Development and Inequality in Malaysia: From Puthucheary to Mehmet

Review Article*

Malaysia has been one of the few success stories of economic development in the third world. With a per capita GNP of U.S. $2,000 in 1985, Malaysia is ahead of Portugal and Hungary in the World Bank’s rankings.¹ Few countries can rival Malaysia’s record of economic growth; per capita GNP has grown by an average of over 4 percent per annum for the past twenty years.² Malaysia is the world’s largest producer of natural rubber, tin, and palm oil and in the 1970s Malaysia became a major exporter of oil. Perhaps the visible sign of Malaysia’s economic progress is the creation of a significant middle class whose residential areas surround Kuala Lumpur and other Malaysian cities.

There is, however, an underside to these positive developments. Poverty remains a persistent problem in rural and in urban areas. Wealth concentration and widening income inequality seem to be accompanying economic growth. The economy remains heavily dependent on primary products. And when the prices of all these products fell in the mid-1980s, Malaysia’s economy went into a tailspin from which it has yet to fully recover.

What theoretical perspective or model can explain these developments and provide a convincing guide for public policy? There is no consensus on this question for Malaysia or any other country. One of the most influential paradigms of theory and research on economic development has been the dependency framework. The basic hypothesis is that economic and political influences from the developed economies can retard the economic progress of developing economies, i.e., there is a relationship of dependency. In the earlier literature of the 1950s and 1960s, the problem was seen


² Ibid.
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as part of an imperialist system where the metropolitan powers milked the colonies or former colonies for raw materials. In contemporary writings the search for cheap labor by multinational corporations (MNCs) is seen as a stimulus for industrialization in some developing countries, but with little chance of long-term economic development. Dependency theory also emphasizes the role of the government and domestic class alignments that affect the course of national development. Because of Malaysia’s economic success it represents a critical test for the neocolonial thesis or the dependency school.

In this essay I review two of the most important studies of the Malaysian (Malayan) economy which were written over twenty-five years apart. In 1960, James Puthucheary published his classic book, Ownership and Control in the Malayan Economy, while detained for his political activities in a Singapore jail.³ Development in Malaysia: Poverty, Wealth, and Trusteeship is the latest study by Canadian economist Ozay Mehmet.⁴ He is the author of a series of widely discussed articles and books on the Malaysian economy and public policy. Neither of these books falls neatly within the dependency school; both authors are more concerned with substance than any orthodox theory. Both books are heavily empirical, but with a fixed purpose—to provide a critical interpretation of the dilemmas and contradictions beneath Malaysia’s economic progress. The historical period from Puthucheary’s analysis of the 1950s to Mehmet’s view of the 1970s and early 1980s covers the post-independence era. These books cannot be considered in isolation, but as bookends for this period of history and the stream of scholarship on the problems of development and inequality in Malaysia.

Although I use the term Malaysia, the focus is really on Peninsular Malaysia, formerly Malaya. Malaya, which had been an independent nation since 1957, was joined with the British colonies of Singapore, Sabah and Sarawak in 1963 to form Malaysia. Singapore left Malaysia in 1965 to become an independent country.

The Neocolonial Critique

James Puthucheary’s thesis was that the corporate economy of Malaya and Singapore was owned and managed by foreign, primarily British, interests. He concluded that foreign control inhibited economic development and progress toward greater equality. Although Puthucheary’s voice was a heretical one at the time, his work has had a lasting impact on several generations of students of the Malaysian economy. A reprint edition of Puthucheary’s book is still available and is regularly cited while most of the other economic studies of that era have all but been forgotten.⁵

³ Puthucheary, Ownership and Control in the Malayan Economy.
⁴ (Mehmet, Development in Malaysia.)
⁵ (Kuala Lumpur: University of Malaya Co-operative Bookshop Ltd., 1979.)
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British rule had created a powerful ideology that the colonial government was benevolent and fair—governing in the long-term interests of the Malayan people. This ideological hegemony pervaded academic and policy circles. The major publications on the Malayan economy of the 1950s rarely mentioned the adverse effects of colonialism or of foreign ownership. Although there were a few studies that documented how colonial rule had favored British interests at the expense of the local population, these ideas were generally peripheral to both academic and popular thinking. Puthucheary’s book was a direct and forceful challenge to the conventional analysis of the 1950s and the early 1960s.

