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Government-Linked Companies: Impacts on the Malaysian Economy

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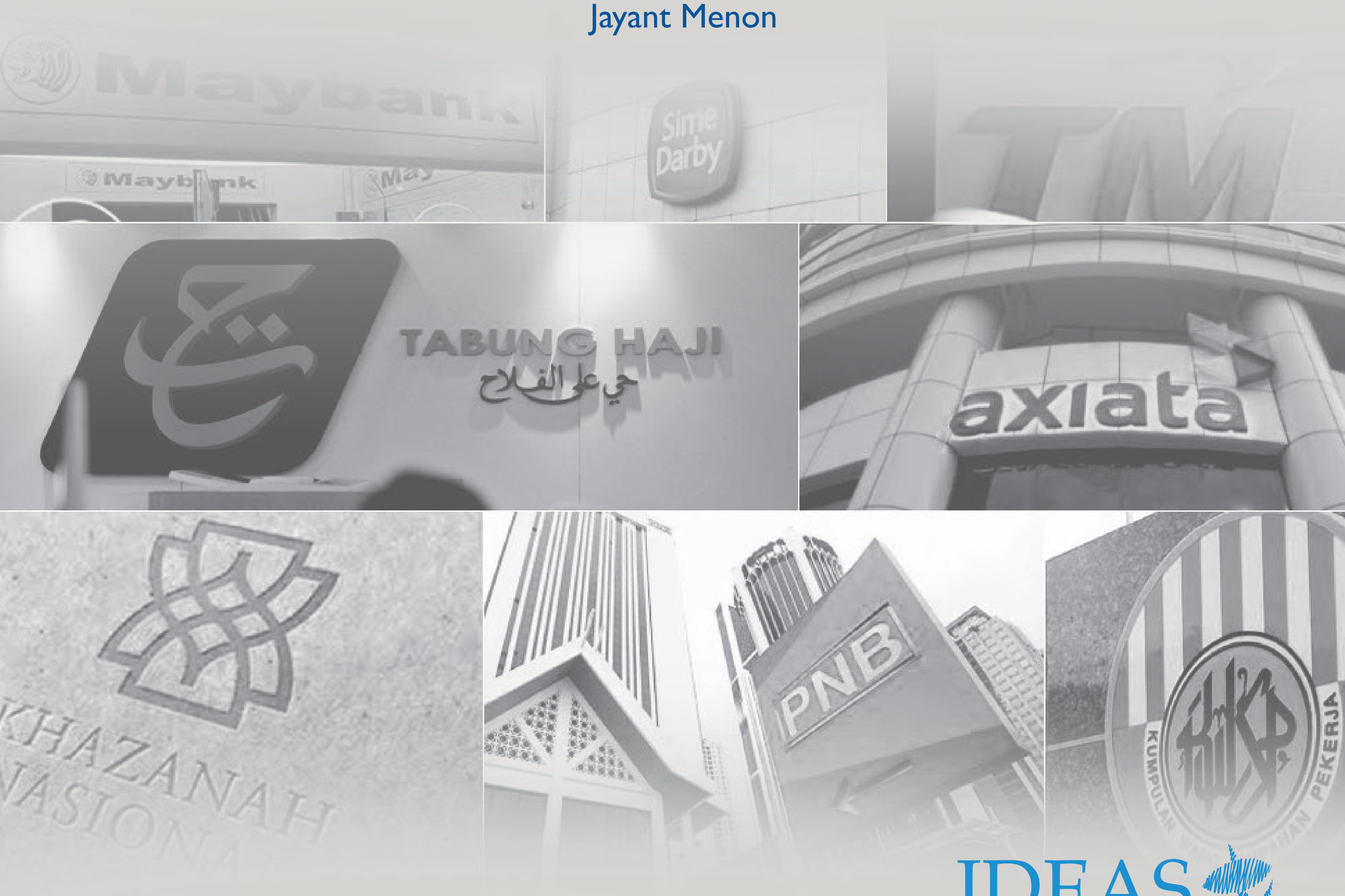

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Introduction

The role that state-owned enterprises (SOEs) or, more generally, government-linked companies (GLCs) play in the Malaysia economy is widespread and pervasive. In terms of countries that have the highest SOE presence among their largest firms, Malaysia ranks fifth highest in the world.[2] The Economic Transformation Program (ETP) has called for a reduced role of government in business, and a program of divestment was concluded in 2015. The government was quick to claim the program a great success, citing its record of having divested itself of 33 out of 34 unidentified GLCs. Despite this apparent achievement, all other indicators point to an increased role of government in business over this period. Not only did the share of GLCs in the Kuala Lumpur Composite Index (KLCI) of the stock market increase significantly, asset acquisitions greatly outstripped asset disposals over the period 2009 and 2015. It does seem that GLCs are alive and well in Malaysia today.

