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MAHATHIR'S ECONOMIC POLICIES

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MAHATHIR'S ECONOMIC POLICIES: AN INTRODUCTION

The title of this book, *Mahathir's Economic Policies* may be seen by some as provocative. There may be those who disagree with such a title for reasons that must be discussed.

There are those, for example, who feel that from 1981, YAB Datuk Seri Dr Mahathir Mohammad has not really formulated the economic policies implemented under his premiership, thus not warranting the title of this book. There is also the view that government economic policies under Dr Mahathir's leadership have merely been an extension of the New Economic Policy (NEP) and other economic policies, particularly industrialisation policies, before Dr Mahathir became Prime Minister. Such views often assume that the present policies were inevitable. Yet another view suggests that these economic policies have been announced and implemented in an ad-hoc fashion, lacking the coherence suggested by such a book.

Some observers also feel that the economic policies pursued under Dr Mahathir's leadership merely reflect his earlier economic philosophy, as enunciated in his famous book, *The Malay Dilemma,* and several other writings and speeches from the sixties and seventies.

It is also often observed that policies implemented since the early 1980s have consistently served to uphold and advance certain business interests, which seem to have strong influence over national leadership. This view is often linked to the development usually known as 'money politics'. This view implies that recent policies were inevitable in view of preceding political and economic developments.

There are undeniable grains of truth in all these views. Similarly, it cannot be denied that most important changes in the ruling Barisan Nasional's economic policies have been inspired by Dr Mahathir, or have at least been attributed to him, regardless of whether they actually originated from him.

On the one hand, although the NEP and other earlier economic policies are still being pursued, it cannot be denied that Mahathir's economic thinking has had a tremendous impact. For example, the 'Malaysia Incorporated' and

privatisation policies have clearly influenced the direction of NEP implementation and the role of the public sector, particularly in the restructuring effort to achieve the 30 per cent Bumiputra equity ownership target. Also, recent heavy industries have influenced the entire industrialisation effort which previously placed greater emphasis on export-oriented production. Meanwhile, the National Agriculture Policy is attempting to develop agriculture on a more capitalist basis with a greater market orientation.

It cannot be denied that there are several contradictions between some government statements and these new economic policies. For example, even though Dr Mahathir launched policies opposing British economic interests and has denounced neo-colonialism, the Malaysian government continues to seek foreign investment, while maintaining technological dependency and the openness of the Malaysian economy. Thus, on the whole, it can be said that economic policies from the early 1980s seek to transform Malaysia into a newly industrialised country (NIC) like South Korea, less dependent on the developed industrial nations, and under genuine Bumiputera capitalist entrepreneurial leadership. Most of Mahathir's economic policies seem to aim to achieve this end.

Even though there has been some consistency between his present economic policies and earlier convictions, it cannot be denied that the ideas underlying present economic policies are more comprehensive, developed and coherent. Some of his earlier ideas include the need for more independent capitalist economic policies to create the Malay millionaires, the absorption of Malays into the modern capitalist sector, tighter control over labour, and efforts to overcome the colonial economic legacy.

The emergence of 'money politics' and other phenomena which reflect the close relationship between political power and business opportunities is clearly related to increasing state intervention in the economy and the centralisation of power, particularly in recent years. It cannot be denied that certain influential groups have enjoyed the opportunities and benefits arising from present economic policies. Nevertheless, it is not useful to assume that all these economic policies are merely an excuse to enrich a select group of influential individuals.

Thus, we should attempt to understand Mahathir's economic policies not only individually, but also holistically. This little book contains several articles which try to critically understand many recent policies and their implications.

This volume begins with Dr Mahathir's 1983 memorandum regarding several new government policies, including the effort to emulate Japanese work ethics, the Malaysia Incorporated policy, privatisation and the attempt

to bring about a 'clean, efficient and trustworthy' administration through 'leadership by example.'

Though perhaps unintended, the announcement and implementation of the Look East policy has proven to be a windfall for many Japanese economic interests. According to Johan Saravanamuthu, this policy has encouraged the invasion of various sectors of the Malaysian economy by Japan's interests – what is referred to as Japan's 'second invasion'.

The next article by Chang Yii Tan clearly demonstrates how giant Japanese and South Korean construction companies, facing difficulties in the Middle East, successfully secured major building contracts in Malaysia in the early and mid-eighties. This has undermined the local construction industry, while these foreign companies have been given a new lease of life from the windfall contracts secured in Malaysia.

The term 'Japan Incorporated' was coined as a reflection of Western anxiety in the 1960s in response to the perception that the Japanese state strongly supported private capital's expansion into the world market. This close relationship between the state and private capital incurred the ire of competitors. The Japanese economic miracle has attracted much attention in the West, with much resentment focussing on this 'unfair' and unique relationship, which is seen as the key to these miracle. Lee Poh Ping summarises the origins of this relationship in the Japanese context to examine the implications of adopting such a concept in Malaysia.

The development of heavy industries in Malaysia has been emphasized since the late seventies, when Dr Mahathir was Minister of Trade and Industry, and has been stepped up since he became Prime Minister in 1981. Unfortunately, the heavy industries being currently developed neither balance nor complement the growth of the other industries. On the contrary, projects implemented have posed a heavy burden on the entire Malaysian economy, requiring heavy investment and protectionism. These industries are also not internationally competitive due to existing gluts on the world market. Also as a result, there has been less capital for investment elsewhere, while foreign borrowing and costs have increased.

Of all the heavy industries, the Malaysian car project has drawn most public attention. The project was originally developed ostensibly to transfer the technology of motorcar production and to encourage ancillary industries in the effort to develop a Malaysian car industry. The next article shows how the Malaysian car project depends heavily on two related Mitsubishi companies, which will reap handsome profits from supplying the production and assembly technology – and 60 per cent of the parts, and various services such as body stamping, painting, training and professional services as well as patent and other fees, regardless of whether or not Proton loses money.

Even though Proton can survive as a result of strong protection and support by the government, and Mitsubishi will make huge profits, the economic burden of the project on the Malaysian economy is considerable. Undoubtedly, the motorcar industry stimulated the American economy from the 1920s, and particularly after the Second World War, as well as the Japanese economy in the 1960s and 1970s. But the Malaysian car project was launched in different global and national conditions. The likelihood of the Malaysian economy sustaining an internationally competitive car industry is slim, and as such, the project will continue to burden the Malaysian people. Chee Peng Lim's contribution attempts to estimate the likely economic burden of the car project and to identify some of its other implications.

Malaysia's industrialisation efforts since Merdeka have been fairly lop-sided mainly due to emphasis given to foreign investment. For a decade from the end of 1950s, the government encouraged import substitution, which attracted investment from foreign companies wishing to take advantage of the government's protectionist policies. These companies had close ties with their parent companies, though rarely with other local industries, minimizing the beneficial effects of such industrial growth. Later, the export-oriented industrialization policy of the 1960s succeeded in attracting labour-intensive industries wishing to employ docile cheap labour, but which was unable to establish ties with local industries. The Malaysian Industrial Master Plan (IMP) acknowledges this and other weaknesses of the manufacturing sector in Malaysia, but has been unable to present a coherent and persuasive alternative.

The new population policy announced by Mahathir aims to achieve a target population of 70 million by the year 2100, ostensibly because such a large population would provide a local market large enough to ensure the success of the heavy industries planned. Such logic is dubious since the market size is determined not only by the population size, but also by the level and distribution of income, and hence, purchasing power. It would be difficult for real wage levels to increase in Malaysia, given the government's insistence an maintaining the low-wage policy inherited from colonial times. Efforts to increase the population – whether by increasing the birth rate or by encouraging immigration – will greatly strain available public services, employment opportunities, and scarce local economic resources.

The National Agricultural Policy (NAP), announced in early 1984, emphasizes efforts to increase farmers' incomes by increasing their productivity, changing their crops and improving agricultural management. The NAP fails to emphasize food production for local consumption, and instead emphasizes cash crops for export. Meanwhile, the government aims to redress the problems of uneconomic-sized farms and idle land by promoting mini-estates,

which will mainly benefit those already owning land. Efforts to overcome land hunger, redistribute land ownership, reduce the burden of land rents and to provide land to the tiller are not considered at all. Even the cooperative movement is de-emphasized, while capitalist agricultural management practices are expected to resolve the problems of peasant agriculture.

The Malaysian Airlines System (MAS) workers industrial action during 1978–79 will probably go down in history as the most recent watershed in Malaysian labour history. Their actions drew in Dr Mahathir, then Deputy PM and Minister of Trade and Industry, who has been seen as responsible for the harsh actions against the unionists and their supporters, the subsequent deaffiliation of MAS workers from the union and the establishment of an in-house union instead, as well as the amendments to the labour laws in 1980. Since the early eighties, union membership has declined, while unemployment has risen and real wages have fallen in most sectors since 1982. One article in the volume reviews government labour policies in the eighties to better understand these trends.

The Malaysian economic crisis since the early 1980s has been the result of several developments, especially the world capitalist economic decline and the fiscal crisis caused by excessive government expenditure. Thus, huge external borrowings have been incurred to finance additional expenditure. Early in the eighties, the government attempted to offset the effects of the global recession by increasing national public expenditure. In 1980, most government departments and ministries increased expenditure, partly because 1980 was the last year of the Third Malaysian Plan period and allocations for the Fourth Plan would be based on their respective performances. With the impending election of a new UMNO Deputy President in mid-1981, and the April 1982 general elections, votes fishing led to increased public expenditure. Only in June 1982, two months after the Barisan Nasional victory, did the government turn around and launch an austerity drive. Subsequently, external borrowings, mainly to finance off-budget agencies which were mainly involved in heavy industries, rose rapidly up to 1984.

'Money politics' – involving the increasing use of funds to secure political office – has worsened in recent years with the increasingly intimate relationship between business interests and political power. Not surprisingly then, Tan Koon Swan and Tee Ann Chuan, both recent presidents of Barisan Nasional component parties were sentenced to jail in 1986 after pleading guilty to various charges involving abuse of power. In mid-1987, Deputy Prime Minister and UMNO Deputy President Ghaffar Baba defended the award of tenders to ruling party politicians who submitted uncompetitive bids, claiming that their allowances from holding public office were

inadequate. In August 1987, Dr Mahathir himself defended the award for the privatisation of the North-South Highway to United Engineers (Malaysia) Berhad, an UMNO-controlled company, on the grounds that UMNO had to make money to cover the costs of its extravagant building, the Putra World Trade Centre. About a year earlier, MIC president Samy Vellu also defended the intimate relationship between politics and business. Political scientist Dr Harold Crouch reviews the origins and implications of the development of money politics.

The cruel murder of Jalil Ibrahim in Hongkong in mid-1983 focussed national attention on Bank Bumiputra's Hongkong subsidiary, Bumiputra Malaysia Finance (BMF) and its shadowy operations in the colony, forcing the Malaysian government to set up an investigation committee headed by the Auditor-General, Tan Sri Ahmad Noordin. Despite its limited powers, the committee's report confirmed popular suspicions and fears of widespread malpractices and abuses of power. Hassan Karim's Black Paper – reproduced here – denounces the government White Paper which accompanied the BMF Committee's final report as a white wash, and summarises the Report's highlights and implications.

The lacklustre performance of the Malaysian public sector is well-known. The question is whether this is an inevitable characteristic of all public sectors, which can only be redressed by privatisation. If the poor performance of most public sector activities is due to the nature, interests and role of those in power, and is not a necessary result of public ownership, privatisation per se will not be able to redress the root problems. The article on privatisation raises several questions about the implications of privatisation in Malaysia today. Even though privatisation may succeed in raising efficiency, such a transfer of ownership is not necessarily in the consumers interests. As privatisation involves many 'public monopolies', privatised monopolies can be abused to maximise profits. The privatisation of public services will burden the people, particularly those who can least afford it. It is also clear that the private sector would only be interested in profitable investments. Hence, the government will be left with unprofitable activities, thus aggravating the fiscal deficit (and confirming the view of public sector inefficiency). While the problems of the public sector need to be overcome, privatisation will mainly benefit the politically influential rich, leaving the public vulnerable to the enhanced powers of private capitalists.

The award of the proposed privatisation of the North-South Highway project to United Engineers Malaysia, an UMNO-controlled company, has generated a growing public outcry, which has led to the creation of a popular coalition against abuses known as the Gerakan Anti-Penyelewengan. GAP's

first memorandum to the Prime Minister summarizes the main issues involved, including the dubious tender process, UEM's poor record and lack of relevant experience, the various government subsidies to UEM, the anticipated toll collection, and the government's weak justification for privatising the Highway project. Needless to say, the exercise flies in the face of the official rationale for privatisation.

Most of Mahathir's economic policies are consistent with his wish to transform Malaysia into a NIC. These policies can be critically analysed from two perspectives: first, whether or not such policies will achieve their stated aims, and secondly, whether or not the underlying aim of these policies – of transforming Malaysia into an industrialized capitalist nation – is in the interest of most Malaysians. The articles in this book reflect both perspectives. Ultimately, a choice will have to be made as to whether the people prefer a modern, capitalist nation, or a more just and free society.

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NEW GOVERNMENT POLICIES

Mahathir Mohammad

The government has announced several policies in its attempt to step up our country's economic progress and development. To avoid misunderstanding and misinterpretation, a brief review of these new policies is provided here.

Look East

This means emulating the rapidly developing countries of the East in the effort to develop Malaysia. Matters deserving attention are diligence and discipline in work, loyalty to the nation and to the enterprise or business where the worker is employed, priority of group over individual interests, emphasis on productivity and high quality, upgrading efficiency, narrowing differentials and gaps between executives and workers, management systems which concentrate on long term achievement and not solely on increases in dividends or staff incomes in the short term, and other factors which can contribute to progress for our country.

Looking East does not mean begging from the East or shifting the responsibility for developing Malaysia to them. Responsibility towards our country is our own and not that of others. Looking East also does not mean buying all goods from or granting all contracts to companies of the East, unless their offer is best.

Malaysia Incorporated

The Malaysia Incorporated concept means that Malaysia should be viewed as a company where the government and the private sector are both owners and workers together in this company. In a company, all owners/workers are expected to cooperate to ensure the company's success. Only through the success of the company, will the owners' and workers' well-being be safeguarded and improved.

If Malaysia is viewed as a company, then Malaysians, whether from the government or private sector, are also the owners and employees in Malaysia

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* Translated from a memorandum by the Prime Minister to senior government officials dated 28th June 1983.

Incorporated. The success of the company is then surely dependent on the efforts and cooperation of all parties, whether from the government or private sector.

A country progresses and prospers with the advancement of businesses and enterprises in that country. The government finances all its expenditure, including staff salaries, with taxes and revenue collected from the activities and profits of private businesses and enterprises. The more successful the private sector and the more plentiful the business and enterprises, the greater the revenue and taxes for government collection.

Since government services are needed for many business activities, hence, the services rendered by government officers and staff play an important role in determining the success of all business in the country. More efficient and prompt government services would increase the companies' prospects for profits. Larger profits in turn ensure more taxes for the government. At the same time, prospering business will create more jobs and related businesses. Those who get these opportunities will spend their incomes, thus inevitably stimulating various other economic activities. The purchase of some of these goods will be taxed. And again, the government will collect taxes to finance the country's current and development expenditure.

On the other hand, poor services from the government will lead to losses or less than satisfactory profits, or increased prices to meet operating costs. In these circumstances, the government will receive less taxes, while the cost of living would increase, bringing a multitude of adverse consequences.

It should be obvious that satisfactory services by government staff would be advantageous to themselves, besides ensuring development and prosperity for the nation.

Malaysia Incorporated can therefore be defined as the concept of co-operation between the government and the private sector for the latter to succeed, thus make greater contributions to national development.

Privatisation

Privatisation means the opposite of nationalisation. The objective of nationalisation is for government to take over the ownership of private enterprises, while privatisation means the transfer of government services and enterprises to the private sector.

Normally, companies and services owned and managed by government have been less successful or have run at a loss because the government's management methods differ greatly from those of the private sector.

On the other hand, private businesses and enterprises are usually profitable. Profit-making private businesses are required to pay taxes amounting to 40-50% of total profit.

If government enterprises are transfered to the private sector, the government will not lose its source of income. 40-50% of this income will continue to be received by government. This is better than for the government to

own businesses and enterprises which constantly run at a loss, thus becoming a liability not only to government, but also indirectly to the people.

Usually, the government operates certain services. In Malaysia, postal and telecommunications services, radio and television, railways, shipping and aviation, airports, hospitals and clinics, ports, educational institutions, roads and other public utilities are state owned. Besides that, the central and local governments have ventured into various businesses and enterprises, either as a monopoly or as a shareholder. The trend towards increasing government participation in business has led to competition with the private sector. Due to its power, the government can easily dominate private businesses and enterprises. However, since government businesses usually lose, not only does the government not receive income from its businesses, the government will also lose tax revenue which would normally be collected from successful businesses.

The government may be able to obtain substantial revenue from telecommunications, ports, radio and television, railways, etc. However, the government would still be able to collect taxes and other payments if these services are run by the private sector instead. And if these services can be better run on a commercial basis, there is a possibility of higher government income than when the government owned these services.

In view of this possibility, there is a need to transfer several public services and government-owned businesses to the private sector. This transfer is called privatisation. The privatisation process can be carried out in stages following detailed study. Permanent changes will bring about temporary chaos and confusion. However, if carried out carefully, this situation of confusion will not last long.

Leadership by Example

This slogan is self explanatory and needs no elaboration. Government leaders, whether politicians or civil servants, are undoubtedly required to set good examples. It is very important that they understand and practise government policies so that their good example will be emulated by all the people in this country for the common benefit and prosperity.

It is hoped that you gentlemen will clearly explain the various concepts and policies to all your officers so that they too will understand them clearly. In this way, these policies can be implemented in accordance with their original objectives and without any confusion.

THE LOOK EAST POLICY AND JAPANESE ECONOMIC PENETRATION IN MALAYSIA

Johan Saravanamuttu

This essay examines the content and objectives of Malaysia's Look East policy in the context of Japanese economic penetration of the ASEAN region in general and Malaysia in particular with a view toward critically examining its underlying assumptions and its practical implications. It argues that not only is the policy many years late in making an appearance in view of Japan's already dominant role in ASEAN, but that as an *ex post facto* policy, it may fail to bring about the anticipated self-sustaining development that is envisaged by its proponents.

The Look East Policy Proclaimed and Explained

Announced in late 1981 and enunciated throughout 1982, Malaysia's Look East Policy is apparently being pursued at two levels by the Malaysian government:

- the level of an external economic policy whereby Japanese-cum-Korean governmental and private sector aid, technical assistance and training is being sought and contracted for in Malaysia. (As an extension of this policy, students are also to be sent to both these countries for vocational and tertiary education in increasing numbers).
- the level of domestic policy wherein the Malaysian government itself seeks to inculcate a supposed Japanese work ethic through various propaganda devices and through concrete promotion and implementation of the policy in the private and public sectors.

Its proclamation came close on the heels of the Prime Minister's deepened disenchantment with apparent British policies in the aftermath of the Guthrie affair.[1] The policy was spelled out appropriately enough at the fifth joint

* This essay draws on different papers presented at the Seventh Malaysian Economic Convention of the Persatuan Ekonomi Malaysia in Kuala Lumpur in January 1983 and the Seminar on "The Japanese Experience: Lessons for Malaysia" in Penang in May 1983.

1. This refers to Malaysia's takeover of Guthrie Corporation in a 'dawn raid' on the London Stock Exchange. The British subsequently tightened the procedures for such takeovers leading to Malaysia's 'buy British last' policy, lifted only in May 1983.

annual conference of the Malaysia-Japan Economic Association, MAJECA and the Japan-Malaysia Economic Association, JAMECA. In his speech, the Prime Minister, Datuk Seri Dr. Mahathir Mohamed, outlined how he thought Japan could help Malaysia emulate Japanese industrialisation, work attitude, ethics and skills. (*The Star*, Feb. 9, 1982).

What Malaysia wanted most was the opportunity to learn how the Japanese had inculcated among themselves particular values such as their attitude towards work and their sense of belonging and loyalty. Malaysia, like Japan, also needed to create a corps of industrial and commercial managers – from shift foreman to able marketing, finance and personnel administrators – as well as to widen its range of skilled manpower and improve the quality of teaching at its vocational and technical institutes. A prosperous Malaysia, he argued, would make a better customer and trading partner for Japan. Furthermore, Malaysia and Japan, being countries of the Pacific rim – slated to be the growth area of the world replacing the Atlantic countries – shared a common economic destiny. "Although we differ in terms of ethnicity, language, history, tradition and culture, there is sufficient commonality in terms of political philosophy and economic thrust that co-operation would be easy to achieve."

It was further asserted that with Japan opening its doors to Malaysians in terms of acquiring skills, knowledge, work attitudes and ethical values, the foundation would be laid for an enduring and meaningful co-operation between the two countries. "In doing so, we would be inculcating in our leaders of tomorrow a better understanding and appreciation of the mode of conduct, culture and thought processes of the Japanese and Malaysian peoples, thereby creating a positive climate for future business activities and various forms of co-operation." Specifically, Dr. Mahathir invited the Japanese government and Japanese companies to provide opportunities and assistance in the following areas:

- academic studies in Japanese universities
- training opportunities in industrial establishments, including training in the day-to-day running of factories and business houses
- turning out higher grades of skilled craftsmen
- adjusting technical training methods to practical aspects, with less emphasis on theory, and incorporating work experience in such training, and
- for Japanese *sogoshosha* to help their infant Malaysian counterparts shorten their lengthy period of learning and promote mutual co-operation.

Dr. Mahathir specially welcomed industries which, for a number of reasons, would no longer be suitable for siting in Japan to be sited or re-sited in Malaysia, as by doing so, Japan would continue to reap the profits from these industries instead of having to abandon them altogether.

These overtures by Dr. Mahathir were also extended to South Korea, seen in some sense as having greater relevance for Malaysia, given its status

as a 'newly industrializing country' (NIC). Indeed, this point was underscored when the Malaysian government awarded its US$233 million Penang Bridge project to the Korean Hyundai Engineering and Construction Co., with the condition that some 400-odd Malaysian were to be trained on the job in a training facility near its worksite (*Far Eastern Economic Review*, Feb. 5, 1982).

Dr. Mahathir's announcement of this policy had the electrifying effect of sparking a unison of positive responses from other Ministers, governmental groups and the private sector, as well as Japanese and Koreans eager to support the new policy for obvious reasons. The Minister in the Prime Minister's Department, Datuk Abdullah Ahmad Badawi in an interview with the UMNO organ, *Merdeka,* pointed out that the new policy would help achieve the targets of the New Economic Policy (NEP) outline perspective plan scheduled for achievement in 1990, a mere eight years away (*Sunday Star*, July 25, 1982).[2] Stressing the virtue of the Japanese and Korean models for rapid development which Malaysia needed to emulate, he said, "For us there are definitely work methods, system of management, techniques and planning which we feel are suitable for emulation and adaptation into our situation...... We hope that this co-operation with Japan and South Korea would result in understanding regarding work methods, culture and thinking..... We also wish to learn from the shortcomings and problems that have arisen as a result of industrialisation that they have overcome so that we will avoid these pitfalls." (*Sunday Star*, July 25, 1982). Enthusiasm reached a high point when the Education Ministry was reportedly considering introducing Japanese and Korean as third languages in secondary schools so as to help the anticipated upsurge of students who were expected to make a beeline for Japan and South Korean universities. The pro-government daily, *New Straits Times* (July 16, 1982) lauded the move to "Learn East", editorialising thus:

> "Only Anglophiles are likely to be flabbergasted. But even they should know that the days of the colonial strait-jacket are over. Their bias has been inherited from another era under Pax Britannica. The world has changed a lot since then. Now only Arabic is taught as a third language in residential schools as a bridge to West Asia. Surely we need similar bridges to the East."[3]

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2. The NEP envisages the restructuring of ownership shares of the modern corporate sector of the economy to achieve a 30% (foreign) – 30% *(Bumiputra)* – 40% *(non-Bumiputra)* formula by 1990. As of 1980, the *Bumiputra*, share was 12.4%, the non-*Bumiputras* reached 40.1%, while the foreign share was still highest at 47.5% (*Fourth Malaysia Plan*, 1981: p. 62).
3. Presumably, we are now in the era of Pax Japonica. There was at least one public protest against this excessive enthusiasm – by Aliran (the social reform movement) – which argued that English was still by far the most important world language. Furthermore, it would be ridiculously onerous to burden students with a third language which the majority will not need. (*The Star*, July 17, 1982).

Dr. Mahathir himself contributed to the incessant airing and media discussion of his policy by giving interviews to pressmen on the subject. Let us examine some of the premier's own explanations and justification for the policy. Submitting that it was a deliberate attempt to steer Malaysia away from a rather pro-Western past, he explained:

> "Whatever you used to do before with the West I think you should also do with the East. That is the Look East policy. And if you have learnt all the bad work ethics of the West before, it is about time you learn some of the good work ethics of the East.... Look East means we should resort to other sources than just the West and this doesn't mean that we are going to give up the West entirely. What is good in the West, we will still follow, but here is a source of ethical values, systems and everything else which are useful to us. So why shouldn't we make a deliberate effort to acquire this from the East?" (*New Straits Times*, July 16, 1982).

Attributing Japan's success to three main factors – work ethics, management system (incorporating a belief in group achievement) and technology – the Premier explicated further that "Looking East means we are also looking towards what we consider – and what the whole world now considers – as the best technology. If we are going to learn, we should learn from people who are the best in the field." (*New Straits Times*, July 28, 1982). The idea, then, is to complement and 'borrow', but what is this very special work ethic that Malaysians should strive to emulate?... (The Japanese) willingness to work very, very hard, to be dedicated, to be loyal, to apply themselves fully to whatever it is that they are faced with. This is the most important single item that contributed not only to their recovery but eventually to their tremendous progress." Linked to this work ethic is the notion of group achievement, which is supposedly the antithesis of the Western stress on individual achievement:

> "We feel the Japanese dedication and Japanese belief in group achievement, rather than personal achievement, is good for us to emulate..... Because it is a group approach, most of the people would be committed to it, rather than just the head or the manager. This kind of management could be applied not to just the private sector, but also the government sector. If we can get this kind of management system we would be more likely to succeed."

Finally, it should be said that Dr. Mahathir does not want Malaysia "to become a satellite of the Japanese or an ally of the Japanese or anything like that. We are just going to learn from them. Of course, in the process, we must appear to be closer together."

Japanese Hegemony and Limits to ASEAN's Growth

Over the last decade, the highly successful penetration of Japanese transnational corporate interests in ASEAN has turned it into a veritable captive market and a reliable source of raw materials for Japan. In this sense, Looking East is already a *fait accompli* and its pursuit would only further buttress

Japan's predominant role in the region and ASEAN's continued subordination as an economic hinterland of Japan.

Indeed, it has already been suggested that Japan's "war-time vision of a Greater East Asia Co-Prosperity Sphere is now a peace-time reality." (Constantino, 1979: 21). While not all may agree with the broad sweep of this generalization, for ASEAN at least, Japan is now undisputably the single most important external economic 'partner' of the region, cornering about 30% of ASEAN exports and 20% of its imports, or a total trade of around 25%. (The United States has fallen to second place with 17%). ASEAN's most Japanese-dependent state, Indonesia, relies on Japan for as much as 43% of total trade, and over 50% of exports. Malaysia ranks second with the Philippines at a far from immodest figure of 23% of total trade (*Asia 1982 Yearbook:* pp. 10-11).

Thus in market terms, Japan has penetrated ASEAN to an extent that has become virtually indispensable to ASEAN, although the converse is by no means true. Nevertheless, it is a mark of ASEAN's growing importance to Japan that it claimed about 10% (US$15.2 billion) of Japanese exports in 1981. One may argue that an interdependent or symbiotic relation of sorts has resulted, but a closer examination of the composition of this trade, in terms of the kind of goods traded, reveals which way the balance tilts. Moreover, Japanese market imperatives also become transparent when one examines the composition of trade. Japan generally consumes ASEAN's natural resources and semi-finished products while it sells capital goods, machinery and vehicles to ASEAN. For example, Japan consumed 30% of Malaysian mineral products and 49% of Malaysian wood and paper, while its chief exports to Malaysia were machinery (31%), vehicles (28%) and base metals, or articles of base metals (19%). (Chew and Thambipillai, 1981: 160). With the exceptions of Indonesia and Malaysia which are surplus oil producers, the rest of ASEAN suffers an overall trade deficit with Japan.

However, trade is but one aspect of ASEAN's general dependence on Japan, two other closely related areas being aid and investment. The three as an Indonesian technocrat has suggested, are like "three cards in one hand". (Weinstein, 1976: 379). The cards have been dealt with varying impact historically. Aid by way of war reparations was the vehicle of penetration in the immediate post World War II period of the 1950's and 1960's. It was rapidly surpassed by trade as Japan overtook the United States and the European states as chief trading partner of ASEAN by the early 1970's, as pointed out earlier. Today, "aid" still has an important supplementary function, but one must be forewarned about its procrustean definition and use by developed countries like Japan. Low by world standards, Japanese official development assistance (ODA) peaked in 1974 at 0.24% of its GNP, but fell to 0.23%, 0.20% and 0.21% in subsequent years, but seems to have reached a new peak in 1979 (0.26%) and 1980 (0.32%) (*Asia 1982 Yearbook:* p. 62). Rather than through ODA, aid is more likely to be channelled today through such developed-world dominated bodies as the International

Monetary Fund, World Bank and, especially for Japan, the Manila-based Asian Development Bank of which Japan is the top contributor with US$1.3 billion as of December 1980 (*Asia 1982 Yearbook*: p. 60). ASEAN's share of ADB aid from 1968 to August 1981 was US$4.1 billion, of which Malaysia's share totalled US$619 million. (Jose, 1982: 41).

Surpassing aid in importance by far are rapidly rising levels of Japanese direct investment in carefully selected industries along the new international division of labour.[4] An examination of cumulative Japanese direct investment in ASEAN over the period 1951 to 1979 shows that ASEAN with 19% of Japan's total investment ranks only second to North America as a repository of Japanese overseas capital. Indonesia should be singled out for mention as its share comprises an inordinately large 64% of the ASEAN total, or a hefty 12% of Japan's world total. Malaysia's share of this is 1.6%. The most significant type of investment in ASEAN is in mining (45%), followed by textiles (39%), of which Indonesia takes the lion's share in both, with Thailand featuring significantly in textiles (Chew and Thambipillai, 1981: 164-165). Typically then, Japan invests in industries that tap natural resources or in manufacturing industries which can exploit cheap ASEAN labour.

Thus, the pattern of Japanese trade, aid and investment in ASEAN reveals an overall Japanese strategy of penetration in the region which generates ever greater economic dependence of ASEAN on Japan. The fact too is that the ASEAN countries, including Malaysia, have already turned to Japan for at least a decade during which Japan had rapidly established its economic hegemony over the region vis-a-vis other major economic blocs.

It is further suggested that the role of Japan in the region and its economic imperatives as the premier capitalist power drastically precludes any thorough-going attempt by ASEAN states to follow the Japanese path to success, assuming that the Japanese experience is relevant in the first place. While ASEAN as a whole, given its economic growth performance, could aspire to NIC or "semi-peripheral" status[5], it is highly unlikely that all the ASEAN states, with their economic variation, could become like Japan without a drastic dimunition of Japanese economic hegemony in the region. Frank (1982) recently pointed out the fallacy of the bulk of Third World aspirations for semi-peripheral or NIC status in the contemporary global system:

> "The general limitation is that export-led growth by a few small countries and the absorption of their exports by the rest of the world is one thing; the generalisation of the same export-led growth to that same rest of the

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4. Essentially, this entails specialisation in control over capital, technology and innovation processes and the most advanced production by developed countries such as Japan, and the standardized and routinized production in the developing areas for both the domestic and world market. See F.H. Cardoso (1973).
5. This concept is suggested by Immanuel Wallerstein (1974).

world (which would export to whom?) is another matter. Consider the prospects and problems of Hongkong and Taiwan-style exports on a Chinese or Indian, let alone Third World scale!"

He furthermore demolishes the myth that development in specific Third World countries can follow, out of historical context, the pattern of the supposedly successful cases of the past:

"The sheer impossibility of such a model is intuitively clear.... particular growth experience, such as that of the NICs, that of post-war Europe and Japan, or indeed of the industrial revolution itself, cannot be generalised to the rest of the world. Precisely because they took place where and when they did, by definition they prevented the rest of the world from doing the same."

