

MAHATHIR'S ECONOMIC POLICY LEGACY¹

In mid-1981, Mahathir Mohamad took over as Prime Minister of Malaysia and as president of UMNO. Mahathir's assumption of national leadership coincided with the unfolding of various developments, most notably global economic recession and declining prices of primary commodities. The increased expansion of public expenditure in the early eighties was not only counter-cyclical in intent, but also attempted to make up for declining private investment, both domestic and foreign.

Under Mahathir's leadership, however, the continued expansion of public sector spending, especially via non-financial public enterprises (NFPEs), or off-budget agencies (OBAs), developed an added significance. More than any previous prime minister, Mahathir has sought to transform Malaysia into a newly industrialising country (NIC) under genuine Bumiputera (indigenous) entrepreneurial leadership. In this sense at least, Mahathir is an economic nationalist.

Mahathir's development strategy was not merely imitative. However contradictory, incoherent and faulty they may have been, the various economic development policies during his tenure represent serious efforts, in circumstances not of his own choosing, to modernise and transform Malaysia into an NIC. Mahathir's economic policies appear somewhat incoherent for reasons to be considered later. They have also been circumscribed by NEP expectations (even after 1990), and hence subordinated to wealth restructuring considerations, especially in favour of politically well-connected Bumiputeras.

The policies are widely presumed to reflect some ideas already expressed or formulated in his earlier speeches and writings, especially in the controversial *Malay Dilemma*, as well as the interests and suggestions of the politically influential businessmen close to him. Nevertheless, Mahathir succeeded in securing broad social and political support for his policies, especially his Vision 2020. The improved electoral fortunes of the Barisan Nasional among the non-Bumiputera electorate since then may well have their roots in the statement's apparent departure from the NEP

For better or worse, Mahathir can be credited with the major innovations in development policy since 1981, of which the Look East policy, heavy industrialisation, 'Malaysia Incorporated', privatisation and the 1998 national economic recovery strategy involving capital controls have been the most significant. Some of the other policies considered here include the 70 million population policy (by the year 2100, presumably to create a larger Malaysian market, from 16 million in 1984) and the National Agriculture Policy (first announced in 1984, and then revised in 1993, and again, in 1998).

The heavy industrialisation policy involved greater state intervention, with public enterprises setting up heavy industries as joint ventures with major Japanese (and Korean) manufacturers with the help of low interest official Japanese credit facilities. While the pro-natalist policy has had serious implications, e.g. for Malaysia's social services as dependency ratios rise, its relationship to his other economic policies is more tangential. However, all indicators suggest that the target will not be attained as birth rates continue to drop, even among Muslims, albeit at a slower rate. And while Mahathir was personally

involved in drafting the first (1984) National Agriculture Policy, which sought to promote more commercially viable smallholder agriculture, he has demonstrated little subsequent interest, except perhaps in matters relating to biotechnology.

The NEP and the Mahathir Legacy

Vision 2020, which pulled together various elements already in place and added a few others, was articulated at a fortuitously good moment of national exuberance and confidence following recovery from the recession of the mid-1980s. While the NEP claimed to provide a new social contract, it enjoyed greater support from the indigenous (Bumiputera) community, especially from the Malays, who were expected to be the primary beneficiaries of both poverty reduction and inter-ethnic redistribution measures associated with the NEP. Non-Bumiputeras reluctantly accepted the NEP as a necessary cost of citizenship, civil peace and personal as well as property security, especially after the events of May 1969, which are portrayed as spontaneous ethnic riots due to prior Malay economic deprivation.

This quasi-official version of 13 May 1969 has been subsequently invoked for similar purposes, principally in support of 'Malay dominance', UMNO hegemony, 'Bumiputera special privileges', and ethnic, religious or cultural discrimination, often associated with the NEP. Needless to say, this version ignores the popular rejection of the ruling coalition in the May 1969 general election by a majority of Malaysians (including half the Malays), the preceding increase in economic inequality and unemployment during the 1960s, as well as the subsequent UMNO 'palace coup' against the first Prime Minister.

Not surprisingly, therefore, Mahathir could not simply replace the NEP with his own economic agenda for the nation when he first took office. The NEP provided too much of a legitimating ideology for UMNO hegemony, with Malay hegemony being a legitimating ideology for the NEP, and the NEP necessary to securing that hegemony. Moreover, the expectations generated by the promises of the NEP – of increased government intervention for rapid economic advance and expanded opportunities -- could not be ignored, but instead had to be pandered to if he was to retain political dominance in national and party elections. NEP implementation in the 1970s itself had brought about major changes in the composition of UMNO's elite as well as Malay society. The emergent business interests of the UMNO elite required the legitimating ideology of Malay hegemony to underpin UMNO's claim to representing Malay interests.

In any case, for the sake of his regime's political legitimacy, he needed to allow the NEP to run its course until 1990. By associating the NEP with the first Outline Perspective Plan (OPP) for 1971-1990, Mahathir sought to end the NEP in 1990 by associating the successor ten-year OPPs with successor policies, namely the National Development Policy with the second OPP for 1991-2000 and the National Vision Policy with the third OPP for 2001-2010 without any explicit repudiation of the NEP. This also provided a decent interval for a transition that could not be faulted as being illegitimate in so far as the NEP was ostensibly still in place.

Many of Mahathir's early policy initiatives failed to garner widespread popular support from the outset. The Look East policy was ambiguously received, and eventually faded

away, although this is sometimes denied by Mahathir and his sycophants. Mahathir's heavy industrialisation policy is generally acknowledged to have been ill conceived, even by proponents of industrial policy and heavy industrialisation. The state initiated heavy industries, funded with Japanese loans that ballooned in ringgit terms from the mid-1980s, helped precipitate the economic crisis of the mid-eighties (Jomo 1990). Its flagship Proton project is likely to be significantly restructured following a decent interval after his tenure is over, while the Perwaja steel plant will be written off as an expensive mistake without much proper accounting or lessons drawn. Though the Malaysia Incorporated policy was well received by Chinese and foreign business interests, others were largely indifferent to it. The predominantly Malay bureaucrats probably correctly perceived it as the beginning of their new subordination to politicians and business interests, but they failed to organise effectively in their own interest.

On the other hand, growing popular resentment and frustration with the public sector contributed to some popular acceptance of privatisation, especially as employee interests were generally protected in the major privatisations. While the interests of the nation, public, consumers and employees were increasingly marginalised, privatisation was managed by the government to retain popular support, e.g. by keeping rates down. Also, despite obvious problems, if not failures, the government continues to make mainly misleading claims about various supposed gains from the policy.

By the time of the announcement of the new post-1990 policies in early 1991, the post-1986 economic recovery had already been sustained for about four years. Thus, the economic policy changes of the mid-eighties – initially announced as necessary compromises in the face of economic crisis -- were reiterated and consolidated as part of broader strategy or vision to build a new Malaysia. Hence, Vision 2020 has come after – rather than before – the major adjustments of the mid-eighties. In the process, what were once portrayed as compromises or necessities, have been recast as virtues, as part of Mahathir's new national development ideology.