Puthucheary’s primary focus was on the commanding heights of the economy—the rubber plantations, tin mines, export/import firms, and large corporate firms. These firms were the base of the export economy that made Malaya the most lucrative colony in the British empire. At first glance, there were hundreds of European and Chinese companies that appeared to be competitive with and independent of one another. But by detailed scrutiny of published reports, Puthucheary was able to show a tightly knit web of European centralization and control over the Malayan and Singaporean economy. For example, eleven agency houses hired and supervised the management of over three hundred European estates and the structure of control over the mining sector was even more concentrated. The agency houses also played a central role by handling most of the exports and imports of the country and by representing the shipping and insurance companies. This oligopolistic control of the Malayan economy, in Puthucheary’s analysis, led to a unified front on wages and strategies toward labor unions. Government policies on taxation and public expenditures, especially during the colonial era, were heavily influenced by the dominant foreign economic institutions.

Drawing upon the writings of Singer and Myrdal, Puthucheary interpreted the deleterious effects of foreign ownership and an unbalanced economic structure on capital accumulation and industrialization.  

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8 Puthucheary, Ownership and Control, p. 46.
9 Ibid., p. 91.
its tended to be repatriated to foreign stockholders or invested in the same lines of economic activity (plantations, mines) in other countries. Since industrialization would offer competition for the imports of the agency houses and also require new forms of economic organization and technical expertise, there was little capital mobility to the secondary sector. In addition, the export economy created few backward or forward linkages that attracted capital. Puthucheary argued that the problem of the Malayan economy was not a shortage of capital, but the lack of effective demand for capital.\textsuperscript{12}

I believe that Puthucheary’s analysis is largely correct for the 1950s. But the postindependence economy of Malaya (later Malaysia) changed in the 1960s. The government became much more active in promoting education and rural development; tariff barriers were set up and a domestic industrialization program was encouraged. But there remained considerable doubt and debate over the long-term economic direction of the postcolonial economy of independent Malaya, later Malaysia.\textsuperscript{13} The official consensus was that economic growth and development would occur with some government pump-priming and that the private economy, foreign and domestic, should be pretty much left alone. Critics charged that foreign interests still dominated the economy at the expense of Malaysian citizens and that major structural reforms were necessary. With few exceptions, however, the debate was not directly addressed with empirical data. Since economic growth and increasing prosperity continued throughout the 1960s, the neocolonial thesis attracted few adherents. There was considerable controversy over economic policy, but the major issue was ethnicity, not class or foreign ownership.

\textbf{The New Economic Policy}  

The watershed in modern Malaysian history was the 13 May 1969 ethnic riots in Kuala Lumpur, and the political and economic changes that followed. The New Economic Policy (NEP) was proposed in 1970 as a twenty-year plan to reduce poverty and to eliminate the association of “race” with economic roles. The latter issue meant that the government would promote a greater integration of Malays throughout the occupational structure and an increasing Malay ownership of the corporate sector.

\textsuperscript{12} Puthucheary, \textit{Ownership and Control}, p. 170.

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To establish benchmark data on corporate ownership, the following figures were published in the *Mid-Term Review of the Second Malaysia Plan*.14