Many of the GLCs are household names in Malaysia. With total assets amounting to 51% of GDP at end-2015, Petronas—in and of itself—epitomizes how GLCs can dominate the economic landscape at home. Its debt amounts to more than 15% of GDP, and its revenue almost a quarter of GDP. In the 2017 Fortune Global 500 List, Petronas ranked 184th. Other GLCs have also become quite well-known internationally, attesting to both their sheer size and influence. For instance, Sime Darby Bhd, along with S P Setia and the Employees Provident Fund, form the Malaysian consortium developing the Battersea Power Station in London. Meanwhile, Tenaga Nasional Bhd is one of the developers of the Shuaibah Independent Water and Power Project in Saudi Arabia.

[1] Parts of this Policy Brief draws freely from Menon (2014) and Menon and Ng (2017). I am grateful to Anna Melendez, Thiam Hee Ng and an anonymous referee for comments. The views expressed in this Policy Brief are those of the author and do not necessarily reflect the views and policies of the Asian Development Bank, or its Board of Governors or the governments they represent.

[2] This is based on Kowalski et al (2013), who use the equally weighted average of shares of SOEs in sales, assets and market value of the country's top ten firms to obtain their ranking.

The objective of this paper is to examine the impacts that GLCs are having on the Malaysian economy and related aspects. The remainder of the paper is in six parts. To set the stage, Section 2 measures the role and influence of GLCs in the Malaysian economy using the most up-to-date data available, and describes the government-sanctioned GLC Transformation Program. Arguably the most pernicious economic impact of GLCs is how they influence private investment decision making. Section 3 examines the theory and evidence on the relationship between GLCs and private investment, with a view to determining whether a crowding out effect is in operation. From a political economy point of view, there is concern that the pervasive influence of GLCs may interfere with good governance. This issue is examined in Section 4. From a social point of view, GLCs may affect income distribution outcomes, and their impact on economic inequality is examined in Section 5. From a fiscal point of view, GLCs can affect government finances in significant ways. Section 6 examines the impact that GLCs have on government revenues. A final section concludes with a summary of main points, and the policy implications in terms of government response.

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2. Overview Of GLC Presence And The GLC Transformation Program

As defined by the government, GLCs are companies that have a primary commercial objective, but where the Malaysian government has a controlling stake in major decisions, such as appointment of management positions, contract awards, strategy, restructuring and financing, acquisition and divestments (Khazanah 2013a). They include companies that are directly controlled by the government and state-level agencies such as Khazanah Nasional, the Ministry of Finance Inc., and Bank Negara Malaysia. They also include subsidiaries and affiliates of GLCs. In practical terms, we use the Putrajaya Committee list to identify the bulk of our GLCs. Government funding for GLCs are allocated through government-linked investment companies (GLICs). [3]

The government estimates that GLCs employ around 5% of the national workforce and account for approximately 36% and 54%, respectively, of the market capitalization of Bursa Malaysia and the benchmark Kuala Lumpur Composite Index (Khazanah 2013a).

Table 1 contains data that illustrate the influence of GLCs. Table 1 lists the 17 biggest GLCs included in the government's GLC Transformation Program. Data relating to market capitalization, total assets, revenue, net income, sector and industry, as well as the top government shareholders is reported. Table 1 clearly demonstrates the pervasive influence of GLCs in the economy.

Although GLCs tend to be associated mostly with resource-based, agriculture and services sectors, there is hardly a sector from which they are absent. GLCs play a dominant role in all sectors except for some food-related, mineral, and services industries. Using either the industry share of operating revenue or income as a proxy for market share, Menon (2014) finds that GLCs are most dominant in utilities (93%) and transportation and warehousing (80%). GLCs' share is greater than 50% in agriculture, banking, information communications, and retail trade. The heavy presence of GLCs in these sectors seem odd, as most of these industries are neither natural monopolies nor strategic.

[3] There are currently seven GLICs in Malaysia: The Employee Provident Fund (EPF), Khazanah Nasional Berhad, Kumpulan Wang Amanah Pencen (KWAP), Lembaga Tabung Angkatan Tentera (LTAT), Lembaga Tabung Haji (LTH), Menteri Kewangan Diperbadankan (MKD), and Permodalan Nasional Berhad (PNB).

