

From 'Looking East' to the 1997 Asian Financial Crisis: How Mahathir Mohamad Steers Malaysia's Economic Development from the 1980s to 2000s

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Abstract. The last two decades of 20th century signifies a time of burgeoning economic growth but also a time of financial turmoil and vulnerability for Southeast and East Asian Countries. Extensive studies have focused on the newly industrialized countries such as Japan and Singapore. The examination and critique on how the emerging new economies like Indonesia and Malaysia adapt to and resist the wave of globalization to achieve its political and economic autonomy remain a compelling topic of discussion, which can be further scrutinized through the lens of leadership roles and impacts. This paper will focus on the time of first tenure of Malaysia's Prime Minister Mahathir Mohamad. Specifically, the paper will answer the question that how the national leadership and its political stance and economic policies play a role in realizing the rapid growth and modernization while revitalizing the economy amidst the contagion of financial crisis. By conducting a chronological analysis on legal documentations on policies implemented through end of 1970s to 2000s and probing onto the official statistics reflective of Malaysia's economy's performance, the paper concludes that an effective national leadership and its affiliated political and socio-economic policies play instrumental roles in helping Malaysia achieve a rapid economic growth and modernization since 1980s, while sustaining the economy's vitality through the 1997 Asian Financial Crisis.

Keywords: Malaysia; Look East Policy (LEP); New Development Policy (NDP); Capital Control; Statist-led Policy; Mahathir Mohamad.

1. Introduction

By the 1970s, under the guidance of the New Economic Policy (NEP) that aimed to eradicate poverty, the Malaysian government implemented a series of affirmative actions to redistribute 30% of the wealth in the economy to indigenous Malays (Bumiputera). With increasing equity ownership by Bumiputera, the NEP had bred a subsidy mentality and increasing inefficiency, which hindered economic growth and aggravated corruption and bureaucracy while being widely criticized abroad and by the large Chinese and Indian ethnic groups in the country. The heavy reliance on government support did not transform Bumiputera's entrepreneurship outlook, and the economy experienced relatively flat GDP growth of 4%, and high inflation averaged around 9% [1]. By the mid-1970s and the coming 1980s, as a net oil and commodity exporter, the Malaysian government did not emphasize fiscal discipline. The following early 1980s global recession led to plummeting of its export income dues to large price drops of commodities. The increasing socio-economic disappointment urged the Malay government to steer its development direction. With an economic model with a dependence on foreign investment and the growing pressure of globalization approaching the 21st century, adapting to a competitive market and surviving the turmoil of the financial crisis imposed critical challenges for Malaysia to address.

Despite the increasing dependence outwards, the socio-economic outlook of Malaysia beginning in its 1980s cannot separate from its inner political stances and situations. Studies and research have focused on the political volatility of racial conflict, which escalated to its peak in the May 13 Incident, a sectarian violence and riots stemmed from long-standing Chinese-Malay wealth disparity. Rogers in his *Asian Survey* particularly identified and discussed the inter-ethnic tensions and the unequal share of political power as major impediments for Malaysia's socio-economic growth in the 70s, especially after the positive discriminatory acts imposed by New Economic Policy [2]. Its neighboring economy, Singapore, has demonstrated unparalleled success among the Southeast Asian

countries since 1970s, largely attributing to its growth by a consistent political stability and promotion on industrialization. The juxtaposition between two neighboring countries in Rogers' studies highlights the significance of inquiring into the role of national leadership and the corresponding public policies initiated during the same period. In particular, the paper will probe into aspects beyond the racial conflicts and examine more extensively on the new policies and policy adjustments implemented after the country's fourth prime minister assumed his office.

This paper will explore how the country's fourth Prime Minister, Tun Mahathir Mohamad, initiated a series of mixed but more state-led development approach in his first term (1981-2003), which advanced Malaysia's modernization and industry privatization throughout the 1980s to 2000s, most notably by the Look East Policy (LEP) and National Development Policy (NDP), bringing rapid economic growth and reduced poverty during his first term in office, while managed to stabilize the economy in the turmoil of 1997 Asian Financial Crisis.

