

ECONOMIC REFORM POLICIES: THE MALAYSIAN EXPERIENCE

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The Malaysian economic policies are designed to increase growth, reduce poverty, and improve governance. Under the "New Economic Policy" (NEP) the objectives were to eradicate poverty and to redistribute wealth. The characteristics of the implementation processes of the NEP was that of government's intervention through direct involvement in the economic activities and commercial sector. Through the NEP years, the economic performance was among the best in the world. This paper describes the distinct features of the Malaysian economic policy and how they are moving forward. The analyses are based on various studies and are presented into two stages. First, the understanding of the key elements of the policies and the implementation processes, and second, on the effectiveness of policy.

Introduction

Malaysia is a heterogeneous, multi-ethnic, or plural society. Its present population is 27 million with a composition of Malays and other indigenous group) 1 (55%), Chinese (36%), Indian (8%), and others (less than one percent). The Malays, being the largest group, is politically dominant but has far lower average income and wealth than the Chinese minority.

Malaysia is a federation of thirteen states and three federal territories directly administered by the federal government. Each state has a titular head. In West Malaysia, these are the hereditary Malay sultans (collectively known as the Rulers), except Melaka and Penang, which have an appointed governor, as do the East Malaysian states of Sabah and Sarawak. The supreme head of state, the Yang di-Pertua Agong, is selected from among the Rulers and serves a five year term. The heads of state have only symbolic powers. The Malay Rulers, however, are responsible for some general issues, mainly protecting the

¹ categorized as the Bumiputeras or sometime referred as "sons of the soils". Groups officially recognized as indigenous include the Malays of Peninsular Malaysia, a small number of aborigines in the peninsula, and most of the non-Chinese ethnic groups of Sabah and Sarawak.

status of Islam, and have occasionally intervened in the political process. The Malaysian Federal Constitution is broadly modelled on Western liberal models, enshrining basic freedoms of speech, religion, assembly and so forth.

Since gaining its independence from the British Colonial Administration on August 31, 1957, Malaysia has put serious efforts to develop its own nation in all sectors generally in political, economic, and social aspects. Prior to 1970, Malaysia's development policy was primarily aimed at promoting growth with a strong emphasis on the export market. Although the economy grew very rapidly during this period at an annual average of 6.0 per cent, there was insufficient emphasis on distributional aspects, resulting in socio-economic imbalances among the ethnic groups with negative social consequences in the form of a racial riot in 1969.

This paper describes and analyses the process of policy formation in Malaysia. The paper focus on the New Economic Policy (NEP). It first looks at the historical setting of Malaysia. It then looks at the distinct features of the NEP and how it is moving forward. The analysis are based on various studies and put in two stages. First, the understanding of the

key elements of the policy, and second, the assessment of long term issues based on the effectiveness of policy. The last section is the concluding remarks.

Historical Setting

In order to understand the development of the economic policy process in Malaysia and to situate the discussion, it would be useful to provide a glint of the country's history.

Malaya (as Malaysia was then known) gained its independence from the British in 1957. In 1963, with the inclusion of Singapore and the Borneo territories of Sabah (formerly British North Borneo) and Sarawak, the new Malaysian Federation was formed. Singapore's membership of the federation was short-lived, however, and the island was expelled from Malaysia in 1965.

At independence, the population of Malaya was 10 million, almost evenly divided between the indigenous Malays and the immigrants: 50 percent indigenous or Bumiputera, 37 per cent Chinese and 12 per cent Indians and 2 per cent category of others. The formation of Malaysia in 1963 (when, Sabah and Sarawak and Singapore joined the Federation of the Malay States) had resulted in a large increase in the Chinese population. With the expulsion of Singapore in 1965, the population was balanced with 55 per cent Bumiputera while non-bumiputera amounted to 44.5 per cent (Chinese 34.1 per cent, Indians 9.0 per cent, and others 1.4 per cent). The Malays are homogenous. They are Muslim and speak Malay. The Chinese and Indians on the other hand are internally divided along religious, linguistic, and cultural lines. Among the Chinese, some are Christian, whilst some are Budhists, Confucianism, and Taoism. The Indians are mainly Hindu and some are Muslim. The Chinese and Indians are heterogenous culturally and linguistically.