Table 1. GLCs in the GLC Transformation Programme

Company Name	Market Cap RM bil (as of 10 Oct 2017)	Assets RM bil (as of 2016)	Revenue RM bil (TTM)	Net income RM bil (TTM)	Employment (Approx)	Industry	Top Government Shareholders (Most recent data available)
Affin Holdings Berhad	5.03	68.89	2.55	0.58	4,680	Banks	Lembaga Tabung Angkatan Tentera (35.42%)
Axiata Group Berhad	47.87	70.49	23.19	0.59	25,000	Mobile Telecomms	Permodalan Nasional Bhd. (15.55%) Kumpulan Wang Persaraan(2.67%) Lembaga Tabung Haji (1.86%)
BIMB Holdings Berhad	7.12	63.15	2.61	0.57	3,000	Banks	Lembaga Tabung Haji (51.94%) Permodalan Nasional Bhd. (6.59%) Kumpulan Wang Persaraan (5.29%)
Bousted Holdings Berhad	6.12	17.93	9.21	0.23	17,670	General Retailers	Lembaga Tabung Angkatan Tentera (61.35%) Kumpulan Wang Persaraan (9.11%)
Chemical Company Of Malaysia Berhad	0.63	1.69	0.72	0.14	1,600	Chemicals	Lembaga Tabung Haji (4.99%) Kumpulan Wang Persaraan (0.43%)
CIMB Group Holdings Berhad	56.85	485.77	19.35	4.16	38,950	Banks	Permodalan Nasional Bhd. (9.17%) Kumpulan Wang Persaraan (6.09%)
Malayan Banking Berhad - Maybank	101.09	735.96	21.42	7.52	43,980	Banks	Permodalan Nasional Bhd. (34.51%) Kumpulan Wang Persaraan (3.10%)
Malaysia Airline System Berhad	--	--	--	--	--		--
Malaysia Airports Holdings Berhad	13.72	21.29	4.35	0.12	9,550	Industrial Transporta-tion	Permodalan Nasional Bhd. (17.65%) Lembaga Tabung Angkatan Tentera (1.02%)
Malaysia Building Society	6.75	43.27	1.68	0.30	1,350	Financial Services	Kumpulan Wang Persaraan (0.46%)
Malaysian Resources Corporation Berhad	3.99	7.51	2.86	0.25	1,770	Construction and Materials	Lembaga Tabung Haji (7.51%)
Sime Darby Berhad	61.55	67.68	31.09	0.55	101,820	General Industrials	Permodalan Nasional Bhd. (44.60%) Kumpulan Wang Persaraan (5.73%)
Telekom Malaysia Berhad	23.37	25.00	12.10	0.76	28,050	Fixed Line Telecomms	Permodalan Nasional Bhd. (20.43%) Kumpulan Wang Persaraan (4.10%)

Company Name	Market Cap RM bil (as of 10 Oct 2017)	Assets RM bil (as of 2016)	Revenue RM bil (TTM)	Net income RM bil (TTM)	Employment (Approx)	Industry	Top Government Shareholders (Most recent data available)
Tenaga Nasional Berhad	80.58	132.90	46.19	6.95	35,680	Electricity	Permodalan Nasional Bhd. (11.08%) Kumpulan Wang Persaraan (5.42%) Lembaga Tabung Haji (1.83%)
TH Plantations Berhad	0.98	3.61	0.66	0.17	--	Food Producers	Lembaga Tabung Haji (73.83%) Kumpulan Wang Persaraan (1.15%)
UEM Sunrise Berhad	4.99	13.52	2.49	0.25	1,420	Real Estate Investment and Services	Lembaga Tabung Haji (6.88%)
UMW Holdings Berhad	6.48	16.26	11.43	-1.64	10,000	Automobiles and Parts	Permodalan Nasional Bhd. (40.77%) Kumpulan Wang Persaraan (8.25%)

Notes: TTM - Trailing Twelve Months. Data unavailable for the Malaysia Airlines

Sources: Financial Times Markets Data, compiled 11 Oct 2017. Market capitalization data for Malaysia Building Society and Sime Darby from Google Finance.

The GLC Transformation Program

GLCs are generally perceived to be less efficient and profitable than private firms, although studies like Lau and Tong (2008) are one of the very few that present evidence to the contrary. In a bid to improve the performance and competitiveness of GLCs, the government launched the ten-year Transformation Programme in May 2004. The Putrajaya Committee on GLC High Performance (PCG) was formed in January 2005 to drive the program.[4]

The program has four phases. The first phase (2004–2005) involved the revamp of Khazanah and corporate boards, and the adoption of leadership changes and key performance indicators for GLCs. The second phase (2006) set policy guidelines and launched the GLC Transformation Manual. The reforms in the first two phases were expected to begin producing results by the third phase of the program (2007–2010). The final phase of the program was expected to produce regional champions and place GLCs at par with its competitors by 2015.

Since the program was launched, progress has been reported mainly in terms of the performance of the 20 largest GLCs, otherwise known as the G-20 (now technically down to 17 GLCs in the wake of mergers, demergers, and other corporate restructuring).[5] Government assessments of the program have been rosy, but perhaps this is not surprising. The Putrajaya Committee on GLC High Performance (PCG, 2015) highlighted some of the key achievements of the G-20. Market capitalization of the G-20 grew 2.9 times (or RM252.2 billion) from RM133.8 billion to RM386.0 billion from 14 May 2004 to 28 July 2015. The total shareholder returns of the G-20 grew by 11.1% annually over the same period, just about keeping pace with the broad Kuala Lumpur Composite Index (KLCI). Aggregate earnings of the G-20 reached a new record high of RM26.3 billion in 2014, from only RM9.9 billion in 2004. In addition, GLCs are reported to have contributed RM62.7 billion in tax revenues and paid out RM108.6 billion in dividends between 2004 and 2014. The GLCs were also lauded for their expansion abroad, raising their overseas share of revenue from 28% to 34% between 2004 and 2014. The number of employees based abroad rose even faster growing from around 2,000 in 2004 to almost 100,000 in 2014.