Conceivably in the very long-term, the contradictions of the present world order may work against currently hegemonic powers like Japan in favour of particular Third World groupings, but such changes will not occur because of policies of emulation like 'looking East'. On the contrary, fundamental structural changes will only take place because Third World groupings delink themselves effectively from hegemonic blocs without sacrificing their own bases for growth. Japan's own historical development may be said to be premised on such a strategy.

The Character of Japanese Investment in Malaysia

It will be appropriate at this juncture to examine in some detail the character of Japanese investments in Malaysia to draw out its implications for the Look East policy.

Japanese investment in Malaysia, like that of other industrialized economies, has contributed to and benefited from both the import-substitution (IS) and export-orientation (EO) phases of Malaysia's development. In terms of cumulative Japanese direct investment, Malaysia's share of US$506 million from 1951 to 1979 represents only 8.3 percent of ASEAN's considerable 19.2 percent total Japanese investment abroad, as shown in Table I.

If we examine Japanese investment from the Malaysian perspective, a sharper and different image emerges. Since 1981, Japan has become the largest foreign investor, with a total investment of reportedly $1.6 billion (*New Straits Times*, 12 March 1983). Statistics on foreign investors in 1981 show Japan surpassing Singapore with a contribution of $67.1 million, which represents involvement in 45 projects, the largest number for any foreign investor, with a potential employment of 5,386 persons (Table 2).

On examining Japanese direct investment abroad by industries, cumulated up to 1977, the overall pattern seems to show strong concentrations in mining, manufacturing and commerce. (Table 3). Japanese investment in ASEAN, for example, shows a heavy concentration in mining and textiles manufacturing. Thus, a closer look at Japanese investment in Malaysia by industry reveals that manufacturing on the whole is highly significant, with textile, chemicals, lumbering and pulp, and electrical machinery particularly

prominent, in that order of importance. Investment in mining is by no means insignificant; indeed, it exceeds the value of each of the manufacturing industries mentioned.

A more detailed examination of Japanese investment in manufacturing industries at the end of 1980 (Table 4), serves to elaborate this pattern and indicates the past and present emphases of Japanese investment in Malaysia. A strong interest in textiles and textile products and in electrical and electronic products, with investment totals of $370 million and $231 million respectively, emerges. This corresponds to the pattern of Japanese investment in other newly industrialising countries (Yoshihara, 1976:53). The next largest investment at $121 million is in non-metallic mineral products, which consists chiefly of cement (MIDA, 1982:25). The concentration in the first two industries shows that Japanese investment strategy has responded well to Malaysia's shift to export-oriented industrial development.

TABLE I: JAPANESE DIRECT OVERSEAS INVESTMENT BY COUNTRY AND REGION

(US$ Million)

	1979		Cumulative Total Form FY 1951 to FY 1979	
	Value	Percentage of Total Value	Value	Percentage of Total Value
ASEAN	595	11.9	6,094	19.2
Indonesia	150	3.0	3,888	12.2
Malaysia	33	0.7	506	1.6
Philippines	102	2.0	537	1.7
Singapore	255	5.1	800	2.5
Thailand	55	1.1	363	1.1
Other parts of Asia	381	7.6	2,549	8.0
Near & Middle East	130	2.6	2,101	6.6
Europe	495	9.9	3,893	12.2
Africa	168	3.4	1,306	4.1
Oceania	582	11.6	2,078	6.5
North America	1,438	28.8	8,202	25.8
Central & South America	1,207	24.2	5,580	17.5
TOTAL	4,995	100.0	31,804	100.0

Source: Ministry of International Trade and Industry, Japan MITI Information Office, 1980.

TABLE 2: SOURCES OF FOREIGN EQUITY IN APPROVED PROJECTS, 1980 & 1981: SELECTED COUNTRIES

Country	No. of Approvals		Potential Employment		Foreign Equity Capital (M$)	
	1980	1981	1980	1981	1980	1981
Australia	15	24	710	2,610	4,022,800	57,869,574
Canada	5	–	495	–	13,688,261	–
Germany	11	18	2,962	2,734	11,133,276	27,552,040
Hong Kong	25	28	4,173	5,595	3,837,650	35,095,585
India	6	12	269	939	2,470,583	11,436,700
Japan	35	45	5,298	5,386	35,654,500	69,131,940
Singapore	63	74	6,349	6,089	53,796,380	42,589,086
Switzerland	5	2	1,666	255	12,560,000	380,000
Taiwan	17	17	1,537	1,357	9,898,891	8,274,822
United Kingdom	23	39	1,940	2,715	15,723,700	33,983,050
U.S.A.	56	38	4,494	7,091	21,836,500	47,033,500

Source: MIDA 1982 p. 24

TABLE 3: JAPANESE DIRECT INVESTMENT BY INDUSTRY IN MALAYSIA & ASEAN (ACCUMULATED TO THE END OF FY 1977)

(US$ Million)

	Malaysia	ASEAN	World	ASEAN/ World
Agriculture & Fisheries	17	163	558	29.2
Mining	104	2,397	6,311	45.1
Manufacturing Industries	268	1,614	7,139	22.6
Foodstuffs	13	88	363	24.2
Textiles	77	505	1,285	39.3
Lumbering & Pulp	41	106	627	16.9
Chemicals	57	167	1,369	12.2
Iron & Non-ferrous Metals	25	206	1,051	19.6
General Machinery	3	54	513	10.5
Electrical Machinery	32	107	848	12.6
Transport Equipment	4	142	538	26.4
Others	16	236	545	43.3
Commerce & Others	30	374	7,856	4.7
Real Estate & Branch Offices	5	34	1,347	2.5
TOTAL	425	4,581	22,211	20.6

Source: Ministry of International Trade and Industry, Japan, 1978.

The two industries mentioned are those in which the Japanese have demonstrated technological superiority over other investors. Thus, the largest Japanese manufacturing concerns to date have been the textile companies, Penfabric and Penfibre, located in the Prai free trade zone, with paid-up capital of $80 million and $70 million respectively. The fairly strong interest

TABLE 4: JAPANESE FOREIGN INVESTMENT BY INDUSTRY, 1980

(M$'000)

Type of Activity	Paid-up Capital	Loan Capital	Fixed Assets	Total
Food Manufacturing	37,710	6,937	34,323	78,970
Beverages & Tobacco	–	–	–	–
Textiles & Textile Products	173,241	20,842	176,096	370,179
Leather & Leather Products	–	–	–	–
Wood & Wood Products	17,125	28,196	28,784	74,105
Furniture & Fixtures	1,360	–	3,706	5,066
Paper, Printing & Publishing	780	–	466	1,246
Chemicals & Chemical Products	9,235	6,139	11,129	26,503
Petroleum & Coal	–	–	–	–
Rubber Products	3,894	–	4,484	8,378
Plastic Products	4,890	1,800	7,996	14,686
Non-metallic Mineral Products	14,783	83,911	22,619	121,313
Basic Metal Products	28,310	7,945	29,965	66,220
Fabricated Metal Products	10,608	5,936	13,480	30,024
Machinery Manufacturing	19,762	–	22,512	42,274
Electrical & Electronic Products	76,680	7,401	147,594	231,675
Transport Equipment	13,390	–	13,924	27,314
Professional, Scientific & Measuring Equipment	2,000	–	2,661	4,661
Miscellaneous	8,465	2,148	14,908	25,521
Hotels & Tourist Complexes	2,720	–	2,288	5,008
TOTAL	424,953	171,255	536,935	1,133,143

Source: MIDA 1982, pp. 70-79

TABLE 5: JAPANESE COMPANIES IN MALAYSIA BY TYPE OF INVESTMENT AND TIME OF ESTABLISHMENT

Type of Company	Before 1970	%	After 1970	%	Year Not Known	%	Total	%
Manufacturing	44	28.6	107	69.5	3	1.9	154	46.8
Mining	3	42.9	3	42.9	1	14.3	7	2.1
Trading and Commerce	24	28.9	40	48.2	19	22.9	83	25.2
Finance and Insurance	2	12.5	14	87.5	0	0	16	4.9
Construction and Engineering	0	0	26	86.7	4	13.3	30	9.1
Miscellaneous	2	12.5	12	75.0	2	12.5	16	4.9
Affiliated	0	0	7	30.4	16	69.6	23	7.0
TOTAL	75	–	209	–	45	–	329	100.0
PERCENTAGE	22.8	–	63.5	–	13.7	–	100.0	–

Source: Computed from a listing of Japanese Related Companies in Malaysia compiled by the Japanese External Trade Organization, Kuala Lumpur, April 1980. (Hereafter cited as JETRO List)

in wood and wood products ($74 million) and in basic metal products ($66 million) should also be noted. In the former case, Malaysia's abundant timber resources explains this interest in a largely export-oriented industry, while in the other case, Japan's prowess in steel technology has been used to site a highly polluting industry outside Japan while simultaneously enjoying a heavily protected captive host-country market. One of the early large Japanese investments in Malaysia was in the Malayawata Steel Company, formed in 1961 with a paid-up capital of $39 million.

We should also note that the largest single investment project in which the Japanese have been involved is the Malaysian Liquefied Natural Gas (LNG) project at Bintulu, Sarawak. A joint venture involving Petronas, Mitsubishi and Shell, it has a paid-up capital of $330 million. Under the terms of contract, the LNG produced will be committed to Japan for the next 20 years.

THE IMPACT OF JAPANESE INVESTMENT

Early Involvement

Japanese investment did not make significant inroads into Malaysia before 1970. With the exception of the Malayawata Steel Company (formed in 1961), by 1962, there were only eight Japanese joint ventures with an average paid-up capital of $3.5 million, most of which were involved in resource exploitation and import-substitution activities. By 1967, the number was still low at 37, and by 1969, it climbed cautiously to 46 (Chee Peng Lim and Lee Poh Ping, 1979: 5-6). Table 5 shows this pattern rather distinctly. Of the total of 329 companies, 209 or 63.5 percent were formed after 1970. All the construction and engineering companies were established after 1970, and as for the largest category, manufacturing, 69.5 percent were established after that date.

The slow and cautious involvement of the Japanese was primarily due to lingering anti-Japanese sentiments stemming from the Japanese Occupation during the Second World War, but more specifically on account of the unresolved reparations and "blood debt" issues. The matter was more or less settled with the donation of two ships to the Malaysian International Shipping Corporation. The upsurge of investment from 1970 was probably due to the institutionalization of a host of investment incentives to attract foreign capital, promoted by the Federal Industrial Development Authority (FIDA) from 1967, embodied in the Investment Incentives Act of 1968 and enhanced by new labour legislation in late 1969 and the stability promised by the re-organized and strengthened post – May 1969 government.

Investment Incentives

Malaysia compares exceedingly well with other developing countries in terms of fiscal and other incentives to foreign investors. Pioneer status is given to companies intending to produce goods not already manufactured on a commercial scale in Malaysia. Companies enjoying this are exempt

from 40 percent company tax and 5 percent development tax with a tax holiday period of 2 to 5 years, which can be extended to a maximum of 8 years. Investment Tax Credit up to 25 percent is granted to companies for location, priority products and local content, while Labour Utilisation Relief, which is similar to pioneer status, is granted according to the number of employees. Others include location incentives (up to 10 years), export incentives (for those manufacturing for the export market), accelerated depreciation allowances, deduction for promotion expenses overseas, increased capital allowance, hotel incentives and special incentives for agricultural industries (Treasury, 1982: 183-6). In terms of physical facilities, the government currently offers some 50 industrial estates and 14 Free Trade Zones scattered throughout the country.

Japanese companies have naturally taken advantage of these investment incentives and facilities. Of the 154 companies listed in the 1980 JETRO list, 31.8 percent still enjoy pioneer status, while the total percentage of all companies known to have received incentives amounts to 78 percent in contrast to only 22 percent which have not received any incentives at all (Table 6). The rather large category of 31 companies with unknown or unspecified incentives reflects the variety of obscure incentives mentioned above. This supports the evidence cited in an earlier study (Chee Peng Lim and Lee Poh Ping, 1979: 8), which found 80 companies out of a total of 158 enjoying some form of incentives in 1978.

Forms of Investment

It is well established that the predominant form of foreign investment in Malaysia is the joint venture, particularly after 1970. Thus, for the period

TABLE 6: INVESTMENT INCENTIVES ENJOYED BY JAPANESE MANUFACTURING COMPANIES IN MALAYSIA

Incentive	No. of Companies	Percentage
Pioneer Status	49	31.8
Investment Tax Credit	3	1.9
Labour Utilization Relief	1	0.7
Incentive Period Ended	36	23.4
Incentive Not Known or Not Specified	31	20.1
No Incentive	34	22.1
TOTAL	154	100.0

Source: Calculated from JETRO List.

1971-79, of the 1,577 projects approved by the government for the manufacturing sector, only 8 percent were wholly-foreign owned, while 92 percent were joint ventures (Kulasingam and Tan Siew Ee, 1982: 22). Table 7, which shows Japan topping foreign investors in the number of projects and equity, also indicates an 88 percent Japanese preference for joint ventures compared to 12 percent for wholly-owned projects. In fact, Japanese companies not only prefer joint ventures but are apparently quite willing to be subjected to minority equity participation. This difference, compared with American corporations, is well documented. Kulasingam and Tan (1982: 25) point out that, as of 1979, of all the firms with U.S. participation in Malaysia, nearly 75 percent were American-controlled. In sharp contrast, about three-fifths of Japanese-associated firms had equity participation of less than 50 percent, while a hundred percent equity participation was limited to only 13 percent of the Japanese firms.

The rise of joint-ventures as the most important form of foreign investment can be directly linked to Malaysia's New Economic Policy (NEP). A general rule is that companies producing for the domestic market are required to have at least 51 percent Malaysian equity. Other guidelines – pointed out by Chee and Lee (1979: 20) – include the following: industries utilizing important non-renewable resources, particularly at the primary processing and extracting level, were required to have 70 percent Malaysian, including 30 percent Bumiputra equity, while industries manufacturing primarily for the export market were allowed foreign majority equity.

Japanese companies do not appear particularly perturbed by the joint-venture form of participation, or even by Malaysian-majority equity probably because effective control does not necessarily require majority equity. According to Weinstein (1976: 389) Japanese firms in Southeast Asia are indeed notorious for their use of "Ali Baba" or dummy shareholding tactics to overcome majority equity. (He cites the case of an Indonesian general involved in numerous Japanese joint-ventures, whose "capital" contribution was his ability to see the President at a day's notice). Japanese lack of preference in Malaysia for majority-equity participation suggests that they are probably able to achieve control by other means.

Various forms of effective or ultimate control by foreign investors have been achieved by means of devices such as management contracts, technical and licensing agreements, trade marks, patent rights and turnkey operations. A statistical analysis for the period 1970-79, by Kulasingam and Tan Siew Ee (1982), found Japanese firms employing all the devices mentioned above. Japan, with 32 percent, was, in fact, the major source of technical and licensing agreements for Malaysian firms. Not surprisingly, in the electrical and electronic industry, it accounted for 43 percent of agreements signed. The other areas where Malaysian firms were with involved such Japanese technology were chemicals and chemical products, basic metals, textiles, pulp and paper products, non-metallic mineral products and scientific instruments. In management contracts, the Japanese – with 13 percent

TABLE 7: SELECTED FOREIGN INVESTMENT STATISTICS BY SELECTED COUNTRIES, 1971-79

Items	USA	UK	Hong Kong	Japan	Australia	Singapore	Germany	Total
No. of Projects	127	154	259	287	98	421	76	1,577
Proposed Equity ($ million)	138	212	161	392	65	124	70	1,385
Percentage of Export Oriented Projects	57	26	37	44	24	18	55	34
Wholly-foreign Owned Projects	47 (37%)	6 (4%)	4 (2%)	34 (12%)	2 (2%)	4 (11%)	13 (17%)	121 (8%)
Joint Ventures	80 (63%)	148 (96%)	255 (98%)	253 (88%)	96 (98%)	417 (99%)	63 (83%)	1,460 (92%)

Source: MIDA, cited in Kulasingam and Tan Siew Ee (1982:23)

– were slightly behind the Americans with 16 percent. Though the U.S. was the main source for patents and trade marks, more than 50 percent of engineering services and turnkey operations involved Japanese firms, mainly in the chemical, textiles and electrical and electronic industries (Kulasingam and Tan, 1982: 49-51).

Location, Size and Activity

An earlier study (Chee Peng Lim and Lee Poh Ping, 1979) has found that in spite of Malaysian government's efforts to attract foreign investors to the less developed States of Perlis, Kedah, Trengganu and Kelantan, Japanese companies were predominantly located in the developed States and major towns. Our findings corroborate this pattern of location. Table 8 shows that Federal Territory, Selangor and Penang had 87, 71 and 45 Japanese companies respectively, or about 62 percent of the total. For manufacturing

TABLE 8: DISTRIBUTION OF JAPANESE COMPANIES BY STATE

State	All Companies (%)	Manufacturing Companies (%)
Federal Territory	87 (26.4)	8(5.2)
Selangor	71 (21.6)	52 (33.8)
Penang	45 (13.7)	31 (20.1)
Sabah	39 (11.9)	5 (3.2)
Johore	24 (7.3)	19 (12.3)
Sarawak	18 (5.5)	5 (3.2)
Perak	17 (5.2)	11 (7.1)
Trengganu	7 (2.1)	6 (3.9)
Kedah	5 (1.5)	5 (3.2)
Negri Sembilan	4 (1.2)	3 (1.9)
Malacca	4 (1.2)	4 (2.6)
Pahang	3 (0.9)	1 (0.6)
Kelantan	3 (0.9)	3 (1.9)
Perlis	1 (0.3)	1 (0.6)
Singapore-Based	1 (0.3)	–
TOTAL	329 (100.0)	154 (100.0)

companies, Selangor, Penang and Johore – all West Coast States – dominated with 52, 31 and 19 respectively, or 66 percent of the total. When Japanese companies are examined in terms of location in state capitals and major towns, Free Trade Zones, and smaller towns (Table 9), the strong concentration in the first category reinforces the observation about the tendency to be located in the more developed parts of the country. The 20 companies located in the FTZs are in fact all manufacturing firms. Their relatively smaller, though not insignificant number suggests two possible explanations. First, and more obviously, that a large number of Japanese companies are in the non-manufacturing sectors, namely trading and commerce, finance and insurance, construction and engineering and others. The 154 manufacturing firms constitute less than 50 percent of all Japanese firms (Table 5). The second explanation is that import-substitution activity probably still comprises an enduring and large component of Japanese investment activity in Malaysia.

We may tentatively surmise, from the analysis of the location of Japanese companies in Malaysia that government objectives of spreading development to the poorest states and less developed areas have not been satisfactorily met by Japanese investment. The tendency to concentrate in developed States and major towns shows that infrastructural facilities and other advantages are still generally more important to Japanese transnationals than are the benefits of locational incentives. As such, Japanese investments have had the tendency to further exacerbate patterns of uneven and unequal regional growth within Malaysia.

The size of Japanese companies may be adduced from the number of employees and the amount of paid-up capital. The two, however, are not necessarily positively correlated as we have found from the JETRO list. There are some companies with token paid-up capital as low as $3, which nevertheless have respectably large operations. (In order to exclude bias stemming from such token paid-up capital, any sum less than 3 digits has

TABLE 9: DISTRIBUTION OF JAPANESE COMPANIES BY LOCATION

	All Companies (%)	Manufacturing Companies (%)
Capitals and Major Towns	217 (66.0)	79 (51.3)
Free Trade Zones	20 (6.1)	20 (13.0)
Others	92 (28.0)	55 (35.7)
TOTAL	329 (100.0)	154 (100.0)

Source: Computed from JETRO List.

been excluded from the calculation of this variable). First, going by the number of employees, Japanese firms are small by most standards. Table 10 shows that about 45 percent of Japanese companies employ less than 50 workers or slightly over 50 percent employ less than 75 persons among 257 companies. Only 13.6 percent of the companies employ more than 500 workers. There was one company with 4 workers and 2 companies with 7 workers at the low end, while at the high end, the largest company employs 2,769 workers. It is interesting to note that 1978 data suggested employment of 3,000 workers for that same company, Pentex Sdn Bhd. (Chee and Lee, 1979: 16). On the whole, however, the firms surveyed in 1980 reflect a slightly better performance compared to 1978. The employment contribution of Japanese companies is nevertheless far from spectacular, if not well below expectations, given their heavy involvement in the (labour-intensive) textiles and electronics industries.

Table 11 refers to the paid-up capital of manufacturing companies. Over 75 percent, or 116 companies, have paid-up capital of at least $1 million. The largest group (27 percent) was in the $1-3 million category. The majority of firms with low paid-up capital were in trading and services (not included in the table). The smallest company (excluding the ones with token paid-up sums) had a capital of $10,000 while the largest – the Malaysian LNG Complex at Bintulu – had a paid-up sum of $330 million. The largest textile firms were Penfabric and Penfibre, with paid-up capital of $80 million and $70 million respectively. Malayawata topped steelworks with almost $39 million, while in finance, the Bank of Tokyo headed the list with about $74 million. Penfabric employed 1,389, Malayawata, 1,501 and The Bank of Tokyo, 152 employees. The largest employer, Pentex, had a paid-up capital of $20 million, demonstrating that there is no necessary correspondence between size in terms of employment and capital.

An examination of paid-up capital categories within and among manufacturing industries reveal some interesting findings. Textiles and Textile Products account for eight or 38.1 percent of companies of $10 million and above. Food manufacturing, ranks second, with three cases, in this category. They are palm oil-based food products and the third is Ajinomoto (M) Bhd. The electronic companies are bunched in the $1-10 million category.

While the vast majority of Japanese companies in Malaysia are small in terms of number of employees, the large majority are big in terms of paid-up capital, at least by Malaysian standards. This relationship clearly shows that paid-up capital, which in our statistics includes the contribution of local partners (including government), does not correspond to employment generated, a primary concern of Malaysian development strategy.

Finally, an examination of Japanese companies by the number of years since establishment shows that as many as 149 or 45 percent of the total had been around for 10 years (Table 12). Combined with the younger group (of 1-5 years), comprising 62 or 18.8 percent of the total, these 1-10 year olds represented the vast majority of Japanese companies. Since the reference

TABLE 10: JAPANESE COMPANIES BY TYPE AND EMPLOYMENT SIZE

(No. of Employees)

Type	Less than 25	25-49	50-74	75-99	100-299	250-499	500-999	1,000 above	Total
Manufacturing	11 (8.0)	10 (7.9)	9 (6.6)	18 (13.1)	40 (29.2)	20 (14.6)	18 (13.0)	11 (8.0)	137
Mining	1 (16.7)	2 (33.3)	–	–	2 (16.7)	–	–	1 (33.3)	6
Trading and Commerce	42 (71.1)	10 (17.0)	3 (5.1)	–	4 (6.8)	–	–	–	59
Finance and Insurance	6 (40.0)	6 (40.0)	2 (13.3)	–	1 (6.7)	–	–	–	15
Construction and Engineering	14 (66.6)	1 (4.8)	–	–	1 (4.8)	2 (9.5)	1 (4.8)	2 (9.5)	21
Miscellaneous	8 (57.2)	2 (14.3)	2 (14.3)	–	1 (7.1)	–	1 (7.1)	–	14
Affiliated	–	2 (40.0)	–	–	2 (40.0)	–	1 (20.0)	–	5
TOTAL	82	33	16	18	51	22	21	14	257
%	31.9	12.8	6.2	7.0	19.9	8.6	8.2	5.4	100.0

Source: Computed from JETRO List. (Figures in brackets refer to row percentages).

Note: 72 companies were excluded since no information was given for employment size.

TABLE 11: PAID-UP CAPITAL OF JAPANESE COMPANIES BY MANUFACTURING INDUSTRY

Manufacturing Industry	Less than 250	250-499	500-999 ($'000)	1,000-2,999	3,000-4,999	5,000-9,999	10,000 & above	N.A.	Total	% ($'000)
Food Manufacturing	2 (14.3)	1 (10.0)	1 (7.1)	5 (11.9)	1 (4.0)	0 (0.0)	3 (14.3)	1 (14.3)	14	8.1
Textiles and Textile Products	0 (0)	1 (10.0)	2 (14.3)	1 (2.4)	3 (12.0)	4 (19.0)	8 (38.1)	1 (14.3)	20	13.0
Leather and Leather Products	1 (7.1)	0 (0)	0 (0)	0 (0)	0 (0)	1 (4.8)	0 (0)	0 (0)	2	1.3
Wood and Wood Products	0 (0)	0 (0)	0 (0)	1 (2.4)	0 (0)	0 (0)	0 (0)	0 (0)	24	15.6
Paper, Printing and Publishing	6 (42.9)	1 (10.0)	1 (7.1)	8 (19.0)	1 (4.0)	3 (14.3)	0 (0)	4 (57.1)	1	0.6
Chemical and Chemical Products	2 (14.3)	1 (10.0)	1 (7.1)	3 (7.1)	3 (12.0)	2 (9.5)	0 (0)	0 (0)	12	7.8
Petroleum and Coal	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	1 (4.8)	0 (0)	1	0.6
Rubber Products	1 (7.1)	1 (10.0)	1 (7.1)	2 (4.8)	1 (4.0)	0 (0)	0 (0)	0 (0)	6	3.9
Plastic Products	1 (7.1)	0 (0)	1 (7.1)	1 (2.4)	1 (4.0)	0 (0)	1 (4.8)	0 (0)	5	3.2
Non-metallic Products	0 (0)	0 (0)	0 (0)	1 (2.4)	0 (0)	0 (0)	0 (0)	0 (0)	1	0.6
Basic Metal Products	0 (0)	1 (10.0)	1 (7.1)	4 (9.5)	0 (0)	2 (9.5)	1 (4.8)	1 (14.3)	10	6.5
Fabricated Metal Products	1 (14.3)	0 (0)	1 (7.1)	1 (2.4)	2 (8.0)	1 (4.8)	1 (4.8)	0 (0)	7	4.5
Machinery	0 (0)	0 (0)	0 (0)	2 (4.8)	0 (0)	0 (0)	0 (0)	0 (0)	2	1.3
Electrical and Electronic Products	0 (0)	3 (30.0)	0 (0)	9 (21.4)	5 (20.0)	7 (33.3)	3 (14.3)	0 (0)	27	17.5
Transport Equipment	0 (0)	0 (0)	0 (0)	3 (7.1)	1 (4.0)	0 (0)	1 (4.8)	0 (0)	5	3.2
Miscellaneous	0 (0)	1 (10.0)	5 (35.7)	1 (2.4)	7 (28.0)	1 (4.8)	2 (9.5)	0 (0)	17	11.0
TOTAL	14	10	14	42	25	21	21	7	154	100.0
%	9.1	6.5	9.1	27.3	16.2	13.6	13.6	4.5	100.0	

Source: Computed from JETRO List. (Figures in brackets refer to column percentages)

Note: Paid-up capital refers to total paid-up capital, including that of Japanese partners.

year is 1980, we may surmise that the great majority of Japanese companies came after the enactment of the Investment Incentives Act (1968) and the promulgation of the NEP in 1970. Trading and commerce account for the largest number (7) in the 21-25 years group and there is only one firm over 26-years-old. This attests to the early importance of the commercial sector. By comparison, construction and engineering companies are newcomers, with 86 percent of companies and below 10 years.

A breakdown of manufacturing companies by the number of years since establishment (Saravanamuttu 1983) discloses that the bulk of electrical and electronic firms (19) and most textile companies (13) were established after 1968. This suggests that export-orientation promotion policies had a definite 'pull' effect on Japanese investment in Malaysia.

In general, Japanese firms in Malaysia are not noted for liberal skill transfer policies. For example, in the recent construction of the $2 billion Bintulu LNG plant during the second half of 1981, more than 5,000 workers (over 45% of the total workforce) were imported from South Korea's Hyundai ostensibly to help the five Japanese construction firms meet their deadlines (*New Straits Times*, July 29, 1982). With Japanese firms virtually monopolising construction tenders in recent years, the same article, rightly inquires ".....whether Malaysians have benefited from this huge influx of foreign enterprise. Has there been any transfer of technology to the Malaysian workers?. . . there is nothing written into any of the contracts of the Koreans or Japanese companies to indicate that there must be a transfer of technology and as such there is no formal training of Malaysian personnel." Questioned about this, a Japanese director could only offer the weak argument that in the normal course of working side by side with foreigners, Malaysians have "picked up sufficient skills". (*New Straits Times*, July 29, 1982).

Yet another newly-incorporated Japanese joint venture, Perwaja Trengganu Sdn. Bhd., will emerge as Malaysia's largest steel plant outstripping the pioneering Malayawata Steel Sdn. Bhd. in Prai, Penang, by providing at least a three-fold increase in productive capacity. The giant project at a cost of $830 million, which when operational will put out 560,000 tons of steel and 80,000 tons of sponge iron, involves the Malaysian HICOM or Heavy Industries Corporation (51%), eight Japanese firms, including Nippon and Mitsubishi (30%) and the Trengganu State Economic Development Corporation (19%). It has been pointed out that:

> "Although the Japanese capital involvement amounts to only 30% of the total investment, they are actually running the show. They provide the technology, machines, technical expertise and even the administration know-how, the latter being rendered only in the company's infant stage." (*New Straits Times*, July 28, 1982).

Here again, such monopolistic behaviour on the part of the Japanese hardly provides opportunities for learning East. Furthermore, it should be pointed out that such plants, which are import-substituting and aimed at Malaysia's

domestic market, serve the overall marketing strategy of Japanese steel multinationals to locate certain production facilities overseas[6] and the Japanese government's desire to site highly polluting steel mills outside Japan.

Simply put, the point is that the *modus operandi* of Japanese firms in Malaysia does not inspire confidence that some of the gains envisaged by the Look East policy – training and transfer of technology – are being promoted by the Japanese themselves. On the contrary, Japanese interests in Malaysia seem to operate on time-honoured business principles of maximising gains and minimising costs and maintaining technological and other advantages as far as necessary and possible.

Finally, something should be said about emulating Japanese and Korean work ethics, a primary pillar of the Look East policy. Few would deny the desirability of a good work ethic inspiring hard work, but it, along with discipline and group loyalty, cannot guarantee equitable development without other important structural-economic prerequisites (Chandra, 1982: 44). Consider, for example, an economic structure that generates various forms of inequality. What would be the rationale of workers increasing their productivity if a large part of the fruit of their labour is siphoned off into the private coffers of others? Furthermore, from the record, Japanese and Korean working habits, management style and tactics abroad are far from exemplary.

In Malaysia, for instance, the South Korean Hyundai Engineering and Construction Co. undertaking the construction of the 5-mile Penang Bridge by 1985 encountered their first work stoppage by the 420 Malaysian workers being trained by them on August 13, 1982.[7] The workers reportedly went on strike over the dismissal of three truck drivers. The testimony of several workers interviewed revealed interesting aspects of Korean management tactics and ethics. One Malaysian charged that "more than 20 others had been similarly dismissed since work started (seven months ago)". An engine driver claimed that the Koreans looked down on the locals and that he had been kicked many times. Others had their allowances cut for no good reason, it was alleged. But the most damning revelation was that the management practised double standards in allowing Korean workers air-conditioned quarters while the Malaysians stayed "eight-in-a-room" without air-conditioning, as admitted by the manager, Mr. Kang Tae In. This case suggests that whatever the merits of Japanese and Korean work ethics as practised in their own countries, there appears to be little of value to emulate from Japanese and Korean company personnel who operate abroad. Indeed, a curious situation arises where would-be emulators are thwarted by the living embodiments of the very models they have chosen to imitate!

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6. Cf. Linda Lim (1980: 3-4) on multinational strategy in taking advantage of both import-substitution and export-orientation in Malaysia.
7. This account is based on reports in *The Star*, August 14, 1982 and *Sunday Star*, August 15, 1982. The workers went back to work after their 24-hour wildcat strike on the assurance that the management would discuss their grievances.

Conclusions

This essay has attempted to point out the weaknesses of the Malaysian Look East Policy in an environment of Japanese economic hegemony. As an anchor for self-sustaining growth and point of departure for delinking Malaysia from its Western moorings, the policy contains laudable objectives. However, the capacity of the Look East policy to derive significant economic mileage with respect to its underlying goals is questionable. Firstly, there are structural limits to potential Malaysian development given Japanese and Western dominance. Secondly, the heavy investment of Japanese companies and their business practices directly impede self-sustaining development for countries like Malaysia. Finally, there is little indication that Japanese firms themselves are providing the impetus for creating the kind of industrial relations sustaining the work ethic and attitudes that the Look East policy seeks to promote.

While the Malaysian government has been somewhat successful in projecting some of its own developmental imperatives on Japanese capital, the latter's own interests and strategy have blended quite well with such shifts as the switch to export-oriented industrialization, often with greater advantage to itself than to the host country. On balance, the returns have tended to be asymmetrically in Japan's favour.

