RUNNING OUT OF STEAM? MANUFACTURING IN MALAYSIA

This paper examines the impact of external and internal forces on the pattern of national accumulation in Malaysia. It explores the role of global accumulation processes in terms of global production networks and financialisation alongside changes in domestic class formations in shaping national forms of accumulation. It focuses on the impact of these on the long-term shift in domestic investment away from manufacturing into services. This discussion takes place within the broader context of industrial upgrading through investments in innovation and technology. Malaysia is especially relevant because industrialisation has been central to the country's accumulation process, and industrial policies have relied on both global production networks and direct state intervention.

The argument presented here is that accumulation strategies were shaped by development (industrialisation) imperatives, global accumulation processes (related to global production networks and financialisation) and class formations (related to the emergence of, and subsequent differentiation within, the Malay middle and business class). Malaysia's accumulation process broadly covers four phases between the country's independence in 1957 and 2008: Phase I (import-substituting industrialisation or ISI, 1957–69); Phase II (export-oriented industrialisation or EOI, and direct state intervention, 1970–84); Phase III (state-led ISI in heavy industries and privatisation, 1985–97); and Phase IV (renationalisation, state ownership and services, 1998–2008). Changes in each phase of Malaysia's accumulation were in response to the structural limitations of the previous phase and changes in social relations, with state accumulation strategies closely connected with attempts not just to develop and upgrade domestic industries but also to create an indigenous (Malay) capitalist class engaged in manufacturing.

Changes in Malaysia's accumulation process over these four phases will be examined on three levels in terms of: 1) changes in industrial policy; 2) the impact of global accumulation; and 3) pressure for economic redistribution by the Malay middle class. Each level here contributes to a broader narrative and cannot be fully explained without accounting for political factors associated with changes in class formations. As such, internal (political) factors play a significant part in each level of the broader narrative. This suggests that Malaysia's accumulation strategies were primarily driven by internal factors related to the changing social balance of power and supported by broader changes in global accumulation processes.

Three sets of evidence will be examined in relation to each level of the broader narrative: 1) manufacturing growth rates; manufacturing share of GDP and exports; high-technology manufacturing share of exports; 2) gross capital inflows; FDI and manufacturing growth; FDI by sector; PI and stock market growth; and 3) privatisation by sector; lending by commercial banks and development financial institutions (DFIs); the 10 largest companies by sector and ownership. The evidence here is consistent with the wider evidence of a longer-term shift away from manufacturing into broad services and specifically the service sectors related to financialisation and privatisation.

Changes in industrial policy

Changes in industrial policy in each phase of Malaysia's accumulation process coincided with broader changes in global accumulation but were also a response to the structural limitations of the previous period that were in part constrained by a specific set of social relations. Phase I (1957–69) was thus a response to a weak manufacturing base as a result of British colonial policies that discouraged local industries and confined manufacturing to processing raw materials for export and some domestic consumption (Jomo and Edwards 1993; Jomo 1994b). As such, early industrial policies in Phase I sought to expand the domestic manufacturing base through ISI by identifying new products and processes to promote 'learning by doing' (Jomo 1993b; Anuwar Ali 1994). ISI relied on high effective rates of protection (ERP) in manufacturing and on attracting FDI through tax holidays and the provision of support services and infrastructure under the 1958 Pioneer Industry Ordinance 1958 (Jomo and Edwards 1993; Alavi 1998). Increasing state intervention occurred with the establishment of Malaysian Industrial Development Finance (MIDF) in 1960 to provide term financing for a range of manufacturing enterprises engaged in a variety of activities including textiles, wood and rubber products, chemical and chemical products, basic metal goods and consumer durables. This was followed by the creation of The Malaysian Industrial

Development Authority (MIDA) in 1965 to coordinate investment in manufacturing, and Bank Bumiputra in 1966 to provide credit to Malays.

Phase II (1970–84) was characterised by FDI-led EOI and direct state intervention through the New Economic Policy (NEP). The shift from ISI to EOI was largely prompted by the inherent limitations of ISI in a small, open capitalist economy and the failure of import-substituting industries to move beyond basic manufacturing and assembly activities. This was in turn facilitated by the emergence of global production networks. At the same time the growth of an increasingly vocal urban Malay middle and business class led to increasing demands for a change in the accumulation process through direct state intervention. The government responded in two distinct but related ways. In the first instance, it promoted FDI in export manufacturing as a way to create industry linkages and advance industrial upgrading. Export incentives including tax breaks, credit and indirect subsidies for 'pioneer industries' aimed at attracting FDI in labour-intensive manufacturing in export processing or free trade zones (FTZs).

In the second instance, the government introduced direct state intervention under the New Economic Policy (NEP) in 1970 to create Malay capitalists through the quick transfer of assets to state agencies and individuals, supported by preferential treatment. The 1975 Industrial Coordination Act (ICA) required companies set aside 30 per cent of shares issued for Malay equity. The Credit Guarantee Corporation (CGC) (1972) and banking guidelines directed lending to priority sectors and categories of borrowers, while the establishment of Bank Bumiputra and takeovers of Malayan Banking in 1969 and United Malayan Banking Corporation (UMBC) in 1976 provided the state ownership of the three largest commercial banks. At the same time the government created around 700 state owned enterprises (SOEs) that were engaged in a variety of economic activity and provided further entrepreneurial training for Malays managers.

Industrial policy in Phase III (1985–1997) emerged in response to the limitations of FDI-led industrialisation and constraints posed by the NEP for national accumulation. The two defining policies here were a second round of ISI led by the state and centred on heavy industries, and a privatisation programme closely related to this. Industrialisation in Phase II was characterised by an emerging dualism between a high-technology, foreign-dominated dynamic export sector as a result of FDI, and a domestic manufacturing sector restricted to SMEs and disconnected from high-technology production and heavy industries (Lall 1999).

The reliance on FDI for EOI had created weak domestic linkages, with low local content, high (intermediate) imports and a narrow export base. The foreign domination of almost all internationally competitive non-resource based industrial capability restricted domestic firms mainly to assembly and subcontracting as original equipment manufacturer (OEM) (Jomo 2001b; Ghazali 1994; Anuwar and Wong 1993; Lall 1995). Low local content, especially in electronics, meant that there were limited linkages and technology transfer between the foreign-dominated manufacturing export sector and domestic firms outside the FTZs (Jomo and Edwards 1993; Arif 1994; Anuwar 1994). A fairly shallow industrialisation process was reflected in the high import content of manufactured exports, with the share of intermediate goods in total imports rising from 35 per cent in 1970 to 47 per cent in 1985, and the share of imported inputs in the gross export value of manufactured exports as high as 75 per cent (Jomo and Edwardes 1993; Jomo 1994b; Ariff 1994). Despite the increasing number of technology transfer agreements (mainly in electronics and electrical products, chemical, and fabricated metal industries) and the relative size and sophistication of Malaysia's manufacturing sector and export profile, the local technological base remained shallow with excessive dependence on technology, marketing, management and components supply (Anuwar 1993, 1994; Felker 1999). As a result, the export base remained narrow, with a heavy dependence on the production of components for export, in particular semiconductors, with consumer and industrial electronics only contributing 15–20 per cent of total output (compared to 55–70 per cent in South Korea and Taiwan).

Phase II was also characterised by the failure of domestic (industrial) capitalists. The absence of performance targets and conditionalities, insulation from market competition and easy access to finance undermined business discipline and 'learning by doing' (Jesudason 1989; Gomez and Jomo 1997). There was little pressure for infant industries to grow up and inefficient import-substituting industries continued to receive high (and even increasing) levels of protection without proper evaluation, monitoring or performance conditions, and irrespective of productive capabilities (Bruton 1992; Alavi 1996, 1998; Jomo and Tan 1999; Rasiah 2001; Rasiah and Ishak 2001). As a result, the NEP did not increase business acumen or produce a class of dynamic Malay entrepreneurs (Gale 1981; Jesudason 1989; Bowie 1991; Kamal 1989; Khoo 1995; Crouch 1996; Gomez and Jomo 1997). Overexpansion of the public sector under the NEP also created a small but powerful 'bureaucratic-capitalist elite' able to largely resist government attempts to impose budgetary discipline, making policy adjustments increasingly difficult (Jomo 1986; Mehmet 1988; Bowie 1991; Bruton 1992; Jomo and Tan 1999). This led to public and private sector inefficiency and a lack of productive base, reflected in the divestment for quick profits and a preference for investments in protected or non-tradable sectors, namely services, property development and construction (see e.g. Anuwar 1991).

The government responded to the limitations of FDI-led industrialisation by creating backward linkages and promoting technology acquisition and innovation in order to develop domestic industries (and capitalists) and to upgrade the industrial structure. This began in 1980 with the creation of the Heavy Industries Corporation of Malaysia (HICOM), encompassing steel, cement and automobile production. By Phase III, technology acquisition and industrial upgrading became a central part of development policy through the First Industrial Master Plan (IMP1) (1985–95), Intensification of Research Priority Areas (IRPA) programme (1986), Technology Action Plan (1990) and Industrial Technical Assistance Fund (ITAF) (1990). Innovation in science and technology (S&T) was promoted through R&D budget allocations under the Fifth and Sixth Malaysia Plans (1986–90 and 1991–95), tax incentives and research grants for small and medium size industries, and technology parks (ready-made clusters of private research facilities and technology-intensive companies) (see e.g. Anuwar Ali 1994; Rasiah 2001; Felker 1998). These policies and programmes were implemented and coordinated by a range of ministries, departments, task forces and research centres. The government also increased incentives through the Pioneer Industries Act (1986) and relaxed licensing requirements with amendments to the ICA in order to attract private investment that had declined. The picture that emerges is thus one of extensive and concerted state intervention to promote industrial upgrading through innovation and technology acquisition even if this was hampered by institutional and coordination problems (see e.g. Felker 1998).