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4 The PCG is chaired by the Prime Minister, and consists of officials from the Ministry of Finance and the heads of the various GLICs. Secretariat support is provided by Khazanah.

5 The 17 firms that formed the G20 are Affin Holdings Bhd, Axiata Group Bhd, BIMB Holdings Bhd, Boustead Holdings Bhd, CIMB Group Holdings Bhd, Chemical Company of Malaysia Bhd, Malayan Banking Bhd, Malaysian Building Society Bhd, Malaysian Resources Corp Bhd, Malaysia Airlines, Malaysia Airports Holdings Bhd, Sime Darby Bhd, Telekom Malaysia Bhd, Tenaga Nasional Bhd, TH Plantations Bhd, UEM Group Bhd and UMW Holdings Bhd.

6 Malaysia Airlines is excluded from the computations due to its delisting.

As part of the GLC Transformation Program and the broader Government Transformation Program adopted in 2010, the government has underscored its intention to gradually divest their non-core holdings and non-competitive assets in GLCs. In July 2011, the government announced that it would speed up the reduction or disposal of its equity in 33 GLCs either through listing, paredown, or outright sale. By December 2014, 32 of the 33 companies had reportedly been divested (Khazanah, 2015). By the end of the program in 2015, apparently 33 out of 34 unidentified GLCs had been divested.

In this vein, two of the five biggest global Initial Public Offerings (IPOs) of 2012 involved Malaysian GLCs: Asia's largest hospital operator, IHH Healthcare Bhd (IHH), and palm oil producer Felda Global Ventures Holdings Bhd (Felda). These two IPOs alone raised some $6.0 billion from the market, and reduced government's stake in IHH from 62% to less than half, and in Felda to 40% (Grant 2012).[7] That same year, Kazanah divested its 42.7% share in Proton to DRB-HICOM (BBC, 2012).

Although the government did not name all of the 33 GLCs, it would seem that the biggest GLCs—the so-called "crown jewels"—-have not been affected by the divestment plan (Kok 2012, Government of the United States of America 2012).

But the problem is an on-going one. It appears that GLCs were still investing in new sectors during the divestment program. There has been a spate of acquisitions by GLCs in private sector finance and property developers (see Jacobs 2011), and these have continued over time. In light of this, Menon (2014) described the initiative as more of a diversification than a divestment program, and the EIU (2016) has since presented more evidence to support this description.

Moreover, an analysis by Wan Saiful Wan Jan (2016) reveals that any gains that could have been made through divestment have been offset by two contrary developments: (i) the increased shares of GLCs in the KLCI—from 2011 to 2015, the Government's shares in the KLCI increased from 43.7% to 47.1%; and (ii) the higher amount of combined GLC and GLIC asset acquisitions (RM51.7 billion) versus asset disposals (RM29.5 billion) since 2009.

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[7] It should be noted however that even after the divestment, the government still retains management control. Also, GLICs seem to have taken a large portion of the shares from the divestment, suggesting that the exercise was more of a cash raising one than privatization per se (Saad 2012).

More than its divestment record, however, the success of the GLC Transformation Program is increasingly being judged in terms of performance of the GLCs. The preferential treatment accorded GLCs, and the impact that they may have in crowding out private investment, suggests that their superior performance is potentially artificially generated, and comes at a high cost. Nevertheless, if it continues to be based on performance, whether real or artificial, the divestment function of the GLC Transformation Program was effectively sidelined.

These developments may reflect a reluctance to pursue divestment more aggressively in the future. Former Deputy Prime Minister Tan Sri Muhyiddin Yassin practically admitted this at a GLC Open Day, stating that the time was not yet right: "…when the government thinks that there is a need to hand over the GLCs to other parties, in various forms or mechanism, then it might happen." He went on to add, "at this level, we still acknowledge that GLCs still have their roles to play, in terms of the relationship between the government and the economy because they explore a lot of important industries in the country, they play important roles other than generating revenues that can be used for the country's development" (quoted in Chi 2011). Although this statement was made in 2011, it would appear that the underlying sentiment continues to resonate until today.

More tellingly, the only substantive reference to GLCs in the 11th Malaysia Plan appears in Chapter 3 on "Enhancing inclusiveness towards an equitable society," more specifically, as Strategy E2 to achieve Focus Area E on "Enhancing Bumiputera Economic Community (BEC) opportunities to increase wealth ownership." Strategy E2 aims to divest non-core GLC and GLIC assets to provide more business opportunities and expand the market share of qualified Bumiputera entrepreneurs.

