

## The Failure to Take Off: The Case of Bahagian *Penyelarasan dan Pembangunan Bumiputera Pulau Pinang*

### Kegagalan untuk Melonjak Ke hadapan: Kajian Kes Bahagian *Penyelarasan dan Pembangunan Bumiputera Pulau Pinang*

AZEEM FAZWAN AHMAD FAROUK

#### ABSTRACT

*The implementation of the New Economic Policy (NEP) ushered in an era of greater state-intervention in the Malaysian economy on behalf of the Bumiputera. However, while the state has devoted a considerable amount of resources, and set up numerous agencies to elevate the socioeconomic standing of the Bumiputera, compared to other Malaysian ethnic groups they still lag behind in terms of household income and economic equity. Indeed, the 2012 Malaysian Household Income and Basic Amenities Survey Report revealed that the median household income for Bumiputera was lower than that of the Chinese and Indian populations, as too was, their average household annual income growth rate between 2009 and 2012. Utilising the case study method, this study analyses the modus operandi of Bahagian *Penyelarasan dan Pembangunan Bumiputera Pulau Pinang*, a Bumiputera Implementing Agency that was established with the aim of improving the socioeconomic standing of Penang's Bumiputera population. The study suggests that the absence of economic calculation and bureaucratic incentive to exaggerate achievements are among the factors that have led to the failure of state-led development for Penang Bumiputera.*

*Keywords: New Economic Policy; state-led development; Penang Bumiputera; Malaysia; Bumiputera Implementing Agency*

#### ABSTRAK

*Perlaksanaan Dasar Ekonomi Baru (DEB) telah menyaksikan satu era di mana negara memainkan peranan yang lebih aktif dan besar dalam ekonomi bagi pihak kaum Bumiputera di Malaysia. Walaupun negara telah memperuntukan sejumlah besar dana, infrastruktur dan mewujudkan pelbagai agensi pelaksana Bumiputera, tahap sosioekonomi kaum Bumiputera bukan sahaja dari sudut pendapatan isi rumah malah juga dari sudut kesaksamaan ekonomi masih lagi jauh di belakang kaum yang lain di Malaysia. Laporan Penyiasatan Pendapatan Isi Rumah dan Kemudahan 2012 mendapati bahawa purata pendapatan isi rumah Bumiputera adalah lebih rendah daripada pendapatan isi rumah kaum Cina dan kaum India manakala purata pendapatan bulanan Bumiputera di antara tahun 2009 hingga tahun 2012 juga lebih rendah daripada kaum Cina dan India. Dengan menggunakan kaedah kajian kes, kajian ini menganalisa modus operandi Bahagian *Penyelarasan dan Pembangunan Bumiputera Pulau Pinang*, sebuah agensi yang ditubuhkan khas untuk menaik taraf tahap sosioekonomi Bumiputera Pulau Pinang. Dapatan kajian ini memperlihatkan bahawa kegagalan untuk melaksanakan perkiraan ekonomi dengan baik dan insentif birokrasi untuk melonjakkan kejayaan adalah di antara faktor kegagalan untuk menaikkan tahap sosio-ekonomi Pulau Pinang.*

*Kata kunci: Dasar Ekonomi Baru; negara pembangunan; Bumiputera Pulau Pinang; Malaysia; Agensi Pelaksana Bumiputera*

#### INTRODUCTION

The implementation of the New Economic Policy (NEP) in Malaysia signalled the end of *laissez faire* economic policy, and the beginning of greater state-intervention in the Malaysian economy. This change in economic policy could well be attributed to the findings of the official report on the 13<sup>th</sup> May 1969 race riot which among others, state that the persistent economic imbalances among the different ethnic groups in the country had

sparked the deadly riot. In order to arrest this troubling phenomenon, the Malaysian government announced that the main objective of the NEP was to promote national unity. The NEP had two aims: to reduce and eventually eliminate poverty among all ethnic communities and to restructure the Malaysian society in order to correct the economic imbalance among communal groups and eventually to eliminate the identification of race with economic function. The key objectives of the

NEP were to be achieved between 1970 and 1990 and were embodied in successive five-year plans (Malaysia Government 1971).

The NEP, had at its core, formalised certain preferential treatment for *Bumiputera*<sup>1</sup>. This is most apparent in the business and education sector. It is common knowledge that the NEP was formulated to advance the socioeconomic status of *Bumiputera*, and narrow the income gap between the *Bumiputera* and the Chinese. Nevertheless, in spite of decades of state-led economic development initiatives, *Bumiputera* remain among the poorest groups in Malaysia. The 2012 Malaysian Household Income and Basic Amenities Survey Report (Malaysia Department of Statistics 2013) revealed that the median household income for *Bumiputera* was RM 4,457 while that of Chinese and Indian were RM 6,366 and RM 5,233 respectively. Average annual household income growth rate from 2009 to 2012 was 6.9 percent for *Bumiputera* and 8 percent and 9 percent for Chinese and Indians respectively. Poverty level among *Bumiputera* was at 2.2 percent while that of the Chinese and Indian were 0.3 percent and 1.8 percent respectively. These facts are particularly baffling because state-led development efforts on *Bumiputera* face fewer problems than international state-led economic development. For instance, *Bumiputera* economic development planning does not face problems of international political economy, such as numerous international bureaucracies, differing national strategic goals, and so forth. Although political economy issues still exist domestically, we would expect them to be smaller than those in the international arena for at least two reasons.

First, the Malaysian government has devoted a considerable amount of resources, including access to funding, and the setting up of numerous *Bumiputera* Implementing Agencies (BIAs) in its effort to uplift the socioeconomic standing of the *Bumiputera*. Therefore, domestic state-led development provides a good case study of state led development due to minimal interference from international agencies. Second, the *Bumiputera* and the Malaysian government are in the same country, making sheer physical distance a non-issue. Monitoring of domestic economic development programs is much easier and less costly than monitoring international programs. However, as Boettke, Coyne dan Leeson (2008) note, geographic distance is not what matters; knowledge distance is more decisive. The greater the knowledge distance between where the rule is designed and where it is to be implemented, the less likely the rule is to stick. Although the geographic distance between the *Bumiputera* and the Malaysian government is minimal, the knowledge distance between the two can be great; the Malaysian government may simply be unable to acquire the relevant knowledge to achieve the desired end (Bowie 1991: 45-50).