A large number of Chinese speak Hokkien, followed by Cantonese, Hakka, Teochiu and other smaller groups with its own spoken language and customs. The Indians are mainly Tamil, but there are also Malayalee, Telugu and Sikh communities.

Prior to independence, the Malaysian economy was based primarily on agriculture and mining. Trade was the largest contributor to Gross Domestic Products (GDP) with gross exports amount to 50 per cent of GDP, whilst manufacturing and construction contributed minimally. Businesses were mainly monopolized by the foreigners who control 65-75 per cent of export trade and 60 - 70 per cent of import trade. Foreign companies also controlled 60 per cent of tin output while the remaining 40 per cent were under Chinese ownership. Bumiputera business were virtually non-existent, even a decade after independence.

Under the British colonial system of "divide and rule," which was designed to preserve the British interests in the country, particularly in securing the economic wealth, the Malays had been mainly in rural areas and largely engaged in agriculture and fishing. The few Malays who were in the urban areas were employees of the government. On the other hand, Chinese and Indian (immigrants) labour forces were imported to work in economically productive sectors. Chinese labourers were imported to work mainly in urban areas, employed in the modern economy, engaged in mining, industry and commerce, whilst the Indian labourers were employed on plantations. As a result of the implementation of such system, it had created a composition of working sector based on race. The non-Malays, particularly the Chinese were dominant in small- and medium scale trade and as proprietor of tin mines, and white collar employees of foreign enterprises. The Malays were predominant in the

bureaucracy, a result of the British policy of regarding Malays as the legitimate rulers of the country (Crouch 1996).

Therefore the process to independence then was not just the negotiations between Malaya and its colonial masters on geographic boundaries but also the internal negotiation between the major ethnic groups. Initially, the British had planned for a 'Malayan Union' - the creation of a unitary state system with *jus soli* citizenship rights for all residents irrespective of ethnic group and a minimal role for the Malay monarchy. However, the plan faced resistance from the traditional Malay elites and the Malay peasantry, through the formation of the United Malays National Organisation (UMNO), which has remained the predominant political force for the Malays ever since. A federal system then was devised, and in the 1957 constitution, it enshrined the independence 'bargain' or the Malay "special rights" whereby the Chinese would accept Malay dominance of the political sphere in return for a guarantee that their business activities would not be undermined. With that, the newly independent Malaya then had to deal with the Citizenship rights for the immigrant population and their descendants, the official language, the status and role of Islam and the Malay sultans which were all contentious issues that could give rise to intra-ethnic tensions.

After independent, social economic imbalances among races had turned to be more serious issue. Efforts and strategies² by the government to help develop Bumiputera

² Such as setting up agencies like Rural and Industrial Development Authority (RIDA) to help Bumiputera participation in business by providing them with access to credit facilities; Federal Land Development Authority (FELDA) a development scheme for opening up, developing and distributing land to peasants who did not own land for the cultivation of cash crops mainly rubber and oil palm. Strategies like awarding business licenses, government employment and educational access also met with limited success.

capitalism were not successful. Since the mid-1960s, the government had been contending with a growing Malay interest groups who felt that little is done to their weak economic position despite their "special rights." Nonetheless, although the Malay discontent at their economic status was welling, inter-ethnic tensions during the early 1960s were kept under wraps (Means 1970). However, at the 1969 general election, the Alliance 3 performed badly, winning less than fifty percent of the vote, although it was able to retain its parliamentary majority. It lost to the opposition party that drew support primarily from the Chinese and Indian communities, which seemed to be a threat to the multiethnic but Malay-dominated coalition. From the viewpoint of the rural and poor Malay community, this was a disaster, since control of government was seen as the essential counterbalance to economic inferiority. On May 13, 1969, 'victory celebrations' by the Chinese opposition parties and counter demonstrations by government supporters who were largely Malays, flared into racial riot which lasted for days.

