA reduced from 100% to 60% in November 1991.

Appendix Table 3:
Fixed Capital Formation and Gross Domestic Product, annual growth rates (%), 1975-97

Year	Fixed Capital Formation		Manufacturing Output	Manufacturing Value-added	GDP
	Private	Public			
1975	-19.5	23.0	26.7	21.7	0.8
1976	0.4	12.6	14.9	20.1	11.6
1977	10.6	17.0	17.9	19.5	7.7
1978	9.8	5.6	33.0	27.0	6.7
1979	17.6	6.8	21.6	14.2	9.3
1980	23.5	21.1	21.6	14.2	7.8
1981	4.1	41.5	-1.7	2.0	6.9
1982	-2.3	20.7	10.2	12.9	5.9
1983	0.8	15.2	11.5	16.2	6.3
1984	16.0	-8.5	-1.5	-1.5	7.8
1985	-8.6	-10.4	-6.9	0.3	-1.0
1986	-16.3	-20.7	19.5	9.6	1.2
1987	4.1	-14.6	28.6	22.1	5.2
1988	22.0	5.0	23.9	26.6	8.9
1989	30.5	34.3	18.6	19.1	9.2
1990	24.8	17.1	25.6	26.9	9.7
1991	27.7	9.2	11.5	12.7	8.7
1992	6.6	11.1	16.8	19.4	7.8
1993	19.1	8.4	25.7	18.1	8.3
1994	27.9	-0.6	25.4	20.4	9.3
1995	25.3	8.7	22.1	22.0	9.4
1996	13.4	1.1	n.a.	n.a.	8.6
1997	8.4	8.6	n.a.	n.a.	7.7

Source: *Economic Report*, various years,
author's calculations, UNIDO Industrial Statistics 1999, CD-ROM.

Appendix Table 4:
Kuala Lumpur Stock Exchange, Selected Indicators, 1980-97

	No. of listed companies	Composite Index	Market Capitalisation (RM billion)	Market Capitalisation (% GDP)
1980	185	366.7	27.5	50.8
1981	187	380.8	34.3	61.2
1982	194	291.4	32.3	51.9
1983	204	401.6	53.3	76.3
1984	217	303.6	47.1	57.2
1985	222	233.5	39.4	51.9
1986	223	252.4	39.2	54.3
1987	232	261.2	46.1	58.5
1988	238	357.4	63.1	67.1
1989	251	565.3	107.5	106.1
1990	285	505.9	131.7	110.6
1991	324	556.2	161.4	119.4
1992	369	644.0	245.8	163.1
1993	413	1,275.3	619.6	359.9
1994	478	971.2	508.9	260.3
1995	529	995.2	565.6	254.2
1996	621	1,238.0	806.8	318.0

Sources: Adam and Cavendish (1995), Table I.13, p. 35; Bank Negara Malaysia, *Monthly Statistical Bulletin*, Tables V.14 and VI.1.

Appendix Table 5:
Projects Exempted from ICA Licensing, Granted Incentives, 1988-95

	1988	*1989*	*1990*	*1991*	*1992*	*1993*	*1994*	*1995*
Number	213	259	216	178	133	88	108	136
Proposed called-up capital:	151.3	138.0	201.6	178.3	92.1	46.5	69.2	95.7
local	99.3	67.4	80.1	80.1	47.0	27.5	45.5	53.2
foreign	52.0	70.6	121.5	98.2	45.1	19.0	23.7	42.5
Total proposed capital investment	372.5	298.5	456.2	448.8	221.0	100.6	173.4	231.1

Source: MIDA *Annual Report*, various years.

Notes

[1] The Second Malaysia Plan (1971-75) enunciated that the "[manufacturing] sector will play an expanded role in the process of modernising and restructuring the economy" (Malaysia 1971: 147).

[2] The National Development Policy was formulated in the late 1980s to succeed the New Economic Policy, and essentially highlights growth, the first prong of the NEP, while de-emphasising redistribution, the second prong of the NEP. Vision 2020, contrived in the early 1990s, has been a more influential policy, and plays a *de facto* ideological institutional role in Malaysia. The central aspirations of Vision 2020 are for Malaysia to attain fully industrialised status by 2020, ostensibly accompanied by a dismantling of the affirmative action policies currently upholding Bumiputera interests.