A focus on the knowledge distance between where the rule is designed and where it is to be implemented is rooted in new development economics. This voluminous body of research examines the emergence, operation, and effectiveness of spontaneously ordered institutional arrangements and promotes the idea that the latter tend to

be efficient and most effective in promoting the ends of indigenous agents. This line of enquiry tended to contrast two kinds of opposing institutional arrangements; those that emerge entirely spontaneously, and those that are constructed and imposed by "outsiders", and posits that indigenously introduced endogenous institutions are those associated with spontaneous order as they embody the local norms, customs, and practices.

An indigenously introduced endogenous institution can simply be thought as endogenously emergent solutions to obstacles confronting socially interacting agents (Hayek 1996). Several things are worth noting about the process by which indigenously introduced endogenous institutions surface. First they emerge endogenously. The institution is not constructed by an entity like a government, but by the market process. Second, the institution's endogenous emergence is necessarily indigenously introduced. The features that make an institution an indigenously introduced endogenous institution are of particular importance in analysing its stickiness properties. First, the endogenous emergence of the institution points to its desirability as seen from indigenous inhabitants' point of view. Indigenously introduced endogenous institution are informal in the sense that they are not compelled and are flexible to changing preferences of the individuals they assist. As such, their persistence tends to indicate their prefer redness to other informal arrangements that might supplant them (Hayek 1991). Second, features of indigenously introduced endogenous institutions suggest that these institutions are firmly grounded in the practices, customs, and values and beliefs of indigenous people and have its foundation in *metis*. A concept passed down from the ancient Greeks, *metis* is characterised by local knowledge resulting from practical experience (Hayek 1991). It includes skills, culture, norms, and conventions which are shaped by the experiences of individuals. In terms of a concrete example, think of *metis* as the set of informal practices and expectations that allow ethnic groups to construct successful trade networks. For instance, the diamond trade in New York City is dominated by orthodox Jews who use a set of signals, cues, and bonding mechanisms to lower the transaction costs of trading. The diamond trade would not function as smoothly if random traders were placed in the same setting. The difference can be ascribed to *metis*. Because it is based on the accepted, understood, and habituated mentalities and practices of indigenous peoples, the presence or absence of *metis* explains the stickiness of various types of institutions. In fact, *metis* can be thought of as the glue that gives institutions their stickiness (Leeson 2006).

Indigenously introduced endogenous institutions ensure their foundation in *metis* for two reasons. First, the fact that they emerge endogenously in an informal unconstructed fashion means that they emerge directly from *metis*. Similarly, their indigenous introduction means that they are in harmony with local conditions, attitudes, and practices. This fact is closely related to Frey (1997) important work on the intrinsic motivations of individuals which suggests that spontaneously emergent institutions effectively reflect and in fact grow out of the

preferences of local actors. In this sense, indigenously introduced endogenous institutions are institutionalised *metis*. As such, indigenously introduced endogenous institutions tend to be the stickiest of all. Domestic state-led development, in theory, should be easier than international state-led development.<sup>2</sup> However, the result of development efforts on *Bumiputera* does not match the expected outcome.

In this article, we examine two factors that contribute to the failure of top-down, state led development on *Bumiputera*; (i) the state's inability to perform economic calculation and (ii) the political allocation of resources. The first factor is important because it provides a reason for the state's inability to achieve its stated goals and within the given means. Because the state operates outside the market, economic calculation is impossible, leading to the second factor, political allocation of resources outside the market, which yields several political economy i.e. problems related to bureaucracy, including perverse incentives and lack of adaptability to changing conditions.

To analyse how these two factors contribute to the failure of state-led development on *Bumiputera*, we focus on *Bahagian Penyelarasan dan Pembangunan Bumiputera Pulau Pinang* (*Bumiputera* Coordination and Development Division, BPPBPP). The BPPBPP is under the jurisdiction of Implementation and Coordination Unit (ICU) of the Prime Minister's Office (PMO), and its main aim is to uplift the socioeconomic standing of *Bumiputera* in the northern state of Penang. We focus on the BPPBPP because this agency is solely concerned with economic development whereas other agencies involved with the *Bumiputera* (for example, *Majlis Amanah Rakyat* (MARA)) or the Council of Trust for the Indigenous Peoples) deal with a variety of services besides pure developmental efforts, which makes it more difficult to separate economic development projects from their other activities. Penang is chosen because it is the only state in Malaysia that has an agency that is solely dedicated to *Bumiputera* socioeconomic development. A total of 14 individuals were interviewed, and they are either current officials or former officials of BPPBPP as well as former politicians who had ties with the organization.

While most studies on the Malaysian political economy (Gomez 1990; 1991; 1994; Jomo 1986; 1990; 1993; Jamaie 2004) have undoubtedly touched on the role of the state in economic development, these studies have privileged the perspective of the political economy of rent seeking. We, nonetheless, concur that modern Malaysia possesses all the characteristics of a deeply rent seeking society. In this type of society, politicians work as brokers in a system of political clientelism. They expand the public sector, exchanging jobs for votes. They also push the private sector into bed with the public sector, assigning to the former secure profits, privileges, and finally explicitly and legally established rents – with bribes and corruption of the modern Malaysian economy.<sup>3</sup> Nevertheless, the above mentioned studies focus solely on the ties between influential tycoons or conglomerates and the ruling parties. What is more, the above-mentioned studies did

not assess the effectiveness of state-led development strategies vis-a-vis the *Bumiputera*, apart from saying that these strategies had bred nepotistic practices. This article complements the existing literature on economic development of the *Bumiputera* by emphasizing the role of economic calculation and the political economy of bureaucracy in explaining the failure of state-led development efforts.