The announcement of the privatisation programme in 1983 was in part a response to public and private sector inefficiencies associated with the NEP that had created barriers to learning and efficiency. It was also closely related to the creation of a domestic industrial capitalist class that was central to domestic heavy industries and sought to address learning failures associated with HICOM, its flagship programme for heavy industries. HICOM was the government's attempt to address the issue of absorbing complex organisational and production processes necessary for technological upgrading and industry linkages. However, as heavy industries were set up to serve domestic, rather than export, markets, there was no systematic attempt to guide or monitor the technological development process, with the sector characterised by soft budgets and the lack of performance targets and conditionalities (see e.g. Lall 1995). The government sought to address HICOM's poor performance by replacing the (Malay) management with foreigners and non-Malays, and later privatising the company.

Privatisation can therefore be partly seen as an attempt to improve the technological acquisition and industrial upgrading process. It was also part of broader moves towards "a more coherent and systematic analysis of the needs and capabilities of manufacturing activities ... closer to the kind of industrial intervention practised by the East Asian NIEs" (Lall 1995: 767). The government centralised policymaking and rent allocation more narrowly among a smaller group of entrepreneurs through the management of key government-linked projects and sought to institutionalise direct, high-level, state–business networks aimed to foster private–public cooperation and consultation for industrial upgrading and free policymaking and the industrialisation project from the distributional constraints and inefficiencies of the NEP (Lall 1995; Felker 1998).

Accumulation strategies in Phase IV (1998–2008) were a direct response to the failures of the state's ISI and privatisation programmes. Phase IV was characterised by renationalisation and a return to state ownership in the form of government-linked corporations (GLCs) as a proxy for Malay corporate ownership, and a shift in policies to promote SMEs. Renationalisation followed the failure of privatisation and reflected the ongoing inefficiency of state-created heavy industries centred on HICOM. HICOM's failure was very much connected to the failure of its subsidiary Proton (to acquire the necessary technology to become a globally competitive car manufacturer) and its parent company's mounting debts and inability (and unwillingness) to continue financing substantial R&D costs (see Tan 2008). The renationalisation of Proton also occurred during a downturn in domestic car sales, increasing competition and expected further falls in sales following regional liberalisation, suggesting that competitive pressures lead to a shift away from manufacturing. Despite starting out as an industrial conglomerate, HICOM's parent company subsequently moved into automotive distribution (selling imported Chevrolet cars), property, construction and services, mainly through government contracts. The failure of privatisation was thus also a reflection of the wider failure of industrial upgrading.

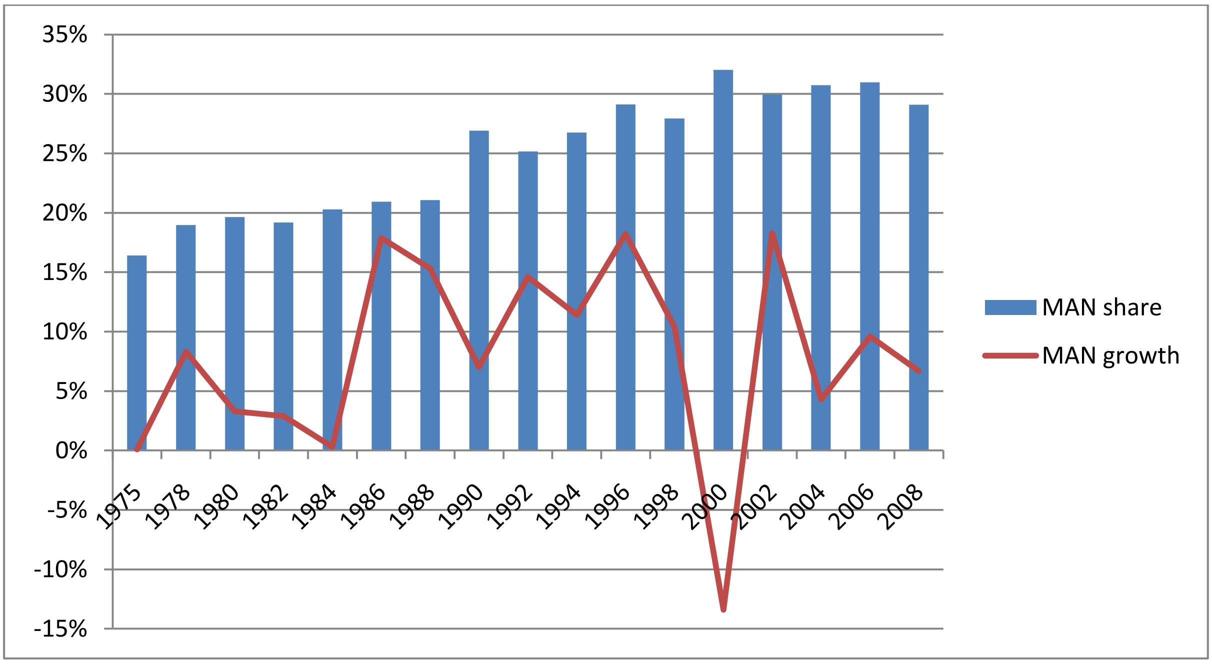
The failure of HICOM (which included its subsequent restructuring and de-listing from the stock exchange) along with large Malay-owned conglomerates bailed out or privatised by the state gradually increased the policy emphasis on the promotion of SMEs in Phase IV. This was also in response to ongoing structural weaknesses in domestic manufacturing which was characterised by low aggregate technology levels, minimal technology spillovers and weak supply chains which lagged far behind the backward linkages of Hong Kong and Taiwan at similar stages of development (Doner and Ritchie 2001; Hobday 2000). Low technology levels were exacerbated by limited local supply linkages, with many heavy industries depending on imported components. As a result, the industrial structure lacked a local capital-goods industry which hindered the 'hub' of technological diffusion and progress.

Phase IV focused on promoting SMEs as part of the global supply chain by strengthening domestic linkages with MNCs through the greater sourcing of local inputs, and strategic alliances and partnerships. Industrial upgrading continued in line with the Second Industrial Master Plan (IMP2) (1996–2005) and the Eighth and Ninth Malaysia Plans (2001–2005 and 2006–2010) through innovation and the application of new technologies. Policies in this phase also marked a move towards higher value-added activities in resource-based industries, particularly petrochemical, pharmaceutical and food product industries through R&D, FDI and 'dynamic industry clusters'. An example of this was the promotion of GLCs and

SMEs in food production through a 70 per cent increase in the budget allocation for agriculture.

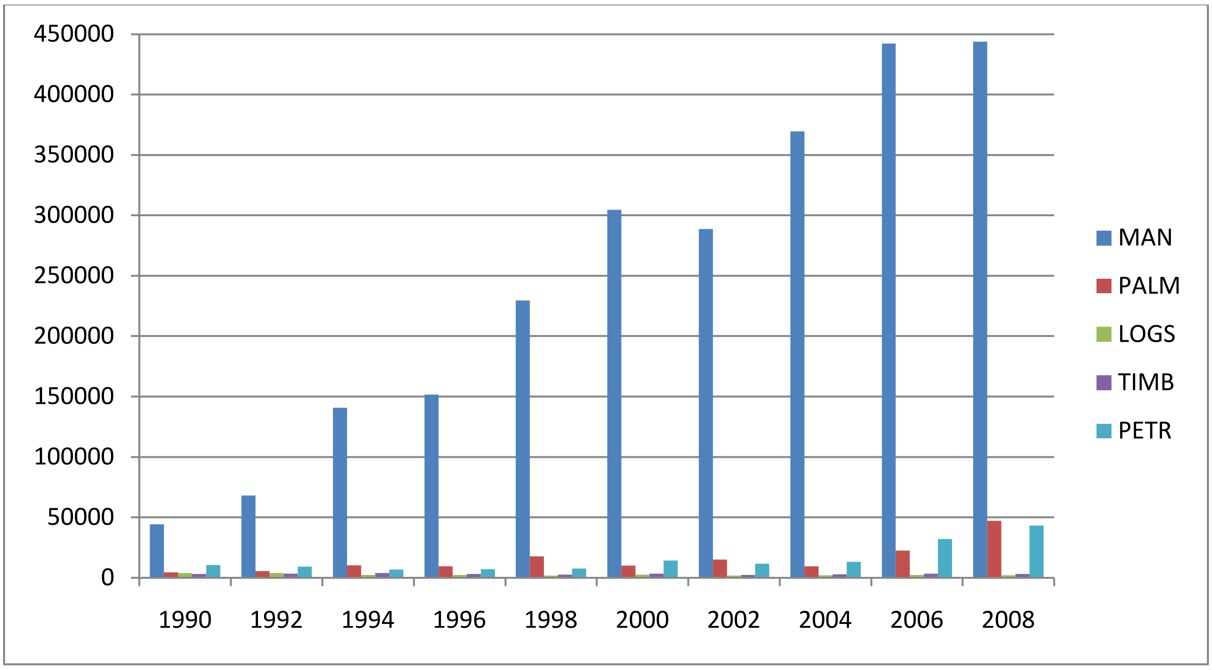
The failure of Malaysia's ISI in heavy industries is a reflection of the wider failure of learning, innovation and industrial upgrading. As a result, the industrial structure remained split between a dynamic (high technology) manufactured export sector dominated by foreign companies, and a domestic industrial base largely disconnected from this and heavy industries. The evidence for this section illustrates the rapid growth of manufacturing in Malaysia and its increasing share of GDP and exports (Charts 1.1 and 1.2) that coincided with the shift from ISI to EOI. However, the growth and high technology composition of manufactured exports (Figure 1.3) were not an indication of domestic industrial capacity because of an unbalanced industrial structure. One feature of this industrial dualism was the continued growth of manufactured exports independent of ISI policies to promote domestic industries.