**Ownership of Share Capital of Limited Companies in Peninsular Malaysia, 1970**

<table>
<thead>
<tr>
<th>Sector</th>
<th>Malays</th>
<th>Chinese</th>
<th>Indians</th>
<th>Foreigners</th>
</tr>
</thead>
<tbody>
<tr>
<td>Agriculture, Forestry and Fishing</td>
<td>0.9%</td>
<td>22.4%</td>
<td>0.1%</td>
<td>75.3%</td>
</tr>
<tr>
<td>Mining and Quarrying</td>
<td>0.7%</td>
<td>16.8%</td>
<td>0.4%</td>
<td>72.4%</td>
</tr>
<tr>
<td>Manufacturing</td>
<td>2.5%</td>
<td>22.0%</td>
<td>0.7%</td>
<td>59.6%</td>
</tr>
<tr>
<td>Construction</td>
<td>2.2%</td>
<td>52.8%</td>
<td>0.8%</td>
<td>24.1%</td>
</tr>
<tr>
<td>Transport and Communications</td>
<td>13.3%</td>
<td>43.4%</td>
<td>2.3%</td>
<td>12.0%</td>
</tr>
<tr>
<td>Commerce</td>
<td>0.8%</td>
<td>30.4%</td>
<td>0.7%</td>
<td>63.5%</td>
</tr>
<tr>
<td>Banking and Insurance</td>
<td>3.3%</td>
<td>24.3%</td>
<td>0.6%</td>
<td>52.5%</td>
</tr>
<tr>
<td>Others</td>
<td>2.3%</td>
<td>37.8%</td>
<td>2.3%</td>
<td>60.7%</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>1.9%</td>
<td>22.5%</td>
<td>1.0%</td>
<td>60.7%</td>
</tr>
</tbody>
</table>

*The percentages do not add to 100 percent because the share capital owned by government and other Malaysian residents are not allocated by ethnicity.

The objective of the government was to show that Malays owned only an infinitesimal share of the country’s productive wealth relative to Malaysian Chinese. But the figures also revealed that more than 60 percent of the corporate economy was owned by foreigners and foreign companies in 1970. The extent of foreign ownership of the “commanding heights” of the economy after thirteen years of independence surprised many people, including economists and other social scientists. During the 1970s a number of studies were undertaken by Malaysian academics to update and broaden Puthucheary’s research on foreign ownership and control.15 Given the time lag between data collection, analysis and publication, these major works were not published until the early 1980s, although their data generally refer to the period from the early to mid-1970s. The collective impact of these studies reinforced the claim of concentrated ownership and the dominance of foreign interests on the Malaysian economy well into the 1970s.


A related finding is that foreign ownership was intertwined with groups of Malaysian capitalists in the 1970s. There appeared to be a web of control by local and foreign interests that had interlocking networks and directorships in the largest companies in all major sectors of the Malaysian economy (rubber, oil palm, tin, manufacturing, property development, and finance). Documenting and describing these patterns was the major accomplishment of these studies. The implications of the new oligopolistic structure of ownership and control on the economy are a far more knotty problem that was only partially addressed by this body of research.

The New Economic Policy (NEP) changed the role of the Malaysian government in the economy. The obligation to ensure a greater share of wealth ownership by the Malay community led to a wide variety of government interventions in the economy, including the creation of dozens of public sector companies. In the mid- to late 1970s government corporations began to purchase corporate shares and then to take controlling interest in many foreign-owned corporations. Boosted by the influx of oil revenues, the public sector acquired the dominant corporate landmarks of the colonial era, including such names as Sime-Darby, London Tin, Guthrie, Harrisons, and Barlow.

How these changes have affected the Malaysian economy and the economic welfare of the Malaysian people is the theme addressed in Mehmet’s *Development in Malaysia*. Mehmet’s primary objective is an assessment of the New Economic Policy which was aimed at structural reform to alleviate poverty and ethnic inequality. His primary conclusion is that the NEP enriched the few, but did little to alleviate the poverty of the masses.

Although his primary focus is on the effects of the NEP on poverty reduction and wealth creation, Mehmet ranges broadly over a number of empirical questions and theoretical issues. He formulates a new perspective with his model of “Development by Trusteeship.” He draws upon data from censuses, industrial surveys, development plans, and other governmental and private sector reports. The original analysis is supplemented with a detailed discussion of the research literature by Malaysian and foreign scholars. Although his is a relatively short book (188 pages), Mehmet covers enough ground to advance thinking and knowledge on a variety of significant questions.