[3] I apply the term 'liberalisation' generally, for simplicity. Debate on the extent of liberalisation, no doubt, might produce more qualified terminology. Indeed, the term 'partial liberalisation' better encapsulates the continual tension between state and market in Malaysia, beyond the mid-1980s. In any case, the term liberalisation is inherently relative in meaning. The crux here is that investment policy from the mid-1980s onwards was more liberal than before.

[4] Jayasuriya (1996 and 2000) calls the East Asian model "authoritarian legalism", while the Western European model he designates as "liberal legalism".

[5] This argument is extended from the premise of a private/public distinction in East Asian/Western European legal systems. "The legal subject in the East Asian legal system is not the individual property right holder but the *enterprise* conceived as an institutional entity. Within this framework, regulations govern institutional entities rather than the individual's property claims" (Jayasuriya 1996: 373).

[6] In North's (1990, p. 47) categorisation, political rules define the hierarchical structure of the polity, its basic decision structure, and the explicit characteristics of agenda control, while economic rules define property rights, i.e. bundle of rights over the use and the income to be derived from property and the ability to alienate an asset or resource. At the stage closest to daily economic activities, contracts contain provisions specific to a particular agreement in exchange.

[7] Their main features, including the preceding Investment Incentives Act (1968), are outlined in Appendix Table 1.

[8] The tension, sometimes acrimony, that stemmed from ICA interference with business ownership, in itself makes an extensive study. Chinese business groups, especially the Associated Chinese Chambers of Commerce and Industry Malaysia (ACCCIM), protested vehemently against the ICA, and consistently appealed for it to be repealed, no less. Other groups, mainly under the de facto leadership of the Malaysian International Chamber of Commerce and Industry (MICCI), were more accommodative of the ICA. The absence of an alliance among business groups precluded the full annulment of the ICA. However, the government made gradual concessions to placate Chinese capital, through a sequence of amendments. In 1977, the threshold for: (1) ICA licensing was increased from RM100,000 to RM250,000, and (2) exemption from equity conditions raised further to RM500,000, and an appeal mechanism – hitherto non-existent – was set up. In 1979, an Industrial Advisory Council was established to advise the Minister of Trade and Industry. See Jesudason 1989, pp. 136-144.

[9] Following on this, the Fourth Malaysia Plan (1981-85) asserted that industrial strategy… will continue to be geared to meet the NEP objectives" (Malaysia 1981: 298).

[10] This was conducted in two steps. From 1 December 1985, manufacturing establishments with RM1 million equity and 50 full-time employees were exempted from ICA-licensing – from the previous figures of RM250,000 in equity and/or 25 full-time employees. From 24 October 1986, these thresholds were raised respectively to RM2.5 million and 75 full-time.

[11] The definition of a 'pioneer' activity or industry also seems to have been liberalised, being pronounced in policy documents as a promoted industry as determined by the Minister of International Trade and Industry, as compared to the specific conditions enunciated in the IIA (see footnote 13). A significant change was also made to the incentive structure of the investment tax credit – which was renamed the investment tax allowance (ITA). Under the IIA, companies enjoying pioneer status had to complete the tax holiday period before being eligible to apply for ITA benefits.

Under the PIA, companies can apply for ITA benefits before pioneer status expires. *MIDA Annual Report 1985*: 18-19.

[12] Appendix Figure 1 shows how, two years after the promulgation of the PIA, i.e. in 1988, the percentage of project approvals that were granted incentives soared. Subsequently, in the late 1990s, investments without incentives formed the vast majority, demonstrating that the trend towards less market intervention was continued.

[13] The Fifth Malaysia Plan (1986-90) pronounced its "major thrust" of Bumiputera participation in the manufacturing sector to be "towards promoting greater self-reliance, and [more dependence] on self-generated funds" (Malaysia 1986: 355). The Sixth Plan (1991-95) went a step further, to avouch that "[l]iberalisation and deregulation of the industrial sector will continue to be undertaken to sustain the momentum of growth and to promote industrial investment" (Malaysia 1991: 139). These two statements summarise the gradual shift away from the heavy NEP-distribution emphasis of the Fourth Plan.

[14] In 1987, the Excess Profit Tax of 3.0 percent was abolished. In 1988, plans were laid – effective from 1989 – to reduce Corporate Income Tax from 40.0 percent to 35.0 percent, and to phase out the 5.0 percent Development Tax beginning with a 1.0 percent point reduction in 1990 (*MIDA Annual Report 1988*: 23).

