

Successful Economic Development in a Multi-Ethnic Society: The Malaysian Case

Donald R. Snodgrass

ABSTRACT

Malaysia is an ethnically heterogeneous country which had the world's tenth-fastest growing economy in 1970-90. This makes it exceptional, since as a group ethnically heterogeneous countries were far poorer in 1990 than ethnically homogeneous countries and achieved a much lower growth rate of real per capita income in 1965-90. Ethnically heterogeneous countries were underrepresented among the fastest-growing countries and overrepresented among the countries that were unable to raise per capita income between 1965 and 1990.

Malaysia is also unusual in having attempted to reduce ethnic economic inequality by undertaking an ambitious affirmative action program -- the New Economic Policy, or NEP -- in 1971. Targets were set for poverty alleviation and the ethnic restructuring of employment and business ownership and control, to be achieved by 1990. As intended (but to the surprise of many), redistribution and restructuring took place in the 1970s and 1980s within the context of economic growth. Malaysia combined a high growth rate in 1970-90 with achievement of most of its affirmative action goals.

Two major analytical questions arise. One is counterfactual: what would have happened in Malaysia in 1970-90 if the NEP had not been undertaken? Although most economists would predict a higher rate of growth in the absence of measures to change the distribution of income and wealth, the analysis suggests that the NEP may actually have boosted the growth rate when sociopolitical factors are taken into account. The second question is factual: What made it possible for Malaysia able to grow while redistributing? Three possibilities are considered: good policy, good luck, and pragmatism. Although all three played a part, greatest credit is awarded to pragmatism, illustrated by key policy changes introduced in 1986.

Malaysia's future is considered, especially its chances of reaching the official goal of becoming a "fully developed country" by 2020. In terms of growth rates, this seems plausible, but continued good management of ethnic politics will be needed. Elevating the economic capacity of the indigenous people may in the long run make it possible to convert ethnic heterogeneity from an impediment to economic growth into an advantage.

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SUCCESSFUL ECONOMIC DEVELOPMENT IN A MULTI-ETHNIC SOCIETY: THE MALAYSIAN CASE¹

Donald R. Snodgrass

INTRODUCTION

The Harvard Institute for International Development (HIID) and Institute of Strategic and International Studies in Kuala Lumpur (ISIS Malaysia) are cooperating on a study of Malaysian economic development.² The project, which emphasizes experience since 1970, with a peek into the early part of the next century, rests on four basic premises:

- (1) That Malaysia is essentially a development success;
- (2) That in many ways it is a different kind of success story from the better-known Northeast Asian cases (Taiwan, South Korea, Hong Kong, Singapore,³ and earlier Japan itself); we take this stand in conscious opposition to the current tendency, promoted by the Japanese government and joined with qualifications by the World Bank, to perceive a single story, dubbed the "East Asian Miracle"⁴;
- (3) That in many respects Malaysia and other rapidly developing Southeast Asian countries (Thailand and Indonesia) have far more structural resemblance to developing countries in the rest of the world than the Northeast Asian countries ever did; and
- (4) That Malaysian (and other Southeast Asian) experience may therefore have more to teach other developing countries than the more intensively studied experience of Northeast Asia.⁵

The HIID-ISIS study has three components, each focussed on a critical difference between Malaysia and the Northeast Asian NIEs (Newly Industrializing Economies).⁶ One of

¹This paper was prepared for the Salzburg Seminar.

²Primary funding for the study is from a group of Malaysian firms; a secondary contribution has been made by HIID.

³Some violence to geographical fact is committed here for reasons given in footnote 6, below.

⁴See World Bank, *The East Asian Miracle. Economic Growth and Public Policy* (New York: Oxford University Press for the World Bank, 1993).

⁵For extensive argument in favor of premises 2-4, see David L. Lindauer and Michael Roemer, eds., *Asia and Africa. Legacies and Opportunities in Development* (San Francisco: Institute for Contemporary Studies for the International Center for Economic Growth and the Harvard Institute for International Development, 1994).

⁶We include Singapore in the former group, despite its Southeast Asian location, because it is normally regarded as an NIE and has structural characteristics (lack of natural resources, relative ethnic homogeneity, etc.) that cause it to resemble the Northeast Asian NIEs more than

these differences, to be developed in this paper, is the presence of an ethnically heterogeneous population, rather than an ethnically homogeneous one.

The second key difference is the creation of a large public sector in the 1970s, which was partially reversed through considerable privatization, government down-sizing, and the revival of private investment in the late 1980s.⁷ The Northeast Asian NIEs maintain relatively small public sectors and intervene in their economies in ways that do not require direct government control of resources. Malaysia followed the more common path among developing countries of expanding its public sector and forming many public enterprises, yet it managed to grow and industrialize; how was this achieved?⁸

The third difference is the presence of significant natural resources. Unlike the Northeast Asian countries, Malaysia (long one of the least-industrialized countries in the world at its level of GNP per capita) has rich and varied natural resources. While this is theoretically a development advantage, many countries have squandered natural resource earnings on extravagant consumption and unproductive public investment. Malaysia has done somewhat better at capturing resource rents for social uses and investing them productively. But some of its resources are, or soon will be, depleted while environmental problems are growing.⁹

MALAYSIA, AN ETHNICALLY HETEROGENEOUS SOCIETY

Malaysia is the veritable model of a heterogeneous, multi-ethnic, or plural society.¹⁰ Its population, which comprises Malays and other groups regarded as indigenous (62 percent),

it resembles its Southeast Asian neighbors. Singapore's growth accelerated remarkably after it was expelled from Malaysia in 1965.

⁷By 1982, public consumption was 20 percent of GNP in Malaysia and public investment was 40 percent of total investment. The large public sector resulted primarily from the pro-indigenous economic intervention under the New Policy and was backed by growing oil and gas revenues in the 1970s. The recession of the early to mid-1980s compelled reconsideration of this policy. Comparable 1991 figures are 15 percent and 31 percent respectively.

⁸Co-authors of this study include Ismail Muhd. Salleh, Dwight Perkins, H. Osman Rani, and Tan Tat Wai.

⁹The research on natural resource and environmental factors in Malaysian economic development is being conducted by Rozali Mohd. Ali and Jeffrey Vincent, along with other contributors on specific topics.

¹⁰The importance of this pattern has been extensively analyzed by Donald L. Horowitz (see especially his *Ethnic Groups in Conflict*, Berkeley: University of California Press, 1985). He notes that many "severely divided societies in Asia, Africa, and the Caribbean" received their independence during or after World War II. "The ethnic groups in conflict do not stand in hierarchical or ranked relationship to each other. Rather, they are parallel or unranked groups, divided by a vertical cleavage." Relatively large, they interact at the center of politics, rather than in isolated local pockets. The groups are marked by ascriptive differences: color, appearance, language, religion, some other indicator of common origin, or a combination of these (Horowitz, pp. 16-18).

ethnic Chinese (30 percent), Indians (8 percent) and others (less than one percent),¹¹ is far less unified than the famously homogeneous societies of Japan and South Korea, or even those of Taiwan (with its split between indigenous Taiwanese and mainlanders) or Singapore (which has the same ethnic groups as Malaysia but is more than 75 percent Chinese). Moreover, Malaysia's largest group (the Malays) is politically dominant but has far lower average income and wealth than the Chinese minority. This has created a strong impetus to use political power to improve the economic position of the Malays.¹² Under such circumstances, the singleness of purpose and close implicit coordination of economic forces that is often given much of the credit for the development success of the Northeast Asian countries is simply impossible, despite official adoption of the imitative slogan, "Malaysia, Inc." in the early 1980s.