The government responded by declaring a State of Emergency. The parliament was suspended and instead, a National Operations Council was installed, headed by the Deputy Prime Minister Tun Abdul Razak. The government sought ways to reassure the Malay constituents (Lee and Heng 2000; Ratnam and Milne 1970). The government argued that the root cause of the May 1969 riots had been the economic disparities between the Malays and the non-Malays, a legacy of the colonial administration and its

³ Prior to independence, UMNO forged a coalition with the Malaysian Chinese Association (MCA), and later the Malaysian Indian Congress (MIC) to create the Alliance, which defeated a range of more multiethnic unitary parties to form the first government. The Alliance, an ethnically-based political parties represent the three main communities.

policy of 'ethnic division of labour'. In an attempt to reverse this, the government introduced the first Outline Perspective Plan. Through the NOC and the Department of National Unity (DNU), a government agency under the direct control of the NOC, undertook to formulate the New Economic Policy (NEP) and introduced new post-riot political systems with a national ideology, "Rukunegara" (literally "pillars of the nation").⁴ The NEP had two ostensible goals - the complete eradication of poverty, and the eradication of the association between ethnic group and economic role.

Following the racial riots of 1969, the Federal Constitution was amended to allow for the designation of 'sensitive issues', on which public criticism of government policy is prohibited. These issues are: (a) The power and status of the Malay Rulers (i.e. the constitutional State monarchs); (b) Citizenship rights of non-Malays; (c) Malay 'special rights' and privileges; (d) The status of Islam as the official religion; and (e) The status of *bahasa Melayu* (Malay) as the national language. Theoretically, it is legally possible to question the implementation of these policies, but not the policies themselves.

The NEP

The launching of the New Economic Policy (NEP) in 1971 was a watershed in the Malaysian economic policy history. It was essentially a statement of goals to be achieved over a 20-year period (by 1990). The objectives of the policy were two "prongs." The first was "to reduce and eventually eradicate poverty irrespective of race through raising income levels and increasing employment opportunities for all Malaysians," and the second "to accelerate the process of restructuring Malaysian society to correct

⁴ refer to Faaland et al. (1990), and Puthcheary (1990).

economic imbalance, so as to reduce and eventually eliminate the identification of race with economic function." The overriding goal was national unity. The NEP highlighted the importance of achieving socio-economic goals alongside pursuing economic growth objectives as a way of creating harmony and unity in a nation with many ethnic and religious groups.

The second "prong" in turn consisted of two concrete objectives, namely: (a) employment was to be restructured by sector and occupation, to eliminate the "ethnic division of labour" that had been created in colonial times; and (b) the ownership and control of wealth was to be restructured. Specifically, the Malays were to hold 30 percent of corporate sector assets by 1990, compared to their current share of 2 percent; Chinese and Indian Malaysians were to hold 40 percent, while the foreign share was to be reduced from 65 percent to 30 percent.

While the NEP concentrated on these two particular forms of "racial economic imbalance," as a redistribution plan it alluded to broader goals: "the process involves the modernization of rural life, a rapid and balanced growth of urban activities and the creation of a Malay commercial and industrial community in all categories and at all levels of operation, so that Malays and other Indigenous people will become full partners in all aspects of the economic life of the nation." The goals of the NEP were to be reached in the context of economic growth and that no one was to suffer any loss of a job, income, or business.

The NEP ended in 1990. The continuing programme is the Second Outline Perspective Plan (OPP2) (1991-2000). On June 17, 1991, the new main national policy was established named as National Development Policy (NDP) to replace the NEP for the next ten years. NDP

is less explicitly ethnic, nonetheless it is to continue the momentum of NEP (Loh 2001; Loh 2002). The Plan would continue the process of eradicating poverty and restructuring society. In terms of equity ownership restructuring goals, the NDP does not have any numerical targets for achievement within its term. "While there will be no specific quantitative targets set to be achieved during the OPP2 [Second Outline Perspective Plan], the target of a least 30 per cent bumiputera participation will continue to guide the strategy for the restructuring of the corporate sector" (Malaysia 1991b, p. 115). The issue that is of high priority is Bumiputera participation policy. The Plan is to establish strong and capable Bumiputeras in business.