Chart 1.1 Malaysia: Manufacturing growth rate and share of GDP, 1975–2008 (%)



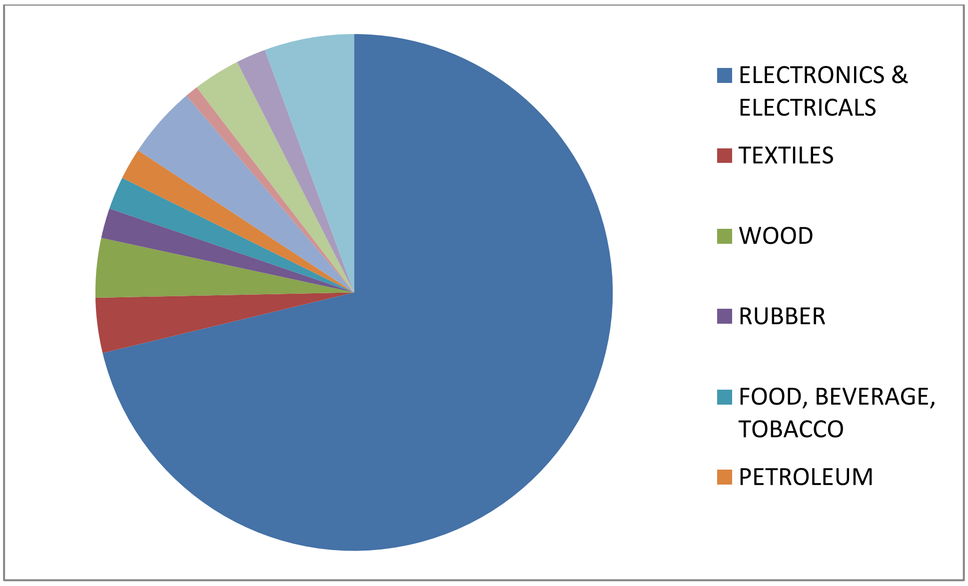
Source: Compiled from Department of Statistics data.

Chart 1.2 Malaysia: Manufacturing share of main exports, 1990–2008 (RM million)



Source: Compiled from Department of Statistics data.
Notes: MAN (manufacturing), PALM (palm oil), LOGS (raw timber), TIMB (processed wood), PTR (petroleum products).

Figure 1.1 Malaysia: Composition of exports by sector, 1999 (%)



Source: Compiled from Department of Statistics and Economic Planning Unit data.

The impact of global accumulation

Malaysia's industrialisation and its accumulation process also coincided with broader changes in global accumulation. These related to: a) the emergence and expansion of global production networks manifested in the outflow of FDI from advanced countries; and b) financialisation and changes in the composition of international capital flows, specifically the growth of portfolio investment (PI).

Foreign direct investment

FDI emerged with the internationalisation of production in the 1960s and was as such limited in the early stages of Phase I (1957–1969). Early (mainly Japanese) FDI was restricted to natural resource-based exports (e.g. timber and rubber products) and the production of consumer goods (TVs, radios, rice cookers, etc) for the domestic market to circumvent trade barriers (Lim and Pin 1983; Jomo and Edwards 1993; Tanaka and Kenney 1996). The shift in industrial policy in Phase II (1970–1984) coincided with increases in FDI as a result of the internationalisation of production beginning in the late 1960s. Malaysia was able to attract a disproportionately large share of FDI flows to developing countries in the 1970s and 1980s due to its position as a node of, and intersection for, the Japanese and US electronics industry production chains (Tanaka and Kenney 1996).

These FDI flows were part of a wider relocation of global production networks for electronics manufacture into the region following changes in global accumulation aimed at reducing labour costs and benefiting from significant tax holidays. FDI inflows in export-oriented industries in Malaysia centred on two relatively narrow US global production chains (semiconductors and hard-disk drives or HDD) and a broader movement of Japanese industries (Tanaka and Kenney 1996; Rowthorn 2001). The timing of these flows helped sustain several rounds of FDI in export-oriented industries, first in the late 1960s and early 1970s mainly by US merchant semiconductor firms and Japanese consumer electronics firms, followed by a second round in the second half of the 1980s (Phase III) by Japanese and Taiwanese firms in response to US FDI in HDD manufacture and in Japan's case, the rising yen following the Plaza Accord (Tanaka and Kenney 1996; Hart-Landsberg and Burkett 1998; Rasiah 1998).

The rapid growth of manufacturing and manufactured exports was thus directly related to large flows of FDI into Malaysia as a result of changes in global accumulation (see Chart 2.1), in turn contributing to rapid industrialisation by increasing the manufacturing sector's share of GDP. Large inflows of Japanese FDI enabled Malaysia to become the world's largest exporter of semiconductors and among the largest exporters of disk drives, telecommunications apparatus, audio equipment, room air-conditioners, calculators, colour TVs and various household and electrical appliances (Lall 1995; Tanaka and Kenney 1996; Hill 2002). As a result, Malaysia's industrial structure in 1990 was only marginally lower than Korea and Taiwan and more advanced than most OECD countries in terms of electronics and electrical manufactures (Lall 1999).

Portfolio investment

The increase of FDI into Malaysia was mirrored and subsequently surpassed by very large inflows of PI, first in the 1990s and again in 2000. The substantial growth of PI globally was related to financialisation. Much of this went into the stock market boom of the early 1990s, attracted by the deepening of capital markets as a result of privatisation and liberalised entry and exit requirements. Unlike FDI, PI indirectly impacted manufacturing by facilitating and reinforcing a wider shift of domestic preferences into shorter-term (financial) investments. As such, any examination of global accumulation in the form of PI flows needs to be part of a discussion of broader accumulation strategies.

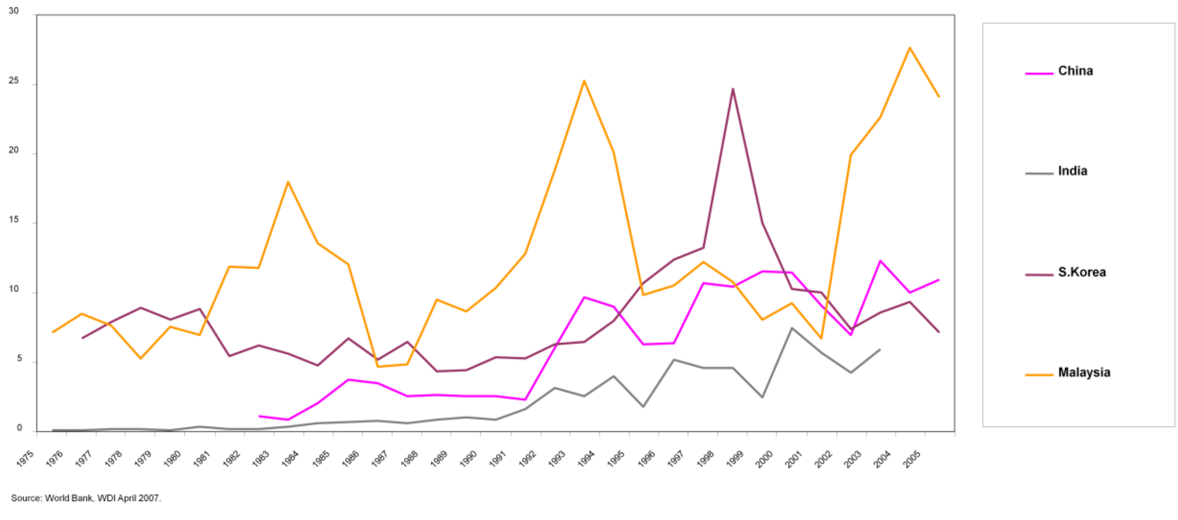
Changes in global accumulation related to financialisation and the growth and acceleration of PI inflows into Malaysia were driven by financial liberalisation designed to promote the stock market, along with the public listing of national utilities and other SOEs as the result of privatisation. The reduction and removal of capital gains and dividends withholding taxes, and liberalised entry and exit requirements made Malaysia the most liberalised market in Asia and contributed to substantial inflows of PI in the early 1990s (Chin and Jomo 2001). PI inflows into Malaysia coincided with the growth of the Kuala Lumpur Stock Exchange (KLSE) (see Chart 2.2). Trends for aggregate portfolio inflows paralleled those for the purchase of shares and corporate securities with the bulk of PI going into these sectors. PI in 1993 totalled RM13.9 billion and went mainly into the KLSE, with foreign holdings contributing to 25 per cent of market capitalisation in 1994 (Jomo 2001; BNM 1999). The flow of PI into the stock market was reflected in the foreign dominance of the KLSE which accounted for 52 per cent (1996) and 45 per cent (1997) of trading volume (BNM 1999). Foreign ownership of corporate equity increased from 25 per cent (1991) to 28 per cent (1995) following the liberalisation of equity conditions in the late 1980s (Aslam and Jomo 2001).

The promotion of the stock market was central to state efforts to create a Malay capitalist class. The Capital Issues Committee (CIC), introduced in Phase II, set (below market) share prices set for Malay individuals and SOEs. Direct state guarantees and implicit assurances boosted confidence in projects linked to plantation agriculture, infrastructure, manufacturing and telecommunication sectors, increased shareholder capital, including PI which increased from negligible levels to 6.1 per cent of gross fixed capital formation (Rasiah 2001). The rapid growth of the stock market allowed for the capture of rents, through higher share prices, and access to relatively cheap funds by the government, political parties and companies (Chin and Jomo 2000, cited in Chin and Jomo 2001). Investment in equities was encouraged through changes in government lending guidelines in 1992 that authorised banks and non-monetary financial institutions to hold stocks in privatised non-financial institutions such as TNB (the national energy corporation), Proton, Malaysia Airlines and Malaysian International Shipping Corporation (MISC), effectively increasing the share prices of these companies. Evidence suggests that companies sought stock market listing for signalling purposes to secure more bank credit on better terms rather than to raise money directly on the stock market. Three quarters of the US$35 billion estimated to have been borrowed from abroad were accounted for by three privatised SOEs, namely Malaysia Airlines, TNB and Telekom Malaysia (Jomo 2002)

The growth of the KLSE was also closely related to the privatisation programme which significantly deepened the capital market. Between 1988 and 1998 market capitalisation increased fourfold to RM375 billion and the ratio of market capitalisation to GDP increased from around 0.6 to 1.35 (BNM 1999). The public listing of the 13 entities privatised by June 1992 raised market capitalisation by RM201.1 billion, accounting for 28 per cent of total capitalisation and making the KLSE the largest stock market in Southeast Asia and the fourth largest in Asia (*Malaysian Business*, 16 August 1992; *Investors Digest*, November 1992). TNB (the national power company) and Telekom Malaysia alone – the two largest companies on the KLSE – accounted for 11 per cent of market capitalisation in 1995 (Tan, C. 1996; Malaysia 1996). Between 1991 and 1999, the market capitalisation of the 10 largest privatised entities accounted for 16–24 per cent of total market capitalisation.