It needs to be emphasised that Malaysia did not experience some of the very painful economic problems which other less fortunate economies of the South experienced in the eighties and nineties. For instance, Malaysia has never really suffered from severe capital shortages, and the authorities did not really borrow very heavily from abroad until the early eighties, ironically when liquidity was tighter and real interest rates were higher than in the late 1970s. And unlike some other late borrowers (e.g. India), its spending, and hence borrowing binge soon came to an end by the mid-eighties. Malaysia has also had tremendous natural resources to call upon, and a relatively small population among which to distribute these.

The making of Malaysian economic policy under Mahathir has underscored the relative autonomy of the executive, as reflected in his ability to virtually, if slowly, abandon policies that had enjoyed significant support and generated considerable expectations. Mahathir effectively discredited these policies by referring to them as having sustained a 'subsidy mentality'. He has also effectively used and deployed the enhanced autonomy and resources at the disposal of the executive to great political advantage, in the process bringing about the partial and selective economic liberalisation so much favoured by big business interests as well as international economic agencies.

The difficulties of introducing potentially unpopular economic measures in the mid-eighties were partly eased by the appointment of Daim Zainuddin as Finance Minister in 1984. As Daim had limited political ambitions, he was quite willing to take responsibility for measures that an appointee with more political ambitions might have preferred to avoid. Without any personal political base in the party, he owed his position to Mahathir, and was hence politically insulated from the party and from others critical of or opposed to the economic reform measures.

There continues to be a great deal of speculation about Mahathir's relationship with Daim. There is much to suggest that Mahathir has long been appreciative of Daim's apparent loyalty, often attributed to his lack of personal political ambition. It appears that Mahathir was generally appreciative of Daim's seeming 'can do' capabilities, with Daim's apparent eye for talent and for grooming competent and loyal executives. Also, after getting the economy into serious trouble with his own heavy industrialisation follies and related fiscal and debt problems, Mahathir may have been grateful for Daim's apparently successful economic management in getting Malaysia out of the 1980s' recession and beginning a decade-long boom². Daim's role as UMNO treasurer from 1984 until 2002 and suspected overseer of party and personal interests linked to the two has been the subject of much speculation over the last two decades and may perhaps be the most important bond between the two men.

When the economy went into a tailspin because of the regional financial crisis in mid-1997, Daim was brought back into overt economic policy-making. Although his own early recommendations in late 1997 concerning macroeconomic policy were even more contractionary – and hence, arguably more 'pro-IMF' -- than Anwar's of December 1997, loyalty to Mahathir was the key issue. With the benefit of hindsight, it is now clear that when Soeharto abruptly resigned in May 1998, a week after he had been in Cairo with Mahathir, the fate of Anwar – who had been reluctant to acquiesce to policy rule changes in November 1997 favouring the UEM-Renong conglomerate believed to be under UMNO control – was sealed (Jomo [ed.] 2002).

Chequered Legacy

When the Malaysian Prime Minister retires in October 2003, it will be the end of an era. Mahathir's presence in Malaysian politics has been overwhelming. One obvious reason, of course, has been the length of his tenure – Mahathir has been premier since mid-1981, and will have led the government for well over two decades.

Another important reason has been the demise of rivals, real and imagined. His first deputy, Musa Hitam, left in early 1986 after less than five years as Deputy Prime Minister in the government. His Finance Minister until 1984, Tengku Razaleigh Hamzah challenged him for the leadership of the ruling UMNO, and narrowly lost under suspicious circumstances in 1987. His long-time ally, protégé and heir designate, Anwar Ibrahim, was sacked as Finance Minister and Deputy Prime Minister, and removed from the ruling party in September 1998 in a manner apparently intended to permanently eliminate him politically. Not surprisingly then, many have observed that, in numerous ways, Mahathir became a caricature of the party and the government leader he so eloquently criticized in his *Malay Dilemma* (Mahathir 1970).

But while observers may debate his greater political authoritarianism over time, his economic policy legacy is far more complicated. Bowie (1991), in particular, claimed that there was a cumulative tendency towards greater state interventionism due to increasing Malay political ascendance from the seventies. One can discern three almost distinct periods or epochs in economic policy-making. While economic policy-making has been far from coherent or consistent, Mahathir's major policy turns may well have been pragmatic responses to economic crises and challenges – often of his own making. Much of this volume highlights flaws, abuses and other problems associated with specific policy initiatives associated in the public mind with his leadership.

But it would be too easy and analytically erroneous to simply dismiss them as quixotic or whimsical, or as only being intended to aggrandise those close to him, although there are many anecdotal examples of both. While there is considerable evidence that Mahathir often intervened to 'help' business interests close to him, giving credence to the popular charges of 'cronyism' and 'nepotism', it would be a mistake to reduce his many policy initiatives to such motives. There is good reason to believe that he did so due to a flawed conviction that such interventions have been necessary to create, incubate and accelerate the emergence of Malaysian 'captains of industry', including, but not exclusive to, a strong Bumiputera commercial and industrial community (BCIC).

The three phases may be distinguished as follows:

1. *1981-1985*: Greater state intervention to promote heavy industrialisation and sogososhas, associated with his 'Look East' policy to emulate Northeast Asia, especially Japan and South Korea.
2. *1986-1997*: New incentives for foreign direct investment, especially in desired export-oriented industries; selective economic and cultural deregulation; partial privatisation; stock market promotion, with greater prudential banking regulation after the late 1980s' banking crisis.
3. *1998-2003*: Once again, the government intervened in an unorthodox counter-cyclical fashion to induce economic recovery after the 1997-98 regional currency and financial crises, and then to try to sustain economic growth in the face of a more adverse international economic environment.

Each phase can be seen as involving responses to a preceding crisis, but also as envisioning a new stage and type of development. Mahathir became Prime Minister in mid-1981 as the world economy slowed down in the wake of oil price hikes of the late 1980s and the recession induced by interest rate increases after the appointment of Paul Volcker as chairman of the US Federal Reserve Bank in 1980. Primary commodity prices tumbled as demand for manufactured exports fell. For a year after his elevation, Mahathir seemed to endorse Finance Minister Razaleigh's counter-cyclical pump-priming efforts to turn the economy around by increasing public spending.

However, after winning the general election in April 1982 to secure legitimacy, Mahathir embarked on an 'austerity drive', cutting government spending and putting state-owned enterprises (SOEs) under closer scrutiny. This was accomplished while ensuring generous funding of his heavy industrialization drive and other favoured projects, mainly in construction. Government sponsorship of heavy industries was construed as part of a

second round of import substitution, unlike the first round in the 1960s, which had seen the emergence of foreign- (mainly British-) owned industries producing consumer goods for the increasingly protected domestic market. Often involving joint-ventures with Japanese firms, Malaysia began borrowing heavily from abroad, primarily from the Japanese government, at very low interest rates. Thus, Malaysia's foreign debt built up primarily to finance these heavy industries as much of the rest of the developing world found itself in the throes of (sovereign) debt crises.