2. Malaysia Coming to the 1980s and Public Policies

2.1 From Look East Policy (LEP) to New Development Policy (NDP)

In 1982, the Malaysian government, under Mahathir's administration, launched the Look East Policy to seek socio-economic development by adopting and emulating practices and models from Japan, South Korea, and other Asian Tiger economies, which enjoyed rapid economic growth before the financial crisis in 1997. Since 1982, over 15,000 Malaysian trainees and students have been sent to Japan. Mahathir believed that Japan's remarkable success trajectory reflected an array of values that Malaysia should learn from and adopt, such as strong work ethics, politeness, and self-discipline. Besides learning technical skills, absorbing Japanese values, and fostering bilateral ties, the LEP brought investment and Japanese capital through increasing trade cooperation.

However, the period of emulation was not without growing pains. While continuing its Look East Policy to overcome the post-colonial economic constraints, the Prime Minister recognized that the heterogenous ethnic composition of the country presents a major variant different from Japan and fostering a self-reliant manufacturing capacity and industrial power was necessary for Malaysia to prosper in an increasingly competitive and turbulent global market. Coming to mid-1980s, Malaysia's economy was hit hard by the oil market, which led to a worldwide recession. The primary commodity prices suffered from a slump due to weakened demand for manufacturing exports, especially in the tin industry [3]. The Mahathir government, while receiving some blame for the culminating crisis in the country's economy, endorsed a mixed approach that helped the country recover and experienced growth from regressive fiscal reforms and export-oriented industrialization as a shift from import substitution, which the government had been adopting in the start of 1980s.

Nevertheless, unlike the trade liberalization experiences of Latin American countries like Brazil, which had encountered the deteriorating value of their exports and the subsequent debt crisis, Malaysia adhered to its own export-led policies and retained its economic autonomy against the prevailing neoliberal economic orthodoxy. The Promotion of Investment Act 1986 was passed to facilitate foreign investments through tax relief, allowances, and exemption incentives. The export-led industries experienced notable growth in technology development and the introduction of higher value-added manufactured goods while also softening their tension and isolation against the domestic-oriented industries. The shift to export-led industrialization was, nonetheless, accompanied by a new form of import substitution under Mahathir's administration. From the early 1980s, Mahathir began privatizing government enterprises in support of Bumiputera businesses following the New Economic Policy. Meanwhile, during the 1980s to mid-1990s, many state-sponsored infrastructure projects were initiated, including the Multi-media Super Corridor (MSC), a special high-tech economic zone emulating Silicon Valley; the North-South Expressway connecting motorway transportation from the border of Thailand to Singapore; and the establishment of Proton, a major joint venture with Mitsubishi which then became the largest automotive company in Southeast Asia, and other HICOM-led (Heavy Industries Corporation of Malaysia) projects [4]. The promotion of

heavy infrastructure projects and industries, with an envisioned role of enhancing the country's manufacturing sector, was essentially calibrated by the traditional import-substitution benchmark and protected by hefty tariffs, subsidized credit, and consistent government procurement provisions [5].

The establishment of heavy infrastructures incurred high public expenditures, which caused increasing budget deficits and worsening external debt terms that exacerbated its peak in the mid-1980s recession. However, despite the accusations and criticism against the ambitious mega-projects for their vast expenditures, the Prime Minister was consistent and firm in the logic of strengthening Malaysia's international bargaining power with a sustained basis of industrial development and supplementing private-sector growth. By 1991, National Development Policy (NDP) replaced the NEP, which aimed to redress ethnic disparity, reduce poverty, and narrow income inequality gaps. The following Bangsa Malaysia policy marked a greater recognition of non-Malay ethnicities. The NDP was a component of Mahathir's Vision 2020, which aimed to transform Malaysia into a fully developed and industrialized country by 2020 with a marked shift from state control to privatization of public-sector activities. From the 1990s to before the 1997 crisis, Malaysia's GDP growth performance remained one of the highest in the world, maintaining an unprecedented annum growth ranging from 9% to 10% [1]. The labor market reforms marked another significant component in the transition to export-led industrialization. Unions were banned and excluded in the key export-oriented sector, such as electronics. In addition, the "compulsory arbitration" of labor disputes and prohibition of striking in specific industries also facilitated labor market flexibility and attracted greater foreign investment.