3. Impact on Private Investment

GLCs in Malaysia are seen to have preferential access to government contracts and benefit from favorable government regulations. An oft-cited concern relates to the preferential treatment that they receive with respect to government procurement. They could also enjoy various other benefits, including direct subsidies, concessionary financing, state-backed guarantees, and exemptions from antitrust enforcement or bankruptcy rules. Hence, GLCs find it easier and more profitable to increase investment in sectors where they already have a significant presence—a level of involvement usually made possible by their special and preferred status to begin with. In contrast, private firms may be reluctant to invest in sectors where GLCs are dominant because they perceive the playing field to be skewed against them. This suggests a negative relationship between the share of GLCs in a sector and the rate of investment by private firms. The relationship may also be nonlinear in the sense that there could be a threshold effect. That is, it is only when the share of GLCs in a sector surpasses a certain limit that it could have a deterrent effect on investment by other firms. Therefore, we would expect that the non-GLCs would tend to invest less in industries where GLC firms are dominant.

There have only been a few empirical studies on how the presence of government-owned companies affects investment by other firms. Razak et al. (2011) set out to examine a related issue by looking at the relative performance of 210 listed firms between 1995 and 2005 to see if ownership matters. They report mixed results, with the relative performance of GLCs and non-GLCs as a group critically dependent on the inclusion of a few, large GLCs. The small sample size and sensitivity of the results to inclusion of a handful of firms prevent any definitive conclusions to be drawn, unfortunately.

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Menon and Ng (2017) examine the relationship between GLC presence and domestic private investment by estimating a modified version of the standard neoclassical investment model. They employ a panel dataset consisting of annual corporate data from 2007 to 2011 for a total of 443 firms. An analysis at the firm level is required in order to accurately test the crowding out hypothesis, since investment by GLCs and GLICs are also treated as private investment in the aggregate data.

After accounting for the other determinants of investment, the research finds that GLC presence in general has a discernible negative impact on non-GLC investment in Malaysia. The research also tested whether there is a threshold effect when it comes to the share of GLC presence in an industry. It is possible that firms tend to invest less when the share of GLC revenue in a particular industry is large. The results revealed that when GLCs account for a dominant share (60% or more) of revenues in an industry, investment by private firms in that industry is significantly negatively impacted. Conversely, when GLCs do not dominate an industry, the impact on private investment is not significant. Sensitivity tests associated with varying the level of the threshold confirm the robustness of the results. Therefore, for the first time, there is unambiguous empirical evidence of a crowding out effect of private investment in Malaysia due to the presence of GLCs.

What many, including the government, had feared for a long time has now been confirmed with empirical evidence—that GLCs have been crowding out private investment. This finding corresponds to a period where we witnessed a dramatic and sustained slump in private investment, starting in the aftermath of the Asian Financial Crisis.

There has been a turnaround in private investment since 2010, however. Whether this is due to a slowing down of the crowding out effect of GLCs or other factors remains unclear. Proponents of the GLC Transformation Program would no doubt like to credit this turnaround to the conclusion of the Program. Despite that, and as noted earlier, this period is associated with an increase in the share of GLCs in the KLCI as well as a higher amount of combined GLC and GLIC asset acquisitions versus asset disposals, contradicting both the intended outcome of the program and any claim to credit it with the investment recovery. Indeed, since investment by GLCs and GLICs would be counted as private rather than public investment, as noted earlier, the acquisitions data suggest that the turnaround could in fact be due, in some part at least, to increased investments by GLCs and GLICs.

Apart from that, some of the increase in private investment, particularly in manufacturing appears to be driven by external factors and a pickup in exports, more than anything else. Meanwhile, the increase in private investment in services has been mainly due to investments in real estate. Although it would be useful to have more empirical evidence relating to the more recent period covering the private investment turnaround, all the anecdotal evidence suggests that this is due to other factors, rather than a diminution of the crowding out effect.

4. Impact on Governance

The nexus between state and business in Malaysia is not only strong, but growing. The challenges that this poses for good governance within a political culture of patronage and a system where institutions remain weak and subject to manipulation, would appear self-evident. GLCs not only operate within such a system, but help to define it, thereby contributing to the problem. The massive 1 Malaysia Development Berhad (1MDB) scandal has been so widely reported that there is no need to revisit it here, except to note that it exemplifies the kinds of problems that can arise. There are others too.

> *In Malaysia, GLCs serve as instruments of government policy, given the explicit role that they have been assigned to play in the affirmative action program, past and present, of redistributing wealth towards the Bumiputera. The New Economic Policy (NEP) targets of this program were based on stock rather than flow measures, namely a redistribution of wealth rather than income.*

In Malaysia, GLCs serve as instruments of government policy, given the explicit role that they have been assigned to play in the affirmative action program, past and present, of redistributing wealth towards the Bumiputera. The New Economic Policy (NEP) targets of this program were based on stock rather than flow measures, namely a redistribution of wealth rather than income. The objective was to reach a Bumiputera wealth ownership share of 30% by 1990, a target that was missed. Many GLCs were created in order to pursue this objective. Section II of the GLC Transformation Manual (pp. 20–21) explicitly spells out this role:

> …the GLC Transformation Program will continue to be a significant policy instrument to execute Government's policies with regard to the development of the Bumiputera community, with the ultimate aim of preparing the Bumiputera community and the nation towards greater competitiveness.