So far, in fact, do multi-ethnic societies deviate from the Northeast Asian norm that many of them, as the following section establishes, have experienced either economic decline or very slow growth in recent decades, in part because of ethnic conflict. Yet Malaysia was one of the ten fastest-growing economies in the world in 1970-90. The fact that its growth record was compiled while the Malaysian government was implementing the New Economic Policy, probably the most ambitious affirmative action program ever undertaken in a developing country, makes the case all the more fascinating. Understandably, the Malaysian experience has attracted the attention of the African National Congress and other groups involved in the rebuilding of South Africa.

The HIID-ISIS study of Malaysian economic growth amid ethnic heterogeneity¹³ addresses two major questions:

- (1) How could Malaysia have grown so fast since 1970-90 while implementing one of the most aggressive affirmative action policies ever seen?
- (2) What will it take to sustain this kind of performance into the early 21st century?

Before summarizing my thoughts on these two questions, some basic findings on the relationship between ethnicity and economic growth since 1965 will be presented.

¹¹Source: estimates for 1990 published in Malaysia, *Yearbook of Statistics 1991* (Kuala Lumpur: Department of Statistics, 1992), p.30. Groups officially recognized as indigenous include the

Malays of Peninsular Malaysia, a small number of aborigines in the peninsula, and most of the non-Chinese ethnic groups of Sabah and Sarawak; the status of recent Muslim immigrants from Indonesia and the Southern Philippines is unclear and controversial. In Peninsular Malaysia, the arena of sharpest ethnic conflict, Malays represented 58 percent of the population in 1990, Chinese 31 percent, Indians 10 percent, and others less than one percent. Information on ethnic groups collected in the 1991 census of population has not yet been released.

¹²Milton Esman has shown that such situations generally lead to the use of political power to improve the relative economic position of the politically powerful group. Moreover, such efforts usually succeed, although at varying levels of cost. See Esman, *Ethnic Politics* (Ithaca, N.Y.: 1994).

¹³My two Malaysian co-authors, Zainal Aznam Yusof and Ishak Shari, bear no responsibility for this particular presentation.

ETHNICITY AND ECONOMIC GROWTH

In 1990 the world contained 103 developing countries (by the World Bank definition) with populations of one million or more. A study was undertaken which aimed to divide this population into ethnically heterogeneous (He) and ethnically homogeneous (Ho) groups. This is a necessarily imperfect exercise. Numerous questions arise, particularly about (1) what classificatory criteria to apply and (2) where to draw the line between heterogeneous and homogeneous (or, alternatively, if a continuous measurement is sought rather than a sorting of countries into two discrete categories, how to measure the degree of heterogeneity that a country exhibits). I used race, religion, and language as criteria, as well as historical experience of ethnic conflict.¹⁴ In most cases, these criteria point in the same direction, providing a clear-cut classification; only in a few instances do signals conflict, necessitating a more arbitrary classificatory decision. Cut-off points were established using either the "index of ethno-linguistic fractionalization" created by Charles Taylor and David Jordice¹⁵ or a two-thirds cutoff rule (i.e., countries in which no racial, religious, or linguistic group claimed a two-thirds majority were treated as ethnically heterogeneous).

Imperfect as the classificatory procedure was, it yielded highly suggestive results. Among developing countries, 56 were listed as He and 47 as Ho. Among developed countries, six were He and 19 were Ho. The world as a whole was quite equally divided between He countries (62) and Ho countries (66); each group had a population of about 2.6 billion in 1990. But there were important differences between the two groups in terms of level and pace of economic development. Not only were Ho countries richer on average in 1990 than He countries; they also grew much faster in the 1965-90 period.

As measured in market prices by the World Bank, Gross National Product per capita in 1990 averaged \$4,750 in Ho countries and \$3,420 in He countries. An adjustment to international purchasing power did not significantly alter the comparison. In these terms, GNP per capita averaged \$5,450 in Ho countries and \$4,300 in He countries. Does this mean that He countries cannot develop? Certainly not, since the United States, Canada, and Switzerland are among those countries classified as He. But it does seem harder for He countries to become rich. Five of the eight countries that were able to achieve high-income status in 1965-90 -- Singapore, Hong Kong, Puerto Rico, Spain, and Taiwan -- were Ho countries; the other three had either oil (Kuwait and the United Arab Emirates) or extraordinary capital and skill inflows (Israel).

Developing countries classified as Ho grew more than twice as fast in 1965-90 as developing countries classified He. The weighted mean average growth rates of real GNP per capita are 4.5 percent for Ho countries and 2.1 percent for He countries. These averages are heavily influenced by the largest countries in each group, China (Ho) and India (He) respectively. China grew faster than India in 1965-90 and both countries grew faster than the average for their groups. Median growth rates, which reduce the influence of these two large countries, differentiate the two groups even more sharply. They are 2.3 percent for Ho

¹⁴Details of the analysis are available from the author in the form of an unpublished "Note on Ethnic Heterogeneity and Economic Growth" (February, 1993).

¹⁵See Charles Lewis Taylor and David A. Jordice, *World Handbook of Political and Social Indicators*, 3rd edn. (New Haven: Yale University Press, 1982).

countries and only 0.5 percent for He countries. It is thus evident that Ho countries grew much faster than He countries.

Some other points from the analysis:

- (1) Out of 14 exceptionally fast-growing economies (those that raised GNP per capita at 4 percent per annum or better), ten¹⁶ were Ho; only four (Botswana, Indonesia, Thailand, and Malaysia) were He.
- (2) At the other end of the performance scale, World Bank data indicate that no fewer than 23 developing countries failed to raise real GNP per capita between 1965 and 1990; ten more countries could surely be added to this group if adequate data were available. Out of this group of 33 countries, 25 were He countries and only eight¹⁷ Ho countries.

What causes this strong relationship between the ethnic composition of national populations and the rate of economic growth? The association of ethnic heterogeneity with lower levels and rates of economic development does not, of course, prove that ethnicity itself was to blame. While the direction of causation is not an issue (high income levels and fast growth could hardly have made countries Ho), it is entirely possible that ethnic heterogeneity is covariant with other country characteristics that provide additional or alternative explanations of comparative development success.

One obvious point is that the regional distributions of Ho and He countries differ significantly. More than half the developing countries classified as He (30 out of 56) are in Sub-Saharan Africa, a region which has experienced many development problems since 1965. Although ethnic rivalry, usually known in Africa as tribalism, is just one of these problems, it is significant and all but ubiquitous because the potential for ethnic conflict was built in when African national boundaries were determined by the colonial powers. The existing states all use colonial boundary lines, which often divide major ethnic groups among countries and/or include two or more major groups within a single nation.

In sharp contrast, Latin America is heavily Ho. The only exceptions are Bolivia, Guatemala, and Peru, countries with significant divisions between indigenous (Indian) and settler groups. One Caribbean nation, Trinidad and Tobago, is also He.

Eastern Europe and Central Asia, a developing region by the per capita income measure, consisted mainly of Ho countries before the fall of the Soviet regime. There were three telling exceptions: Czechoslovakia, which has since split in two; Yugoslavia, now bloodily dividing into several pieces; and the USSR, a large He country evolving into a number of successor states, most of which will eventually be Ho (in part because resident Russians are now returning to Russia). Eastern Europe is, of course, an important example of the power of revived ethnicity. While ethnic ferment is not the primary cause of recent economic decline in this region, it has contributed to it.

We have seen that developed countries are mostly Ho. Most West European countries are based on a single ethnic identity and are Ho. The only exceptions are Belgium and Switzerland, which have significant linguistic divisions. Among the countries of European

¹⁶China, Egypt, Hong Kong, Japan, Lesotho, Oman, Paraguay, Singapore, South Korea, and Taiwan.

¹⁷Argentina, El Salvador, Jamaica, Kuwait, Libya, Nicaragua, Somalia, and Venezuela.

settlement, where early settlers from the British Isles were later joined by migrant from other areas, Australia and New Zealand are still sufficiently European to be classed Ho, while Canada and the United States now qualify as He.

