



**Initiative for Policy Dialogue  
Privatization Task Force**

**Privatization's Distributional Impact in Malaysia<sup>1</sup>**

**Jomo K. S.**

**Applied Economics Department, University of Malaya, Kuala Lumpur, Malaysia**

Malaysian Prime Minister Mahathir Mohamad's 1983 announcement of his government's intention to embark on a privatization policy represented a dramatic reversal of preceding Malaysian government policy although it was very much consistent with his own personal ideological and policy preferences as well as the then new wave of conservative market reforms beginning in the West with the election of the Thatcher Government in the United Kingdom in 1979 and the Reagan administration in the United States late the following year. Privatization has proceeded unevenly since its emergence in the 1980s. Of the 2,100 known cases of divestiture in developing countries between 1980 and 1991, over half (around 1,300) were in Mexico and Chile alone, leaving a low single digit average for the others (Kikeri, Nellis & Shirley, 1992: 7). Hence, the wholesale approach – advocated by the *Privatization Masterplan (PMP)* (Malaysia, 1991a) – was an exception rather than the rule. However, privatization has since become more significant elsewhere, especially in the so-called transitional or former communist economies.

The Malaysian Government has identified five different policy objectives for its privatization policy, of which contributing to the New Economic Policy (NEP) has arguably been the most important. The NEP, first announced in 1970, sought to create the conditions for 'national unity' by reducing poverty and reducing inter-ethnic disparities, especially between the indigenous, mainly ethnic Malay Bumiputras and the mainly ethnic Chinese non-Bumiputras, usually referred to in Malaysian discourse as 'restructuring society'.

This paper reviews the Malaysian privatization policy as well as what has happened in Malaysia in the name of privatization, even though some such developments may not be considered as privatization in the strict sense of the term. Particular emphasis is placed on the likely distributional consequences of Malaysian privatization. Unfortunately, much of Malaysian privatization and economic distribution has been shrouded in secrecy. Also, it would not be correct to attribute broad distributional trends to privatization alone as many other contemporary factors and developments would also have had distributional consequences. Hence, the story that emerges is spotty and only comprehensive in so far as it has attempted to review and utilize publicly available materials.

The first part reviews the evolution of public policy from the colonial period resulting in the emergence, growth and privatization of state-owned enterprises (SOEs) in Malaysia. This is followed by a review of the SOEs in the 1980s, when the privatization policy was first announced and then implemented. These two sections serve as background to the subsequent review of Malaysia's experience with privatization.

This review begins with a critical appraisal of the official rationale for the privatization policy. The following section reviews Malaysia's experience of privatization, or more accurately, of what has been done in the name of privatization. More careful examination of the efficiency consequences of privatization and its implications for consumer welfare are

reviewed, with a view to the likely distributional implications. The distributional implications of the under-pricing of privatized SOE initial public offers (IPOs) are reviewed next. The final part deals with other distributional implications of privatization and other policies associated with economic liberalization in Malaysia from the mid-eighties. It begins with a review of trends in income and wealth distribution, poverty reduction as well as NEP redistribution policy efforts. The consequences of the 1997-8 financial crisis for the privatization policy are then reviewed with a view to its distributional implications. A brief conclusion closes the paper.

### ***The Growth and Privatization of Malaysian SOEs***

Colonial policy in British Malaya was essentially conservative. The colonial authorities recognized the need to develop utilities and other infrastructure so crucial to profit making in the colonial economy. Hence, public enterprise or state owned enterprise (SOE) emerged during Malaya's colonial era to provide the public goods and services needed by British private enterprise to secure profits from their control of tin mining, plantation agriculture and international commerce.

Faced with a communist-led insurgency and the prospect of a debilitating stalemate or, worse still, defeat in its economically most lucrative colony after the Japanese Occupation during World War Two, the colonial authorities sought to win 'hearts and minds' from the early fifties after little success with its original strategy of repression from the late forties. In this context of social reform to complement repression, the British colonial authorities established new SOEs oriented primarily to rural development efforts to consolidate a Malay yeoman peasantry as a bulwark against a Chinese-led rural insurgency with some peripatetic efforts to encourage petty Malay business in the face of ubiquitous Chinese dominance of petty trade and industry.

The advent of an elected Malay-dominated post-colonial government saw a deepening of such efforts, by the ruling Alliance led by the United Malays National Organization (UMNO), mindful of its primarily Malay electoral base. Hence, after independence in August 1957, rural development efforts intensified, with some proliferation of new rural development agencies. The momentum to advance Malay business interests accelerated from the mid-sixties, especially after the convening of the first Bumiputera Economic Congress in 1965. From the early sixties as well, the post-colonial government's import substituting industrialization policy required the establishment of some SOEs to provide industrial financing and organize factory sites on industrial estates, but little more, as the conservative Alliance government was concerned to ensure that it did not upset British and other foreign companies seeking to consolidate their market shares in the growing post-colonial market by relocating some plant and machinery, primarily for assembly and packaging, in the former colony.

From the mid-sixties, most Malaysian state governments also began setting up state economic development corporations (SEDCs) to enhance the flexibility of the state governments in undertaking initiatives of their own, particularly in exploiting their own natural resources and trying to ensure some spatial dispersal of new industries. The abolition of municipal elections – typically won by opposition parties since their advent in the fifties – from the mid-sixties may well have inadvertently pre-empted similar initiatives at the municipal level.

Making the transition to export-oriented industrialization in the late sixties with the exhaustion of import substitution, various federal and state government agencies provided much of the necessary infrastructure and other facilities to attract foreign manufacturers to relocate in and use Malaysia as their new export platform offering relatively cheap, docile and largely un-unionized labor.

The May 1969 elections and ensuing race riots and palace coup within the UMNO – and hence government – leadership resulted in very significant regime changes, resulting in the tremendous expansion of state intervention and the public sector for the next dozen years (until Mahathir's elevation to become Malaysia's fourth Prime Minister in mid-1981). The new national leader, Razak announced a New Economic Policy (NEP) committed to achieving national unity by reducing poverty and achieving inter-ethnic economic parity, especially between the politically dominant Malays and economically ubiquitous Chinese. From 1971, the Malay elite-dominated Malaysian government's NEP was officially committed to reducing poverty and inter-ethnic economic disparities, ostensibly to achieve national unity, understood primarily in terms of reduced inter-ethnic resentment. New statutory bodies, government corporations, government-owned or controlled publicly listed companies as well as government-owned or controlled private companies all became means to achieve government objectives, including – but not only – the NEP's corporate wealth redistribution target of increasing indigenous (Bumiputera) ownership share to 30 percent by 1990 from 2.4 percent in 1970.

The NEP's Outline Perspective Plan for 1971-1990 (OPP1) also envisaged the creation of a Bumiputera commercial and industrial community (BCIC), while the Fourth Malaysia Plan for 1981-1985 expected Bumiputera 'trust agencies' to account for 83 percent of Bumiputera share capital in 1990, i.e. only 17 percent – or 5.2 percent of total share capital – was to be held by Bumiputera individuals. By 1990, however, Bumiputera share capital<sup>2</sup> had risen to 20.3 percent of total share capital, with trust agencies accounting for 6.3 percent and individuals for 14.0 percent, i.e. 31 percent and 69 percent of the Bumiputera share respectively!

Existing SOEs were strengthened and new ones created to achieve these goals. Intensified rural development efforts continued to be directed mainly at the Malay peasantry. Greatly expanded educational efforts, particularly at the tertiary level, rapidly grew to expand and consolidate the Malay middle class. Malay employment in the modern sector grew rapidly, both in the public and private sectors, though not without some state coercion in the latter case. And perhaps most importantly, in terms of what the NEP has come to mean in Malaysia, various 'Bumiputera trust agencies' rapidly acquired tremendous corporate wealth, ostensibly on behalf of the predominantly Malay indigenous (Bumiputera) community. The conservative fiscal policies of the early post-colonial era were abandoned in favor of growing deficit financing, primarily from domestic sources, mainly the forced savings of the Employees Provident Fund (EPF), set up as part of the labor reforms of the early fifties. The discovery and extraction of newly discovered petroleum reserves, as international oil prices rose from 1973, greatly increased the Malaysian government's degree of freedom in terms of spending, and hence, SOE expansion, which extended to regional and spatial dispersal objectives as well. Malaysia's newfound status as a net petroleum exporter from the mid-seventies enabled it to continue to increase public spending until the end of the decade without any dramatic increase in foreign borrowing.

By the end of the decade, however, the decline of oil prices and the US-led tightening of liquidity induced a new international recession, which the Malaysian Government initially hoped to spend its way out of with increased public spending and a public employment expansion policy financed with foreign borrowings, mainly from commercial sources. As the deep structural nature of the international recession became increasingly apparent, the government abruptly abandoned the counter-cyclical expansionary fiscal strategy by announcing an austerity campaign soon after improving its electoral position in the April 1982 general elections.

Nevertheless, however, the government continued to guarantee heavy foreign borrowings, mainly from Japan, to finance new Prime Minister Mahathir's heavy industrialization

strategy, in the form of steel, cement, auto-assembly and motorcycle plants set up through SOEs. Thus, Malaysia's foreign borrowings increased most dramatically in the first half of the eighties, after real interest rates increased as inflation dropped in the face of the deflationary tendencies associated with tightening international liquidity.

In 1985, international recession adversely affected Malaysian export earnings from most commodities (especially palm oil, rubber, tin) and electronics. And in September that year, the major industrial economies agreed to a major international currency realignment, with the yen appreciating significantly against the US dollar for a decade until mid-1995. Malaysia's ringgit – which became increasingly tied to the US dollar after independence, and especially after the sterling devaluation of 1967 – then depreciated against the US dollar, resulting in a virtual doubling of the value of the yen in ringgit terms, with a corresponding increase in the yen-denominated foreign borrowings. As a consequence, Malaysia experienced negative growth in 1985, for the first time since independence. With the collapse of the oil price in early 1986, the Malaysian authorities were under considerable pressure to respond with policy changes favored by the Bretton Woods institutions.

The Malaysian government was among the first in the South to voluntarily climb on the privatization bandwagon, enthusiastically endorsed and promoted by the Bretton Woods institutions. Less than two years after becoming Prime Minister in mid-1981, Mahathir Mohamad announced the Malaysian government's own commitment to privatization in 1983. Unlike the 'Look East' policy and the 'Malaysia Incorporated' concept – also associated with Mahathir's administration – which faded in significance by the mid-1980s, privatization achieved new vigor, especially after the appointment of Daim Zainuddin as Finance Minister in mid-1984 and the deepening economic crisis of 1985-86.

After quietly announcing the suspension of the NEP, the government basically discontinued its heavy industrialization program while consolidating and accelerating various economic liberalization measures, including several already announced by Mahathir in the early eighties, including privatization. In 1985, the Economic Planning Unit of the Prime Minister's Department announced its *Guidelines for Privatisation*, spelling out the official rationale and broad guidelines for Malaysian privatization. Finance Minister Daim, appointed by Mahathir in 1984, is sometimes credited with responsibility for implementing these policy reversals. It is interesting to reflect on his ability to pursue somewhat unpopular measures – including reversal of much of what the NEP had come to stand for – in light of his relative insulation from political pressures, having been appointed to this powerful position without enjoying a personal political mandate from either the party or the public.

The subsequent sustained economic boom, led by export-oriented manufacturing, especially of industries relocating from Japan, Taiwan and other increasingly expensive economies of East Asia, enabled the government to claim credit for it, also giving it the confidence to consolidate the economic development program with the expiry of the first Outline Perspective Plan (OPP) for 1971-1990 associated with the NEP. In February 1991, Prime Minister Mahathir announced his Vision 2020 to achieve developed country status by the year 2020, on the basis of a liberal economic program including privatization. In the same month, the government issued its *Privatization Masterplan*, including a Privatization Action Plan.

Not surprisingly, Malaysia's privatization program was, at least initially, widely perceived as the antithesis of the NEP's expansion of the public sector despite official insistence that the program would contribute to NEP objectives, referring mainly to the inter-ethnic redistributive efforts. After all, the NEP had come to be perceived increasingly in terms of Malay wealth accumulation, with 30 percent of total corporate wealth set as the target for 1990. The Malay share of corporate wealth seemed to be growing as scheduled – from 2.4 percent in 1969 – during the first half of the seventies, but seemed to slow down thereafter,

especially after 1983, when it reached 18 percent. Perhaps more significantly, whereas the *Third Malaysia Plan, 1976-1980* had envisaged that the Malay share would be held through government established trust agencies, on behalf of the entire community, the privatization program has actually accelerated private Malay accumulation, arguably at the expense of the community as a whole, and certainly, of its poorer members.

As suggested earlier, the advent of privatization in Malaysia did not occur in an international vacuum and was certainly encouraged by the changed ideological climate of the eighties, especially with the advent of governments of the new right in the Anglo-American world. While Prime Minister Mahathir was once believed to be hostile to such cultural influences, this is less true today, and possibly then as well, as suggested by the secret bilateral military treaty he signed – as Prime Minister and also Defense Minister – with the Reagan administration in the mid-eighties and his mid-2002 rapprochement with President George W. Bush. Interestingly, the market conservative ideology of the new right accorded with views he had expressed in the mid-seventies – against the tide of prevailing Malay public opinion then.

### The SOE Sector Before Privatization

For an economy usually viewed as being fundamentally *laissez faire*, Malaysia's SOE sector has been surprisingly large. Indeed, it is among the largest in the world outside some of the transitional or previously socialist planned economies, with over 1,100 SOEs extending well beyond utilities. Here, SOEs include the entire range of government equity holdings, both direct and indirect, whether majority or minority interests. Since Malaysia is a federation, SOE equity is held directly by the central or federal government, but also by the state governments or the many regional development authorities.<sup>3</sup>

Since enterprises are not analyzed by ownership, there is no comprehensive measure of the overall contribution of the public sector – including SOEs – to GDP. All measures are thus only approximations, including official statistics on 'consolidated' public-sector financial performance, where the federal and state governments' financial positions are consolidated with those of 40 to 60 of the larger wholly-owned SOEs.<sup>4</sup> Centralized collection of detailed financial data on the SOE sector only began in 1985 when the government contracted Permodalan Nasional Berhad to provide a financial data collection and monitoring system for the SOE sector through the Central Information Collection Unit (CICU).

### *Size and Structure*

Official estimates suggest that by the late 1980s, as the privatization program began in earnest, SOE sector output accounted for around 25 percent of GDP (World Bank, 1989c: 58). 1987 CICU accounts revealed that almost half the 1,148 enterprises – mostly subsidiaries and associated companies of state enterprises – were still in the red, involving a net loss of RM1.9 bn. Some 562 companies had losses totaling RM7.5 bn, while another 446 had profits of RM5.6 bn, with the remainder inactive or in the process of closing down. Total public sector investments in the 1,148 companies came to RM15.3 bn, or about 71 percent of the total paid-up capital of RM21.5 bn, with the state holding at least half the equity in 813 of these companies (*South East Asia Digest*, 21 July 1989).

By the end of March 1990, there were 1,158 SOEs (78 percent of them operational), with total paid-up capital of RM23.9 billion (Table 1). Of these companies, 396 (or 34 percent) were 100 percent government-owned; a further 429 (37 percent) majority government-owned; of the remaining 333 (30 percent), the government held minority equity stakes. The total government equity share in the SOE sector then accounted for 70.3 percent of the total, amounting to RM16.7 billion.

Table 1. State Owned Enterprises by Paid-up Capital

	<i>Number of Companies</i>	<i>Total Capital (RM mil.)</i>	<i>Govt Equity (RM mil.)</i>	<i>Govt % of Total (RM mil.)</i>	<i>Equity as Average Capital</i>	<i>(RM mil.)</i>
Federal	556	18,521	12,738	68.78	33.3	
State	553	5,048	3,829	75.85	9.1	
Regional	49	241	170	70.54	4.9	
TOTAL	1,158	23,810	16,737	70.29	20.6	

Source: Adam and Cavendish 1995: Table 1.4.

Malaysia's SOEs are broadly spread across all sectors, with finance (12 percent of all SOEs), services (27 percent) and manufacturing (28 percent) dominating in terms of number of enterprises. A similar picture emerged in terms of capitalization, with finance and manufacturing accounting for about 60 percent of total capitalization. The SOE sector has been extremely concentrated: the largest 20 SOEs (less than two percent of the total number) had a combined capital of RM5.2 billion (5 percent of GDP and almost 22 percent of total SOE capitalization) and a combined turnover of RM29 billion (57 percent of the estimated total turnover of the sector for 1988) (Adam and Cavendish 1995: Table 1.3). The majority of the SOEs are small, however. Excluding the top 20 (whose average capitalization was RM260 million), average capitalization was only RM18 million (US\$6.7 million at 1988 prices), and most enterprises operated in relatively competitive markets.

Table 2. Distribution of SOEs by Sector

Sector	Federal	State	Regional	Total
Agriculture	5	19	3	27
Construction	8	26	1	35
Extractive	6	27	1	34
Finance	100	33	1	134
Manufacturing	153	155	14	322
Plantation	22	61	12	95
Property	44	53	1	98
Services	162	135	16	313
Logging	0	25	0	25
Transport	56	12	0	68
Others	0	7	0	7
TOTAL	556	553	49	1,158

Source: Adam and Cavendish 1995: Table 1.7.

Adam and Cavendish (1995: Table 1.4) showed that SOEs in Malaysia were held almost equally between federal and state governments, with only four percent owned by the regional development agencies. State SOEs predominated in the primary sectors – agriculture, extractive industry, plantation agriculture, and logging – while the transport and finance sectors were dominated by federal SOEs; there were a large number of state manufacturing and service SOEs, most of which were created to reduce regional income inequalities (Table 2). The federal government SOEs were much more highly capitalized, but with relatively smaller shares of the total capital of SOEs. Federal SOEs tended to be significantly larger than those held by state or regional agencies in terms of equity, accounting for 78 percent of total equity capital and 79 percent of debt. State and regional SOEs are significantly smaller,

and are much less likely to raise capital from sources other than the government (Adam and Cavendish 1995: Table 1.5).