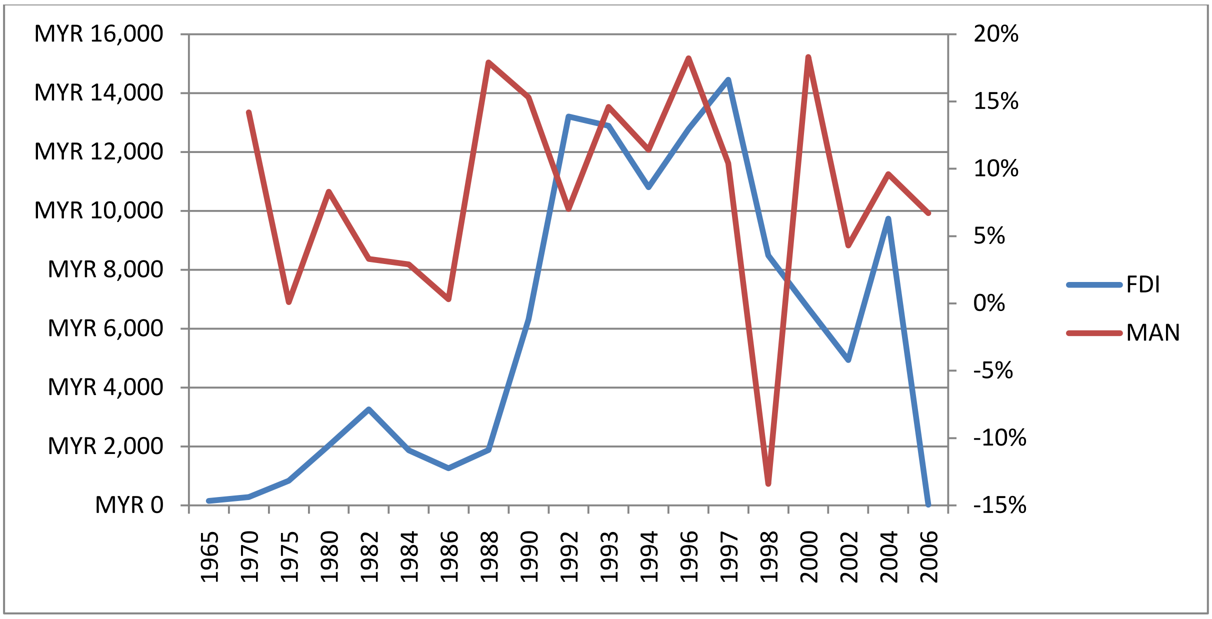
The evidence for this section illustrates the different impacts of FDI and PI on Malaysia's accumulation process. Malaysia was able to attract disproportionately more inflows of capital as a share of GDP than other countries in the region (Chart 2.1). FDI contributed to manufacturing growth (Chart 2.2) and in particular, the growth of high technology manufacturing in electronics and electrical products (Figure 2.1). In particular, the evidence indicates that FDI occurred in the very same high technology sectors that have been driving Malaysia's export growth. This in turn contributed to rapid industrialisation but also to an industrial dualism that has characterised Malaysia's manufacturing sector. PI inflows were far larger and more volatile, coinciding with the stock market boom in 1993 and 2002–3 (Charts 2.3 and 2.4). However, large PI inflows appear to be the result of national accumulation strategies related to the promotion of the stock market and privatisation. Rather than shape national accumulation, financialisation (through PI inflows) reinforced patterns of accumulation in the sectors where domestic capitalists concentrated in, namely 'construction', 'wholesale and retail trade, hotels and restaurants' and 'finance, insurance, real estate and business services' (see Jomo 2001a).

Chart 2.1 Gross private capital flows, selected countries, 1975–2005 (% GDP)



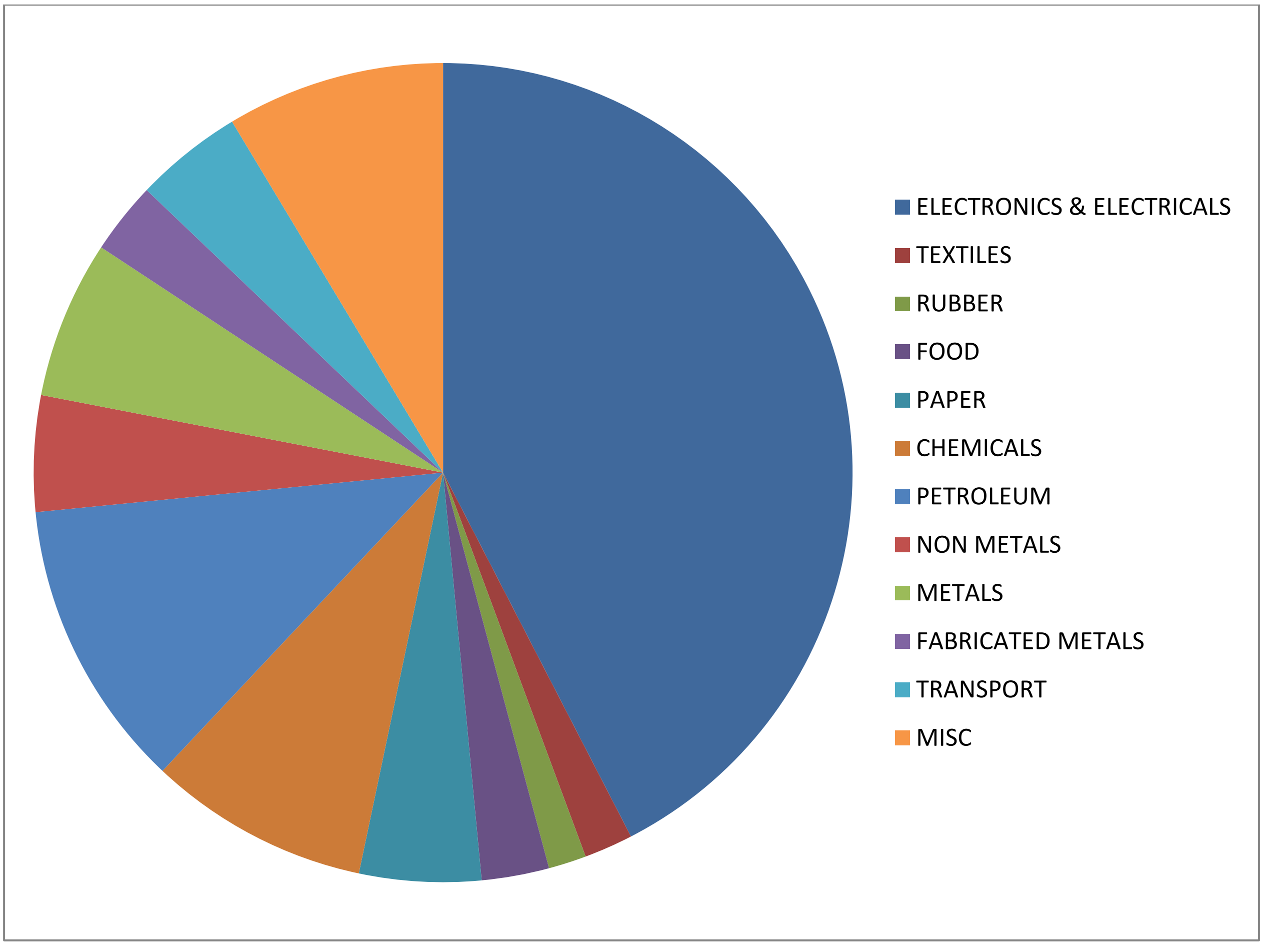
Source: World Bank, World Development Indicators.

Chart 2.2 Malaysia: FDI and manufacturing growth rates, 1965–2006 (RM million, %)



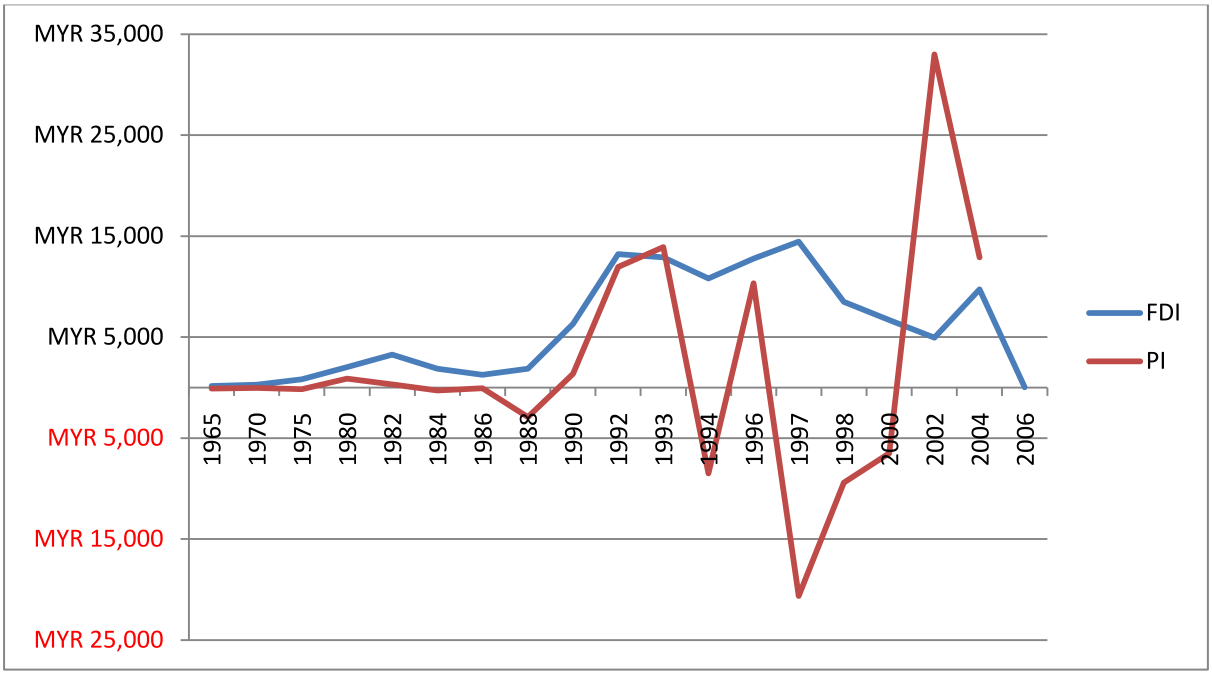
Source: Compiled from Department of Statistics data.