The analysis of the actual impact of Japanese investment – through the activities of Japanese transnational companies in Malaysia – shows that it does in fact contribute to uneven and unequal growth in Malaysia, as evidenced by the preponderant location of Japanese companies in the developed West coast states and major towns. Again, one may surmise that Japanese interests are still greatly attracted to infrastructural and other facilities concentrated in the more developed regions of the country; apparently, locational incentives have yet to make significant impact on Japanese investment site choices. Japanese companies' preponderance in labour-intensive industries, like textiles and electronics, and their interest in resource-based industries also reinforce newly emerging, yet still inequitable global division of labour essentially favouring economies like Japan's. The analysis also shows that Japanese transnationals have not hesitated to take advantage of various fiscal and other incentives accorded by Malaysia but with apparently less than satisfactory reciprocal benefits to the host country. The employment record of Japanese companies also, surprisingly, falls short of expectations, given their keen interest in labour-intensive industries. This reflects significant Japanese investments in non-productive activities, including commerce and financial serivces. Finally, we have found that technological control and dependence, rather than technology transfer, seems to be the result of Japanese participation in joint ventures, management contracts, licensing agreements, turnkey operations and the like.

We may conclude that while Japanese economic activity in general has contributed to Malaysia's growth, particularly in the 1970's, and continues to play a major role today, it has reinforced a dependent relationship which

weighs heavily against the host country. Even should Malaysia succeed in forging a speical relationship with Japan via its Look East policy, the long-term impact of Japanese involvement will be the entrenchment of an endemically unequal relationship predicated upon the international division of labour in the world economy.

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TILTING EAST — THE CONSTRUCTION PROBLEM

Chang Yii Tan

The recent outburst[1] of "frustration and resentment within the Malaysian construction business" at the Look East Policy comes as no surprise. The largest of the Malaysian construction firms have been pitted against international Japanese and Korean construction giants in the fight for multi-million dollar construction project in Malaysia. Though mindful of the need for diplomacy and tact, the two largest building industry associations – the Housing Developers' Association and the Master Builders' Association Malaysia – have nonetheless voiced their discontent at the foreigners; implying an oblique criticism of the Malaysian Government awards of most of its larger construction projects to the foreign firms.

This criticism is certainly not without basis. The Master Builders' Association estimates[2] that between $4 billion to $6 billion worth of construction jobs have been awarded to foreign firms since 1981. In a construction market worth about $6 billion annually this is indeed a very large share. In a separate survey of ongoing projects worth $4.2 billion undertaken by 17 construction firms, Bank Negara found that 8 foreign contractors has secured two-thirds of the total contract value (i.e. worth $2,788 million).[3] The survey also revealed that imports accounted for 28% of building materials and 48% of all machinery and equipment used; also, 12.5% of total payments of contract and professional fees and salaries in the construction industry were expected to be paid foreign consultants and professionals.[4] Hyundai, the principal contractors for the Penang Bridge project, estimated that "30%

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[1] See the paper presented by Senator Kee Yong Wee at the 7th MAJECA/JAMECA Joint Annual Conference, March 1984, reprinted in *Perumahan Housing & Property*, March/April 1984.

[2] *Asian Wall Street Journal.* (AWSJ), 8 March 1984, "Malaysian Builders Hit Japan Dominance".

[3] Bank Negara Malaysia (BNM) *Annual Report 1983.* p. 118.

[4] *Ibid.*

of their materials and most of their heavy machinery and equipment are imported."[5]

The main area of conflict seems to be for the larger construction projects. Table 1 below shows some of these projects. However, Japanese and Korean contractors are also perceived to be trying to win "even comparatively small construction jobs, which they didn't compete for in the past."[6] This probably means that the market for local contractors has been shrinking even further. This is clearly unacceptable to an industry which has experienced significantly high growth rates in the past 14 years.

The construction sector has grown four fold since 1970. Its share of the national output was also increased, from 3.9% (1970) to 5.4% (1984). During 1970-1983, the construction sector's annual growth rate was 9.3% in real terms compared to 7.9% for the Gross Domestic Product (GDP). During 1976-80, the sector grew at 13.1% per annum; during 1981-84, this sector is estimated to have grown at 13.3% per annum. By 1981, there were 4,584 construction firms, providing employment to almost a quarter of a million people. The income generated was $6 billion annually and the fixed assets of all construction firms were valued at almost $1 billion. The estimated annual output of the construction sector was valued at $1.94 billion in 1984.[7]

The high growth observed in the seventies and early eighties was primarily a result of the Malaysian government's stated objectives and plans. The high development expenditure allocations under the *Third Malaysia Plan* and in the early 2 years of the *Fouth Malaysia Plan* provided the impetus to the construction sector. The concept of a house owning democracy and the concomitant generous government housing loan allocations for civil servants created a huge demand for most categories of housing types. Also, the Government's commitment to certain infrastructure development – such as the construction of highways, ports, airports, new townships, etc. has also stimulated the civil engineering and non-residential construction sectors.

The economic crisis of the early eighties has forced the Malaysian Government into an austerity drive. Public development expenditure has been slashed significantly. The most severe cutback was reported in the recent 1984/85 *Economic Report* where public sector construction was cut by 8.5%. Public works expenditure was cut by 7.7% from $1,027 million in 1983 to $984 million. Allocations for development within the Education, Defense, Health, and Home Affairs Ministries were slashed by 16% to $548 million.

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[5] *New Straits Times*, 13 July 1983. "What It Takes To Build Penang Bridge".

[6] *Asian Wall Street Journal*, 8 March 1984.

[7] Bank Negara Malaysia, *Annual Report 1983*, p. 1.

TABLE 1

CONSTRUCTION PROJECTS SECURED BY JAPANESE AND KOREAN COMPANIES

Project		Foreign Construction Companies
Dayabumi	(J)	Takenaka Komuten & Kumagai Gumi
UMNO Headquarters	(J)	Takenaka Komuten, Kumagai Gumi, Shimizu and Konsetsu
Permodalan Nasional Berhad Headquarters	(J)	Shimizu Kenetsu
UBN/Shangrila Hotel	(J)	Taisei Kensetsu
Employees Provident Fund Headquarters	(J)	Taisei Kensetsu
PKNS Low-cost Housing	(J)	Hazamagumi, Taisei Kensetsu
Urban Development Authority Bukit Nanas	(J)	Taisei-Marubeni
Penang Bridge	(K)	Hyundai
Maybank 58-storey Headquarters	(K)	Keang Nam/DaeWoo Construction
Kenyir Dam	(K)	Hyundai
Sabah Natural Gas Project	(K)	Daelim
Prefabricated houses Pahang/ KL housing parts	(K)	Samick
Resins project, Pahang	(K)	Young Dong

Source: *Star*, 27 March 1984, "Nightmare for Local Builders"; and *Far Eastern Economic Review*, 14 June 1984, Seoul builds bridges".

(J) Japanese main contractor

(K) Korean main contractor

However, the government increased development expenditure allocations to the National Electricity Board (LLN) and the Telecoms Department. Off-Budget Agency investments were also not cut. Additional incentives have also been offered for hotel construction.

1984 saw a 48% reduction in demand for medium and high cost houses and the emerging glut of office and commercial space. In the Federal Territory, the private residential construction sector suffered a 9.5% decline in 1983 and a further 20% drop in 1984. There has also been a drop in housing permits issued and the number of housing units proposed in 1984.

In 1982, there were an estimated 9 million square feet of office and commercial floorspace in Kuala Lumpur. The proposals of 62 projects for construction between 1983-87 would supply an additional 21 million square feet of office space. Already, rents of office space in the Kuala Lumpur area have begun declining because of the present over supply. The Bank Negera Annual Report cautioned that "prudent banking practice requires . . . a very objective approach in assessing their commitments to property development, including the use of real estate as collateral."[8] There is a large amount of undrawn loan commitment, and as such, the full impact of lending for construction and real estate development on the bank sector has yet to be felt.[9]

Thus, the effects of the recession and the increased penetration of the Japanese and Korean construction firms taking advantage of the Government's Look East policy have undermined the position of the large local contractors. Hence, the latter have no choice but to turn their guns on the foreign firms.

Senator Kee Yong Wee, the President of the Housing Developers' Association, has acknowledged[10] that there have been positive effects from Japanese participation in the construction industry. First, these foreign firms are experienced and efficient, and hence can bring about a significant transfer of technology in building construction and management. Second, because they are linked with giant multinationals, they can provide a financial package which means that their local clients (government-linked) firms included) do not have to immediately mobilise large amounts of capital. Third, these foreign firms have been 'close' to certain key decision makers, and thus have by-passed some bureaucratic red-tape and proceeded without much hassle. Fourth, a little *friendly competition* could help shake local firms out of their complacency. Fifth, labour training is supposed to be provided and

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[8] BNM, *Annual Report 1983*, p. 22.

[9] By 1983, 30% of all new commercial loans were given to the construction and real estate development sector, *ibid.*

[10] *Perumahan Housing and Property*, March/April 1984.

this should *enhance labour skills* in the construction industry. These seem to provide the rationale for foreign participation.

The reality of the situation, the Master Builders' Association retorted,[11], was quite different. First, actual transfer of technology is minimal because local professionals are not operating in top management positions, and hence skill and knowledge at the planning and design stage is absent. Second, local concerns and a well-organised multinational firms are not on equal footing as far as competition is concerned.[12] Third, foreign firms try to use and import as much foreign equipment and materials as possible, and this takes away potential business for local suppliers, results in a larger ourflow of foreign exchange, and hence exacerbates the deficit in the service account. Fourth, in a recessionary situation, the competition will eliminate many local construction companies while saving the successful foreign ones. Fifth, skilled labour is largely imported, while actual training only has minimal positive efforts. In fact, unskilled and semi-skilled labour form the major component of local content. Local labourers are discriminated against as far as wages and working condition are concerned.[13] Sixth, foreign exchange is also lost in several ways – through professional and consultancy fees, repatriated profits and also transfer pricing.[14]

Mr. Choo Yoon Seong, a Vice-President of the Master Builders' Association, has added that an unhealthy dependence on foreign contractors will result if foreign contractors squeezed out too many local contractors.[15] He speculated that the foreign contractors are in Malaysia because of the recession.

There seems to be some truth to this speculation. In 1983, up till November, banks provided US$5.8 billion worth of payment guarantees to South Korean construction firms operating outside of South Korea. Foreign loans to South Korean firms total US$3.7 million.[16] Most of these financially trouble companies were working on Middle East projects. Of the 62 contractors, 18 of them had no new jobs.[17] That may perhaps be the reason for their

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[11] *Perumahan Housing and Property*, September/October 1983.

[12] In the case of Dayabumi, another joint venture company quoted $71 million less than the successful bidder but nonetheless did not get the contract.

[13] *New Straits Times*, 13 July 1983. The Overseas Construction Association estimates that non-Koreans working in Korean firms outside Korea get only ½ the wages of a Korean worker, but have a productivity level of at least 80% the Korean level. See *Malaysian Business*, 1 April 1984, "South Korea Construction Companies in Trouble".

[14] *Star*, 27/2/84; see also Lin See Yan "Malaysia – Japan Trade Revisited" MAJECA – JAMECA 7th Joint Annual Conference, Kuala Lumpur, 5-6 March 1984.

[15] *Perumahan Housing and Property*, Sept./Oct. 1983.

[16] *Malaysian Business*, 1 April 1984, "South Korean Construction Companies in Trouble".

[17] *Ibid.*

readiness to underbid in the Malaysian market. The case of Keang Nam a South Korean firm pulling out of the construciton of the 58 storey Malayan Banking building in Kuala Lumpur is ominous.[18]

When the government announced a new policy to eliminate malpractices of certain foreign construction giants, the Master Builders Association (MBA) welcomed it with open arms.[19] Although the new policy did not address itself to the major issues raised by the MBA, it was nevertheless a sign that the government had noted the resentment of the local big-time construction companies, and relented somewhat.

Nonetheless, the Look East policy remains. The basic questions raised by the MBA and others however remain unanswered. Is Malaysia actually benefitting from the transfer of technology? Are Malaysian workers being trained in the kind of technology needed here? What would be the long-term effects of the large amount of undrawn building loans on the banking industry? In a situation where there is already an oversupply of office and commercial space and a depressed hotel industry, what will happen to big-time local contractors? What would be the consequences if more international construction firms default? Its plea answered, the MBA is once again silent on these issues.

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[18] *Star*, 17 October 1984, "Keang Nam Pulls Out."

[19] *New Straits Times*, 26 October 1984, "Builders hail new rules for foreign firms"

'JAPAN INCORPORATED' AND ITS RELEVANCE TO MALAYSIA

Lee Poh Ping

The term "Japan Incorporated" when first used not too long ago was meant to be perjorative. It connotes a people that cared only about business and very little about the finer things of life such as culture and so on. Indeed, the very unflattering epithet 'economic animals' was used alongside with it. It is also meant to suggest a very close relationship between government and business such as led to charges of unfair competition by western business facing Japanese business. Remarkably, the meaning of the term has changed today. It is now more a term of praise and even something to be emulated. Our government belongs to the category of admirers and has now launched "Malaysia Incorporated".

But what exactly is meant by "Japan Incorporated"? Our government obviously means the close relationship between business and government. I will therefore discuss three important features of this relationship in Japan and consider their relevance to Malaysia.

There is first in Japan a very close relationship between the Bank of Japan or the Central bank with the other big Japanese commercial banks so much so that the Bank of Japan ultimately guarantees many of the loans given by the commercial banks to private business. This guarantee, of course is not legally sanctioned but a result of informal understanding between the private banks and the Central bank. Given the nature of Japanese society this informal understanding is a very strong bond. Because of this, the private banks lend very liberally to business ventures, particularly if that venture comes from the same group as the bank. For example, let us say, the Mitsui Bank lending to Mitsui Bussan (Mitsui Sogososha). As a result of this private firms can operate on a large debt-equity ratio – it has been suggested the ratio in some firms is as much as ninety three to seven, the loan mainly coming from the banks who know that the Bank of Japan will bail them out if things go wrong. The up-shot of this is that such firms need not bother about stockholders. They can thus plan a long term strategy such as for example in marketing, they can sell at a loss or at a very small profit initially in order to capture a market. Firms which have a very large percentage of

their capital raised from stockholders will find it difficult to do such as they have to think of dividends to their stockholders.

Can Bank Negara or the government be the ultimate guarantor of business ventures in this country? The situation here is much more complex than that of Japan. First, our government participates directly in more business ventures than in the Japanese case, and helps stimulate the economy, thus having some of the "Incorporated" element in it. But the government is not a business organization, and it is from the commercial banks that funds for industry should come. Can these banks establish a relationship of trust with the Central Bank like the Japanese? My own opinion is that it will take some time. Many of our big commercial banks are still foreign-owned and hence oriented to foreign interest, and most of our local banks are still too influenced by the Western tradition and are nowhere likely to lend to firms on the same scale as their Japanese counterparts.

The second feature is the practice of administrative guidance. Here, a group of bureaucrats, primarily drawn from the Ministry of International Trade and Industry (MITI), plan out a long-term strategy for industry in Japan. Among other things, these bureaucrats identify what are called sunrise industries (competitive ones such as robotics, computers and so on) and sunset industries (obsolescent ones such as textiles and so on). They then get industries to promote the former and phase out the latter. This of course is a very difficult task and likely to encounter resistance from those in the sunset industries. They have not been totally successful but their record is better than Western nations. Among the reasons for this administrative guidance are that the bureaucrats are themselves knowledgeable and because they are not subject to immediate business pressures, they can see the long-term.

It will be an understatement to say that our system is very different from that of Japan and more complex. Japan's economy is not dominated or penetrated to any great extent by foreigners. In addition Japanese industrialists are of the same race as the bureaucrats, and in many cases their affinity is reinforced by being graduates of the same university such as Tokyo University. In Malaysia much of the private sector is dominated by the Chinese and foreigners while the bureaucracy is controlled by the Malays. The former might not so easily accept administrative guidance from the latter. But this does not mean some attempts should not be be made to overcome this antagonism between private and public sectors, given the fact that many Chinese business wish to be seen as nationally-oriented and the present governments attempt to have a more rational administration.

A third lesser feature is the Japanese government aid to Japanese business abroad. There are government agencies such as the overseas economic co-operation Fund (OECF) and the Export-Import Bank which financially aid large-scale risky Projects undertaken by Japanese companies abroad, for example, in the Asahan Project in Indonesia. There are also institutions

like JETRO which is quite efficient in data-collecting activities, together with commercial attaches in embassies, and so on. There is not much of a problem for the Malaysian government to encourage Malaysian economic activities abroad, either in financing some of them or in using its influence to get our firms to export more overseas. The present attempt to form sogososhas can be seen in this light.

But vital to this "Japan Incorporated" is the group orientation of the Japanese. This includes not only loyalty to the company for which the Japanese are famous but their ability to work as a collectivity in almost anything they do. If Malaysia were to adopt successfully the "Malaysia Incorporated" concept we must first learn to work towards the collective good and be less individualistic.

DOUBTS OVER HEAVY INDUSTRIALIZATION STRATEGY

Raphael Pura

When Mahathir Mohamad – then minister of trade and industry – unveiled plans for a state-owned heavy industries corporation in 1980, he punctuated the announcement with some typically forthright opinions. Malaysia, he said, had relied too long on light import-substitution manufacturing and processing of raw commodities. It was time to move up the technology ladder to basic industries such as steelmaking if private investors were reluctant to move into such industries, Dr. Mahathir added, the government was prepared to lead the drive.

The new industrial policy wasn't universally welcomed. Some economists and businessmen worried that the government would saddle Malaysia with expensive showcase projects. With a small domestic market and scant hope of achieving international competitiveness soon, inefficient industries would need costly protection and could squeeze private-sector competitors at home, they argued. Some suggested, hopefully, that Kuala Lumpur's enthusiasm for heavy industry would wane.

It hasn't. Today, Dr. Mahathir is prime minister and Malaysia's commitment to building a state-owned heavy industry base appears firmer than ever. Indeed, the strategy has emerged as one of the leading economic themes in the premier's administration, as Malaysia struggles to assert greater independence from an international trading system that Dr. Mahathir thinks short-changes commodity producers. The policy has acquired a special importance because – like Malaysia's campaign to learn from Japan and South Korea – it bears Dr. Mahathir's personal stamp. "It's his baby," declares a senior Malaysian official involved in the program, "his brainchild."

It's a fast-growing baby. Since Dr. Mahathir took office in mid-1981, Malaysia has launched plans for major projects valued at more than US$1.3 billion. The Heavy Industries Corp., known as Hicom, is building a US$455 million sponge-iron and steel-billet plant and will be the controlling partner in a new US$215 million cement plant. In May 1983, the agency signed

*Slightly edited version of "New Doubts Arise Over Mahathir's Industrial Brainchild" and published in **Asian Wall Street Journal**, June 10-11, 1983.

contracts for a US$245 million auto-body-stamping plant, a big step toward realizing Dr. Mahathir's dream of building a homemade Malaysian car. At the same time, Hicom has concluded agreements with three Japanese companies to build three separate motorcycle plants, and the prime minister has approved the agency's plans to proceed with a pulp and paper project that could cost as much as US$350 million. Most of the Hicom projects are to be 70%-owned joint ventures with foreign partners.

But before this smorgasboard of ventures can prove or disprove the wisdom of Malaysia's new industrial strategy, a recession-induced squeeze on government finances may put the brakes on Dr. Mahathir's ambitious program. So far, Kuala Lumpur hasn't cancelled or delayed projects in progress – a step Indonesia and the Philippines have been forced to take recently. But the government's squeeze is likely to stall millions of dollars in industrial projects currently on the drawing board. A US$1 billion oil refinery for Petronas, the state oil company, already has been deferred, for example. "Basically, all those projects that aren't cleared yet by the cabinet are on go-slow," says Hicom executive director Mohammed Saufi Abdullah. That category includes, among other ventures, plans for a US$100 million heavy-engineering complex and the addition of a US$250 million cold-rolling mill to Hicom's steel complex. "We hope the economic situation will improve soon to allow us to move ahead with projects in the pipeline," Mr. Saufi says.

Others hope a lull in the heavy-industry drive might open the door to renewed debate over the policy, however. One main worry is whether Malaysia, with a population of 14.7 million and easy access to imported manufactured goods, can run profitable basic industries for its domestic market unless they're sheltered behind high protectionist walls. The skeptics say that developing countries that have enjoyed most success in heavy industries, such as South Korea, have directed their output to export markets, competing successfully with established producers. While few officials, economists or businessmen are willing to criticize the program publicly, some harbor private doubts about it. Some of these doubts have bubbled to the surface.

The national car project – a 70% Hicom-owned venture with two Mitsubishi group companies – has generated the biggest controversy. Because it aims to capture as much as 70% of Malaysia's auto market by 1991, private-sector auto assemblers say it will result in the stagnation or closure of their businesses. Consumers worry that the cars will be expensive and that high tariffs will curtail their choice of imports. And some analysts complain that the project doesn't make economic sense. "The Malaysian car is neither viable nor relevant in the present context of our economic development," University of Malaya industrial economist Chee Peng Lim told a Malaysian economic convention in early 1983.

Concerns, though less openly expressed, are raised about other projects. Hicom officials concede the planned steel complex may also need protection. The cement plant will face stiff compeitition in a local market threatened with oversupply from Malaysian manufacturers and cheap imports. And rivalries among Japanese motorcycle makers may force Hicom into three separate engine ventures that compete against each other.

The government has revealed little about the assumptions on production costs, raw-material supplies, markets or product pricing upon which the feasibility of its projects are based. "These projects are shrouded in mystery," complains an economist in Kuala Lumpur, "nobody knows what the numbers look like." When some details of plans have surfaced – for example, Hicom's projection of 8% annual growth in Malaysia's auto market through the 1980s – they've been questioned by industry executives who consider them overly optimistic. Malaysia's car market has stagnated for two years and isn't expected to grow in 1983.

Other critics maintain that by concentrating on basic industries, Malaysia is investing in fields threatened by global overcapacity. "If you had to pick four industries that will be glutted world-wide through the 1980s, I'd be hard pressed to name others than cars, steel, cement and oil refining," asserts a foreign analyst. The impact of recession could demonstrate that some of the heavy-industry projects are luxuries Malaysia can't afford. Economic analysts point to a steep budget deficit, mounting foreign debt and a gaping shortfall in Kuala Lumpur's current account, which measures trade in goods and services, plus certain unilateral transfers.

Although the Hicom and other industrial projects will require comparatively small outlays of equity, they will need heavy foreign borrowing. With Dr. Mahathir emphasizing speedy construction and turnkey contracts, in which the contractor assumes total responsibility for designing and building a project, much of the capital investment involved will flow to foreign suppliers of imported hardware and technological knowhow. "It looks like a helluva expensive way to transfer technology to a few workers," maintains a foreign economist.

So far, such reservations haven't deterred Hicom planners, mainly because Dr. Mahathir continues to back the policy and the agency enthusiastically. When he became prime minister in July 1981, Dr. Mahathir took control of Hicom with him, shifting responsibility for the agency to his office from the Ministry of Trade and Industry. He cranked up the pace of the agency's agenda for the cement, steel and motorcycle projects. And he also took Malaysia's national-car project off the back burner, where it had simmered since 1980, and gave it top priority. Since then, he's advanced the start-up date of the car project by six months to mid-1985. Dr. Mahathir continues to shepherd the Hicom program diligently. "Not a month goes by without a meeting" with Hicom executives, an official says. "He's happy with what

we're doing." "He's very gung ho," concurs a non-government source. "It's a full-speed-ahead attitude."

According to one senior official, "The projects we're going into aren't purely economic projects." He adds, "They have quasi-political, economic and strategic-considerations." One key concern is to reduce Malaysia's dependence on exports of raw and semi-processed commodities that earn more than 70% of its foreign exchange and render the country especially vulnerable to world market forces it can't influence. Coupled with his frustration over what he views as a Western-dictated trade system is Dr. Mahathir's often-voiced disillusionment with the commitment of industrial nations – except for Japan – to help developing countries acquire higher level technology to widen their manufacturing bases. Instead, he's admired newly industrialized countries such as South Korea, which have systematically built locally controlled manufacturing bases to spur their economies.

Some powerful political considerations play a role, too. The government's involvement in the projects will help Kuala Lumpur meet its New Economic Policy goal of restructuring the national economy to increase the participation of Malaysia's bumiputras, or indigenous ethnic groups. The government-sponsored plants – notably the car, cement and steel plants – will erode the domination of ethnic Chinese entrepreneurs in those industries and serve as training grounds for a new class of bumiputra industrial managers and skilled blue-collar workers. "There's a strong economic nationalism aspect to all this," a Western diplomatic source maintains. "It involves building pride and reducing dependence on the foreigners." This worries some businessmen, especially non-bumiputras, wary of government domination of the economy.

Officials argue that domestic investors can't or won't muster the money, technology or will to make large commitments to projects with long gestation periods and rather unattractive rates of return. The alternative of plants controlled by foreign multinational investors is politically unattractive, they add. The industrial planners also contend that the government is best placed to coordinate the use of state-controlled natural resources such as gas and oil in the country's industrialization game plan. Finally, they say that the government presence in individual projects will encourage foreign investors to participate as minority shareholders in ventures that might otherwise prove unappealing and make it easier for the state to raise funds for the projects. Mr. Saufi of Hicom says that the government intends to play the role of "catalyst" for heavy industry "as long as there's a need" to do so.

HICOM PROJECTS MOVE AHEAD; MORE PLANNED

Here's a run-down on projects planned by Malaysia's state-owned Heavy Industries Corp.

Steel: Hicom is building a $455 million sponge-iron and steel-billet plant in Trengganu state in a joint venture with a Nippon Steel Corp.-led Japanese consortium. The plant will convert imported iron ore into sponge iron – the first step is making steel – using energy from gas fields off the Trengganu coast.

The bulk of the 600,000-ton-a-year sponge-iron output will be fed into a 560,000-ton-a-year facility to be converted into billets, another intermediate product in steelmaking. The rest will be sold directly to local steel mills and foundries. When production begins in 1985, output of sponge iron and billets will "just about meet" national consumption, Hicom officials say. Officials acknowledge that sponge-iron produced at the plant will be more costly than imports and that the plant "may need some protection initially" to compete with them.

But the agency hopes to get preferential treatment in pricing of state-controlled supplies of gas and electricity to enhance competitiveness. The plant will be financed mainly by Japanese-government export credits and by Nippon Steel on concessional terms. It will employ about 850 workers.

Hicom is also considering building a $240 million cold-rolling mill as the next step in the steelmaking complex. In November 1981 it signed a letter of intent with second Nippon Steel-led consortium to build the mill. It would produce 600,000 tons a year of cold-rolled sheets for local companies. No contract has been signed, however, and the rolling mill is likely to be deferred, at least until Malaysia's economy picks up.

Cement: Hicom holds a controlling 40% stake in Kedah Cement Bhd., which is building a 1.2 million-ton-a-year cement plant on Langkawi island, north of Penang. Partners in the $215 million venture are Kedah State Development Corp., Nichirin Holdings Sdn. Bhd., a unit of Nichirin of Japan, and Temasek Holdings Ltd., a state-owned Singapore investment company. The plant will compete unaided with private Malaysian cement makers, taking advantage of Langkawi's large deposits of limestone and its seaside location to cut transport costs.

Despite its advantage, private-sector cement producers say the plant could be hit by overcapacity in the peninsula that may approach 30% by 1985 if rapidly growing demand slackens. Kedah Cement in late 1981 signed a letter of intent to expand the plant's annual capacity to 2.4 million tons, but hasn't proceeded with the plant.

Automobiles: Hicom, in partnership with Mitsubishi Corp. and Mitsubishi Motors Corp., will construct a $245 million body-stamping plant at an industrial estate's building near Kuala Lumpur. The plant will have initial capacity of 80,000 units a year when it opens in 1985 and will expand to 120,000 units a year by 1988. It will produce parts for locally designed cars that will be powered by 1300 and 1500 cubic centimeter Mitsubishi engines. The plant is intended to be the first step toward an integrated local auto industry that will promote local manufacturing in related fields. The Mitsubishi companies and commercial banks are financing the projects.

Motorcycles: Hicom initially intended to build a $60 million motorcycle-engine plant in a partnership with Yamaha Motor Co., and signed a letter of intent for this in November 1981. The plant was to have a capacity of 240,000 units a year in the third year after its scheduled 1984 start-up, and was intended to supply standard engines of 110 cc or smaller to all existing motorcycle assemblers here. Hicom was to hold 51% of the venture.

That plan unraveled, however, when other major Japanese producers got wind of it. Honda Motor Co. and Suzuki Motor Co. demanded that they, too, start engine ventures with Hicom. After the protests, Hicom reopened talks with all the motorcycle makers. In October 1983, the agency announced three separate joint venture engine projects – one with each of the Japanese companies – to produce a total of 300,000 to 400,000 seventy c.c. and eighty c.c. engines a year by 1991.

Hicom will hold 30 percent of each venture. The three projects will require about US$75-80 million in investments, some industry sources worry that splitting the engine project among all three makers will make all the ventures less viable and more costly.

Pulp and paper: Hicom is studying plans for a pulp and paper mill in Kelantan state that's likely to cost $250 million to $350 million. The plant would be Malaysia's first and would have a capacity of 100,000 tons a year of pulp and 130,000 tons a year of printing and writing paper when it begins production in 1987. Current Malaysian paper consumption is about 80,000 tons a year, but the market has been growing 18% a year.

A French consortium led by Sogee has prepared a feasibility study for the mill at its own expense and will be given the first option to join Hicom in a venture to build it if it's judged viable. If the Sogee group doesn't participate, other partners may be invited, Hicom officials say.

Heavy engineering complex: This project – still on Hicom's drawing board – would create a group of high-technology machine-manufacturing industries. Plans initially called for it to include a foundry and metal-machining plant; an automotive-parts plant making brake drums, hubs and suspension brackets; a forging plant; a moulds and dies plant; a machine-tools plant; a steel-fabrication plant; a tractor-undercarriage-parts plant, and a plant making wheels for heavy commercial vehicles.

The facilities, which would cost about $100 million, would be built adjacent to Hicom's auto plant. Hicom would hold a majority stake in the complex. This project is likely to face delays, however, because it hasn't won cabinet approval.

PROJECT PROTON: MALAYSIAN CAR, MITSUBISHI PROFITS

Jomo K.S.

The proposed assembly of a supposedly 'Malaysian Car' is popularly associated with the 'Look East' policy. It is rather difficult to discuss this project satisfactorily because details are shrouded in secrecy. For instance, the announcements by Datuk Musa Hitam and Datuk Seri Dr. Mahathir at the end of October 1982 and the subsequent signing of the various agreements have not provided many details.

* The joint-venture company established for the project, Proton – or Perusahaan Otomobil Nasional (National Automobile Enterprise) – involves two main parties, namely the Heavy Industries Corporation of Malaysia (Hicom), which will contribute 70% of the total paid-up capital of $180 million, and Mitsubishi, more specifically, Mitsubishi Corporation (15%) and Mitsubishi Motor Corporation (15%). The remaining $380 million required for construction of the (currently) estimated $560 million 52-hectare plant is to be borrowed from the Export-Import Bank of Japan and other commercial banks. 12 billion yen is to be borrowed via Mitsubishi and the balance through a syndicated commercial loan.

The turnkey project contracts will ensure Mitsubishi profits at least from technical assistance plant construction and the supply of equipment and parts. It is envisaged for example, that, at least at the early stages, Mitsubishi will provide important components such as engines and transmissions (possibly produced in the Philippines, also by Mitsubishi). A body stamping plant, as well as a test track, assembly line and paint shop are to be set-up on the 900-hectare Hicom industrial estate near Shah Alam, Selangor, recently purchased for a high $88 million from Sime Darby's plantation holdings subsidiary, thus partly off-setting the poor record of its usual money-making subsidiaries due to recessionary conditions.

It is expected that, beginning with 20,000 cars in 1985, production is expected to increase to a maximum of 100,000 cars per year by 1991. The production levels expected are very much lower than the production capacity envisaged for the complex, i.e. 80,000 cars per year in 1985 rising

* Translated and revised from a Malay language article in *Nadi Insan* 47 (March 1983)

to 120,000 by 1988. Two basic body models are envisaged, namely the 4-door saloon to be produced from 1985 and the 3-door hatchback from 1987. Both will be front wheel drive models, and each will accommodate two engine sizes of 1,300 c.c. and 1,500 c.c. respectively. Operations were originally scheduled to start in 1986 but subsequently, plans have been brought forward and the the first car will come off the line in 1985.