This reversal of public sector expansion and increasing government intervention was consolidated and accelerated by Mahathir's appointment in 1984 of Daim Zainuddin as Finance Minister – and UMNO Treasurer – to replace Razaleigh after the latter's second unsuccessful challenge to Musa Hitam for the party deputy presidency. Not surprisingly, given the strong association of policy with personality, and Daim's very low-profile operating style, there is continued speculation, to this day, regarding how much is to be attributed to Mahathir, as opposed to Daim. However, since Mahathir is not given to delivering speeches that are diametrically opposed to what he believes, there is considerable evidence to suggest that Mahathir probably endorsed and approved the economic policy changes – including apparent policy reversals – associated with Daim, including regressive fiscal (tax and spending) reforms, public expenditure cuts, privatisation, deregulation and financial liberalisation. In any case, Mahathir's strong commitment to private enterprise had already been made quite clear by the mid-1970s (Mahathir 1976).

Just as the first period was not just one of growing state intervention in the form of government spending or regulation, the second period was also not simply a headlong rush to economic liberalization in line with the Washington Consensus. The new investment regime introduced in the mid-1980s sought to reduce the disincentives associated with the 1975 Industrial Coordination Act and other regulations associated with the inter-ethnic wealth redistribution objective of the New Economic Policy (NEP). The 1986 Promotion of Investments Act not only sought to encourage export-oriented manufacturing investments, but also reduced the insulation between export-oriented and domestically oriented production. More importantly, the new investment regime sought to encourage higher value-added industries, skill development and technology upgrading, though technology development policy often progressed by trial and error (Jomo and Felker [eds] 1999).

A confluence of factors came together to ensure a decade of rapid growth and structural transformation from 1987. Given the rapid build-up of its foreign debt in order to finance the heavy industries, the Malaysian monetary authorities had little choice but to allow the ringgit to depreciate against the US dollar after it was decided in the second Plaza Hotel meeting of September 1985 that the greenback should depreciate against the yen. Indonesia had three major devaluations from 1983, while Thailand devalued in 1984. Thus, Malaysia's yen-denominated sovereign debt doubled in ringgit terms as the Malaysian authorities sought to secure competitiveness through devaluation. As the yen and the currencies of other first generation newly industrialising economies appreciated, Japanese and, later, Taiwanese and, to a lesser extent, Korean and other industries relocated to Southeast Asia and China. This relocation was often done also to overcome

labour shortage problems. Thus, all three Southeast Asian economies experienced a decade of rapid growth before the great collapse of 1998.

However, Malaysia's strong economic recovery at the end of the 1980s could not head off the banking crisis that had been building up since the 1985 recession, with commodity price collapses and the bursting of property and stock market bubbles. By 1987 and 1988, almost 30 per cent of loans from commercial banks were designated 'non-performing'. The 1989 Banking and Financial Institutions Act (BAFIA) and other stricter prudential regulations from the aftermath of this debacle were to later protect Malaysia from a more severe crisis in 1998. Private interests needed to secure central bank approval to borrow from abroad, e.g. by satisfying the monetary authorities that the borrowed funds would generate foreign exchange earnings in order to reduce potential currency mismatch problems.

However, following economic recovery from the late 1980s, other financial reforms pursued financial liberalisation. These reforms concentrated especially on stock market development. Renewed stock market promotion seemed to ignore the problems of the mid-1980s that had culminated in the banking crisis of the late 1980s. Thus, while more prudent and stricter banking regulation and supervision limited Malaysian exposure to (private) foreign borrowings, Malaysian corporations, especially favoured ones associated with 'cronies', were very highly leveraged. To make things worse, commercial banks lent generously, inadvertently fuelling property and stock market bubbles, which burst in 1997 with devastating effect.

It has become popular to blame the 1997-98 regional crises on cronyism and other related abuses in the region. However, despite the obvious popular appeal of such an attribution, it lacks sound analytical and empirical bases. These problems undoubtedly exacerbated the region's problems and compromised policy responses to them, but failure to recognize the true roots of the crises runs the risk of not learning lessons from the calamity. Tragedy becomes farce the second time round. Rather, it is now generally acknowledged that the crises were due to systemic factors exacerbated by financial liberalisation. Since the destruction of the Bretton Woods system in 1971, the world monetary and financial system has developed in an ad hoc fashion, with little overall regulation and supervision to check against bias, abuse and systemic failure.

Malaysia had become vulnerable even though it was less exposed than Thailand, Indonesia and Korea. This happened to Malaysia because of the far greater role of easily reversible portfolio investment inflows in its relatively much larger stock market. With the reversal of confidence in the region, capital inflows into the country were slowly reversed at the end of the first quarter of 1997, before momentum picked up with the floating of the Thai baht in July. The Prime Minister's valiant, but quixotic attempts to stem the outflow only exacerbated the rush for the door. To make matters worse, he also seemed overly anxious to protect cronies from the crisis, as well as from some consequences of their own earlier excesses. Such complications exacerbated the growing divergence between Mahathir and Anwar on matters of policy. It is likely, though, that the break became irreconcilable when the former suspected the latter of fomenting a palace coup against him, the plausibility of which has been disputed elsewhere (Jomo [ed.] 2001: Introduction).

In hindsight, Mahathir's recovery package was probably too late, flawed, biased (towards those interests he favoured) and, arguably, unnecessary. Nonetheless, its basically counter-cyclical thrust (as opposed to the IMF's and the market's pro-cyclical preferences) and its emphasis on capital flow management (reversing earlier commitment to capital account convertibility, considered sacred by economic orthodoxy) were basically correct. Introducing capital controls 14 months after the crisis began, after stock market de-capitalization by over three quarters, was not very useful – unless there was likely to be further haemorrhaging due to yet another crisis, as Kaplan and Rodrik (2000) have argued. However, it would also be unfair to fault Mahathir for introducing radical measures in early September 1998, after the Russian crisis in August. No one then could have foretold the US Federal Reserve's lowering of interest rates and initiative in organizing a private sector bail-out for LTCM after its crisis became public knowledge in September 1998. The Fed's interest rate policy response succeeded in strengthening and stabilizing East Asian currencies as well as reducing interest rates in the last quarter of 1998.

It is now also apparent that the funds and mechanisms created by the government to restore banking liquidity, manage non-performing loans, re-capitalise banks, and restructure the banking system and major conglomerates have been biased and abused to varying degrees in practice, if not in intent. Billions of ringgit of debt were taken over by the government, with apparently little adverse consequences for the borrowers, apparently because some were said to have incurred such debt while performing 'national service'. Previously privatised assets have been 're-nationalised' at well above market prices, again with no apparent penalisation. Thus, cronies are cynically said to have been doubly 'blessed' – first, when they were chosen to benefit from privatisation, and then, by being allowed to 'walk away' virtually unscathed – at public expense.

But such abuses do not detract from the fact that these funds and mechanisms did also serve to restore liquidity, although hardly as much as desired by the authorities. Government spending – as well as good luck, in the form of increased demand for electronics (especially from Korea and Malaysia) and the conclusion of 1998's El Nino drought – also helped ensure a strong economic recovery in 1999 and 2000. The Korean recovery, despite onerous IMF conditionalities, was stronger, probably due to sturdier domestic industrial capacities and capabilities. Although the Thai recovery was less impressive, interest rates fell below Malaysian rates in the fourth quarter of 1998 despite IMF program requirements. Hence, it is difficult to make an unequivocal case that the strong Malaysian recovery was due to its unique recovery program. But the evidence also does not allow the converse case to be made – contrary to the dire predictions of the market prophets of doom.