Asia presents the most mixed picture. China, with its large Han Chinese majority, is Ho,¹⁸ while India -- with its perennial ethnic, religious, and linguistic conflicts -- is He. The four NIEs are all Ho.¹⁹

Most other Asian countries have enough divisions of one kind or another to qualify as He. The exceptions are Bangladesh (tellingly created to attain ethnic homogeneity in a predecessor state, Pakistan, that was itself formed to bring about religious uniformity but suffered from ethnic and geographic division), Cambodia, Jordan, Mongolia, North Korea, Oman, Saudi Arabia, Viet Nam, and Yemen. Although the fastest-growing Asian countries are Ho, a few He countries -- Thailand and Indonesia in addition to Malaysia -- have also done well.

The reasons why the aforementioned 33 countries in various regions failed to raise per capita income in 1965-90 are multiple and vary from case to case. They include general economic mismanagement, wars and insurrections unrelated to ethnicity, and declines in earnings from natural resources caused by falling world prices and/or domestic resource depletion. Ethnic or religious conflict appears to have been a major contributing factor in at least 14 cases: Afghanistan, Angola, Bolivia, Cambodia, Central African Republic, Chad, Ethiopia, Lebanon, Liberia, Mozambique, Peru, Sudan, Uganda, Zaire, and Zambia. It is these countries that may have the most to learn from the experience of Malaysia.

WHAT HAPPENED IN MALAYSIA

In May, 1969 there were racial riots in Kuala Lumpur, Malaysia's capital, in which a number of people²⁰ (mostly Chinese) were killed (mostly by Malays). The proximate cause was elections in which parties that drew support primarily from the Chinese and Indian communities seemed to be threatening to take over from the multiethnic but Malay-dominated coalition that had run the country since independence in 1957. From the viewpoint of the largely poor and rural Malay community, this was a disaster, since control of government was seen as the essential counterbalance to economic inferiority (Malay households earned less than half as much on average as non-Malay households at the time).

Government leaders proclaimed an Emergency, suspended parliament, and sought ways to reassure their Malay constituents. Since the mid-1960s, they had been contending with small but growing Malay interest groups, such as businessmen who wanted government

¹⁸The Chinese case could be debated, however. One possible argument to the contrary is that the many regional dialects form the basis of separate ethnic groups. A different line of argument is that the political system represses expressions of ethnic difference that might be more evident in a country with a more open system.

¹⁹Singapore is the most debatable case, but with a population more than 75 percent Chinese my two-thirds rule makes it Ho.

²⁰The exact number has been disputed. The official tally was 196 dead, but some commentators claimed that the real toll may have been several hundred. See Karl von Vorys, *Democracy without Consensus: Communalism and Political Stability in Malaysia* (Princeton, NJ: Princeton University Press, 1975).

contracts and students who wanted university places and eventually good jobs. Malay "special rights" had been written into the 1957 constitution but were seen by many Malays as an inadequate response to the weakness of their economic position.²¹

The government took some time to formulate its response, which ultimately took the form of the New Economic Policy, announced in June, 1971. The NEP was essentially an artfully crafted statement of goals to be achieved over a 20-year period (by 1990), with little said at that point about policies for achieving the goals. It had two "prongs." The first was "to reduce and eventually eradicate poverty," the second "to accelerate the process of restructuring Malaysian society to correct economic imbalance, so as to reduce and eventually eliminate the identification of race with economic function."²² The second "prong" in turn had two aspects: (a) employment was to be restructured by sector and occupation, eliminating the "ethnic division of labor" that had been created in colonial times and remained quite evident in 1970; (b) the ownership and control of wealth was to be restructured; specifically, Malays²³ were to hold 30 percent of corporate sector assets by 1990, compared to their current share of 2 percent; Chinese and Indian Malaysians were to hold 40 percent (NB: this was a few points above their current share), while the foreign share was to plummet from 65 percent to 30 percent.

While the NEP concentrated on these two particular forms of "racial economic imbalance," it alluded more generally to broader goals: "the process involves the modernization of rural life, a rapid and balanced growth of urban activities and the creation of a Malay commercial and industrial community in all categories and at all levels of operation, so that Malays and other Indigenous people will become full partners in all aspects of the economic life of the nation."²⁴ The overriding goal to which these objectives were expected contribute was national unity.

All NEP goals were to be reached in the context of economic growth. No one was to suffer any loss of a job, income, or business, although obviously some loss of opportunity to improve one's job or increase one's income or business was implicit in the redistribution plan.

A detailed narrative and analysis of what happened over the succeeding two decades will appear in our forthcoming book. In very brief summary, the 1970s saw rapid economic growth and public sector expansion fueled by significant oil and gas findings and generally buoyant raw materials prices. Thanks largely to the creation of free trade zones in the early 1970s, which led to the establishment of labor-intensive electronic component and garment industries, job creation was also rapid in the 1970s, permitting the children of farmers to obtain industrial and service sector jobs. The unemployment rate declined throughout the decade. Controversies in the mid-1970s over control of the oil industry and application of affirmative action to private firms were overcome through conciliation and the assuaging effects of prosperity.

²¹See Gordon P. Means, "'Special Rights' as a Strategy for Development: The Case of Malaysia," *Comparative Politics* 5, no. 1 (October 1972): 29-61.

²²*Second Malaysia Plan 1971-1975* (Kuala Lumpur: Government Press, 1971), p. 1.

²³The original specification was Malays in Peninsular Malaysia. This was later changed to Bumiputera in Malaysia without altering the numerical target (30 percent).

²⁴*Ibid.*

In the early 1980s, however, more serious challenges were encountered. Dr. Mahathir Mohamad came to power in 1981 pledged to the creation of a heavy industrial sector under government sponsorship but was soon faced with negative developments in the world economy. He persevered in the effort to create expensive and controversial auto, steel, and cement enterprises, even in the face of mounting economic adversity. Malaysia ran large budget and balance of payments deficits in 1981-84, as the government waited and prayed for world commodity prices to pick up and salvage the situation. When this did not happen, overdue fiscal corrections finally began to be made in 1985 and 1986. Even more important, regulations governing private investment were liberalized in 1986 to exempt many firms from local ownership and affirmative action requirements. Since the latter actions fortuitously coincided with large capital flows from Northeast to Southeast Asia (motivated by wage increases, exchange rate realignments, and loss of GSP -- General System of Preferences -- status in the Northeast Asian countries), the liberalization succeeded in attracting billions of dollars of investment to Malaysia.²⁵ Since 1987, growth has averaged nearly 9 percent a year, leading to previously unknown prosperity, full employment (reversing the resurgence of unemployment caused by the recession and subsequent retrenchment measures), and significant worker migration from neighboring countries.

OUTCOMES

Many Malaysians are still unsure that they have really succeeded in developing and restructuring their economy. They have experienced some ups and downs, including a major recession in the 1980s and (especially if they are Chinese or Indian) some degree of alienation by government policies, and they are uncertain what the future holds.

To this observer, however, it appears that Malaysia since 1970 is a major development success story. These days, with bitter ethnic strife occurring in so many regions, avoiding violence, expropriations, and expulsions for more than two decades should qualify an ethnically heterogeneous country to be counted as a success. But Malaysia has met a far higher standard of success because it grew fast while implementing the NEP.

There could be contention about both parts of that statement (fast growth and implementation of the NEP), so brief examination of the facts is required.

Growth

According to official figures, growth of real GNP averaged 7.6 percent per annum in the 1970s, then slowed to 5.9 percent in the 1980s. The major difference between the two decades is that commodity price trends were more favorable in the 1970s (when all significant commodity prices followed a rising trend) than in the 1980s (when all except timber fell), a decade punctuated by a severe recession which threw growth into reverse in 1985-86. As we now know, however, the story ended well with the flurry of rapid growth that began in 1988 and has not stopped yet, although it will certainly slow down at some point. For the full 1970-90 period, real GNP growth averaged 6.7 percent a year.