Federal SOEs tended to have correspondingly larger debt than state or regional SOEs. Interestingly, the level of debt as a share of total capital in February 1990 did not vary all that much, with federal SOEs slightly less dependent on federal government loans and more dependent on both private domestic and foreign loans (Table 3). The average debt from all sources of federal SOEs was RM61 million, that for state SOEs was RM15 million and for regional SOEs, less than RM5 million. The federal SOEs also had, on average, much larger exposure in domestic and foreign financial markets (accounting for 51 percent and 27 percent of total debt respectively), while the principal debt for state and regional SOEs was from the government. The overall SOE debt-equity ratio of 180 percent was significantly higher than the average private-sector ratio (estimated to be approximately 100 percent).<sup>5</sup> While the government can (and does) extend cheap credit to SOEs, it has also been a less demanding shareholder in terms of dividend requirements, i.e. it has been associated with ‘soft budget constraints’.

Table 3. State Owned Enterprises by Source of Borrowing

	<i>Number of Companies</i>	<i>Govt. Loans</i>	<i>Foreign Loans</i>	<i>Domestic Loans</i>	<i>Total Loans</i>	<i>Debt/Total Capital</i>
Federal	556	21.38%	27.54%	51.08%	100.00%	184.89%
State	553	34.67%	24.28%	41.05%	100.00%	169.53%
Regional	49	41.35%	11.81%	46.84%	100.00%	98.34%
TOTAL	1,158	24.13%	26.81%	49.06%	100.00%	180.73%

Source: Adam and Cavendish 1995: Table 1.6.

### Performance

Aggregate performance figures for the SOE sector have been overwhelmingly determined by the performances of PETRONAS and its subsidiaries. Official data from the Ministry of Finance<sup>6</sup> (Adam and Cavendish 1995: Table 1.8) shows that, despite relatively poor operating performance, the SOE sector undertook very high levels of development expenditure. However, the generally weak SOE performance was obscured by high profits for PETRONAS and its subsidiaries (whose surplus reached 5 percent of GDP in 1982). The counter-cyclical fiscal strategy of the early 1980s saw a huge expansion of development expenditure from 1981 to 1984, accompanied by a rapid expansion in development expenditure by the SOEs – mainly to promote heavy industrialization – which rose from 4.2 percent of GDP in 1981 to almost 10 percent in 1984 (Jomo 1990). This surge in public-sector capital expenditure was – for the three years 1981-1983 – consistently in excess of 25 percent of GDP.

Table 4 provides a broader picture of the SOE sector’s aggregate financial performance,<sup>7</sup> supporting the picture suggested above of poor operating profits and rapid fixed capital formation. They suggest SOE turnover accounted for between 40 to 50 percent of GDP, and a considerable rise in overall interest costs. Clearly, the Malaysian SOE sector was a net consumer of public resources and, if not for the petroleum sector, the financial burden would have been greater. Table 5 shows that approximately 40 to 45 percent of all SOEs were unprofitable throughout the 1980s. Of these, almost half (or 25 percent of all SOEs) had negative shareholders’ funds<sup>8</sup> – which presumably would not be allowed under private ownership.

Table 4. SOE Financial Performance (RM million and as percentage of GDP)

*1980 1981 1982 1983 1984 1985 1986 1987 1988*

Gross turnover	24,172	22,910	22,868	26,013	32,870	34,468	34,076	42,849	
	51,026								
Operating profit	11,378		9,751	8,764	8,022	10,273	10,478	9,133	8,738
	11,277								
Interest charges	536	697	912	1,218	1,673	1,643	2,099	2,820	3,103
Post-tax profit	7,368	5,285	4,465	3,208	5,096	4,731	3,553	3,217	5,096
Dividends	440	496	2,082	2,711	2,504	3,001	3,075	3,014	3,608
Gross fixed capital formation	0	3,612	4,642	5,784	5,407	2,713	2,233	8,093	1,620
Overall balance	6,928	1,177	(2,259)	(5,286)	(2,815)	(983)	(1,754)	(7,890)	(132)

*External debt*

Debt to govt. (o/s)	3,218	4,917	5,253	5,247	5,247	4,569	4,589	9,590	8,658
External debt (o/s)	4,483	5,964	7,345	8,672	8,578		10,031	9,744	9,542
	9,669								
Domestic debt (o/s)	2,560	2,904	3,536	3,317	3,698	4,085	4,623	4,397	4,147
TOTAL DEBT	10,261		13,785		16,135	17,235	17,523		18,685
	18,956	23,529	22,504						

*SOE Performance as percentage of GDP*

	1980	1981	1982	1983	1984	1985	1986	1987	1988	
Group turnover	45.3	39.8	36.5	37.4	41.3		44.4	47.9	54.5	
	56.2									
Operating profit	21.3	16.9	14.0	11.5	12.9		13.5	12.8	11.1	
	12.4									
Interest charges	1.0	1.2	1.5	1.8	2.1		2.1	2.9	3.6	3.4
Post-tax profit	13.8	9.2	7.1	4.6	6.4	6.1	5.0	4.1	5.6	
Dividends	0.8	0.9	3.3	3.9	3.1	3.9	4.3	3.8	4.0	
Gross fixed capital formation	0.0	6.3	7.4	8.3	6.8		3.5	3.1	10.3	1.8
Overall deficit	13.0	2.0	-3.6	-7.6	-3.5	-1.3	-2.5	-10.0	-0.1	

*External debt*

Debt to govt. (o/s)	6.0	8.5	8.4	7.5	6.6		5.9	6.4	12.2	9.5
External debt (o/s)	8.4	10.4	11.7	12.5	10.8		12.9	13.7	12.1	
	10.7									
Domestic debt (o/s)	4.8	5.0	5.7	4.8	4.6		5.3	6.5	5.6	4.6
TOTAL DEBT	19.2	23.9	25.8	24.8	22.0		24.1	26.6	29.9	
	24.8									

Source: Adam and Cavendish 1995: Table 1.9 from Permodalan Nasional Berhad Central Information Collection Unit.

Table 5. Summary of Profitable and Unprofitable State Owned Enterprises (percentages)

	1980	1981	1982	1983	1984	1985	1986	1987	1988
Profitable <sup>a</sup>	61	60	54	58	58	52	52	53	60
Unprofitable	39	40	46	42	42	48	50	47	40

Note: <sup>a</sup> Reporting net operating profit.

Source: CICU Report, February 1990.

Table 6 analyzes the relative performance of the SOEs over time according to general performance criteria based on enterprise profitability relative to capitalization. Although it does not reflect the relative size of ‘sick’, ‘weak’, ‘satisfactory’ and ‘good’ companies, it does indicate the existence of a very large number of unprofitable companies drawing on taxpayers’ funds. Even at the height of the public sector boom in the early 1980s, over 40 percent of all SOEs were either ‘sick’ or ‘weak’. The findings suggest that SOEs were allowed to survive when market discipline would have caused closure and reallocation of resources to more profitable activities.

Table 6. Relative Performance of State Owned Enterprises, 1980-1988 (percentages)

	<i>Sick</i> <sup>a</sup>	<i>Weak</i> <sup>b</sup>	<i>Satisfactory</i> <sup>c</sup>	<i>Good</i> <sup>d</sup>
1980	12.53	26.24	10.88	50.35
1981	13.19	26.74	9.63	50.44
1982	15.25	29.15	9.86	45.74
1983	12.12	30.12	10.04	47.72
1984	14.02	26.98	11.80	47.20
1985	16.79	30.20	11.09	41.92
1986	18.95	29.54	13.31	38.20
1987	19.23	27.43	13.87	39.47
1988	16.67	24.15	14.42	44.76

- Notes: a) Companies with negative shareholders’ funds.  
 b) Loss making companies with shareholders’ funds <200% of paid-up capital.  
 c) Shareholders’ funds <100%, but currently profitable.  
 d) Shareholders’ funds >100% and profitable.

Source: Adam and Cavendish 1995: Table 1.11.

Clearly, by the early 1980s, the generally lackluster performance of the Malaysian public sector, including many SOEs, required a policy response. Various reasons have been advanced to explain the generally poor performance of SOEs. In many instances, state-owned enterprises had been hampered by unclear or contradictory objectives. Similarly, performance criteria had been ambiguous, if existent. In Malaysia, so-called ‘social’ – i.e. ethnic redistributive – objectives were often invoked to marginalize profit, efficiency or other cost-effective criteria. Coordination problems have also been serious, especially with the different levels of government (federal, state, municipal, regional authorities, etc.) as well as inter-ministry and other intra-governmental rivalries. With the proliferation of such enterprises in Malaysia in the 1970s and early 1980s, many were assigned or developed similar, often redundant, functions.

As noted earlier, monitoring and evaluation of SOE performance was virtually non-existent until the mid-1980s, and has continued to remain weak and superficial. As the larger enterprises developed in size and clout, they often became less answerable to external monitoring, let alone supervision. The non-financial public enterprises (NFPEs) – previously known as the off-budget agencies (OBAs) – have proved particularly problematic, especially as they were not subject to normal federal and state budgetary constraints. And, even when SOEs were subject to such constraints, the administrative and political circumstances often meant that they were only subject to ‘soft’ budget constraints (Soenarno and Zainal 1985).

## **PRIVATIZATION: AN OVERVIEW**

To be sure, Mahathir's own commitment to private enterprise – rather than SOE – began much earlier, reflected in his *The Malay Dilemma* (1970) and especially his *Menghadapi Cabaran* (1976; published in English translation as *The Challenge* in the mid-1980s). His consistent commitment is all the more remarkable because of his two predecessors' commitment to SOE as the main vehicle for furthering national, and especially ethnic Malay business interests. Two years after Mahathir's first announcement in 1983, the Economic Planning Unit (EPU) of the Prime Minister's Department issued its *Guidelines on Privatization*, which remained the main official document on privatization until early 1991. In February 1991, the government published the *Privatization Masterplan* (PMP) document not long after the October 1990 general election, and just before announcing the rest of its post-New Economic Policy (NEP) – or post-1990 – economic policy. Hence, the *PMP* can be regarded as one of four major programmatic documents issued in 1991 outlining Malaysian economic development policy for the foreseeable future. Claiming success for its privatization program thus far, the *PMP* announced the government's intention to 'expand and accelerate further the pace of privatization process' [*sic*].

Generally, privatization has been defined in terms of the transfer of enterprise ownership from the public to the private sector. More generally, privatization refers to changing the status of a business, service or industry from state, government or public to private ownership or control. The term sometimes also refers to the use of private contractors to provide services previously provided by the public sector. Privatization can be strictly defined to include only cases of the sale of 100 percent, or at least a majority share of a SOE, or its assets, to private shareholders. Full or complete privatization would therefore mean the complete transfer of ownership and control of a government enterprise or asset to the private sector. In Malaysia, such privatizations are not the norm, the most prominent cases involving the North-South Highway, Kumpulan Fima and Peremba.

In Malaysia, the term 'privatization' is often understood to include cases where less than half of the assets or shares of SOEs are sold to private shareholders. In fact, privatization is usually understood to also include cases of partial divestiture where less than half of the assets or shares of SOEs are sold to private shareholders, with the government retaining control through majority ownership. Before 1992, besides contracting-out, leasing and build-operate-transfer arrangements, privatization in Malaysia included nine official divestitures by the Economic Planning Unit, and nine sales of relatively small enterprises by UPSAK, the Unit for Monitoring Government Agencies and Enterprises, charged with reforming ailing SOEs. Of the former, there had only been four full divestitures – involving Sports Toto, Padang Terap Sugar Limited, the Security Printing Branch of the Government Printers and MAS, which was totally divested in early 1994. The other five – Kelang Container Terminal (KCT), Airod, Tradewinds, MISC, and Sarawak Cement Manufacturers – only involved partial divestiture with the government retaining control, even without majority ownership. However, in the case of KCT, a management contract was awarded to the new minority partner (see case study later).

The definition of 'privatization' in Malaysia is so broad that it includes cases where private enterprises are awarded licenses to participate in activities previously the exclusive preserve of the public sector, as in the case of television broadcasting from 1984. Contracting out of services, especially by municipal authorities (e.g. involving garbage disposal and parking), and private ownership or even contracted leasing of public properties – e.g. enabling the imposition of tolls on roads previously built by the Public Works Ministry or the Malaysian Highway Authority (Lembaga Lebuhraya Malaysia, or LLM) – are also frequently considered to be privatization. In Malaysia, when a SOE legally formed as a government department or statutory authority, is privatized, it necessarily first entails corporatization, or the formation of a limited company incorporated under the Companies Act, 1965. On the other hand, the

privatization of a SOE that has been constituted as a limited company would merely entail a transfer in share ownership from the public to the private sector without any change in the legal form of the enterprise.

While acknowledging poor and inefficient management of many, if not most Malaysian SOEs, the key question should be whether such inefficiencies are necessarily characteristic of public ownership, and hence cannot be overcome except through privatization. The impressive performance of SOEs in neighboring Singapore, which used to be part of Malaysia, or of Malaysia's well-run Petronas underscore this point. Less politicized – and perhaps ethnic – criteria for recruitment, appointment, promotion and accountability, as well as greater SOE autonomy, transparency and organizational flexibility would probably radically improve SOE performance (Mustapha Johan & Shamsulbahriah 1985). If the record of Malaysian SOEs has primarily been due to the nature, interests and abilities of those in charge, rather than a consequence of public ownership *per se*, then privatization in itself cannot and will not overcome the root problems. Also, while privatization may improve enterprise profitability for the private owners concerned, such changes may not necessarily benefit the public or consumers.

Since a significant portion of such activities are public monopolies, privatization will hand over such monopoly powers to private interests who are likely to use them to maximize profits. The privatization of public services tends to burden the people, especially if charges are raised for privatized services. Obviously, private interests are interested only in profitable or potentially profitable activities and enterprises. This may mean that the government will be left with unprofitable and less profitable activities that, consequently, will worsen overall public-sector performance, resulting in the claim of inevitable SOE or public sector inefficiency becoming a self-fulfilling prophecy.

### **Privatization Policy Rationale**

The Malaysian government summed up its five arguments for privatization in its *Guidelines on Privatization* (EPU, 1985). Firstly, it was supposed to reduce the 'financial and administrative burden of the government', particularly in undertaking and maintaining services and infrastructure. Secondly, it was expected to 'promote competition, improve efficiency and increase productivity' in the delivery of these services. Thirdly, privatization was expected to 'stimulate private entrepreneurship and investment', and thus accelerate economic growth. Fourthly, it was expected to help reduce 'the presence and size of the public sector, with its monopolistic tendencies and bureaucratic support'. Fifthly, privatization was also expected to help achieve NEP objectives, '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'. In other words, privatization was supposed to accelerate growth, improve efficiency and productivity, trim the public sector, reduce the government's financial and administrative role, and redistribute wealth to the Bumiputeras.

These arguments in favor of privatization have been rebutted on the following grounds, all of which have important distributional implications:

The public sector can be more efficiently run, as has been demonstrated by some other public sectors, e.g. in Singapore (Rodan, 1989), Taiwan (Wade, 1990) and South Korea (Amsden, 1989). 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 private interests taking over public-sector activities. Also, by diverting private-sector capital from productive new 'green field' investments to buying over public-sector assets, economic growth would be retarded, rather than enhanced.

Greater public accountability and a more transparent public sector would ensure greater efficiency in achieving the public and national interest while limiting public-sector waste and borrowing. Legislative reforms since the mid-1980s have actually reduced both public sector transparency and accountability though the government appears to have taken some measures to increase SOE oversight.

The government would be able to privatize only profitable or potentially profitable enterprises and activities because the private sector would only be interested in these, leaving loss-making SOEs in public hands, thus exacerbating the public sector's fiscal burden. Privatization may postpone a fiscal crisis by temporarily reducing fiscal deficits, but it would not necessarily resolve the underlying problem because the public-sector would lose income from the more profitable public-sector activities, and would be stuck with financing the unprofitable ones, which would undermine the potential for cross-subsidization within the public sector.

Privatization tends to adversely affect the interests of the public-sector employees and the public, especially poorer consumers, which the public sector is more sensitive to.

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 un-influential.

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

Public pressure to ensure equitable distribution of share ownership after privatization may inadvertently undermine pressures to improve corporate performance since shareholders would then only have small equity stakes, and would therefore be unlikely to incur the high costs of monitoring management and corporate performance. With ownership concentrated in the hands of state-owned or controlled enterprises in Malaysia, corporate governance and accountability are more likely to improve if the government exercised greater oversight as an activist owner than by privatization, with its high transaction costs and uncertain consequences.

According to several superficial criteria, privatization in Malaysia made good progress, especially in terms of the government's own declared objectives. In terms of raising efficiency and productivity, it is generally agreed that the establishment of TV3 introduced some competition into the television broadcasting industry previously dominated by the government's two channels. After the supposed 'privatization' of the Kelang Container Terminal (KCT) in 1986, average turn-around time per vessel fell from 11.7 to 8.9 hours, while throughput rose until the mid-1990s. Since its corporatization in 1987, Telekom Malaysia has introduced several new services and improved existing services. The Labuan Water Supply Project was said to have been completed ahead of schedule, and at lower cost than suggested by the public-sector authorities owing to its privatization (*New Straits Times*, 10 August 1989).

Privatization has been credited with enhancing economic growth (Tan Chwee Huat 1991). Resources are said to have been released for corporate expansion through efficiency gains, although no evidence of this has been produced. Growth is also said to have been generated by allowing private entrepreneurship in sectors previously monopolized by the government. While this seems plausible, the examples of build-operate-transfer projects and licensed activities are less than convincing since they merely involve the private sector substituting for

what the public sector would otherwise have undertaken at lower cost to users, as is clearly the case for the North-South Highway, for example (see Jomo *et al.* 1989).

The Malaysian government's claim that privatization contributes to growth is vague and even spurious. After announcement of the policy in 1983, Malaysia went through a deep recession in 1985-86, before experiencing rapid export-oriented manufacturing-led growth since the late 1980s. Although the mid-1980s' recession was exacerbated by the contractionary consequences of public spending cuts, which can be analytically distinguished from privatization *per se*, there is also no clear evidence that privatization in particular has significantly contributed to recent economic growth.

Also, no claim has yet been made that privatization was a necessary and indispensable ingredient for the broader economic liberalization measures of the mid-1980s which probably induced the foreign investment increase associated with the subsequent boom. On the contrary, however, it may be argued that private acquisition of public assets probably diverted potential investment funds. While it is now generally agreed that the stock market undoubtedly expanded with privatization, this has not been important for corporate financing of the more dynamic foreign-dominated manufacturing sector.

Advocates of privatization in Malaysia also claimed that it would reduce the government's financial and administrative burden. While there undoubtedly are one-off revenues for the government from the sale of public assets, it is not self-evident that the retention of such assets would not have been in the government's and the public's medium- and long-term interest for the variety of reasons mentioned above.