## THE ORIGINS OF BPPBPP AND STATE-LED DEVELOPMENT IN PENANG

The origins of the BPPBPP can be traced to 9<sup>th</sup> September 1975 when the then Prime Minister, Tun Abdul Razak Hussein ordered the setting up of a special task force to look into the socioeconomic standing of *Bumiputera* in Penang. Upon completion, the federal government was of the view that the best way to uplift the socioeconomic standing of the *Bumiputera* in Penang was to create a steering committee for *Bumiputera* participation which was called *Jawatankuasa Pemandu Penyertaan Bumiputera* (JKP) that would oversee and coordinate state-led developmental initiatives for the community. The steering committee was made up of both federal and state officials. In order to assist the steering committee in achieving its objectives, the federal government agreed to provide a dedicated agency to act as a secretariat for the JKP, and as such, on 23<sup>rd</sup> June 1977 the BPPBPP, the first federal agency in Penang that was devoted to *Bumiputera* economic development was established. The BPPBPP also acts as a secretariat for *Majlis Pembangunan Bumiputera Pulau Pinang* (Penang *Bumiputera* Development Council). At the time of writing, both the BPPBPP and the JKP are still placed under the purview of the ICU of the Prime Minister's Office. The main function of BPPBPP is to coordinate socioeconomic development initiatives for *Bumiputera* in Penang, and it is the leading federal government agency that is given the responsibility to formulate strategic development initiatives for *Bumiputera*. Among the key sectors that BPPBPP is currently focusing on are housing and real estate, human capital development, tourism, and entrepreneurship and cooperatives.<sup>4</sup>

The BPPBPP's primary goal has been to increase *Bumiputera* participation in the economy although it has also introduced an added emphasis on making the community attractive to business by improving its human capital. To designate the *Bumiputera* in Penang as a depressed community and hence qualify BPPBPP to receive federal funding, several measures have been used including employment pattern, household income, and land and house ownership. Nevertheless, it should be noted that in terms of household income, the *Bumiputera* in Penang is not the poorest group in Malaysia, and in comparison to other *Bumiputera* in the country, Penang *Bumiputera* enjoy a higher quality of life.<sup>5</sup> With that being said, it should be made clear that Penang *Bumiputera* has not been able to cope with the pressures of modernization and urbanization. Their socioeconomic position is worse off in comparison to

that of other ethnic groups in Penang especially that of the Chinese. Given that unemployment is not a major issue in Penang, low income (in comparison to other ethnic groups) among the *Bumiputera* in Penang has become a worrying trend.<sup>6</sup> Malaysia's former Second Finance Minister has remarked that Penang *Bumiputera* are trapped in a vicious cycle that begins with low income and ends up with their inability to own assets particularly in real estate.<sup>7</sup> It should also be noted that *Bumiputera* land and/or property can only be sold to other *Bumiputeras* thus limiting their asset appreciation. This indirectly contrasts the dynamism of properties that are traded in the open market. This vicious cycle is then repeated from one generation to the next. Since the value of real estate rises at a much higher rate than the income of Penang *Bumiputera*, the socioeconomic gap between the Penang *Bumiputera* and the other ethnic groups has grown wider. One simple way to analyze the preceding claim is to look at the ownership pattern of low-cost homes in Penang. As of 2010, Penang *Bumiputera* made up 70% of those who purchased houses priced between RM50,000 and RM100,000 whereas the other ethnic groups made up 80% of those who purchased houses priced between RM100,001 and RM150,000 (Malaysia Implementation and Coordination Unit 2014).

There is no clear relationship between BPPBPP initiatives and a significant rise in Penang *Bumiputera* economic standing. Given the agency's mission, it seems that well-allocated and well-spent federal funding would be used for projects that would up-lift the socioeconomic standing of the Penang *Bumiputera*. However, the discussions and the data on Penang *Bumiputera* suggest that such has not been the case. The 2013 data on Penang *Bumiputera* entrepreneurs reveals that there are only 2,308 *Bumiputera* entrepreneurs in Penang, and the bulk of them (52.4%) are involved in the construction industry (Malaysia Implementation and Coordination Unit 2014). This could well be due to the fact that government contracts in the construction sector are reserved solely for *Bumiputera*. More importantly, it goes to show that *Bumiputera* entrepreneurs can only thrive under state patronage. The consistent pattern of involvement in sectors that do not give high returns, low quality asset ownership, and rent seeking behaviour<sup>8</sup> is a sure testament that no clear and reliable progress has occurred toward BPPBPP goals. In fact, the most recent figures on the employment pattern of Penang *Bumiputera* in different professions show that they are trailing behind other ethnic groups. For example, there are 1986 doctors among other ethnic groups whereas there are only 656 *Bumiputera* doctors in Penang; there are 143 *Bumiputera* accountants in Penang while there are 1376 accountants among other ethnic group, and as far as the legal profession is concerned; there are 827 lawyers among other ethnic groups while there are only 277 *Bumiputera* lawyers in Penang (Malaysia Implementation and Coordination Unit 2014). Again, these figures demonstrate the lack of progress toward BPPBPP stated goals. In the next section, we provide insights into why BPPBPP's means have failed to achieve its stated ends.

## THE CENTRALITY OF ECONOMIC CALCULATION

Mises (1927, 1949) and Hayek (1935, 1945) work on economic calculation and the knowledge problem is critical in understanding why state-led development on Penang *Bumiputera* has not had the expected effect on uplifting their socioeconomic status. As Boettke (1998: 332) notes "economic calculation refers to the decision-making ability to allocate scarce capital resources to competing uses". In other words, economic calculation is the process by which the economic problem of how to allocate resources is solved. Prices as well as profit and loss provide continual feedback to economic factors regarding how resources should be allocated and reallocated in order to maximise their value. Price information represents knowledge about a continually and rapidly changing structure of economic relationships (Lavoie 1984). For rational economic calculation to be possible, there must be a system of private-property rights that allows free price changes and the resulting profit-and-loss accounting. Without these prerequisites, rational economic calculation cannot occur because the necessary feedback will be distorted or absent, and individuals will be unable to figure out how to allocate resources among different uses in an economically efficient manner.