The Implementation Processes of the NEP and the Enforcement Systems

The NEP was published in 1971 in the form of the Second Malaysia Plan, 1971-1975 (Malaysia 1971). It was implemented over a 20 year period, from 1970-1990, through four Malaysian Plans i.e Second Malaysia Plan (1971-75), Third Malaysia Plan (1976-80), Fourth Malaysia Plan (1981-85) and Fifth Malaysia Plan (1986-90). It is essentially an affirmative action programme or 'Malay first.' As stated earlier, the NEP set out two major goals. The first was the eradication of poverty irrespective of race, and the second was the restructuring of Malaysian society. The basic idea of these goals and objectives was to lift up the economic positions of the bumiputera whose economic positions were historically inferior due to the held back during the colonial period, to that of Chinese and other ethnic groups in Malaysia. This basic idea was made explicit through the two objectives of the restructuring program, namely, the restructuring of employment patterns and the

restructuring of ownership in the corporate sector.

The objective of restructuring employment patterns was to "ensure that employment in the various sectors of the economy and employment by occupational levels will reflect the racial composition of the country" (Malaysia 1973, p. 9). This policy was specifically intended to encourage preferential employment of bumiputera in professional occupations and modern industrial sectors. The employment structure which originated in the colonial period had confined Malays to rice farming, fishing, and other specific occupations. The Malaysian government hoped that by 1990, the racial composition of employment in each occupation would be changed to correspond to the racial composition of the country, and the NEP would enabled the Bumiputera to be employed in professional occupations and modern industrial sectors. In order to achieve this goal, the government intervened in the labour markets and introduced an ethnic quota system into higher education.

With regards to the objective of restructuring of ownership in the corporate sector, the Malaysian government maintained the issue of equity ownership restructuring high on its priority list to enhance the economic and social position of Malays. The goal set was to increase equity ownership share of Malays to 30 per cent, and this formula served as a guideline in other areas of 'Malay-first' policies (Khoo 1995, p. 104).

During the NEP period, implemented various restructuring plans to narrow the economic gap between the ethnic communities. It established new policies, namely the industrialization policy and privatization policy. Under these two policies, the private sector was to be the engine of growth whilst the public sector provides the enabling

environment. The aim was to transform the nation's economic base to boost Malaysians and foreigners to participate in the Malaysian corporate sector since the NEP had stipulated that 30 per cent of public-listed companies should be owned by Bumiputeras. Government-owned enterprises were also increased in all sectors of the economy (Gomez and Jomo 1995). Among the government agencies established to accelerate Bumiputera participation in commerce and industry were Perbadanan Nasional Berhad or National Corporation (PERNAS) and Permodalan Nasional Berhad or National Equity Corporation (PNB).

During the Third Malaysia Plan (1975-1980) the government introduced new strategies to spur the economic growth of the Bumiputera community by encouraging more Bumiputera to engage in government projects and provide generous credit assistance.

The most salient feature in the implementation of the NEP was the government's direct involvement in economic activities through various forms such as direct intervention into the market by state administrative agencies and the establishment of joint ventures using state funds.

The second feature was that state intervention was expanded from agriculture and rural development as in the 1960s into the industrial and commercial sectors. The emphasis was on fostering bumiputera entrepreneurs in the commercial and industrial sectors.

The third feature was the establishment of systems for the creation of individual Malay shareholders as a means to achieve goal of restructuring equity ownership in favor of Malays. This program was carried out in two stages— first, the introduction of the

Petroleum Development Act (PDA) in 1974 and Industrial Co-ordination Act (ICA) in 1975, and second, the establishment of the Perbadanan Nasional Berhad (PNB) and Amanah Saham Nasional Berhad (ASNB) in 1978.