2.2 Responses and Recovery Performance of Malaysia in 1997 Asian Financial Crisis

Beginning in July 1997, the Asian Financial Crisis started to hit Thailand with a major collapse of the Thai currency baht due to heavy speculation. The financial contagion soon spread to other Asian economies. Malaysia's currency ringgit devaluated, with a significant outflow of foreign investment and capital and a plunging main stock exchange index [8]. Against the conventional practices and belief of cutting government spending, the Mahathir government refused the IMF bailout, which recommended austerity measures. Mahathir imposed fiscal expansion and stringent capital control while pegging the ringgit on 3.8 against the US dollar, effective in September 1998. Meanwhile, the overseas trade and investments in domestic ringgit were frozen as the government rendered the ringgit held abroad invalid. This helped prevent the trading speculators from selling short the currency and further devaluation. Compared with the exchange rate ranging from 2.4 to 2.7 in a free float regime from 1990 to 1997, the measure to shift to a fixed exchange system proved to be a painful but necessary and prudential defense to prevent further plunging of the ringgit. However, Malaysia now had adopted a managed float system when the crisis's adverse effects subdued mainly after 2004.

Nonetheless, compared with other Southeast Asian and East Asian countries, Malaysia demonstrated effective economic moderation and stabilization results. Indonesian rupiah, South Korean won, and Thai baht all experienced the plunging of their values, which read in a two-year range from 1997-98 by 83.2%, 34.1%, and 40.2%, respectively [6]. The unconventional measures by Mahathir's governance to adopt the fiscal expansion, in contrast to an austerity intervention proposed by IMF, remained controversial, but hard for the critics to negate its prowess amid the adverse contagion effects of economic contraction. Malaysia's recovery from 1999 to 2000 observed increasingly potent growth with declining inflation and unemployment, easing capital control, and subsequently a gradual boost of investor confidence. As figure 1 demonstrates, the GDP growth increased from -7.3% in 1998 to 6.1% in 1999 and 8.9% in 2000, which exceeded the original 7.3% before the 1997 crisis and maintained annual growth from 5.4% to 6.3% till 2007. The inflation level per consumer price declined from 5.3% in 1998 to 2.7% in 1999, which is the same rate as in 1997 before the contagion effects of the crisis. From 2000 to 2007, inflation averaged 1.975%, keeping at a lower steady range compared with the high volatility in the early 1990s. The total unemployment has remained at a range of 3.2% to 3.6% from 1998 to 2008, which demonstrated healthy reduction compared to the mid-1980s recession, during which the unemployment peaked at 8.3% in 1986 [1].