Despite the strong recoveries in 1999 and 2000, Malaysia has continued to run large budget deficits, presumably to sustain the recovery. However, economic growth has slumped since then, owing to continued Malaysian reliance on and vulnerability to external conditions. The end of the Clinton-era boom and the continuation of economic lethargy in Japan and in much of Europe have dampened economic recovery in Malaysia's still very open economy. Post-crisis policy declarations of domestic-led growth have not gone much beyond continued public spending, especially on

construction projects, perceived cynically as yet more ‘jobs for the boys’. Meanwhile, the prospects for continued export-oriented growth are increasingly seen as problematic, with the rise of lower cost producers with competitive skill endowments, especially in China.

A balance sheet for the Mahathir era suggests that he has much to answer for. His penchant for expensive, prestigious construction projects is well known. These include the new administrative capital of Putrajaya, with the Prime Minister’s palatial official residence at its centre, the Kuala Lumpur International Airport (KLIA) and the F1 Grand Prix race track at Sepang, the Petronas KLCC (Kuala Lumpur City Centre) Twin Towers, and the Daya Bumi, among many others. He has also been associated with very expensive speculative failures, most notably the massive buying of sterling before its collapse in September 1992, which was reflected in heavy central bank losses in 1992 and 1993. Another well-known failure was the effort to corner the tin market in the early 1980s, which resulted in immediate losses of well over half a billion ringgit, and eventually, incalculable losses due to the collapse of that market (Jomo [ed.] 1990).

Corporate losses absorbed by the government over the last two decades have also reached new dimensions. The steel corporation Perwaja is probably the most spectacular failure, with losses exceeding RM10 billion by the mid-1990s. Before its acquisition by the Bank of Commerce, Bank Bumiputra Malaysia had been re-capitalized several times to the tune of several billion ringgit. There is yet to be a careful accounting of the losses associated with the privatisation and re-nationalisation exercises of the mid-1980s. Public assets were sold at a discount, chiefly to the politically well connected, but also to the general public, in order to secure popular support for the policy. Many were virtually re-nationalised after failing to perform, with the beneficiaries generally paid well above market prices to more than cover their costs and expenses. In short, profits and profitable assets have been privatised, while losses and liabilities have been socialised – through ‘bail-outs’ at public expense – with the cronies bearing minimal risk.

Despite this poor track record, it would be unfair to dismiss the Mahathir economic policy regime as an unmitigated disaster, not only because there is little convincing evidence that the policies were solely, or even principally motivated by self-aggrandisement except perhaps for some notable exceptions. Despite all the flaws and abuses, the Malaysian economy is now very different than in 1981, and arguably more robust, although not resilient enough to weather the massive global economic restructuring now taking place. Many critics, however, would insist that the same cannot be said of his long time ally, Daim Zainuddin – for whom Mahathir should bear responsibility. Nonetheless, Mahathir probably has to be accountable for his flawed policies, which he seems incapable of acknowledging and withdrawing. Also, he has to answer for policies that were abused despite supposedly noble intentions, as many such abuses have long been well known, but have remained largely unchecked.

Many would also challenge the desirability of public policy to aggrandise a select few, apparently to accelerate the creation of ‘captains of industry’. There is little evidence that the government’s additional tax revenue from privatisation has more than compensated for the value of the discounts and other direct and indirect official support to beneficiaries of the privatisation policy. Ironically, for someone who has attacked the ‘subsidy mentality’ among the poor who expect government subsidies and support, Mahathir has

not had similar criticisms for cronies and others expecting government intervention on their behalf, e.g. in the wake of the 1997-98 crisis. In fact, he has publicly defended such 'bail-outs' and other public assistance as being in the national interest and supposedly necessary for economic recovery and future development.

Hence, the ambivalence of many analysts about the Mahathir economic policy legacy. While they appreciate his recognition of the need for investment and technology policy interventions to accelerate Malaysian economic growth and structural transformation, reflected for example by the Industrial Master Plan and other documents (Jomo [ed.] 1993; Jomo and Felker [eds] 1999), they also view these efforts to have been severely compromised by whimsical, as well as other poorly conceived interventions. Such public action has generated considerable cynicism about and opposition to industrial policy and other policy interventions, often believed to be intended to benefit cronies. Mahathir's willingness to adopt heterodox counter-cyclical policy measures to induce economic recovery and create conditions for sustained growth after the 1997-98 crisis deserved support. Yet, one cannot defend either the bias and abuse associated with the implementation of these policies, or the Prime Minister's failure to adopt and pursue appropriate policies to sustain subsequent development, instead of mainly creating more 'jobs for the boys' through fiscal deficits. Sadly for Mahathir, it seems likely that the baby will be thrown out with the bathwater when his economic policy record is subject to critical scrutiny.

It also seems probable that the new regime will revert to a combination of NEP-type ethnic preference policies and neo-liberal economic policies regarding other matters. The former will be seen as necessary in order to retrieve ethnic Malay political support, but it is also probably reflective of heir apparent Abdullah Badawi's intended political and financial base. After all, Abdullah will take office with only limited and conditional access to the ruling party's finances, which were re-organised beyond accountability to the entire party leadership after the party crisis in the late 1980s.

And in so far as many abuses associated with the Mahathir era have been blamed on his public policy interventions, it is quite likely that neo-liberal economic orthodoxy, preferred by financial markets and most academically-trained economists, will become much more influential in his absence. An uncritical adoption of neo-liberal orthodoxy at a time when its theoretical and practical soundness has come under increasing scrutiny and during a period of major global economic re-structuring may well prove disastrous for Malaysia. The circumstances of the transition have been such that it may be quite some time before Abdullah will be able to assert himself in terms of public policy, as Mahathir's long shadow forces him to continually look over his own shoulder.

This Volume

The subtitle of this book -- *Mahathir's Economic Policy Legacy* -- will be provocative to some people. There are those who will disagree with such a subtitle for reasons that should be discussed. Thankfully, there are a few who still claim that Prime Minister Mahathir Mohamad has not really formulated most of the economic policies implemented under his premiership, and that therefore the title of this book is inaccurate.

There is also the view that government economic policies under Dr Mahathir's leadership have merely been an extension of the New Economic Policy (NEP) and other earlier

economic policies, e.g. industrialisation policies, before he became Prime Minister. Such views often assume that the policies were inevitable. Another view suggests that these economic policies have been introduced and implemented in an ad hoc fashion, and therefore lacking the coherence suggested by the title.

Some observers also feel that the economic policies pursued under Dr Mahathir's leadership merely reflect the economic philosophy³ he enunciated in his famous book *The Malay Dilemma* and in several other writings and speeches from the sixties and seventies. It is also often observed that policies implemented since the early 1980s have served to protect and advance certain business interests, which seem to have had a strong and growing influence over the making of national economic policy. This view is often linked to developments associated with 'money politics' and implies that the policies were merely due to such political and economic interests and developments.