Privatization is also credited with having reduced the government's financial burden.

According to the *PMP*, proceeds from the sale of government equity in privatized companies has generated RM1.18 billion, while the government is said to have saved more than RM8.2 billion in capital expenditure for infra-structural development through privatized B-O-T projects, and a further RM7.45 billion of the government's outstanding debt is said to have been transferred to the private sector (*New Straits Times*, 10 August 1989). With privatization, the government also now enjoys revenue from lease payments as well as corporate taxes. Moreover, with the availability of private loan financing arrangements from capital markets, demands on government finances have also been reduced.

While these claims are valid, the apparently deliberate under-valuation of government assets – ostensibly to encourage and popularize the privatization policy – has greatly reduced the one-off revenues accruing from the sale of government assets as well as lease payments.

There has been considerable evidence of heavy discounting in asset prices for sale or lease to the politically influential and to secure public support for the program. Also, while it is obliged to retain those less profitable activities and assets of little interest to the profit-seeking private sector, the sale of the government's most revenue-generating assets contributes to the self-fulfilling prophecy of the poor profitability of public-sector economic activities.

The contraction of the public sector also reduces the scope for government intervention, e.g. for equity reasons or in support of development or industrial policies. Many of the major privatization exercises have involved tax exemptions as sweeteners. Hence, not surprisingly, there is little evidence of significant tax revenue increases attributable to privatization. After all, widespread corporate tax evasion is suspected, while corporate tax rates in Malaysia have continued to be reduced across the board since the mid-1980s.

The official view also ignores the important potential for cross-subsidization of socially desirable public works and other projects and programs with revenue from profitable ones. Privatization of the lucrative North-South Highway, for instance, means that toll revenues from it will not be available to subsidize the construction of rural roads and bridges since there is no mechanism established for the state to capture the rent from the former to

subsidize the latter. If the lucrative Highway had stayed with the Malaysian Highway Authority (LLM), such cross-subsidization would have been possible. Instead, LLM and the government ended up subsidizing the private owners of the Highway by transferring existing built assets from LLM at a huge discount, providing soft loans, tax breaks and, more recently, a longer concession period.

Meanwhile, the private capital market access argument ignores the fact that most non-financial public enterprises and even government development expenditure have been primarily financed by the private capital market, albeit with government-guaranteed loans in the former instance and government borrowings in the latter case. On the contrary, the government's desire to ensure the success of its privatization policy (e.g. by discounting asset prices) has crowded out productive, but riskier or otherwise less attractive investment options in favor of private acquisition of government stock, i.e. for the transfer, rather than the creation, of assets.

There is also considerable concern about the extent of 'contingent liabilities' incurred by the federal government's privatization program which has frequently guaranteed minimal revenue flows to private operators, e.g. to toll concessionaires. Such guarantees have been estimated by World Bank consultants, and are rumored to have involved RM20-30 billion. Such arrangements basically guarantee profits to the beneficiaries of privatization at the public expense and imply that risk has hardly been privatized with the government's privatization program.

Privatization has undoubtedly deepened Malaysia's stock market very considerably. The public listing on the Kuala Lumpur Stock Exchange of the thirteen entities privatized by June 1992 raised market capitalization by RM201.09 billion, accounting for 28 percent of total capitalization and making the KLSE the largest stock market in Southeast Asia and the fourth largest in Asia (*Malaysian Business*, 16 August 1992; *Investors Digest*, November 1992). As of 25 February 1994, the 15 privatizations on the KLSE had involved RM29.89 billion, or 22 percent of the KLSE's total market capitalization of RM117.33 billion (*New Straits Times*, 9 March 1994).

However, it is moot whether the consequent deepening and broadening of the stock market are desirable in themselves as the development of financial intermediation and instruments seems to have had a tendency of divorcing financial transactions from the real economy with all its casino-like consequences, which contradict and threaten to undermine the equity financing objectives of stock market development. Privatization undoubtedly exerts heavy demands on private-sector financial resources to mobilize both debt and equity capital. Hence, it has been suggested that, with privatization, capital resources – which might otherwise have been invested in expanding productive capacity – have instead been diverted into acquiring existing public-sector assets.

There is considerable evidence that companies in Malaysia seek stock market listing for signaling purposes to secure more bank credit on better terms, rather than to raise money directly on the stock market. Malaysia was less vulnerable to the 1997 currency crisis because of stricter regulatory control on borrowing from abroad and lower foreign debt exposure, especially to short term debt, despite its much greater trade openness and consequent need for (short-term) trade credit. Three quarters of the US\$35 billion estimated to have been borrowed from abroad were accounted for by three privatized SOEs, namely Malaysia Airlines (MAS), Tenaga Nasional, the power company, and Telekom Malaysia, the telecommunications company (Jomo 2001).

In their detailed study of welfare improvements after partial divestiture, Jones and Fadil (1992c) claim efficiency gains of 53 percent in the case of KCT, 22 percent in the case of MAS, and 11 percent in the case of Sports Toto. In the case of KCT, the improvements came from (internal) management changes resulting in cost-efficiency gains. At MAS, (external)

price competition and investment decisions were credited with the improvements. Meanwhile, Sports Toto gained market share through improved marketing even before complete divestiture.

While the distribution of welfare consequences necessarily changes as a result of partial divestiture, firm behavior need not. Hence, partial divestiture may be merely cosmetic, e.g. to give the appearance of privatization without changing firm operational behavior or conduct. Advocates of partial divestiture claim, however, that the resulting mixed (public/private) enterprises ensure the best of both worlds, e.g. by introducing (private) pressures for greater efficiency while ensuring (public) accountability and the public interests. Critics emphasize that, in reality, the result is the worst of both worlds, with the private pursuit of profits augmented by government privileges (regulation, licensing, credit, etc.).

Jones and Fadil (1992c) suggest that Malaysian partial divestiture emulates the 1980s' Japanese trend, rather than British privatizations, which tended to involve full divestiture. As with Singapore government ownership of mixed enterprises, Japanese partial divestitures of telecommunications, the Japan National Railway, and the tobacco monopoly saw government control retained. They hint that such mixed enterprise is consistent with an ostensibly East Asian mode of intimate government involvement in business affairs, and was in line with Prime Minister Mahathir's 'Look East' and 'Malaysia Incorporated' policies.

The key question here is whether the ostensible efficiency and welfare gains from partial divestiture could have been achieved without such divestiture. For example, could such gains have been achieved through other means of ensuring greater autonomy, flexibility or managerial reform, such as through corporatization and commercialization? Jones and Fadil (1992c) admit that there is no necessary logical reason why this could not have been the case, but argue that this is irrelevant because they would not have been taken. The presence of private shareholders may also have given the government the excuse it needed to do what it had wanted to do before, anyway.

However, the welfare gains they claim cannot be attributed to partial divestiture. Also, there are policy alternatives to partial divestiture, which have not been seriously considered by the authorities concerned. Their most compelling argument for partial divestiture is that the presence of private shareholders reduces the probability of reversal of efficiency-enhancing SOE reforms, e.g. with a change of government. In the case of the Malaysian International Shipping Corporation (MISC), privatization actually only involved partial divestment, with majority ownership – and hence, ultimate control – still in the hands of the government, which remained the majority shareholder. In 1998, Petronas was ordered to take over MISC, which had controversially taken over ownership of a financially distressed smaller shipping line from the Prime Minister's son, who remained as chief executive of the *Konsortium Perkapalan Bumiputera*.

In most cases involving large SOEs, privatization has actually only involved partial divestment, with majority ownership, and hence ultimate control, still in the hands of the government, which remains the majority shareholder. Even if the government share should decline to less than half, in preparing some enterprises for privatization, e.g. MAS and MISC, the government has created a 'golden share', allowing it to retain control or at least veto powers even with considerably diminished minority ownership.

In the first phase of MAS privatization by the Malaysian government, in September 1985, a substantial minority (48 percent) of the company's shares was sold, of which the Brunei government held around 10 percent (*Malaysian Business*, 16 January 1994), raising only RM180 million from the sale of almost half the national airline. This, in itself, cannot be said to have led to any significant change in firm behavior which can be attributed to ownership divestment. A substantial amount of MAS stock was held by the central bank, Bank Negara Malaysia, giving the public sector – as a whole – continued majority ownership. Apparently,

‘the airline held weekly meetings with the government [at least] until [1990], even though it was privatized in 1985’ (*Far Eastern Economic Review*, 20 December 1990). The government clearly continued to retain direct control over the company, first as the majority shareholder, and then as the single largest shareholder. Before 1993, MAS was in the black only because of the sale of some of its aircraft. For the financial year 1992/3, for example, although the airline had an operating loss of RM179.6 million, it was able to declare a pre-tax profit of RM157.5 million due to revenue from aircraft sales worth RM337.1 million (*Malaysian Business*, 16 January 1994).

After it became apparent that MAS could show a profit without having to sell any of its assets (*New Straits Times*, 28 February 1994), Malaysian Helicopter Services Berhad (MHS) acquired a 32 percent stake in MAS from Bank Negara for RM1.79 billion, or RM8 per MAS share, to be paid for ‘through an issue of 112 million new MHS shares of RM1 each at an issue price of RM16 a share’ (*Malaysian Business*, 16 January 1994). MHS, one-fifth the size of MAS in terms of paid-up capital, was controlled by Tajuddin Ramli, a close associate of Economic Adviser to the government, Daim Zainuddin.

The government retains a 29 percent direct stake in MISC, 75 percent of Telekom Malaysia, 77 percent of Tenaga Nasional and 8 percent of Edaran Otomobil Nasional (EON), all of which still operate as virtual monopolies (*New Straits Times*, 8 February 1991; *Investors Digest*, November 1992). Such partial divestiture cannot really be considered privatization because the government’s power to determine firm behavior is virtually unchanged, though, of course, firm behavior may change in response to the presence of minority owners, or of more minority owners than was previously the case.

Although publicly available information does not allow a full assessment, there is considerable evidence that management of MAS deteriorated in private hands. A controlling share in MAS was finally bought back by the government in late 2000, with the government paying almost three times the market price, ostensibly because it was paying the price it sold the stock at (RM8 each), even though MAS’s debt and other liabilities had grown and its net tangible assets had probably declined in the interim. The price paid to Tajuddin – once a protégé of Daim, then Finance Minister and UMNO Treasurer – was also much higher than the price paid a month before to the Brunei Sultan, who had bought significant stakes in MAS from the mid-1980s.

Privatization has reduced the size of public sector employment as well. With corporatization and privatization, the number of public-sector personnel declined by at least 54,000 with their transfer to the private sector, according to the *Privatization Masterplan* in 1991. It has been argued, however, that the problems of public-sector personnel hiring, firing, promotion, and training remain, and have possibly been exacerbated with the New Remuneration Scheme (Sistem Saraan Baru or SSB), which took effect from early 1992. The singular priority given to privatization, it has been argued, has contained and undermined much-needed public-sector reforms, including those affecting personnel. It is believed that the predominance of Malays among public-sector employees, the presence of relatively large unions in the major public utilities earmarked for privatization, the sharp decline in public-sector employee recruitment since the post-election austerity drive from June 1982, and the virtual public-sector (real) wage freeze since 1980 and the perceived need to offer carrots to induce workers not to resist privatization encouraged the government to ensure employment security for five years and better service terms and conditions.

Hence, though workers often had the option of not joining the corporatized or privatized entity, very few actually did so; the vast majority had the option of continuing with the government’s scheme of service or accepting the new company’s seemingly more attractive scheme, which the majority tended to pick (Kuppusamy 1995). Privatization also served to consolidate labor market dualism between a primary labor market in the public sector and

large private – including privatized – enterprises, and a secondary market of casualized, contract, often more female, immigrant, unskilled and less skilled or credentialed workers (Siti Rohani, 1993). While many affected public sector employees may 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 to, if not supportive of the policy.

Many Malaysians have associated the growth of the public sector with increased state intervention and growing Malay hegemony under the New Economic Policy (NEP), and have seen privatization as a desirable policy change that could reverse these trends, which apparently discouraged private investment, and may thus have slowed down growth. Some others identify state intervention with socialism and support privatization as a measure to expand capitalism. While statist capitalism (Jomo, 1985) is certainly not socialism, undermining the public sector, especially public services, through privatization has had important adverse welfare implications for the people, especially public sector employees, consumers, and the poor.

The government has had to legislate many changes to existing laws to facilitate privatization. The primary concern has been with overcoming legal obstacles to privatization. Little attention has gone into ensuring greater competition or public accountability, although many of the privatized entities remain virtual monopolies. Since the Malaysian government tacitly – and sometimes explicitly – acknowledges that there is not much scope for increasing competition with natural monopolies, it promises appropriate regulatory frameworks to protect consumer interests, particularly in terms of price, quality and availability of services, as well as “commercial freedom” for the privatized monopolies. Often, such regulation is inadequate or does not yet exist, and, where it exists, is widely believed to be inadequately implemented or enforced.

Deregulation and other efforts to encourage competition are well behind those of privatization. While there has been a great deal of rhetoric about deregulation accompanying privatization, such efforts have been quite limited and mainly oriented to inducing private, including foreign investments. In many instances, especially with public utilities, the government has retained effective control of privatized entities despite some changes in ownership. With corporatization and privatization of such utilities and services, the government has retained special rights through maintaining a ‘golden share’, which basically guarantees control over the privatized enterprise, ostensibly to enable it to exercise veto powers over decisions deemed to be of strategic and public significance. Such control suggests that there may only be limited loosening of public-sector control through privatization. After all, privatization, in itself, involves only the transfer of property rights, and in many instances in Malaysia (e.g. the privatization of major public utilities and management buy-outs), even management personnel have not been significantly changed with privatization.

Improvements in management generally reflect management initiatives encouraged by increased enterprise and administrative autonomy as well as new incentive systems, i.e. changes which do not require privatization as a prerequisite, but can also be achieved by greater decentralization or devolution of administrative authority – long advocated by trade unions (e.g. see Mustapha Johan & Shamsulbahriah, 1987) and others in the public sector. Such authority had become increasingly centralized in the early 1980s with official acceptance of the Cabinet Committee Report on new salary structures for the public sector, chaired by then Deputy Prime Minister Mahathir, and the later centralization of authority over the public sector, in the Prime Minister’s Department under Mahathir, especially through the strengthening of the Public Services Department (JPA).

Also, the so-called non-financial public enterprises (NFPEs) or off-budget agencies (OBAs) were less subject to the Treasury's budgetary discipline, especially after then Finance Minister, Tengku Razaleigh Hamzah, challenged Mahathir's preferred candidate (Musa Hitam) for the ruling party's deputy leadership, and traditionally, the deputy prime ministership as well. If competition and enterprise reorganization – rather than mere changes in ownership status – are more likely to induce greater enterprise efficiency, then it becomes difficult to conclude that economic efficiency has been improved because of privatization in Malaysia. Some of the often exaggerated claims of efficiency gains have been brought about by greater employee and managerial motivation with new incentive systems and greater scope for managerial initiative with administrative autonomy, i.e. enterprise reform. Privatization in Malaysia was also supposed to free market forces and encourage competition in the economy generally, especially in the sectors concerned. However, the owners and managers of privatized entities have a common interest in getting the public sector to privatize services, which can be far more important. Not surprisingly, with Malaysia's experience of privatization thus far, there has been widespread concern about and even evidence of the existence of formal and informal collusion (e.g. cartel-like agreements, for instance in bidding for contracts, suggesting collusion among bidders, as well as some politically well-connected companies enjoying special influence and privileged (insider) information, and thus consistently able to bid successfully for profitable opportunities from privatization.

While privatization undoubtedly reduces the role of the public sector in the economy, it is not clear whether this is supposed to be a desirable end in itself, or merely the means to an end. If the former, then the policy is essentially either intended to aggrandize its politically influential beneficiaries, or clearly ideologically inspired, or else meant to please ideologically motivated governments and powerful international economic agencies (such as the World Bank, IMF or Asian Development Bank) the Malaysian government seeks to find favor with. There is evidence that all three factors may be relevant in the Malaysian case.

Some other adverse consequences of privatization to be considered include:

- increased 'costs' to the public of reduced, inferior or costlier services, e.g. the unit charge for local telephone calls was increased by 30 percent just before Telekom Malaysia was incorporated;
- 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;
- the effects of minimal investments by private contractors concerned with short-term profits as in the case of IWK which made few of the investments it had promised to make when it proposed sewerage privatization. (However, investments have been more substantial in cases of partial divestiture [where government control has been retained] as well as when soft loans or other special incentives have been provided.);
- increased costs of living and poorer services and utilities – especially in remote and rural areas – due to 'economic costing' of services, e.g. telephone, water supply and electricity;
- reduced jobs, overtime work, and real wages for employees of privatized concerns;
- the contractionary consequences of fewer jobs or lower wages, or both.

In terms of the government's own stated policy objectives, it may have seemed that privatization in Malaysia was probably most successful in contributing to the government's NEP objective, particularly Bumiputera wealth acquisition and creation of a Bumiputera commercial and industrial community (BCIC). One might even argue that the prioritization of this objective undermined achievement of the other stated aims of its privatization policy. However, it is unclear how the creation and distribution of substantial economic rents through

ethnically biased privatization has been in the national interest, whether this is understood in developmental or equity terms. There is now widespread acknowledgement that most of these rents have not been effectively deployed through productive investments to significantly accelerate industrialization or to consolidate genuine Bumiputera entrepreneurship.

Instead, much has been wasted on rent-seeking costs associated with political involvement in business, while the very source of such rents and the limited abilities of those who controlled them contributed to their deployment in real property, construction, finance and other investments with a short-term time horizon, thus adversely affecting investment priorities and activities generally in an economy seeking to sustain manufacturing-led growth. Privatization did not enhance the NEP's other equity objectives (inter-ethnic parity in occupational and employment distribution, and poverty reduction), and may instead have undermined public welfare as a result of the strengthening of private monopolistic interests reflecting in higher user charges.

In Malaysia, it is widely recognized that there are strong influences from private interests who try to determine what is to be privatized, in what manner and to whom. For example, Sapura Holdings commissioned a consultancy report by Arthur D. Little of Boston entitled "The Advantages and Feasibility of Privatizing Jabatan Telekom Malaysia" in 1983 for the attention of the Malaysian government; it is generally acknowledged that Sapura was initially the main beneficiary of the privatization of telecommunications in Malaysia (Kennedy, 1991). The circumstances leading to many, if not most subsequent cases of privatization are widely believed to be similar and to have contributed to increasing what are politely called 'cronyism', 'money politics' and corruption more generally.