What did this amount to in per capita terms? If we assume that the 1991 population census total reflects the same degree of underremuneration as was measured in the 1980 Post Enumeration Survey, population growth seems to have averaged 2.5 percent annually in the NEP period. Skepticism may be warranted as to whether this estimate takes full account of

²⁵Recorded direct private foreign investment exceeded US\$ 16.5 billion in 1989-1993.

illegal immigration,²⁶ but if it does, real GNP per capita grew at an average of about 4.2 percent from 1970 to 1990. Again, the growth rate was lower (probably 3.2 percent) in the 1980s than in the 1970s (4.5 percent). Not only was economic growth slower in the 1980s, population growth was a quite a bit faster (2.3 percent vs. at least 2.7 percent, more if immigration is underestimated). Putting these growth numbers into an international context, the World Bank's World Tables 1992 also gives 4.2 percent as the average growth rate of Malaysia's real GNP/head in 1970-90, expressed in U.S. dollars. This places Malaysia tenth among 126 nations with populations of one million or more.²⁷ It is interesting to see which countries grew faster. Seven of the nine are in East Asia: the four Little Dragons (Korea at 7.4 percent, Taiwan at 7.1 percent, Singapore at 6.1 and Hong Kong at 5.9), plus Big Dragon China (5.4 percent), Thailand (4.8), and Indonesia (4.6). In the whole rest of the world, only two tiny, resource-rich African countries grew faster than Malaysia: Botswana (8.1 percent a year) and Lesotho (4.5 percent).

These numbers send a mixed message of good and bad news. The good news is that Malaysia's growth performance beats nearly all countries in other regions of the world. The bad news is that most East Asian countries did better than Malaysia. The only ones that grew more slowly are Japan, whose growth rate fell to 3.5 percent during the period, and the notorious underachievers: the Philippines, the Indo-China countries, and Myanmar.

Point-to-point growth rates like these are influenced by the choice of end points, but in this case not by much. Stopping in 1987 would have produced a slightly lower rate for Malaysia, while extending the series to 1993 or 1994 would have led to a somewhat higher one. Like all economies, Malaysia has its ups and downs, as the difference between the 1970s and the 1980s shows. But as Henry Bruton and his co-authors emphasized in their World Bank-sponsored comparative study on the political economy of poverty, equity, and growth in Malaysia and Sri Lanka,²⁸ the ability to sustain economic growth by avoiding deep and prolonged set-backs is one important reason why Malaysia has out-performed most other developing economies. For reasons that require further exploration, Malaysia has an ability to sustain rapid growth.

Implementation of the NEP

The second question is whether, while growing fast, Malaysia did in fact implement the NEP. The answer is basically yes. Earlier it was noted that the NEP, as originally proclaimed, was less a policy than a statement of goals. Policies for reaching the goals were introduced as time went by, and in some cases modified later when needs changed or they were found to be ineffective.

²⁶The Department of Statistics says that it does, but registered births and deaths seem to account fully for intercensal population growth, leaving no room for the substantial net immigration that is known to have taken place.

²⁷Taiwan, which the World Bank omits from its published tables for political reasons, has been added to the data set.

²⁸Henry J. Bruton in collaboration with Gamini Abeysekera, Nimal Sanderatne, and Zainal Aznam Yusof, *Sri Lanka and Malaysia: The Political Economy of Poverty, Equity, and Growth* (New York: Oxford University Press for the World Bank, 1992).

There are many ways of measuring the achievements of the NEP. A relatively narrow focus on specific quantitative goals indicates very substantial progress, although NEP targets were exceeded in some areas and only partially achieved in others.

Poverty eradication was a clear-cut, impressive success. According to official definitions, nearly half (49.3 percent) of all households in Peninsular Malaysia lived in poverty in 1970. Official estimates for 1990 record a decline to 15.0 percent in Peninsular Malaysia, bettering the first Outline Perspective Plan's original target of 16.7 percent. The official figure for Malaysia as a whole in 1990 is 17.1 percent. One does not have to take the official measures compiled by the Economic Planning Unit, which register sharp declines in poverty, on faith. Independent calculations by Ishak Shari confirm that a very substantial decline took place over last the 20 years. Urban poverty has been virtually eliminated and rural poverty is shrinking rapidly in Peninsular Malaysia, mainly because of growing opportunities for non-agricultural work. Most of these new jobs require migration to the towns, but many others are consistent with continued rural residence.

Employment restructuring basically succeeded. The number of Bumiputera (Malays and other indigenous people) working in the industrial sector (mining, manufacturing, construction, utilities and transport) in Peninsular Malaysia soared from 173,000 in 1970 to 918,000 in 1990. Similarly, Bumiputera employment in the service sector went from 213,000 to 1.2 million. These totals substantially exceeded Outline Perspective Plan (OPP)²⁹ targets.

Achievements in occupational group terms, which for some reason were not published in the Second Outline Perspective Plan (OPP2) document, are also impressive. Bumiputera are now slightly over-represented in professional and technical and in service occupations (thanks to government employment, no doubt) and almost proportionately represented in clerical work. They are coming up fast in production jobs and remain seriously under-represented only in administrative and managerial positions and in sales work. These broad occupational groups do not fully reflect the breakdown into high-, middle- and low-level employment. Bumiputera are still significantly under-represented at the higher levels of the private sector. For example, they still made up only 29 percent of the membership of the eight registered professions in 1990³⁰ (but this leaves out government lawyers, who would undoubtedly boost the Bumiputera share). Casual empiricism confirms that major changes in employment structure have taken place; by 1992 one saw Malays in many places where one would never have seen them in 1972.

Clearly Malays have had considerable success in entering the private sector, although still predominantly at the lower levels. The public sector, formerly the one area in which substantial numbers of Malays held high-level jobs, has become even more Malay-dominated, since it has been called on to make a major contribution to Bumiputera entry to high-level jobs. This has had the unfortunate effect of strengthening ethnic compartmentalization, when the overall thrust is to reduce it.

Restructuring of corporate ownership and wealth, with its famous 30 percent target, was the most ambitious of the NEP targets as well as the most controversial, and as expected proved to be the hardest to reach. Official figures, which some claim are understated, indicate a Bumiputera ownership share of 20.3 percent in 1990. This is a fantastic achievement

²⁹Second Outline Perspective Plan 1991-2000 (Kuala Lumpur: Government Press, 1991), p. 49.

³⁰Sixth Malaysia Plan 1991-1995 (Kuala Lumpur: Government Press, 1991), p. 35.

compared to the starting point of 2.4 percent in 1970, but it is still well short of the 30 percent target. Even getting to 20 percent involved the creation of a massive network of trustee agencies, whose operations have often been controversial. A frequently overlooked sidelight is that the first Outline Perspective Plan (OPP1),³¹ which formalized NEP targets, also called for the share of non-Bumiputera Malaysians to rise from 32.3 percent in 1970 to 40 percent by 1990. Since the basic approach of the NEP was supposed to be redistribution with growth (although we did not call it that in the early 1970s because Hollis Chenery, Montek Ahluwalia and others at the World Bank had not yet coined the phrase)³², it is interesting to note that this target for non-Bumiputera was over-fulfilled, with an achievement of 46.2 percent in 1990. The simultaneous increases in the Bumiputera and non-Bumiputera shares were of course made possible by a sharp decline in the foreign ownership share, from 63.3 percent, one of the highest in the world, in 1970 to a much more moderate 25.1 percent in 1990. Malaysians thus went from owning less than 40 percent of their corporate sector in 1970 to owning three-fourths of it in 1990, a truly amazing achievement that was accomplished fairly smoothly, discounting some hurt feelings in London and Houston (over the acquisition of controlling shares in British firms on the London Stock Exchange and treatment of the international oil companies in the late 1970s, respectively), and without seriously impeding economic growth.