There are undeniable grains of truth in all these objections. However, it cannot be denied that the most important changes in the ruling Barisan Nasional's economic policies under his stewardship have been inspired by Dr Mahathir, or have at least been approved by him, regardless of whether they actually originated from him. Although the NEP and other earlier economic policies are still being pursued, it cannot be denied that Mahathir's economic policy innovations have had tremendous impact, for better or for worse.

The NEP under Mahathir has been quite different from the NEP in the seventies under the leadership of his two predecessors. The Razak and Hussein administrations in that decade were characterized by a tremendous expansion of government intervention and of the public sector. This expansion seemingly continued in the first half of the 1980s with state-led heavy industrialization under Mahathir, only to be reversed with partial liberalization and privatisation from the mid-1980s, apparently in response to the 1985 recession.

And as the first part of this introduction has argued, Mahathir's economic policies can be seen as pragmatic – even if flawed – responses to economic problems and crises as perceived by him. This does not deny his preference for private interests and his efforts to re-subordinate the bureaucracy through 'Malaysia Incorporated' and other similar policies. Yet, ironically, the public sector's contribution to gross domestic capital formation has increased unevenly from 18 per cent in 1970 to 31 per cent in 1980, 35 per cent in 1990 and 50 per cent in 2000.

It also cannot be denied that there have been several differences, if not contradictions between earlier government economic policies and the Mahathir government's economic policies. For example, even though Dr Mahathir launched policies opposing British economic interests and denounced neo-colonialism and economic imperialism, the Malaysian government continued to depend on foreign investment. In fact, after three decades, Britain was once again the leading source of foreign direct investment (FDI) in Malaysia in 1998, except that most of the new British investments after the 1997-98 crisis consisted of 'fire-sale' acquisitions, rather than 'green-field' FDI. During his tenure, and especially after the mid-1980s, reliance on foreign investments grew once again, with enhanced incentives that implied proportionately fewer net benefits to Malaysia.

Promotion of the stock market, often by Mahathir himself, attracted volatile foreign portfolio or equity investors who fled in late 1993 and again from mid-1997 with devastating consequences. Under Mahathir, Malaysia's trade openness also increased dramatically despite his rhetoric about increased self-reliance and the desirability of barter arrangements. Despite his strident nationalist rhetoric, the value of external trade in relation to economic output – a common indicator of economic openness -- almost doubled over his long tenure from 1981.

While these high proportions in fact reflect the considerable reliance on intermediate inputs in manufactured exports from the country, they also underline the distance between rhetoric and reality on the one hand, and the extent to which he has often been misunderstood, both by friends and foes, on the other. Hence, while Mahathir has been sharply critical of Western governments from time to time, he has always sought to differentiate them from Western business interests, whom he has been in the main ready to embrace whole-heartedly. And while the 1998 currency control measures undoubtedly discouraged short-term portfolio investments initially, the decline of foreign direct investment into Malaysia since 1996 has not been exceptional, contrary to the claims of some of his ill-informed critics. Foreign direct investment, especially of the green-field variety, has declined throughout the world, with the notable exception of China, since the late 1990s, and there is little hard evidence that Malaysia has been particularly penalised for its 1998 control measures.

Since most cronies were not 'captains of industry' in any serious sense, technological dependence has also increased as Malaysia failed to develop many new internationally competitive indigenous technological capabilities despite much hype and rhetoric to the contrary (Jomo and Felker [eds] 1999; Jomo, Rasiah and Felker [eds] 1999). Strengthened intellectual property rights, as well as a consolidated form of monopoly power in an age of ostensible liberalisation, have not only reduced technology transfer, but also raised the costs of such undertakings. Limited Malaysian industrial and technological capacities and capabilities in the face of FDI dominance have therefore meant limited private investment in research and development (R&D) despite Mahathir's pleas and government incentives to the contrary.

On the whole, Mahathir's economic policies from the early 1980s sought to transform Malaysia into a newly industrialised country (NIC) with a Bumiputera capitalist class. Some of his economic policies have aimed to create more Malay millionaires, promote Malays in the modern capitalist sector, control labour, and overcome the colonial economic legacy. Even though there has been some continuity and consistency between his earlier convictions and later policies, the ideas underlying his economic policies have been more comprehensive, developed and coherent.

The 'Malaysia Incorporated' and privatisation policies clearly influenced the nature and direction of economic policy in general, as well as implementation of the NEP and the role and nature of the public sector, particularly the efforts to achieve 30 per cent Bumiputera equity ownership target. Also, recent domestic-led growth policies or earlier heavy industrialisation have influenced the entire industrialisation effort, which previously placed greater emphasis on export-oriented production. Meanwhile, the

various versions of the National Agriculture Policy (NAP) since 1984 have attempted to develop agriculture on a more commercial or capitalist basis, and with a greater market orientation.

The emergence of ‘money politics’ and other phenomena that reflect the close relationship between political power and business opportunities have evidently been related to state intervention in the economy and the centralisation of power during the Mahathir years, but the relationship is more complex than is often assumed. Certain influential groups have undoubtedly enjoyed more opportunities and benefits thanks to Mahathir’s economic policies. Nevertheless, it is not useful to presume that all these economic policies have merely been pretexts and means to enrich a select group of influential individuals and corporate interests. While ‘cronyism’ and, arguably, ‘nepotism’ have come to characterise some aspects of government-business relations, it would be analytically erroneous to reduce all government-business relations to ‘money politics’, collusion, corruption or rent-seeking.

This book contains articles that try to critically understand many of Mahathir’s economic policies and their implications. We attempt to understand his economic policies, not only individually, but also more holistically. This volume begins with Mahathir’s 1983 memorandum summarising his major early policy innovations, including the effort to emulate Japanese work ethics, the Malaysia Incorporated policy, privatisation, and the attempt to bring about a ‘clean, efficient and trustworthy’ administration through ‘leadership by example’.

After various, often grandiose, interpretations of the Look East policy were given by an assortment of enthusiastic supporters, including some anxious to take advantage of the new policy initiatives for their own ends, and adverse reactions came – for varying reasons – from a broad range of groups, Mahathir claimed, in the mid-1980s, that all he really wanted from “looking East” was for Malaysians to be more productive by adopting work ethics from Japan and South Korea. Chandra Muzaffar’s (1983) suggestion that it “is easier to obtain enthusiastic acceptance of a certain value like hard work if it is presented as an Islamic virtue” did not fall on deaf ears, and this ‘work ethic’ later became the central element in the government’s subsequent policy for the assimilation of Islamic values.

Though perhaps unintended, implementation of the Look East policy proved to be a windfall for many Japanese and Korean economic interests. The policy, in fact, facilitated the penetration of various sectors of the Malaysian economy by Japan’s interests – Japan’s ‘second invasion’ for the somewhat paranoid. Giant Japanese and South Korean construction companies – facing difficulties in the Middle East after the oil bust, the Iranian Revolution and the outbreak of the Iran-Iraq war – successfully secured major building contracts in Malaysia in the early and mid-eighties. This constrained and even undermined the development of the local construction industry, as these foreign companies were given new leases of life by the windfall contracts secured in Malaysia (Chang Yii Tan 1985).