Many informed observers question the Proton car plans, although few do so openly, usually citing the Prime Minister's strong personal commitment to the project in mitigation. (This strong personal commitment does of course, raise questions about the commitment of subsequent Malaysian governments to the Proton project.) The main problem often mentioned is the limited size of the local market which will rule out possible economies of scale and hence increase the unit production cost of the Proton car. Current estimates of optimum annual production capacity are in the region of 200,000-400,000 units per annum, while an output level of 100,000-200,000 cars per year is generally considered the economic minimum.

But in 1981, total Malaysian car sales totalled only 108,000 for the whole of Malaysia, including Sabah and Sarawak. These sales figures were achieved before the full effects of the recession were felt in Malaysia, and also before the taxes on cars were raised (e.g. an 15% import duty on knocked-down kits was introduced in 1982) to increase government revenue and to protect the local market in anticipation of the Proton car. Also, though the sale of new cars actually declined in 1982, Hicom plans are reputedly predicated on forecasts that demand will increase steadily by 8% per year from 1981.

In fact, the Proton car will essentially still be a Mitsubishi car, possibly with an exclusive body design, involving (largely marginal) design changes by Malaysians, and assembled locally with a higher proportion of locally-produced components, largely to be accounted for by the Mitsubishi-supplied body-stamping plant. At the outset, only 36% of the total value – not weight – of the car will comprise locally-made equipment, which has generally been much more expensive and of poorer quality than if imported. Achieving the eventual stated goal of 85-90% local content could involve prices thrice those of imported vehicles. Even the initial 36% local-content target is expected to make the Proton cars 50% more expensive than comparable imported cars, before taking into account tariffs, of course.

The project is expected to create only 3,000 job opportunities – a total lower than the number of workers already currently involved in the local assembly of cars. Hence, except for those who are absorbed into the new project, many car assembly workers and even sales and distribution personnel are likely to be displaced as the Proton car corners the market.

Potential consumers are also unhappy since production of the Proton car will increase the price of all cars. Most also anticipate a poorer quality 'Malaysian Car' in light of the previous experience with locally assembled vehicles. Locally assembled vehicles currently actually cost at least 20% more than equivalent imported cars, before taking into consideration the

effects of the protective tariffs. The more heavily protected market will also mean a reduction in the range of available models as well as a severe reduction in the introduction of new foreign models into the local market. Government revenue from taxes on imported cars will also decline as consumers are forced to buy the Proton car.

Mitsubishi's strong interest in the 'Malaysian Car' project proves that they anticipate profitable returns from this venture. The turnkey project arrangements and protection of the local market will ensure profitability of the project as far as Mitsubishi is concerned. Besides profits from sale of the cars – which, admittedly, are not yet assured – Mitsubishi stands to make substantial gains from the supply of car parts, production equipment, technical and managerial support, etc. on turnkey project terms. Hence, Mitsubishi will certainly profit even if the Proton car project is unprofitable for Hicom.

Hence, with an investment of only 54 million ringgit, Mistubishi will capture a huge share of the Malaysian car market. This is indeed an impressive coup since Mitsubishi's previous position was not particularly enviable. Over the past two years, Mitsubishi's position in the market dropped from third to fifth place, accounting for only 8% of the car market in 1982. In contrast, Hicom forecasts that the Proton car will command two-thirds of the car market by 1991.

Besides the 'Malaysian Car' project, Mitsubishi has also made similar inroads in the Philippines (transmissions), Thailand (wheel drums) and Indonesia (body stamping). With all this, Mitsubishi is well poised to ensure the development of an ASEAN car under its auspices. However, the decision by the Mahathir government to go it alone has fouled up previous planning for an ASEAN car – except under Mitsubishi's patronage, of course. More significantly, it has been widely interpreted as a unilateral repudiation of Malaysian commitment to regional economic cooperation and all that would entail. Admittedly, however, the ASEAN car project was fraught with problems to begin with and was unlikely to materialize in the near future in light of the dismal record of the other ASEAN industrial projects.

Several arguments have been advanced in support of the 'Malaysian Car' project. Proponents often refer to publicly unavailable feasibility studies which ostensibly show that the Malaysian car project is viable. In view of the market size and Malaysia's existing technological base, it is difficult to accept bald unsubstantiated assertions of this sort, especially since they directly contradict most generally accepted findings. It is also claimed that Mitsubishi's willingness to invest in the project is further proof of the project's viability. However, as argued above, Mitsubishi's own profitable involvement does not in itself imply that the project is viable or likely to be profitable for the joint venture as a whole.

The existing Malaysian car assembly industry is a burden upon Malaysian consumers in terms of both price and quality, while reducing potential revenue from import taxes otherwise accruing to the government. The only

ones who appear to have benefited from past government promotion of the assembly industry have been the foreign car companies and their local subsidiaries or partners in a position to derive monopoly profits from a protected market.

While it is increasingly acknowledged that the Proton car project is going to be economically burdensome, especially for consumers, it has been argued by certain parties that the car project is essential for the pursuit of a new stage of industrialization emphasizing the development of heavy industries. It certainly cannot be denied that the car industry has played a major role in the economic growth of both the United States and Japan. But for several reasons, Malaysia cannot realistically expect to follow suit by trying to replicate the experiences of these economies in fundamentally different economic circumstances. Hence, for instance, it will be difficult for the 'Malaysian Car' project to achieve more than some minimal economies of scale from the standardization of locally-produced components, currently produced inefficiently, expensively and poorly by about 75 local ancillary industrial firms.

On the other hand, several countries have succeeded in their industrialization plans without resorting to car manufacturing. Although a car industry can give impetus to other industries and otherwise stimulate industrialization in Malaysia, this can be better achieved with more equitable consequences by encouraging other industries, e.g. for the production of bicycles, motorcycles, agricultural and electrical equipment, which cater to the needs of a greater proportion of the people, require technological pre-conditions which will not involve heavy dependence on foreign companies and will involve more linkages with other existing or feasible local industries.

Such a more integrated, balanced and equitable industrial strategy would render technological appropriation and self-reliance more feasible, meet popular industrial needs and be consistent with a more equitable and independent overall development strategy. This would also be consistent with a transportation system oriented towards public needs rather than private demand, as embodied by the passenger car.

THE PROTON SAGA — NO REVERSE GEAR! THE ECONOMIC BURDEN OF THE MALAYSIAN CAR PROJECT

Chee Peng Lim

The choice has been made so there is no point in debating the merits and demerits of the Malaysian car project.[1] Like the $2 billion BMF loan, the money for the car project is a sunk cost and like the illfated loan, a large portion of it is unlikely to be unrecovered. Thus, as someone has said, there is no point in getting excited over money that has already been lost. So we will not try to reopen the debate over the Malaysian car project in this paper. Instead this paper will examine the difficulties which this project will face and the implications which will arise from its implementation. For unlike the BMF loan, the car project is likely to have a long and lasting impact not only on the Malaysian manufacturing sector but also on the economy as a whole. Also unlike the BMF loan where the total disbursement was made within a relatively short period of time, Malaysia will be paying for the car project by instalments spread out over a relatively long time horizon. But in the end, when we add up the direct and indirect costs, the total loss from the Malaysian car project may not be very much less than the loss incurred by BMF (see Section 3 below).

Wrong Timing

BMF's loan turned sour because it was made at the wrong time – just before the property market in Hong Kong collapsed. Similarly, one day, historians will note that the Malaysian car project failed because it was implemented twenty years too late. If the project had been launched in the early 1960s it might have had a slim chance of success. However, at that time, Malaysia decided that it should go into assembling rather than manufacturing

*Paper presented at the ISIS Workshop on the Malaysian Car, Institute for Strategic and International Studies, K.L., 30 October 1984.

[1] In any case, the project has already been intensively debated. See for example, Chee 1983(a).

motor cars. Thus the Volvo assembly plant (Swedish Motor Assemblies Sdn. Bhd.), Malaysia's first motor car assembly plant, began production in December 1967.[2]

With hindsight we now know that decision was wrong because the motor car assembly industry has been a dismal failure. We ended up paying a higher price for a lower quality car. The direct employment generated in the assembly industry totalled less than 6,000 workers, but more significantly, most of these were unskilled workers. According to Tuan Syed Shahrir, Executive Secretary of the Transport Equipment and Allied Industries Employees Union, only 10 per cent of assembly plant workers are skilled, and these are the panel beaters, welders, colour sprayers and mechanics. The rest are unskilled workers who only have to learn how to use a screw driver and have acquired even less skill in the course of their work than a cook or a barber. Thus, there has been hardly any technology transfer and the country learned almost nothing about motor car technology. Malaysia did not even learn much about making automotive components (much less than making a car), partly because the 12 assembly plants were assembling 27 makes and 129 models of passenger cars (*Business Times*, 23, May 1981).

The fragmentation of plants and proliferation of makes and models made it difficult for the component manufacturers to achieve economies of scale. Consequently, locally produced components were relatively expensive so the assemblers preferred to import almost all their components. Only a few simple components were sourced locally. Not surprisingly up till now, local content is valued at less than 18 per cent.[3]

In short, the motor vehicle assembly industry, which was supposed to have ushered us into a new age of industrialization turned out to be an illusion. The minimal benefits that we obtained were hardly commensurate with the costs we had to pay. In the end, it appeared that perhaps the only beneficiaries in the motor vehicle assembly programme were the government and the assemblers. The former managed to collect vast sums of money by gradually increasing its import duties on completely-built-up (c.b.u.) cars, while the latter profited from the heavy protection imposed on the motor vehicle industry.

But if Malaysia made a wrong choice by going into motor car assembly twenty years ago, that decision will not be rectified by going into motor car manufacturing today. Twenty years ago, that decision might have been rational. Firstly, the motor car industry was expanding and the market was not

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[2]For further details of the history of the motor car assembly industry in Malaysia, see Chee 1983(b).

[3]Local components are mainly tyres, paint, wiring harness, battery, exhaust pipe, seat belt and safety glass.

very competitive. Secondly, technological progress in the motor car industry was slow and there were not many changes, either in the manufacturing process or the use of new components or materials. Under those conditions, Malaysia might have been able to establish a viable motor car manufacturing industry. But today, the situation is radically different.

The industry is presently going through a period of deep crisis. When the crisis subsides some major motor car manufacturers in the industry will disappear or be absorbed by an oligipoly of giant motor car manufacturers which will then have a firm grasp of the world market for motor cars. In fact, a U.N. study has predicted that given the high and rising costs of developing, producing and marketing new vehicles, "only the very large volume Asian car manufacturers will be able to compete in the 1990s" (Centre for Transnational Corporations, U.N., 1982). In view of these developments, Malaysia's decision to go into motor car manufacturing at this point in time is almost like sailing a small sampan into the eye of a hurricane. If some of the larger ships will not survive the hurricane, what kind of chance will the sampan have?

The crisis in the motor car industry has affected its growth rate. For example, in Western Europe in the 1960s, the growth rate was around 8 per cent per annum on average: in the 1970s, the figure dropped to around 4.5 per cent, and in the 1980s, that estimates go no higher than 2 per cent. Similar patterns are observed in North America: though in Japan, while lower than in the past, growth rates are still likely to be significantly above those in the other OECD countries. This trend reflects a shift towards replacement markets, i.e. those in which new buyers represent only a small proportion of total purchases. Indeed, OECD estimates suggest that around 85 per cent of purchases in the region during the present decade will be of the replacement type (UNIDO, 1984).

On a global scale, the prospects are not significantly better, since OECD sales alone represent some 82 per cent of the global figure, and therefore greatly influence total growth calculations. The EEC Commission has estimated that in the period 1975-80 world growth was around 5.6 per cent per annum, and has suggested that in the period 1980-85, this figure would fall to around 3 per cent. The figure suggests a significant degree of optimism with regard to developing country purchases. However, recent events, and in particular, the collapse of markets in the largest developing countries, suggest that optimism is by no means well-founded (UNIDO, 1984).

In short, the demand for motor cars has slowed down considerably. On the other hand, the world market for motor cars has become saturated so that any newcomer to the industry can expect very strong competition (Bhaskar, 1983). The new firm will not only have to face stiff competition from large well-established multinational corporations, but will also have to

adapt to rapidly changing technological conditions in the industry. This because motor car manufacturing technology has developed at an extremely rapid rate during the last five years.

More specifically, there has been a massive transformation of the production process, and the establishment of new norms in process technology, consumption and corporate organizations. Even factory organization is undergoing a transformation, which amounts to a revolution in an industry previously noted for slow evolution. Flexible manufacturing systems (FMS), robotization, the introduction of computer-aided design (CAD) and computer-aided manufacturing (CAM) systems are completely changing the face of the car factory. Furthermore, the possibilities of incorporating not only microelectronic devices, but also new materials have put the industry on the threshold of a major switch in industrial orientation, i.e. away from the traditional electromechanical base towards an electronic-plastics base.

In short, not only has the world demand for motor cars slowed down considerably; technological progress has advanced so rapidly, that competitive conditions in the motor car industry have stiffened significantly in recent years. For this reason, Malaysia's decision to go into motor car manufacturing suffers from a wrong sense of timing.

Lack of Viability

Most economists, both in and outside the government, are agreed that the Malaysian car project is not viable. Undoubtedly, the Malaysian car project has a strong band of supporters, but these are mainly politicians or businessmen who have their own reasons for supporting the project. There is a lack of support from many economists who think that the project is not viable in terms of Malaysian interests.

To begin with, the project is very costly. The actual costs may never be known because the Malaysian car project is surrounded by a shroud of financial secrecy. A very conservative estimate puts total costs at around $1.5 billion. This includes total direct and indirect costs estimated as follows.

Firstly, the direct costs of manufacturing the Malaysian car are estimated at no less than $1 billion. This includes the cost of infrastructural facilities, machinery and equipment, training and associated expenses.[4] To this, we must add three major indirect cost items. The first is the cost of closing or reducing the capacity of the present motor car assembly plants and distribution networks. Presently, there are 12 assembly plants and more than 50

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[4]According to UNIDO (1984), "it now takes between 3 and 4 years and US$500-700 million to put even the simplest car into production". Thus, our figure is an underestimate, rather than an over-estimate.

distributors and dealers in the country (Chee, 1983b). It is inconceivable that all of them will be able to produce at their present capacity, or even remain in operation once the Malaysian car reaches its planned output levels. The losses which will be incurred by motor car assemblers, distributors and dealers are estimated at about $30 million.

The second major indirect cost item is the price differential which the consumer has to pay for the Malaysian car in place of an imported equivalent. If this is estimated at $5,000 per unit, and we take an output of 100,000 units, then this will add up to another $5 million per annum. In addition, we have to consider the costs of repairing and repainting a lower quality car (assuming that the quality of the Malaysian car will be no better or no worse than the presently assembled car). This bill will cost the consumers at least $2 million a year. If we assume that the Malaysian car project will be around for a least ten years, total indirect costs for this item will be $70 million.

The third major area of indirect costs is much more difficult to quantify. It relates to the opportunity costs of investing $1 billion in a more viable project and the costs arsing from the loss of consumer's surplus. If all these are conservatively estimated at $30 million per annum, then the loss in consumer's surplus, together with the opportunity costs, would total $300 million over a ten year period.

To sum up, at the end of a ten-year period, the Malaysian car will cost the country at least $1.4 billion, which may not be very much less than the BMF loan losses. In view of its immense costs, it is not difficult to see why the project will not be viable.

Undoubtadly, there will be several benefits, such as national pride, technological spin-offs and employment. An indirect benefit of the Malaysian car project is that it will set in motion a rationalisation process in the local car assembly industry. Such a process will weed out low volume and inefficient assemblers. Another important indirect benefit will be increased business, which the Malaysian car will provide to motor car mechanics and repair shops. Even at present, consumers have a liturgy of complaints against locally assembled cars (*Utusan Konsumer* October 1980). The complaints are likely to increase when the Malaysian car is put on the road.

However, it is difficult to see how all these, and whatever benefits may be attributed to the project, can justify the vast sums of money involved. In fact, if we allow any reasonable return on capital, the overarching problem is how to prevent the Malaysian car project from being permanently in the red.

High Production Costs and Small Market

The Malaysian car will be produced at a relatively high domestic resource cost because of its relatively small scale of production. The planned output

(120,000 units) of the Malaysian car will only be a small fraction of the current optimum level of production (500,000 units per annum) required for efficient production (UNIDO 1984).[5] Consequently, the Malaysian car industry car industry will be a relatively high cost producer.

There is little prospect of increasing production much higher than the planned output level because the local market for cars is relatively small. Although HICOM has optimistically projected an annual growth rate of 8 per cent in the Malaysian car market for the rest of this decade, industry sources consider the estimate overly optimistic. Malaysia's car market has stagnated since 1980 and only a marginal growth rate is expected for 1984.[6] This may be partly due to the recession, and partly to the fact that at the present price levels, the motor car has become a luxury rather than a necessity. Given its high costs of production, the price of the Malaysian car may be expected to increase at regular intervals.

The cost and subsequent price increase will become more significant as the local content of the Malaysian car increases. Figure 1 shows the relation between the extent of local integration (LC), volume of production and cost increases in relation to figures observed in OECD plants. The higher the volume of production, the better the rise in costs can be contained. Indeed, the chart hints at the possibility of production costs being quite close to OECD levels provided sufficient scale output could be maintained. The problem is that in the Malaysian car project, such output scales are unlikely in view of the small domestic market and slow growth in demand for motor cars.

In view of the above, another set of difficulties facing the Malaysian car industry will be rising costs, increasing prices and stagnating demand. The industry may obtain some relief through heavy tariff protection, and such protection may be expected to increase and become a permanent feature in the industry in much the same way as the tariff protection imposed on imported tyres.

No Export Potential

While other industries may be expected to develop their export potential by becoming price and quality competitive over time, it is difficult to see

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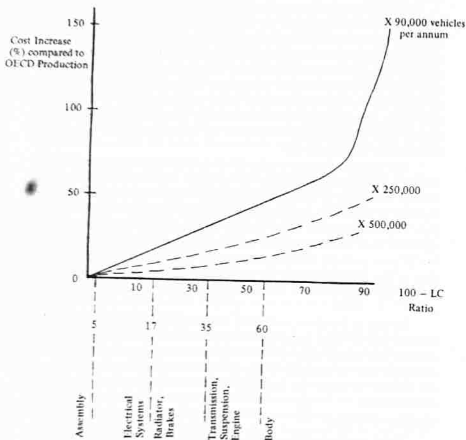
[5] Proton plans to produce an average of 74,600 units of the Malaysian car per year for the first five years of production (*Business Times*, August 7, 1984). Installed capacity will rise to 120,000 units by 1989 (*Business Times*, May 23, 1983).

[6] In fact growth in 1984 may even be negative. According to figures recently released by the Malaysian Motor Traders Association, sales over the first six months of 1984 were 5 per cent lower than those of the preceding year (*Business Times*, October 2, 1984). On the other hand, when the car project was first announced, car sales were projected to increase by 8% from 110,000 in 1982. Instead, sales have gone down to around 92,000 for 1984.

FIGURE 1

APPROXIMATE RELATION BETWEEN EXTENT OF LOCAL INTEGRATION, VOLUME OF PRODUCTION AND COST INCREASE



Notes : In the LC percentage ranges marked on the horizontal axis the kinds of local activity at each step are indicated. Both these ranges and the extent of cost increase are orders of magnitude only. Precise curves would differ according to the specific models, the length of time for which they have been produced in the DC (as a proxy for familiarity with the production technology) and the efficiency of operation of component suppliers as well as the vehicle producer.

Source : Based on R. Sekaly, *Transnationalisation of the Automobile Industry*, University of Ottawa Press, 1981.

how the Malaysian car can ever hope to break into the export market (notwithstanding the numerous export enquiries supposedly received by Proton). The industry could have hoped to develop some export potential if the agreement establishing the Proton joint venture had insisted on the inclusion of an export clause. After all, Taiwan managed to get Toyota to agree on such a clause when it negotiated its national car project with the Japanese company.[7]

It is true that building an export capability into the Malaysian car project would increase the costs significantly, but then in these kind of projects, a critical mass is important. No country can hope to establish a viable motor car industry by producing only for the domestic market, especially when that market is miniscule.

Technology

The most serious problem which will confront the Malaysian car project will be technology acquisition, development and adaptation. Malaysia does not even have a tradition in bicycle manufacturing, let alone motor car manufacturing.[8] Thus we have to start from scratch and rely entirely on foreign technology. Technological dependence may be perpetual, given the rapidly changing technology in the motor car industry. We can try to develop our own technology, but it will be extremely expensive to manufacture a car for a small domestic market. Even then, what good is a technology which does not keep up with up-to-date developments. For this, we will need to do research and development (R & D) in motor car manufacturing. That will be even more expensive. In the end, the government will realize that it may be cheaper to depend on imported technology. When that happens, the Malaysian car will always be one technological step behind foreign cars. After all, we cannot expect Mitsubishi to transfer its latest motor car technology to Malaysia.

Implementation

The method of implementing the Malaysian car project leaves a lot to be desired. Proton – a joint venture with Mitsubishi controlled by HICOM, a public enterprise – suffers from the inefficiencies and problems plaguing most Malaysian public enterprises so it is not a suitable vehicle to implement the

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[7]The deal has stalled, but not because of the export clause, although the 50 per cent export stipulation appeared rather excessive to Mitsubishi (Kraar, 1983).

[8]Even now our bicycle plants are not manufacturers, but mere assemblers of bicycles using imported components (Chee, 1977).

project. It might have been more desirable to encourage a major motor vehicle assembler or a group of assemblers to initiate, undertake or at least participate in the project. At the very least, the assembler would have some experience in the motor vehicle industry whereas Proton has virtually none. At the same time, the government should have close consultations with the Malaysian Motor Vehicle Assemblers Association on the project, instead of keeping the project closely under wraps. In short, the way the project is being implemented does not inspire much confidence for its future. Moreover, its method of implementation violates the expectations raised by the Malaysian Incorporated and privatisation concepts, which the government is propagating.

Impact

The immediate and direct impact of the Malaysian car project will be felt by the existing motor vehicle assemblers. The assemblers of vehicles with an engine capacity in excess of the Malaysian car (1,200-1,500 c.c) may be less affected than assemblers of vehicles with a similar engine capacity. But even the former will find the market gradually shrinking as higher import duties force the consumer to buy the Malaysian car. As for the latter, there will be no alternative but to wind down their operations.[9] The worst hit will be those assemblers which recently stepped up their investments, such as the Ford Assembly plant and Sejati Motor Sdn. Bhd., a subsidiary of United Motor Works. These assemblers will be lucky if they can recover their investments, let alone make a profit.

Many of the existing motor vehicle assembly companies have made plans to diversify their investments. Some, like Tan Chong, are going into real estate, construction and automotive component manufacturing.[10] For example, Tan Chong has set up Auto Parts Manufacturers Co. Sdn. Bhd. to manufacture leaf springs and shock absorbers (*Malay Mail*, 12 July, 1980). Sarawak Motor Industries (SMI) is branching out into property development and timber. The move away from its traditional motor assembling base is reflected in SMI's purchase of 5 hectares of land with development potential in Kuching. Apart from that, SMI has also been granted six timber concessions covering about 60,703 hectares to extract "Ramin" logs in Sarawak (*Business Times*, 20 January, 1982). None of the above will provide a satisfactory solution. Traditionally, manufacturing companies have no expertise in the highly competitive property and construction industry. As for automotive

[9] This applies particularly to low volume assemblers. The Malaysian car plans to capture 70 per cent of the market for passenger cars so there will only be room left for a few locally assembled makes (*Business Times*, 29 December 1982).

[10] For further details, see the recent annual reports of these companies.

components, the market is already saturated. Up to the end of 1982, the government had issued 170 licences for the manufacture of various car components, of which 100 had begun production (*Business Times*, 30 December, 1982).

Along with many of the assemblers, many motor car distributors and dealers will also have to turn to other lines of business. Undoubtedly, a few distributors and dealers will be allowed to market the Malaysian car, but many will find that the new distribution network will have no place for them.

Another group which will be adversely affected by the Malaysian car project will be the assembly plant workers. Out of the 6,000 workers or so employed in the plants, a very small proportion of skilled workers, such as welders and painters, will have no difficulty in looking for another job. But the majority, who are unskilled workers, will face a serious problem. No plan has been drawn up to re-train or to absorb these workers in the Malaysian car plant (which, in any case, will not be able to absorb more than a fraction of these workers).

More significant is the long-term impact of the Malaysian car project on the manufacturing sector in particular, and on the economy in general. One expects that the implementation of a costly and massive project such as this should have a stimulating effect on the manufacturing sector. But this is not likely to be the case with this project. On the contrary, the effect is likely to be negative, simply because the project is not viable in the public interest. What this means is that the project will need permanent tariff protection, with the tariff escalating as production costs accelerate. The technological spin-offs from the Malaysian car project will have very limited application in other industries, while the ancillary firms spawned by the project will have no incentive to be efficient. This is because there will be only one, or at the most, two ancillary firms for each automotive component. Moreover, some of the ancillary firms have asked Proton to guarantee that it will purchase their components before they will agree to set up production. In any case, given a monopoly and high tariff protection, these ancillary firms will be contented solely with supplying the Malaysian car project. They will have no incentive to reduce production costs or to seek markets overseas.

The negative spread effects of the Malaysian car project will spill over into other sectors of the economy, especially the transportation sector. The unnecessarily high price which the Malaysian consumer has to pay for the motor vehicle will increase the costs of transportation and thus raise the cost of living.

Finally, what is most detrimental about the Malaysian car project is its opportunity cost. The money which will be spent on the project could have been used to provide a firm foundation for the growth of the Malaysian manufacturing sector which is at a crossroads in its development (Chee 1984).

At this stage of its development, a large sum of money is required to upgrade productivity and technology in the manufacturing sector, to improve infrastructural and marketing facilities and to intensify the training of skill workers. Thus, the $1.4 billion should be used to set up the proposed Foundry Development Centre, expand the Metal Industry Technology Centre, establish R & D facilities and an intensive training programme for skilled workers. Any one of these projects will have a far more positive impact on the development of the manufacturing sector than the Malaysian car project.

Future Options

In view of the anticipated difficulties and accelerating costs confronting the Malaysian car project, we suggest that the government considers one of three options for the industry at the end of its ten year trial run.

The first option is to renegotiate the joint venture arrangement with Mitsubishi to plan for a more efficient and larger scale of production of at least 300,000 units per annum. At the same time, Mitsubishi should be required to export at least half the increased output. The arrangement may not be as impractical as it appears since it will allow Mitsubishi to use Malaysia as an offshore base to circumvent the restrictions it faces on car exports to the West.

The second option is to produce a simple, low cost motor car rather than the one which is designed for high income countries.[11] Such a vehicle can be purchased by small businessmen, farmers and industrial workers. More importantly, this type of vehicle is less subject to economies of scale and more appropriate to the economic circumstances of a developing country, such as Malaysia.

The third option is to gradually convert the Malaysian car plant into the production of replacement parts, which can be sold on the international market. Taiwan, South Korea and Singapore appear to be moving in this direction. Under present circumstances, and in view of the anticipated changes in the world motor car industry, the third option appears to be the most sensible for a number of reasons.

Firstly, the first option is a high risk gamble, and even if it is successful, our motor car industry will be effectively mortgaged to a multinational corporation whose interests may not always coincide with ours.

Secondly, there does not appear to be any other more satisfactory option. The strategy of continuing with the present course will become so costly, and the failure will become so apparent before the end of this decade,

[11] For further details, see UNIDO 1978.

that even the most ardent supporter of the Malaysian car project will be looking for a way out. One alternative is to become a manufacturer of original equipment and components on an international scale, but this option ignores the emerging reorganisation of the motor vehicle industry.

A UNIDO (1984) study predicts that following its reorganisation, the structure of the motor vehicle industry will become more concentrated. Motor vehicle manufacturers will insist on the reduction of systems stocks, the geographical location of component suppliers within a fixed radius of the manufacturer and single sourcing of major components. All these changes will favour the traditional domestic suppliers at the expense of their new overseas counterparts.

Finally, the third option can form the basis for reviving the ASEAN Automobile Complementation Scheme. This Scheme appears to provide the best prospects for developing the motor car industry on a regional basis.[12] Unfortunately, this Scheme has been grounded because the ASEAN countries think that they can do a better job of developing the industry on an individual basis. Ten years from now, like Malaysia, they will realize that regional cooperation is vital for success.

In short, the options are very limited, so we may have to settle for the next best strategy of being a manufacturer of automotive replacement parts for the world market.

Conclusion

In the same way that the BMF loss led to a tightening of banking regulations, we hope that the lessons from the Malaysian car project will lead to a tightening of regulations on industrial planning and project selection. The most obvious lesson that we can draw from this project is that industrial planning should be left to the experts, and the projects should be selected very carefully. Industrial planning cannot be based on the whims and fancies of personal inclinations, and project selection must be based on viability. In addition, it would be useful to involve all the parties concerned in the process of planning and selection. Here, a useful lesson may be learned by looking east.

In Japan, industrial planning is carried out by a highly competent team of professional economists in the Ministry of International Trade and Industry (MITI). Once the plan is drawn up, specific projects are identified. But even before the plan and projects are drawn up, there is a series of extensive discussions to harmonise the views of the public and private sectors. This

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[12]For further details, see Chee 1983(b). See also ESCAP, 1982.

process involves a huge network of hundreds of committees, councils, associations, institutes, and so on, involving thousands of leaders in various fields, including academia, labour unions, farm groups, consumer and other organizations in countless meetings, whose results are funnelled into the Industrial Structure Council at the top. The decisions arrived at (on new technologies and core industries to promote in the next decade or so, on the shifts in industrial structure, on the ways to promote competition in various industries, assistance to small and medium industries, and so on) are then implemented by MITI, the Ministry of Finance, other ministries and agencies, again, largely through extensive discussions with relevant business and other affected groups. (For futher details, see Johnson, 1982, Tsurumi, 1976, Ozawa, 1974 and Bieda, 1970).

The underlying assumptions in this time consuming, costly and difficult approach to decision-making are that less mistakes are made with "more wise heads", to whom in any case, the relevant information must be spread; that decisions on basic industries and technologies affect all groups in the economy, (workers, if the technology is labour-saving, and consumers, if the technology is polluting, for example); and that the lost time and the costs incurred can be recouped through swift and effective implementation when disparate views and objections are properly taken into account and reconciled.

In contrast to the foregoing procedures, the impression one gets is that the decision on the Malaysian car project was hastily made by a small group of people in the government with sporadic, ad hoc consultations involving a very small group of businessmen and engineers. In my view, this is not the way to make decisions which are so vital to the long-term progress of the economy as a whole. The wrong decision can have a baneful effect on the economy in the long run. For example, Nehru's decision to invest in heavy industries condemned India's manufacturing sector to a state of inefficiency, from which it has yet to recover. Similarly, the late President Park's decisions in the mid-1970s are the major sources of serious problems which the South Korean economy is facing today.

There is, of course, no need to involve so large a network of committees and individuals in Malaysian planning for so long a time as in Japan. But a systematic and comprehensive effort to tap the best minds among various groups besides business and government agencies is a necessity if mistakes are to be avoided.

In conclusion, there is an urgent need to review not just the Malaysian car, but also the other projects which HICOM is undertaking. With a small domestic market and little hope of achieving international competitiveness, these projects will be high cost producers needing costly protection and will ultimately reduce the competitiveness of local industries. The above review is

particularly urgent at this time when Malaysia has a huge budget deficit, a mounting foreign debt and a large shortfall in its current account. Perhaps, the best time to undertake the review will be when the Industrial Master Plan is completed.

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THE INDUSTRIAL MASTER PLAN

The publication of the Industrial Master Plan (IMP) by the government in early 1986 was the first master plan of its kind in Malaysia's history. The IMP documents embody a remarkable combination of sober – even critical – analysis of Malaysia's industrial heritage and current problems on the one hand, and what has best been described as "enlightened wishful thinking" in the form of industrial policy proposals on the other. The IMP offers a useful analysis on the structural problem associated with Malaysia's manufacturing sector, but then goes on to propose industrial policies to improve Malaysian industry without getting to the root of most of the structural problems it identifies earlier.

The IMP points out that despite or rather because of its growth and development record, Malaysia has been a relative latecomer to industrialization. The IMP attributes Malaysia's "delayed industrialization" to its successful specialization in primary exports. Malaysia has lagged behind the so-called "normal pattern" apparently because successful expansion of primary export production has adequately financed import needs, thus weakening the commitment to industrialize. Similarly, the availability of other more profitable alternative investment opportunities also discouraged industrial investments. The IMP seems to suggest that as a result, "industry will develop only after income levels and investment rates have risen as a consequence of the growth of primary production" (IMP, 1986: p. 11).