A lot more needs to be said about ownership and control. In a sense, the critics are right that the 20 percent Bumiputera share greatly understates the degree of Bumiputera (government) influence in corporate affairs. A 1991 review by Fujio Hara of the business empire of the ten supposedly richest Malaysian Chinese shows that all of their companies now have significant Malay involvement. He concludes that although "large Chinese corporations have been growing at amazing speed...to sum up the situation in one phrase, the purely Chinese-owned and managed enterprise has become a thing of the past in Malaysia."³³

A broader interpretation of the NEP would probably lead to a somewhat more mixed but still positive reading on its outcome. To sum up briefly:

- (i) The modernization of rural life is certainly taking place. The rural areas are becoming much better integrated into Malaysian society, at least in Peninsular Malaysia.
- (ii) Regional inequalities remain, but they are not particularly wide, contrary to what is generally thought,³⁴ and will almost certainly narrow by themselves a

³¹This was published originally as part of the Mid-Term Review of the Second Malaysia Plan 1971-75 (Kuala Lumpur: Government Press, 1971, pp.), then revised (see Third Malaysia Plan 1976-1980 (Kuala Lumpur: Government Press, 1976, pp.)

³²See Hollis Chenery et. al., Redistribution with Growth (New York: Oxford University Press for the World Bank, 1974).

³³Fujio Hara, "Malaysia's New Economic Policy and the Chinese Business Community," *The Developing Economies* 29, no. 4 (December 1991), p. 369.

³⁴The National Economic Commission, established in 1989 to debate the post-1990 (i.e., post-NEP) policy framework, lamented regional inequalities in its (as yet unpublished) report. Among other things, it noted that the infant mortality rate in rural areas in 1987 was 16 per thousand.

bit later in the development process. The only potentially serious problem of regional economic inequality is between Peninsular and East Malaysia.

- (iii) Meanwhile, inequality in the size distribution of income, although still large, had already begun to improve in the late 1980s and will probably continue to do so through the 1990s as the labor market tightens further (although exactly how tight it will become depends in large measure on immigration policy).
- (iv) Creation of a real Bumiputera Commercial and Industrial Community remains a major challenge, despite some progress. The basic problem, often addressed by Prime Minister Mahathir, is how to convert business people whose success to date has depended largely on access to preferences of different kinds into independent and creative entrepreneurs. Official rhetoric has increasingly emphasized the need for this change to occur of late, but the enormous power of the government unsurprisingly continues to be used to provide business advantages to well-connected individuals and groups as well as to Bumiputera in general. Nevertheless, the ability of Bumiputera to survive and sometimes thrive in more openly competitive situations is clearly increasing.
- (v) It is very hard to determine whether national unity, described as the ultimate objective, has increased or not. The main argument for a positive judgment is that there have been few overt expressions of discontent since 1987. But this is an untrustworthy criterion, since in ethnically heterogeneous societies discontent can be lurking just below the surface. Moreover, Malaysia has been prosperous for several years now; no one be sure what problems of disunity may arise when the next recession hits, as inevitably it must at some point.³⁵ The main argument for a negative judgment on the achievement of national unity is that some of the means used to implement the NEP have widened inter-communal divisions; this view posits a trade-off between racial economic balance and national unity, contrary to the official position that the two are mutually supportive. This issue is further discussed below.
- (vi) Finally, it may be worth noting Tan Sri Ghazali Shafie's statement that the true, although unannounced, goal of the NEP was to break down ethnic job compartmentalization and create a common middle class.³⁶ He links this goal to political stability, which he thinks is the main prerequisite of economic

But the national average in that year was 14.6, so while the overall rate was still a bit higher than those common in developed countries the rural-urban gap was in fact smaller than in most developing countries.

³⁵The extreme version of the national unity objective, which would anticipate the creation of a single Malaysian identity that no longer recognized ethnic or religious divisions, seems totally unrealistic. It is falsified by the histories of many ethnically heterogeneous societies. For an example from the United States, see Nathan Glazer and Daniel Patrick Moynihan, *Beyond the Melting Pot: The Negroes, Puerto Ricans, Jews, Italians, and Irish of New York City* (Cambridge, Mass.: MIT Press and Harvard University Press, 1963).

³⁶Tan Sri Ghazali Shafie, retired civil servant and later UMNO politician and cabinet minister, was the principal ideologist responsible for the final formulation of the New Economic Policy. This paragraph is based on an interview with him on November 23, 1992.

development. As noted earlier, considerable progress has been made toward breaking down ethnic job compartmentalization since 1970.

Broadly, then, Malaysia did grow fast in 1970-90 while implementing large parts of its ambitious affirmative action program. This is an outcome that was not anticipated by any of the participants in the heated debate that accompanied the formulation of the NEP in 1969-71. No one then would have dared to predict that Malaysia would be one of the world's ten fastest-growing economies in 1970-90. On the contrary, both those who favored and promoted the NEP and those who feared and opposed it agreed that a sharp trade-off existed between growth and redistribution. More emphasis on eradicating poverty and particularly on restructuring employment, ownership, and control of business, should have lowered the growth rate below what it would otherwise have been, according to the universal view at that time. Was this view mistaken, and if so, why?

A comparison of actual growth in GNP expenditure components with OPP projections provides only one hint as to why the general expectation was falsified. Exports grew faster than projected in 1970-90 and imports grew almost twice as fast as expected (10 percent per annum vs. the 5.2 percent projected), indicating greater-than-expected capital inflows. Relative to GNP, exports rose steadily from about 45 percent of GNP in 1970 to a massive 85 percent in 1991. Exports cannot be such a large percent of GNP without imports also being large. One reason why imports grew so extraordinarily fast is that Malaysian industrialization in the period appears to have been highly import-intensive.

Quality of life. Another issue that has been raised is whether fast economic growth really improved the quality of life. The answer is, yes, definitely. According to the Human Development Index developed by the United Nations Development Program under the leadership of Mahbub ul Huq, a flawed but widely cited index of social development, Malaysia ranked fourth in the world in terms of improvement in the HDI between 1970 and 1990.³⁷ Only Saudi Arabia, South Korea, and Mauritius did better. Malaysia generally performed well in terms of life expectancy and education and health measures. The quality of life improved so much that by 1990 Malaysia ranked somewhat higher according to the HDI than it did according to per capita income. Alternatively, if we accept Amartya Sen's suggestion that life expectancy is the best single measure of development, Malaysia's figure of 71 years at birth in 1992 places it above most other middle income countries and just six years (8 percent) behind the average for the developed countries. There can be little doubt that social development has accompanied economic development in Malaysia, as in most countries.

Besides economic growth, poverty alleviation, and ethnic restructuring, the other really notable event of these two decades was dramatic change in the structure of the economy. Agriculture fell from 31 percent of GDP to 19 percent. Industry rose from 25 percent to 42 percent. The percentage of workers who identified themselves as farmers fell from over 50 percent to 26 percent, and many of the farmers who remained in 1990 derived a significant share of their income from non-agricultural activities. Manufactures grew from a tiny share of total exports in 1970 to more than 60 percent in 1990. Rubber and tin, the commodity stalwarts that still provided well over half of earnings from merchandise exports in 1970, fell almost off the chart, to about four percent and one percent respectively in 1990.

³⁷See United Nations Development Programme, Human Development Report 1992 (New York: Oxford University Press, 1992), p. 24.

Structural change has accelerated since 1987. In Peninsular Malaysia, only 22 percent of employment was in agriculture, forestry, hunting, and fishing in 1990. Very few young people are entering rural occupations. By 2000, primary-sector employment can be expected to have fallen to about 10 percent of the total in Peninsular Malaysia. Although Sabah and Sarawak will remain substantially more rural for some time to come, Peninsular Malaysia will already be an urban, industrialized society by 2000.