Figure 2.1 Malaysia: Approved FDI by manufacturing sector, 1995 – 2006 (%)



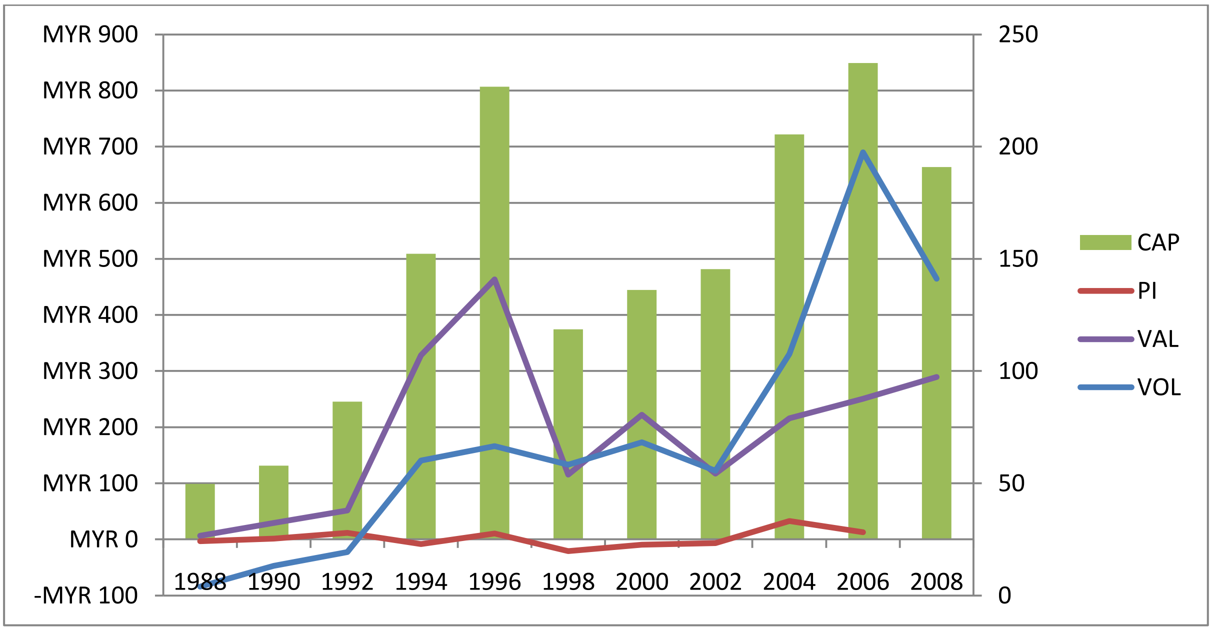
Source: Compiled from Department of Statistics data.

Chart 2.3 Malaysia: FDI and PI flows, 1965–2006 (RM million)



Source: Compiled from Department of Statistics data.

Chart 2.4 Malaysia: PI inflows and KLSE market capitalisation, value and volume (RM billion, million units)



Source: Compiled from Department of Statistics data.

Pressure for economic redistribution by the Malay middle class

Malaysia’s industrial policies need to be located within the wider accumulation process that has been driven by the twin imperatives of growth and redistribution. This process was institutionalised under the New Economic Policy (NEP) in 1970 and is closely connected with state attempts to create a Bumiputra [Malay] Commercial and Industrial Community (BCIC). Efforts to promote a Malay industrial capitalist class were thus closely linked with industrial policy and need to be considered as part of the national accumulation process. Each phase in Malaysia’s accumulation process was directly related to this and driven by social changes within the Malay middle class.

The turning point of Malaysia’s accumulation policies occurred in Phase II (1970-84) with the introduction of the NEP as the direct result of pressure from an increasingly vocal Malay middle and business class that sought greater redistribution through changes in the accumulation process. The emergence of this class can be traced back to colonial policies that attempted to create a Malay commercial and industrial bourgeoisie through state protection (Malay quotas for business licenses, employment and education), assistance (credit, training and business premises) and acquisition (Malay corporate ownership) (Lim 1985). The subsequent growth of the Malay middle class led to pressure through the Associated Malay Chambers of Commerce, Kuala Lumpur Petty Traders Association, and ruling Malay party UMNO. Demands and threats made at the first and second Bumiputra Economic Congress (BEC) in 1965 and 1968 culminated in “race riots” in 1969 that were led by elements of the Malay middle class linked to the ruling Malay party (see Kua 2007). This shifted the balance of power within UMNO and led to the introduction of the New Economic Policy (NEP) in 1970 (see Tan 2008). The accumulation process in Phase I was thus shaped by structural constraints arising from former colonial policies and subsequently driven by changes in social relations.

Demands made at the BEC led directly to the establishment of Bank Bumiputra and the reorganisation of the Rural Industrial Development Authority (RIDA) in the form of MARA (the Council of Trust for Indigenous People), and formed the basis for the NEP. The NEP institutionalised the redistribution of wealth to this class through substantial increases in education, (public) employment and business opportunities, and the state ownership of corporate equity with the aim of creating a BCIC. In the interim absence of an existing Malay capitalist class, Phase II was characterised by state accumulation on behalf of Malays through the state acquisition of profitable (foreign) companies, including (British) mining and plantation conglomerates, which increased de facto Malay corporate ownership and provided management training.

The introduction of privatisation in Phase III (1985–97) was similarly driven by changes within the Malay middle and business class. The overexpansion of the public sector created a small but powerful 'bureaucratic–capitalist elite' able to largely resist government attempts to impose budgetary discipline, making policy adjustments increasingly difficult (Jomo 1986; Mehmet 1988; Bowie 1991; Bruton 1992; Jomo and Tan 1999). Despite its continued dependence on the state, the Malay business class grew in organisation and influence (Jesudason 1989), with the growing number of Malay businessmen fostered by the NEP becoming an increasingly important element in the Malay political elite by the 1980s. This was reflected in the changing composition of UMNO leaders from politicians and 'administocrats' to a combination of politicians and businessmen (Leigh 1992), with significantly more Malay politicians active as businessmen (on their own and on UMNO's behalf) and Malay businessmen active in politics after the NEP (Ho 1988). State efforts to control the 'commanding heights of the economy' (e.g. plantations and tin mines) also produced a powerful group of former state managers increasingly active in business (Jesudason 1988).

The late 1970s saw the emergence and transformation of the Malay bourgeoisie from primarily directors – not owners – of large corporations (before the mid-1970s) to Malay millionaires, with professional and trustee Malay executive directors becoming prominent by the late 1980s (Lim 1985; Searle 1999). This paralleled changes in the occupational background and outlook of UMNO leaders and grassroots members, with school teachers and other local leaders replaced by businessmen and university-educated professionals produced by the NEP (Crouch 1993; Searle 1999). 'Middle class elements' were able to completely take over UMNO by the early 1980s, and by the time privatisation was introduced, there was already a large Malay middle class, including a younger, more professionally trained managerial cadre whose support was important and who had to be accommodated (Jomo 1999b; Milne and Mauzy 1999).

The changing composition of the Malay middle class reshaped the internal politics within UMNO local branches. Increasing economic patronage changed the nature of the patron–client relationships, transforming local UMNO representatives into political patrons. Elected members of parliament who were previously political patrons (providing political support in return for economic benefits) greatly increased their control of the district development machinery, allowing them to distribute development benefits and purchase continued support (Shamsul 1986). While Malay businessmen were heavily dependent on their access to government patronage, they became an important force in the internal politics of UMNO through the party's extensive patronage network, increasing factional struggles for nomination and outbreaks of violence at UMNO branch and division meetings after 1984 (Khoo K.J. 1992; Crouch 1993; Aziz 1997; Shamsul 1986). Although factions were already present in all levels of UMNO, the rise of 'money politics' was closely related to (if not a direct result of) the NEP (Ahmad 1985; Shamsul 1986). This resulted in a series of bitter contests between 1981 and 1987, culminating in the leadership challenge and open party split in 1987 (Khoo 1992; Crouch 1993).

These changes in social relations help explain the seemingly dramatic policy shift from direct state intervention under the NEP to privatisation (and a second round of ISI). While this shift was in part motivated by economic considerations related to NEP inefficiencies, it was largely politically driven by social changes related to the growth of, and subsequent differentiation within, the Malay middle class under the NEP. In particular, was the emergence of an influential group of Malay businessmen linked to key NEP institutions and closely associated with key political leaders in UMNO, and whose support enabled the Prime Minister to centralise authority and introduce privatisation (Leigh 1992; Felker 1998). Privatisation was thus an extension of the NEP and part of ongoing state policies to create Malay capitalists through the transfer of resources, this time favouring an emerging group of big businessmen that stood to benefit from the sale of state assets at the expense of those who continued to rely on NEP-style assistance and hand-outs.

However, the process of accumulation remained constrained by the lack of domestic entrepreneurial capacity and (as a consequence) a preference for non-productive sectors as opposed to manufacturing, with privatisation focussing largely on sectors where Malay enterprises were most concentrated, namely in ‘construction’ (the largest privatised sector), ‘government services’, and ‘wholesale and retail trade, hotels and restaurants’, and primarily benefited the emerging group of Malay businessmen closely associated with the key political leaders in UMNO (Gomez 2002b; Tan 2008) (Figure 3.1).