The IMP also acknowledges that Malaysia's industrial structure is characterized by various imbalances. The IMP contends that the manufacturing sector is narrowly based on a few labour-intensive and resource-based industries. Yet, despite the official emphasis on export-oriented industries since the late sixties, manufactured exports account for less than 20 per cent of total manufacturing output. These industries produce low-skilled labour intensive exports, requiring relatively simple final assembly work. Meanwhile, the relative share of resource-based products has declined, accounting for only 9.7 per cent of all manufactured exports in 1983 (IMP, 1986: 13). The IMP also correctly argues that the debate on heavy industries, should not be on whe-

ther or not to develop heavy industries, but rather which heavy industries to develop. Unfortunately, most of the heavy industries developed so far – including the Malaysian car project, three motorcycle engine plants, a petroleum refining and petro chemical project, a sponge iron and steel billet plant, two additional cement factories and even a paper mill – will have had to deal with gluts on the world market, e.g. in steel, cement, cars, petrochmicals, ship-building and repairing. With little export potential, they require significant protection, while in turn, pushing up production costs and consumer prices. Often involving sophisticated foreign technology, heavy, industrialization has involved massive government borrowings from abroad to invest in unprofitable projects, huge imports of capital goods, deepening technological dependence and requiring massive protection.

By 1987, it was found that Malaysia' cement production capacity of 7.2 million metric tonnes annually was double domestic consumption in the mid-eighties. Surcharges on imported cement to protect the domestic market now exceed 50 percent. After investing over $1.2 billion Malaysian ringgit (over US$500 million) in the Perwaja steel plant in Terengganu, it uas been discovered that the prototype 'direct reduction' industrial process used is not vible, for which the supplier has agreed to pay only $467 million ringgit in compensation. Since the ringgit has depreciated by about 70 percent against the yen in the interim (after September 1985), the actual rate of compensation in yen terms is considerably lower than what it appears to be in ringgit terms.

The burden of the car project has been estimated to be at least $1.6 billion ringgit (Chee 1985). The project was originally based on estimates of annual car sales rising by 8 precent annually from 110,000 in 1982. Instead, total sales are expected to drop to about 30,000 in 1987 (after only 14,335 sales in the first half), due to the recession and increased car prices owing to the appreciation of the yen and higher import tariffs to protect the car. (Taxes on completed cars are on a rising scale beginning from 150 percent, while taxes on CKD kits are only slightly lower). It has been estimated that car export price subsides to the USA will be in the region of M$5,000 per vehicle, or about 40 percent of the expected retail price of US$5,000. This will be over and above the 4,500 ringgit per vehicle believed to exist for cars produced for the local market. And for all intents and purposes, the Proton Saga remains very much a Mitsubishi product; about 60 percent of the parts are imported, with at least half the balance produced by the Proton plant in Shah Alam under licence and with equipment and technical personnel from Mitsubishi.

While acknowledging the impressive growth of the electronics industry, the IMP also recognizes the limited and lopsided nature of its development to date:

"Structurally, it has a heavy dependence on production of components, accounting for 80 to 85 per cent of the industry's total output; and within this sector, semiconductors assembly and testing activities have predomi-

nated, contributing 83 to 92 per cent of total component output. The consumer and industrial electronics, which normally account for more than 55 to 70 per cent of total output in other NICs and advanced countries, only contribute 15 to 20 per cent in Malaysia. This lopsided structure makes the Malaysian electronics industry very precarious, particularly because components manufacturing is limited to relatively simple assembly and testing activities based on imported materials, and is dominated by foreign transnational corporations whose main motivations to operate in Malaysia are low wages and attractive tax incentives available in the country. The side effect of this extreme structural skewness is the lack of linkages within the industry, especially between the companies in FTZs and non-FTZs." (IMP, 1986: 49).

While claiming that foreign investment has made a positive contribution in manufacturing growth, the IMP acknowledges that the heavy and sustained dependency on foreign investment in some important industries in the key areas of technology, marketing, management and components supply jeopardises the development of an indigenous industrial base (IMP, 1986: 13). The plan also acknowledges that the manufacturing sector is dominated by large often foreign dominated firms. However, the IMP documents do not mention the massive outflow of the economic surplus in various forms as a consequence of foreign ownership and control of the manufacturing sector.

As the IMP acknowledges, the Malaysian manufacturing sector's technological dependence is excessive. Such dependence has resulted in the outflow of royalty payments, fees and other charges to the parent transnational, ostensibly in connection with technology transfer. As many transnational corporations actually prefer to get into joint-ventures with local firms, especially in industry and the services, such outflows have increased in significance compared to simple profit repatriation. It has been found that most joint ventures with local majority holdings have actually been controlled by the foreign partner, especially in technology-related matters (Abdul Razak, 1987).

There is very little evidence of any significant and meaningful transfer of technology. This should not be surprising nince, in the present context, technology is transferred only in so far as it is necessary and desirable for the foreign firm's profit maximization. Obviously, transnationals will not transfer technology so that the recipient can eventually threaten their domination. In their study of electronics and electrical firms in Malaysia in 1980, Cheong & Lim (1981) found that transnationals retained research and development activities with the parent firm in the home country and controlled equipment and parts supply, key personnel and marketing. Productive activities mainly involved assembly, processing and testing, requiring little skill and training – which were generally irrelevant to other manufacturing sector activities in any case. With weak linkages to the rest of the economy, other industries could hardly benefit from whatever technology transfer which might have taken place.

In summary, the IMP claims that the following five major problems have adversely affected Malaysian industrialization:

(1) technological dependence and lack of an indigenous industrial technology capacity;

(2) shortages of engineers and technicians;

(3) deficiencies in existing industrial incentive schemes including:
- ad-hoc and excessive domestic market protection;
- large firm and capital-intensive biases as associated with the pioneer status incentive;
- neglect of small industry problems and requirements;
- rigidities and inflexibility in the existing incentive scheme;
- biases in export incentives;
- few incentives for technological development;
- some major incentives not automatically available.

(4) lack of private sector initiative;

(5) constraints imposed by NEP restructuring efforts.

Unfortunately, although the IMP has provided much information and many useful insights into the problems of Malaysian industrialization, its overall analysis and policy recommendations have been severely constrained by the IMP's basic perspective. Lacking deeper appreciation of the overall character of the Malaysian economy and its history, and ignoring the class and state interests involved, the IMP is likely to remain very much a dead letter despite its bold vision and noble intentions. The following discussion will try to provide this perspective, before considering the IMP proposals in more critical light.

The success or failure of the government's current economic strategy, as articulated in the IMP and the Fifth Malaysia Plan, hinges crucially upon the performance of the industrial sector. The government's policy instruments to promote industrial growth include a battery of incentives, aimed to liberalise industrial investment and reduce market distortions. Some of the major policy instruments to this end include:

i) liberalisation of foreign investment;

ii) reduction of public sector service charges for electricity, water, international telephone calls, telex services, etc.;

iii) greater incentives for using local material as inputs;

iv) reduction in protectionism and greater encouragement of export oriented incentives;

v) greater export promotion efforts;

vi) concentration on a few selected industries with high potential;

vii) acceptance of the economics of location, i.e. virtual abandonment of regional dispersal efforts.

The IMP stresses the need to further develop natural resource based industries as well as improve indigenous technology and external competitiveness, while emphasising export expansion of selected priority industries. This would require policy measures such as:

(a) reduction and rationalisation of tariff structure to limit excessive protection and promote effeiciency.
(b) reduction of income tax on export earnings and strengthening the export credit scheme to encourage exports.
(c) relaxation of regulations, including licensing requirements and foreign equity ownership.

In line with this, foreign equity ownership conditions in the manufacturing sector were liberalized in July 1985, by linking the share of foreign equity ownership to the export share of total output. This was followed by further relaxation of the 1975 Industrial Coordination Act in 1985 and legislation of the Promotion of Investments Act in 1986. Additional incentives were also introduced in the 1986 and 1987 Budgets while subsequent government announcements have introduced yet more incentives.

While the IMP akcnowledges the incapability of Malaysia's industrial entrepreneurs (especially in terms of technology and organization) and the problems arising from the kind of state intervention that has taken place, it makes fairly predictable proposals focussing on technology, manpower and incentives. By ignoring the main reasons for the skewed character of the existing Malaysian market structure – largely attributable to the inequitable distribution of wealth and power, and hence income, and therefore purchasing power and the pattern of effective demands, as well as modern transnational corporate ideological influences – the IMP planners are left with little choice but to advocate yet more export-led industrialization.

In the process, they make crucial but unrealistic assumptions – (e.g. an impossibly rosy average GDP growth rate of 6.4 per cent yearly during 1986–95 – and wishfully set arbitrary ten-year targets such as a billion ringgit worth of tyre exports and another billion worth of industrial electrical equipment in 1995 – (from zero and S87 million ringgit in 1981 respectively).

For years, one of the main arguments advanced by the Malaysian government in defence of foreign investment has been the need for technology transfer. However, this argument is faulty even in conception. Rationally, it is inconceivable that transnationalreliant on their technological edge to ensure profitability will voluntarily surrender their special technological capacities to anyone else, especially potential competitors. This does not mean that no technology transfer will take place, but rather than such transfer are planned to maximize profitability, not to lose it. Hence, it is naive to expect that such

technology transfer can eventually develop an internatinally competitive technological capacity.

Perhaps, the most welcome IMP proposal is for reduction of excessive protectionism, which has inequitably protected profits and inefficiency among the usually foreign-dominated local factories at the expense of Malaysian consumers.

It is increasingly acknowledged that achievement of the IMP goals will depend very much on progress in the first couple of years. Yet, it is also acknowledged that such progress depends heavily on reform of the related bureaucracy, legislation and policies, which is unlikely to be achieved in the near future, especially in view of the entrenched vested interests involved.

The twists and turns of official Malaysian industrialization efforts have also given rise to criticisms that the government lacks well-coordinated, consistent and systematic long-term industrial planning, at least until the advent of the IMP. However, even the IMP offers no programme to develop a coherent and integrated industrial base with strong linkages between specific industrial sectors. Over the last three decades, there have also been major reversals or switches in industrial policy – e.g. from import substitution to export-oriented industrialization, from light to heavy industries and also away from regional dispersal efforts.

Private sector interests also complain of lack of consultation and participation in the formulation of industrial policies. Medium and small local industrialists feel especially ignored and neglected by the relevant government authorities, which are often accused of being more concerned with the interests of big, especially foreign capital, However, in the case of the Malaysian car project launched in the first half of the eighties, it appears that local car essemblers and their foreign principals were all ignored in the conceptualization, formulation and implementation of the project.

In this connection, it is often argued that several major industrial decisions have been made on political, rather than economic considerations, especially in connection with efforts in the early eighties to promote heavy industries. It is believed that some such projects were launched without adequate feasibility studies. Often, politicians and bureaucrats made crucial decisions and were put in charge of implementing such projects despite lacking an adequate understanding of and competence in the issues involved. Usually, such projectn involved joint-ventures, often with foreign firms, on terms unfavourable to the Malaysian government or the agency concerned due to political interference, incompetence and corruption.

THE 70 MILLION POPULATION POLICY

Another Mahathir policy, is the 70 million population target for the year 2100 AD, i.e. by the end of the twenty-first century. A completed family size including five children is now recommended in order to achieve this demographic goal. A great deal of discussion in the press and elsewhere has disputed several aspects of this policy, including the relationship between the recommended number of children and the new population target, the feasibility of accelerating population growth by increasing fertility, the desirability of more rapid population growth, as well as the rationale for the new population target itself.

In effect, the announcement of the new population target implicitly rejects neo-Malthusian population philosophy and policies, which have been imposed on Third World countries, such as Malaysia, by international aid agencies, such as the World Bank, often as a condition for obtaining loans. Such policies were promoted on the basis of the claim that underdevelopment and poverty in the Third World are due to excessive population growth rates caused by large families.

In 1974, the United Nations-sponsored World Population Conference rejected this view and put forward this recommendation instead: 'take care of the people and the population will take care of itself'. This recommendation took into consideration the prevalent belief that many parents are compelled to have many children in societies where the economic welfare of the members of the society is not assured by either society or the state. Then, the number of children parents have become their hope for additional family income, especially after the parents are old and no longer able to make their own living.

The rejection of neo-Malthusian population policies, although only implicit in the new population policy, is welcome. Nevertheless, it is important that women's right to control their own bodies, including their own reproductive capacities must be defended, while their advances in the social sphere, which have enabled them to take on new social roles (besides their traditional responsibilities as wives and mothers), should not be sacrificed in implementing the new policy, which has already been interpreted as an effort to drive women back into the sphere of the home.

Furthermore, the rationale for the new population policy should be examined critically. It is argued that heavy industrialization is essential to the achievement of the vision of Malaysia as a great society (sometimes interpreted in terms of becoming a newly industrializing country a la South Korea). Heavy industries, in turn, require a large domestic market, and this is to be created by increasing the size of the Malaysian population. However, the relationship between population size and the size of the local market needs clarification. The size of the domestic market is determined by the pattern and level of effective demand which is, in turn, influenced by the level and distribution of income, and hence, consumption or purchasing capacity. After all, economic needs are not necessarily expressed in terms of economic demand, except as mediated by income, and hence spending or expenditure capacity. Except for certain basic consumption needs (e.g. food, clothing, shelter) and amenities, a larger population does not, in itself, generate a correspondingly larger market. Hence, to get beyond basic needs type production, attention should be given to raising per capita income levels and ensuring more equitable distribution, rather than raising population numbers. Hence, increasing the population size cannot, by itself ensure a corresponding expansion of the local market. In fact, the increased expenditure required to support the costs of more rapid population growth will inevitably reduce the economic surplus available for capital accumulation to accelerate economic growth.

The implications of the new population policy for employment are also worrisome. By the mid-eighties, the unemployment rate had risen from 5.7 per cent in 1980 to 7.6 per cent in 1985 and 8.7 per cent in 1986 for Malaysia, and from 6.7 per cent in 1980 to 8.7 per cent in 1985 among Bumiputeras. Despite the current efforts to upgrade industry and to move out of labour-intensive agriculture and industries, as well as to increase worker productivity, serious consideration has not been given to how the increased population will be absorbed productively. In the absence of a clear strategy to deal with this problem, current economic policies appear to be contradictory, to say the least.

While it is true that it will be necessary to expand the size of the domestic market in order to develop a more balanced and self-reliant economy, this can be achieved by effective efforts to redistribute income and wealth more equitably. Various studies have shown that the poor have a higher marginal propensity to spend additional income (compared to the well-to-do) and that their expenditure is more likely to be spent on locally produced goods and services. Hence, it is clear that a self-reliant economic strategy will also require a more equitable distribution policy to ensure success.

THE NATIONAL AGRICULTURAL POLICY

In January 1984, the government released the long-awaited National Agricultural Policy (NAP). The final draft of the NAP document released to the public is said to have been personally authored by the Prime Minister himself. Despite the years of waiting for the NAP, it is short (only 13 pages) and not very specific on details. The new policies were only spelt out at greater length in the *Mid-Term Review of the Fourth Malaysia Plan* (MTR4MP) released later in 1984. NAP policies responded boldly to World Bank criticisms in 1983 about Malaysia's declining agriculture in a document entitled *Considerations for a National Agricultural Policy*, which criticised Malaysia's overinvestment in rice, slow progress in smallholding amalgamation and bureaucratic duplication and policy confusion.

The NAP's thrust complements other economic policies, especially efforts to accelerate industrialisation. The NAP emphasizes efforts to increase peasant incomes by raising productivity, and changing crops as well as agricultural management practices. The NAP includes plans to group rubber smallholders and rice farmers into larger-scale mini-estate operations to attain economies of scale in labour, management and production. Peasant farms, especially rice growers, are to be consolidated into larger mini-estates. All these proposals assume that farmers will opt for cash crops to maximise farm incomes.

Despite a considerable drop in its share of the Gross Domestic Product (GDP) – from 60 per cent in 1950 to about 20 per cent in 1983 – agriculture continues to contribute 30 per cent of Malaysian foreign exchange earnings. Agriculture sustained economic growth in the fifties and sixties, before Malaysia's manufacturing and petroleum exports became significant in the seventies.

The decline in the agricultural sector's performance has been especially serious in the eighties. Productivity has slipped, while sectoral growth rates for value added have dropped to 3.4 per cent per annum between 1981–85, compared to 4 per cent per annum during the seventies and 6.2 per cent per annum during the sixties. And if not for the continued expansion of palm oil production, agricultural sector growth performance would have been only

one per cent per year during 1981–85; new pollination techniques increased yield by 24 per cent in 1982 alone.

The good years for agriculture in the sixties and seventies resulted from buoyant world trade, rapid rubber production increase due to replanting programmes begun in the fifties, generous timber logging policies, an eleven-fold increase in oil palm acreage and several new large rice irrigation schemes – developments which are unlikely to be repeated in the forseeable future.

The NAP lays down long-term strategies to try to revitalise agriculture and reduce inefficiency in that sector. The document emphasises increased food production, setting production targets for greater meat, dairy and rice self-sufficiency, though it has reduced the previous emphasis on food self-sufficiency, and instead recommends export-oriented cash crops.

Both the NAP and the MTR4MP also recognise that food production programmes have suffered chronically "from lack of policy, organisation, technological and management capabilities". Although the NAP accepts that full self-sufficiency cannot be achieved, it still wants 80–85 per cent of national rice consumption produced domestically, with livestock and dairy production targets at somewhat lower percentages of national consumption levels. Hence, food production continues to be encouraged by the NAP for "national security reasons".

Balance of payments considerations also encourage more domestic food production. Malaysia imports ever-increasing amounts of food and animal feed. The World Bank estimates these imports at more than half of Malaysia's total requirements, while dairy produce, wheat, animal feed and sugar account for more than 60 per cent of agricultural imports. In fact, food imports reached $1.74 billion, or 5.7 per cent of total imports in 1982, an 8.7 per cent increase over 1981. Food imports increased further to $1.9 billion in 1984, before slowing down to $1.8 billion in 1985 and $1.7 billion in 1986. Rice imports particularly, fell by 54.6 per cent in 1986 to $117 million or 7 per cent between 1983–85 despite an 11.4 per cent decline in total rice production in 1986. Besides cutting down on growing imports, Malaysia's merchandise account would also gain from greater food exports.

The NAP recommends against new rubber planting, opting instead for oil palm expansion, mainly at the expense of existing rubber acreage. More cocoa and tobacco planting is also proposed. The government has virtually abandoned the previous practice of setting quotas or specific targets, whereas in the past, Malaysia's agricultural policies have focussed on particular export commodities, with little coordination among programmes. The NAP reflects the government's rejection of this approach.

Productivity differentials between the plantation sector (producing a few perennial export crops) and the peasant sector (producing food, about 70 per cent of the country's rubber in the mid-eighties and minor export crops such as pepper) have been growing wider. In 1985, rubber estate yields were 32 per cent higher than smallholder yields, averaging 1419 kg/ha, compared

to the latter's 1076 kg/ha. Drastic falls in agricultural commodity prices, forest conservation policies and the switch from rubber to oil palm have also adversely affected production of the commodities concerned.

The MTR4MP recognises "that the performance of agricultural productivity is now constrained by the small size of agricultural holdings, particularly of rubber smallholders and paddy farmers". The MTR4MP also recognises that "good agricultural land is becoming scarce". Extensive land development schemes have contributed enormously to smallholder export crop production by adding 25 per cent more agricultural land after 1956. The MTR4MP also notes that land development costs and the amount of idle farmland were both rising. With 60 per cent of suitable land already under cultivation, "the reluctance of various states to allocate land to federal agencies" has now become a major constraint to future land development.

The NAP envisages major changes for the public agencies providing extension, marketing and other services to farmers. The Federal Land Development Authority (Felda), the Rubber Industry Smallholders Development Authority (Risda) and the Malaysian Rubber Development Corporation (Mardec) appear to be the prime targets for such organizational and policy reform. In rubber marketing, for example, agencies have competed with one another overseas, while duplicating one another, often at great cost, in domestic transport and processing services. Felda and Risda, in particular, have developed reputations for empire building. The MTR4MP argues that the government presence in agriculture has been excessive, proposing that future agricultural investment must depend primarily on private sector investments, in line with public sector development expenditure cutbacks since mid-1982.

In 1983, the major sources of agricultural credit were Felda (which gave almost 50 per cent of all agricultural loans and credit), commercial banks, finance companies, the government's Bank Pertanian (Agricultural Bank) and various rural cooperatives. With the reduced public sector role, in 1983, private financial institutions increased their share of new agricultural loans by about 12 per cent over 1982. However, whether the private sector will respond to calls for greater agricultural investment is problematic. In 1983, banks and other financial institutions lent almost $17 billion for property development, compared to only $4 billion for agriculture. In 1985, bank loans to the property sector increased to $21.0 billion, compared to $4.8 billion for agriculture. Furthermore, most private sector lending went to plantation enterprises, rather than small farmers, and to activities such as leasing heavy agricultural machinery. Recent government moves – such as the decision to increase the possibilities of using Malay reserve land as collateral, or changes to the land code facilitating amalgamation of agricultural land – may eventually make private institutional loans to small farms more attractive.

For many years, rice production has been strongly identified with rural poverty. According to the MTR4MP, in 1983, 54 per cent of rice farmers

lived below the poverty line. Citing a different government source, then UMNO Youth leader, Anwar Ibrahim said that 76.2 per cent of rice farmers were living below the poverty line in 1983. Although more than two billion ringgit has been spent on development of the rice sector (mainly for irrigation infrastructure) since the fifties, rice agriculture continues to be highly dependent on subsidies.

While the NAP emphasises efforts to increase output, no anti-poverty strategy is proposed to overcome problems arising from existing land tenure systems and rural development strategies biased against small producers. To refute the need for land reform, the Prime Minister had claimed that Malaysia has no absentee-landlord problem. Consolidating uneconomic-sized farms into mini-estates is Mahathir's alternative to redistributing rural land. Mini-estates are proposed to overcome problems of uneconomic farm sizes and idle land; this would obviously favour landowners over those without land of their own. Land reform measures to overcome land hunger, limit land rents and provide land to the tiller are ignored. Even the cooperative movement is de-emphasized, while modern capitalist agricultural management practices are expected to resolve the main problems currently associated with peasant agriculture.

LABOUR POLICIES IN THE EIGHTIES

More authoritarian anti-labour policies have been pronounced since the start of this decade. After the tightening up of the labour laws in 1980, in the aftermath of the 1978/79 MAS industrial action, industrial relations machinery and labour policies have changed largely at the expense of labour, while wage employment has continued to rise despite growing unemployment since 1982. Membership of trade unions have actually declined in the early 1980s while the official unemployment rate has risen from 4.7 per cent in 1982 to 9.5 per cent in 1987, and is expected to rise to 9.4 per cent in 1988. The increasingly widespread use of poorly paid immigrant labour – especially in plantation agriculture, land development schemes and construction – as well as government and management endorsement of more easily controlled in-house unions have further weakened the bargaining position of labour in the 1980s. In the meantime, the government's emphasis on work ethics and related schemes (such as quality control circles) are intended to boost labour productivity at minimal cost to management. The penalties for those who step out of line have been sufficiently severe to discourage labour militancy.

During the sixties and seventies, there were occasional government efforts to portray itself as a neutral arbiter standing above and mediating between capital or management and labour, though by and large, the state generally favoured capital over labour, e.g. as reflected in various amendments to the labour laws or the government's role in industrial relations. In the eighties, however, the anti-labour character of the state has become even more blatant, as can be seen in the following brief review of the more important recent labour policies.

This new era is generally seen as dating from the harsh government reaction to the industrial action by employees of the government-owned Malaysian Airlines System (MAS) in late 1978. Soon after the industrial action came to public attention, the government directly and openly intervened to intimidate the MAS employees, eventually detaining – without

trial – several of the more active union leaders under the notorious Internal Security Act (ISA). Later, MAS employees were disallowed from continuing to be members of the Airline Employees Union (AEU). Instead, the government and MAS's management sponsored a new in-house union exclusively for MAS employees, which has proved to be more docile and manipulable. In 1980, the government introduced further amendments to tighten up the already restrictive labour laws, further limiting union rights and increasing government control over them.

With relatively high economic growth in the seventies, especially with the development of labour-intensive, export-oriented industries and the public sector, the official unemployment rate reached a post-independence low of 5.7 per cent in 1980. With emigration of Malaysian labour to Singapore and elsewhere, especially the Middle East, increasing in the mid and late seventies, real wages actually rose, and pockets of labour shortages even emerged, usually in activities offering low wages, poor work conditions and the option of easy outmigration. To offset the pressure on wages, and ostensibly to overcome these labour shortages, the government adopted several measures, most notably by tacitly approving increasing extra-legal labour immigration, primarily from Indonesia, Southern Thailand (especially to the northern States of Peninsular Malaysia) and the Southern Philippines (to Sabah). The magnitude of such recent illegal immigration is difficult to measure, but estimates vary from half a million to a million and a half by the mid-eighties – compared to a national population of over sixteen million and a labour force of less than six million. Recessionary tendencies generally, as well as attempts to freeze and reduce the size of the public sector through privatization have resulted in increasing unemployment in the 1980s as well as other pressures on wages. The increased use of illegal immigrant labour and contract labour has further depressed real wages. Although sometimes justified in terms of the need for the Malay-dominant government to strengthen itself further by increasing the number and proportion of ethnic Malays, the tacit approval of such massive illegal labour immigration has adversely affected wages.

Soon after Mahathir's ascendance to the prime ministership in mid-1981, he announced his Look East policy. Initially, this policy was widely believed to refer to changing foreign orientation in a wide variety of matters. 'Looking East' seemed to refer not only to efforts to emulate specific aspects of Japanese and South Korean success in terms of economic development, especially industrialization, e.g. by state intervention to develop heavy industries, state encouragement for the establishment of Japanese-style sogoshosha trading agencies, 'Malaysia Incorporated' or efforts to get the government bureaucracy to better serve private sector interests and even

privatization. For a time, 'Looking East' was also believed to mean favouring Japanese and South Korean investors, as well as companies bidding for Malaysian government tenders, e.g. an estimated six billion ringgit of construction projects are believed to have been given to such companies in the early eighties.

After considerable criticism (not least by those disfavoured by the new preferences) and some experience (some of which has been very costly, e.g. with heavy industries and the sogoshosha experiments), Mahathir emphasized that the main thrust in Looking East should involve the inculcation of Japanese-style work ethics, mainly referring to efforts to increase productivity through harder work and greater loyalty to the company (and management). And while the Japanese 'achievement' in this regard has involved complex culturally and historically rooted systems of material incentives (e.g. including guaranteed life-long employment and seniority wage systems), the Malaysian version has emphasized virtually costless work ethics, quality control circles (QCCs) and in-house unions.

The blatant government promotion of in-house unions in the 1980s represents a departure from previous labour policy. In-house unions have existed for some time in Malaysia, mainly in the statutory bodies. In the mid-1970s, the government intervened on behalf of management to enable the establishment of an in-house union for employees of United Motor Works (UMW), although many of the workers involved had already joined another union, not unlike what happened a few years later with the MAS employees. Despite ostensible government support for in-house unions, very few new in-house unions have been registered where no unions existed before. Instead, it appears that in-house unions are being encouraged to replace 'troublesome' unions already in existence. Seen in this light then, government encouragement of in-house unions for the private sector appears to be intended to further weaken the already weak trade union movement in the country.

In his 1987 Budget speech, delivered in October 1986, the Finance Minister called for a voluntary wage freeze for the following three years. The government made no commitment, however, to instituting a freeze on prices, nor did it try to explain why such a freeze was needed for three years. Instead, a mandatory wage freeze was threatened if the call for a voluntary freeze was not heeded. In the context of rising prices and productivity, a wage freeze would enable capital to increase its share of the product at the expense of labour. With growing unemployment, this would mean that a growing population would be dependent on decreasing real wages.

Other developments in the eighties as well as proposed amendments to the labour laws to encourage in-house unions, and reduce overtime payments and retrenchment benefits further confirm the essentially anti-labour drift in the eighties after some economic – though not political – gains for labour in the seventies, largely attributable to high growth and low unemployment.

DEBT ADDICTION

Malaysia's debt problem is relatively recent in origin, having grown out of the fiscal and balance of payments crises of the early eighties. On the one hand, as we have seen as a result of the decline in most Malaysian primary commodity prices since the beginning of the decade, and declining prospects for export-oriented industries due to growing protectionism in the OECD economies, the two main engines for Malaysia's export-led growth have been in serious trouble. This has, in turn, adversely affected Malaysia's balance of payments position, particularly the current account. On the other hand, Malaysia's counter-cyclical budgetary strategy during 1980–82, and the continued growth of off-budget public expenditure for several years after that have required financing. Malaysia's high credit rating, due to its impressive growth record in the sixties and seventies and other factors (e.g. its status as a net oil-exporting economy), enabled it to quickly accumulate a huge external debt in addition to its growing domestic debt – in the early eighties.

Many of the loans (from both domestic and foreign sources) went into what are now acknowledged to be "non-performing projects" which are not expected to yield sufficient returns to service the loans. Such projects include poorly planned projects, such as the Kuantan Port, East-West Highway and the $1.2 billion Perwaja steel mill; prestige projects, such as the $850 million Penang Bridge, the $0.3 billion Daya Bumi building and the $1.2 billion Komtar Complex in Penang; heavy industrial projects, such as the Proton car project, the new cement plants in Langkawi and Perak.

The government's austerity campaign announced in June 1982, after the April general elections, signalled the end of the previous counter-cyclical budgetary policy. In the next two years, the government trimmed development expenditure drastically, from the announced budgetary allocation of $14.6 billion for 1982 to $8.7 billion for 1984. However, continued government-guaranteed borrowings by non-financial public enterprises (NFPEs) not subject to the usual constraints of the federal budget sustained the rapid growth of the public debt, especially the foreign debt, over the next couple of years, before new borrowings began to level off around the mid-eighties.

However, since 1983, the NFPE expenditure has increasingly come under closer scrutiny. In 1985 the government set up a Central Information Collection Unit (CICU) to monitor the performance and financial position of 841 public enterprises in which the government has a stake. Fifty-six major NFPES have been identified for monitoring and reporting. Even recently, development spending by the NFPEs has remained substantial at $7.2 billion in 1985 and $6 billion in 1986 compared to total Federal government development expenditure of $6.8 billion in 1985 and $7.5 billion in 1986. In 1986, outstanding loans given by the federal government to state governments, NFPEs and state owned companies amounted to $33 billion. The depreciation of the US dollar since September 1985 has also increased the size of the Malaysian external debt denominated in most other currencies (notably the yen) since the government has let the Malaysian ringgit depreciate with the US dollars. The following analysis traces the rapid growth of the Malaysian public debt, especially foreign borrowings, in the early eighties.

Growth of the Public Debt

The total outstanding federal government debt over five years doubled from $11.3 billion in 1975 to $23.4 billion in 1980, before jumping to $30.6 billion in 1981, $41.1 billion in 1982, and then growing increasingly gradually to $50.8 billion in 1983, $58.8 billion in 1984, $62.5 billion in 1985 and $70.0 billion in 1986.

Over the past decade, the domestic debt has grown fairly steadily from year to year, doubling from $8.9 billion in 1975 to $18.5 billion in 1980, and then again to $40.7 billion in 1985 and $45.2 billion. It is estimated at $45.2 billion in 1986. The most important source of government domestic borrowing has been the sale of government securities – purchased primarily by the Employees Provident Fund (EPF) – which have grown quite steadily throughout the decade, from $7.4 billion in 1975 to $16.8 billion in 1980 and $36.6 billion in 1985, and is expected to increase to $40.9 billion in 1986. Treasury bills, however, have not increased significantly during 1975–80, but doubled from $1.4 billion in 1980 to $2.8 billion in 1985, and is expected to reach $3 billion in 1986. Government (mainly short-term) loans from commercial banks and others have risen from an average of $0.3 billion during 1975–82 to around $1.0 billion during 1983–6.

The federal government's external debt also grew steadily during 1975–80, doubling over five years from $2.4 billion in 1975 to $4.9 billion in 1980, before jumping to $8.3 billion in 1981, and $13.2 billion in 1982, and then rising more slowly to $17.7 billion in 1983, $20.8 billion in 1984, $21.8 billion in 1985 and $24.9 billion in 1986. New federal government borrowings jumped from $2.1 billion in 1975 to $2.6 billion in 1980 to $7.5 billion in 1981 and $10.8 billion in 1982, before declining to $8.9 billion in 1983, $7.2 billion in 1984, $4.5 billion in 1985 and $6.3 billion in 1986.