Structural change has been so rapid that Malaysians have not fully adjusted to it. The tables in the back of Treasury's annual Economic Report still tell us how much tin is exported, but not what amount is manufactured. The government still has so many agencies dedicated to helping out rubber smallholders that the day may not be far off when the combined staffs of these agencies outnumber the smallholders themselves. It is hard to adjust to such rapid structural change.

Analysis

Several issues require further analysis. The most important of these was alluded to earlier: how real was the trade-off that everyone thought existed in 1969-71? Did the NEP necessarily mean slower growth than would have been achieved without it? Unfortunately, this is one of those counterfactual questions that can be debated endlessly because there is no way to settle the issue once and for all. Advocates of an all-out pro-growth strategy have long argued that Malaysia could have grown much faster, say at Singapore's rate of 6.1 percent per capita instead of Malaysia's actual rate of 4.2 percent in 1970-90, if it had not pushed affirmative action so hard. This, they have contended, would not only have raised per capita income but also, in the end, would have solved the problems of poverty and unbalanced participation in the economy, largely through the creation of a tight labor market, which would have drawn workers of many different types into more productive jobs, created incentives for training, and raised the real wages of unskilled labor.³⁸ According to advocates of this position, emphasis on economic growth and job creation, with no explicit affirmative action, would have produced better performance on growth, poverty alleviation, and perhaps even social restructuring.

Looked at from a purely economic viewpoint, these arguments have a lot of merit. In fact, careful analysis of the factors leading to the reduction of poverty and restructuring of employment under the NEP³⁹ indicates that the gains registered in these areas resulted more from economic growth than from the specific NEP policies intended to achieve these goals. But there is also a strong counter argument. If Malaysia had gone full-tilt for growth and not undertaken an affirmative action program like the NEP, it might have suffered other violent political blow-ups on the lines of May 1969 long before full employment was achieved. This would have created sociopolitical instability that might have scared away the domestic and foreign investment needed for growth. As a result, Malaysia's growth rate in 1970-90 could

³⁸For varying presentations of this line of argument, see W. B. Gates, T. J. Goering, and D. H. Keare, "The Role of Land in the Economic Development of West Malaysia," Harvard Development Advisory Group, 1967 (unpublished); Pang Eng Fong, "Race, Income Distribution, and Development in Singapore and Malaysia," in Linda Lim Yuen Ching and L. A. Peter Gosling, eds. *The Chinese in Southeast Asia*, Vol. 1. *Ethnicity and Economic Activity* (Singapore: Maruzen Asia, 1983), pp. 316-335.

³⁹See our forthcoming book.

conceivably have ended up looking less like Singapore's and more like Sri Lanka's (2.8 percent per annum, better than one would have expected under the circumstances), or even Uganda's (-2.0 percent per annum) or Lebanon's (unknown but also negative). For what it is worth, nearly all thoughtful and well-informed Malaysians now seem to agree that the NEP has been a good thing for Malaysian economic growth.

So was the trade-off real? Definitely, in a purely economic model, but perhaps not if we take account of broader sociopolitical factors. As the earlier discussion of global patterns suggests, ethnically heterogeneous societies may not have the same growth potential as ethnically homogeneous societies. Perhaps Malaysia did about as well as it could. Yet this runs contrary to the argument, which one hears frequently in the United States and increasingly in Malaysia, that within a stable political framework ethnic heterogeneity can be an advantage for economic growth because it provides a broader range of talents that can be utilized productively. Tan Sri Ghazali Shafie and some other supporters of the NEP would reconcile the two arguments by saying that Malaysia needed to restructure its society before it could become stable enough to utilize its multiethnic talents. Whether this is correct becomes a key issue when we consider the future.

While it is fascinating to speculate about the counterfactual, the issue can never be resolved. It may be more useful, therefore, to concentrate on explaining what actually happened. How was rapid growth made to coexist with generally successful affirmative action? Three hypotheses appear to merit examination, namely:

HYPOTHESIS NO. 1. Malaysia had good policy; this enabled it to avoid, or at least weaken, the trade-off.

HYPOTHESIS NO. 2. Malaysia had good luck; exogenous forces made things turn out better than they otherwise would have.

HYPOTHESIS NO. 3. Malaysia escaped the growth-vs.-redistribution trade-off by changing its policy when it became clear that growth was seriously threatened; in other words, it was pragmatic.

I shall briefly consider the arguments for and against each of these hypotheses.

Good policy

The arguments for Hypothesis #1 are substantial:

- Throughout the period of the NEP, monetary, fiscal, and exchange rate policies continued to be prudently framed and carefully implemented, as they had been before the start of the NEP. Except for a brief episode of double-digit imported inflation in 1973-74, the rate of price increase remained low. Again except for 1973-74, real interest rates were kept positive.
- Although public enterprises grew out of control as some 1,000 new ones were created in the 1970s and the failure of some Bumiputera businessmen to repay their loans was treated rather tolerantly by the government, most of these excesses were corrected in the early 1980s, thanks in part to the pressures of the recession.
- The introduction of labor-intensive export-oriented manufacturing (textiles and electronics) in the 1970s created a lot of non-agricultural jobs, reduced the

prevalence of poverty, and introduced many Malays to the discipline of industrial work.

- The heavy industry policy of the early 1980s gave Malaysia a needed push in the direction of increased industrial sophistication. This argument is put forward by industrial policy enthusiasts but strongly opposed by economists of a more neo-classical bent (see below).
- Structural adjustment, privatization, government downsizing, and investment promotion were brilliantly conceived and boldly executed in the 1980s.

But there are also some strong arguments against the hypothesis:

- Fiscal imbalance was allowed to become severe in the early 1980s because the government mistakenly thought it could spend its way out of the recession. The consolidated public sector deficit went over 20 percent of GNP in 1981. The Federal government's overseas debt ballooned from RM 5 billion in 1980 to RM 28 billion by 1986. That can hardly be called good economic management.
- The willingness and ability of ethnic Chinese and foreign-owned business to provide investment and economic dynamism were undermined by aggressive implementation of the NEP, particularly the Industrial Coordination Act and Petroleum Development Act of 1975.
- Many economists have noted that the heavy industry policy involved large, low-productivity investments that caused the incremental capital-output ratio (ICOR) to exceed the extraordinarily high level of 7:1 and created excess capacity in industries that will achieve a comparative advantage only in the next century, if ever.
- Efforts to reduce wastage of resources by public enterprises have been blunted by political considerations. Divestment (which has not really gone far enough to be called privatization in most cases), managerial changes, and other corrective actions have only marginally improved the situation. Many problems remain unsolved and will resurface when the current boom ends. No one can say when that will happen, but there is no reason to believe that Malaysia will be as successful in avoiding the effects of the next world recession as it was the last time around. In the future, the Malaysian growth rate is likely to be closer to the world economic growth rate that it was in the late 1980s and early 1990s.⁴⁰

Good luck

Or did Malaysia simply get lucky? There are some reasons to think so:

- As in earlier times, Malaysia benefitted greatly from its good natural resource endowment. Although rubber and tin prices eventually declined, the massive

⁴⁰Malaysia and the rest of Southeast Asia boomed throughout the world recession of the early 1990s, from which the United States and, more slowly, Western Europe and Japan have recently recovered. The region's immunity from this particular recession seems to have been earned through a significant increase in market share, achieved in a stagnant world market through massive capital inflows, mostly from Northeast Asia.

investment in oil palm paid off nicely and timber made a major contribution to export earnings. Despite the astounding rise of manufactured exports, primary commodity exports are still more than one-quarter of GNP.