[15] Effective 1 November 1991, the pioneer status period could not be renewed beyond five years, and the tax break was reduced from 100 percent to 70 percent. The maximum investment tax allowance was also decreased, from 100 percent to 60 percent. Indicative planning increased its focus on the upgrading of facilities and building of domestic capacities; the list of promoted products was "rationalised" to "facilitate a transition to lower import content, higher value-added and capital- and technology-intensive industries, to strengthen industrial linkages and to enhance greater export capabilities" (*MIDA Annual Report 1991*: 44).

[16] Part of the 1977 ICA amendments introduced an appeals mechanism, in which manufacturers could bring their grievances to the Minister of Trade and Industry. The task of evaluating license applications was also devolved to the newly-instituted Licensing Officer – who has typically been the Secretary-General of the MTI/MITI. In 1979, another mediatory measure was instituted, with the setting up of the Industrial Advisory Council, which has representation from the private sector. While the main motive for these new deliberative forums has been to assuage Chinese business discontent, the process has probably had an ancillary effect of a higher degree of consistency.

[17] The waves of FDI influxes have coincided with favourable external factors. Capital for the first electronics first expansion of the 1970s was supplied by U.S. firms, that were relocating abroad to maintain competitive cost with Northeast Asian producers. The boom from the mid-1980s was a similar development, only that this time it was the Northeast Asian electronics corporations that transferred operations in the wake of their currencies' appreciation. These conjunctures of favourable extraneous change with domestic developments indicate the pragmatism and flexibility of Malaysian policy-making, as well as its good fortune in abounding from apparently fortuitous circumstances.

[18] One survey found that, in 1982, manufacturing establishments employing less than 30 (average value of fixed assets: RM180,900) comprised 60.0 percent of the total. The corresponding figure for firms employing less than 50 was 74.4 percent (RM260,600) and for firms employing less than 100 was 87.1 percent (RM437,000). Another survey concluded that in 1985, 64.0 percent of companies employed below 50 workers, while 81.0 percent employed less than 100 workers. The PIA ruling of 75 employees and RM2.5 million as the borderline between licensed and exempted projects, therefore, exempted between 75 and 87 percent of manufacturing establishments from the equity redistribution requirements.

[19] This section has focused on Malay capitalist developments. The assertion of the Malay capitalist class, naturally, had implications on other players in the economy. Concurrently, Chinese capitalists, adapting to the new ways of the political economic, ventured to personalise links with Bumiputera politicians, and usually by appointing them to be directors (Gomez and Jomo 1997: 47).

[20] The 'UMNO Split' culminated in 1987 with the showdown between Dr. Mahathir and Tengku Razaleigh for party presidency. The Mahathir faction won slimly, but was quick to reconstruct the party along different lines, one of which is the dominance of large capitalists. See Khoo 1992.

[21] The FDI influx is truly dramatic. The average annual growth of production from 1984-85 was 8.8% for local firms and -1.7% for foreign firms. From this performance, output from 1986-90 grew 11.6% for local firms, and a remarkable 20.86**%** for foreign firms (Okamoto 1994: Table V, p. 471).

[22] 0.30 corresponds with the 30 percent target for equity ownership of Bumiputera in the New Economic Policy. ICA equity redistribution, as mentioned earlier, also required 30 percent of projects' equity to be offered to Bumiputera interests.

[23] Out of 72 projects over the period 1983-93, 21 were conducted through sale of equity, 10 through public listing, another 10 through build-operate-transfer arrangements, 7 through sale of assets, and the rest through other methods. See Gomez and Jomo 1997, Table 4.1, p. 84.

[24] North contends that conditions in Third World countries approximate world economic history: "Opportunities for political and economic entrepreneurs are still a mixed bag, but they overwhelmingly favour activities that promote redistributive rather than productive activity, that create monopolies rather than competitive conditions, and that restrict opportunities rather than expand them" (North 1990: 9).

[25] An example of an expeditious measure is the 1989 Budget decision to *automatically* grant pioneer status to designated SMIs (Fong 1990: 177). Less optimistically, Felker and Jomo (2000: 29) note that the Domestic Investment Initiative of 1993, only "slightly expanded access to pioneer status for SMIs, but amounted to little more than a repackaging of existing facilities". In addition, the 30 percent local content requirement of 1990, ostensibly to countervail favouritism of foreign capital, was more symbolic and poorly enforced.

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