



# Policy Brief 13

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Inter-Regional Inequality Facility  
sharing ideas and policies across Africa, Asia and Latin America

## Affirmative Action

## Malaysia

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### Objectives

In Malaysia, inequality between the major ethnic groups – the *Bumiputera* (Malays and other indigenous groups), Chinese and Indians – has long been a central development issue. When the country achieved its independence in 1957, there were already sizeable inequalities between these groups, and these widened further between 1957 and 1970. Mounting tensions between groups broke out into riots during 1969.

The centerpiece of the Malaysian approach to reducing inequality and inter-ethnic economic imbalances, and what can be termed loosely as its affirmative action plan, is the New Economic Policy (NEP). The NEP was introduced in 1970, and has two main objectives:

- first, to eradicate poverty, irrespective of race or ethnicity;
- second, to restructure society so as to remove the identification of race or ethnicity with economic status and/or function.

### Description

The NEP consisted of policies covering a number of different areas, including:

- an explicit target to achieve at least 30% *Bumiputera* ownership of total share capital by 1990, from its level of about 2% in 1970;
- requirements that employment in large, modern-sector firms should reflect the ethnic composition of the country's population;
- price discrimination in support of *Bumiputera*-operated businesses (e.g. subsidised loans and credit, financial and management training);
- quotas for ethnic groups in tertiary education enrolment;
- special schemes for the poorest households, including support for petty trading, cottage industries, livestock, and aquaculture.

### Lessons learned

Since its inception, the NEP has made substantial progress towards its objectives. Between 1970 and 2002, all ethnic groups witnessed substantial reductions in poverty. At the same time, the *Bumiputera* increased their share of total share capital to 19%, they increased their share of employment in modern, high-productivity industries, and their average household incomes rose relative to both Chinese and Indian households. The main factors underlying this success have been a clear and coherent policy framework, including a focus on ensuring gains among all groups; a strong statistical system for the monitoring of inequalities between groups; and flexibility in the implementation and enforcement of policies, particularly during economic downturns.

## Background

With a population of about 25 million comprising three major ethnic groups, Malaysia is a plural society. Today, the Malays and other indigenous groups, together termed *Bumiputera* (sons of the soil), account for 67.3% of the total population, the Chinese make up about a quarter and the Indians 7.2% of the total population. The *Bumiputera* still have a higher birth rate and fertility level compared to the Chinese and Indians, suggesting that they will remain the majority in the future.

Inequality between the major ethnic groups has been a central development issue in Malaysia. Between 1957 (when the country achieved independence) and 1970, it is generally accepted that average non-Malay income increased at a faster rate than average Malay income, leading to a widening of income inequality. The incidence of poverty was also, around 1970, much higher among the *Bumiputera* than among Chinese or Indians. In employment, a high proportion of the *Bumiputera* were employed in agriculture and in the less-skilled occupations, while the Chinese and Indians were mainly employed in higher skilled and high-income occupations. In the corporate sector, *Bumiputera* owned in 1970 just 2.4% of the share capital of companies, while Chinese and Indians owned almost a third (foreign interests owned about 63%).

The New Economic Policy (NEP) was the immediate product of the racial economic clashes in May 13th, 1969, following the election results of the May general elections. The ruling dominant party won less than half of the votes and the Chinese opposition parties increased their votes and seats. Following provocations involving political rallies in the capital Kuala Lumpur, racial clashes broke out. Parliament was suspended and emergency rule under the National Operations Council (NOC) was put in place. The NEP was formulated during the emergency rule.

## Details

The NEP was first set out in the Second Malaysia Plan (1970–1975), and was expanded and clarified in subsequent five-year development plans. Its broad strategy for reducing inequalities was to be through growth, and not disruptive redistribution. It was succeeded in 1991 by the National Development Policy (NDP), and in 2001 by the National Vision Policy (NVP). Both the NDP and the NVP incorporated the two-pronged objectives outlined in the original NEP, namely: a) eradicating poverty, irrespective of race or ethnicity; and b) restructuring society to correct the identification of race and ethnicity with economic function. The NEP included policies covering a number of different policy areas.