Often, privatization in Malaysia has not even involved the formalities of an open tender system, as sanctioned by the official 'first come first served' policy – by which the government justified awarding privatization opportunities to those who had supposedly first proposed the privatization of a government property or activity. 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 RM1.4 billion worth of water supply projects involving 174 schemes had been awarded to Antah Biwater without open tender. Hailed as the nation's first privatized water supply project, it did not involve significantly more than awarding all such construction contracts to the private sector – a foreign company and its politically well-connected local partner with no previous relevant experience – as the government will remain responsible for the operation and maintenance of the schemes. Antah Biwater – which was 51 percent owned by the Negeri Sembilan royal family's Antah Holdings Bhd and 49 percent owned by the British water supply and treatment group, Biwater Ltd had – for all intents and purposes – secured a turnkey contract with a British government financing arrangement sweetener thrown in as part of an aid for trade (ATP) project. Most of the design and engineering work has been handled by Biwater – since Antah has no relevant engineering experience – at the expense of Malaysian engineers and consultants who have long handled such projects.

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 that ministers and public officials may arbitrarily and unilaterally deem secret or confidential. The classification of a document or other information as an official secret cannot be challenged in any court of law, while the amendments require a mandatory minimum one year jail sentence for any OSA offence. Such legislation, accompanying the privatization drive, further reduces the already limited scope for meaningful governmental transparency and public accountability.

In the increasingly authoritarian and centralized Malaysian polity, with public accountability and governmental transparency considerably diminished deliberately by those in power, the strengthening of private business interests, especially of the politically well connected, transformed and increased – rather than eliminated – the opportunities for rent appropriation. Ironically, the remaining democratic features of the system in such a context have served to sustain competition and rent-seeking behavior, costs and waste. However, this does not necessarily mean that further authoritarianism will necessarily reduce such waste. Rather, it serves to emphasize that enhanced public accountability, government transparency and other democratic safeguards are crucial for reducing rents – which should instead be more productively deployed – and, more importantly, rent-seeking behavior in the context of privatization.

Malaysia's experience thus far suggests that the government revenue-generating, government deficit-reducing, private sector control-increasing and capital market-deepening official objectives of Malaysian privatization have largely been subordinated to the ostensibly Malay wealth-enhancing objective through rent allocation, particularly to the politically well-connected. In this limited sense, Malaysia's privatization program is ostensibly more explicitly redistributive than most. The privatization policy's multifarious objectives undoubtedly require various trade-offs, but this apparently consistent bias suggests serious abuse for the purposes of political patronage and personal wealth aggrandizement at the expense of the other objectives of privatization, ostensibly in the national interest. Such 'cronyistic' rent allocations have also been justified as a type of cross-subsidization of the beneficiaries who are ostensibly obliged to perform 'national service' by undertaking less lucrative projects in the national interest including those requiring massive capital investments or long gestation periods. One major problem in this connection is the absence of any serious financial projections and accounting to justify this claim.

### **Privatization in Practice**

Public sector inefficiencies and other problems need to be overcome, but privatization in Malaysia has primarily enriched the few with strong political connections to secure many profitable opportunities, while the public interest has increasingly been sacrificed in favor of private business interests. Some of the more well-known instances of such political patronage summarized below suggest that the privatization policy has greatly enriched rentiers closely connected to the Prime Minister and Finance Minister, often at the public or consumers' expense. There is no evidence that such rent allocations have been effectively deployed for developmental purposes, though inter-ethnic redistribution has often been cited in justification.

The issue of the country's first and only private television broadcasting license in 1983 to Sistem Televisyen (Malaysia) Berhad (TV3), whose major shareholders then included the Fleet Group, UMNO's holding company, the UMNO-controlled Utusan newspaper publishing group, MIC's Maika Holdings, Daim Zainuddin himself, and the now bankrupt Syed Kechik group. Later, the then Daim-controlled New Straits Times group, previously held through Fleet and more recently by the Renong group, took control of the then lucrative TV3 from the other main minority shareholders before a management buy-out through the Malaysian Resources Corporation Berhad (MRCB) in early 1993 – with not inconsiderable help from the Hong Leong group's Quek Leng Chan – placed both TV3 and the NST group firmly in the camp of Finance Minister Anwar Ibrahim, which he effectively deployed to become UMNO Deputy President, Deputy Prime Minister, and clearly in line to succeed Mahathir as Prime Minister (Gomez, 1990, 1994).

In 1985, 70 percent of the potentially very lucrative Sports Toto was sold – without any prior public announcement of its availability – to the Vincent Tan-controlled B&B Enterprise Sdn

Bhd (60 percent) and to Tunku Abdullah's Melewar Corporation (10 percent) for what is widely acknowledged to be a very low price. While Vincent Tan was then reputedly close to then newly appointed Finance Minister Daim, Tunku Abdullah is well known to be a very close personal friend of Mahathir's for at least four decades (Gomez, 1990, 1994). Tan later bought out Tunku Abdullah's stake. By greatly increasing its operations through aggressive sales efforts, with its problematic social consequences, Sports Toto tripled its previous contribution to government but also became far more profitable (Jones *et al.* 1992b). Although its turnover per outlet is much lower than rival gaming operations, Sports Toto is believed to have been the most lucrative major asset in Tan's Berjaya conglomerate. Sports Toto's profitability has been enhanced by its lower tax rates – compared to other legal gambling operations, as determined on a discretionary basis by the Finance Minister – as well as its modest – if highly publicized – contributions to sports development in Malaysia. In September 1988, Big Sweep lottery operations were privatized to Pan Malaysian Sweeps Sdn Bhd, controlled by Ananda Krishnan, another close associate of Mahathir (*New Straits Times*, 16 February 1989). The license for the Big Sweep lottery had been issued to the Selangor, Perak, and Penang Turf Clubs, which only sold lottery tickets to their members. With Pan Malaysia Sweeps taking over, tickets have been sold to the general public since February 1989. Big Sweep's more lucrative prizes adversely affected sales of the government Welfare Ministry's own Social Welfare Lottery, which was subsequently closed down by the government, ostensibly in line with its Islamization policy, giving Big Sweep a virtual monopoly.

Also in January 1989, the Totalisator Board of Malaysia, a statutory body which organized and regulated horse-racing totalisators since 1961, appointed Ananda Krishnan's Usaha Tegas Sdn Bhd to manage the Numbers Forecast Totalisator Operation (NFO), which had been managed by the turf clubs since 1988. The management of the NFO was undertaken by Usaha Tegas' wholly owned subsidiary, Pan Malaysian Pools Sdn Bhd, incorporated in July 1988. The NFO operated two gaming activities – the '3-digit' operation, which had commenced in 1961, and the '1+3' digit operation, introduced by Pan Malaysian Pools in September 1989 (*Malaysian Business*, 16 November 1991) – further enhancing the gambling monopoly rents accruing to Ananda Krishnan's stable.

In 1987, the RM86 million Jalan Kuching/Jalan Kepong interchange project was contracted to a RM2 Bumiputera company, Seri Angkasa Sdn Bhd, which was set up by the family of Datuk Lim Ah Tam, and later, 35 percent owned by Sri Alu Sdn Bhd, owned by Wahab Zainuddin – a brother of Daim, then the Finance Minister responsible for awarding such contracts – and Hassan Abas, who had worked with Daim in Peremba in the early 1980s. The entire project was sub-contracted to Mitsui Construction Co. from Japan and financed by a series of loans personally guaranteed by Wahab, Mohamed Amir Senawi (a nephew of Daim who became a director of Seri Angkasa), and their business associates. This lucrative 'build-operate-transfer' (B-O-T) project enabled the Lim family to execute a reverse take-over of Kamunting Corporation, and eventually, the previously MCA-controlled Multi-Purpose Holdings, once the second largest company on the Kuala Lumpur Stock Exchange (KLSE) after the government-sponsored Permodalan Nasional Berhad (PNB) (see Jomo *et al.*, 1989; Gomez, 1992).

Also, in 1987, the government awarded the North-South Highway project on a similar B-O-T basis to United Engineers (Malaysia) Bhd (UEM), then an ailing public-listed company long suspended from trading on the KLSE after an embarrassing construction (piling) scandal in Penang in the early 1980s, and with no previous experience in highway construction (Jomo *ed.* 1985). UEM was, by then, majority-owned by an UMNO holding company, Hatibudi, on which the UMNO President, Deputy President, Secretary-General and Treasurer sat as trustees (*Asian Wall Street Journal*, 28 January 1988). The Prime Minister himself justified

this privatization to an UMNO company on the grounds that the party needed funds to pay off the costs of building its massive then new RM360 million party headquarters complex (*The Star*, 29 August 1987).

After a public outcry, it was revealed, perhaps inadvertently, that UEM had not submitted the best offer in terms of cost to the government (in terms of government-subsidized loans, government revenue guarantees, duration of the concession period, and government including Malaysian Highway Authority assets to be handed over) or to users (in terms of toll rates). Due to its inexperience and incapacity, UEM was 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) – for which it paid a heavy price on terms undisclosed to the public, besides causing resentment among excluded sections of the Malaysian highway engineering community. While UEM succeeded in completing the highway project many months ahead of schedule, and could thus begin collecting toll revenues much earlier for a longer period of time, it incurred massive cost over-runs, which, some analysts suggest, continued to limit UEM's profitability and contributed to its huge debt burden and eventual take-over by the government in late 2001.

UEM has also been the beneficiary from several other privatized projects, including the Ministry of Health's pharmaceutical stores and services project and the lucrative second link to Singapore (see Jomo *et al.*, 1989; Gomez 1990, 1994). In 1985, it was awarded a RM250 million contract to design the National Sports Complex near Kuala Lumpur (*Business Times*, 5 January 1987); UEM later secured the RM400 million contract to build the National Sports Complex (*New Straits Times*, 20 May 1993). In 1987, UEM was also awarded the RM47.5 million project management consultancy for the expansion of the gas processing plant and the export terminal in Terengganu under the Peninsular Gas Utilization (PGU) Phase II project (Lim Kit Siang, 1990). In February 1990, UEM secured a contract from the Penang State government to reclaim 392 hectares of foreshore land (*The Star*, 12 February 1990). In December 1990, UEM was given the project to construct the first phase of the RM1.671 billion second causeway between Malaysia and Singapore without any open bidding, ostensibly on a 'first-come, first-served' basis (*New Straits Times*, 14 December 1990). In 1992, the Health Ministry announced that the government had handpicked UEM to privatize the government's medical store, which handled around half a billion ringgit worth of pharmaceutical drugs annually (*The Star*, 10 January 1992).

In 1993, Indah Water Konsortium Sdn Bhd – set up by a consortium of companies led by Vincent Tan's main listed vehicle, Berjaya Group Bhd, which has a controlling 20 percent stake – was awarded, without any tender process, the RM6 billion national sewage-disposal project (*The Star*, 18 May 1993). Berjaya and Indah were said to be 'fronting' for Northwest Water (M) Sdn Bhd, a subsidiary of the privatized British utilities company. The contract involves the privatization of '143 local water authorities throughout Malaysia to manage, operate and maintain the urban sewerage systems for 28 years' (*Malaysian Business*, 16 December 1993). 'Complaints of favoritism are underscored by Berjaya's relative lack of experience in public works. Although Berjaya is involved in small road-building projects in Malaysia, it has never built anything the size of the national sewerage project' (*Far Eastern Economic Review*, 1 April 1993).

Shortly before the general elections in October 1990, it was suddenly announced that Food Industries of Malaysia Bhd (FIMA) and Peremba Bhd were being privatized through management buy-outs. The former went to Mohd. Razali Mohd. Rahman and Hassan Abas, both close associates of then Finance Minister Daim, while the latter went to Tan Sri Basir Ismail, reputedly very close to Mahathir, and previously appointed to various powerful and prestigious positions including Chairman of Petronas and Bank Bumiputra (Gomez 1991a).

In early 1994, the government announced the privatization of the RM15 billion Bakun hydroelectric dam project in Sarawak, which had previously been cancelled by the government in the late 1980s after protests by environmentalists and others doubting the technical and economic feasibility of the project. The contract was awarded, without tender, to Ekran Bhd, controlled by timber and construction tycoon, Ting Pek Khiing, a close associate of Prime Minister Mahathir, government Economic Adviser Daim and Sarawak Chief Minister Taib Mahmud (*Asian Wall Street Journal*, 2 February 1994). Other notable shareholders of Ekran include Robert Tan, a close associate of Daim, and Shuaib Lazim, closely associated with the Prime Minister – who had received and botched a privatized contract to develop a commercial center under Kuala Lumpur’s Merdeka Square. After the regional currency crisis began in mid-1997, then Finance Minister Anwar Ibrahim announced the cutting back of various ‘mega-projects’ late that year, including the Bakun Dam project. Prime Minister Mahathir intervened to ensure that the contractors were handsomely and speedily compensated for work done. After sacking and jailing Anwar in September 1998, and winning the late 1999 general election, Prime Minister Mahathir revived the Bakun project again, although there have been serious doubts about the new dam’s likely actual power generating capacity as well as the feasibility of the controversial proposed submarine cable transmission connection with Peninsular Malaysia. It is widely rumored that successive chief executives of the government controlled corporatized national power company Tenaga Nasional have been replaced for dissenting over the Bakun dam project.

#### *Consumer Welfare and Efficiency Gains*

Privatization is supposed to enhance enterprise efficiency. There are two relevant aspects of efficiency to be considered here, namely productive and allocative efficiency. Productive efficiency is attained when a firm’s output is produced at minimum resource cost. Allocative efficiency is achieved when the consumer’s marginal valuation of the product equals the marginal cost of production, assuming no externalities. (However, this does not imply allocative efficiency in terms of satisfying consumer preferences for quality services.) To achieve both productive and allocative efficiency privatized enterprises generally need to be exposed to greater competition, liberalization, marketization, and deregulation, notwithstanding scale economies and other ‘extenuating’ circumstances.

In so far as allocative efficiency may be best achieved through greater competition and deregulation – which have not been important in the Malaysian privatization experience thus far – it is doubtful that consumer welfare has been significantly enhanced through privatization. In fact, there is considerable evidence to the contrary with increases in consumer charges for utilities and services in anticipation of, or soon after, privatization, as shown in Table 7.

The government has been preoccupied with getting privatization off the ground. It has sought to ensure public acceptance for the policy by selecting profitable or potentially profitable entities for privatization and by share under-pricing. It had also minimized employee opposition by providing job security and improved terms and conditions of service (especially incomes). The authorities have ensured that the politically well connected have secured control of the privatized entities. In pursuing these other goals, efficiency and consumer welfare concern have been compromised. Efficiency here is understood broadly to involve gains to consumers, employees, (private) buyers, (government) sellers and competitors.

Table 7. Recent Consumer Charge Increases Associated with Privatization

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Utility/Service	Old	New	Year	Increases
Telephone unit charge (sen)	10	13	1987	30%
Toll (sen per km)	5	7.5	1993	50%

Source: Goh and Jomo 1995: Table 7.1.

Given the privatization process, the motivations for the privatization policy, and the nature of the privatized entities in Malaysia, competition for most of the entities privatized has been limited, implying the transformation of public monopolies into privatized monopolies. In all cases, user costs have not been lowered, and in most cases, consumer prices have been significantly increased, ostensibly to reflect the better services provided. This is hardly suggestive of greater efficiency, though it has certainly ensured greater profitability

#### *Kelang Container Terminal*

In Malaysia, the case of the Kelang Container Terminal (KCT) has been much celebrated as proof of the success of the country's privatization policy. This is no accident as KCT was carefully chosen as the pioneering entity for privatization to ensure success and acceptance for the policy besides profits for the shareholders. There have been several studies of KCT's privatization – Nankani (1988), Leeds (1989), Ismail (1991), Adam and Cavendish (1995) and Jones and Fadil (1992a) – all claiming to find significant efficiency and welfare gains in that case. Of these studies, Jones and Fadil have analyzed KCT's performance before and after divestiture more carefully than the other researchers. A critical review of their findings provides a better idea of the actual gains from that privatization.

#### *Divestiture*

The Kelang Port Authority (KPA), a government statutory body, previously had the financial autonomy to manage the entire port facility, including the container terminal. With this financial autonomy, it was expected to raise funds for its investments and to pay corporate taxes. Financially, KPA had never been in the 'red', and soon after its container terminal went into operation, it became the primary source of earnings for the KPA.

According to Noorul Ainur (2001: Table 4-8), from 1980 until 1985, i.e. prior to the privatization of the Kelang Container Terminal in 1986, Kelang Port Authority made profits and did not suffer losses from its operations. However, profits were declining during this period, for example, by 5.8 percent in 1981 from the previous year, by 16.2 percent in 1982, before an increase of 23 percent in 1983, and renewed decline by 0.03 percent in 1984 and by 21.7 percent in 1985 (Noorul Ainur 2001: 172). Table 8 shows that while the Kelang Container Terminal made pre-tax profits from 1986 to 1999, its profits did not steadily increase, but actually declined sharply after the regional currency crisis in 1997.

The container terminal was a good candidate to become Malaysia's first privatized project as it met a number of criteria. The authorities apparently felt that the first privatization project had to be successful to secure public support for the policy. Therefore, it was important to choose an entity that was not politically sensitive. Noorul Ainur (2001: 5) categorizes the container port terminal as a hard service because it involves limited human interaction or involvement in service delivery and did not impact heavily on vulnerable groups, with privatization unlikely to cause drastic changes. Also, the enterprise to be privatized needed to have a track record of profitability (Leeds, 1989: 746)

**Table 8. Kelang Container Terminal Profits and Losses, 1986-1999**

	<i>Change of</i>	<i>Change of</i>	<i>Change of</i>
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<i>Year</i>	<i>Turnover (RM million)</i>	<i>turnover from preceding year (%)</i>	<i>Expen- diture (RMm)</i>	<i>expenditure from preceding year (%)</i>	<i>Pre-Tax Profit (RMm)</i>	<i>profit from preceding year (%)</i>
1986 <sup>a</sup>	58,062	-	37,868	-	15,194	-
1987	75,185	41.7	49,599	31.0	25,586	68.4
1988	91,089	21.2	54,718	10.3	36,371	42.2
1989	107,756	18.3	69,135	26.3	38,621	6.2
1990	127,221	18.1	89,070	28.8	38,151	-1.2
1991	151,370	19.0	110,099	23.6	41,271	8.2
1992	160,839	6.3	112,361	2.1	48,478	17.5
1993	171,640	6.7	127,079	13.1	44,561	-8.1
1994	181,551	5.8	133,783	5.3	47,768	7.2
1995	189,272	4.3	116,442	-13.0	72,830	52.5
1996	191,897	1.4	118,596	1.8	73,301	0.6
1997	189,071	-1.5	125,816	6.1	63,255	-13.7
1998	142,700	-24.6	112,465	-10.6	30,235	-52.2
1999 <sup>b</sup>	118,441	-17	91,488	-18.7	26,953	-10.9
Total	1,951,094	-	1,348,519	-	602,575	-

Notes: <sup>a</sup> Covering period from March 17 1986 to December 31 1986.