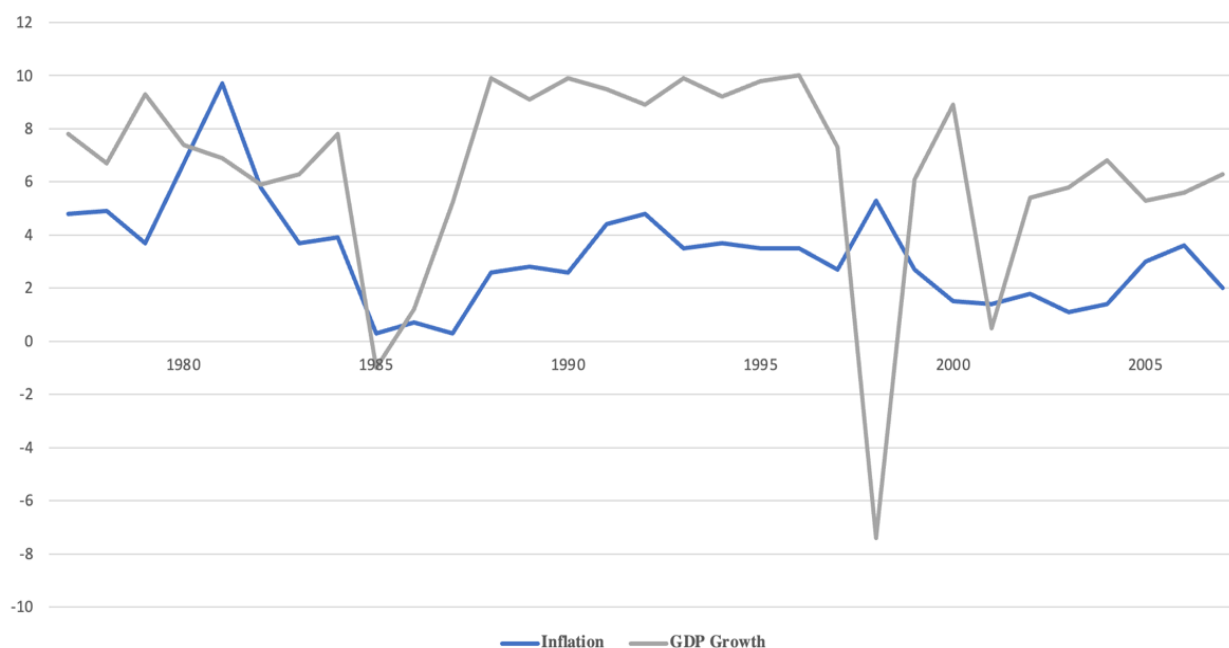


Figure 1. Malaysia's GDP Growth (annual %) and Inflation, Consumer Price (annual %) from 1977 to 2007 [1]

Compared to Indonesia and Thailand, the recovery performance of Malaysia is closely related to its market-skeptical and more statist approach. In 1998, the government established National Economic Action Council (NEAC), which launched National Economic Recovery Plan (NERP) to guide structural reforms and financial strengthening. According to the recommendations in NERP, the government established the *Corporate Debt Restructuring Committee* (CDRC), *Danahrta*, an asset management company created by the sovereign wealth fund of Malaysia aimed at addressing bad debts, or non-performing loans (NPLs), and *Danamodal*, a special purpose vehicle to address recapitalization of banking institutions [7]. All three agencies proved to undertake and meet the recovery objectives, especially on the corporate rescue and rehabilitation: by the second quarter of 1999, *Danahrta* had acquired 16 billion ringgits of NPLs; *Danamodal* recapitalized ten banking institutions totaling 6.2 billion [8]; CDRC managed to resolve total debt outstanding of 45.8 billion within 57 corporation cases, which all assisted the country's businesses and banking institutions moving into an improved capital situation [9].

A series of statist-led approaches seemed ever more pertinent and successful after experiencing the initial policies focused on what the IMF recommended as fiscal austerity, which had only served to "exacerbate adverse domestic conditions" and growing nationalism invoked in the early stage of the crisis. [10]. It was determined that Malaysia was effectively secured from the crisis with speedy recovery performance and maintained a stable level of economic autonomy amidst what Mahathir referred to as the "new colonialism" of the global capital markets through the strict capital controls, pegging of the domestic ringgit against the US dollar, and other steps such as the establishment of bank restructuring and deficit-fixing institutions.

3. Summary

The last two decades of the 20th century had been a period of transformation, cultural deregulation, a construction boom, financial turmoil and fragility, and economic recovery. Malaysia demonstrates remarkable economic growth, improved ethnic disparity, and recovery performance amid the mid-1980s recession and 1997 crisis. As a small emerging post-colonial economy, effective leadership and policy instruments proved indispensable to its success. The country's fourth and seventh Prime Minister, Mahathir Mohamad, is a dominant figure in realizing Malaysia's modernization. From the

late 1980s to the 1990s, the Mahathir government initiated a series of mega-infrastructure projects, which led and contributed to its growing manufacturing capacity and export-oriented industrialization.

Malaysia's experiences and responses to the 1997 Asian Financial Crisis showed the possibility of achieving financial recovery while maintaining a high level of economic autonomy amidst the contagion effects of currency speculation, devaluation, and exacerbating capital outflow. The unconventional statist measures such as fiscal intervention, strict capital control, and establishment of structural reform agencies enabled the economy recovery to outperform its Southeast Asian neighbors, backed by rapid and sustained GDP growth, low inflation, and unemployment levels throughout the post-crisis period to 2007. Despite criticism towards some of Mahathir's approaches and initiatives, Malaysia's political stability and progressive socio-economic development cannot be doubted or separated from the Mahathir government's mixed state-led policy stance and implementations.

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