### Poverty eradication

To lift rural households out of poverty, the NEP gave heavy emphasis to agricultural and rural development policies and programmes. Investments were made to raise the productivity of rubber production, through the development of higher-yielding varieties, and to support diversification away from rubber into palm-oil production. Price support (a guaranteed minimum price) was granted to producers of rice, the staple food commodity. Large-scale land development schemes were launched, spearheaded by the Federal Land Development Authority (FELDA),

which granted landless farmers with land and management support for commercial production of rubber and palm-oil. Less productive small farms were encouraged and given support to be amalgamated into more productive, larger farms.

After the Second Plan, increasing attention was put on supporting the poorest households, defined as those with average monthly incomes less than half of the poverty line. Agencies such as FELDA, the Federal Land Consolidation and Rehabilitation Authority (FELCRA) and the Rubber Industry Smallholders Development Authority (RISDA), contributed to a special scheme for this sub-group of the poor. A development programme for the poorest was also launched, which supported petty trading, cottage industries, livestock, aquaculture and commercial production of food crops. Interest-free loans were also granted.

### Income inequality

Despite the focus on inter-ethnic income inequality, no explicit targets for income inequality were incorporated in the five-year development plans. Inequalities between ethnic groups – in, for example, mean monthly household income between the ethnic groups – were monitored and assessed, but not targeted. Subsequent development plans did, however, put emphasis on supporting the bottom 40 per cent and/or bottom 30 per cent of the entire household distribution, and on reducing income inequality within the *Bumiputera* community, although again no explicit targets were set.

### Restructuring company ownership and control

The NEP had an explicit target to reduce inter-ethnic inequality in company ownership and control. The target was to achieve at least 30% *Bumiputera* ownership of total share capital by 1990, from its level of about 2% in 1970. The non-*Bumiputera* target was 40%, with the remaining 30% allowed for foreign ownership.

The key policy used was the quota. First, companies were encouraged or persuaded over the long-term to restructure their pattern of ownership to reflect the macro 30:40:30 policy target. Second, companies that planned to grow had to set aside at least 30% of their share capital to *Bumiputera* interests (individuals or institutions). Third, new companies, especially those in the manufacturing sector, were required to fulfill the *Bumiputera* ownership quota. Fourth, active take-overs and acquisitions of foreign-owned companies by state-owned institutions, particularly in the plantations and mining sectors, increased *Bumiputera* ownership.

These approaches were complemented by a more interventionist state sector. Public enterprises were developed in the industrial and commercial sectors, and added to the increase in *Bumiputera* ownership and control in the economy. State investment holding institutions, especially Permodalan Nasional Berhad (PNB), were active in increasing the amount of *Bumiputera* ownership.

### Restructuring employment

Quotas were also used in the area of employment. Employers in modern sectors with large establishments were required to reflect the ethnic composition of the country's population structure at all levels of employment. The composition of the board of directors of companies also had to reflect this composition, although there was greater flexibility in this case.

## The *Bumiputera* Commercial and Industrial Community

Another key part of the NEP was to create an indigenous entrepreneurial class, to be called the *Bumiputera* Commercial and Industrial Community (BCIC). Several policy measures were utilized. First, quotas were used: construction projects, for example, had to have 30 per cent *Bumiputera* participation. Second, price discrimination was utilized. For example, in bidding for construction projects, a price/cost discount was granted to *Bumiputera* businessmen: a ten per cent price discount was a normal practice. Third, there were subsidized programmes for the training of *Bumiputera* businessmen, especially in finance and management, usually managed by the state-sponsored institutions. In addition, the ownership restructuring policies referred to above helped increase the size of the BCIC.

## Human capital and education

There were explicit quota policies on enrolment in tertiary education under the NEP. Generally, the quotas were for enrolment, in terms of percentage of *Bumiputera*, in specific academic disciplines, e.g. science and arts. The use of the National Language, or Bahasa Malaysia, was initially thought to favour the *Bumiputera*, but more recently it has been accepted that all groups are equally proficient. Matriculation courses in the universities were also implemented to assist all, including the *Bumiputera*, to gain admission to the degree courses. Reforms to enrolment policy, implemented in 2003, have put greater emphasis on the merits of students but it is uncertain whether quotas have been dropped permanently.