<sup>b</sup> up to September.

Source: Noorul Ainur 2001: Table 4-9. Computed from data provided by the Finance Division, Kelang Container Terminal (1999).

Jones and Fadil (1992) commented that the privatization of Port Kelang was akin to selling a goldmine. They considered the choice of KCT as 'playing it safe' to ensure the success of the first privatization exercise by privatizing a successful entity. Consequently, there was no unfavorable publicity after the privatization of KCT. Should a less successful or failed entity have been privatized first and if problems were to have subsequently arisen, adverse publicity could have derailed the entire policy. To avoid such untoward criticisms, the government's safe privatization of KCT was deemed necessary for the privatization policy and program (Noorul Ainur 2001: 205).

The KPA container terminal satisfied the above criteria, but was functioning at a low level of efficiency by international standards. Pilferage was disturbingly high and terminal security lax. The below-par performance of the container terminal was believed to be the result of too many bureaucratic controls. It was felt that if it had the freedom and flexibility to manage and operate its facilities on a more commercial basis, performance would undoubtedly improve. In October 1985, KPA incorporated Kelang Container Terminal as its wholly owned subsidiary. KCT was awarded a 21-year license to operate the KPA container terminal. In March 1986, KPA sold 51 percent of KCT to Konnas Terminal Kelang Sdn Bhd (KTK), retaining the remaining 49 percent. KTK is a joint venture between Malaysian and foreign interests, with Kontena Nasional (KN) owning 80 percent and P & O Australia Limited (POAL) holding the remaining 20 percent of KTK (see Adam and Cavendish 1995). For the KCT, besides the RM111 million sale of business and movable assets (Table 9), the government also received RM16.9 million as annual lease payments to be increased by 10 percent every three years. Most importantly, KCT autonomy involved handing management over to KTK, and especially to POAL, which had some experience of container terminal management.

Table 9. Port Kelang Privatization: Payments Received by the Government

<i>Year</i>	<i>Company</i>	<i>Method</i>	<i>Lease Period</i>	<i>Amount Received</i>
1986	Kelang Container Terminal	Sale, Lease of assets	21 years	RM111 million
1992	<i>Kelang Port Management</i>	Sale, Lease of assets	21 years	RM361 million
1994	Kelang Multi Terminal	Sale, Lease of assets	33 years	RM110 million
			TOTAL	RM582 million

Source: Noorul Ainur 2001: Table 4-1; Data provided by Finance Division, Kelang Port Authority, 1999.

### Welfare Gains

Jones and Fadil (1992a: Table 13.17) also offer an analysis of the welfare impact of the KCT privatization, which is summarized in Table 10. According to Table 10, summarizing the distribution of welfare gains from the KCT privatization, buyers enjoyed a positive welfare impact. They had paid RM57 million for an income stream worth RM193 million, thus obtaining a net gain of RM136 million. Of this, domestic shareholders enjoyed a net gain of RM109 million, with RM27 million going to the foreign shareholders

Who were the shareholders? Ninety percent of the KPA shares were still in the hands of the government (see Adam and Cavendish 1995) P & O Australia, the foreign buyer, has the remaining 10 percent of KCT shares, through its 20 percent share in KTK, which has a 51 percent share in KCT. P & O's management of the KCT is widely credited for the welfare gains. If this is truly the case, the welfare gains could presumably have been achieved without divestiture, e.g. by awarding a management contract. It is not self-evident that divestiture was necessary for the change in management. It is also not clear that P & O offered the most competitive management contract available since there never was any competitive (e.g. tender) process involved in determining the new managers of KCT. Such a competitive process may well have resulted in a Malaysian firm securing the management contract, thus reducing payment outflows for securing improved management. If necessary, foreign expertise could be secured by hiring foreign consultants as and when needed, instead of allowing foreign management control.

### Performance

KCT's performance after privatization was initially quite impressive after a slight decline during 1986, the year of the KCT's ostensible privatization. As Noorul Ainur (2001: Table 4-20) and Table 11 show, the terminal had handled more ships and container cargo in 1985 prior to privatization than in 1986 owing to the 1985-86 economic downturn. Ships and cargo picked up rapidly with the economy thereafter, though the rate of expansion declined from the mid-1990s, initially with the establishment of Kelang Port Management from 1992. From 244,120 TEUs in 1985, containers handled by KCT rose to 273,335 TEUs in 1987 and 603,257 TEUs in 1991, before growing more slowly during the mid-1990s, and then experiencing a sharp downturn in 1998 and 1999, also experienced to varying degrees by the other container port companies at Port Kelang. Besides the impact of the regional crisis of 1997, another reason for the sharp decline in the late 1990s was the opening of the Kelang Multi Terminal in 1994, which soon developed more attractive facilities than KCT (Noorul Ainur 2001: 200). The average turnaround time also improved from 13.4 hours in 1985 to 11.3 hours in 1987, while the average length of time that each container remained on the dock declined from 8 to 3.8 days within the first two years after the management change associated with the KCT's 'privatization' in 1986.

Table 10. Kelang Container Terminal Distributional Impact Statement

(RM million, 1985 present values)

	Operated by		Gains from Privatization		
	Private	Public			
<b>Domestic</b>					
Consumers	1,539	1481	58		
Government	1,887	1530	357		
Taxes	1,650	967	683		
Net Quasi-Rents			185	563	-378
Share Sales (less transaction costs)				52	0
Debt Subsidy/Take-over				0	0
Others	0	0	0		
Shareholders	109	0	109		
Diversified			0		
Concentrated	109	0	109		
Employees	0	0	0		
Miscellaneous	284	330	-47		
Employees (as inputs)			66	0	66
Competitors			217	330	-113
Providers			0	0	0
Citizens			0	0	0
<b>Domestic Total</b>		<b>3818</b>	<b>3341</b>	<b>477</b>	
<b>Foreign</b>					
Consumers	770	740	29		
+ Shareholders			27	0	27
+ Competitors	54	83	-28		
+ Others			0	0	0
<b>Foreign Total</b>	<b>851</b>	<b>823</b>	<b>28</b>		
<b>World Total</b>	<b>4669</b>	<b>4164</b>	<b>505</b>		

Source: Jones and Fadil (1992a).

Since fixed assets were stable from 1982 to 1987, the improved performance can be attributed to labor productivity and managerial innovations. Also, the costs of energy, working capital, and rentals did not experience any significant changes in the same period. The only major change was apparently due to wage increases as average workers' compensation rose at an average compound rate of 12 percent after privatization. This may be due to overtime payments and increased incentive payments, which may have contributed to considerably greater increases in labor productivity. Although it was claimed that there has been no change in service charges, 'free' storage time was decreased from seven to five days in late 1986. This has effectively meant a 28.6 percent increase in storage costs to customers, which in turn contributed to a 3.9 percent increase in overall costs to them from 1986 to 1989. Clearly, the increase in turnover (output growth) has been the main source of improved profitability for KCT.

Table 11. Kelang Container Terminal: Number of TEUs Handled, 1985-1999

<i>Year</i>	<i>Number of TEUs handled</i>	<i>Change in TEUs handled from preceding year (%)</i>
1985 <sup>a</sup>	244,120	–
1986 <sup>a</sup>	241,186	-1.2
1987	273,335	13.3
1988	319,557	16.9
1989	393,954	23.3
1990	494,978	25.6
1991	603,257	21.9
1992	672,642	11.5
1993	759,251	12.9
1994	804,455	6.0
1995	863,870	7.4
1996	946,788	9.6
1997	992,995	4.9
1998	788,703	-20.6
1999 <sup>b</sup>	671,952	-14.8

Notes: <sup>a</sup> KCT was privatized on 17 March 1986. Earlier data refer to the KPA business operations taken over by KCT.

<sup>b</sup> up to September

Source: Noorul Ainur 2001: Table 4-23; computed from data provided by Kelang Container Terminal (1999).

Since output growth has been the main source of improved profitability, could output growth be due to privatization *per se* or to exogenous demand shifts? To assess whether output growth was a result of increased demand, Jones and Fadil (1992a: Fig. 13.7) compared real GDP and KCT output indices. From 1983 to 1986, output growth seemed to grow with real GDP, but after divestiture, it grew faster. They then concluded that since output growth after divestiture exceeded real GDP growth, the difference could be attributed to efficiency gains from privatization. However, the export-led nature of the economic recovery of the late 1980s has involved proportionately greater increases in imports and exports compared to GDP growth, which the authors did not take into consideration.

Throughput has been on the increase since 1987, and from 1989 to 1991, it registered more than 20 percent growth in each year (see Table 11). However, it is misleading to attribute this increase to improved efficiency due to privatization *per se* since many other changes were also taking place at the same time, most importantly the changes in management, organization and worker incentives. After the 1985-1986 recession, the Malaysian economy picked up tremendously from late 1986, with export-led industrialization using imported components and equipment. Exports and imports continued to grow rapidly in the late 1980s and early 1990s. From 1987 to 1990, annual growth of exports as well as imports was in excess of 20 percent (see Table 11). Thus, KCT's increased turnover was probably also due to the growth in international trade during the late 1980s and early 1990s. KCT's performance probably also improved with its upgrading of facilities and infrastructure at its North Port base with heavy capital investment in new equipment. The new management also reduced the bureaucratic red tape, thus enhancing the attraction of the port facilities (Noorul Ainur 2001: 207).

## Government

According to Jones and Fadil (1992), the government enjoyed the bulk of the positive welfare impact from the KCT privatization. Although it gave up a profit stream of RM378 million, it received RM52 million from share sales (less transaction costs) and substantial tax gains of RM683 million inclusive of the rental payment plus a variable payment based on throughput. This impressive positive welfare impact was primarily a result of increased tax revenue from higher profitability after privatization

However, the authors beg the question of how much more benefits could have been obtained if the KCT was still fully KPA-owned with the changed management. Prior to the KCT privatization, KPA had never been in the 'red'. Although its performance was considered inefficient, the container terminal – the most lucrative KPA operation – was contributing a positive net cash flow. It is quite possible that if the KPA had been given the freedom and flexibility to operate the terminal on a commercial basis, the government may have benefited just as much, or even more than by allowing P & O to take a share in KCT and to take over KCT's management.

Unfortunately, such counterfactual analysis is not possible, especially since the relevant information is not available and cannot be meaningfully inferred. However, other studies of KCT's privatization suggest that efficiency and productivity gains and improvements in performance have primarily been the result of managerial and organizational reforms by the new private management team, rather than due to the ownership change *per se*. After all, there is not much change in ownership as KCT remains 88.7 percent owned by government-owned enterprises.

As noted earlier, there has been a distinct tendency for the government to sell their 'most lucrative enterprises' first in order to create a positive public impression of privatization. Economically, however, this policy undermines the potential gains from privatization for the government. If the 'worst-run enterprises' – presumably, therefore, in greatest need of privatization – had instead been sold first, the welfare outcome might have been quite different.

## **Employees**

According to Jones and Fadil, employees also gained from higher wages by an estimated RM66 million. This is in line with the government's assurance that employees would be rewarded for greater productivity, with terms and conditions not worse than those they were enjoying while serving the government. But were there real gains? Although wages increased, real welfare gains may have increased by less than the full amount of the wage increase. Workers may have to work harder, for longer hours. Also, future compensation and promotion prospects are supposed to be directly linked to work performance, rather than seniority. In the privatized KCT, lifetime job security is no longer guaranteed. Instead, the government only required the KCT to guarantee that, 'no employee would be fired or retrenched for a period of five years'. Hence, the immediate welfare gains are primarily of a short-term nature, with some non-monetary long-term losses not adequately reflected in typical welfare analysis. It is also expected that the union may lose its ability and influence to negotiate better terms and conditions for its members in dealing with a completely profit-oriented private sector employer, instead of a public-sector employer, which also does not seem to figure in Jones and Fadil's welfare accounting.

## **Consumers**

According to Jones and Fadil (1992), consumers gained from improved services by about RM88 million. There has been significant progress in terms of reduction of turnaround times, crane handling movements, and the increasing numbers of vessels calling at the port. The

expected operation of the second container terminal, Kelang Port Management (KPM), from mid-1993 has provided some competition to KCT (Mazida, 1992). KPM is expected to offer a wider range of services, including container handling. This should be beneficial to consumers, as competition should enhance efficiency, though actual welfare gains are difficult to predict without further information about the nature of the expected duopoly. While consumers' welfare has been enhanced in the case of KCT, this is not necessarily true in all cases of divestiture.

### ***Malaysia Airlines (MAS)***

In the early 1980s, Malaysia Airlines (MAS) suffered losses due to high interest rates and fuel costs. The government's own financial difficulties and other priorities also limited the funds available to MAS for expansion. An attractive solution to the problem was partial divestiture, regarded by some as a form of privatization. In the case of MAS, therefore, privatization only involved partial divestiture as majority ownership remained in the hands of the government. With its 'golden share', ultimate control will continue to remain with the government even if it loses majority ownership

MAS's post-divestiture experience has been different from KCT's. Management style has not changed significantly as virtually the same people are still in charge. There is no evidence of any change in managerial autonomy, as the government seems to be still very much in control. However, investment increased to meet anticipated future demand. This resulted in an apparent decline in productivity due to the greater rise in capital relative to output, and also to the increase in non-fuel intermediate input costs (mainly advertising and marketing expenditure).

MAS has been operating in two different market conditions. The airline faces an oligopolistic market internationally while enjoying a domestic monopoly. Hence, prices (fares) have been largely exogenously determined internationally, while domestic fares are subject to government regulation. Domestically, fares have been adjusted within a designated band to maintain profitability. If deregulation accompanies divestiture, such an arrangement could easily be abused to the disadvantage of domestic consumers. Of course, increased competition on domestic routes can be generated by allowing foreign carrier or even other domestic carriers to compete, but this has not been allowed. For example, Singapore International Airlines (SIA) wanted to fly between Singapore and Sarawak. However, MAS retained its virtual monopoly, invoking its claim to cross- subsidization of commercially unprofitable routes.

According to Jones and Fadil, domestic consumers have been net losers, as they have had to pay higher prices and have received only a small fraction of the benefits of the increased investments. Instead, the bulk (four-fifths) of the welfare gains have accrued to foreign shareholders, competitors, and consumers, with consumers benefiting most due to lower airfares in the international market.

### **Postal Services**

The corporatization of the Postal Services Department (PSD) took place on 1 January 1992 with promises to provide better quality and more efficient services. As with other privatized utilities and natural monopolies, it is important to ask if there is a need to privatize to achieve such improvements. The PSD has been financially stable with an impressive track record in recent years, showing increasing profits yearly without any increases in postage rates in almost 10 years. In 1988, its revenue was RM186.3 million and profits were RM11.3 million. In 1989, revenue was RM202.3 million and profits were RM15.9 million. In 1990, revenue increased to RM252 million with profits more than doubling to RM44 million (*Business Times*, 31 December 1991). With such impressive earnings, it cannot be argued that the

privatization of the PSD is to reduce the financial burden of the government. Furthermore, government departments and agencies had been enjoying free postal services all along. With corporatization, however, the government had to begin paying between RM5 million and RM20 million a year to Pos Malaysia Berhad (PMB) (Kartini, 1991).

Table 12. Comparison of Malaysia's Domestic Postage Rates with those of Singapore, Thailand, Indonesia, Japan, and India as at 1 May 1991 (RM)

<i>Weight/Country</i>	<i>Malaysia</i>	<i>Singapore</i>	<i>Indonesia</i>	<i>Thailand</i>	<i>India</i>
<i>Japan</i>					
Up to 20 gm	0.20	0.30	0.31	0.22	0.14
21 - 50 gm	0.30	0.45	0.61	n.a. <sup>1</sup>	0.41
51 - 100 gm	0.45	0.75	0.76	0.35 <sup>2</sup>	0.47

Notes: <sup>1</sup> Not available as rate is based on a combined system, part of a marketing strategy.

<sup>2</sup> Surface service only, does not involve air service.

Sources: Goh and Jomo 1995: Table 7.4.

As Table 12 shows, Malaysia's domestic postage rate for a letter of up to 20 gm was only 20 sen, the lowest in the region after India. Also, Malaysian postal services have long been among the best in developing countries, featuring its low charges and relative efficiency. With the core of postal services constituting a natural monopoly, there is not much room for enhancing competition. Hence, it is unclear how privatization *per se* is expected to contribute to achieving productive efficiency.

The Postal Services Department has been a monopoly, and with privatization, it is likely to become a private monopoly. Corporatization of the PSD has already involved hefty increases in consumer charges. It may also involve increased labor costs in the form of bonuses and increased salaries for staff, as well as increased expenditure for overheads for assessment rates and quit rent.

**Table 13** compares postage rates before and after corporatization, showing postage rates rising tremendously in 1992 with corporatization. For letters (weighing less than 20gm) posted to destinations within Malaysia, the postage rate increased by 50 percent; for those posted to Singapore and Brunei, the postage rate increased by 100 percent. A detailed comparison of the tables will show that some of the postage rates increased by more than 100 percent in 1992.

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### **Telephone Services**

The corporatization of the Telecommunications Department (Jabatan Telekom Malaysia) has seen the introduction of some better services such as improved counter-services; the option of a detailed billing system reducing errors (for which one has to pay more), and quicker responses to applications for telephone installations. There is no doubt that there has been some efficiency increase and better services, but not without higher charges. Since corporatization of the telecommunication services in 1987, even basic telephone charges have increased. For example, a three-minute call unit used to be charged 10 sen, but such a call has been charged 13 sen since corporatization, i.e. a 30 percent increase.

It is highly unlikely that these improvements in services could not have been achieved at much lower cost than the additional consumer charges. Hence, it can hardly be argued that the consumers are better off on the whole since the improvements cost much less than the extra they have to pay. This does not mean that Telekom Malaysia is less efficient than its predecessor, but rather that it is capturing an enhanced rent from the private monopolistic position it enjoys.