The intention was to facilitate the creation of a new class of Bumiputera entrepreneurs, through a two-pronged approach: first, by creating, promoting and nurturing GLCs, and then through a process of divestment. The PCG suggests that they expect that the objectives of making GLCs better performing companies and the development of genuine Bumiputera suppliers and vendors as well as the development of Bumiputera human capital within GLCs are not mutually exclusive objectives. Apparently a mutually reinforcing relationship was possible, where stronger GLCs are able to be better developers of Bumiputera small and medium-sized enterprises (SMEs) and human capital that in turn would contribute to the strengthening of the GLCs themselves. All of this may sound good in theory but, how does it work out in practice? Unfortunately, there is little evidence to support the realization of these expectations amongst the Bumiputera community. The expected burgeoning Bumiputera SME sector was nowhere to be found, despite numerous government-supported programs (Lee et al., 2012). On the human capital formation front, the data shows that unemployment is highest amongst Bumiputera graduates (Lee and Nagaraj 2012).

Instead of engendering a new class of self-reliant and independent Bumiputera enterpreneurs, we see much of the opposite occurring: a rise in crony capitalism, state-dependence, regulatory capture and grand corruption (Vithiatharan and Gomez, 2014; Gomez 2012). Evidence for these types of concerns are generally difficult to identify or quantify, but there are indirect indicators. For instance, according to the Economist's crony capitalism index (Economist, 2016), Malaysia had the second highest share of crony wealth as a share of GDP (next to Russia) in 2016, up from number three in 2015. The share of non-crony wealth, on the other hand, was the lowest among the 22 countries included in the sample.

Recently, we have also seen how GLCs can also be called upon to play a part in promoting international economic diplomacy. When Prime Minister Najib Razak visited the United States in September 2017, he announced an unexpected and unusual objective associated with his visit—that of helping "strengthen the US economy". This was to be done in several ways, including through purchases of Boeing aircraft using Employees Provident Fund (EPF) monies, for the previously bankrupt but still financially ailing GLC, Malaysian Airlines Berhad. This appeared surprising to some since it wasn't that long ago that the airline had been aggressively trying to reduce the number of unprofitable routes, which inevitably involved reducing the number of aircraft in its fleet. The sums involved are also massive, with the EPF alone expected to expend between \$3 to \$4 billion. The Prime Minister also announced an increase in future investments in companies in the Silicon Valley, through Khazanah Nasional Berhad.

When business decisions such as these are made for expressed diplomatic rather than economic reasons, this raises questions over financial soundness and, ultimately, national interest. The vast array of GLCs at the disposal of the government provides the modality to pursue foreign relations through flexible but questionable business decision making. In short, it can compromise good governance.

5. Impact on Inequality

Although Malaysia's Gini coefficient of income distribution has been declining since 2012 (Table 2), income inequality in Malaysia remains high at almost 0.4. Furthermore, there are indicators that suggest that other forms of inequality may be rising (Muhammed Abdul Khalid, 2014). Inequality is a multidimensional phenomenon and we need to look beyond traditional measures of income or expenditure disparities, especially when public perception and discourse are at odds with official statistics, to get a better understanding of the problem.

The link between GLCs and inequality operates through the central role that GLCs have been assigned to play in pursuing the affirmative action program. There is a large body of evidence that links all forms of discrimination in the labor market to persistent and rising inequality. As noted earlier, the target was related to wealth, and so we need to look at asset ownership and similar stock measures to hone in on the relationship.

There is no data measuring wealth inequality directly, but there are various related indicators that can be used. A recent study by Lee and Khalid (2016), for instance, point to a growing concentration in car and property sales at the top income percentiles, and asset accumulation in the largest unit trust funds being driven by the upper and middle income segments. They also report rising wage inequality in the 2000s, all pointing to increasing polarization within society.

Using information provided in the EPF's 2016 Annual Report, only 0.4% or 28,727 of its members have about RM47.2 billion worth of savings in it, which is more than the combined savings of the bottom 51.9% or 3.6 million of its members, who collectively owned RM43.9 billion in the fund. The same data also showed that two-thirds of its members aged 54 or less have less than RM50,000 in their EPF account while 1 in 5 have less than RM8,000 (reported in Tan, 2017). These EPF data clearly point to a high level of wage inequality, resulting in similarly high level of financial asset inequality. This paints a very bleak picture on wealth inequality even before considering land or capital asset ownership.