In this context, the accumulation process in Phase IV (1998–2008) may be seen as a reflection of failed industrial and entrepreneurship policies in the previous two phases. Privatisation ended with the state restructuring, bailout and takeover of companies owned by the small group of Malay businessmen who received the bulk of privatisation, with significant dilutions of Malay interests in privatised enterprises overall (Malaysia 1996, 2001). This is can be seen in the ownership structure of the largest companies (see Table 3.2) and was best illustrated with HICOM’s move into largely protected, non-tradable sectors following the renationalisation of its subsidiary Proton.

Phase IV also saw the state purchasing non-performing loans (NPLs), many from privatised enterprises or companies involved in privatised projects. This was mainly in construction and real estate, where NPLs increased from 16.8 and 8.3 per cent respectively by the end of 1998 to 29.7 per cent for both sectors by the end of 1999 (Chin and Jomo 2001). By early 2000, the state asset management company Danaharta had acquired RM47 billion worth of NPLs from financial institutions, including RM3.09 billion (the single largest NPL) from Renong (the largest privatisation beneficiary) (Chin and Jomo 2001; *Far Eastern Economic Review*, 22 February 2001). As a result, by 2001, the government begun scaling back the privatisation programme following the failure and renationalisation of several large privatisations and companies involved in these, signalling the end of its ‘owner-manager’ model by replacing the private owners with professional (state) managers (see e.g. *The Star*, 10 August 2002; Kennedy 2002). The emergence of GLCs may be seen as a return to proxy ownership of corporate equity by the state on behalf of Malays.

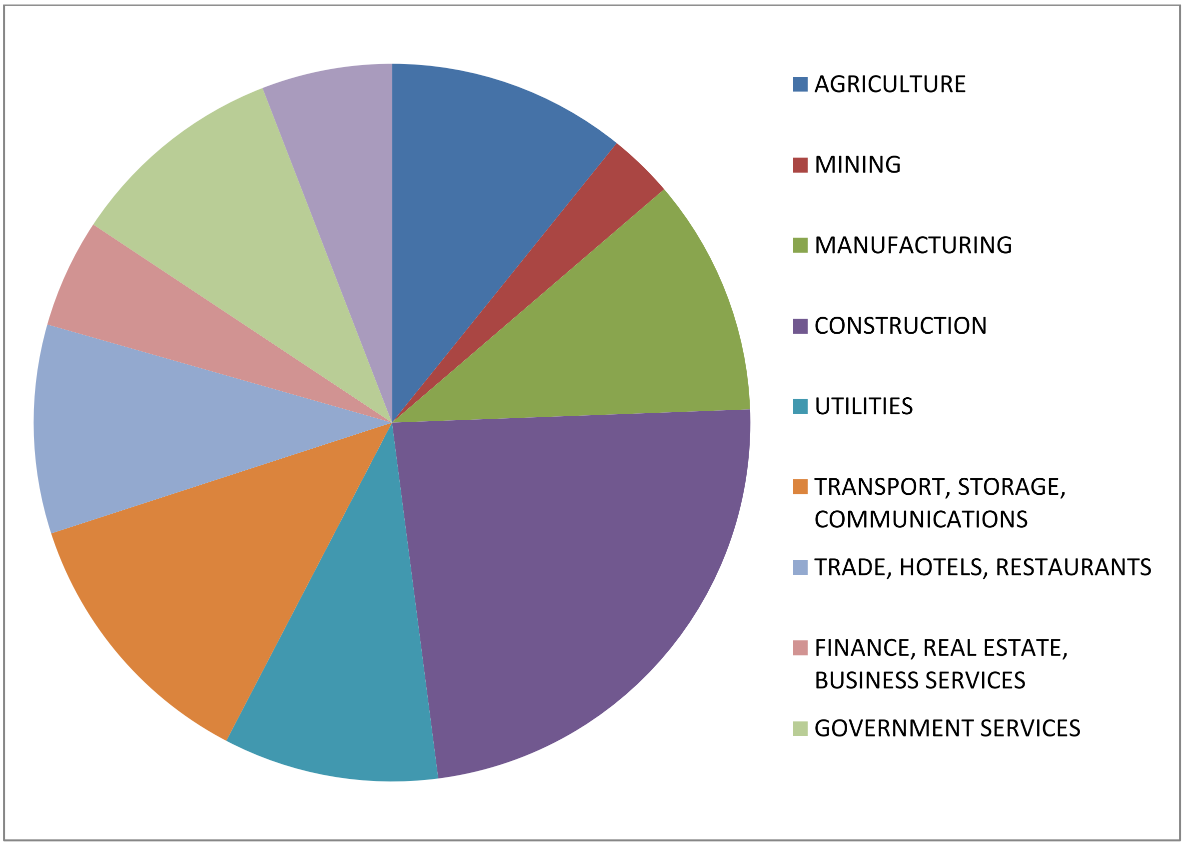
The resumption of state ownership and control through GLCs reflected the failure of domestic companies to improve their competitiveness and move into higher technology sectors, particularly in the face of increasing competition. External liberalisation pressures from the WTO, ASEAN and APEC forced the removal of a number of incentives and tariffs and but this only pushed domestic capital into other unproductive, rentier activities, in particular property and share purchases (Rasiah 2001). Domestic companies continued to rely on state subsidies and protection, with Malays in particular restricted to property, construction and finance, and dependent on government contracts, continued state support and intervention. This was reflected in the sectoral distribution of privatisation that reflected the ongoing preference of Malay businessmen for these sectors (see Tan 2008) (Figure 3.1). The dominance of these sectors was related to accelerated construction activity in response to real property booms and government infrastructure projects (Jomo and Hamilton-Hart 2001: 81; Chin and Jomo 2001: 114; Jomo 2001b: 170). The expansion of credit, especially in the 1990s, raised loans-equity ratios to extremely high levels and further fuelled investments in property, shares and construction (at the expense of longer-term investment in manufacturing). This was reflected in the increase in loans to these two sectors and the concentration of NPLs in the broad property sector (40 per cent of total portfolio loans in 1988) and share-based financing (BNM 1999; Rasiah 2001; Jomo and Hamilton-Hart 2001; Chin and Jomo 2001).

The evidence for this section provides some indication of how changes in accumulation under the NEP and privatisation shaped industrial strategies and the wider accumulation process. The shift away from manufacturing was reflected in the pattern of commercial bank lending in general and to Malays specifically, where the trend suggests a long-term tendency toward loans for the property sector, financial services and the purchase of securities (Charts 3.1 and 3.2). This pattern is reinforced, to an extent, by the lending patterns of official development financial institutions (DFIs) (Chart 3.3). The growth here of loans for manufacturing was driven primarily by MIDF which accounted for 57% of total loans by DFIs, and which was set up mainly to finance manufacturing enterprises. On the whole, industrial finance policy and targeted credit initiatives were very limited especially in the 1970s, with specialised industrial finance organisations accounting for a very small share of lending to industry because most industrial development was due to foreign investment

(Jomo and Hamilton-Hart 2001). The lack of incentives for Malaysian banks to favour long-term lending is one reason for the limited development of (non-resource based) manufacturing, with manufacturing firms increasingly relying on internally generated funds (Chin and Jomo 2001).

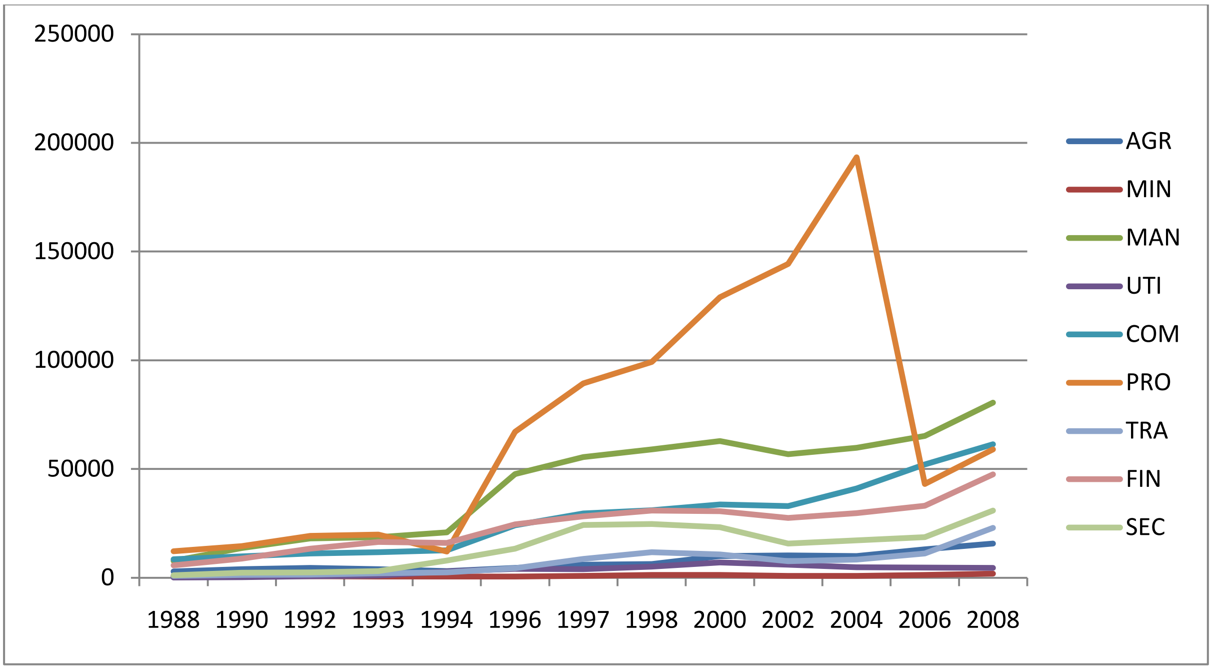
The lending patterns here correspond with the preferences of Malay businesses and domestic capital as indicated in the distribution of privatisation by sectors (Figure 3.1) and the main investment activities of the largest companies between 1971 and 2008 which have shifted away from mining (MIN) and industry (IND) into trade and services (TS) and finance (F), with Petronas Gas (the state gas company) the only company categorised under 'industrial' in 2008 (Table 3.1). Finally, the failure of domestic companies is reflected in the ownership pattern of companies where seven out of the 10 largest companies in 2008 were state owned or controlled, and where not a single private Malay company featured in the largest 20 companies (Table 3.2).