The ICA aimed to strengthen state control over Chinese as well as foreign capital. The PDA was intended to establish unitary state control over oil resources. The ICA of 1975 contained measures to compel individual enterprises in the industrial sector to live up to NEP requirements. The ICA made it mandatory for all enterprises above a certain size, upon applying for a manufacturing license, to present to the government written information which detailed their business activities. The government's intent was to use the manufacturing license as leverage to get enterprises to reorganize themselves to comply with NEP requirements which prescribed ethnic rules for capital structure, composition of employment in various occupational categories and the promotion of bumiputera companies. The ICA possessed strong enforcement powers which previous legislation and policies lacked.⁵

The second was aimed at increasing the share of equity ownership held by Malay individuals. Three agencies were established for this purpose: Yayasan Pelaburan Bumiputera (YPB, Bumiputera Investment Foundation), Permodalan Nasional Berhad (PNB, National Equity Corporation), both established in 1978, and Amanah Saham Nasional Berhad (ASNB, National Unit Trust Scheme), which was set up the following year.

Performance

There are many ways of measuring the achievements of the NEP. A narrow focus on specific quantitative goals would indicate a

⁵ See Snodgrass 1980, p. 211; Jesudason 1989, p. 54).

very substantial progress, although NEP exceeded its targets in some areas and only partially achieved in others.

Broadly speaking, since 1970, Malaysia has gone through several robust economic developments. Its economic performance through the NEP years was among the best in the world. Real GDP growth has been constantly average at 7.5% a year. Per capita income soared from US\$370 in 1970 to US\$2,400 in 1990. The incidence of poverty was reduced, life expectancy rose, and infant mortality decreased. Its real GNP per capita grew at an average of about 4.2 percent from 1970 to 1990. However, like other economies, Malaysia has its ups and downs. The growth rate was lower in the 1980s than in the 1970s. In an international context, according to the World Bank's World Tables 1992, the average growth rate of Malaysia's real GNP/head in 1970-90 was 4.2 percent and Malaysia was placed tenth among 126 nations with populations of one million or more. In the 1980's through to 1990s, just before the East Asian financial crisis, Malaysia was dubbed the "East Asian Miracle" (World Bank 1993). By the 1990s the then Prime Minister, Mahathir Mohammad was focused on "Vision 2020," a plan to push Malaysia to developed-country status by that date.

Poverty eradication

The target to eradicate poverty was a clear-cut, impressive success (Jomo 1990). According to official definitions, nearly half (49.3 percent) of all households in Peninsular Malaysia lived in poverty in 1970. Twenty years later, Official estimates record a decline to 15.0 percent in Peninsular Malaysia (Malaysia 1986:85; 1991:46), which exceeded the first Outline Perspective Plan's original target of 16.7 percent. The official figure for Malaysia as a whole in 1990 is 17.1 percent.

Restructuring to correct economic imbalance

Restructuring in the employment.

The number of Bumiputera working in the industrial sector (mining, manufacturing, construction, utilities and transport) in Peninsular Malaysia soared from 173,000 in 1970 to 918,000 in 1990. Similarly, Bumiputera employment in the service sector went from 213,000 to 1.2 million. These totals substantially exceeded Outline Perspective Plan (OPP) targets. The numbers of Bumiputeras school leavers and graduates increased. Bumiputeras are represented in professional and technical and in service occupations (mostly in government employment) and almost proportionately represented in clerical work. However, these broad occupational groups do not fully reflect the breakdown into high-, middle- and low-level employment. They remain seriously underrepresented in administrative and managerial positions and in sales work. They are also still significantly under-represented at the higher levels of the private sector.⁶ As reported in the Sixth Malaysia Plan, Bumiputeras have had considerable success in entering the private sector, but they are predominantly at the lower levels.

In the public sector, a substantial number of Bumiputera are in the high-level jobs. And this reinforced further the "Malay-dominated" sector, whereas the objective is to reduce the number of Malays in the sector. Somehow, the non-Malays do not seem to be attracted to work in the public sector.