Further, as Hayek (1945) emphasises, for central planning to work, all relevant data, including the dispersed knowledge of "time and place" would have to be known by one central figure or a small group of central figures in a government. He concludes that this centralised possession of the relevant knowledge is unattainable because much of the relevant data are not given to any one person at a point in time but must be discovered through the dynamic market process. Hence, the government cannot perform a rational economic calculation necessary for economic progress because the kind of knowledge required for such a task is dispersed among all individuals producing and consuming in a society rather than being centralised in one omniscient figure.

As noted previously, state-led development on Penang *Bumiputera* benefits from a short physical distance between government agencies and the targeted recipients in contrast to longer distances involved in international development efforts. However, one of the main implications of the "knowledge problem" logic is that "knowledge distance" is more important than geographic distance (Boettke, Coyne & Leeson 2008). Relevant local knowledge might relate to culture, workforce skills, viable resources, and a variety of other factors important to the process of development and business planning. Although the geographic distance between Penang *Bumiputera* and BPPBPP is minimal, the knowledge distance between the two seems to be great, where BPPBPP has simply been unable to acquire the relevant knowledge to achieve the desired end. Although the BPPBPP has property and input prices, it cannot engage in economic calculation because it does not price its outputs and therefore cannot utilise profit-and-loss accounting. Instead, its services take the

form of unilateral transfers from the government to the Penang *Bumiputera*, and no profit or loss calculation is possible. In a market economy, profit and loss provide important feedback information to producers for both current and future decisions. Expected profits affects current production decisions, and actual profit or losses affect future decisions. Outside the market, rational economic calculations are impossible. Mises (1944) explains, the absence of profit and loss is precisely why government bureaucracies cannot perform economic calculation. Skarbek and Leeson (2009) apply this argument to international aid and its inability to solve the economic problem. Penang *Bumiputera* provides a domestic case of the same issue and the application of the same logic.

Some striking examples illustrate the state's inability to engage in rational economic calculation when selecting and implementing economic development projects for Penang *Bumiputera*. For example, consider two small trader centres built in September 2005 in Kepala Batas – *Kompleks Dato' Kailan* and another in Permatang Pauh – *Pusat Komersial Permatang Pauh* in which BPPBPP poured in RM 1 million and RM 1.5 million respectively toward construction. Nevertheless, both premises were almost empty upon completion, and both complexes were under utilised for a few years. Since both buildings were not fully occupied for quite some time, BPPBPP had to subsidise its operating costs. More importantly, the small trader centres were built without a business plan, leaving the BPPBPP to create one after the construction has completed.<sup>9</sup>

In addition to errors in the selection and implementation process caused by the inability to perform rational economic calculation, the absence of profit-and-loss accounting makes it necessary to find other measures of achievement. One such measure is the number of *Bumiputera* entrepreneurs trained by BPPBPP via other *Bumiputera* implementing agencies. To suppose that a simple measure of the number of entrepreneurs trained is equivalent to a measure of wealth creation or value added to the economy is a fallacy. For example, BPPBPP might create more *Bumiputera* entrepreneurs by increasing the number of *Bumiputera* trained in entrepreneurship, but such measures would not add value because they would not increase productivity or create goods and services that consumers value, which is the essence of economic progress. While the Austrian economist Joseph Schumpeter put entrepreneurs at the centre of his model of capitalism, he also argued that innovation was crucial to dynamism and growth. It is the “new combinations” of economic factors they brought together that propelled the whole system onward and upward (Schumpeter 1941). In order to evaluate BPPBPP's year-to-year success, the agency self-reports several measures, including an examination of how close its actual results for creating entrepreneurs compare to its stated targets.<sup>10</sup> However, these targets are not the same thing as economic progress because they are centrally planned – planners select the ends to pursue and the means to employ in pursuing those ends.

A former state assemblyman notes that BPPBPP programs did not have “a significant effect, achieved

inconclusive results, and may even detract from a more flexible and educated work force”.<sup>11</sup> If we recognise that BPPBPP does not have the market mechanisms and economic calculation to guide its decisions, it is unsurprising that the former politician finds that BPPBPP programs have an insignificant and possibly even a damaging effect. As another example of the implication of the absence of economic calculation, consider that BPPBPP spent RM25 million to develop *Bumiputera* entrepreneurs that would specialize in tourism between 2007-2013, but a recent assessment by the Penang Malay Chamber of commerce reported that *Bumiputera* involvement in tourism was a failure.<sup>12</sup> Much like the small trader centre projects mentioned previously, the funds spent on tourism were not supported by a sound business plan based on profit-and-loss accounting. Many *Bumiputera* entrepreneurs were simply not well suited for tourism; lacking proper skills, knowledgeable workforce, transportation, ability to converse in English and other foreign languages, and amenities such as accommodation for visitors that are necessary for a successful tourist operator.<sup>13</sup> Before investing in tourism, a private entrepreneur operating in the market would have had the profit-and-loss mechanism guiding his decisions, to which no savvy entrepreneur would have invested in what seemed to be a likely failure. However, with the BPPBPP providing the funding for these projects, success is not measured by expected profit and loss because the projects operate outside the market; hence economic calculation is impossible.

One potential response from the institutional stickiness and the new development economics perspective is that although BPPBPP is ineffective in picking initial projects, it can adapt through a process of trial and error to correct its mistakes. However, the evidence indicates that such adaptation does not occur; many BPPBPP projects are kept continually operational with subsidies or additional help from other agencies. For example, many *Bumiputera* entrepreneurs are still involved in small scale trading activities, and about 1,150 of these entrepreneurs had either failed or were being subsidized, and almost 557 of them were being subsidized (Malaysia Implementation and Coordination Unit 2014). Given that a business's need for subsidies indicates a failure to satisfy customer wants, these continually subsidized projects should also be considered failures. They are also failures from the standpoint of adaptability because rather than being shut down, they are being propped up and kept in operation by subsidies.