Figure 3.1 Malaysia: share of privatised projects by sector, 1991-2000 (%)



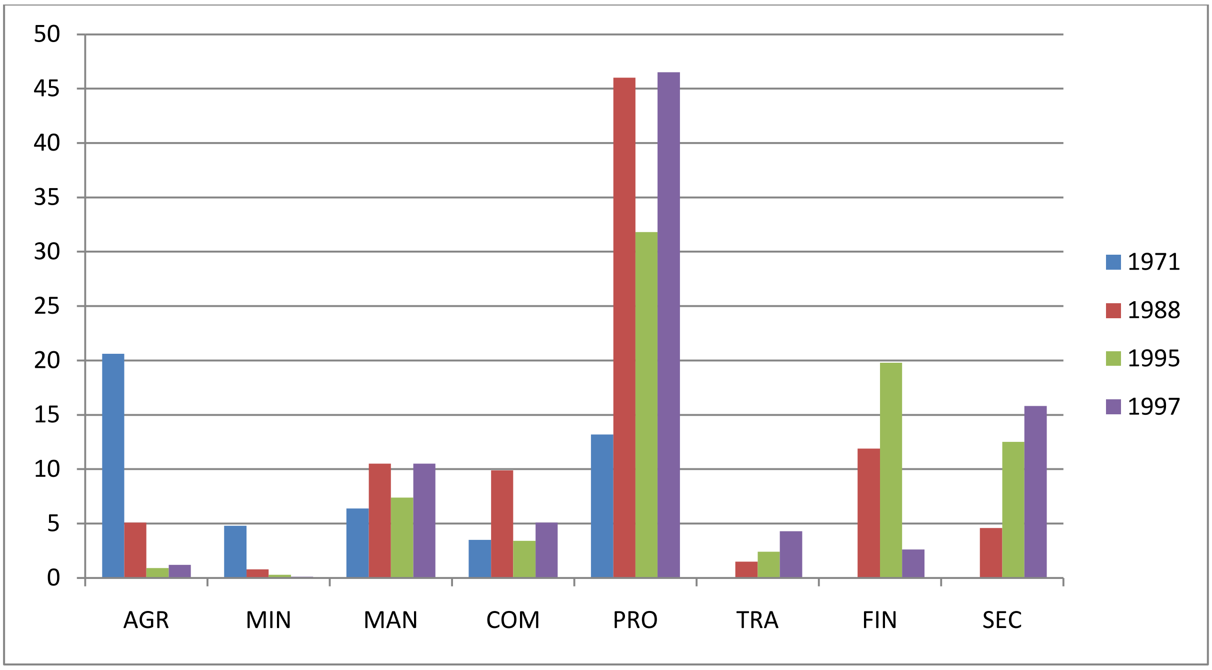
Source: Malaysia (1996); Malaysia (2001b).

Chart 3.1 Malaysia: Commercial bank lending by sector, 1988–2008 (RM million)



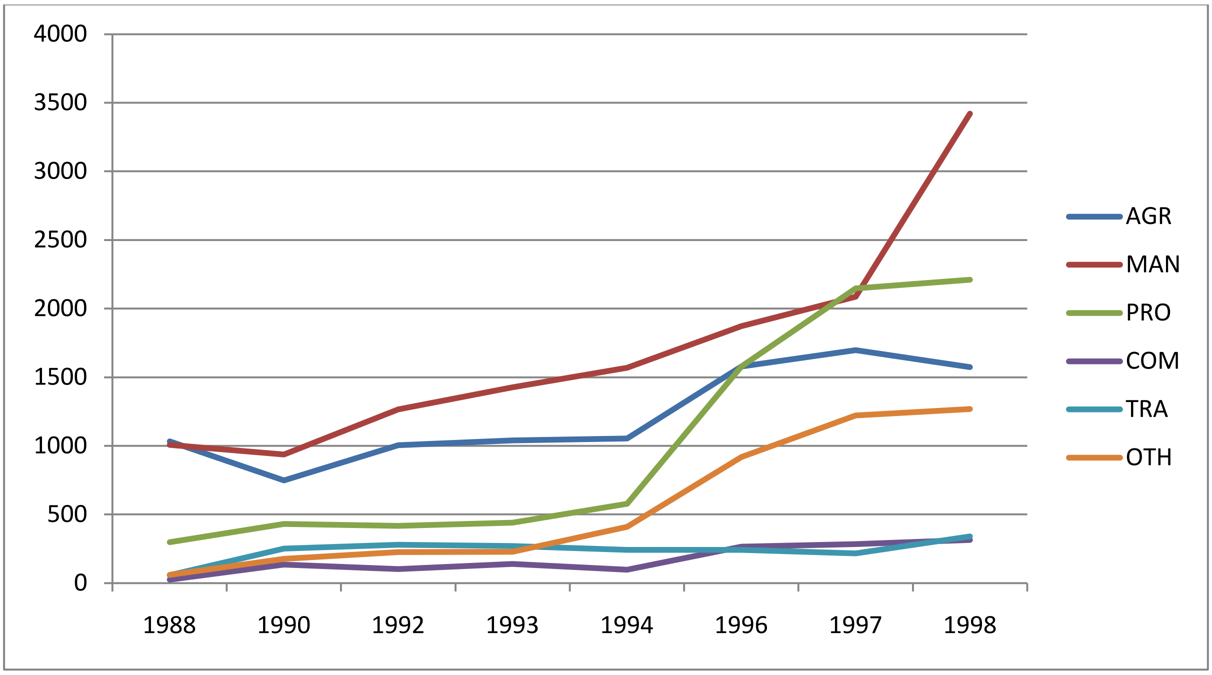
Source: Bank Negara Malaysia, various reports.

Chart 3.2 Malaysia: Commercial bank lending to Bumiputra, selected years (RM million)



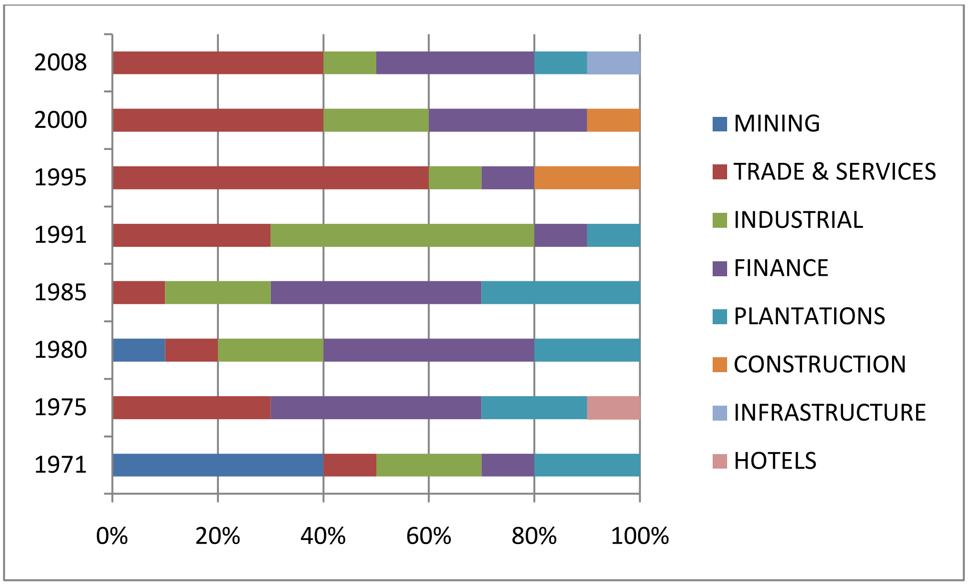
Source: Bank Negara Malaysia, various reports.

Chart 3.3 Malaysia: Development finance institutions, lending by sector 1988–98 (RM million)



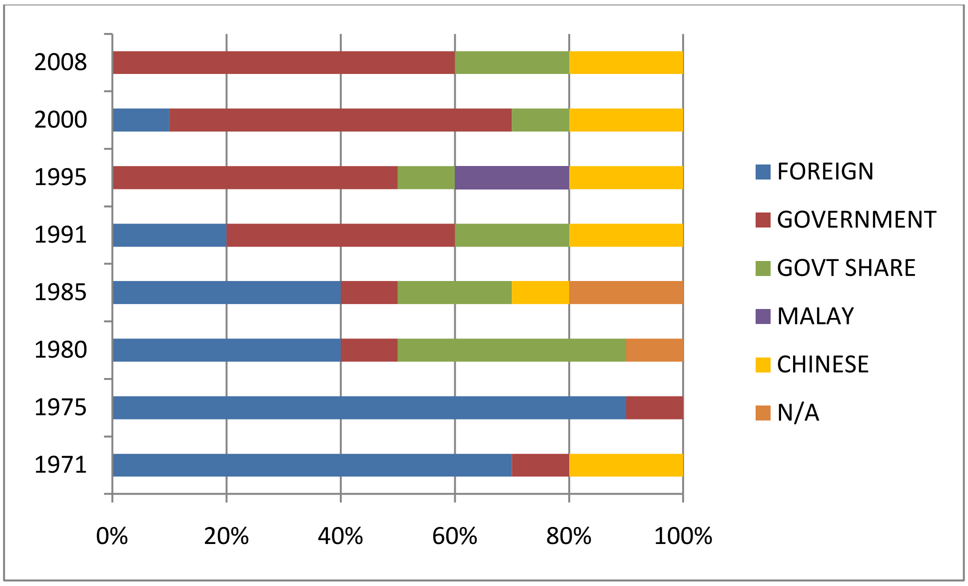
Source: Bank Negara Malaysia 1999.

Table 3.1 Malaysia: 10 largest companies by sector, 1971–2008



Source: KLSE monthly reports.