Restructuring of corporate ownership and wealth

This is the most controversial targets of the NEP. Official figures, indicate Bumiputera

⁶ Sixth Malaysia Plan 1991-1995 (Kuala Lumpur: Government Press, 1991), p. 35.

(mostly Malays) ownership share of 20.3 percent in 1990. Although it is an impressive achievement, as compared to the starting point of 2.4 percent in 1970, it is still short of the 30 percent target. This increase was largely due to the involvement of the massive network of trustee agencies on behalf of Bumiputera individuals such as Pernas, MARA, and UDA and other related institutions that had been created, that actually accumulated the capital. Further, the simultaneous increases in the Bumiputera and non-Bumiputera shares were made possible by a sharp decline in the foreign ownership share, from 63.3 percent, one of the highest in the world, in 1970 to a much more moderate 25.1 percent in 1990.

The actual level of ownership held by Bumiputera was around 8.2 per cent (Fazilah 2002). Nonetheless, the wider implications of the NEP were that by early 1990s there were more Bumiputera corporations in the corporate sector. However, with the recession in the mid-eighties, the growth of Bumiputera ownership had slowed down due to their limited resources, cutback in the activities of the trust agencies as well as the more liberal policy guidelines on equity ownership.

Quality of life

Malaysia generally performed well in terms of life expectancy and education and health measures. This is supported by other social indicators such as the fall in the infant mortality rates from 39.4 per thousand live births in 1970 to 13.5 in 1989, the rise in school enrolment from 88.2 per cent to 98.9 per cent and the rise in life expectancy from 61.6 per cent to 69.0 per cent for men and from 65.6 per cent to 73.5 per cent for women (Malaysia 1991:44). According to the Human Development Index developed by the United Nations Development Program

Malaysia ranked fourth in the world in terms of improvement in the HDI between 1970 and 1990.⁷ The quality of life improved so much that by 1990 Malaysia ranked somewhat higher according to the HDI than it did according to per capita income.

Besides economic restructuring, a significant change was also recorded in the structure of the economy. Agriculture fell from 31 percent of GDP to 19 percent. Industry rose from 25 percent to 42 percent. The percentage of workers who identified themselves as farmers fell from over 50 percent to 26 percent, and many of the farmers who remained in 1990 derived a significant share of their income from non-agricultural activities. Manufacturing sector grew from a small share of total exports in 1970 to more than 60 percent in 1990. Rubber and tin, the main commodity for exports in 1970, fell to about four percent and one percent respectively in 1990. In Peninsular Malaysia, only 22 percent of employment was in agriculture, forestry, hunting, and fishing in 1990. Very few young people are entering rural occupations. It looks like Malaysia is set to be an industrialized society by the year 2020.

It is thought that Malaysia's political system which had significant continuity had undoubtedly facilitated the relatively smooth adjustment process that characterized the NEP. A major cause for concern when the NEP was first adopted was the expanded opportunities for rent-seeking that were opened up by the greatly enlarged role of government. While there existed rent-seeking and corruption that accompanied the implementation of the NEP, it is recognized that they did not prevent the achievement of the broad social goals discussed earlier.

⁷ United Nations Development Programme, Human Development Report 1992 (New York: Oxford University Press, 1992), p. 24.

Conclusion

The focus of the NEP had been social issues, mainly poverty eradication, distribution of income among the poor Bumiputeras, and improvement in asset ownership among Bumiputera and human resource development. In essence, the NEP served as the catalyst for Bumiputera to participate in the economic sector. The outcome of the NEP implementation showed that a. Eradication of poverty yielded a commendable performance; b. the equity ownership share of bumiputeras improved to 20.3 per cent although the actual individual Bumiputera ownership was only 8.2 per cent. The figure fell short of the target figure of 30 per cent. However, the result is the emergence of a Malay middle class and new Malay entrepreneurs; and c. Quality of life had improved, as reported in the HDI; and c. the structure of the Malaysian economy changed significantly, from agricultural-based to industrial-based economy. Many studies recognized that these achievements under the NEP were facilitated by the significant continuity of the Malaysian political system.

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