The term ‘Japan Incorporated’ was coined to reflect Western anxiety from the 1960s in response to the perception that the Japanese state strongly supported private capital’s

expansion in the world economy. This close relationship between the Japanese government and private business incurred the ire of competitors, especially in the West. The Japanese economic miracle attracted much attention in the West, with resentment focussing on supposedly 'unfair' Japanese competition, considered as key to its miracle (Lee Poh Ping 1985).

The Malaysian Airlines System (MAS) workers' industrial action during 1978-79 will probably go down in history as the most important watershed to have shaped Mahathir's labour policies. Their actions drew the ire of Mahathir, then Deputy Prime Minister and Minister of Trade and Industry, who was seen as responsible for the harsh actions against the unionists and their supporters, the subsequent de-affiliation of MAS workers from the Airlines Employees Union, and the establishment of an in-house union instead, as well as subsequent amendments to the labour laws in 1980. Union membership declined from the early eighties, while unemployment rose and real wages fell through the early and mid-1980s, until the 1988-97 boom improved workers' fortunes.

The AFL-CIO (American Federation of Labour-Congress of Industrial Organisations) attempted to persuade the US Congress in 1988 to consider withdrawing Malaysian privileges under the Generalised System of Preferences (GSP). This forced the Malaysian government to release Malaysian Trades Unions Congress (MTUC) secretary-general V. David from ISA (Internal Security Act) detention without trial following Operation Lalang against various dissidents in October 1987. The government was also forced to allow workers in the electronics industry to form unions, albeit only on an in-house basis.

The new population policy announced by Mahathir sought to achieve a target population of 70 million by the year 2100, presumably because such a large domestic population was supposed to provide a market large enough to ensure the success of the heavy industries he desired. Of course, this logic is dubious since market size is determined not only by population size, but also by the level and distribution of income, and hence, purchasing power. Meanwhile, the government insisted on maintaining the low-wage policy inherited from colonial times. Efforts to accelerate population increase – whether by increasing the birth rate or by encouraging immigration – have strained available public services, employment opportunities and scarce domestic economic resources.

The first National Agricultural Policy (NAP), announced in early 1984, emphasised efforts to increase farmer incomes by increasing their productivity, changing their crops and improving agricultural management. The NAP de-emphasised food security, instead encouraging cash crops for export. Meanwhile, the government sought to redress the problems of uneconomic-sized farms and idle land by promoting mini-estates, which mainly benefited those already owning more land. Efforts to overcome land hunger, redistribute land ownership, reduce the burden of land rents and provide land to the tiller were not considered at all. Even the cooperative movement was de-emphasised, while commercial agricultural management was expected to resolve the problems of peasant agriculture.

Malaysia's industrialisation efforts since Merdeka -- including the role of foreign investment -- have changed over time. For a decade since the end of the 1950s, the government encouraged import substitution, which attracted investment by foreign

companies wishing to take advantage of government protection as well as other incentives and policies. These factories had close ties with their parent companies, though rarely with other Malaysian industries, thus limiting the linkages and multiplier effects of such industrial growth. Later, the export-oriented industrialisation policy of the 1970s succeeded in attracting labour-intensive industries wishing to employ docile cheap labour, but these too established limited links with local industries.

The development of heavy industries in Malaysia had initially been promoted by Dr Mahathir while he was Minister of Trade and Industry as well as Deputy Prime Minister in the late seventies, and was stepped up after he became Prime Minister in 1981. The new heavy industries neither balanced nor complemented existing industries. On the contrary, the projects have become heavy burdens on the Malaysian economy, requiring heavy funding and massive protection. These heavy industries were financed with low interest loans from Japan, which doubled in ringgit terms with the mid-1980s' currency realignments, thus exacerbating the mid-1980s crisis. Unlike their Korean counterparts, however, these heavy industries have not become internationally competitive, but instead have become great albatrosses stifling the development of the Malaysian economy.

Proton was originally developed to acquire motorcar or automobile production technology and to promote ancillary industries in order to develop a Malaysian car industry. Initially, the Malaysian car project depended heavily on two related Mitsubishi companies, which reaped handsome profits – from supplying the production and assembly technology, 60 to 70 per cent of parts, and various services, such as body stamping, painting, training and professional services as well as patent and other fees – regardless of whether or not Proton lost money.

Even though Proton has survived and has been seemingly profitable since the 1990s thanks to tremendous government protection and support, the economic burden of the project on the Malaysian economy has been considerable. As the likelihood of the Malaysian economy developing an internationally competitive car industry remains in grave doubt, the project is likely to continue to burden the Malaysian economy and people. Already, the ASEAN Free Trade Area (AFTA) has been delayed due to Malaysian government insistence on a deferred schedule to extend protection for Proton. Yet again, Petronas funds have been used, not only to bail out Proton, but also to finance the expansion of its production capacity with the building of a new factory with a half million per annum capacity in Proton City which will effectively triple Proton's total capacity. In light of Proton's sluggish export growth since the early 1990s, it is unclear whether this new capacity will ever be profitably utilized.

Although often flawed, many of Mahathir's economic policies reflected his desire to transform Malaysia into a newly industrialising country (NIC). However, the poorly conceived and badly integrated initiatives of the eighties imposed a terrible economic burden on the Malaysian economy and people, exacerbated by unfavourable international economic developments. The first Malaysian Industrial Master Plan (IMP) for 1986-95 acknowledged many weaknesses of the manufacturing sector in Malaysia, and suggested the importance of a more coherent alternative (Jomo [ed.] 1993). The IMP was never seriously implemented as it was overtaken by desperate official efforts to revive

economic growth and industrialisation after the mid-eighties' recession and currency realignments.

Early in the eighties, the government had attempted to offset the effects of the global recession by increasing national public expenditure. Because of the impending election of a new UMNO Deputy President in mid-1981, and the coming April 1982 general elections, 'vote-buying' also contributed to increased public expenditure. In June 1982, the government turned around to launch an austerity drive two months after the ruling Barisan Nasional coalition's electoral victory in April. Subsequently, external borrowings – primarily to finance off-budget agencies (later called non-financial public enterprises) mainly involved in heavy industries – rose rapidly until 1985 (Jomo 1990). The Malaysian economic recession in the mid-1980s was thus the result of several developments, especially the world economic recession, commodity price declines as well as the fiscal and debt crises caused by foreign borrowings to finance the heavy industries.

Perhaps reflecting his ambiguous attitude towards so-called market forces, Prime Minister Mahathir sought to corner the tin market in the first half of the 1980s in an attempt to reverse the sliding prices of tin. In a secret operation only exposed half a decade later, the authorities set up a company -- using workers' pensions funds from the Employees' Provident Fund (EPF) – to trade on the London Metal Exchange (LME), relying on the advice of some dubious international commodities traders. The scheme collapsed at great cost to Malaysia when the LME changed its trading rules to let contracting suppliers off the hook with small fines after failing to deliver metal as promised. The rule change meant that the main premise of the attempted tin market corner -- to secure monopolistic rents and higher tin prices -- was gone. The EPF was most prominent among those who ended up paying this bill, for which there has been no full and proper public accounting to date. This spelt the end of the Malaysia's tin mining industry, which had been the world leader for over a century since the American civil war (Jomo [ed.] 1990).