Though many examples are available to illustrate BPPBPP's struggle to pick “winning” projects, there have not been many studies regarding the effect of BPPBPP projects on the socioeconomic development of Penang *Bumiputera*. A study commissioned by the State Economic Planning Unit is only a report that examines the effectiveness of BPPBPP projects. It suggests that BPPBPP aids had little effect on the growth rates of income during the time the aid was given and no significant effect afterward (Penang State Economic Planning Unit 2007). This study highlights an important point i.e. BPPBPP cannot plan economic development

centrally and they cannot do so successfully without market signals and individual entrepreneur's effort. As Bauer (2000: 16) points out, "throughout history innumerable individuals, families, groups, societies, and countries – both in the West and in the third world have moved from poverty to prosperity without external donations." He highlights how trading on a small scale leads to economic development, indicating that individual entrepreneurs operating in local markets ignite the spark that starts the fire of economic development. Development is achieved through the market process of experimentation, risk taking, and profit and loss signalling (Holcombe 1998). The players' ever-changing rational economic calculations, based on prices as market signals, guide innovation and ultimately produce economic growth.

#### THE POLITICAL ECONOMY OF BUMIPUTERA ECONOMIC DEVELOPMENT IN PENANG

Given that BPPBPP cannot rely on markets and economics calculation to allocate resources, political rather than economic forces was given to guide its decisions. Several political economy issues such as the emergence of a *Bumiputera* rentier capitalist, and patronage network affect the outcomes of government-sponsored economic development projects. For example, the failure and the closing down of a Malay Cultural Centre in Teluk Bahang and the inability to sustain a consortium set up to supply construction materials to *Bumiputera* building contractor have been attributed to rent seeking and patronage.<sup>14</sup> As such, the economics of bureaucracy sheds light on some of the pitfalls in economic development planning outside the market. This body of analysis assumes that bureaucrats behave like other self-interested individuals. They are not able to ignore their self-interest for the sake of the "greater good." Given the incentives they face, they seek to maximise their individual well-being within their own constraints. The incentives created by a bureaucratic structure of operations unfortunately are perverse in that they encourage different outcomes than the stated goals of economic development projects for Penang *Bumiputera*. Niskanen (1971) notes that the bureaucrat's desired ends – greater fame, power, prestige, a larger agency – are all consistent with one primary goal: budget maximization. Each of the variables related to a bureaucrat's utility – "salary, prerequisites of the office, public reputation, power, patronage, ease of managing the organization, and ease of making changes" – is positively related to the size of the agency's budget (Niskanen 1968: 293). Thus, by maximizing the agency's budget, a bureaucrat simultaneously maximizes his utility.

In the case of Penang *Bumiputera* socioeconomic development projects funded by BPPBPP, many actions are consistent with bureaucratic incentives. One outcome of efforts to maximise the agency's budget is an incentive to overstate the agency's achievements. By overstating its achievement, the agency can prove that it is worthy of more funding in the coming years.

Such exaggeration is exemplified by the BPPBPP's 2012 Strategic Planning Plan, which states that the projects "do indeed produce socioeconomic mobility at a relatively low cost. The estimates clearly suggest that the projects are having its intended effect" (Penang Regional Development Authority 2012: 5). However, an earlier study carried out by the Penang State Economic Planning (2011) indicated that BPPBPP initiatives do not produce long term increases in income and do not create a linkage between the public and the private sector. In spite of this contrary report, BPPBPP does not have an incentive to report poor figures for its own work, especially given that it is its own evaluator. In order to continue receiving funds, it instead has an incentive to overstate its achievements. As an example, consider BPPBPP's most recent self-report for the fiscal year 2013. Here BPPBPP measures its success in part by examination of how close the actual results in creating *Bumiputera* entrepreneurs, training given to *Bumiputera* entrepreneurs or potential entrepreneurs, building human capital and fulfilling the needs for affordable homes among *Bumiputera*. The report gives the results of investments as far back as 2001, and as recent as 2012, noting that the targets were met for creating entrepreneurs and building human capital for every year of BPPBPP expenditure, with success rates as high as 530 percent for some years (Malaysia Implementation and Coordination Unit 2013). These numbers are difficult to be taken seriously because they indicate a 100 percent success for every year, a lofty but unreasonable goal even for the savviest entrepreneur in the private sector.

Given the goal of budget maximization, another expected result is that agencies will strive to make themselves politically well connected because budget allocation is decided based on political rather than economic imperatives. It pays to stay politically well connected. With these incentives in place, the BPPBPP resembles any other agency, using political favour to garner a larger budget. A former BPPBPP official calls the BPPBPP a "golden goose for some influential politician" noting that politics obscures rational economic decisions<sup>15</sup>. A former UMNO politician notes that BPPBPP has given the Penang *Bumiputera* little return on their investment and instead become a slush fund for the well connected.<sup>16</sup> BPPBPP values its partnership with senior UMNO politicians as evidenced by its *modus operandi*. It is therefore no secret that BPPBPP senior management direct resources toward the appropriation of additional funds from the federal government, is supported by nurturing relationships with those who can directly affect the agency's budget. In addition to the perverse incentives created within the bureaucracy, the grants given to communities in need also create perverse incentives for the people they are ostensibly supposed to help – the Penang *Bumiputera* themselves. By supplying grant money and other forms of federal assistance that end up composing a large percentage of Penang *Bumiputera*'s start-up capital, the state creates what Clark et al. (2005) calls a "Samaritan's dilemma", where a donor intending to help those in need inadvertently increases the amount of need (Nazrolnizah 2014). In other words, by continually providing aid to

those in poverty, we provide an incentive for them not to invest wisely or to become a self-starter because if they should do so, the aid will be stopped. This situation creates an incentive for aid recipients to remain wards of the state, dependent on government handouts to survive. As Williamson (2009: 29) notes, aid can have a range of undesirable and unintended effects, including creating dependency on aid, undermining local markets, destroying institutions, increasing conflict, increasing rent-seeking activities, and altering incentives to engage in less productive activities.