Mehmet’s primary contribution, in my opinion, is his model of trusteeship for the management of the Malaysian economy. While there are some parallels between the 1980s and the foreign-dominated oligopolistic economy of the 1950s and 1960s, there are too many differences to simply continue with a neocolonial model of the Malaysian economy. Multinational corporations continue to play a key role in the Malaysian economy, but an increasingly significant share of ownership and power rests with the new Malaysian bureaucratic elite and bourgeoisie. This new structure of economic dominance and its dynamics pose troublesome ques-
tions for social science analysts. Mehmet attempts to develop an original conceptual framework for the Malaysian case.

Mehmet's model of trusteeship identifies a ruling elite as consisting of two groups: "'political decision-makers' and "officials and public service staff.'" These elites control governmental budgets and resource allocation by nonmarket-based rules and political criteria. Mehmet says that the trusteeship strategy arose out of the bureaucratic expansion of government and public sector enterprises during the NEP. The trustees have used their positions of authority to enhance their own power and wealth. The strategy of development by trusteeship relies on cheap labor, a philosophy rooted in the colonial past. In fact, Mehmet claims the current trustees are "'successors of the colonial elite.'" This interpretation is supported by data showing an increasing level of wealth concentration and abuses of power by the ruling elites.

Mehmet offers an insightful description of the actors and institutions that control the Malaysian economy and government. His account of the abuses of power is right on target and provides an effective counterbalance to the image of market forces as dominant. What is less clear is the character of the bureaucratic capitalism that rules the Malaysian economy. Is it a variant of state socialism, a Japanese style system of government-coordinated oligopolies, or perhaps an emerging Latin American pattern of dominant businesses owned and run by leading politicians and their families? The problem is not simply that Mehmet does not deal with the broader theoretical questions, but that his analysis does not move from description to a discussion of institutional dynamics. What are the likely tendencies of the current economic structures toward investment, industrial diversification, and research and development? Clearly greed is a dominating motivation, but I do not believe that it is a sufficient explanation of the entire system.

The other major contribution of Mehmet's book is the empirical analysis of trends in poverty, income distribution, industrialization, and wealth concentration. Here my evaluation is mixed. In his broad survey of data and issues, Mehmet has uncovered some very important patterns. For example, the ratio of estate workers' earnings to those of manufacturing workers shows the impoverishment of the plantation sector workers. The conclusion that most Malaysian fishermen and rice farmers will be unable to substantially improve their incomes under any reasonable set of circumstances is well documented. The record of financial abuses by the ruling...

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16 Mehmet, Development in Malaysia, p. 6.
17 Ibid., preface.
18 Ibid., chapter 6.
19 Ibid., p. 24.
20 Ibid., p. 58 and p. 60.
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elite is laid out in considerable detail. But other analyses are simply confusing. Tables are often presented in a less than clear fashion with an incomplete discussion of key issues. For example, the discussion of the trend in poverty does not clearly distinguish between the incidence of poverty in a group and the proportional share of the total poor in that group. Consequently, I would be reluctant to recommend Mehmet’s book as a clear guide to recent empirical trends and patterns in the Malaysian economy.

Concluding Discussion

Modern economic history can be divided into three phases: (1) the colonial era up to 1957, (2) the first phase of independence from 1957 to 1970, and (3) the NEP from 1970 to the present. During the colonial era the Malayan economy supported a ruling class of European administrators and managers who lived in great wealth but did little to bring the masses of the population much above the subsistence level. A small middle class rooted in government service and in the business sector assumed political power in 1957 with plans for continuity of a generally laissez-faire economic system.

But independence did bring many significant changes to the Malayan economy. Support for the replanting of smallholding rubber, tariff barriers to stimulate industrialization, and substantial investment in human capital (through education and health programs) were products of a government responsive to popular aspirations for social and economic development. One thing that did not change, however, was the structure of ownership of the corporate sector of the economy. Almost two-thirds of the most modern sectors of the economy remained under foreign ownership and control in 1970.