'Money politics' – involving the increasing use of funds to secure political office – is widely believed to have worsened during the Mahathir era. And contrary to the wishful thinking of neo-liberals, political business and its corollary, money politics, have been facilitated by privatisation, partial economic liberalisation and the increasingly intimate relationship between business interests and political power.

The cruel murder of Jalil Ibrahim in Hong Kong in mid-1983 focussed national attention on Bank Bumiputra's Hong Kong subsidiary, Bumiputra Malaysia Finance (BMF) and its shadowy operations in the colony, forcing the Malaysian government to set up an investigation committee headed by then Auditor-General, Tan Sri Ahmad Noordin. Despite its limited powers, the committee's report confirmed popular suspicions and fears of widespread malpractices and abuses of power.

Not surprisingly also, Tan Koon Swan and Tee Ann Chuan, both presidents of Barisan Nasional component parties in the mid-1980s, were sentenced to jail in 1986 after pleading guilty to various charges involving abuses of corporate power. In mid-1987, Deputy Prime Minister Ghafar Baba defended the award of tenders to ruling party politicians who submitted uncompetitive bids, claiming that their allowances from

holding public office were inadequate. In August 1987, Dr Mahathir himself defended the privatisation of the North-South Highway to United Engineers (Malaysia) Berhad, an UMNO-controlled company, on the grounds that UMNO had to make money to cover the costs of its extravagant building complex, the Putra World Trade Centre. About a year earlier, MIC president Samy Vellu also defended the intimate relationship between politics and business.

With the strong economic recovery and sustained growth after 1986, the somewhat nationalistic rhetoric and policies of the early Mahathir years increasingly gave way to the more liberal economic policies of the mid-eighties. Slowly, but surely, the Mahathir government adopted more liberal economic policies that undermined various Malaysian government policy initiatives of the seventies and early eighties.

The lacklustre performance of the Malaysian public sector had become more obvious with the increased public spending of the early and mid-1980s. The key policy question should have been whether this is an inevitable characteristic of all public sectors, to be redressed only by privatisation. Since the poor performance of most public sectors have been due to the nature, interests and abuses of those in power, and not a necessary or inevitable result of public ownership, privatisation has not been able to redress the root problems. Even when privatisation per se may have raised efficiency in some rare instances, such transfers of ownership have not necessarily been in the public interest.

As privatisation involved many 'public monopolies', privatised monopolies were easily abused for profit gouging. The privatisation of public services has undoubtedly burdened the people, particularly those who can least afford it. Understandably, the private sector has only been interested in profitable or potentially lucrative investments. Hence, the government has been stuck with unprofitable activities, thus aggravating the fiscal deficit and thus seemingly confirming the popular view of public sector inefficiency. Clearly, while the problems of the public sector need to be addressed, privatisation has mainly benefited the politically influential, leaving the public vulnerable to the enhanced powers of private capital.

The 1987 privatisation of the North-South Highway project to United Engineers Malaysia, an UMNO-controlled company, generated public outcry. As in many other instances, this particular exercise flew in the face of the official rationale for privatisation. This led to unprecedented popular mobilisation against such abuses that include the dubious tender process, UEM's poor record and lack of relevant experience, the various government subsidies to UEM, the anticipated toll collection, and the government's weak justification for privatising the Highway project. However, the public outcry over the privatisation of the North-South Highway vanished after the crackdown of late October 1987. In early 1988, the Supreme Court ruled against then parliamentary Opposition Leader, Lim Kit Siang, and his DAP colleague, Karpal Singh, who had gone to the courts to try to stop the government's privatisation of the Highway, and were detained without trial from October 1987 under the Internal Security Act.

In the new climate of fear in the country after the crackdown and the executive's assault on the judiciary in early 1988, probable conflicts of interest and abuse of power in the privatisation of the Jalan Kuching road works and toll concession to interests closely

associated with the Finance Minister met almost no public reaction. This underscored the tremendous potential for abuse as privatisation in Malaysia proceeded unfettered by public accountability, which was the main unrecognised victim of the October 1987 repression. The repression followed the 1986 Official Secrets Act amendments that reduced the transparency of government economic transactions.

Many of the new economic policies from the mid-1980s undermined state intervention, government regulation and public sector growth in favour of the private sector, especially the politically influential (Jomo 1994). Yet, they were not strongly resisted, and were sometimes even welcomed by a Malaysian population sickened by the abuse, corruption and waste associated with the greater role of government since the seventies. Given the economic recovery and strong growth in the late 1980s due to the changed regional situation, these 'liberal' and inequitable aspects of their policy reform agenda were increasingly presented and implemented as necessary for economic recovery, and later for sustaining growth and modernisation, especially with the new policy directions announced in 1991.

In many ways, the great policy reversal of the mid-1980s seemed successful (Jomo 1994). A decade-long boom from the late 1980s only came to an end with the 1997-98 regional currency and financial crises. However, Malaysia was not alone, as both Thailand and Indonesia also had comparable achievements over the same decade. While all three countries devalued their currencies against the Japanese yen and the US dollar in the mid-1980s, there is little conclusive evidence that the region's booms can be attributed to more liberal economic policies. On the contrary, it has been argued that although inferior to those in Japan, Korea, Taiwan and Singapore, increased foreign direct investment from these economies as well as selective industrial policies in the host economies contributed significantly to the accelerated industrialisation of this period (Jomo *et al.* 1997; Jomo [ed.] 2001b, 2003a, 2003b).

Nevertheless, the apparent success of the policy U-turn of the mid-1980s encouraged the Mahathir government to consolidate what were originally presented to the public as temporary policy reversals necessitated by the economic slowdown and crisis of 1985-86. The opportunity for doing so was provided by the end of the NEP's first (20 year) Outline Perspective Plan (OPP) for 1971-90. In early 1991, Mahathir made a landmark speech, entitled 'The Way Forward', outlining his vision for Malaysia to become a developed country by the year 2020. The February 1991 Vision 2020 speech emphasizing growth and modernization – in contrast to the NEP's stress on redistribution – was followed by a new (ten year) Second OPP for 1991-2000 associated with a National Development Policy (NDP) and the *Seventh Malaysia Plan, 1991-1995*. In 2001, the NDP was replaced by a National Vision Policy with a third OPP for 2001-2010.

This newfound confidence was reflected in other policies as well. In line with his advocacy of South-South investments, reflected in the South Commission's recommendations, Mahathir advocated foreign direct investment (FDI) abroad by Malaysian companies, often taking a keen personal interest in facilitating such investments. Such Malaysian investments abroad have acquired a chequered record and mixed reputation, with sometimes embarrassing consequences (Jomo [ed.] 2002). Malaysian companies have been harshly criticised and even expelled, resulting in massive

losses, often of investments financed by external US dollar borrowings, which have since appreciated considerably. In any case, the 1997-98 crisis has largely brought an end to such Malaysian abroad, with some notable exceptions involving Petronas and some who came through the crisis stronger than ever, e.g. YTL, raising suspicions about their 'pulling out' of the country in anticipation of Mahathir's exit.