Table 2. Gini Coefficient, 1992-2016

	1992	1995	1997	1999	2002	2004	2007	2009	2012	2014	2016
Malaysia	0.459	0.456	0.459	0.443	0.461	0.462	0.441	0.441	0.431	0.401	0.399
Ethnic Group											
Bumiputera	0.442	0.441	0.448	0.433	0.435	0.452	0.43	0.44	0.421	0.389	0.385
Cina/Chinese	0.42	0.428	0.416	0.434	0.455	0.446	0.432	0.425	0.422	0.405	0.411
India/Indians	0.402	0.404	0.409	0.413	0.399	0.425	0.414	0.424	0.443	0.396	0.382
Lain-lain/Others	0.556	0.414	0.555	0.393	0.449	0.462	0.545	0.495	0.435	0.433	0.391

Source: Economic Planning Unit. www.epu.gov.my/household-income-poverty

The government, to its credit, has repeatedly acknowledged the problem of inequality, with Prime Minister Najib once describing it as the "biggest challenge" to be overcome in becoming a high-income nation. Accordingly, the 11th Malaysia Plan includes "enhancing inclusiveness towards an equitable society," as one of its strategic thrusts, and outlines new affirmative action measures to further enhance the economic status of the Bumiputera community. These include the divestment of profitable non-core GLCs and GLICs assets and activities to Bumiputera entrepreneurs, as previously noted.

Affirmative action policies may improve horizontal inequality but they tend to worsen intra-group and vertical or overall inequality. Malaysia presents affirmation of this phenomenon. In the past, we have seen income inequality worsen within all communities, and more so within the Bumiputera community than it has within the Chinese or Indian communities (Zin 2012; Saari 2015). If disparities between the communities had fallen in the past, then it had been more than compensated for by increases in inequality within the communities, resulting in a rise in overall inequality. Some of this must be attributed to the affirmative action program, and therefore to GLCs, given the role that they have played in implementing it. The more recent official Gini estimates of income inequality suggest that this trend within the communities has been falling modestly since 2002, and then very sharply between 2012 and 2016 (Table 2), although very little explanation is provided to account for it.

An obvious candidate accounting for this outcome would be the transfer programs of the government, such as BR1M – Bantuan Rakyat 1 Malaysia – and other similar schemes that target the poor and lower income households with payments in cash and in kind. In its first year, just prior to the last election in 2013, BR1M had disbursed RM 2.6 billion to 5.2 million households, representing more than 80 percent of families. That more than 80 percent of households should receive such handouts from the governments is in itself astounding. This raises concerns over the efficacy of the targeting of the program, as it must clearly extend beyond the low to middle income group. What is the economic or social rationale for providing cash handouts to families earning up to RM 4000 a month, as happened in 2015? This wide coverage, together with the timing of these programs to coincide with general elections, raises questions over the underlying motivations of the program itself.

Given its size and reach, issues of sustainability also arise, as well as the net impact it has on the target population after accounting for indirect impacts operating through changes in the fiscal balance, in the form of rising costs and interest rates. Nevertheless, the large transfer to lower income households must have made a dent on income and expenditure inequality, and some of the reported changes must reflect the impact of these programs.

"*Given its size and reach, issues of sustainability also arise, as well as the net impact it has on the target population after accounting for indirect impacts operating through changes in the fiscal balance, in the form of rising costs and interest rates.*"

Another less obvious candidate accounting for this pronounced trend decline in inequality could be the increasing share of documented and undocumented foreign workers, who occupy most of the lowest wage and income groups, but are excluded from the household income survey. This factor, operating in concert with the transfer programs mentioned earlier, may account for the incredibly high rise in household income growth for the bottom 40 percent of 15.9 percent per year between 2012 to 2014.[8] But the real disparities that relate to the impact of affirmative action through GLCs would appear in measures of asset ownership or wealth, and data of this type disaggregated by race is limited.

Earlier we referred to how Malaysia came in second in 2016 in the Economist's crony capitalism index. The data also suggests that almost all wealth in the country is related to so-called "crony sectors", and more so than any other country. This is not to imply that all wealth from this sector is associated with cronyism, but rather that there is, on average, a greater likelihood that wealth generated from these sectors could be associated with cronyism. More than 13 percent of GDP in 2016 is classified as billionaire wealth, and more than 95 percent of this is said to consist of wealth emanating from the crony sectors. Since GLCs dominate this sector, this suggests a potential link with the increase in asset and wealth inequality in the country.

The crowding out of private investment referred to earlier may also contribute to rising inequality, to the extent that it makes it more difficult for micro and small and medium sized enterprises (MSMEs) to compete domestically. This is an oft-cited concern relating to SOEs in Indonesia, and the chaebols in South Korea, for instance. With GLCs present in sectors such as agriculture, beverages, food services, and fisheries, where MSMEs tend to be concentrated, there is significant risk that their prospects are threatened by their huge rivals. Instead of supporting the growth and development of MSMEs, as intended by various government programs linked to supplying GLCs, the opposite may have occurred.