Project loans and market loans remained roughly equal during 1975–80. However, most of the growth in government foreign borrowings after 1980 has been from market sources. Project loans have grown quite steadily over the past decade from $1.1 billion in 1975 to $2.7 billion in 1980, $5.1 billion in 1985 and $6.2 billion in 1986. Market loans grew more slowly in the second half of the seventies, from $1.3 billion in 1975 to $2.2 billion in 1980. However, they jumped during the next four years to $4.8 billion in 1981, $9.0 billion in 1982, and $12.3 billion in 1983, before slowing down to $14.7 billion in 1984, $15.5 billion in 1985 and $17.8 billion in 1986.

Hence, the proportion of market loans to total (project and market) foreign borrowings actually declined from 56 per cent in 1975 to 45 per cent in 1980, before jumping to 76 per cent in 1983, and then declining slightly to 71 per cent in 1985 and 72 per cent in 1986. The actual proportion of market loans in total external public debt is actually even higher because most federal government guaranteed external loans are from private financial market sources. Market loans from private sources generally involve higher interest rates and virtually no supervision of how the borrowed funds are used, though project loans – usually from multilateral aid agencies – may involve other more onerous terms (e.g. conditionality), especially once the country's credit rating drops due to excessive borrowing, declining balance of payments position, etc.

In the meantime, federal government-guaranteed loans (mainly for the NFPEs) doubled from $0.6 billion in 1975 to $1.3 billion in 1976, and then grew more gradually to $3.6 billion in 1981, before accelerating again to $5.0 billion in 1982 and $7.0 billion in 1983, and then growing more slowly to $8.9 billion in 1984 and $9.9 billion in 1985, before jumping to $17.0 billion in 1986. Most of this increase has been accounted for by foreign borrowings, which rose fairly steadily from $0.6 billion in 1975 to $2.4 billion in 1980 and $3.7 billion in 1982, before accelerating to $9.1 billion in 1985 and $15.2 billion in 1986. Federal government guaranteed domestic loans rose from a negligible $11 million in 1975 to $0.7 billion in 1980 and $1.8 billion in 1984, before dropping to $0.8 billion in 1985 and an estimated $1.8 billion in 1986.

The total outstanding Malaysian public debt – inclusive of federal government-guaranteed loans – therefore rose quite steadily from $11.9 billion in 1975 to $26.5 billion in 1980, before jumping to $34.2 billion in 1981, $46.2 billion in 1982 and $57.8 billion in 1983, largely due to the sudden huge increase in government market loans from abroad. Malaysia's outstanding public debt has since grown more slowly to $66.7 billion in 1984, $72.4 billion in 1985 and $87.1 billion in 1986.

Net public sector domestic borrowings rose from $2.5 billion in 1980 to $3.7 billion in 1981, $6.4 billion in 1982 and $5.3 billion in 1983, $4.2 billion in 1984, $2.7 billion in 1985 and $5.5 billion in 1986, while net public sector external borrowings jumped from $0.6 billion in 1980 to $4.0

billion in 1981 and $5.6 billion in 1982, before slowing down to $6.3 billion in 1983, $4.7 billion in 1984, $3.0 billion in 1985 and $9.2 billion in 1986.

Public sector domestic borrowings have risen fairly steadily both before and after 1980. The dramatic growth in the public debt after 1980 has largely been due to very much increased foreign borrowings in 1981, which have only decelerated gradually and unevenly since then. Total outstanding public external debt jumped by 55 per cent during 1980–81, compared to only 9 per cent the previous year in subsequent years; public sector foreign borrowings grew by 50 per cent (1981–82), 38 per cent (1982–83), 20 per cent (1983–84), 11 per cent (1984–85) and 30 per cent (1985–86) respectively.

In the meantime, the domestic debt component of the total outstanding public debt vacillated slightly in the late seventies, declining only slightly from 75 per cent in 1975 to 72 per cent in 1980. However, with the tremendous growth of foreign borrowings after 1980, this proportion fell to 67 per cent in 1981, 53 per cent in 1982, 60 per cent in 1983, 58 per cent in 1984, 57 per cent in 1985 and 54 per cent in 1986. Conversely, the foreign debt component of total public debt rose slowly from 25 per cent in 1975 to 28 per cent in 1980, before jumping to 43 per cent in 1985, and 46 per cent in 1986.

As a proportion of the Gross National Product (GNP), federal government debt has grown from 10 per cent in 1980 to 28 per cent in 1983, and 32 per cent in 1985, and 43 per cent in 1986, while the total public sector debt (including federal government guaranteed loans) rose from 21 per cent in 1980 to 49 per cent in 1985 and is 66 per cent in 1986. Taking private sector debt into consideration, the total Malaysian foreign debt as a proportion of the GNP rose from 28 per cent in 1981 to 42 per cent in 1982, 49 per cent in 1983, 51 per cent in 1984, 59 per cent in 1985 and 77 per cent in 1986! Private sector debt in Malaysia is not only significant in itself, but also because much of it has been borrowed by government – owned or controlled private sector companies, though some of it, of course, consists of loans by foreign companies to their local branches, subsidiaries, etc..

Malaysian government policymakers have prided themselves on the fact that as a proportion of Malaysia's total exports, public external debt servicing has remained low. According to the World Bank, it was only 6.8 per cent in 1984, comparing favourably with Brazil, Mexico and South Korea. While relevant, this provides us with a rather distorted picture because Malaysia is a very open economy exporting about three fifths of what it produces. In fact, the size of Malaysia's external debt in relation to its GNP is a matter of great concern. Malaysia's total external debt was 51 per cent of its GNP in 1984, compared to the developing country average of 40 per cent. Malaysia's public external debt was 38 per cent of its GNP in 1984, compared to the developing country average of 33 per cent in 1984, while public external debt servicing came to 6.9 per cent of the GNP, about fifty per cent higher than the developing country average of 4.5 per cent in 1984. This apparently

paradoxical situation – of a relatively high debt ratio to GNP on the one hand and a relatively low debt servicing ratio to GNP – is easily explained. Debt ammortization or repayments on loans incurred during the early eighties borrowing spree were mostly not yet due before 1984. However, principal repayments rose significantly between 1984–86, with the maturity of several big loans obtained in the early eighties. The situation will probably look worse in 1987–88, as many of the debt chickens from the early eighties come home to roost.

Capital Flight

In an article published in *World Financial Markets* (March 1986), the Morgan Guaranty Trust Company estimated that capital flight from Malaysia totalled US$12 billion (about M$30 billion) during 1976–85. The article concluded that if not for capital flight, Malaysia's gross external debt of US$20 billion could have been reduced to US$4 billion. It also argued that Malaysia's gross debt as a percentage of exports of goods and services would have been 18 per cent – instead of 103 per cent! – at the end of 1985, if not for capital flight. The article also cites an IMF estimate of identifiable Malaysian non-bank residents deposits in foreign banks of US$1.0 billion in September 1985!

According to another estimate by the World Bank, unaccountable capital outflows from Malaysia exceeded US$7.7 billion (about M$20 billion) during 1979–85. (*The Star*, 25 November 1986). Data derived from the exchange records of the banking system suggest that more than M$10 billion was taken out of Malaysia during 1983–85 for investment or to be placed in fixed deposits with foreign banks (*New Straits Times*, 27 November 1986).

Debt Servicing

Federal government debt servicing has grown from $1.1 billion in 1975 to $2.6 billion in 1980 and $6.1 billion in 1984, before doubling to an estimated $12.2 billion in 1985 and then declining to $7.1 billion in 1986. Predictably, domestic debt servicing has risen fairly steadily from $0.7 billion in 1975 to $2.0 billion in 1980 and $4.2 billion in 1985 before falling to $3.7 billion in 1986. Federal Government foreign debt servicing has risen a little faster from $0.3 billion in 1975 to $0.6 billion in 1980 and $2.6 billion in 1984, before jumping to $8.0 billion in 1985, before declining to $3.4 billion in 1986.

Federal government principal repayments (loan ammortization) rose from $0.4 billion in 1975 to $1.1 billion in 1980 and vacillated during 1980–4, before soaring to an estimated $7.2 billion in 1985 (mainly due to foreign loan prepayments to take advantage of lower interest rates), before declining sharply to $1.9 billion in 1986. Federal government interest payments, on the other hand, have risen more steadily, while reflecting the growing size of the debt, interest rate fluctuations and the increasing proportion of

foreign, especially market loans. Hence, not surprisingly, the fastest growing item in federal government operating expenditure has been debt servicing.

As a proportion of operating expenditure, federal government debt servicing rose from 23 per cent in 1983 to 31 per cent in 1984, before jumping to 61 per cent in 1985 (mainly due to early loan prepayments) and declining to 35 per cent in 1986. Federal government foreign debt servicing alone rose from 4 per cent in 1980 to 13 per cent in 1984, before jumping to 40 per cent in 1985 (again due to prepayments), before declining to 16 per cent in 1986.

Meanwhile, debt servicing as a proportion of federal revenue rose from 23 per cent in 1983 to 29 per cent in 1984, before soaring to an estimated 58 per cent in 1985 (prepayments again), before declining to 37 per cent in 1986.

In 1975, new borrowings of $2.1 billion significantly exceeded debt service payments of $1.1 billion by 97 per cent. By 1980, after a few more years of steady debt expansion, debt servicing ($2.6 billion) had caught up with new borrowings (also $2.6 billion). The tremendous growth of debt in the early eighties pushed new borrowings well ahead of debt servicing during the years 1981–83, but by 1984, the chickens began to come home to roost as debt servicing ($6.1 billion) almost caught up with net borrowings ($7.1 billion). In 1985, debt servicing ($12.2 billion) was almost the value of net borrowings ($4.5 billion), though in 1986, debt servicing exceeded net borrowing by only 12 per cent.

Malaysian external debt servicing payments rose from $2.3 billion in 1981 to $3.1 billion in 1982, $3.7 billion in 1983, $5.3 billion in 1984, $7.0 billion in 1985 and $7.4 billion in 1986. Servicing of public sector loans rose from $1.2 billion in 1981 to $1.9 billion in 1982, $2.3 billion in 1983, $3.4 billion in 1984, $5.0 billion in 1985 and $5.4 billion in 1986. External public debt servicing grew steadily during 1981–83, before accelerating during 1983–85. Federal government external debt servicing rose from $0.8 billion in 1981 to $1.4 billion in 1982, $1.7 billion in 1983, $2.4 billion in 1984, and $3.0 billion in both 1985 and 1986, while servicing of federal government guaranteed loans rose from $0.4 billion in 1981 and 1982 to $0.5 billion in 1983, $1.0 billion in 1984, $2.0 billion in 1985 and $2.5 billion in 1986.

Interest payments abroad grew steadily with the growth of the external debt, being offset only slightly by the lowering of interest rates in the mid-eighties. Total interest payments abroad rose from $1.2 billion in 1981 to $1.6 billion in 1982, $2.1 billion in 1983, $3.0 billion in 1984 and $3.5 billion in 1985, before decreasing slightly to $3.3 billion in 1986. Interest payments on the public sector external debt rose from $0.8 billion in 1981 to $1.2 billion in 1982, $1.6 billion in 1983, $2.4 billion in 1984, $3.0 billion in 1985 and $3.1 billion in 1986. Interest payments on federal government foreign loans rose quite steadily from $0.6 billion in 1981 to $1.0 billion in 1982, $1.2 billion in 1983, $1.7 billion in 1984, $2.1 billion in 1985, and

$1.9 billion in 1986, while interest payments on government-guaranteed external debt rose from $0.2 billion in 1981 and 1982 to $0.3 billion in 1983, $0.7 billion in 1984, $0.9 billion in 1985 and $1.0 billion in 1986.

Clearly then, the continued increase in external debt servicing has been primarily due to the increase in debt repayments or loan ammortization after 1983. Total external debt repayments rose from $1.1 billion in 1981 to $1.5 billion in 1982 and 1983, $2.3 billion in 1984, $3.5 billion in 1985 and $4.1 billion in 1986. Public external debt ammortization rose from $0.4 billion in 1981 to $0.7 billion in 1982 and 1983, $1.0 billion in 1984, $2.0 billion in 1985 and $2.5 billion in 1986. Most of this was initially accounted for by federal government loan repayments, which rose from $0.2 billion in 1981 to $0.5 billion in 1982 and 1983, $0.7 billion in 1984, $0.9 billion in 1985 and $1.1 billion in 1986. Meanwhile, repayment of government-guaranteed loans shot up from $0.2 billion yearly during 1981–83 to $0.3 billion in 1984, $1.1 billion in 1985 and $1.4 billion in 1986. Loan repayments also increased during 1984–6 because the Malaysian government chose to amortize its fixed interest rate loans incurred during the initial phase of the borrowing spree in the early eighties when higher interest rates prevailed.

The gross external debt service ratio has been rising rapidly with the growth of foreign borrowings and especially loan repayments – from 7.1 per cent in 1981 to 9.2 per cent in 1982, 97 per cent in 1983, 11.4 per cent in 1984, 15.8 per cent in 1985 and 17.6 per cent in 1986. The public sector external debt service ratio alone has grown from 3.8 per cent in 1981 to 5.6 per cent in 1982, 6.0 per cent in 1983, 7.5 per cent in 1984, 11.3 per cent in 1985 and 12.8 per cent in 1986. This has been largely due to the rise of the federal government external debt service ratio from 2.6 per cent in 1981 to 4.3 per cent in 1982, 4.6 per cent in 1983, 5.3 per cent in 1984, 6.7 per cent in 1985 and 7.0 per cent in 1986. As explained earlier, debt service ratios have been much higher during 1984–86 as the Malaysian government made prepayments.

New loans of $11.1 billion in 1985 and $5.7 billion in 1986 and the depreciation of the ringgit took the public sector external debt from $30.5 billion in 1984 and $35.1 billion in 1985 and $43.5 billion in 1986. If the mounting outstanding external debt is taken into account, the World Bank's debt servicing projections for Malaysian public sector external debt servicing for 1984–91 based on outstanding loans as of 1984 would be much higher. Hence, based only on the outstanding public sector external debt of $28.0 billion as of 1984, debt servicing was expected to rise to $6.6 billion in 1988, before falling off after that. However, this is unlikely to happen because the Malaysian public sector external debt continues to grow, albeit not as rapidly as in the early eighties.

Malaysia's total outstanding external debt has grown from $24.3 billion in 1982 to $51.0 billion in 1985, while the private sector's external debt has remained quite steady averaging about $7.5 billion during 1982–86. Hence,

Malaysia's public sector external debt has grown from $16.9 billion in 1982 to $43.5 billion in 1986. During 1982–86, the NFPE external debt grew more rapidly from $3.7 billion in 1982 to $15.2 billion in 1986 compared to the federal government external debt which grew from $13.2 billion in 1982 to $28.3 billion in 1986.

The continuing rapid growth of the outstanding external debt contrasts greatly with the general decline in net borrowing during the period. Net external borrowing declined from $8.7 billion in 1982 to $1.1 billion in 1986, with private sector net borrowings declining from $3.0 billion in 1982 to $0.2 billion in 1985, before actually turning negative with repayments exceeding new disbursements by $0.4 billion in 1986. Net federal government borrowing has gone down quite steadily from $4.9 billion in 1982 to $1.3 billion in 1986. An unusual kink occured in 1985, when the federal government prepaid many of its earlier loans taken at higher fixed rates, replacing most of the new loans at lower variable interest rates. Hence, while disbursements of new loans to the federal government generally declined from $5.6 billion in 1982 to $2.9 billion in 1986, in 1985, new disbursements shot up to $7.3 billion. Correspondingly, federal government loan repayments and prepayments rose relatively steadily from $0.5 billion in 1982 to $1.5 billion in 1986, except in 1985, when such loan ammortization payments jumped to $6.4 billion.

Meanwhile, net NFPE borrowing rose from $0.8 billion in 1982 to $2.3 billion in 1984, before declining to $0.2 billion in 1986. New NFPE loan disbursements rose from $1.1 billion in 1982 to $2.7 billion in 1984, before declining to $1.6 billion in 1986, while NFPE loan repayments have risen from $0.2 billion in 1982 to $0.3 billion in 1984 and $1.4 billion in 1986.

Net external borrowings – i.e. after deducting loan repayments and repayments from gross loan disbursements – rose by $8.7 billion in 1982, $7.8 billion in 1983, $5.7 billion in 1984, $2.2 billion in 1985 and $1.1 billion in 1986. However, the outstanding external debt increased by $7.5 billion in 1983, $5.4 billion in 1984, $5.1 billion in 1985 and $8.7 billion in 1986. Hence, while the increases in the outstanding external debt largely reflected net external borrowings in 1983 and 1984, the increases in the outstanding external debt were $2.9 billion (135 per cent) and $7.6 billion (693 per cent), higher than the net external borrowings in 1985 and 1986 respectively. Similarly, the federal government's outstanding external debt increases exceeded net borrowings by $1.3 billion (132 per cent) in 1985 and $3.9 billion (288 per cent) in 1986, while the NFPEs outstanding external debt increases exceeded net borrowings by $1.4 billion (146 per cent) in 1985 and $3.0 billion (1847 per cent) in 1986.

This growing discrepancy in 1985–86 was probably largely due to the depreciation of the ringgit from September 1985, not only against the yen and some major European currencies, but even against the US dollar itself before early 1987. Since most of Malaysia's external borrowings have been

denominated in either US dollars or Japanese yen, the depreciation of the ringgit in late 1985 and during 1986 has significantly increased the size of Malaysia's external debt denominated in ringgit. The data also suggests that NFPE external debt has been proportionately more greatly affected by the depreciation of the ringgit compared to the federal government. This suggests that a far higher proportion NFPE debt has been yen-denominated compared to the 17 per cent of the federal government debt which was yen-denominated in 1986 (Treasury, 1986).

Perhaps even more importantly, debt – like drugs – is addictive. The more one borrows, the more one needs to borrow. Let us say a country borrows $1,000 each year from abroad, to be repaid in five equal instalments over five years plus a 10 per cent interest on the annual balance outstanding. After servicing the debt (i.e. repaying the principal plus paying interest), the net capital inflow declines each year, eventually becoming negative. By the third year, $840 of the new $1,000 loan goes for debt service payments. In the fourth year, the new $1,000 loan is no longer sufficient to meet accumulated debt obligations. Hence, a government's development plan requiring a net foreign loan inflow of $1,000 annually actually requires an increase in borrowing, which would involve a growing foreign debt. Hence, once it starts borrowing, it is hard for a government to stop. It would still need to keep borrowing unless it develops alternative sources of foreign exchange earnings, e.g. a growing trade surplus. In the example then, $1,080 would have to be borrowed in the fourth year and $1,300 in the fifth year only to service the accumulated debt. And if exports decline or interest rates rise, even more borrowing is needed.

Hence, it should be clear that most countries – including Malaysia – cannot seriously expect to borrow their way out of economic difficulties. If anything, such borrowing usually tends to worsen, rather than relieve the economic resource shortages it is supposed to overcome. Hence, it should be very clear that what was perceived as a solution to an apparently temporary problem in the early eighties has actually turned out to be a virtually permanent affliction on the Malaysian economy in the form of debt addiction.

MONEY POLITICS IN MALAYSIA*

Harold Crouch

Prime Minister Mahathir Mohamad has issued several strong warnings recently against the spread of "money politics" in the United Malays National Organization, the dominant party in Malaysia's ruling coalition. This isn't a new theme for Dr. Mahathir. In 1984, he warned that "one day only the millionaires will lead the UMNO." He went on to say that "If we sell our vote today, one day we will sell our party and possibly our country."

Corruption is indeed a growing problem for the UMNO, especially as more middle-class Malays enter politics and the competition for political power grows. The buying of votes in internal party elections and the use of other dirty tactics such as smear campaigns could undermine the confidence of the people in the UMNO's capacity to lead the country.

Dr. Mahathir's recent warning came in mid-1985 as the UMNO's local branches and divisions were holding elections. The most important posts at stake in 1985 were those of division head, the party leader in each of the peninsula's federal parliamentary constituencies. By winning the divisional leadership, an aspiring politician can put himself in a good position to be selected as the party's candidate for a seat in the national Parliament or at least a state assembly. Sitting members who lose divisional contests are in danger of being dropped from the party's ticket. The struggle at the divisional level in 1985 was particularly intense because of rumours that the government might call an early election before the term of Parliament expired in 1987.

Political campaigning within the party can be expensive. Candidates are expected to supply food and drink to party members who come to listen to their speeches, and it is essential, especially in rural areas, to provide transport to bring supporters to the polling booths. Besides these indirect ways of winning support, there is also direct buying of votes. Small sums might be given to ordinary party members, while those with influence can obtain more substantial rewards.

In his recent warning, Dr. Mahathir claimed that some local influence-ped-

* Edited from *Asian Wall Street Journal*, June 17, 1985.

dates receive all-expense-paid trips to Tokyo or Medan while others get pilgrimages to Mecca. Dr. Mahathir also mentioned the case of one local leader, who is said to have spent $800,000 on his campaign to head a division. Stories of others spending $100,000 or $200,000 are not uncommon.

The sharp rivalry between aspiring leaders at the local level has brought about great changes in the party during the past 20 years. In the old days it was common for UMNO local meetings to be held in the house of one of the members, with the wives providing light refreshments. Former UMNO Secretary-General Mustafa Jabar said in 1984 that "In those days, almost everyone was reluctant to hold posts, less still to contest against their friends for any post, for fear of offending or hurting the feelings of others. They had to be coaxed or even forced to hold posts. But now it is different."

In the past, most of the UMNO's members lived in villages and a large proportion of its local leaders were schoolteachers. Even during the 1970s, it was estimated that about 40% of the delegates to the party's annual General Assembly were teachers. But now the teachers are being pushed aside by a new generation of businessmen and professionals who often reside in Kuala Lumpur or the provincial capitals but return to their home villages each weekend to canvass local support. Nowadays, party meetings are no longer held in members' homes but often in big hotels with the expenses borne by contestants.

Unlike the teachers, whose daily contact with party members gives them a natural channel for influence, the urban politicians must use other means. As Information Minister Rais Yatim said last year: "This man comes in a big car to the kampung (village) and talks to the *ketua kampung* (village head), 'Here take this $1,200, and how about making me the branch (village-level) leader.' Well, $1,200 is the ketua kampung's allowance for one year; of course he's tempted."

The influx of Malay businessmen and professionals into the UMNO is a result of the New Economic Policy and the accompanying education policy launched by the government in the early 1970s in response to the racial rioting of 1969. The basic aim of the NEP has been to create a new Malay middle class alongside the established non-Malay middle class. Although Chinese are still preponderant in business and, together with Indians, continue to dominate the professions, the proportion of Malays in the middle class has grown rapidly. Under the NEP, Malays have been given special access to business licenses, bank loans, government contracts, opportunities to purchase shares and other facilities. There has also been an enormous increase in the number of Malays obtaining university degrees. Many of the members of the new Malay middle class come from rural families and still have relatives in their home villages.

Government policy has made available business opportunities for Malays but it is government patronage that determines which Malays actually get the opportunities. For example, big fortunes have been made by Malay businessmen with UMNO connections who have been awarded land for housing development, major government construction contracts, or shares in Chinese or foreign companies undergoing "restructuring." At lower levels, UMNO supporters have benefited from business licenses, medium and small construction contracts, mining concessions and so on.

Having acquired their wealth through government patronage, it is only natural that businessmen and aspiring businessmen should want to strengthen their influence in the ruling party by winning office in the party organization and eventually seats in Parliament or the state assemblies. As UMNO Secretary-General Sanusi Junid put it recently, "These people are 'investing' money to reap material gains when they are in power." A few years ago, then Deputy Prime Minister Musa Hitam expressed his fear that "if an analysis on this question is made today, it will reveal that many had joined the party to acquire more wealth." Datuk Musa said then that he was worried that the UMNO would turn into a 'get-rich-quick club" whose members were interested only in such benefits as timber concessions and import permits.

Part of the problem lies in the common perception among Malays (and other Malaysians) that politics provides the means to wealth. Datuk Sanusi said party activists "should realize that they cannot treat political duties as a business, as politics and business are two different things."

But during the past 15 years, politics and business have not in fact been two different things for UMNO members. Despite Dr. Mahathir's anti-corruption slogan in the last election ("Clean, Efficient, Trustworthy"), many UMNO members have a very permissive view of corruption. It is only "excessive," as opposed to "ordinary," corruption that seems to provoke moral outrage.

It will not be easy to change such deeply entrenched attitudes. But if the UMNO is going to do so, its leaders will have to do more than make speeches. Taking more corrupt officials to court is one answer. During the past decade or so only three UMNO members of state executive councils have been convicted for corruption; no federal ministers have been convicted.

Dr. Mahathir has said that he will continue to control the selection of pary candidates for parliamentary and state assembly elections and has stated explicitly that division heads will not automatically be selected. This is a step in the right direction. Dr. Mahathir, however, sounds pessimistic about his chances of eliminating "money politics" from the UMNO. "If members themselves do not give their support," he says, "then it will be extremely difficult for the party leadership to take appropriate action."

BMF — THE PEOPLE'S BLACK PAPER

Hassan Abdul Karim

The BMF–Carrian Scandal: Grand Theft in Three Acts

For convenience, the unfolding of the BMF – Carrian scandal can be distinguished into three phases as follows:

Phase One :

The BMF scandal started with two major developments:

- First, the take-over of a Hongkong (HK) public-listed company Mai Hon – later renamed Carrian Investment Ltd. – and various transactions to inflate the price of its shares in the HK stock market.
- Second, the acquisition of Gammon House for US$200 million, to be resold to the Malaysian government for US$250 million, i.e. for a quick profit of US$50 million. A HK$2 company, Plessey International Ltd. (PIL), was formed under the control of an undischarged bankrupt, George Tan to be the vehicle to receive total loans of US$292 million from BMF to finance the Gammon House purchase. The money was drawn from Bank Bumi's Kuala Lumpur headquarters and its international network of branches.

Phase Two :

This involved a series of loans from September 1981 to October 1982 totalling US$580 million, firstly, to purchase Grand Marine Holdings (GMH), a shipping line, for HK$800 million, again for the purpose of reselling it to the Malaysian government for HK$1000 million – i.e. for a profit of HK$200 million – and secondly, to provide a cash flow for the Carrian Group.

Phase Three:

BMF and even Bank Bumi tried to keep Carrian afloat after it faced serious liquidity problems, surreptitiously and deceptively releasing further loans to Carrian and financing the purchase of Carrian assets – already charged to BMF – at inflated prices. During this time, Jalil Ibrahim was murdered; the collapse of Carrian and the arrest of George Tan followed.

ACT ONE: Tengku Razaleigh & Gammon House

Then Finance Minister Tengku Razaleigh's alleged proposal to buy Gammon House for the Malaysian government kicked off the first phase. When former Bank Negara governor, Tan Sri Aziz Taha queried Bank Bumi executive chairman Dr. Nawawi Mat Awin as to how the loans to Carrian grew so much so quickly, Dr. Nawawi is reported to have said:

"It started with a proposal by the Minister of Finance to purchase Gammon House as a centre to house the operations of various Malaysian agencies in Hongkong. Bank Bumi was asked to finance the transaction, but the deal fell through. Nevertheless, it went ahead with the financing . . ."

Plessey's US$292 million

Loans totalling US$292 million were given to a *HK$2 company* of the Carrian group – *Plessey International Ltd. (PIL)* – supposedly to buy Gammon House. *These loans were approved without security documentation or even signatures,* and released between 19 December 1979 and June 1980. George Tan was still an *undischarged bankrupt* when the first loans were released to him!

In a statement to the Committee of Inquiry, *Dr. Rais Saniman* said he first became aware of the Gammon House Project in August 1979 at a dinner given by George Tan at Swire House, and attended by Lorrain Osman, Dato Hashim Shamsuddin, Ibrahim Jaafar and "Carrian chaps". He was informed by Dato Hashim that Tengku Razaleigh had decided to acquire Gammon House, with George Tan acting as agent for the Malaysian government. He also stated that all those present at the dinner were aware of the decision of the Malaysian government to buy Gammon House. Dr. Rais also told the Committee that it was impressed upon him that the project was a secret "special exercise" approved by Tengku Razaleigh. Dr. Rais said he was aware of the Malaysian Treasury policy to have government agencies, trade offices, etc. under one roof, and that Bank Bumi had previously participated in a similar exercise in New York when it was asked to find a suitable one-stop building. All this persuaded him that the Gammon House project was genuine.

But Dr. Rais also claims that he had his misgivings: he considered the arrangements "unorthodox", since if the Malaysian government wished to acquire Gammon House, there was no reason why it should not do so openly, rather than through companies controlled by George Tan, operating with BMF financing.. He claims to have told Datuk Hashim that if the matter

became public knowledge, it would shake the government because of the size of the loan and the way it was handled.

Largest Loan Ever!

Not surprisingly in the circumstances, Bank Bumiputra never held any ceremony to announce the "largest loan ever given out by Bank Bumi "to a single borrower, although it would have been common practice to do so for such a loan. Indeed, as a result of Bank Bumi's financing 100 per cent of the Gammon House purchase, the Carrian group's total loans shot up to M$459.4 million in 1980, i.e. amounting to 7939 per cent of BMF's share capital and reserves, or 129 per cent of Bank Bumi's share capital and reserves! *What was the basis and justification for Bank Bumi to finance 100 per cent of the Gammon House purchase, and to grant its biggest loan ever without any security – through a HK$2 shell company (Plessey International) to George Tan, an undischarged bankrupt?*

Moreover, there is much confusion as to the identity of the borrower, the purpose of the loans, the securities offered, the existence of loan applications, loan approvals, loan documentation, and loan repayments and even whether BMF was lender or merely agent for other Malaysian "investors"

US$50 Million Quick Profit

It appears that the transaction was on behalf of influential Malaysians for resale to the Malaysian government for a quick profit of US$50 million. How else can one explain the loans?

Bank Bumi–Plessey?

On 3 November 1982, George Tan wrote to Ibrahim Jaafar stating that ". . . your parent company Bank Bumiputra is the major shareholder of Plessey International." George Tan also affirmed an affidavit on 4 March 1985 stating that "9 customers of the merchant banking arm of Bank Bumi became and still remain beneficial owners of a 54% interest in Plessey International." What is the basis for George Tan's claim that Bank Bumi controlled the majority interest in Plessey? This crucial question remains unanswered.

Regardless of who the major shareholders of Plessey International were, the fact remains that US$292 million was released by BMF to a HK$2 company incorporated only a month before the initial release of the loans. Part of the money went to buying Gammon House through yet another Carrian company, Extrawin. The rest went towards building up the Carrian empire.

The purchase of the prestigious Gammon House catapulted George Tan to fame in HK property market circles.

Tengku Razaleigh has categorically denied any connection to the Gammon House proposal in the White Paper. However, his denial sounds weak and unconvincing. In effect, Tengku Razaleigh is virtually suggesting that there is a conspiracy by Dr. Rais, Dato Hashim, Ibrahim Jaafar and George Tan to implicate him.

ACT TWO: US$580 Million for Grand Marine

At the same time that BMF supposedly "became concerned" with the over-concentration of its loan portfolio to a single group of customers (namely George Tan and the Carrian Group), and with the inadequate security provided by the Carrian group for the outstanding earlier loans, BMF released yet another series of loans to the Carrian Group totalling US$580 million! This huge sum of money was used to acquire Grand Marine Holdings (GMH) and to provide cash flow for the Carrian Group.

HK$200 Million Profit

Around 15 April 1983, George Tan told Jalil Ibrahim that he was acting for some party in Malaysia to acquire Grand Marine at a cost of HK$800 million, which he expected to sell to the Malaysian government at a price of HK$1 billion for a profit of HK$200 million.

Musa Hitam : Not In Black & White

A note from George Tan to BMF on 18 May 1983 said, "We acquired Grand Marine as suggested by Dr. Rais acting on behalf of the Deputy Prime Minister of the Malaysian government, but subsequently this project remains in the Carrian Group." According to Jalil Ibrahim's diary, George Tan also told Jalil that "in the end, the Malaysian Government did not buy Grand Marine and I was stuck. Dr. Rais instructed me to do the deal with his Norwegian consultant. The money came from BMF . . . ." Datuk Musa's name was also mentioned by Ibrahim Jaafar to the Committee, as the party in the Malaysian government interested in the Grand Marine deal, because of the "close connection between Dr. Rais and that particular Minister."

There is no disagreement that BMF financed the purchase of GMH. Also there are grounds for further investigation into the claims by George Tan that he acquired GMH for resale to the Malaysian government for a profit of

HK$200 million, and that he acquired GMH on the instructions of Dr. Rais, who was acting on behalf of the Malaysian government.