- Oil and gas were a special gift to the economy, particularly to federal government finances. Malaysia and its government were trebly blessed: (1) production grew following new discoveries; (2) OPEC raised export prices; and (3) the federal government took a large share of the revenue for itself, at the cost of the states and the international oil companies.
- The timing of investment liberalization in 1985-86 was star-crossed, since it coincided with changes in Japan, Korea, Taiwan and Hong Kong (exchange rate appreciation, the loss of GSP -- General System of Preferences -- trading preferences, and rising wages) that caused many of their manufacturers to seek lower-cost production sites offshore. Liberalization increased Malaysia's attractiveness at precisely the right moment to trigger a massive response to the policy reform.
- Just as children are well advised to pick their parents carefully, countries do well to locate themselves in the right region. Malaysia has benefitted tremendously from being in the part of the world that proved most adept at sustaining economic growth in the 1980s and 1990s. This is probably the main reason why it was able to defy gravity by growing fast in the late 1980s and early 1990s while most of the world was mired in recession.

But there are also some good arguments against the explanation based on luck:

- Commodities prices go up at times, but they also go down. Malaysia benefitted from international price movements in the 1970s, but it suffered from them in the 1980s. Over the NEP period as a whole, price fluctuations were more or less a wash.
- In the American phrase, you make your breaks. Other countries have squandered the benefits of rich natural resources and high commodity prices. In the long run, a country gains only if it has the wit to take advantage of these strokes of good fortune.
- The same point applies to the investment liberalization in the 1980s. Certainly, it was a good time to do it, but the government still had to have the wisdom and courage to take action. There was strong political opposition.⁴¹

Pragmatism

Arguments for Hypothesis #3:

- Again, the government had to do the best it could with the hand it was dealt. In the early 1980s economic growth was slowing down and achievement of the NEP targets was starting to look highly problematical. Various policy responses were possible, but the government chose to liberalize its policies to promote economic growth, even at the substantial political risk of being accused of abandoning the NEP.

⁴¹Interviews with Tun Daim Zainuddin and Tan Sri Ghazali Shafie.

- Pragmatism is not limited to the Malaysian government. The Malaysian people are also pragmatic. Despite the many stresses of the past two decades, and even though significant numbers of them were unhappy much of the time, they seldom turned to violence.⁴² Tan Sri Ghazali Shafie attributes this fact to the value of tolerance in Malay culture and specifically to the continuous willingness of the United Malays National Organization (UMNO) to share power with parties supported by the Chinese and Indians. Interestingly, another Malay informant emphasized the adaptive, pragmatic character of the Chinese minority, contrasting the violent responses of even smaller minorities in other countries. While these arguments are hard to evaluate, it is certainly conceivable that the same policies would have provoked a far more violent response in other countries.

Arguments against:

- It is hard to think of any, which makes this a leading explanation of how economic growth and the NEP were reconciled. One could argue, as some in UMNO apparently did, that the liberalization in the mid-1980s was a betrayal of the NEP, but it is hard to counter the argument that Former Finance Minister Tun Daim Zainuddin says he and the Prime Minister made at the time: If we don't grow, there will be nothing to redistribute. It seems that economic growth -- material self-improvement -- is a deeply and genuinely shared value in Malaysian society.

What more can be said about why Malaysia was so pragmatic when ethnic heterogeneity so often leads to fanaticism and violent conflict? While the Chinese community was often frustrated by its inability to influence policy through political action ("voice," in Albert Hirschman's terminology)⁴³, its resort to emigration ("exit") was surprisingly limited, given the tensions generated by the NEP⁴⁴. One must conclude that in an imperfect world many Chinese decided that adaptation to the new situation in Malaysia was their best course of action.

⁴²The only noteworthy outbreaks of violence during the 1970s and 1980s were minor incidents in December, 1974 (student protests in Kuala Lumpur and Penang), 1975 (Communist attacks), 1978 (language and religious riots), October 1980 (religious extremism again), November 1985 (the same), and August 1987 (ditto).

⁴³Albert Hirschman, *Exit, Voice and Loyalty: Responses to Decline in Firms, Organizations and States*. Cambridge, Mass.: Harvard University Press, 1970.

⁴⁴There was net emigration of Chinese from Malaysia during the NEP period, amounting to perhaps 100-200 thousand. Since many of those departing were of high educational and skill status, this emigration was of greater qualitative than quantitative significance. Educated Chinese went primarily to Singapore and to developed countries such as Australia, Canada, and the United States. Some working class Chinese, such as miners displaced by the collapse of the tin industry, also emigrated. Many of them went to Northeast Asian countries, sometimes as illegal immigrants.

The nature of Malaysia's political system undoubtedly facilitated the relatively smooth adjustment process that characterized the NEP.⁴⁵ The changes proposed by the NEP, although radical, were to be achieved gradually over a 20-year period, long enough to give all parties time to adjust. A politician's promise to reach certain goals by a point two decades in the future would be given little credence in most countries, where several regime changes might well occur over the intervening years. In Malaysia, however, the stability and predictability of the system under which UMNO rules while parties representing other communities serve as its junior partners gave the pledge considerable credibility. Although, as it turned out, Malaysia had three Prime Ministers during the NEP period, all three were bound to respect the NEP commitments by the nature of the Malaysian political system.⁴⁶

A major cause for concern when the NEP was first adopted was the expanded opportunities for rent-seeking that were opened up by the greatly enlarged role of government. While rent-seeking and corruption certainly accompanied the implementation of the NEP, it is important to recognize that they did not prevent the achievement of the broad social goals discussed earlier. It can be argued that the fundamental factor which kept rent-seeking under some degree of control was a deep commitment to material improvement that is shared by all groups in Malaysia's essentially immigrant society.⁴⁷ Despite the keen interest in ethnic distribution, it was seen as in everyone's shared interest that the size of the "cake" to be shared keep growing.

THE FUTURE

The Malaysian government naturally wants the ISIS-HIID studies to tell them about the future. As scholars, we find the future much harder to study than the past, so to cover ourselves we argue, with some validity, that a good understanding of what happened in the past helps one prepare for the future. As a response to this argument, it is fair to ask what study of the past in fact tells us about the future.

Formally, the Malaysian government charted the nation's economic future in 1991 through Prime Minister Mahathir's "Vision 2020" speech, which was followed by publication

⁴⁵This point is attributable to Professor Mavis Puthuchery, who served as a consultant on the political aspects of the NEP.

⁴⁶There were, of course, variations in the degree of commitment and the relative importance attached to the various parts of the NEP program. From the point of view of a strong advocate of ethnic restructuring, both Tun Hussein Onn (1976-81) and Dr. Mahathir Mohamad (1981-) represented some backsliding from the original vision of Tun Abdul Razak (1971-76). For an expression of this viewpoint, see Just Faaland, Jack R. Parkinson, and Rais Saniman, *Growth and Ethnic Inequality: Malaysia's New Economic Policy* (Kuala Lumpur: Dewan Bahasa dan Pustaka in association with Chr. Michelson Institute, 1990).

⁴⁷Even many members of the "indigenous" groups are either immigrants themselves or descendants of relatively recent immigrants -- in their case, usually from islands that now form Indonesia. Alternatively, they may be products of inter-marriage. It has been pointed out that only one of the four Malays who have served as Prime Minister of Malaysia was of "pure" Malay background; one was part-Thai, another had Turkish ancestry, and the third is part-Indian.

of the Second Outline Perspective Plan and the Sixth Malaysia Plan, 1991-1995.⁴⁸ The overall effect of these pronouncements was to replace the NEP with a National Development Policy (NDP), which retains the liberal investment and business conduct rules adopted in 1986. The principle of Bumiputera preferences is also retained, but the NDP includes none of the specific redistribution and restructuring targets that characterized the NEP. The one target specified, which has been given wide publicity, is that Malaysia should become a "fully developed country" by the year 2020. Despite a great deal of qualifying discussion, the overwhelming emphasis in the NDP is on continuation of the rapid economic growth that Malaysia has enjoyed in the past few years, the achievement of which is expected to be assured by continuation of the policies followed since 1986.⁴⁹ There has been much discussion of the transition from the NEP to the NDP, particularly about how it came about and whether it is a real policy change or just a shift in rhetoric.