[8] There are other apparent anomalies during this period that defy explanation, and could account for Putrajaya's unusual silence over this apparent achievement. For instance, looking at the disaggregated data, we find that the Gini coefficient for the norther state of Perlis fell from 0.455 in 2012 to 0.346 in 2014. This kind of reduction in inequality has never been recorded over such a short time period, and there is no reason to have expected such a historic outcome in this case either. For further discussion of this and other apparent anomalies, see https://www.malaysiakini.com/news/315933#14EDppKKUja2xzDX.99

6. Impact on Government Revenues

To the extent that GLCs receive preferential treatment of one form or the other, there will be social and financial costs as a result of it. The social costs are more difficult to identify and measure, but they exist all the same. The financial costs arise when the special treatment extends to the provision of direct subsidies, concessionary financing, state-backed guarantees and the like. There may also be social costs that accrue for such treatment, but there is a direct financial cost coming out of government coffers. That is, GLCs pose a fiscal burden to the country, and result in a more expansionary budgetary position than would otherwise be the case.

"Although the federal government's fiscal deficit has declined lately, the public sector's overall deficit has increased due to rising development expenditures by the government and GLCs, particularly Petronas, which is wholly owned by the government (OECD, 2016)."

Although the federal government's fiscal deficit has declined lately, the public sector's overall deficit has increased due to rising development expenditures by the government and GLCs, particularly Petronas, which is wholly owned by the government (OECD, 2016).

There has also been a string of government bailouts over the years, resulting in a huge drain on the public purse. Some of the more notable bailouts in the past few years include RM1.5 billion for Proton in 2016, and RM 6 billion for Malaysia Airlines in 2014. One estimate suggests that around RM85.51 billion have been used to bail out GLCs over the past 36 years (Mahavera and Leong, 2017). Given the enormous sums involved, it is also likely that the pressure placed on interest rates as a result of recurring budget deficits may have been a separate factor operating to crowd out private investment, at the margin.

7. Conclusion

There is a legitimate role for government in economy, when it comes to the provision of public goods or in addressing market failures. In Malaysia, however, the role of government in business extends far beyond these functions. Through its many GLCs, government is present in almost every industry, and sometimes in a towering way. The government is acutely aware of the problem this poses, and had instituted a divestment initiative in the form of the GLC Transformation Program. Although the program was declared a success when it was concluded in 2015, the net result left government playing an even greater role in business. The fact that these two apparently opposing outcomes should be possible is explained by the fact that the divestment program was associated with an even more aggressive program of diversification, where government entered new sectors as it appeared to be reducing its influence in existing ones.

Where does this leave us? There is empirical evidence that GLCs have been crowding out private investment, and probably contributing to the long slump in investment that began following the Asian Financial Crisis. It appears that the recovery in private investment over the last few years may be even be driven by the GLCs themselves, or by domestic growth and external demand factors. If this is the case, than there has not been any diminution of the crowding out effect, although additional research should shed more light as more data becomes available.

The state is widely and deeply involved in business in Malaysia. This poses grim challenges for good governance within a political culture of patronage and where institutions can be manipulated. GLCs not only operate within such a system, but help to define it, thereby contributing to the problem. Several GLCs have gained domestic and international notoriety through public financial scandals, raising concerns about the impact that they are having on the quality of governance at home.

There are signs that asset and wealth inequality are rising in Malaysia, despite recent reductions in reported income inequality. This being the case, it is likely that GLCs have contributed to it through its role in assisting in the wealth redistribution target of the affirmative action program. GLCs also continue to be a drain on public resources, and the massive bailouts suggest that there are huge financial costs associated with maintaining them.

Given the varied and significant negative effects that GLCs have on the economy, polity and society, what should government do? A sincere, committed and legitimate program of divestment is the only real solution. But the difficulties associated with implementing such a program cannot be underestimated, as demonstrated by the performance of the PCG. Even though the PCG had clearly failed, the greater tragedy, it would seem, is that it has either not realized it, or has refused to recognize it. By recommending alternatives to genuine divestment in their Graduation Report, the PCG (2015) may have legitimized the outcomes they were instituted to address. These alternatives include, for instance, proposals that GLCs should focus on new industries, collaborate more with the private sector and focus on their core activities. The final report even highlighted the potential role that GLCs and GLICs can play in catalyzing private investment, turning the problem into an apparent solution, while appearing to absolve themselves of their core failings.

All of this suggests that genuine commitment to divestment is still lacking in the Malaysian context. How that commitment can be engendered is admittedly complex, and requires a separate study focusing on much broader issues. But at a minimum, it would seem to require confronting vested interests and addressing the underlying political economy motivations that continue to provide a lifeline for GLCs, and allowing them to flourish. Until this commitment can be instituted, the cost of sustaining GLCs will have to be borne by the rakyat (citizenry).

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