George Tan's Mysterious Seven

A substantial loan totalling US$138 million was released by BMF to seven companies nominated by George Tan, which enabled him and the "nine overseas investors" who controlled Perak Pioneer, yet another George Tan company, to acquire Grand Marine. The BMF records merely show that this "loan" was given to seven borrower companies for "investment"! There are no evaluations of these seven companies. These seven companies were all HK$2 companies, four of which were only incorporated after the loans had been approved and released! Actually, the "loans were all paid out in a round-about route" to Carrian Holdings Ltd.

This US$138 million, plus another US$30 million from BMF were used to acquire Grand Marine. The Committee of Inquiry felt that "the manner in which these sums were released and the use to which they were put to established the fact that the sums . . . were not loans granted in the normal course of banking business"

Nine Mysterious (Malaysian?) Investors

Who are the "nine investors"? Who were behind the "seven borrower companies"? And did Datuk Musa really approve the purchase of Grand Marine on behalf of the Malaysian government?

Seven Writs Withdrawn

There is another mystery in this sordid deal. Seven writs were filed against George Tan as guarantor for the seven loans on 29 December 1983. However, no attempt was ever made to serve these writs. The BMF board finally resolved – almost a year later – that the seven writs be served on George Tan. On the same day, however, the management of Bank Bumi – at a meeting chaired by Dr. Nawawi – "over-ruled" this decision, and instructed the BMF management to "take back" the writs after they had been served on George Tan's solicitors, allow them to lapse and agree that the writs had not been served!

Bank Bumi's Curious Behaviour

Why did Bank Bumi act in such a curious manner?

- First, it refused to act when the Committee of Inquiry recommended that a police report be lodged because the withdrawal and use of the US$292 million and a greater part of the other loans – which resulted in substantial losses to Bank Bumi and BMF – were tantamount to *theft!* The Committee also found the accounting records of all the companies involved – such as Carrian Holdings Ltd., Carrian Investment Ltd., Plessey International Ltd., Extrawin, Max Entry and BMF itself – had been made up to disguise the true nature of the transactions, this being tantamount to *false accounting* and *fraud*!
- Second, why did Bank Bumi withdraw the seven writs?

No BMF, No Carrian

One might ask how loans totalling $2.3 billion came to be given with little or no security to George Tan and his associates within the short space of three years. Why did BMF spend billions to build up George Tan, from an undischarged bankrupt, into a multi-millionaire? Indeed, "without BMF there would have been no Carrian", the Committee of Inquiry asserts in the opening sentence of its final report.

The answer lies in the close relationship between George Tan and the five key men in BMF – Lorrain Osman, Datuk Hashim Shamsuddin, Dr. Rais Saniman, Ibrahim Jaafar and Henry Chin. As BMF money dealer, Mansor Saat put it, Carrian and BMF were so close that it was "just like one family . . . our directors were just like their directors." Not surprisingly, huge loans were given out without loan applications being submitted, or even before the borrowing companies had been incorporated! In return for approving the loans, Lorrain and company received money, gifts and business favours from George Tan.

George Tan also took good care of the rest of the BMF staff. Around the end of 1981, he gave them two gifts of a million Carrian Investment shares each time. Mansor Saat admitted that as a result of the gifts, "when it came to documenting Carrian loans, this was not properly done." Although these shares were subsequently lost in the stockmarket, one might ask how much the chairman, directors and managers were worth if the ordinary staff were worth two million Carrian shares to George Tan. Not surprisingly, in late 1982, Carrian seemed unperturbed that it was facing imminent collapse and

already owed BMF and Bank Bumi more than US$872 million or M$2.1 billion.

Poor Tan Sri Aziz

Instead, then Bank Negara Governor, Tan Sri Aziz Taha seemed more worried as to how he could approve Bank Bumi's accounts for the year 1982. Tan Sri Aziz first briefed Datuk Seri Dr. Mahathir regarding BMF's problems on 16 November 1982, three weeks after Carrian announced that it was facing liquidity problems. Later, he wrote the prime minister a report on 2 April 1983, warning him that BMF's shareholder funds could be wiped out if the Carrian group failed to pay interest on their loans!

ACT THREE : Enter The PM : Another US$158 Million

Bank Bumi chairman, Dr. Nawawi's efforts – approved by the Prime Minister – to send "good money" after "bad money", ostensibly to salvage the BMF loans to the Carrian group distinguish the third phase of the BMF scandal.

US$70.2 Million : Carry On, Carrian.

In trying to keep Carrian afloat, Bank Bumi released two more loans to the Carrian group totalling *US$70.2 million.* These loans were given *after* Carrian announced that it was facing liquidity problems and was unable to meet existing commitments! The first loan was made three days after Carrian announced that it was facing liquidity problems. Within 30 days, BMF released another US$40 million to the Bank of Communications, to be loaned, in turn, to the Carrian Group.

US$87.5 Million To Buy Back Your Own

It also agreed to buy over two sets of Carrian assets to ease Carrian's cash flow problems. These were the same US assets which BMF had tried, but failed to secure on its outstanding loans. The two purchases – of Carrian's US assets and Carrian shares in China Underwriters Ltd and the Union Bank of Hongkong – cost another *US$87.5 million.* Despite being informed by valuers that the US assets were worth about US$56 million, much less than the proposed purchase price of $78 million, and only a tenth of George Tan's valuation (US$560 million), Bank Bumi went ahead with the acquisition. According to the Committee of Inquiry, the devious manner in which these purchases were made constituted a *conspiracy* on the part of the *Bank Bumi*

board to *defraud* its shareholders as well as a *breach* of its *fiduciary duties*, they were, in fact, schemes to finance the Carrian group and to keep it afloat. The government's White Paper conveniently whitewashes this third phase and does not mention this secret rescue plan.

Wow-wow-wee, Nawawi

It is now evident that, in the third phase of the BMF scandal, the Bank Negara governor and the Finance Minister had been pushed aside. The entire affair was being handled by Dr. Nawawi, who reported regularly and directly to the Prime Minister.

Bank Negara : Sorry–lah

On April 3, 1983, Dr. Mahathir stated that it was not necessary for him to interfere in the BMF problem as the matter had been well-handled by Bank Bumi officials. Ironically, this statement was made at the time when the Bank Negara Governor wrote to the Prime Minister to put on record the inability of Bank Negara to intervene in the matter.

Bank Bumi : A Law Unto Itself

Bank Negara had many opportunities to prevent the BMF scandal from reaching its final magnitude and dimensions, but failed to do so. Besides backing off from trying to control Bank Bumi – which enjoyed special privileges and independence as far as the central bank was concerned – Bank Negara must also take its share of responsibility in another crucial matter.

Bank Negara had lifted crucial external controls and limitations on Bank Bumi and BMF, thus enabling Bank Bumi and BMF officials to make virtually unlimited loans to the Carrian Group and others, thus enabling them to participate in an elaborate conspiracy to defraud, commit criminal breach of trust as well as aid and abet in the theft of public funds.

A vigilant and fearless Bank Negara could have stopped the BMF scandal by April 1981, before the second phase of the BMF scandal had unfolded. Under section 22(1) of the Hongkong Deposit – taking Companies Ordinance, credit facilities or loans to any one customer or group of customers should not exceed 25 per cent of its paid-up capital and reserves, except for transactions guaranteed by the parent bank *and* supervisory authorities of the country of incorporation of the parent bank. On 30 April 1981, Bank Negara

approved the issuance of such a letter of Comfort by Bank Bumi to BMF. Such approval allowed BMF to operate outside the normal controls imposed by the Hongkong authorities, and therefore imposed on Bank Negara an even greater responsibility to closely monitor BMF's operations. In fact, Bank Negara should have inspected BMF's operations thoroughly before approving the Bank Bumi's letter of Comfort in April 1981, and should also have imposed a limit on the BMF's lending powers.

An examination of BMF's accounts for 1980 would have revealed its over-exposure – in terms of loans and advances – to the Carrian Group, already amounting then to HK$1063 million, or 7939 per cent of BMF's share capital and reserves, or 129 per cent of Bank Bumi's share capital and reserves. None of this was done.

See No Evil

On 21 February 1983, then Finance Minister, Tengku Razaleigh, said there was "nothing amiss" in the BMF dealings, and that the loan situation was nothing more than a normal business problem. He also claimed that the Bank Bumi board was responsible directly to the Prime Minister. However, in October 1983, when the Prime Minister reiterated that Bank Bumi was under the jurisdiction of the Finance Minister, Tengku Razaleigh remarked that if the Prime Minister said if he was in charge, than he was in charge!

The Buck Doesn't Stop Here

Dr. Mahathir now claims in the White Paper that he was only given a "rough briefing" by the chairman of Bank Bumi and the governor of Bank Negara. In one of the briefings, Bank Bumi chairman, Dr. Nawawi told him of the actions being pursued to recover as much money as possible from George Tan, his associated companies, and those responsible for approving the loans. "I agreed with this course of action. However, I was not informed of the details and was not involved in the execution of these actions," Dr. Mahathir claims. A lame excuse indeed, especially for a PM who claims to lead a "clean, efficient and trustworthy" administration.

When such a monstrous crime against the nation has been committed, one would think it would be the PM's responsibility, duty and obligation to constantly monitor the situation closely and check on the measures being taken to salvage the situation. One cannot just try to wash one's hands off the whole sordid business, and then try to pass the buck to one's appointees.

BMF: White Paper or Whitewash?

The government's White Paper on the BMF Scandal is an unconvincing and flimsy whitewash of governmental responsibility and complicity in the loss of about M$2.5 billion. The wideranging BMF Report – by the Ahmad Nordin Committee – cost the public over M$2 million and took the committee two years to prepare.

Passing The Buck

Unfortunately, the government has chosen to divert attention and shift responsibility for Malaysia's biggest ever financial scandal with its White Paper which says nothing new, but instead tries to absolve top Barisan Nasional (BN) cronies from responsibility. Instead of stating what form of action should and will be taken against those responsible, and the changes necessary to prevent similar occurrences, the government seems most concerned with focussing exclusive responsibility on a few names, while trying to get BN – connected politicians and businessmen off the hook. Much of the accompanying press coverage has tended to reinforce this picture.

Instead, even more amazingly, the inquiry committee – especially Tan Sri Ahmad Nordin himself – have become the subject of a vicious campaign to discredit them in the eyes of the public.

Government Inaction : Part of the Problem

The BMF White Paper and the government's incredible record of virtual inaction since the BMF scandal first came to public light in late 1982 is in itself a remarkable statement on its complicity. More recently, further governmental inaction on various issues raised by the Committee of Inquiry suggest that far from being part of the solution, the government is part of the problem in the handling of the BMF affair.

Royal Commission Needed

At this stage, it is clear that only a full-scale investigation – by an independent Royal Commission – would be able to further investigate the issues, interests and persons involved in the BMF scandal. Despite the uncooperative, and sometimes even hostile attitude of BBMB (Bank Bumiputra Malaysia Berhad) and government officials, the Committee of Inquiry has come up with a great deal of information. Unfortunately, with the limited powers and terms of reference available to them, the investigation is still far from complete, with many loose ends which can only be tied up with the investigative powers of a Royal Commission.

Big Three Involved

Interestingly, and significantly, Datuk Seri Dr. Mahathir Mohamad, Datuk Musa Hitam and Tengku Razaleigh Hamzah – the three UMNO-BN leaders holding three of the most powerful positions in government during the folding of the BMF fiasco – have all been implicated in it.

Tengku Razaleigh Hamzah, the Finance Minister in 1979, apparently initiated the dealings culminating in the BMF scandal. In separate meetings with the committee, Dr. Nawawi Mat Awin, Dr. Rais Saniman and Datuk Hashim Shamsuddin, confirmed that the Finance Minister made the decision to purchase Gammon House for the Malaysian government, and instructed Bank Bumiputra to finance the transaction. Subsequently, this deal did not materialise. If it had, George Tan would have made a quick US$50 million profit.

Ku Li's Unconvincing Denial

In the Government's White Paper, Tengku Razaleigh emphatically denied any involvement in the Gammon House project. Although he admits that the government had plans to acquire properties in Hongkong and elsewhere to house various government agencies, according to him, Gammon House was never ever considered. He said the building the government had in mind and eventually bought was the Lap Heng Building.

The Committee of Inquiry also suggests that Tengku Razaleigh benefitted materially from the dealings in Hongkong, by accepting travellers cheques worth US$415,000. Tengku Razaleigh has since claimed that he subsequently paid for the cheques, though he does not offer any evidence of having done so.

Financial Cronyism

He went on to deny any knowledge of the 1980 BMF loans to Asiavest and Sherridon, companies he has a material interest in.

Asiavest's ownership is complicated. It is owned by several families well connected with UMNO, including Tengku Razaleigh's family, former Kedah Mentri Besar, Datuk Sri Syed Nahar Shahabuddin's family, Dr. Syed Mahmood's family, Datuk Syed Kechik and Tunku Mansur Yaacob. Sherridon is mainly controlled by Datuk Seri Syed Nahar's family, Dr. Syed Mahmood's and Tenku Razaleigh's family.

Indeed, there were no application records for the US$15 million loan to Asiavest or the HK$5 million facility obtained by Sherridon. Only the loan approvals were in the records. Asiavest also had some "shady" deals during 1981-83 with "Knife and Dagger" – BMF general manager *Ibrahim Jaafar's* company.

With Friends Like Mak . . .

But the greatest damage to Tengku Razaleigh must have been made by Jalil Ibrahim's convicted murderer, ***Mak Foon Than*** in his recorded statement of 6 August, 1983. After his arrest, Mak claimed that then Finance Minister, Tengku Razaleigh had sent him to Hongkong to collect money from Hongkong businessmen for "the Finance Minister's people". Indeed the contradictory statements Mak made in court later only served to arouse curiosity. When was Mak telling the truth – in court or in jail? Had he been threatened? Or bought off? Which statement had been concocted? Unfortunately, the Hongkong court convicted Mak without establishing a clear motive for the murder, which might, in turn, shed more light on the BMF scandal.

UMNO Investment

Fleet Holdings, the *UMNO investment company*, and high UMNO officials have been shown to have profited from the BMF scandal. The Fleet Group received $950,000 from either "Knife and Dagger", (BMF general manager, Ibrahim Jaafar's company) or "Silver Present" (owned by ***Datuk Hashim Shamsuddin***, Bank Bumi Executive Director, and one of BMF's directors.)

The chairman of Fleet Holdings Sdn. Bhd., ***Datuk Junus Sudin*** received $500,000 in November 1981. When questioned by the BMF Committee of Inquiry, he said "this should not have been in Carrian's account", but refused to cooperate any further with the Committee.

Silent 'Knight'

Tan Sri Kamarul Ariffin, the former Bank Bumi chairman (until April 1982), accepted HK$1.58 million in consultancy fees. His open conflict with Dr. Mahathir in 1983 over responsibility for the BMF scandal suggests that he was willing to keep quiet as long as the PM did not implicate him. What does he know that prevented the PM from pursuing the matter further after having publicly accused Tan Sri Kamarul of responsibility for and complicity in the BMF scandal?

The Johore Complex

An August 1982 letter from George Tan to ***Datuk Musa Hitam***, discussed a secret Johore Baru City Development Project – supposely a joint venture between UMNO and the Johore State Government, which was to provide 10 acres in the Johore Baru town centre for a commercial development project.

George Tan – through one of the Carrian companies – put up a deposit of M$1.5 million in the form of an interest – free loan for six years to AAY Holdings, a company owned by two UMNO members. George Tan also promised "to donate 20 per cent out of the net profit to UMNO to be utilised as a new UMNO headquarters construction fund."

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UMNO Building Fund

Thus, the widespread rumours that profits from BMF loans were to be syphoned back for the UMNO headquarters building fund has at least some basis in fact. After all, Datuk Hashim Shamsuddin was then treasurer of the UMNO headquarters building fund committee, of which Tengku Razaleigh was chairman.

Datuk Hashim also received a sum of HK$13,134,000 through his company, Silver Present, during his tenure as BMF director and Bank Bumi executive director. He also received consultancy fees from BMF totalling HK$965,000.

According to the Committee of Inquiry, these "payments to Malaysians and Malaysian companies require further investigation by the Police or the appropriate Anti-Corruption Agency."

Nawawi's Comet

Dr. Nawawi Mat Awin replaced Tan Sri Kamarul as Bank Bumi chairman in mid-1982. Dr. Nawawi was a rising star in UMNO then, closely identified with ***Dr. Mahathir***, and even tipped at one stage to replace Tengku Razaleigh as Finance Minister. It is now clear that Nawawi lied to the Bank Negara Governor and to the public about BMF's actual problems when he categorically denied any serious problems in BMF. And while he was assuring the governor, yet more loans were being given to George Tan. Dr. Nawawi also approved a costly plan to rescue Carrian after it failed to repay its loans, causing the losses to mount further. Dr. Nawawi is clearly responsible for Bank Bumi and BMF's covert attempts to rescue the Carrian Group and George Tan. Why the secrecy? What did he have to hide? Were there "other interests" to be protected?

Despite their protestations to the contrary, UMNO's top leaders do not come out clean. Very few people will believe that the BMF chairman, general manager and directors, could defraud the country of M$2.5 billion without the collaboration, or at least, complicity of more powerful people.

Someone Is Bluffing

Then Deputy PM, Datuk Musa Hitam is also alleged to have approved a Malaysian government plan to buy Grand Marine Holdings (GMH), a shipping line, through George Tan. Before the 1984 UMNO elections, rumours linking Datuk Musa with the GMH deal were widespread. Whether or not he was actually involved cannot be established now because Datuk Musa's close associate and friend, Dr Rais Saniman has given different versions of Datuk Musa's involvement. Datuk Musa's claim that he stopped Dr. Rais from discussing personal business matters with him does not refer specifically to the GMH purchase, which was supposedly for the Malaysian government after all. Clearly, either Dr. Rais or Datuk Musa is not telling the truth.

See No Evil

Datuk Seri Dr. Mahathir claims in the White Paper that he first heard of the BMF scandal through the newspapers. This is, of course, hard to believe. The PM is implying that Bank Bumi – already run by Dr. Nawawi, his appointee, by then – was still fooling his government, and that Bank Negara and the other relevant government agencies were incredibly incompetent and ineffective, or that he was not interested in the matter until the newspapers drew public attention to the loans fiasco. If Dr. Mahathir's explanation is to be believed, then, upon knowing of the fiasco, he should have taken prompt and appropriate action immediately. But evidently, this did not happen.

Bank Bumi's Secret Rescue Plan

Even after the PM had been briefed several times by the Bank Negara Governor about the seriousness of the BMF loan situation, Bank Bumi continued to hatch an elaborate deception to save George Tan and the Carrian empire. Could the secret rescue plan have been launched without the PM's knowledge? In any case, the plan was not only illegal and dishonest, but also failed miserably, at further cost to Bank Bumi, and ultimately, the Malaysian people.

Why, Oh Why?

Why did Dr. Mahathir not expose Tan Sri Kamarul further after the PM alleged that he had been involved in a "heinous plot"? Why did Dr. Mahathir and other top government leaders continue to deny that there were serious problems in BMF and Bank Bumi even after it was clear to them that the loans fiasco were a financial disaster? Why the deception? Why the cover-up? Why the hostility against those who want to get to the bottom of the mess? Why oppose the establishment of a royal commission to conduct an inde-

pendent investigation? Why resist publication of the Committee of Inquiry's final report?

A considerable part of the White Paper tabled in Parliament consists of the denials by top UMNO–BN politicians and their agents. Some of them now claim that the White Paper is proof of their innocence, that they have not done anything wrong, and that UMNO and the BN are not involved. The White Paper defends the government leaders, while implying that the BMF scandal report unfairly criticises the government.

If the ruling politicians are the innocent lambs they expect the people to believe they are, they could have fired the Bank Bumi and BMF officials in late 1982 when the problems were brought to the attention of the Prime Minister. More than three years later, the Malaysian government has yet to initiate any criminal proceedings against any of those involved in the BMF loans fiasco and the Bank Bumi rescue and cover-up.

Instead, Bank Bumi poured more than US$150 million more to save George Tan and Carrian. Since the Bank Bumi chairman, Dr. Nawawi was in constant touch with the PM on the BMF fiasco, are we expected to now believe that the PM did not know or agree to Bank Bumi's secret BMF rescue plan?

Many Malaysians believe that we would still be very much in the dark today if the BMF scandal took place in Malaysia, instead of Hongkong. Tragically, only after Jalil Ibrahim's murder, did the Hongkong police raid the BMF and Carrian offices, which provided crucial evidence leading to the current prosecutions in Hongkong. Yet, many other crucial questions – such as the motive for Jalil Ibrahim's murder – remain unanswered.

Yet, the true story of the BMF scandal may never be fully known because of the massive cover-up efforts condoned, if not urged by top government leaders. The cover-up continues even today.

For Malaysians who hoped to learn more about the Malaysian involvement in the BMF loans fiasco, the cover-up and Bank Bumi's costly secret rescue plan, the White Paper proved to be a real whitewash.

BMF: A Trail Of Cover–Ups

In early January 1986, Prime Minister Datuk Seri Dr. Mahathir Mohamad received a very important letter from Tan Sri Ahmad Noordin, head of the Committee of Inquiry into the BMF scandal. Tan Sri Ahmad Noordin had volunteered to take responsibility for publishing the two volumes of the Committee's final report. His Committee, he said, had taken great care in preparing the final report to ensure that all sensitive parts had been

removed. Furthermore, they had consulted a Queen's Counsel on the finer legal points pertaining to its publication and its implications for outstanding court cases.

Tan Sri Ahmad Noordin's offer received an angry reply. The Prime Minister reprimanded the Auditor General for seeking self-glorification, overstepping the terms of appointment, and not following proper procedures in advising and informing the government. Basically, he was chided for not "toeing the line".

The "line" was the government's efforts to 'contain' the shameful BMF scandal.

Since the announcement that the BMF Committee of Inquiry's Final Report had been completed and submitted to the government and to Bank Bumiputra, public opinion grew for the Report to be made public. Nonetheless, the government resisted.

Citing various excuses, mainly the question of who would accept responsibility for publication, the government cautioned that the report had to be carefully studied by its legal advisers, i.e. the Attorney General's office. However in July 1985, the Attorney General had already publicly advised the government against publishing the report.

It appeared then that the government might succeed in covering up the report under a pile of legal and political execuses. Tan Sri Ahmad Noordin and Mr Chooi Mun Sou, however, stood up to the various attempts to discredit them and to threaten their careers and positions.

The Cover-up

In fact cover-up efforts began as soon as the BMF office opened in Hong Kong. The Final Report has documented the release of very substantial loans without approval, some even without any loan applications. Indeed, a few loans were released to companies which had not yet been formed! There were very poor records of loans released in the BMF office. For some very large loans, the real borrowers could not even be identified. Indeed, the Report described the attempts to conceal the actual amount of the loans given by BMF to the Carrian group.

When the property market in Hong Kong stabilised in mid-1982, after a boom of more than a year, several developers could not repay their loans. Carrian Investment Limited announced that it faced liquidity problems in October 1982.

An article in the Hong Kong-based *Asian Wall Street Journal* on 10 November, 1982 highlighted the BMF loans to Carrian, Eda and Kevin Hsu. Dr. Nawawi Mat Awin, the BBMB chairman then, categorically denied that BBMB was facing a loans crisis, though BMF was rumoured to have been heavily

exposed to Hong Kong developers who could not repay their loans. Dr. Nawawi claimed that the news reports of BMF's problems were exaggerated.

Only two days later, on 12 November, 1982, Dr. Nawawi was explaining to the Bank Negara governor how the loans had become so large: ". . . it started with a proposal by the Minister of Finance to purchase Gammon House . . . .". Dr. Nawawi had lied to the press and to the public.

Two months later, on February 21, 1983, Finance Minister Tengku Razaleigh Hamzah said there was "nothing amiss" in the BMF loans and that it was nothing more than a normal business problem. Less than a month later, Tengku Razaleigh said in Parliament that because Bank Bumiputra's accounts for 1982 were not ready yet, it was unclear whether BMF would actually suffer losses. Tengku Razaleigh was either lying about the extent of the problems at BMF and BBMB, or was intentionally trying to mislead the public about the situation at the Bank.

During mid-1982, Bank Negara conducted a study of the problems faced by BMF and BBMB. On 16 November 1982, and again on 5 January 1983, the Bank Negara governor, together with Dr. Nawawi, briefed the Prime Minister on the extent of the loans problems. Finally, on 2 April 1983, the Bank Negara governor wrote a 10 page report to the Prime Minister reminding him of the various occasions the matter had already been raised, describing the history of the loans, the extent of the problem faced by BBMB, the breakdown in the securities for and checks on loan approvals, and explaining the latest developments in BMF and the measures Bank Negara had taken to overcome the problem.

Tan Sri Aziz concluded gravely: ". . . BMFL would incur a large loss for the year ended 31/12/82 and as the interest income on these loans was approximately HK$600 million, a loss of HK$500 million would completely wipe out BMFL's shareholders' funds and consequently affect seriously the financial position of BBMB. . . ".

Clearly, Tan Sri Aziz had emphasized the seriousness of the BMF problems to the Prime Minister as the head of the government. The chairman of BBMB was also in direct contact with the Prime Minister on the matter.

On the following day, 3 April 1983, the Prime Minister told the press that it was not necessary for him to interfere in BMF as the matter was now handled very well by BBMB officials. However, he did not tell the press how BBMB officials would handle the BMF problem.

BBMB had a plan. Instead of trying to reduce its over-exposure and recover its loans, especially in the wake of Carrian announcing its liquidity problems, BBMB hatched a top-secret plan to pump more money into Carrian. It involved setting up more shell companies in Liberia and Hong

Kong. A loan of US$85 million was then channeled to Carrian in a complicated arrangement involving several of these companies: Marmel to Trans Pacific Trust to Dragon Base and Darton, on to Carrian. At all times, BBMB was the beneficial owner of these conduit agencies.

According to the BMF report, more that US$200 million had been released to the Carrian group after April 1982, when Dr. Nawawi took over as executive chairman. Yet in October 1984, Dr. Nawawi claimed that during his tenure as executive chairman, no approvals had been given for BMF loans to George Tan's companies. Once again, he lied. While publicly denying any problems in BMF and BBMB, he had initiated and helped implement secret plans to save the sinking Carrian empire.

This is not the end of the story.

The extent of the political connections and interests associated with the BMF and Carrian scandals have been discussed elsewhere in this book. The political implications are, of course, very serious. A few government politicians are enriching themselves through various schemes involving fraud, criminal breach of trust, corruption and theft. Investment funds have disappeared, been squandered or stolen. It looks bad for the government, especially UMNO.

It is very important to emphasize that it was not within the terms of reference of the Committee of Inquiry to investigate the involvement of such politicians or government leaders. The information only arose in the course of studying the BMF problem. It would have been beyond the terms of the reference of the Committee to take up the various issues which arose incidentally in the course of their investigations.

The cover-ups have also involved concocting convincing reasons to fill gaps in the official position. The White Paper on the BMF affair is filled with such assertions, as well as claims of innocence by Ministers, well-connected UMNO members, businessmen and lawyers who have at one point or other been involved in various deals, though of course, not all the deals involved were criminal in nature. It is interesting to note that, many of the letters appearing in the White Paper were by those who had declined to be interviewed by the Committee or had refused to answer questions posed by the Committee.

The White Paper contained the government's version of the scandal. People with different versions were not given this platform, most notably Dr. Nawawi and Tan Sri Kamarul Ariffin, both previous executive chairmen of BBMB, who have different versions. Tan Sri Kamarul's exchanges with the Prime Minister in the newspapers is especially significant; it appears that

even the Prime Minister cannot touch him and has had to back off. They must know something all of us do not.

But more than just providing different versions and flat denials, the government actually escalated its cover-up efforts.

Ironically, the publication of the final report of the BMF Committee of Inquiry also helped the cover-up efforts. The Attorney General had previously gone on record to say that the report should be suppressed. He even invoked the Lord President's comments in a case totally unrelated to the BMF case, claiming that the Lord President had ruled that legal prosecution cannot cross extra-territorial boundaries. The Prime Minister and the Finance Minister also made public their reservations.

However, public pressure continued to mount, including dissenting voices within the ruling BN, who had nothing to lose and hoped to salvage BN credibility in the process. When Tan Sri Ahmad Noordin and Mr. Chooi Mun Sou offered to take responsibility for the publication of the final report, the Government had no more excuses to resist publication. Given the limited coverage of the final report - prepared by a committee constrained by limited powers and terms of reference - the government took a calculated risk to try to restore some credibility by honouring its earlier commitment to publish the Report.

Several months later, some would argue that the gamble paid off. The public clamour over BMF has subsided as the government efforts - abetted by the media – have narrowed public attention and blame for the BMF scandal on certain already notorious individuals: George Tan, Lor rain Esme Osman, Dr. Rais Saniman, Ibrahim Jaafar and Henry Chin.

However, the problem is far from being satisfactorily resolved. Since the release of the BMF report, the Attorney-General and the government have refused to act further. The Attorney General has hidden behind the lame excuse of "no evidence, no prosecution". Despite the nature of the problem, he has lost his otherwise zealous enthusiasm for prosecuting personal and government adversaries. When faced with crimes of such monumental proportions involving public funds, the public interest and cronies of the ruling clique.

In a sense, the public is being mesmerized by the BMF shadow play. But the real dalang (puppet masters) are not yet in the dock. There is still much mystery in the BMF story – who, for instance, ordered Jalil Ibrahim's murder, what were the government politicians' actual roles in the complex dealings, how far up did authorisation of the loans go?

Without further investigation by an independent royal commission, the shadow play will continue to work.

The cover up continues...

Dengan Tangan

2hb April, 1983

RAHSIA

Y.A.B. Dato' Seri Dr. Mahathir bin Mohamat,
Perdana Menteri Malaysia,
Jabatan Perdana Menteri,
Bangunan Parlimen,
Kuala Lumpur.

Y.A.B. Dato' Seri,

Bumiputra Malaysia Finance Limited, Hong Kong

On November 16, 1982 and January 5, 1983, I briefed Yang Amat Berhormat on the affairs of Bumiputra Malaysia Finance Limited, Hong Kong (BMFL) following press reports that BMFL, a wholly-owned subsidiary of Bank Bumiputra Malaysia Berhad, had granted substantial loans to Eda Investments Limited, Kevin Hsu Group and the Carrian group of companies, which are facing liquidity problems. I now write to provide Yang Amat Berhormat a clearer picture as to how BMFL got itself into this predicament and to keep Yang Amat Berhormat informed of the latest development in the deposit-taking company and the measures it has taken to overcome its problems.

BMFL was incorporated on March 1, 1974 with an initial paid-up capital of HK$2. In 1981, its capital was raised to HK$75 million. Its directors are Lorraine E. Osman and Dato' Hashim Shamsuddin. The deposit-taking company commenced operations in December 1977 and, in less than five years, had built up its total assets from *HK$0.233 billion (approximately M$82 million)* as of December 31, 1978 to HK$5.192 billion (approximately M$1.817 billion) as at June 30, 1982. Profits of the deposit-taking company also increased seventyfold from HK$0.675 million in 1978 to HK$47.498 million in 1981.

Bank Negara Malaysia carried out an inspection of BMFL for the first time in July 1982 with the date of reference of the inspection as of June 30, 1982. . . . This inspection disclosed a very unsatisfactory state of affairs in the management, and operations of the deposit-taking company. It revealed the pursuit of unsound lending policies and inadequacies in control and supervision by management. Of serious concern is the substantial amount of loans

granted to the Carrian group of companies, the Kevin Hsu group of companies and Eda Investments Limited. The todal loans granted to these companies amounted to HK$4.213 billion (approximately M$1.475 billion), accounting for about 84% of the total loans of BMFL as at June 30, 1982. From the standpoint of banking, this large concentration of credit is regarded as undesirable and imprudent, and a highly irresponsible action on the part of management concerned. . . .

The Carrian Group of Companies

By June 30, 1982, the total exposure of BMFL to this group of companies amounted to HK$3.246 billion, with about HK$2.539 billion being granted in 1981. The total loans of HK$3.246 billion outstanding as at June 30, 1982 comprised term loans of HK$1.099 billion and money market loans of HK$2.147 billion. . . .

The term loans were granted to 14 newly incorporated companies of the Carrian group. Seven of these loans amounting to HK$808 million were secured by public quoted shares of companies within the group, in Carrian Investments Limited, which was publicly quoted on the Hang Seng Stock Exchange. As at June 30, 1982, the market value of the shares held as security for the seven loans amounted to HK$856 million. The other seven term loans amounting to HK$291 million were secured by legal charges on properties reported to be worth HK$339 million. This valuation appeared to be inflated as it was noted that, within a short period of time, the purchase consideration of some of the properties concerned was boosted up with each sale within the Carrian Group. . . The money market loans, on the other hand, were mostly unsecured. Of the HK$2.147 billion outstanding as at June 30, 1982, BMFL was only secured by securities valued at HK$57 million.