The goal of economic development by BPPBPP is to raise the socioeconomic status of Penang *Bumiputera*, and one of the main aims is to create more *Bumiputera* entrepreneurs. Nevertheless, entrepreneurship can be productive, unproductive, and in some cases destructive (Baumol 1990; Coyne and Leeson 2004). Entrepreneurs can seek profits by creating wealth or through seeking rent. Without the right tools for evaluating the success and failures of Penang *Bumiputera* entrepreneurs, BPPBPP has a hard time knowing when the entrepreneurs are merely operating at their existing level, and when they are making things that would not have happened otherwise (Mazzucato 2015).

The Penang *Bumiputera* dependency on aid and government work is evident in data from a study commissioned by the Penang State Economic Planning unit (2006). One indicator of dependence on government and the extent of unproductive entrepreneurship is the percentage of all jobs that are in the public sector. In Penang *Bumiputera* community, this figure is higher than 50 percent of jobs in the public sector (Penang State Economic Planning unit 2012). This situation creates a powerful incentive to maintain government intervention on behalf of Penang *Bumiputera*. More intervention means more government contracts. With the government dollars flowing onto BPPBPP for economic development projects comes the incentive for rent-seeking. Rent-seeking can simply be defined as redistributive activity that takes up resources but costly to growth. Nevertheless, rent-seeking activities exhibit very natural increasing returns even though rent-seeking activities particularly by government officials will hamper economic growth. Gordon (1967; 1993) and Krueger (1974) explain rent-seeking incentives and the economic impact of rent-seeking. BPPBPP has used political means to obtain large sums of government money for aid and development projects for Penang *Bumiputera*. As long as abundant rents are available to be sought, the incentive to undertake productive activity is reduced. Hence, resources are shifted from production to lobbying, and the entrepreneurial activities necessary for economic growth are diminished. Public job holders “profit” by rent-seeking, so the more rents are available, the larger the public sector is expected to grow as entrepreneurs seize the opportunity to acquire these available yet socially unproductive gains.

A recent study by Universiti Sains Malaysia on the socioeconomic development of Penang *Bumiputera* (Penang Regional Development Authority 2012) notes that the latter’s involvement in economic development were (and in many cases, still are) as grant seekers whose

success was and is measured solely on the basis of how much federal largesse they can obtain for themselves. The perverse incentives created by such a system only encourage further rent-seeking activities and institutionalize the idea that Penang *Bumiputera* must continue to depend on the government for their survival. This system of bureaucracy, budget enlargement, and rent-seeking has contributed to the lack of economic development among Penang *Bumiputera*. In the absence of economic calculation, resource-allocation decisions must be made through the political process. However, this process creates perverse incentives that contribute to the persistence, if not worsening, of the situation that the initial intervention was supposed to remedy.

## CONCLUSION

Although state-led development efforts on Penang Bumiputra enjoy tremendous support from the federal government, their economic status has not changed drastically in the past four decades of funding. Several conclusions emerge from our enquiry into this situation.

First, BPPBPP’s inability to achieve its stated goals does not reflect a lack of resources. In spite of the great amount of resources – both financial and human – devoted to economic development over many decades, Penang *Bumiputera* has not achieved the same levels of economic well-being as the rest of the non-Malay population in Penang. Increases in resources committed to these goals have not corresponded to increases in economic well-being for Penang *Bumiputera*. This disconnect implies that the solution to economic development is not allocation of more resources to the means already being employed. Instead, the means themselves must be altered in order to change the course of economic development for Penang *Bumiputera*. Second, knowledge distance is a more significant factor than geographic distance. Although Penang *Bumiputera* lives within the Malaysian borders, the federal government has been unable to stimulate growth within that community. The planners lack the relevant knowledge necessary to plan economic progress. The policy implication is that no matter how geographically close the targeted economic development area is, economic growth cannot be centrally planned. Third, to create incentives for productive entrepreneurship and to minimize unproductive rent-seeking, economic development efforts need to focus on general rules instead of micro planning. Such rules would allow for economic calculation and private entrepreneurship. The implication is that throwing more money at the problem without changing the “rules of the game” will not have the desired effect and, in fact, may have the opposite effect.

BPPBPP is one example of among many BIAs attempt to bring about economic development to the *Bumiputeras*. All state-led efforts suffer from the same problems that BPPBPP encounters. Though state handouts may appear to yield immediate benefits for Penang *Bumiputera*, these short-run solutions come at the cost of a long-run economic stagnation and the

institutionalization of incentives inconsistent with entrepreneurship and, ultimately, economic growth and development. For Penang *Bumiputera* to have the best environment to cultivate entrepreneurship and economic growth, a bottom-up approach directed by the *Bumiputera* entrepreneurs themselves must replace the current method of top-down, state-directed, economic development planning. Penang *Bumiputera* themselves have the capacity to remedy their current plight by using local knowledge and creative entrepreneurship. With that being said, the findings of this study has contributed to the deepening of our understanding of the political economy of the bureaucracy in that it has identified the critical factors that influence a bureaucratic outfit in exaggerating its achievements. In addition, it calls into question the over reliance on the bureaucracy to carry out development projects without undertaking the much needed economic calculation.

#### ACKNOWLEDGEMENT

This work was supported by the Ministry of Education Malaysia under the Fundamental Research Grant Scheme [203/PSOSIAL/6711415].