The NEP has radically changed the economic system in the years since 1970. More and more of the national economy is in Malaysian hands, largely acquired through the purchase of foreign companies by Malaysian government and state-run corporations. The political objective was not to increase state management of the economy, but to increase the share of corporate ownership by Malay capitalists. Many questions remain, however, about the ultimate beneficiaries of this program and the implications for economic development and equity.

Of major importance in the Malaysian context is the degree of Malaysian control that has been acquired with growing Malaysian ownership. The battle for control of Sime Darby in the late 1970s reveals that substan-

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21 Ibid., pp. 135–51.
tial Malaysian ownership does not automatically bring corporate control.\(^{22}\) Malaysian interests did win that battle for a majority of seats on the board of directors, and presumably will also insist on a controlling degree of influence in the other corporate giants recently acquired. But the degree of Malaysian influence on the hundreds of recent cases of corporate restructuring and joint ventures with foreign MNCs remains uncertain. The basic NEP objectives are to achieve ownership by a majority of locals and a significant share of Malay employment, especially at the higher rungs of the corporate administration. But many questions remain about the transfer of technology, access to raw materials and foreign markets, and pricing decisions.\(^{23}\) It may be that MNCs will be able to continue to make critical decisions even with a minority ownership.

Another basic issue, raised twenty-five years ago by Puthucheary, is whether the growth of a class of Malay capitalists will do much for the situation of the majority of the Malay community. Puthucheary noted that the presence of successful Chinese capitalists had not solved the problem of poverty for most Chinese households.\(^{24}\) Studies of the composition of corporate boards of directors show that a few Malays, often of aristocratic background or of high rank in the political/administrative structure, often have seats on many boards.\(^{25}\) This problem is also evident in the distribution of shares in ASN (Amanah Saham Nasional)—the agency set up in 1981 to give investment opportunities to all Malays. Shares were set at a constant M$1 per unit and shareholding was restricted to fifty thousand units per individual in order to spread the benefits widely. Yet, only about one-third of all eligible Malays have participated in ASN, and about three-quarters of those participating have five hundred or less units. At the other extreme, one-half of one percent of participants owns twenty-five thousand or more units.\(^{26}\) It is difficult to claim that this program will increase the incomes of the majority of poor Malays.

It seems almost inevitable that an unrestrained capitalist economy leads to an increasing concentration of capital ownership, independently of whether it is foreign or locally owned. The findings of Lim and Sieh that one hundred or so families or individuals own almost half the capital in Malaysian corporations are indicative of the strong tendency toward con-


\(^{24}\) Puthucheary, *Ownership and Control*, p. 179.


centration. It is against this current that the NEP goal of the redistribution of ownership to Malay capitalists must be evaluated. The links between capital and the exercise of political influence are well known. Typically, the direction of influence is from the economy to the polity, with powerful economic interests seeking to shape political decision making. In Malaysia, the direction of influence is the reverse. Political power is being used to create a capitalist class.

A final question is, what is the impact of the structure of ownership on economic growth? There is evidence that foreign-owned companies reinvest a smaller fraction of their profits than do local firms. This is true, in spite of the fact that foreign firms have higher rates of profitability than locally owned ones and also pay a lower level of taxation. On the other hand, it is sometimes argued that foreign firms are able to make unique contributions by the transfer of technology, having access to foreign markets, and filling in niches of the local economy where domestic capital is not yet ready to invest. There is less research (to my knowledge) on the investment behavior of the new joint ventures between MNCs and Malaysian state corporations.

The 1970s—the era of the NEP—was the most prosperous period in Malaysian economic history. In spite of the many problems detailed by Mehmet, economic growth averaged 7 to 8 percent per year. It is premature to assign cause and effect, but active government intervention in the economy did not seem to slow down the economy. Even if much of it was wasted in mismanaged projects and by the conspicuous consumption of the elite, there was a lot left over for significant increases in the average incomes of most Malaysians. Public spending, especially in the areas of education and health, also reached throughout the society to improve the lives of many Malaysians. There remains considerable room for the evaluation of the impact of the NEP and of the successes and failures of the Malaysian economy.

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