With such a large exposure, it is indeed surprising that the Board of BMFL had not even ensured that adequate securities were obtained to protect the interests of the deposit-taking company. This neglect to duty had no doubt put BMFL and Bank Bumiputra to great risk. Worse still, Bank Negara's inspection disclosed no evidence of proper credit appraisals of the Carrian group of companies. Both the financial stability and management of the Carrian group were taken for granted. No evidence was available in BMFL's records to show who the people behind the group were. The creditworthiness of a borrower and the integrity of the people with whom a bank is dealing are important considerations for sound banking practice, but clearly, the management of BMFL failed to adhere to sound lending principles.

It is clearly evident in Carrian's case that BMFL had gone beyond banking prudence. Carrian would appear to have enjoyed an unusually close relationship with BMFL because Bank Negara's inspection also disclosed that BMFL had even assisted one of the companies in the Carrian group to window-dress its accounts for the financial year ended December 31, 1980. . . . Our inspection revealed that BMFL did not have any legal documentation to support its so-called acquisition of the properties. Furthermore, the purchase consideration appeared highly inflated in comparison with the sale price transacted for properties in the same building.

As a consequence of the window-dressing scheme, BMFL's accounts as at December 31, 1980, showed an increase in fixed assets of HK$200 million, while its loan portfolio showed a corresponding reduction by HK$200 million.

In another instance, our inspecting officers noted that BMFL assisted the Carrian group to circumvent the requirements of the Companies Ordinance, Hong Kong. . . . BMFL derived no financial benefit from the transaction but, on the contrary, had to bear certain liquidity costs as it had to maintain a certain amount of the deposits accepted in the form of liquid assets. It is obvious that BMFL had gone out of its way to accommodate the Carrian group, even to the extent of circumventing the law.

The Kevin Hsu Group of Companies

BMFL granted loans to the Kevin Hsu group of companies amounting to HK$754.717 million as at June 30, 1982, of which HK$709.982 million represented term loans granted to 18 companies in the group, while the balance of HK$44.735 million was money market loans granted to five other companies of the same group. Of the term loans granted, an amount of HK$677.283 million was secured by charges on various properties valued at HK$676.4 million, while the balance of HK$32.699 million was either guaranteed by Kevin Hsu or unsecured.

. . . Contrary to this, the General Manager of the deposit-taking company was noted to have granted some money market loans and term loans on an unsecured basis to the group using these reinstated limits. As at June 30, 1982, the outstanding amount of the money market loans granted to the group was HK$44.735 million, while the term loans outstanding amounted to HK$709.982 million.

As in the case of the loans to the Carrian group, there was no evidence to show that BMFL had carried out any proper credit appraisal to establish

the creditworthiness of the borrower before the loans were granted. It would seem that BMFL was relying mainly on the securities taken when granting these loans. Nevertheless, the high margin of the loans in relation to the value of securities indicated that BMFL had been very liberal in granting loans to the group.

Interest on the money market loans had been serviced regularly by the Kevin Hsu group of companies, but interest on the term loans, however, was not serviced because of cash flow problems faced by the group... In spite of the borrowers' poor interest servicing record, BMFL extended further credit in July 1982, following a restructuring of loans to the group. This restructuring exercise involved the granting of additional loans of HK$73 million, most of which were utilised to settle three unsecured loans amounting to HK$21.4 million, payment of overdue interest of HK$39.2 million and interest receivable of HK$7.5 million on various loans. A sum of HK$4.9 million was disbursed as additional loan to Kevin Hsu which amount, in fact, represented the net increase in the lending to this group arising from this restructuring exercise. The effect of the loan restructure was the suppression of the unsatisfactory interest servicing record of the group. The manner in which the restructuring exercise was carried out serves to illustrate how liberal BMFL had been in its dealings with the group.

Eda Investments Limited

The Board of BMFL granted a term loan of US$40 million to Eda Investments Limited, a publicly quoted company in Hong Kong, in September 1981....

... As of the same date, the market value of the shares accepted as security stood at HK$425,418,137 (equivalent to US$72,013, 226)....

Sources of Funds

BMFL has been able to continue to carry such a substantial amount of loans because of its heavy reliance on borrowings from the foreign branches of Bank Bumiputra and Malayan Banking Berhad, Hong Kong. Of total borrowings of HK$4.863 billion (about M$1.702 billion) as at June 30, 1982, HK$2.944 billion (about M$1.03 billion) or 60% was from Bank Bumiputra Malaysia Berhad and Malayan Banking Berhad.

... BMFL has exposed itself to the classical risk of borrowing short and lending long. The risk is aggravated by the fact that nearly 85% of BMFL's

loans was concentrated on three groups of borrowers, all of which are suffering from the effects of speculation in properties. Clearly, BMFL cannot survive without full support from Bank Bumiputra.

Developments Since Inspection Date

The visit in September 1982 by British Prime Minister Mrs. Margaret Thatcher and the announcement of talks on the future of Hong Kong appeared to have triggered a steep decline in property values in the colony. This slump in the property market was accompanied by a sharp decline in the stock market. Consequently, many property companies and financial institutions in Hong Kong experienced varying degrees of liquidity problems. One of the first casualties was Carrian Investments Limited. In late October, Carrian made a public announcement that it was facing "short-term liquidity problems," and was seeking assistance from. The Hongkong & Shanghai Banking Corporation to reschedule its existing loans as it had insufficient cash to meet loan repayments due in 1982 and 1983. Its financial adviser, Wardley Limited, was reported to be in the midst of drawing up a rescue plan.... To-date, this rescue plan has not been agreed upon by the major creditors as most of the creditors are demanding for details on the financial condition of Carrian's Chairman, George Tan, as well as information on the financial backers behind the group's mysterious parent, Carrian Holdings Limited, before they could consider and accept the plan.

A week after Carrian's announcement, Eda Investments Limited announced that it was unable to repay its debts. In order to stave off lawsuits and forced liquidations, Eda, with the assistance of Schroeders & Chartered Limited, proposed a scheme to restructure its outstanding loans of HK$1.900 billion and outstanding guarantees of HK$1.903 billion. . . . BMFL did not join in the proposed scheme as a litigation between Eda and BMFL was pending. . . . But on January 17, 1983, Barclays Asia took action again, this time to put Eda under liquidation. Eda therefore became the first fatality of the property market slump in Hong Kong.

The Carrian group also experienced difficulties; the rescue package put up by its financial adviser, Wardley Limited, had not been agreed by all creditors. Because of the size of the group's debts, a Carrian collapse would affect the financial system in Hong Kong adversely. . . .

The prolonged properly slump had also affected the Kevin Hsu group, which was already showing signs of difficulties at the time of Bank Negara's inspection. . . .

On November 12, 1982, I met with Dr. Nawawi Mat Awin, Executive Chairman of Bank Bumiputera, to express my grave concern over BMFL and to discuss with him the issues involved. I informed Dr. Nawawi that immediate action to get the situation under control was necessary and we agreed that the first priority was to improve Bank Bumiputera's position by obtaining as much security as possible. Verification of the value of securities, proper documentation of securities and ensuring the enforceability of claims are crucial and urgent tasks. Dr. Nawawi informed me that he had set up a Supervisory Committee in the bank, with himself as the Chairman, to monitor closely the operations of BMFL. He said he was quite happy with the situation as BMFL had obtained additional securities in the form of unencumbered properties in the United States for the loans granted to the Carrian group. According to Dr. Nawawi these properties were valued at HK$4.6billion and were owned by two companies under the Carrian group. The documentation on these properties were being finalised, and upon completion, would give BMFL a legal charge on them and the right to dispose of the properties. I told Dr. Nawawi that the magnitude of BMFL's exposure to Carrian was such that Bank Bumiputera should obtain another independent valuation on the United States properties and it should also seek legal opinion on the enforceability of the legal charge that was said to be under finalisation at that time.

Dr. Nawawi also informed me that the Kevin Hsu group of companies were cooperating with BMFL. . . . Dr. Nawawi indicated that HK$157 million would be repaid by the group by December 15, 1982. During a follow-up meeting with Dr. Nawawi on February 5, 1983, it was revealed that no repayment had been made to reduce the loan.

Dr. Nawawi told me that his main task was to get these three problem accounts resolved. The Supervisory Committee, of which he is the Chairman, would closely supervise the operations of BMFL, which had also been given instructions not to grant any new loans or make any new decisions without consulting him beforehand.

In mid-December 1982, BMFL submitted to Bank Negara copies of some documents relating to valuation of properties. Examination of these documents revealed that the U.S. properties in Oakland and Orlando were already encumbered to third parties. The valuation of the two properties appeared to be very optimistic. The advance copy of the valuation report examined by Bank Negara showed that the property in Oakland was valued at about US$447 million, while the properly in Orlando was valued at about US$330 million. It appeared that these two properties have been valued on the basis of the potential development of the land. With the Carrian group in financial

difficulties now, it is difficult to see how Carrian will be able to raise additional financing to develop these properties so as to enhance their value. The properties were bought for only US$13.6 million and US$9.1 million respectively in October 1980 and August 1981. As such, it would be difficult to accept a valuation ranging from US$300 million to US$400 million for these properties. . . .

Directors' Fees and Consultancy Fees

Apart from the problem loans, the inspection also disclosed that in addition to the normal directors' fees, BMFL paid consultancy fees to its two directors, Lorraine Osman and Dato' Hashim Shamsuddin, and to Tan Sri Kamarul Ariffin and Dr. Rais Saniman, the alternate director to Dato' Hashim. The fees paid amounted to HK$0.8 million, HK$1.0 million and HK$1.4 million in 1979, 1980 and 1981. The consultancy fees paid, however, were not disclosed in the annual accounts of BMFL, and thus, a contravention of the Hong Kong Companies Ordinance had been committed. I do not see any justification for the payment of these consultancy fees.

Late Position

On March 31, 1983, I met with Dr. Nawawi and Datuk Mohamad Nor Mohamad, partner in charge of the audit of Bank Bumiputra Group, to review and discuss the latest situation on BMFL. Dr. Nawawi stated that the *position at December 31, 1982* was as follows:—

Eda Investments Ltd. (HK$253 million)

Carrian Group (HK$3,935 million)

The big difference in the valuation by Wardley (HK$1,709 million) and the cost of the properties according to BMFL (HK$5,259 million) is difficult to resolve. . . It is important that these securities be verified thoroughly as to their value and enforceability, before an opinion can be expressed and a decision taken to determine the extent of loss which might have to be provided. Equally important, every effort should be made to obtain more securities from the Carrian group. . . .

Kevin Hsu Group (HK$896 million)

The valuation of security amounted to HK$566 million, thus indicating an exposure of HK$330 million. . . ..

In summary, the exposure to irrecoverability of loans at December 31, 1982, is as follows:–

The above summary of exposure is not final since proper legal documentation and enforceability are not yet complete. Also, independent professional valuation of the properties is still to be carried out.

Financial Impact on Bank Bumiputra's Accounts

In the light of these problem, it is necessary to make an assessment (though tentative at this point of time) of the financial impact on Bank Bumiputra's accounts should these problem loans become irrecoverable. . . . The profit for 1982 was arrived at mainly because interest charges on the three problem loans were taken to income account. Since the three borrowers were faced with liquidity problems and have not only rescheduled their debts, but also stopped paying the interest, the standard banking practice is to suspend the interest and not to recognise it as income. On this basis, BMFL would incur a large loss for the year ended December 31, 1982. As the Interest income on these problem loans is approximately HK$600 million, a loss of about HK$500 million (about M$170 million) would completely wipe out BMFL's shareholder' funds and con sequently affect seriously the financial position of Bank Bumiputra as the parent of BMFL. Bank Bumiputra made a profit of M$63.9 million in 1981. . . . Therefore, if interest on the problem loans is suspended in accordance with normal accepted accounting practice, Bank Bumiputra would be showing a substantial loss for the year 1982.

In addition, possible losses on the principal amounts of the loans when finally determined would further increase the aggregate loss of Bank Bumiputra.

I would appreciate an opportunity to discuss with Yang Amat Berhormat the BMFL affair and the question of how to deal with the accounts of the Bank Bumiputra group, taking into consideration requirements of the Company law, banking low, accounting practice, and possible repercussions from these problem loans as far as the public is concerned.

I have sent a similar letter to Y.B.M. Menteri Kewangan.

Dengan Hormatnya,

Abdul Aziz Taha

JALIL IBRAHIM'S UNFINISHED LAST LETTER

My dearest Rus and all the children,

Selamat Berpuasa – I trust you are fasting – the bigger children should learn to fast too . . .

My stay in Hong Kong may end quite soon i.e. if my fears come thru. You remember I told you earlier that the Bank is buying certain projects in the USA (office complexes, land under contruction, oil exploration companies) – well the Bank has entered into a sale and purchase agreement for those projects – if the sale goes thru they need someone to manage those assets in the USA – the only person other than the Directors and General Manager who knows about these assets/projects is myself – so I anticipate being asked to go to the USA say for at least 6 months to a year to manage these assets. So I must now think of a reply in case I am asked to go.

Honestly I have reached the limit of my patience here. If I don't have the contract at the back of my mind – I would give notice of resignation and find a less worrysome, less problematic job. It seems to me that the reward for being a good worker is to load him with more and more problems until he goes mad.. The problems in Hong Kong are not my making and from today onwards I am going to think of myself and my family first and put the interests of the Bank, the race and the country behind me. If those Directors had thought of the interests of the Bank, the race and the country first they wouldn't have made all those blunders in the first place. I have sacrificed enough and suffered enough for their blunders and if I am asked to make further sacrifices, become another mad man by going to the USA then I will not hesitate to give them a piece of my mind. They can recall me to KL on 24 hrs notice – that's fine with me. Basically they must know I have had enough and I mean it.

PRIVATISATION THREATENS WORKERS AND CONSUMERS

The recent spate of privatisation in the Third World is actually rather western in inspiration, with Thatcher's Britain and Reagan's America setting trends globally, while the generally lacklustre performance of the Malaysian public sector, including most public enterprises, cries out for a policy response. The real question, however, is whether such inefficiencies are characteristic of the public sector and hence cannot be overcome except through privatisation. If the current record of Malaysian public enterprises is primarily due to the nature, interests and abilities of those in power, rather than solely due to public ownership, then privatisation cannot and will not overcome the root problem. Though privatisation may increase enterprise efficiency in order to increase profits for the private owners concerned, such change will not necessarily benefit the public or consumers in every respect. Since a major portion of such activities are public monopolies, privatisation will hand over such monopoly powers to private interests who may use them in order to increase profits. The privatisation of public services would tend to burden the people especially those who cannot afford the privatised services. Obviously, private interests will only be interested in profitable activities and enterprises. This will mean that the government will be stuck with the unprofitable and less profitable activities. And this will worsen public sector performance, already considered less than efficient. Public sector inefficiencies and other problems need to be overcome, but privatisation will primarily enrich the few with the strong political connections to secure these profitable opportunities, while the people's interests become increasingly vulnerable to private capitalists' power and interests.

Privatization in Malaysia officially began in 1983, after Datuk Seri Dr. Mahathir Mohamad took over as Prime Minister in 1981 (Mahathir 1983). Unlike the Look East policy and the Malaysia Incorporated concept – also associated with Mahathir's administration – which appear to have faded in significance by the mid-eighties, privatization has achieved new vigour, especially after the appointment of Daim Zainuddin as finance minister in mid-1984 and the deepening economic crisis of 1985–86 (see EPU, 1985).

While most potentially affected public sector employees have felt threatened by privatization, many other Malaysians fed up with the waste,

inefficiency and corruption usually associated with the public sector have been indifferent, if not supportive of this policy. Many Malaysians also associate the growth of the public sector with increased state intervention and the ascendance of Malay hegemony under the New Economic Policy (NEP), and see privatization as a desirable policy change that would reduce these trends which have apparently discouraged productive investments, and thus slowed down growth. Some others incorrectly identify state intervention with socialism, and support privatization as a measure to restore capitalist hegemony. While statist capitalism (Jomo, 1986) is not socialism, undermining the public sector especially public services, through privatization has important welfare implications for the people, especially public sector employees, consumers and the poor.

The current campaign for international privatization goes back to the beginning of the eighties, especially after the election of Margaret Thatcher in Britain in 1979 and Ronald Reagan in the United States in 1980, the accompanying swing to right-wing economic thinking in the West (e.g. monetarism and supply-side economics), and the promotion of privatization, by powerful international agencies, such as the World Bank and the Asian Development Bank (1985), often as part of a larger package favouring private capitalist interests.

The growth of the public sector since the thirties has occurred in varying circumstances internationally. In the advanced industrial capitalist economies of Europe, and, to a lesser extent, in North America, the growth of the public sector has been largely associated with the growth of the welfare state, especially under the influence of social democratic movements and Keynesian economic ideas. However, in the Third World, the public sector has developed most under so-called 'intermediate' regimes (Kalecki, 1967) – established by populist nationalist movements (e.g. Sukarno's Indonesia, Nasser's Egypt, India) – as well as statist capitalist governments, using state intervention and planning to achieve rapid economic growth in favour of the ruling interests (e.g. Suharto's Indonesia, Marcos' Philippines, South Korea, Malaysia under the NEP and Kenya).

While different factors have contributed to the growth, nature and role of the public sector in these different contexts, there are also important similarities. This is especially true for the public services, which sometimes involve natural monopolies not priced strictly according to cost or profit maximizing criteria. Important considerations of social welfare and political legitimacy have often been very influential in their development. The following discussion deals primarily with the implications of the privatization of such public services, rather than statist capitalist activities without any public welfare pretensions whatsoever, which, in any case, have not been the main target of privatization in Malaysia.

Privatization – or denationalization – refers to changing the status of a business, service or industry from state, government or public to private

ownership or control. The term often also refers to the use of private contractors to provide services previously rendered by the public sector. In practice, privatization in Malaysia has included:

(a) the sales or divestment of state concerns. The public service concerned usually has to be first established legally as a public company to facilitate such a sale, e.g. the establishment of Syarikat Telekom Malaysia Berhad on 1 January 1987 to take over the activities of the Telecoms Department

(b) public issue of minority or even a majority of shares in a state-owned public company, e.g. Malaysian Airlines System (MAS) in 1985 and the Malaysian International Shipping Corporation (MISC) in 1987

(c) placement of shares with institutional investors, e.g. the sale of about 5 per cent of MAS stock to the Brunei government in 1986

(d) sale or lease of physical assets, e.g. the lease of the Lady Templer Hospital to Rampai Muda in 1984

(e) Joint public/private sector ventures, e.g. the establishment of Perbadanan Otomobil Nasional (Proton) in 1983 with 70 per cent held by HICOM, the Heavy Industries Corporation of Malaysia and 30 per cent by two Mitsubishi companies (see Chee, 1985 and Jomo, 1985)

(f) Schemes to draw private financing into construction projects, e.g. North Port Kelang toll road bypass and the Jalan Kuching toll flyover.

(g) 'Contracting out' public services by enabling private contractors to provide services previously provided within the public sector, e.g. the contracting-out of various local government authorities' activities, such as parking services and garbage disposal, Telecoms' M$2.5 billion telecommunications development projects, Port Kelang's container terminal services

(h) allowing private competition where the public sector previously enjoyed a monopoly, e.g. the launching of a third television channel (TV3) in 1984 owned by Sistem Televisyen Malaysia Berhad, now controlled by New Straits Times Press Berhad, and controlled in turn by the UMNO-owned Fleet Group.

The Malaysian government has summed up its arguments for privatization as follows (EPU, 1985):

"Privatization has a number of major objectives. First, it is aimed at relieving the financial and administrative burden of the Government in undertaking and maintaining a vast and constantly expanding network of services and investments in infrastructure. Second, privatization is expected to promote competition, improve efficiency and increase the productivity of the services. Third, privatization, by stimulating private entrepreneurship

and investment, is expected to accelerate the rate of growth of the economy. Fourth, privatization is expected to assist in reducing the size and presence of the public sector with its monopolistic tendencies and bureaucratic support, in the economy. Fifth, privatization is also expected to contribute towards meeting the objectives of the New Economic Policy (NEP), especially as Bumiputera entrepreneurship and presence have improved greatly since the early days of the NEP and they are therefore capable of taking up their share of the privatized services."

However, these arguments have been refuted on the following grounds:

(a) The public sector can be more efficiently run (as has been demonstrated by some public sectors). Also, privatization is not going to provide a miracle cure for all the problems (especially the inefficiencies) associated with the public sector, nor can private enterprise guarantee that the public interest is most effectively served by their taking over public sector activities. Also by diverting private sector capital from productive new investments to buying over public sector assets, economic growth will be retarded rather than encouraged.

(b) Greater accountability and more effective popular control over the public sector would ensure greater efficiency in achieving the public and national interest while limiting public sector waste and borrowing.

(c) The government would only be able to privatize profitable or potentially profitable enterprises and activities because the private sector would only be interested in these.

(d) Privatization would not resolve the fiscal problem because the public sector would lose income from the more profitable public sector activities, and would be stuck with financing the unprofitable ones; this would undermine the potential for cross-subsidization within the public sector.

(e) Privatization tends to adversely affect the interests of public sector employees and the public, especially the poor, which the public sector is supposed to be more sensitive to.

(f) Privatization would give priority to profit maximization at the expense of social welfare and the public interest, except on the rare occasions when the former and the latter coincide; hence, for example, only profitable new services would be introduced, rather than services needed by the people, especially the poor and politically uninfluential.

(g) Privatization exercises in Malaysia may not even pretend to achieve their alleged advantages and benefits by invoking NEP restructuring considerations, supposedly to increase Bumiputera wealth ownership and business opportunities. With increased Bumiputera competition, where collusion cannot be arranged, however, it is likely that political influence and connections will become increasingly decisive.

The privatization policy has put increasing pressure on public sector employees and those sectors of the population dependent on public services. The burden of privatization in these times has proven to be especially harsh because it is being pursued in the midst of Malaysia's most serious recession since independence. For instance, while the government's austerity drive since 1982 and the privatization policy have justified the reduction of government health expenditure, the recession has forced more people to turn to the public health services.

In many cases of privatization in Malaysia, it is popularly believed that there are strong influences from private interests who try to determine what is to be privatized, in what manner and to whom. Often, privatization does not even involve the formalities of an open tender system. Instead, many beneficiaries are believed to have been chosen on the basis of political and personal connections.

For example, in 1986, it was announced that $1.4 billion worth of water supply projects involving 174 schemes had been awarded to Antah Biwater without open tender. Though hailed as the nation's first privatized water supply project, the government will remain responsible for the operation and maintenance of the schemes. It appears that Antah Biwater – which is 51 per cent owned by the Negeri Sembilan royal family's Antah Holdings Bhd. and 49 per cent owned by the British water supply and treatment group, Biwater Ltd. – has in fact secured a turnkey contract with a government financing arrangement thrown in. It is anticipated that most, if not all, the design and engineering work will be handled by Biwater, at the expense of Malaysian engineers and consultants.

In December 1986, the Malaysian parliament passed amendments to the Official Secrets Act (OSA), which extended the definition of official secrets to include among other things, government tender documents (even after completion of the tender exercise) and any other documents or material which ministers and public officials arbitrarily deem. The clarification of a document or matérial as an official secret cannot be challenged in any court of law, while the amendments impose a mandatory minimum one year jail sentence for any OSA offence. Such legislation, coming in the midst of wide-ranging and intense privatization drive, further reduces the already limited scope for the meaningful exercise of public accountability, particularly in this regard.

Privatization is also supposed to free market forces and encourage competition in the economy generally, and especially in the sectors concerned. But this is negated by the fact that potential beneficiaries have a common interest in getting the public sector to privatise services. Such common interests can be far more important than the market environment ostensibly generated, e.g. as in the case of the privatization of Malaysian telecommunications development projects worth about M$2.5 billion several years ago. Not surprisingly, with the limited experience of privatization thus far, there is already widespread concern about:

- the existence of formal and informal collusion, e.g. cartel-like agreements.
- possible patterns, e.g. by region, in bidding for contracts, suggesting collusion among bidders.
- some companies enjoying special influence and privileged information, thus being able to consistently bid successfully for profitable opportunities from privatization.

Some adverse consequence of privatization to be considered include:

- increased 'costs' to the public of reduced, inferior or costlier services.
- the implications of two sets of services, i.e. one for those who can afford privatized services and the other for those who cannot, and hence have to continue to rely on public services, e.g. medical services and education.
- reduced jobs, overtime work and wage incomes.
- the effects of minimal investments by private contractors concerned with short-term profits.
- increased costs of living – especially in remote and rural areas – due to the economic costing of services, e.g. telephones, water supply and electricity.
- the deflationary consequences of fewer jobs or lower wages, or both.

FOR WHOM THE ROAD TOLLS?
THE NORTH-SOUTH HIGHWAY, UEM & UMNO

(A Memo To The Prime Minister)
Gerakan Anti-Penyelewengan

Driven by a sense of concern and responsibility, the Movement Against Abuse wishes to draw your attention to several serious abuses in awarding the privatisation of the North-South Highway (NSH) to United Engineers Malaysia (UEM).

These practices conflict with the government's own justifications for its privatisation policy, and make a mockery of the government's 'clean, efficient and trustworthy' slogan, and of its espoused promotion of Islamic values!

The awarding of the NSH tender to UEM has caused public anxiety as there are clearly numerous malpractices involved.

It is now clear that UEM was unable to provide the most competitive bid in several crucial regards, such as construction costs, the financial burden on government involved, the toll rates to be levied, the period of toll collection, and the total amount of toll expected.

You must surely also be aware that the other bidders were given less time to prepare their tenders (less than 3 months) compared to UEM. Nevertheless, UEM's tender is still more onerous than at least some of the others preselected.

Of course details of the tender document are not publicly available as they are deemed secret by virtue of the amendments to the Official Secrets Act passed late last year, and the mandatory heavy penalties for violating the Act, even if it is in the public interest.

As you know, prior to being awarded the NSH project, UEM had never built any roads and has a dismal record in many other respects. UEM has been a virtually insolvent company, suspended from trading on the Kuala Lumpur Stock Exchange, with accumulated losses of $90 million up to 1985; half of its shares are said to have been taken over recently by Hatibudi Sdn. Bhd., whose trustees include the President, Deputy President, Secretary General and Treasurer of UMNO.

This will surely raise more than eyebrows among the people, as the UMNO Treasurer is also the Finance Minister responsible for tender decisions, while

the Attorney General – who should investigate and prosecute malpractices as well as prepare government contractual agreements – comes under the Prime Minister, who is also UMNO President.

As you are aware, the problem of 'money politics' – which has been strongly denounced by yourself – has worsened in recent years as a result of increasing involvement by ruling party politicians in business. Your explanation that UMNO needs to settle debts incurred by the Putra World Trade Centre through such involvement is extremely disappointing to say the least. The sale of MIC-sponsored lottery tickets by the Work's Mihister to UEM is also most irregular.

In line with the 'leadership by example' slogan, UMNO and all other political parties ought to divest themselves of business involvement. This is all the more urgent because UEM has recently procured several other lucrative tenders, such as the pharmaceutical stores and services project with the Ministry of Health (even though this was reportedly opposed by the Director General of Health), the National Sports Complex and the Peninsular Malaysia Utilisation Project natural gas pipeline consultancies. In some instances, it appears that UEM lacks staff competence, and actually serves as a front for foreign companies, collecting handsome commissions for its connections.

The argument that, nevertheless, UEM ought to be awarded the NSH project as it originally proposed the privatisation of the Highway borders on the ridiculous, especially considering the sums involved. Not only are there differences of several billion ringgit between the competing tenders concerned, but such an argument is especially dubious when some of the same people are involved with both UEM and the government.

According to the Works Minister, UEM will be able to collect $34 billion in tolls over a 25 years period! This has been scaled down from UEM's original demand for $54 billion over 30 years, after this became public knowledge.

Further, UEM is to be guaranteed minimum traffic volume and toll collections for 17 years by the government, and will even be compensated for shortfalls in toll collection!

In fact, one of the justifications for the privatisation policy is that private entrepreneurs, and not the government, ought to bear the risks involved, especially in view of the vast differences in the forecasts of UEM, the project consultants (Rendel, Palmer and Tritton), and the Malaysian Highway Authority (LLM).

The Malaysian government's record for making sound projections leaves alot to be desired. While the Malaysian car project (Proton Saga) was being formulated, the government forecasted that new car sales would increase at about 8 per cent yearly from 110,000 units in 1982. As you know, the reality

since has been otherwise, with total sales for 1987 expected to be less than 50,000!

The privatisation of the NSH will fail to achieve the government's privatisation aims for the following reasons:

1. Due to UEM's conditions, apparently accepted by the government, the financial burden on the government will increase in several ways:

   1.1 The government has agreed to advance credit facilities to UEM at government-subsidized rates to the tune of $750 million (reduced from $1650 million in mid-July 1987, after some public outcry).

   1.2 The Malaysian Highway Authority (LLM) will hand over highways, for which it spent $3,320 million to UEM, which will then charge even higher toll rates on them, while the government will have to pay off the remaining loans of $1,600 million incurred by the LLM.

   1.3 UEM will be exempted from various taxes, estimated to cost the government about $2,650 million.

   (The government was reportedly also prepared to offer guarantees against currency devaluation, rising interest rates, delays and appreciating costs, worth about $1,150 million, to UEM. When these became public knowledge, they were withdrawn).

2. There is no evidence that the privatisation of the NSH will encourage competition and increase efficiency or productivity when the government's virtual monopoly of the highways falls into private hands, with all its attendant implications and consequences.

3. It is clear that the privatisation of the NSH, especially to UEM, will raise living costs, particularly for transport, and especially for workers, peasants, fishermen and other low-income groups. The poor, who are already suffering in the current economic conditions, will be further hardpressed because the imposition of tolls will inevitably raise the cost of living. To add insult to injury, tolls are going to be collected on highways which have previously been toll-free, e.g. the Federal Highway from Kuala Lumpur to Kelang, which is not part of the North-South Highway.

   In terms of redistribution, it has been found that many UEM shares are still held by a foreign company, United Engineers Ltd. of Singapore, while most other shortlisted bidders for the tender were local companies, including Bumiputera companies apart from UEM.

As UEM has had no direct experience in highway construction, UEM will be heavily dependent on its foreign partners – Mitsui and Co. (Japan), Taylor Woodrow International Ltd. (UK) and Societe Francaise de Dragages et de Travaux Publics (France).

As you are aware, a high proportion of construction expenditure in the early and mid-1980s flowed out of the country to the foreign companies who secured the projects. In the Daya Bumi project, the Bumiputera partner publicly complained that there were merely used as front men for dealing with the government, with no significant transfer of technology taking place. Lately, it has become even more evident that significant potential economic gains have been lost with privatisation, e.g. the Antah-Biwater water supply project has not realised the expected gains in terms of utilisation of local products, employment for local engineers or other benefits that might accrue from such a massive civil engineering project.

4. As you know, due to the economic downturn, government expenditure has had to be severely reduced. Hence, remaining public expenditure has to be especially well-planned, so as to help revive the national economy, even though rising commodity prices lately have also helped improve the situation a little.

You are also aware that construction is not a productive activity, though its recovery may help stimulate growth. The question here is to what extent the government should channel limited resources to such a giant construction project, given to a company heavily dependent on its foreign partners, compared, for example, with greater investment in smaller agricultural and fishing projects as well as small industries, which can generate greater benefits in terms of employment and production in the long run.

Yet another question arises: Would it not be more beneficial in the long run not to rush this project in such a short time? Would it not be more apt – if the project is indeed desired by the people – to implement the project over a longer period of time, so that its economic benefits will be spread over a long time period. This would surely be wiser, especially in view of the Works Minister's contention that the NSH project has to be privatised because the government can only afford to spend $150 million a year on it.

The key question is the recent NSH privatisation scandal is that it involves several gross abuses in the award of the tender to UEM. To avoid these abuses – which will surely materialise if the agreement with UEM is signed – we, on behalf of all Malaysians who abhor the abuse of power, wish to demand that:

- the government cancel the privatisation of the NSH project to UEM, and reconsider the project itself.

- if desired by the people, implementation of the NSH project – including its planning, construction, and toll collection rights – should be handled by the Malaysian Highway Authority (LLM), while ensuring greater accountability of the LLM to the public.
- the question of how to tax the road user should also be resolved equitably – whether by road taxes or tolls – allowing only reasonable toll collection, considering rates, location, alternative routes, etc.
- the government should approve of and even encourage public discussion of the problems of abuse of political power – especially the privatisation of the NSH – in the mass media and other public fora.

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