## Regional inequality

In the early phase of the NEP attempts were made to reduce regional inequality. The approach was to develop new regional growth centers in the less developed states, through public investment in infrastructure, and the granting of tax incentives to firms setting up in the regions.

## Impacts

### Poverty

The incidence of absolute poverty in Malaysia fell from about half (49%) of total households in 1970, to 37% per cent in 1980, 17% per cent in 1990 and 5% per cent by 2002. Reductions in rural and urban poverty were of similar magnitude, and the incidence of severe poverty also fell.

All ethnic groups recorded progress in poverty reduction, although the *Bumiputera* poverty level still exceeded the level of non-*Bumiputera* groups. By 2002, *Bumiputera* poverty had fallen to 7.3%, while Chinese and Indian poverty had reached 1.5% and 1.9%. Thus although poverty had not (as of 2002) been eradicated, irrespective of race, there had undoubtedly been a very great deal of progress toward this objective of the NEP.

### Income inequality

Between 1970 and 2002, overall income inequality in Malaysia narrowed slightly, from a gini coefficient of 0.52 in 1970 to 0.46 in

2002. Income disparities between the *Bumiputera* and non-*Bumiputera* also narrowed (Table 1). In 1976, the ratio of mean incomes of *Bumiputera* relative to Chinese households was 2.3; by 1995 it had narrowed to 1.8, and by 1999 it had narrowed to 1.7. The equivalent ratio between *Bumiputera* and Indian households also declined over the period, from 1.8 in 1970 to 1.3 in 1995. However, in more recent years, the ratio of mean incomes of *Bumiputera* relative to Chinese households has risen slightly, to 1.8 in 2002.

**Table 1** Mean monthly gross household income by ethnic group, 1970–2002

	1970	1990	1995	1999	2002
<i>RM (current prices)</i>					
<i>Bumiputera</i>	172	931	1,604	1,984	2,376
Chinese	394	1,582	2,890	3,456	4,279
Indians	304	1,201	2,140	2,702	3,044
<b>Malaysia</b>	<b>264</b>	<b>1,163</b>	<b>2,020</b>	<b>2,472</b>	<b>3,011</b>
<i>Income ratios</i>					
Chinese/ <i>Bumiputera</i>	2.3	1.7	1.8	1.7	1.8
Indians/ <i>Bumiputera</i>	1.8	1.3	1.3	1.4	1.3

Sources: The Second Outline Perspective Plan 1991–2000 (1970–90), the Eighth Malaysia Plan 2001–2005 (1995–99), and the Mid-Term Review of the Eighth Malaysia Plan 2001–2005 (2002).

## Restructuring of company ownership

The inequality in ownership and control was reduced following the implementation of the NEP. By 1990, Malaysians of all ethnic groups owned approximately 66% of the total share capital of the corporate sector, and the share of foreign interests had fallen to about a quarter. By 2002, the share of foreign interests had risen slightly, but still remained below 30%.

The *Bumiputera* ownership target was not achieved however. By 1990, they owned approximately 19% of total share capital, compared to 47% by non-*Bumiputera*. By 2002, ownership among the *Bumiputera* remained at 19%, while the non-*Bumiputera* reduced their share to 43%. Nevertheless, this still represented significant progress from their share of ownership in 1970.

## Restructuring of employment

Employment restructuring recorded some progress. More *Bumiputera* found employment in the more modern, high productivity industries and occupations, particularly the more educated *Bumiputera*. Nevertheless, the non-*Bumiputera* continued to be dominant in the better paying occupations and economic activities.

## The *Bumiputera* Commercial and Industrial Community

There was mixed progress in developing the BCIC. Many more *Bumiputera* businesses and enterprises were established in the commercial and industrial sectors, many of which were small to medium-sized enterprises (SMEs). However, many of the *Bumiputera* enterprises established were adversely affected by the sharp economic downturn brought about by the Asian financial crisis. A key issue had to do with the dependence of *Bumiputera* enterprises, particularly in the construction industry, on government contracts and tenders. The downsizing of the public sector, and fiscal

constraints on public expenditure, have had particularly adverse repercussions on *Bumiputera* enterprises.