### ***Passenger Railway Services***

The corporatization of Keretapi Tanah Melayu (KTM) on 1 August 1992 has been seen as a step to ease its financial burdens. Compared to other corporatized or privatized monopolies (e.g. Tenaga Nasional Bhd and Pos Malaysia), KTM Bhd faces more competition from road (as well as sea and air) transport.

KTM Bhd has to show a track record of profitability before it can be publicly listed on the Kuala Lumpur Stock Exchange (KLSE). One obvious option available to KTM to cut its losses is to increase its fares (Philip, 1992). On 1 January 1993, five months after corporatization, KTM increased fares for the second time in three months, as shown in Table 14. While railway services are said to have improved after corporatization, as in many of the other cases reviewed earlier, these generally marginal improvements cannot be said to justify the fare increases, implying a definite decline in consumer welfare

Table 14. Railway Passenger Fare Increases

From 1/8/84 (sen/km)	Effective 1/10/92 (sen/km)	Effective Increase (sen/km)	Effective 1/1/93 (sen/km)	Increase (compared to fare of 1/8/84)
First-class coach	12.14	13.96	15%	15.00 24%
Second-class coach	5.47	5.74	5%	6.50 19%
Third-class coach	3.36	3.53	5%	3.65 7%
Supplementary charge for air-conditioned coach <sup>a</sup>	RM3	RM4	33%	RM4 33%
Berth charge for first-class coach <sup>a</sup>	RM15	RM25	67%	RM25 67%

Note: <sup>a</sup> This is a standard charge irrespective of distance.

Source: Goh and Jomo 1995: Table 7.6.

### **Highways**

Until the mid-1980s, the construction and maintenance of public roads in Malaysia were the sole responsibility of the public sector. As part of the government's privatization thrust, the construction and operation of toll roads by the private sector were introduced in the mid-1980s. In existing and proposed road privatization projects, the method for private sector involvement is the build-operate-transfer (B-O-T) approach. Under this system, the private company finances the construction – in some cases merely involving the widening or improvement – and operation of public roads for a specific period, and collects tolls over the concession period. The concession period varies from the 9 years for the Jalan Kuching/Jalan Kepong Interchange and Jalan Kuching Upgrade projects to 30 years in the case of the North-South Highway. The concession period varies with the time the concessionaire ostensibly needs to recoup the investment. In some B-O-T projects, the toll charges are fixed for the

duration of the concession.. In the case of the North-South Highway, there is explicit provision for a toll revision after 1996 (see Naidu 1995).

On 1 January 1993, effective toll charges were increased by 50 percent for the North-South Highway, from 5 sen to 7.5 sen per kilometer. For example, the original toll charge from the Sungei Besi tollgate to the Tangkak tollgate was RM7.10, while the new toll charge is RM10.60. With the increased toll charges, consumers will be adversely affected through higher prices charged for transportation, goods and other services, with a negative impact on real incomes and welfare.

### Hospital Support Services

As Table 15 shows, Ministry of Health expenditure for hospital support services for the year 1996 (prior to privatization) was RM143.0 million. Compared to 1996, there was a 228 percent increase in this expenditure in 1997 (to RM486.9 million), 240 percent in 1998 (to RM468.5 million) and 255 percent in 1999 (to RM507.9 million). After the big increase in 1997 with privatization, the subsequent annual increases were much more modest, i.e. by 3.9 percent in 1998 from the previous year, and subsequently, a 4.3 percent increase in 1999 over 1998.

Table 15. Ministry of Health Expenditure on Hospital Support Services, 1996-1999

<i>Year</i>	<i>MoH Payments (RM million)</i>	<i>Increase since 1996</i>	<i>Increase over preceding year</i>
1996	143.0	-	-
1997	468.5	228	228
1998	486.9	240	3.9
1999	507.9	255	4.3

Source: Noorul Ainur 2001: 300 - Table 6.2. Computed from unpublished data provided by the Finance Division, Ministry of Health.

Despite Bumiputera ownership and control of most, though not all privatized enterprises, it seems likely that privatized entities have contracted more to non-Bumiputeras. It has been widely acknowledged that greater official commitment to Bumiputera economic advancement has raised the 'Bumiputera premium' rates. Greater profit maximization by privatized entities has probably resulted in less contract awards to more expensive Bumiputeras. Although the number of contracts to Bumiputeras remains high, the value of contracts to non-Bumiputeras – especially foreigners – is probably much higher (AMMB *et al.* 1995: Table 2.17).

### Under-pricing of SOE Initial Public Offer (IPO) Share Issues

One of the declared aims of privatization is to reduce the financial burden of the government. The sale of government-owned enterprises is therefore meant to raise revenue for the government. Such one-off proceeds may relieve the government's financial burden in the short run, but may result in forgone income in the long run. Table 16 sums up the proceeds to the government derived from the sale of equity of some government-owned enterprises.

Table 16. Proceeds from the Sale of Equity

<i>Company</i>	<i>RM million</i>
Sports Toto Sdn Bhd	113
Malaysian Airlines System Berhad	469

Malaysian International Shipping Corporation	90
Edaran Otomobil Nasional	29
Malaysian Shipyard and Engineering	247
Syarikat Gula Padang Terap	51
Perusahaan Otomobil Nasional (PROTON)	177
Tenaga Nasional Berhad (TNB)	248
Syarikat Telekom Malaysia Berhad	639

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Total 2,063

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Source: Goh and Jomo 1995: Table 7.7.

In all cases of public flotation of government-owned enterprises, there has been substantial under-pricing of shares in the initial public offerings. Table 17 reveals that high initial premiums were obtained on the first day of secondary trading. As a consequence, the government has foregone considerable revenue, amounting to nearly RM4.8 billion for the 14 companies.

In the case of Sports Toto, the first 70 percent was sold for RM28 million to Vincent Tan's B & B Enterprise, said to be 60 percent Bumiputera-owned, of which 10 percent was subsequently sold to Tunku Abdullah's Melewar Corporation. The remaining 30 percent was later sold for RM85 million to the Daim-connected Raleigh Berhad (26 percent owned by Bumiputeras). While the second sale involved a share price seven times that of the first, when Sports Toto was listed on the KLSE, it traded at a much higher price on the first day (see Table 17), implying under-pricing even in the second instance, and hence, gross under-pricing in the initial sale. Since Berjaya Corporation (B & B's holding company) had almost 56 percent of Sports Toto at the end of the 1990-1991 financial year, and was about 42 percent Bumiputera-owned, Jones and Fadil (1992c) conclude that private Bumiputera interests had relinquished control by selling out, while presumably realizing very considerable capital gains to non-Bumiputera interests.

Such under-pricing of initial public offerings seems to have been deliberately done to improve the likelihood of the share offer's success since failure could have adverse consequences. Another reason advanced for such "under-valuation" of assets is to promote wider share ownership in line with the government's redistribution objectives. Unfortunately, this politically popular objective of wider share ownership may not be sustained as there is widespread 'staggering' (selling a share almost immediately for profit) (Toh, 1989). This can be seen in Table 17, which shows that turnover has been relatively high for MISC, Sports Toto, and KCT.

However, some writers have argued that there has been no under-pricing of the public offerings, which are, according to them, only initially and temporarily, priced higher than their intrinsic value by the market due to speculative demand. As evidence, they cite the considerable variation in the degree of under-pricing with different share issues. For example, the listing of Syarikat Telekom Malaysia Berhad occurred during the Gulf Crisis, resulting in a relative modest premium of only 22 percent on the first day of trading. In contrast, the initial premium for TNB, listed in May 1992, was 94 percent!

When Hicom Holdings Berhad (HHB) was formed from Hicom Berhad's reverse takeover of New Serendah Rubber Company Berhad in December 1993, when the stock market was very bullish, the stock traded at RM12. Just before the public share issue in March 1994, the stock traded at around RM8.50. Based on its own 1994/5 forecast earnings per share of 18 to 20 sen, HHB was trading at a huge price earnings (P/E) ratio of about 63 (*Malaysian Business*,

16 February 1994). The Capital Issues Committee (CIC) apparently sets share issue prices rather conservatively, based on a P/E ratio of between 3.5 and 8.0. Interestingly, Bumiputera interests have divested RM1,794.7 million worth of shares in publicly listed companies up to 1993, of which 53 percent were shares of companies listed during 1990-1992. Consequently, there have been significant dilutions of Bumiputera interests in privatized enterprises (see AMMB *et al.* 1995: Table 2.16). At the average market prices quoted for the earlier part of 1993, these shares were valued at RM14,147.8 million, of which 68 percent were accounted for by the companies recently listed in 1990-1992. This clearly reinforces the impression of general under-pricing of recent share issues, much of which is accounted for by privatizations, suggesting private capture of rents due to the under-pricing of public assets. The difference between the market price and the par value of the shares divested by Bumiputeras was RM12,353.1 million, i.e. 688 percent of the par value of the shares, which provides some indication of the enormity of the rent capture associated with under-pricing (Malaysia, 1993: 69).

As Table 18 shows, the actual Bumiputera allocations in share issues associated with privatizations have increasingly been in excess of the much-mentioned and often-presumed 30 percent. More ominously, a great proportion of this is allocated by the government through procedures which are not transparent, and which are popularly presumed to favor those well connected with the dominant faction of the ruling party, or even the Minister of Finance himself. Whereas some such allocations were done by the Ministry of Trade and Industry in the 1980s, this prerogative was increasingly exercised by the Ministry of Finance in the 1990s. In this period, there have also been corresponding increases in both actual Bumiputera share allocations as well as those selected by the government, including non-Bumiputera interests, suggesting the increasing politicization of such share allocations, and therefore greater politically-determined privatization-related rent capture.

Since these types of allocations greatly overlap, it suggests that political influence and access are very important determinants of such rent capture among politically influential Bumiputeras. However, in so far as they do not coincide, it suggests that there are important non-Bumiputera beneficiaries from such government allocations. The magnitude of these allocations suggests that the 1993 furor over the diversion of 90 percent of ten million Telekom Malaysia shares allocated to Maika Holdings – controlled by the Malaysian Indian Congress (MIC), a non-Bumiputera component member of the ruling coalition – to companies personally selected and believed to be controlled by the MIC President, only reflects the tip of the iceberg of such possible ‘abuses’ involving personal aggrandizement ostensibly on behalf of party political interests. Almost incredibly, the very fact of such political allocations coupled with under-pricing in themselves have not been the subject of investigative scrutiny (see *Sunday Times* (London), 13 March 1994).

The likelihood of such abuses is exacerbated by the lack of transparency in these allocations. A glance at the share ownership profile of some recently privatized companies shows that large, politically favored, predominantly Bumiputera, institutional investors and nominee companies have emerged as the major shareholders. According to Telekom Malaysia’s 1991 Annual Report, for example, as of March 1992, the Ministry of Finance Incorporated (MoF Inc.) still held 78.1 percent of the company’s paid-up capital, followed by Permodalan Nasional Berhad (PNB) with 4.6 percent, Hongkong and Shanghai Bank (HSB) Nominees with 2.8 percent, Citibank Nominees N.A. with 2.5 percent, Cartaban Nominees with 1.8 percent and Chase Manhattan (Malaysia) Nominees with 1.1 percent. According to TNB’s 1992 Annual Report, as of October 1992, MoF Inc still held 73.2 percent of its paid-up capital of RM3,000,000,001, followed by PNB with 6.0 percent and HSB Nominees with 1.2 percent.

## ***DISTRIBUTIONAL IMPLICATIONS***

### Distribution Trends

**There is no theoretical or analytical consensus on the relationship between privatization and distribution, whether in Malaysia or globally. While distribution data have been collected by the national authorities, much of the data is jealously guarded by them, with findings only selectively published or announced. Since the 1970s, the major policy pre-occupation has been with inter-ethnic distribution, especially progress towards reducing inter-ethnic economic disparities between Malays and Chinese. Public discourse and research effort has tended to reflect this preoccupation. This section will review some of the most relevant distribution trends since the 1970s, to draw attention to developments since privatization began in the 1980s.**

The NEP's Outline Perspective Plan, 1971-1990 (OPP1) forecast that the official poverty level would be reduced from 49 percent in Peninsular Malaysia in 1969 to 16 percent in 1990. According to official government plan documents, the poverty rate was reduced to 18 percent by 1984 and 17 percent by 1987, progress with poverty reduction was brisk through the 1970s until the early 1980s, but seems to have been considerably slower since then. Table 19 summarizes official data on the incidence of poverty in Peninsular Malaysia since 1970. Poverty incidence declined from 49.3 percent (official estimate) or 56.7 percent (Anand 1983) in 1970 to 39.6 percent in 1976, 18.4 percent in 1984 and 17.3 percent in 1987 in Peninsular Malaysia alone. In absolute terms, the number of poor households in the peninsula dropped from 791,800 in 1970 to 764,400 in 1976 and further to 483,300 in 1984, before rising slightly to 485,800 in 1987 after the 1985-6 recession. Poverty incidence for all of Malaysia, i.e. including Sabah and Sarawak, fell to 6.1 percent in 1997, before rising after the 1997-8 regional financial crisis to 7.5 percent in 1999.

Table 19. Malaysia: Incidence of Poverty, 1970-1999

	<i>1970</i>	<i>1980</i>	<i>1990</i>	<i>1997</i>	<i>1999</i>
Total	49.3	29.2	16.5	6.1	7.5
Rural	58.6	37.7	21.1	10.9	12.4
Urban	24.6	12.6	7.1	2.1	3.4
Hard-core Poor			3.9	1.4	1.4

Sources: Malaysia plan documents.

Official statistics suggest very impressive reductions of poverty in the 1970s and early 1980s, especially in Peninsular Malaysia. Although there are many legitimate reservations about the quality and nature of this data, there are few observers who would doubt that poverty, as officially defined in absolute terms, has been significantly reduced, even though part of the decline in poverty may have been due to some changes in the measurement of poverty. In view of the generally rapid growth of the Malaysian economy in most of the 1970s and part of the 1980s, poverty – as defined by the government – could have been further reduced, if more just and effective redistributive policies had been implemented, government waste minimized, and government allocations ostensibly for poverty eradication were used effectively for reducing poverty, instead of enriching politicians, their 'clients' and contractors securing rural development projects. More significantly, per capita income levels have generally risen with the rapid growth and structural change since the seventies. Since poverty is officially conceived in absolute, rather than in relative terms in relation to a poverty line income, income inequality can grow as the poverty rate declines if economic growth is sufficiently high. Income distribution trends do provide important indications of the welfare implications of economic growth and recession, especially as they affect inter-ethnic, spatial and other income inequalities. However, it should be remembered that under the NEP,

there has been no official commitment to reducing income inequality, but instead an emphasis on reducing economic disparities between ethnic groups, particularly between the Bumiputeras and non-Bumiputeras.

Table 20 shows monthly household income trends by ethnicity and location in Malaysia, especially Peninsular Malaysia, since the 1970s. These trends suggest that rising incomes and poverty reduction in the 1970s may have been accompanied by growing income inequality, but there is other evidence to suggest that income inequality declined during the seventies and eighties, and has not changed much since then. Average inter-ethnic income disparities also declined during the NEP period, but appear to have risen in the 1990s.

**Table 20. Peninsular Malaysia: Mean Monthly Household Incomes by Ethnic Group and Stratum, 1970-1999**

	1970	1973	1976	1979	1984	1987	1990	1995	1999
All	423	502	566	669	792	760	1,16	2,02	2,47
Bumiputera (B)	276	335	380	475	616	614	7	0	2
Chinese (C)	632	739	866	906	1,08	1,01	940	1,60	1,98
Indian (I)	478	565	592	730	6	2	1,63	4	4
Others	1,30	1,79	1,39	1,81	791	771	1	2,89	3,45
Urban (U)	4	8	5	6	1,77	2,04	1,20	0	6
Rural (R)	687	789	913	942	5	3	9	2,14	2,70
Disparity ratio (C/B)	321	374	431	531	1,11	1,03	955	0	2
Disparity ratio (I/B)	2.30	2.21	2.28	1.91	4	9	1,61	1,28	1,37
Disparity ratio (U/R)	1.73	1.69	1.56	1.54	596	604	7	4	1
	2.14	2.11	2.12	1.77	1.76	1.65	951	2,58	3,10
					1.28	1.26	1.74	9	3
					1.87	1.72	1.30	1,32	1,71
							1.70	6	8
								1.80	1.74
								1.33	1.36
								1.95	1.81

Note: Figures for 1970-87 in constant 1978 prices; figures for 1990-99 are constant 1990 prices.

Sources: *Fourth Malaysia Plan, 1981-85, Mid-Term Review of the Fifth Malaysia Plan, 1986-90, Seventh Malaysia Plan, 1996-2000, Eighth Malaysia Plan, 2001-2005.*

Table 21 shows income distribution trends for the whole country as well as by location in Malaysia, especially Peninsular Malaysia, since the 1970s. The table suggests that income inequality declined during the seventies and eighties, and has increased slightly since then. Despite the popular rhetorical commitment by politicians to poverty eradication, the 1970s and early 1980s saw growing emphasis on the NEP's other pronounced objective to 'restructure society' to abolish the identification of ethnicity with economic function, especially to create, expand and consolidate the Malay capitalist and middle classes. As officially interpreted, 'restructuring' is not meant to abolish or change socio-economic relations between classes or economic interest groups; in practice, it mainly seeks to increase Bumiputera capital ownership and personnel shares in the more attractive – mainly professional – occupations.

In practice, restructuring efforts have been largely aimed at increasing the share of Bumiputera capital as well as the number of Bumiputera businessmen and professionals in the context of continued open capitalist development by using the public sector and state

intervention extensively. The NEP's restructuring prong mainly involves redistribution of corporate stock ownership, employment and education, with the latter two sometimes considered together. There is particular interest in ownership of the modern corporate sector, though only a small minority of the population is actually involved, reflecting the dominance of capitalist interests in defining supposedly ethnic or communal interests.