Despite the apparent end of the NEP, the Malaysian public continues to be interested in its agenda for redistribution, especially to reduce inter-ethnic disparities, particularly in corporate wealth ownership as well as tertiary education opportunities. However, it is unclear to what extent government policies contributed to reducing poverty, which went down considerably in the 1970s and early 1980s. After all, both Indonesia and Thailand had comparable achievements, and in the case of the latter, without the benefit of any serious and sustained policy commitment to poverty reduction. And while the original 1971-90 OPP 'restructuring society' targets were not achieved, it is also not clear whether the reduction of inter-ethnic economic disparities has been sufficient to improve inter-ethnic relations and achieve the elusive 'national unity' target of the NEP.

The failure to conclude the Uruguay Round of negotiations under the General Agreement on Tariffs and Trade (GATT) as scheduled, i.e. by December 1990, prompted Mahathir to call for an East Asian Economic Grouping (EAEG), seemingly as an alternative. Arguably visionary and ahead of its time, the proposal was not embraced by the Japanese government, but was instead relegated to ASEAN for approval. This ensured its eventual marginalisation as the original proposal was progressively watered down, initially as an ASEAN proposal for an East Asian Economic Caucus (EAEC) and later with the US promotion of APEC as the regional economic framework.

Eventually, however, elements of the original proposal began to take shape, first in the guise of 'ASEAN + 3', and then, with some lukewarm European endorsement, in the context of the biennial Asia-Europe consultations. Then Japanese Vice-Minister of Finance (International Affairs) Sakakibara Eisuke's suggestion of an Asian monetary facility or fund (AMF), in the immediate aftermath of the East Asian currency and financial crises of mid-1997, renewed interest in Mahathir's original proposal, though forces within and without the region seem to have successfully collaborated to limit its progress. This revival of interest in East Asian regional economic cooperation underscores the significance of the 1997-98 crises as a watershed, not only for Malaysia, but more generally, for the whole region.

The preceding boom and the apparent success of liberal economic policies came to an end with the 1997-98 regional currency and financial crises (Jomo [ed.] 1998, 2001a). After a severe banking crisis in the late 1980s, when non-performing loans reached 30 per cent of the commercial bank loans, the authorities had improved prudential regulation and supervision, with the help of the Banking and Financial Institutions Act, 1989 (BAFIA). The authorities limited foreign bank borrowings, especially short-term loans, despite having one of the most open economies in Southeast Asia. Hence, Malaysia was far less exposed when the crisis began, both in terms of foreign borrowings as well as the proportion of short-term loans.

However, the Mahathir government's earlier success in attracting portfolio investments in

the stock market, especially after breaking with the Singapore market in 1990, had fuelled stock market price bubbles, in 1993 and again in 1996-97, which were abruptly ended by capital flow reversals in late 1993 and, again, in mid-1997. The crisis was exacerbated by ill-considered policy responses, mainly intended to help the business interests of the politically well connected. Even more audaciously, the bank merger proposal -- pursued at a moment of enhanced government influence, with banks indebted to Danaharta and Danamodal -- appears designed to consolidate politically well-connected interests.

The situation continued to deteriorate while Finance Minister Anwar loyally took policy cues from Mahathir until November 1997. The Finance Minister then got out of Mahathir's frying pan into the IMF fire in December with contractionary pro-cyclical fiscal and monetary policies, which he eventually reversed in mid-1998 after the IMF was roundly condemned throughout the region for exacerbating the crises. Hyped by the international media to accelerate Mahathir's succession, Anwar's protestations of loyalty to his erstwhile patron fell on deaf ears. His fate was sealed in early September 1998, when Mahathir also introduced effective capital control measures.

While conceived as necessary in the face of continued international uncertainty, with the benefit of hindsight, it now appears that the controls were probably unnecessary as the regional situation turned around in September 1998. When the Russian crisis broke in August 1998, bringing down Long-Term Capital Management (LTCM) and threatening Wall Street, the US Federal Reserve intervened to lower US interest rates, thus strengthening and stabilizing, from the last quarter of 1998, the previously weakened and highly volatile East Asian currencies. Nonetheless, their effective design and enforcement proved that such controls can work, without the disastrous consequences promised by the neo-liberal prophets of doom.

The strong V-shaped recoveries in Korea, Malaysia and Thailand in 1999 and 2000 demonstrated once again that the IMF's prediction of protracted U-shaped recoveries was yet another one in a series of misdiagnoses of the causes and management of the region's crises. However, the inability to sustain the recovery and to return to the high growth rates before 1998 point to the changed international situation, marked by stagnation in Japan and perhaps Europe, with the US situation only marginally better. There is far less FDI, especially of the green-field variety as vulture capitalists mainly seek acquisitions of distressed assets, i.e. fire-sale FDI, with little promise of superior outcomes. And even more of world FDI has been going to China than ever before.

As Mahathir prepares for retirement in October 2003, he can look back on a chequered legacy of economic policy. While it is tempting to dismiss this as marked primarily by his penchant for cronyism, this volume underscores his many other motives. In considering his 22 years at the helm, it is clear that he has been more pragmatic than his rhetoric might suggest. The major policy innovations or changes around 1981, 1986 and 1998 were largely in response to problems and difficulties as he perceived them, though he undoubtedly had certain biases and preferences.

In many ways, his policies have been bold, if not original, and he has rarely been inhibited by budgetary and other such constraints. Instead, he has often circumvented and ignored such limitations required of accountable and transparent governance. And since

much of this has benefited private interests associated with him and his closest associates, he has boldly embraced the charge of ‘cronyism’, attempting to turn it on its head to nationalist acclaim, rather than rejected it. Never shy of controversy, he has argued that this has been the only way to advance modernisation and economic progress in the Malaysian context.

On the international front, however, Malaysians are likely to be more charitable. As with much of his foreign policy, Mahathir has often enjoyed ‘bipartisan’ support on such matters. Many people all over the world will probably miss his often forthright, if sometimes quixotic and misreported, if not ill-specified criticisms of international economic relations.

If there is ever anything close to a careful and full accounting of the benefits and costs of his economic policies, however, it is likely that the verdict on him will be adverse, especially given the passage of time and the emergence of the nation from the long shadow cast by his lengthy tenure and formidable presence. This is also likely as the next regime seeks to address pressing economic problems while trying to regain lost political ground. But having succeeded Mahathir with his consent, if not enthusiasm, it will probably not be able to distance itself from him. And in so far as it attempts to do so, it is likely to re-invoke the rhetoric of the NEP in an attempt to regain the lost Bumiputera ground associated with it. This can only further narrow the scope of the debate on economic policy and alternatives, with unfortunate consequences for public discourse, economic policy and the nation itself.

Notes

¹ I am grateful to Greg Felker, Terence Gomez, Maznah Mohamed and Khoo Khay Jin for their helpful criticisms, comments and suggestions, but bear full responsibility for this final version, which they will all probably disagree with.

² Malaysia, Thailand, Indonesia, China and others all experienced rapid economic growth and industrialisation as Japan and the first generation East Asian newly industrialised economies of South Korea, Taiwan, Singapore and Hongkong relocated lower-value export and domestic market oriented production abroad.

³ The appendix offers a critical review of Mahathir’s erroneous flirtation with Mendelian genetics in *The Malay Dilemma*.