## Human capital and education

Greater progress was made in advancing the educational attainment of the lower income groups, especially among the *Bumiputera*. Educational policies had a wide impact on *Bumiputera* enrolment at the primary, secondary and tertiary level of education. *Bumiputera* enrolment in public tertiary institutions tended to be higher than in the private tertiary institutions. A significant number of *Bumiputera* who were funded by the state were also enrolled in overseas tertiary level institutions.

### Lessons learned

#### Clear conceptual framework

It helps to clarify and enunciate clearly the concepts and approach to inequality. In Malaysia the focus was clearly on inter-ethnic economic imbalances and inter-ethnic inequality. The two broad macro targets were on eradicating absolute poverty, and the capital ownership targets. Their advantage lay in providing a clearly stated quantitative vision, the efforts required, and the likely financial resources. Incorporated in long-term development plans, the targets formed a coherent part of the framework and the approach to inter-ethnic inequality.

#### Counter-reactions to affirmative action policies

Despite the focus on one ethnic group, the other groups must also enjoy benefits. An issue in Malaysia has been the potential counter-reaction to the affirmative action policies by the Chinese and Indians. Overall however, affirmative action policies have not been detrimental to the Chinese and Indians: their absolute poverty has been reduced much faster than the *Bumiputera*, their income has grown and their share of ownership has exceeded the planned target.

#### Implementation, monitoring and evaluation

A good system of statistics greatly helps in assessing the impact of affirmative action policies on poverty and inequality. In Malaysia, the Department of Statistics (DOS) has ensured the collection of such statistics on a regular basis, from sources including household income and expenditure surveys, surveys on ownership of share capital, firm surveys, and other specialised surveys. The key statistical indicators covered include income, employment, occupations, assets and education.

#### Quotas – costs and efficiency

Quotas tend to be used widely for affirmative action policies, and these can have side effects. A rigid use of quotas can have efficiency effects, as when institutions “lower” standards to accelerate the enrolment of the target groups. Although it is difficult to quantify these side effects, critics and policy makers were aware of the negative side effects and some adjustments have been made to these quotas. The ownership quota has been liberalized over the years. More recently the educational quotas have been adjusted and greater emphasis has been put on merit for enrolment in the universities.

#### Price discrimination – costs and efficiency

Preferential pricing for target groups can also lead to distortions. When the prices of assets, services, tenders and contracts are lowered for the target groups, there will be excess demand. The

beneficiaries then have an incentive to sell-off the assets in the short-term on the receipt of their entitlements, as there is a premium on the subsidized assets. In Malaysia, it has been fairly common for the recipient to sell-off, for example, their share capital on the open market. These types of problems need to be monitored closely.

#### Rentier behaviour and spurious fronts

Shortages on the supply side for qualified *Bumiputera* can encourage rentier behaviour and the setting up of spurious alliances with non-target groups. “Ali Baba” ventures enjoying access to contracts and tenders have been notorious in Malaysia: these were joint-ventures between a less qualified *Bumiputera* with a financially endowed non-*Bumiputera*. Unqualified *Bumiputera* also “rented” their ethnic status by having access to the benefits of affirmative action policies, and sold-off the entitlements to the non-*Bumiputera*. Nominees can also be used to disguise the actual beneficiaries of the affirmative action policies. Again, these types of problems need to be monitored closely.

#### Pragmatism and flexibility in policies

Finally, rigidity in implementing affirmative action policies should be avoided. Unintended and unanticipated situations will arise. Employers will find genuine difficulties in complying with the policies: employers and investors can find it difficult to meet the quotas on employment and ownership, and the beneficiaries can sell-off their ownership stakes in the very short-term. In particular, implementation should be less rigidly enforced during economic downturns. In Malaysia, implementation of affirmative action ownership policy was less rigidly enforced in the late 1980s, when growth slowed down.

### Further reading

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