**Table 21. Malaysia: Income Shares by Income Group, 1970-1999**

	1970	1973	1976	1979	1984	1987	1990	1999
<b>Total</b>								
Top 20%	55.9	53.7	61.9	54.7	53.2	51.2	50.0	50.5
Middle 40%	32.5	34.0	27.8	34.4	34.0	35.0	35.5	35.5
Bottom 40%	11.6	12.3	10.3	10.9	12.8	13.8	14.5	14.0
<b>Urban</b>								
Top 20%	55.0	–	–	–	52.1	50.8		48.9
Middle 40%	32.8	–	–	–	34.5	35.0		36.7
Bottom 40%	12.2	–	–	–	13.4	14.3		14.9
<b>Rural</b>								
Top 20%	51.0	–	–	–	49.5	48.3		48.0
Middle 40%	35.9	–	–	–	36.4	36.7		36.7
Bottom 40%	13.1	–	–	–	14.1	15.0		15.6
Gini Index	0.50	0.50	0.57	0.49	–	–	0.44	0.44
Theil Index	0.48	0.43	0.71	0.42	–	–		

Note: The published figures for urban and rural Malaysia in 1990 and 1999 do not add up to 100.0 percent, but only the 1990 calculations are omitted because of the much greater disparities involved.

Sources: Malaysia plan documents.

Thus, wealth restructuring – particularly the 30 percent target for Bumiputera share ownership by 1990 – remains the main obsession in most discussions about the NEP. Table 22 reflects the distribution of ownership of the corporate sector by ethnicity and residence for 1969 and then from 1983 until 1999. The Bumiputera share rose sharply from 1.5 percent in 1969 and 2.4 percent in 1970 during the 1970s until the mid-1980s. While the original *Mid-Term Review of the Second Malaysia Plan, 1971-1975 (MTR2MP)* target (Malaysia 1973: 84, Table 4.8) of 9.0 percent Bumiputera ownership by 1975 was surpassed, only 12.5 percent of the corporate sector was in Bumiputera hands by 1980 (instead of the projected 16.0 percent) and 19.1 percent in 1985 (instead of the 23.0 percent expected). Instead of the 30.0 percent targeted for 1990, the Bumiputera share has hovered around twenty percent since 1983 – 18.7 percent in 1983, 19.1 percent in 1985, 19.4 percent in 1988, 19.3 percent in 1990, 20.6 percent in 1995 and 19.3 percent in 1999.

Meanwhile, the share of foreign residents fell from 63.4 percent in 1970 to 42.9 percent in 1980, 33.6 percent in 1983, 26.0 percent in 1985 and 24.6 percent in 1988, before rising to 25.4 percent in 1990, 27.7 percent in 1995 and 32.7 percent in 1999. Meanwhile, the ethnic Chinese share rose from 22.8 percent in 1969 to 45.5 percent in 1990<sup>9</sup> (when ethnically anonymous ownership of locally controlled companies was largely assigned to Chinese), before declining sharply to 40.9 percent in 1995 and 37.9 percent in 1999. Meanwhile, the

Indian share rose slightly from 0.9 percent in 1969 to 1.2 percent in 1985 and 1988, and 1.5 percent in 1995 and 1999.

The trust agencies ostensibly set up to advance Bumiputera share ownership as well as entrepreneurial and managerial capability have been associated with the growth of the public sector under the NEP. The *Third Malaysia Plan, 1976-1980 (3MP)* (Malaysia 1976: 86, Table 4.16) projections for the 30 percent Malay share of the corporate sector in 1990 anticipated 7.4 percent for 'Malay individuals' and 22.6 percent for 'Malay interests'. The *Fourth Malaysia Plan, 1981-1985 (4MP)*, however, reduced the share for Bumiputera individuals to 5.2 percent (or 17.3 percent of total Bumiputera ownership) and raised the share for 'Bumiputera trust agencies' to 24.8 percent (or 82.7 percent). However, since then, far greater emphasis has been given to Bumiputera individual wealth acquisition, in conjunctions with the privatization policy.

The share of Bumiputera individuals rose significantly from 7.6 percent in 1983 to 14.2 percent in 1990, 18.6 percent in 1995 and 17.4 percent in 1999. Meanwhile, the Bumiputera trust agencies' share declined from 11.1 percent in 1983 to 5.1 percent in 1990 and 1.7 percent in 1999. Individuals accounted for 73.4 percent of total Bumiputera ownership in 1990 and 91.0 percent in 1999. The share for Bumiputera trust agencies correspondingly fell to 9.0 percent in 1999 – a very dramatic reversal in a relatively short space of time, with important implications for the composition and nature of Malay capital as well as the character and role of state intervention and the public sector in Malaysia. Of course, the issue of wealth ownership – whether of shares or other wealth – mainly involves the interests of a small elite.<sup>10</sup>

Government occupational statistics also suggest that inter-ethnic employment disparities have been considerably reduced. Nevertheless, Bumiputera employment in the public sector and in agriculture greatly exceeds their overall demographic share. According to the World Bank, government remuneration is, on average, about 25 percent higher than in the private sector. As Table 23 shows, for the vast majority of the population, inter-ethnic employment disparities have been greatly reduced. As far as occupational restructuring is concerned, Bumiputeras were significantly under-represented (i.e. less than 45 percent) only at the 'administrative and managerial' level (24.1 percent in 1970, 28.4 percent in 1988 and 37.0 percent in 2000) and in sales-related occupations (26.7 percent in 1970, 36.5 percent in 1988 and 37.3 percent in 2000). Nevertheless, the Malay proportions in these occupations have greatly increased since Independence, and especially under the NEP, though the Chinese proportions still significantly exceed their declining population shares.

Otherwise, occupational disparities have been significantly reduced. Rather, the main sources of tension over employment restructuring involve access to business opportunities and the more lucrative occupations. This mainly affects and concerns the middle class. Bumiputeras are still under-represented in some of the most lucrative professions, such as medicine, accountancy and architecture, though much of this is temporary and will decline as the population ages. Hence, it is very likely that tertiary education, and especially access to these professions, will continue to preoccupy the middle class, who feel they stand to gain or lose most in this regard. For obvious reasons then, focus on the lucrative professions is likely to remain.

Tertiary education as well as related employment and promotion opportunities are the main concerns and primary sources of inter-ethnic resentment and conflict, especially among the middle class, who correctly see these as determining their life chances. Ethnic percentages in professional and technical occupations increasingly reflect demographic proportions in the Peninsular Malaysian population, though Bumiputera under-representation in the more lucrative and prestigious professions has been highlighted by the Malay middle class,

politicians and the government in their arguments for continued if not increased affirmative action measures.

Official concern appears to have moved away from school enrolment ratios, where Bumiputeras are now actually 'over-represented' owing to the generally larger size of Bumiputera families as well as the higher enrolment of non-Bumiputera children in private institutions. Even interest in enrolment at the tertiary level has declined with the considerable Bumiputera advances since the 1970s and the unprecedented, though occasional phenomenon of graduate unemployment since the mid-1980s. Instead, the focus is now primarily on the lucrative professions, where Bumiputeras are still relatively under-represented despite rapid progress, especially since the 1980s.

As Table 24 shows, the Bumiputera proportion of the eight prized professions rose from 4.9 percent in 1970 to 29.0 percent in 1990 and 33.1 percent in 1995 and 32.0 percent in 1997, before measurement changes reduced the number of professionals by 45.5 percent in 1997 and the Bumiputera share to 27.3 percent in 1997 and 28.9 percent in 1999. There may also be some underestimation of the Bumiputera proportion as far as those in government service (e.g. the legal and judicial service) are concerned. Perhaps, more importantly, recent Bumiputera advances into the professions mainly involve the younger age cohorts. Hence, the Bumiputera proportion will continue to increase as the population ages, even if the current proportions remain unchanged. Malay professionals also seem to earn proportionately more, suggesting a likely ethnic premium in their professional charges (Merican, 1987).

As far as tertiary education more generally is concerned, the Bumiputera population in government-accredited local universities and university colleges was 67 percent in 1985 (Malaysia 1986: 490-1), up from 40 percent in 1970 (Malaysia 1973: 193). The ratio was supposed to be 60 percent from the early 1980s, as part of a 'compromise' resolution of the Merdeka University issue from the late 1970s. The controversy over ethnic quotas for public university admissions has continued to the present.

Such ethnic preoccupations previously constrained state approval of private initiatives in human resource development and domestic tertiary education development, despite the considerable foreign exchange savings that have since accrued. The situation has changed significantly since the mid-1980s as businesses have successfully invested in providing tertiary educational credentials. Since then, private tertiary level institutions have been allowed and several hundred have been established since then, with most offering 'twinning programs' with universities overseas for handsome premiums. Continued regulation has provided lucrative opportunities for rentier marketing of such degrees. Such preoccupations as well as the regime's obsession with controlling campus dissent have stood in the way of the urgent need to reform higher education in order to better prepare the Malaysian population for rapid cultural and technological changes.

Since the mid-1990s, several Bumiputera controlled firms – including Petronas, Tenaga and Telekom, i.e. the latter two recently privatized – have been given licenses to set up private universities, with the senior Chinese partner in the ruling coalition receiving one in mid-2001. The vast majority of students in private and overseas tertiary institutions have been non-Bumiputera. Most of the thousands of Bumiputera students abroad are believed to be government-funded, compared to only a small proportion of non-Bumiputeras.

### ***NEP Redistribution***

After the NEP's inception, the state's commitment and priorities — as reflected by NEP expenditure allocations — increasingly shifted away from poverty eradication towards restructuring (Jomo 1990). Only a small percentage of the Bumiputera population benefits significantly from restructuring expenditure, compared with the far greater proportion of the Malay population who have benefited from expenditure for those considered poor. There is

considerable evidence that only a fraction of poverty eradication funds actually benefits the poor, considering the huge bureaucracy and other expenses involved. The nature of poverty eradication expenditure also provide greater benefits to the non-poor, but there is no evidence that liberalization and privatization since the mid-1980s have improved poverty targeting as the pattern of public expenditure serves the interests of the ruling coalition in securing continued political support. Shifting the emphasis from poverty eradication to restructuring society probably tended to increase inequality within the Malay community.

The Malaysian government has already passed two opportunities (1991, 2001) to break with past policies in the interest of greater economic efficiency, more rapid growth and fairer distribution. It seems unlikely that the present ruling coalition will have the political will to make reforms in this direction if they threaten its political support. Instead, the government chose to continue the basic thrusts of the NEP with some changes, bearing Mahathir policy priorities, including greater emphasis on growth, industrialization and the emergence of Bumiputera Commercial and Industrial Community (BCIC) plus new names. This compromise formula sought to insert and assert Mahathir's priorities without overly threatening his UMNO following who are still yet to be weaned off the NEP. This process has been continued in 2001 with the announcement of a new National Vision Policy to coincide with the Third Outline Perspective Plan period (2001-2010), an obvious reference to Mahathir's Vision 2020, first enunciated in February 1991.

Whether or not the new government policy represents any significant departure from policy in the 1990s is difficult to gauge, but seems unlikely. In view of policy trends under Mahathir, which have mainly benefited the private sector, including foreign investors, there is little evidence of any significant advances in social policy to enhance the welfare of the majority. Unlike the first decade of the NEP in the seventies, when social policy – albeit primarily ethnic-oriented – became important, the last two decades have witnessed redistribution efforts, including privatization, increasingly captured by politically-connected Malay business and middle class interests while private sector promotion has primarily benefited politically well-connected rentier or crony interests, not necessarily only from the Malay community as more careful examination will reveal.

With privatization opportunities from the mid-1980s largely decided on a discretionary basis by the government leadership, there has been growing resentment and criticism of 'rent-seeking' and 'cronyism'. Such disbursement of privatization opportunities also strengthened the leadership's means for patronage, in turn encouraging competition for party and government political office and upward mobility. The selective nature of the 'bail-out' processes and procedures following the 1997-8 currency, financial and economic crises have strengthened, rather than undermined these tendencies.

### ***'Cronyism': From Privatization To Re-nationalization***

As we have seen, during the "hubris of the early [and mid-] 1990's when any grandiose idea was thought not only possible but also profitable" (Jayasankaran 2001), privatization proceeded rapidly. Well over 400 projects were privatized, ranging from power utilities, telecommunications, highways, ports, water, TV stations to rubbish disposal. Privatization reduced public sector employment, with over 97,000 employees, or 11.4 percent of the total public sector workforce transferred to the private sector by the end of 2000 (Matthias 2000). Privatization also increased capitalization of the Malaysian stock market and contributed to asset price bubbles, attracting massive inflows of foreign portfolio investments. The collapse of the ringgit -- together with other regional currencies -- from July 1997 accelerated the collapse of the stock market and property market bubbles, with tremendous adverse repercussions for financial institutions and other corporate interests.

Ironically, the popular impression that the privatization policy in Malaysia has been abused in practice to advantage a few politically well-connected business interests has been reinforced by its recent abandonment and virtual reversal in the aftermath of the currency and financial crises of 1997-1998. After some policy ambivalence between July 1997 and August 1998, the Mahathir administration undertook a series of policy measures which have had the effect of disproportionately saving and advantaging politically influential business interests popularly identified as 'cronies' (Johnson and Mitton 2001). Hence, the Mahathir policy regime in response to the crisis, especially the measures introduced in or implemented from early September 1998, is viewed as having given priority to 'bailing out' such 'cronies'.

The fate of Indah Water Konsortium (IWK) has become emblematic of the failure of privatization itself and is now 'widely considered the worst privatized project in the policy's 17-year history' (Jayasankaran 2001). In 1993, Vincent Tan's IWK was awarded a 28-year concession to own, operate and maintain more than 2,800 state-owned sewage-treatment plants nationwide. In turn, IWK promised to improve sewage-disposal system at a cost of over RM6 billion over two decades.

In an unprecedented civic action, hundreds of thousands of Malaysians signed petitions opposing the IWK privatization as their sewage bills ballooned. Consumers and businesses complained bitterly about IWK, while the media exposed gross abuses in IWK operations. IWK was apparently forced to reduce its tariffs twice, but only half its customers pay their fees. Several changes of ownership and management had little impact (Jayasankaran 2001). In June 2000, the Malaysian authorities finally paid over RM192 million to take over Prime Utilities Bhd, which controls Indah Water Konsortium (IWK), probably inheriting an estimated RM0.9-1.4 billion in debt, described as "clearly irrecoverable losses". Customers owe IWK another RM145 million, while IWK is supposed to spend over RM3 billion over five years to upgrade its treatment plants. Incredibly, although most observers agree that it would be almost impossible to make the company viable in the present circumstances, IWK may still go back to private hands, reflecting the government's continuing faith in the policy and the continuing influence of interested Malaysian business parties (Jayasankaran 2001). When the Malaysian authorities finally nationalized Indah Water Konsortium (IWK) in mid-2000, the minister in the Prime Minister's Department, Bernard Dompok claimed that IWK was a "special case" and that no other privatized entities would be taken over by the government. Indeed, the privatization policy has not been suspended or subject to critical review by the government. Hashim Ismail, the Ministry of Finance's parliamentary secretary, told Parliament on 7 August 2001 that the country had saved RM123 billion due to the policy, and had received another RM24 billion from the sale of equity and assets (Pillai 2001). According to Hashim, only 'three or four' of the 457 privatization projects had failed. According to him, without privatization, the impact of the 1997-98 financial crisis on Malaysia would have been far worse.

In late 2000, the government agreed to pay RM1.79 billion for the 29 percent stake in Malaysia Airlines System Bhd, owned by Naluri Berhad and controlled by Tajuddin Ramli. At RM8 per share, the government paid more than double MAS' market value of RM3.62 per share as at 20 December 2000, which was more than fifty percent higher than its share price a month before. The bailout eased Tajuddin's huge personal debts of RM999.4 million and Naluri's debt of RM888 million. Under Tajuddin's leadership, MAS had accumulated debt of about RM9.4 billion by the end of 2000 and had experienced six years of losses by the end of 2001, with forecasts no better for the near future (Matthias 2000) with the downturn in the world aviation industry after September 11, 2001.

The MAS bail-out was soon followed by the announcement of what would have been the biggest bailout of other failed privatizations, i.e. the proposed purchase of the light rail transport (LRT) assets of Putra, controlled by Renong, and Star, owned by the Employees

Provident Fund (EPF), British construction company Taylor Woodrow and other state-run funds, for RM6 billion (US\$1.57 billion). Projek Usahasama Transit Ringan Automatik Sdn Bhd (Putra) and Sistem Transit Aliran Ringan Sdn Bhd (Star) both operate LRT systems in Kuala Lumpur (KL) that have fallen far short of their optimistic passenger and revenue projections.

Then Finance Ministry advisor Mustapa Mohamad blamed the high development and upgrading costs of the LRT system and reduced passengers due to the economic downturn for the LRT problems (Matthias 2000). The government proposed to sell bonds with maturities of five to 15 years, at coupon rates of from 5.8 to 7.2 percent, to raise funds for the purchase. However, after the resignation of Finance Minister Daim in mid-2001, the terms of these 'nationalizations' are being reconsidered to ensure that they are less lucrative for the former minister's protégés who controlled the Renong group, which they have since lost control of. The third LRT system for KL was to be built by a company controlled by Vincent Tan. It was supposed to have built the third RM2.2 billion monorail project in exchange for his group securing the right to develop the Linear City project -- touted as the longest building in the world, on the banks of the Kuala Lumpur rivers and the space over them. By 1998, the government was being asked to take over the monorail project as the Linear City project became unattractive in the face of the property price collapse accompanying the financial crisis. This LRT has still not been completed despite receiving a special concessionary loan of RM300 million in mid-1998, i.e. well into the 1997-8 crisis.

Thus far, the privatization of public transport has cost the government RM15 billion, buying back privatized companies from the private sector with little loss to those politically well-connected (Pillai 2001). The government has acquired Malaysia Airlines (MAS) and the Renong conglomerate, and is likely to take over the two urban light-rail transit (LRT) systems for about RM9 billion ringgit (Jayasankaran 2001). The government also paid compensation of almost RM1 billion to the original Bakun hydroelectric dam project concessionaire when it cancelled the project in 1998 besides giving the concessionaire lucrative logging rights to the area.

### ***The Renong Group***

Renong Bhd emerged in the late eighties as the core listed company of the group that took over UMNO's assets after UMNO was declared illegal in a desperate attempt to preserve Mahathir's leadership of the party and the government after a court challenge by supporters of his opponent then, Tengku Razaleigh Hamzah. The group is led by Halim Saad, a protégé of UMNO Treasurer, former Finance Minister, Minister with Special Functions and Executive Director of the National Economic Action Council (NEAC), Daim Zainuddin. After the ruling party UMNO was dissolved by court order in early 1988, UMNO and government leaders often claimed that the new UMNO -- established in its place -- was no longer involved in business. The Renong group was said to no longer be under the control of UMNO, while clearly, the UMNO Supreme Council did not control Renong. Thus, for all intents and purposes, the holdings were the private property of Halim and other major shareholders, who were believed to be answering to Daim, who was UMNO Treasurer from mid-1984 until mid-2001. The Renong group was probably not accountable to UMNO as an organization in any way, and there is no evidence of it contributing to UMNO's finances, although it may well have contributed to the finances of certain UMNO leaders.