As far as one can tell, liberalization in 1986 responded to the short-term problem of the recession but then worked so well that the government became committed to it as a long-run development strategy. The alternative interpretation is that the Prime Minister and some influential others, such as Finance Minister Daim, wanted all along to move policy in this direction and used the recession as an opportunity to do so. But that is somewhat far-fetched. Although Dr. Mahathir has long argued for things like hard work, higher productivity, and more self-reliance while criticizing subsidies and dependency, he is hardly a consistent free-market economist. He is more reminiscent of Franklin Delano Roosevelt, coming to power in the Depression and casting about pragmatically to find some solution. The earlier general argument in favor of a finding of pragmatism seems applicable to Mahathir in particular as well.

Can Malaysia in fact become a fully developed economy by 2020? The Prime Minister's "Vision 2020" speech says that 7 percent growth will do it, assuming population growth averages 2.5 percent over the 30-year period. The speech says that this will require slightly faster growth in 1990-2020 than in 1970-1990.

This calculation bears rechecking. One can, of course, define "fully developed economy" in various ways, but for 1990 the World Bank put the threshold at GNP per capita of US\$7,620.⁵⁰ According to the Bank, Malaysia's GNP per capita was US\$2,320 in 1990. If one accepts that figure and calls the target for 2020 US\$7,620 in 1990 prices, the average annual growth rate for real per capita income has to be 4.0 percent, actually a bit lower than

⁴⁸See "Malaysia: The Way Forward (Vision 2020). Working Paper Presented by the Prime Minister at the Inaugural Meeting of the Malaysian Business Council, 28 February 1991 (Kuala Lumpur: National Printing Department, 1991); *The Second Outline Perspective Plan 1991-2000* (Kuala Lumpur: National Printing Department, 1991); and *Sixth Malaysia Plan 1991-1995* (Kuala Lumpur: National Printing Department, 1991). As noted earlier, these documents were preceded by the National Economic Consultative Congress, which met from 1989 to 1991.

⁴⁹As the Prime Minister stated in his Vision 2020 speech, "No nation can afford to abandon a winning formula. And this nation will not. For the foreseeable future, Malaysia will continue to drive the private sector, to rely on it as the primary engine of growth." ("Malaysia: The Way Forward," p. 15)

⁵⁰See *World Development Report 1992* (New York: Oxford University Press for the World Bank, 1992), p. xi.

the 1970-90 rate of 4.2 percent. In these simple numerical terms, therefore, the goal appears reachable.

But what will it really take? Like the question of the counterfactual addressed earlier, this one can also be considered in either economic or sociopolitical terms. In purely economic terms, one has to ask what is happening to the world economy, where the Asia-Pacific region (which is clearly improving its relative economic standing in the world) will fit into it, and how Malaysia can fit into the regional and world economies. It is also necessary to address questions that have been raised about "extensive economic growth" in East Asia.

Although the prospects for the world are not modest at best, prospects for Southeast Asia and Malaysia are surely much better. But growth will have to be faster than it was in the 1980s, when real income per capita increased at an estimated rate of only 3.2 percent annually. Continued growth at this rate will not realize the 2020 target.

Straight-line projection is often deficient. We are beginning to see that there is a strong tendency for economic growth to slow down as countries become developed. The basic reason may be that as countries approach the world's technological frontier it becomes harder for them to grow by borrowing technology; they now have to develop more technology of their own. Japan has dropped below Malaysia's growth rate, at least temporarily, and Alwyn Young's recent analysis⁵¹ suggests that Singapore will grow more slowly in the future because while it is good at mobilizing savings, it is less adept at selecting productive investments. A recent analysis by Paul Krugman is even more pessimistic, equating "extensive growth" in East Asia with the failed and discredited pattern of the Soviet Union.⁵²

It seems reasonable to expect that Malaysia can still progress rapidly in the catch-up mode for another 20-30 years, but it will have to be flexible and adaptive to do so. Already it is moving out of the cheap-labor phase, although its labor migration policy (which should be debated as a major national policy issue, not just allowed to happen) will determine how fast this occurs.⁵³ China, India, and Indonesia should dominate markets for labor-intensive

⁵¹See "A Tale of Two Cities: Factor Accumulation and Technical Change in Hong Kong and Singapore," in Olivier J. Blanchard and Stanley Fischer, eds. *NBER Macroeconomics Annual* (Cambridge, Mass: MIT Press, 1992), pp. 13-54.

⁵²See Paul Krugman, "The Myth of Asia's Miracle," *Foreign Affairs* 73, no. 6 (November/December 1994): 62-78. However, the Soviet economic collapse has been attributed to an inability to substitute capital for the slow-growing labor supply, a problem that seems unlikely to afflict East Asian economies. See William Easterly and Stanley Fischer, "What We Can Learn from the Soviet Collapse," *Finance and Development* 31, no. 4 (December 1994): 2-5.

⁵³Certain Malaysian industries, notably estate agriculture and construction, have become heavily dependent on immigrant labor for their survival. Employers in these industries have thus favored either a liberal immigration policy or tolerance of illegal immigration. Malay politicians and officials are also said to have abetted the immigration and subsequent naturalization of Muslim immigrants from Indonesian and the southern Philippines as a way of augmenting the ranks of Bumiputera. While it is clear that working-class Malaysians would benefit from a more restrictive immigration policy, the degree of restriction that is in the broad national interest is harder to determine. At some point, Malaysia will have to give up most of its estate agriculture and low-wage industries such as garments and textiles, but when precisely this should occur is

goods, so countries like Malaysia will have to continue moving up-market to more capital- and technology-intensive lines, a process that it has already begun.

Official discussions of the challenge ahead have given much emphasis -- no doubt correctly -- to the issue of human resource development. Will the Malaysian workforce be upgraded fast enough to create the new resource base that the country will need to compete in the future? This is as much a sociopolitical as an economic question.

Malaysia turned to the NEP in 1970 because the results of economic growth were unacceptable to a large group of its people, who had a modicum of political power. After about 15 years of strong affirmative action, it shifted back toward greater emphasis on growth. For the time being, at least, it remains committed to that emphasis in the longer run. But emphasis on economic growth is precisely the policy that was abandoned after the 1969 riots. What reason is there to believe that the outcome, in terms of income and wealth distribution and opportunities to participate, will be more acceptable than it was last time? We cannot be sure that it will; the next recession will provide a key test. Nevertheless, this paper will end with the suggestion that there is in fact reason to be hopeful. The reason is that years of affirmative action have provided thousands of Bumiputera with the kinds of educational and work opportunities that they were denied, or at least had not received, before 1970. Given their improved capabilities, they should be more willing to accept the outcomes provided by reasonably competitive factor and product markets in the future than they were in the past. Thus equity could make economic growth more compatible with equity. Future experience will either verify or falsify this optimistic hypothesis.

A FINAL GENERALIZATION

By way of a conclusion, we return briefly to the general question of ethnic heterogeneity and economic development. Is ethnic heterogeneity bad for economic development, as the statistics examined earlier suggest, or good for it, as American ideologists have long claimed? Perhaps Malaysian experience over the next couple of decades will show whether an affirmative action program like the NEP is capable of changing ethnic heterogeneity from a liability into an asset for economic development.

unclear. Also somewhat uncertain is the extent to which immigration can be controlled, given Malaysia's long coastlines and land borders, especially in East Malaysia.