Table 3.2 Malaysia: 10 largest companies by ownership, 1971–2008



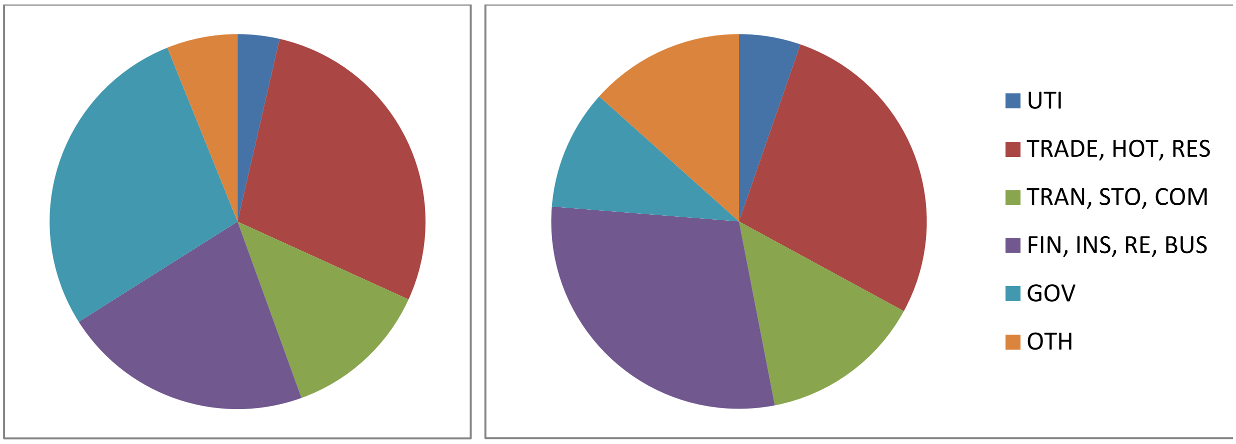
Source: KLSE monthly reports.

Broader trends and conclusion

Malaysia's accumulation process can be roughly divided into four broad phases. Changes in these phases can be explained in terms of: 1) changes in industrial policy; 2) the impact of global accumulation; and 3) pressure for economic redistribution by the Malay middle class. Industrial policies were marked by the shift from ISI (Phase I) to EOI (Phase II) and a second round of ISI (Phase III). This was facilitated by substantial inflows of FDI which directly contributed to the rapid growth of Malaysia's manufacturing sector and (high technology) manufactured exports. These industrial strategies were part of broader accumulation strategies that were shaped by the twin imperatives of (manufacturing-led) growth and redistribution which were in turn driven by FDI in the former, and demands from the emerging Malay middle and business class.

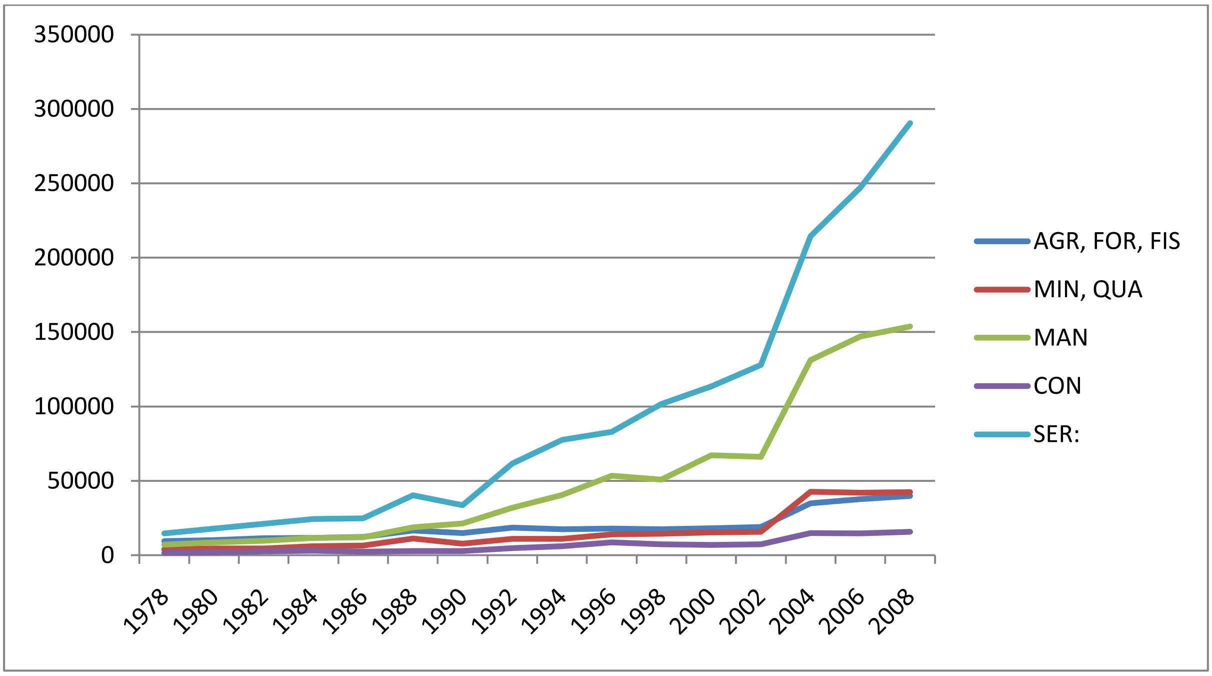
The ongoing reliance on FDI-led manufacturing growth was a reflection of the inability of the state to promote domestic (heavy) industries and a domestic capitalist class. This is supported by the evidence on each of the three levels (that indicate the dominance of foreign companies in high technology manufactured exports and the historical preference of domestic capital for non-tradable sectors) and reflected in the broader evidence below which illustrates a longer-term sectoral shift towards services (Figure 4.1 and Chart 4.1). A breakdown of the service sector in turn reveals the rapid growth of sectors consistent with financialisation, namely ‘utilities’, ‘finance and insurance’, and ‘real estate and business services’ sectors, consistent with financialisation (Chart 4.2).

Figure 4.1 Malaysia: GDP by sector, 1978 and 2008 (%)



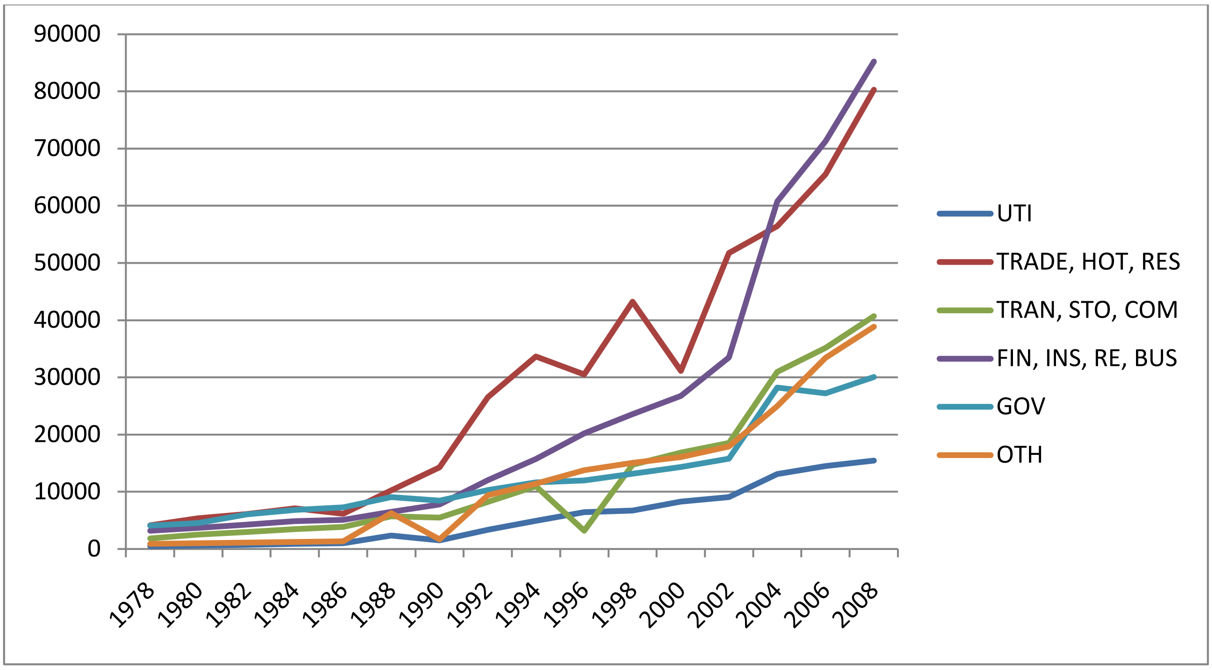
Source: Compiled from Department of Statistics data.
Notes: UTI (utilities), TRADE, HOT, RES (wholesale and retail trade, hotels and restaurants), TANS, STO, COM (transport, storage and communications), FIN, INS, RE, BUS (finance and insurance, and real estate and business services), GOV (government services), OTH (others).

Chart 4.1 Malaysia: growth by sector, 1978–2008 (RM million)



Source: Compiled from Department of Statistics data.

Chart 4.2 Malaysia: service sector growth by type, 1978 – 2008 (RM million)



Source: Compiled from Department of Statistics data.

Malaysia's industrialisation and accumulation process provides potential lessons for other developing countries. The reliance on FDI and global production networks for industrial upgrading potentially restrict domestic companies as suppliers, and the ability to move up the technology ladder and to grow is tightly circumscribed by the technological gap and nature of innovation within global production networks (see e.g. Nelson and Winter 1982; Dosi 1988). In addition, developing countries are also faced with an entrepreneurial gap – that is the absence of a capitalist class to undertake the innovation process necessary for industrial upgrading. Industrial policy is thus about developing national manufacturing capacity and national capitalists. This will ultimately depend on the state's ability to manage the learning process. The Malaysian case suggests that domestic capitalists may prefer to capture rents in less competitive sectors. This is not surprising given the rapid development within the field of high technology manufactures, and intense competition in manufactured exports and for FDI, most clearly illustrated with the emergence of China. Under these circumstances, FDI may lead to an industrial dualism and facilitate a shift away from manufacturing. In Malaysia's case, the accelerated expansion of construction and services at a time when Malaysian manufacturing was still dominated by low value added OEM activities did not just undermine technological deepening (see e.g. Rasiah 2001; Ghazali Atan 1994) but was also an outcome of learning failure.

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