#### END NOTES

<sup>1</sup> Throughout this article, the term *bumiputera* refers to the Malay community in Penang. The Malays together with the natives of Sabah and Sarawak, are categorised politically as *bumiputera* or “sons of the soil” and are given special privileges under the Malaysian constitution and the NEP. It should, however, be noted that the Malaysian Constitution speaks of Malays and the natives of Sabah and Sarawak. The term *bumiputera* has no legal basis. See Shad Saleem (2003).

<sup>2</sup> State-led development focuses on resource allocation so as to produce different production and investment outcomes than would have occurred with either international state-led development or simulated free market policies. To direct this different outcome, state-led development first chooses certain sectors judged to be important in the international and domestic economy. Then it uses state capital resources, control over exports and imports, command over foreign exchange, and control of the financial system to create an environment favorable to the development of the chosen industrial sectors and to discourage the use of resources in other sectors. Therefore, international state-led and state-led approaches differ fundamentally on a crucial point; the market-led approach assumes that countries are assigned certain comparative advantages within which developing nations should work, while the state-led approach seeks to shape the comparative advantage that they have to use in the international and domestic economy. That is, while every country has a comparative advantage in trading with other countries, not all comparative

advantages are created equal. State-led approaches try to develop the capacity for greater comparative advantage in the international market instead of just working within the comparative advantages it may currently possess, which may be cheap labor, mineral resources, or agricultural raw goods. In other respects, the state-led approach seeks to apply the most useful elements of the free market in a controlled manner, while the proponents of the market-led approach advocate that developing nations go straight for a Western-style market economy. Proponents of the market-led approach overlook that while the market economy works well for industrialized Western economies, full exposure to the global market may terminate nascent industries in developing countries. In comparison, the moderated use of free-market forces through policy tools such as temporary tariffs against certain foreign goods and tight regulation of foreign investment allows budding domestic industries of state-led economies to benefit from these free-market forces while still being screened from their full strength. This type of state control over change affords a political, social, and macroeconomic stability that is often absent during rapid adoption of free-market policies. See Wade (2009).

<sup>3</sup> The Malaysian Corruption Barometer 2014 states that 50 per cent of respondents say that corruption in the public sector is a serious issue while 69 per cent of respondents say that political parties are the most corrupt. See New Straits Times 15<sup>th</sup> May 2014.

<sup>4</sup> This information was obtained from interviews with Tan Sri Dato’ Seri Haji Mohammed Yusuff Latiff, the President of Penang Malays Association (PEMENANG) and the former Deputy Director of BPPBPP. Interview with Tan Sri Dao’ Seri Yusuff Latiff was held on 15<sup>th</sup> October 2014 and the interview with the former deputy director was held on 12<sup>th</sup> November 2014.

<sup>5</sup> These facts are obtained from an interview given by Dr. Nungsari Ahmad Radhi, a member of Penang United Malays National Organization’s (UMNO) economic bureau to *Utusan Malaysia* on 22<sup>nd</sup> September 2006.

<sup>6</sup> 80% of Penang Bumiputera are employed in the lower end of manufacturing sector. See *Utusan Malaysia* 18<sup>th</sup> March 2010.

<sup>7</sup> This statement was made by Tan Sri Nor Mohamed Yakcop while giving a keynote address at a seminar organized by Penang Malays Association (PEMENANG) on 20<sup>th</sup> November 2006.

<sup>8</sup> For additional information on this claim see Takashi Torii (1997).

<sup>9</sup> This information was obtained from a former officer of BPPBPP who requested anonymity. An interview with this official was conducted on 30<sup>th</sup> June 2014.

<sup>10</sup> See *Malaysia Implementation and Coordination Unit (2014)*.

<sup>11</sup> Interview with a former United Malays National Organization (UMNO) state assemblyman on 2<sup>nd</sup> July 2014.



- <sup>12</sup> This estimate is given by a former official of BPPBPP, and the information from the Malay Chamber of Commerce was obtained from an interview with Dato' Seri Abdul Rahman Maidin, former President of Penang Malay Chamber of Commerce, 4th July 2014.
- <sup>13</sup> Interview with an officer from the Penang Malay Chamber of Commerce on 25<sup>th</sup> July 2014.
- <sup>14</sup> Interview with an officer from BPPBPP who requested anonymity on 25<sup>th</sup> September 2014.
- <sup>15</sup> Interview with a former BPPBPP officer, 12<sup>th</sup> August 2014.
- <sup>16</sup> Interview with a former UMNO state assemblyman on 14<sup>th</sup> May 2014.