After the recent downfall of the Renong group, many observers now take the view that the Renong group's assets should not have been privatized in the first place. According to Prime Minister Mahathir in the late 1980s, the North-South Highway (NSH) was privatized to UEM on very generous terms to help UMNO pay for its then new building (the Putra World Trade Centre complex). The NSH has been the main 'cash cow' for the Renong group. In any

case, the UMNO building should have been more than paid for by now, but the Renong group continued to grow. There is no reason why the Highway should not have reverted to the Malaysian Highway Authority (LLM) or to the government in some other form.

In the late 1990s, the CDRC's bailout terms extended the toll concession by five years, albeit at slightly lower authorized toll rates, with a view to raising its value to its owner. Renong Bhd had submitted a bailout proposal -- prepared by Renong consultants, Credit Suisse First Boston (CSFB) merchant bank -- at great cost to the Malaysian government and public. The proposed deal implied the following:

The government would have to forego future tax payments by PLUS of RM4.5 billion, although the government had a large budgetary deficit and had cut public spending in general, including for health, education and welfare.

The government would transfer the RM824 million soft loan provided to finance completion of the Second Link from PLUS to Linkedua, who were unlikely to ever be able to pay back, while the Renong group would get to keep the 27,000 acres it received at a nominal price of just over RM1 per square foot to cross-subsidize the Second Link.

The government would guarantee RM8 billion in zero-coupon [meaning no income between the date of purchase and the date of redemption] bonds (likely to be sold to the EPF, etc., i.e. public funds under government control) to replace the Renong group's debts to lenders.

The government would extend the North-South Highway toll concession to PLUS.

The proposal claimed that the bailout was necessary because the Renong group owed around RM20-28 billion, i.e. accounting for more than five per cent of the loans by the Malaysian banking system. Without such a bailout, it was claimed, the Renong group's debts would put the Malaysian banking system under great stress. Even if this argument was true, the key question should have been: how and why did Renong rack up such a huge debt in the first place. Further, there were other ways of resolving the problem that duly punish -- not rewarded -- those responsible for the mess. The proposed bailout was against a clear principle of the NEAC's 1999 National Economic Recovery Plan, i.e. that culprits would not be allowed to get away without penalty; under the proposal, no penalty would be imposed on either the top management or the major shareholders of the Renong group.

Worse still, many benefits of the bailout would have gone to the Renong group's foreign creditors, to whom at least RM3 billion was owed. Furthermore, since many major shareholders of Renong and UEM were foreigners (often using nominees), the Renong group bailout proposal would benefit them as well. In short, Malaysian public funds would be used to allow the owners of Renong, including its foreign shareholders, to walk away with their asset value partly restored at public expense, and to pay off their creditors, including foreigners. Also, the proposal sought to 'nationalize' or 'socialize' the Renong group's debts and liabilities, while allowing Renong to retain its profitable privatized assets.

For example, the Second Link was not expected to be profitable in the short-term, but Renong had bid for it. As an inducement, the government gave the group more than 42 square miles of what is now valuable land around Gelang Patah. The CSFB proposal would have a proposed Infrastructure Development Corporation take over the Second Link, while the Renong group would get to keep the land, some of which it had already resold for more than RM10 per square foot, i.e. ten times the price it paid for it! Also dominant in the consortium that took over KTM, the peninsula's railway, Renong also suggested that the proposed IDC take over the generally unprofitable railway services while Renong and others would retain the lucrative railway land for itself.

The 1 September 1998 introduction of currency and capital controls provided the government with an opportunity to use monetary policy in particular and macroeconomic policy more

generally to stimulate economic recovery and to clean up the abuses of recent years. But it is now clear that this opportunity could also be abused, not only to bail out selected companies, but also certain well-connected individuals (Johnson and Mitton 2001).

The bailout measures are thus seen as complementing the privatization policy to advance or protect crony business interests. For critics, the privatization policy was never meant to serve the public interest, but was instead meant to enrich a well-connected few at the expense of the government and the public. With many of these beneficiaries in trouble due to the crises, they are believed to have lobbied senior government leaders for the government -- and the public -- to bail them out, by lowering interest rates, ensuring less onerous loan conditions, providing emergency credit facilities, taking over their debts and liabilities, and providing supplementary sources of revenue generation, while protecting the lucrative and profitable corporate assets and private wealth of the owners.

At the time of the announcement of the government takeover of MAS, then Finance Minister Daim Zainuddin denied any bailout in favor of Tajuddin and insisted that the MAS value was above the market price, and that MAS had good assets and potential. The price paid by the government was more than double the market price, which had risen mysteriously during the month before the government's announcement. Then Finance Ministry advisor Mustapa Mohamad made similar claims, citing the Asian financial crisis as the reason for the government's bailouts (Matthias 2000).

In mid-2001, UMNO Treasurer and Finance Minister Daim Zainuddin left the cabinet and resigned his party position. In the months that followed, some of the more generous bailout terms benefiting his protégés have been subjected to review and are likely to be revised to favor them less. The huge Renong conglomerate has been restructured with public funds used to take over UEM, which had come to control the Renong group after a controversial reverse takeover in November 1997. Other ailing enterprises closely associated with the UMNO leadership have also been reorganized under new management.

Far from penalizing the businessmen handed privatized entities on a silver platter, several have been 'rescued' from their failures with multi-billion ringgit bailouts at the expense of the government and the taxpayers. The bailouts often involve "conversion of private debt to public debt." Nationalization via government bailouts seems to have become an accepted means of taking over unprofitable privatized companies, as if confirming the widespread view that the privatization strategy has been to "privatize profits and socialize losses". Ironically, the main check on this trend may well be due to Daim's resignation, which is likely to limit bailouts of business interests associated with him, as those previously aggrieved by him are allowed by Prime Minister -- and once again, Finance Minister -- Mahathir to shape and influence public policy.

## Conclusion

Public policy from the late colonial period resulting in the emergence, growth and privatization of state-owned enterprises (SOEs) in Malaysia involved a combination of developmental and distributional concerns. However, there is considerable evidence of poor conceptualization, development and management of many of the SOEs by the 1980s. Ineffective accountability and budget constraints as well as poor incentives to encourage improved performance exacerbated the performance of many Malaysian SOEs. The complex circumstances for the emergence of SOEs suggest that privatization would be a rather blunt policy instrument for addressing the range of problems faced by Malaysian SOEs. This conclusion is reinforced by critical appraisal of the official rationale for the privatization policy. The following review of Malaysia's actual experience of policies pursued in the name of privatization raises further concerns.

The review of the efficiency consequences of privatization suggests that the actual achievements may have had more to do with organizational, managerial and incentive reforms, which do not require privatization as a precondition. While there have undoubtedly been many improvements in the quality of services provided, user costs have generally risen disproportionately higher, with obvious adverse implications for consumer welfare and distributional implications. The under-pricing of privatized SOE initial public offers (IPOs) has undoubtedly enhanced public support from direct beneficiaries, many of whom have been politically well-connected, at the state's and the public's expense.

Privatization advocates usually claim that enhanced efficiency will be achieved through the interaction of private ownership and competition. In the Malaysian context, however, privatization has not been accompanied by significantly increased competition. For example, MAS, Pos Malaysia Berhad, Tenaga Nasional Berhad, Telekom Malaysia, and MISC remain virtual monopolies.

In contrast to privatization, which conceptually only involves property rights, the broader concept of marketization – sometimes termed ‘commercialization’, or sometimes even more ambiguously, ‘economic liberalization’ – is understood not only to entail privatization, but also market liberalization, involving greater competition. Privatization is then expected to be accompanied by the relaxation or abolition of monopolistic practices, including statutory monopoly powers, such as those usually conferred on and enjoyed by public utilities.

Privatized entities are thus expected to face competitive markets or environments.

Competition may encourage more efficient behavior among private – as well as public – entities or companies, in order to achieve both productive and allocative efficiencies, unless increasing returns to scale are attainable.

In all these cases, the transfer of ownership from public to private hands has not involved reduced user costs or significantly enhanced quality of services. Instead, user costs have generally risen quite significantly, resulting in net consumer welfare losses. Hence, efficiency gains have not been significant, though they have nevertheless been exaggerated by proponents of privatization in Malaysia. And in so far as they have occurred, they are unlikely to have been the result of privatization *per se*, but have been mainly due to managerial and organizational reforms which do not require privatization.

There should instead be a comprehensive critical review of the public sector, including the statutory bodies and other SOEs, with a view to reform in order to enhance efficiency, cost-effectiveness as well as dynamic, equitable, balanced, and sustainable national economic development. Many SOEs had been set up ostensibly because the private sector was said to be unable or unwilling to provide the services or to produce the goods concerned. Such claims may still be relevant in some cases, no longer relevant in other cases, and perhaps never even true or relevant in yet other cases. And regardless of the validity of the rationale for their establishment in the first place, many SOEs have turned out to be problematic, often inefficient, frequently even failing to achieve their own original declared objectives or abused by those who control them for their own ends, and draining scarce public resources due to their ‘soft budget constraints’ and the very inertia of their existence.

But privatization is certainly not the universal panacea for the myriad problems of the public sector it is often touted to be. Privatization may be no more of a solution to the problems of SOEs than the SOEs have been a solution to the problems they were set up to overcome. In many instances, the problem of public enterprise is not a problem of state ownership *per se*, but rather due to the absence of explicit, feasible or achievable objectives, or even to the existence of too many, often contradictory goals. In other cases, the absence of managerial and organizational systems (e.g. flexibility, autonomy) and cultures supportive of and encouraging fulfillment of these goals and objectives may be the key problem. Privatization may facilitate the achievement of such organizational goals or objectives with the changes it

may bring about in train, but this does not necessarily mean that the fact of privatization is responsible for the improvements concerned.

In such cases, managerial and organizational reforms may well achieve the same objectives and goals, or even do better, at lower cost, and thus may be the superior option. However, the better option cannot be determined *a priori*, but should instead be the outcome of careful study of the roots of an organization's malaise. Such a critical review – with a view towards reform – should consider the variety of modes of privatization, marketization and other reform measures as alternative, sometimes complementary options in dealing with the public sector as it has evolved in Malaysia. With such an approach, privatization becomes one among several options available to the government for dealing with the undoubted malaise of the Malaysian public sector. This flexible approach seems superior to the still prevailing narrow dogmatic approach, which views privatization as the only – and presumably – best solution to the complex variety of problems faced by the Malaysian public sector.

The existing approach also neglects the persistent problems faced by the rest of the public sector not targeted for privatization, which may in fact require more urgent attention.

Ironically, their problems are probably more serious – which may explain the lack of private-sector interest in privatizing them – and hence in greater need of remedy. Furthermore, if the privatization policy succeeds in selling off the sector's most profitable enterprises and activities, the public sector will be left with uneconomic, unprofitable, and unattractive enterprises and activities, thus only confirming prejudices and charges of public-sector incompetence and inefficiency, besides worsening the public-sector deficit with the reduction of possibilities for cross-subsidization.

Unfortunately, however, there does not seem to have been any significant progress in checking the various problems that have emerged from the privatization process thus far, and in avoiding them in future privatizations. The entire privatization process itself seems to be beyond accountability, and the lack of transparency hampers the few who might still feel inclined to blow the whistle despite the onerous penalties for doing so.

The significant increases in consumer prices for privatized or soon-to-be privatized utilities, services and infrastructure have been reluctantly accepted by consumers without much public dissent, except in the case of the Cheras tolls just before the 1990 general election and the sewerage privatization to IWK in 1993. The staggered nature of such price increases as well as of the privatizations themselves limits the likelihood of coordinated mass protests against privatization. It is unlikely, however, that when the cumulative effects of these privatizations are finally realized at the public level, their political consequences may undermine the mandate to rule of those responsible. The ruling coalition in Malaysia constantly reshaped the political system and other rules, institutions and cultures to consolidate its continued incumbency and to co-opt and undermine political dissent and opposition.

Enhanced efficiency is traditionally conceived of as due to the interaction between private ownership and the competitive environment. Hence, a privatization exercise that merely involves selling a portion – even a majority – of the shares of a SOE to the public, but is not accompanied by greater exposure to market forces, may not bring about desired efficiency improvements. Conversely, efficiency gains may be achieved through other changes, e.g. management reforms, without any changes in ownership. Even improvements in capital resource allocation may be achieved by eliminating soft budget constraints, typically identified with, but not a necessary characteristic of, public sectors and strengthening management accountability, e.g. through greater organizational transparency.

In the case of Malaysia, therefore, desired improvements in efficiency and distribution may not be achieved through privatization, since there has been little evidence of increased competition associated with privatization. Some of the selected enterprises already privatized or expected to be privatized, are natural monopolies. Thus, if privatization merely involves

transforming a public monopoly into a private monopoly, consumer welfare may well be adversely affected. In such circumstances, even greater enterprise efficiency may not necessarily enhance consumer welfare, but only the monopoly profits accruing to the privatized enterprise. To evaluate the impact of privatization on the economic performance of an enterprise is not easy. In Malaysia, there is some uneven evidence suggesting improvements in various aspects of some firm performances following privatization. The problem here is that such improved performance may be wrongly attributed to changes in ownership *per se*, without any conclusive evidence of such causation. Efficiency gains, for instance, may well be due to other changes coinciding with, but not caused by, the change in ownership associated with privatization.

This is not to deny some efficiency gains accompanying privatization. However, the Malaysian experience suggests that the uneven and modest overall efficiency gains associated with privatization have been misleadingly attributed to privatization. Improvements in efficiency as well as service quality have been accompanied by disproportionately higher user costs, i.e. diminishing consumer welfare. This can be largely attributed to the retained monopoly status and poor regulation of privatized entities.

The review of recent distributional trends in income and wealth distribution, poverty reduction as well as NEP redistribution policy efforts suggests growing inequalities since the late eighties. However, such broad distributional trends cannot be attributed to privatization alone as many other contemporary factors and developments would also have had distributional consequences. Seen from a rent-seeking perspective, it is not surprising that many of those who had previously advocated and benefited from privatization, urged the government to nationalize their debt and liabilities in the aftermath of the 1997-98 financial crisis.

It might be argued that privatization has been an important means to enhance Bumiputera stock ownership, but there has been little increase of the overall Bumiputera share of corporate wealth since the mid-eighties, i.e. the period since the privatization policy was first implemented. Instead, there is now considerable evidence that privatization was an important means for enhancing the private wealth of the politically influential and well connected, and not just among the Bumiputera elite. It is not clear whether this was either necessary or desirable for improving inter-ethnic relations. After all, one could just as well argue such blatant aggrandizement by a few cronies resulted in the country's political crisis since mid-1998.

There is also little evidence that privatization has significantly enhanced growth. In fact, a case can be made that financial resources -- which may have gone into new productive capacities -- were diverted to buy over assets from the government at discounted prices, i.e. at the expense of the state and the public. Hence, there are few, if any, progressive distributional outcomes attributable to privatization *per se*.

This does not mean that it could not have been worse, as suggested by some commentaries about some Latin American or Eastern European experiences. However, there is little evidence that the government's retention of golden shares, limited privatization of minority portions to nationals and other checks on private power have been crucial to limiting possible abuse. Arguably, some checks and balances emerged due to some whistle-blowing -- despite considerable threats and intimidation -- by some opposition parties, non-governmental organizations and public intellectuals, with little help from a tightly regulated and owned media.

Notes

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- <sup>1</sup> Help and critical feedback from Dr Noorul Ainur and others are gratefully acknowledged with the usual caveat that they should not be held responsible for the contents of this paper.
- <sup>2</sup> However, it should also be pointed out that various criticisms have been made about official share distribution data. Besides the valuation problem raised by using nominal or par values which, it is claimed, especially underestimates the market value of Bumiputera corporate wealth, and underestimation owing to the use of nominee companies, the Malaysian government has not explained how share capital owned directly by the government and other bodies – such as Bank Negara Malaysia (the central bank) or the Employees Provident Fund – is categorized.
- <sup>3</sup> The holding agencies are organized under various Federal Ministries, the principal ones being the Ministry of Public Enterprises, the Prime Minister's Office, the Ministry of Primary Industries, and the Ministry of Regional Development. In addition, the Minister of Finance (Incorporated) holds equity directly in a small number of enterprises – in particular, those that have been partially privatized.
- <sup>4</sup> Although these fifty account for a major share of the sector by most economic criteria.
- <sup>5</sup> A value of 100 percent represents equal amounts of debt and equity capital in total long-term liabilities.
- <sup>6</sup> Which, as noted, captures financial data on only approximately 50 of the SOEs.
- <sup>7</sup> CICU data extend back to 1980, but cover only about 40 percent of the full SOE sample. Average enterprise performance indicators are applied to the full SOE sector (assumed to be 1,000 enterprises).
- <sup>8</sup> Where accumulated losses exceed paid-up capital.
- <sup>9</sup> This happened despite some official discouragement of Chinese investments and capital flight attributable to the Industrial Coordination Act, higher interest rates abroad as well as emigration and investments overseas ('exit') due to Chinese frustrations in Malaysia. The resilience of Chinese capital should not be underestimated, however.
- The decline in ethnic Chinese political influence after the 1960s has resulted in various responses and initiatives, varying with the specific interests concerned. From 1985, some of the more politically inspired initiatives were exposed as business scams dependent on political patronage or protection, exploited by politicians and businessmen for their own selfish ends. These exposures have further undermined the already seriously eroded position of the Malaysian Chinese Association (MCA), the second most important party in the ruling coalition. Despite its sizeable share of the economy, Chinese capital has limited control over the financial (banking, etc.) sector and the 'commanding heights' of the traditional capitalist sectors (international trade, primary production), which have mainly been taken over from foreign (especially British) capital by the state, ostensibly for the Malays.
- <sup>10</sup> The high concentration of share capital ownership within each ethnic community was almost definitely understated in the case of the ASN during the 1980s, and the ASB since then. Although well over two million Bumiputeras were involved by the late 1980s, the vast majority had invested RM500 or less, while about 1.3 percent of all eligible Bumiputeras owned 75 percent of all ASN shares!