## REFERENCES

- Baumol, W. 1990. Entrepreneurship: Productive, unproductive, and destructive. *Journal of Political Economy* 98 (5): 893-921.
- Bauer, P. 2000. *From Subsistence to Exchange, and Other Essays*. Princeton, NJ: Princeton University Press.
- Boettke, P. 1998. Economic calculation: The Austrian contribution to political economy. *Advances in Austrian Economics* 6: 67-88.
- Boettke, P., Coyne C. & Leeson P. 2008. Institutional stickiness and the new development Economics. *American Journal of Economics and Sociology I* 67: 331-58.
- Bowie, K. 1991. Unravel the myth of the subsistence economy: Textile production in nineteenth-century Northern Thailand. *The Journal of Asian Studies* 51(4): 45-50
- Clark C., Anderson K., Ostrom E. & Shivakumar, S. 2005. *The Samaritan's Dilemma*. Oxford: Oxford University Press.
- Coyne, C. & P. Leeson. 2004. The plight of underdeveloped countries. *Cato Journal* 24(3): 235-49.
- Frey, B. S. 1997. *Not Just for the Money: An Economic Theory of Personal Motivation*. Cheltenham: Edward Elgar.
- Gomez, T. 1990. *Politics in Business: UMNO's Corporate Investment*. Kuala Lumpur: Forum.
- Gomez, T. 1991. *Money Politics in Barisan Nasional*. Kuala Lumpur: Forum.
- Gomez, T. 1994. *Political Business: Corporate Involvement of Malaysian Political Parties*. Townsville: Centre for Southeast Asian Studies, James Cook University of North Queensland.
- Gordon, T. 1967. The prisoner's dilemma and mutual trust. *Ethic* 77: 229-50.
- Gordon, T. 1993. *Economic Freedom of the World: 1975-1995*. Vancouver: Fraser Institute.
- Hayek, F. A. 1935. The present state of the debate. In *Collectivist Economic Planning*, edited by F.A. Hayek, 201-42. New York: Augustus M. Kelly.
- Hayek, F. A. 1945. The use of knowledge in society. In *Individualism and Economic Order*, edited by F.A. Hayek, 77-91. Chicago: University of Chicago Press.
- Hayek, F.A. 1991. *The Fatal Conceit*. Chicago: University of Chicago Press.
- Hayek, F.A. 1996. *Individualism and Economic Order*. Chicago: University of Chicago Press.
- Holcombe, R. 1998. Entrepreneurship and economic growth. *Quarterly Journal of Austrian Economic Review* 64: 291-303.
- Jamaie Hamil. 2004. *UMNO dalam Politik dan Perniagaan Melayu*. Bangi: Penerbit Universiti Kebangsaan Malaysia.
- Jomo, K. S. 1986. *Development Policies and Income Inequality in Peninsular Malaysia*. Kuala Lumpur: Institute of Advance Studies, University of Malaya.
- Jomo, K. S. 1990. Whither Malaysia's New Economic Policy? *Pacific Affairs* 63(4):469-99.
- Jomo, K. S. 1993. *U Turn?: Malaysian Economic Development Policies after 1990*. Townsville: James Cook University of North Queensland.
- Krueger, A. 1974. The political economy of the rent-seeking society. *American Economic Review* 64:291-303
- Leeson, P. 2006. Escaping poverty: Foreign aid, private property, and economic development. *Journal of Private Enterprise* 23(2): 39-64.
- Lavoie, D. 1984. *National Economic Planning: What is Left?* Cambridge, Mass.: Ballinger.
- Mazzucato, M. 2015. The innovative state. *Foreign Affairs*. <http://www.foreignaffairs.com/articles/142496/mariana-mazzucato/the-innovative-state>. Retrieved on: 12 January 2015.
- Malaysia Government. 1971. *Second Malaysia Plan 1971-1975*. Kuala Lumpur: Percetakan Nasional.
- Malaysia Implementation and Coordination Unit. 2014. *Penang Bumiputera Strategic Development Plan 2014-2016*. Penang: ICU.
- Malaysia Implementation and Coordination Unit 2013. *Penang Bumiputera Strategic Development Plan 2011-2013*. Penang: ICU.
- Malaysia Department of Statistics. 2013. *Household Income and Basic Amenities Report*. Kuala Lumpur: Percetakan Nasional.
- Mises, L. V. 1927. *Liberalism in the Classical Tradition*. Irvington-on-Hudson, New York: Foundation for Economic Education.
- Mises, L. V. 1944. *Bureaucracy*. New Haven, Conn: Yale University Press.
- Mises, L. V. 1949. *Human Action: A Treatise on Economics*. Chicago: Henry Regnery.
- Nazrolnizah Mohamed Noorzeli. 2014. Hubungan di antara perniagaan dengan Profil HRV biofeedback usahawan Amanah Ikhtiar Malaysia. *Akademika* 84 (1&2): 45-56.
- New Straits Times*. 2014. Political Parties Most Corrupt, May 15.

- Niskanen, W. 1968. The peculiar economics of bureaucracy. *American Economic Review* 58 (2): 293-305.
- Niskanen, W. 1971. *Bureaucracy and Representative Government*. Chicago: Aldine-Atherton.
- Penang State Economic Planning Unit (UPEN). 2006. *Pola Pekerjaan dalam Kalangan Bumiputera Pulau Pinang 2003-2005*. Penang: UPEN
- Penang State Economic Planning Unit (UPEN). 2007. *Bumiputera Economic Study*. Penang: UPEN.
- Penang State Economic Planning Unit (UPEN). 2011. *Kajian Keushawanan Bumiputera Pulau Pinang 2010-2011*. Penang: UPEN
- Penang State Economic Planning Unit (UPEN). 2012. *Kajian Kemiskinan Bumiputera Pulau Pinang 2010-2012*. Penang: UPEN
- Penang Regional Development Authority. 2012. *Laporan Socioekonomi Bumiputera Pulau Pinang 2011*. Penang: PERDA.
- Shad Saleem Faruqi. 2003. Affirmative action policies and the constitution. *Kajian Malaysia* 21 (1&2): 31-57.
- Skarbek, D. & Leeson, P. 2009. What can aid do? *Cato Journal* 29(3): 391-97.
- Schumpeter, J. 1941. *Capitalism, Socialism, and Democracy*. New York: George Allen and Unwin.
- Takashi Torri. 1997. The New Economic Policy and The United Malays National Organization - with special reference to the restructuring of Malaysian society. *The Developing Economies* XXXV-3, (September 1997): 209-39.
- Tan Sri Nor Mohamed Yacop, 2006. Pembangunan Tidak Setara dan Perbandaran di Pulau Pinang. Kertas kerja dibentangkan sempena Seminar ke-86 Persatuan Melayu Pulau Pinang (PEMENANG), 20 November, Pulau Pinang.
- Utusan Malaysia. 2006. Melayu Pulau Pinang Masih di Belakang, 18 Mac.
- Wade, R. 2009. *Governing the Market: Economic Theory and the role of Government in East Asian Industrialization*. Princeton: Princeton University Press.
- Williamson, C. 2009. Exploring the failure of foreign aid: The role of incentives and information. *Review of Austrian Economics* 23 (1): 17-33.

Azeem Fazwan Ahmad Farouk  
 School of Social Sciences  
 Universiti Sains Malaysia  
 E-mail: azeemf@usm.my

Received: 22 December 2014

Accepted: 30 March 2015