

# Explaining The Trend In Malaysian Income Distribution

Ragayah Haji Mat Zin\*

## Abstract

*This paper attempts to link the trends of Malaysian income distribution to the different economic policies implemented by the government during the three last three decades sine 1970. Except for the recession in the mid-1980s and that during the Asian financial crisis, the economy grew at a rapid rate resulting in a considerable structural transformation of the economy. The high average rate of the whole economy is associated with the intensive growth of the manufacturing sector.*

*The analysis is based on published aggregated household income data mainly based on the Household Income Surveys (HIS) conducted by the Malaysian Department of Statistics (DOS). The HIS employed a comprehensive definition including cash and non-cash incomes of households from employment as well as transfers and value of owner-occupied houses. It was found that the trends of the overall, rural and urban income distribution all peaked in 1976 and fell thereafter to 1990. Urban inequality continued to narrow till 1999, but the trends of the overall and rural inequalities experienced a U-turn in the 1990s. Ethnically, the trend of Bumiputera income distribution is similar to the overall trend, while that of the Chinese followed the urban income distribution pattern. Indian income disparity fell to 1990, but widened since 1990.*

*During the New Economic Policy 1971-1990, a number of policies could be identified to explain the pattern of income distribution. The promotion of export-oriented industrialisation, driven primarily by foreign direct investment, generated demand for labour, thus lowering unemployment and raising household incomes. The blend of human-capital policies, encompassing education, health and other services, enabled the labour force to raise productivity and for the Bumiputeras to undertake the employment restructuring exercise. Moreover, the restructuring of equity ownership and assistance in asset accumulation in favour of the Bumiputeras also contributed to the narrowing of income disparity. While the various other redistributive in the form of rural development helped in poverty eradication, their effectiveness in redistribution needs to be improved.*

*Several hypotheses have been forwarded to explain the widening of income inequality during the National Development Plan 1991-2000. These include the difference in the growth rates of incomes of the rural and urban areas due to the sluggishness in the growth of the agriculture sector. The changing of land status from agricultural to industrial land in certain parts of the country and the phenomenon of back migration, where the wealthy move to settle in the rural areas. However, these have yet to be ascertained.*

*Although Malaysia was also negatively affected by the financial crisis, the intensity was less severe compared to some of her neighbours. This was mainly attributed to the government's relatively high social expenditure and pro-poor programs since the*

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\* Institute of Malaysian and International Studies and the Faculty of Economics, Universiti Kebangsaan Malaysia, rogayah@pkrisc.cc.ukm.my

*implementation of the NEP rather than short-term, transitory poverty reduction programmes. Since crisis are more likely to occur in the future, there is a need to develop cost-effective social safety net programmes. Moreover, the government still needs to play an important role in reducing inequalities, although it faces many challenges since globalisation requires it to reduce its role and increase that of the private sector.*

## **1. Introduction**

Prior to 1997-1998 Financial Crisis, it was assumed that the rapid rate of growth of the East Asian would help to ensure poverty eradication and the reduction of income inequality, resulting in the coinage of the term “Growth with Equity”. However, in the aftermath of the crisis it is realised that these nations cannot rely on rapid growth to eliminate poverty and reduce inequality since, often, the economic growth was brought about by inappropriate and sustainable economic activities associated with the bubble economy (Medhi 2002). Moreover, in certain countries, the question of income inequality has been relegated to the background of policy determination during the euphoria of economic prosperity. While Malaysia has always been sensitive to the distribution issue, the 1990s also saw the widening of income inequality among Malaysian households. The growing inequality enabled the rich to be involved in speculative activities that contributed to the subsequent economic disaster. Having learnt this hard lesson, the future policy focus must be on the sustainability of economic development with a concern for narrowing income inequality so that poverty reduction can be made permanent rather than transitory.

Given the above concern, this paper attempts to relate the attainment of economic growth and the trend of income distribution in Malaysia in the past so as to identify the appropriate policies to ameliorate income distribution that would be consistent with more sustainable development. For this purpose, the Malaysian economic growth and structural transformation since 1970 will be presented in the next section. Section 3 will describe the data sources, their definition and comparability. Section 4 will analyse the trends and patterns of overall, rural and urban inequality while Section 5 will examine the impacts of the various development policies and programmes on income distribution. Section 6 concludes the paper.

## **2. Structural Transformation of the Malaysian Economy**

**Table 1** shows that the real (in 1978 prices) gross domestic product (GDP) of Malaysia grew at an average of 7.8% per annum in the 1970s but slowed down to below 6 % per annum in 1980s. Until the 1997-1998 crisis, the average growth rate in the 1990s exceeded eight and a half percent. However, the growth rate plunged by 7.4% in 1998 but recovered speedily to attain a growth rate of 6.1% in 1999 and 8.3% in 2000. The dampening of the US economy, the continuing recession in the Japanese economy plus of 11 September 2001 impacted negatively on Malaysia such that the economy registered only 0.4% growth for 2001, but recovered somewhat to 4.2% in 2002.

The high growth rate of the whole economy is associated with the intensive growth of the manufacturing sector. The latter accelerated at double-digit growth rate between 1970 and 1995, with the exception of the 1981-1985 period when it slowed down

considerably. In contrast, the primary sector, which grew at 4.8% per annum in the early 1970s, slowed down to a mere 2% per annum in the 1990s. This rapid growth of the manufacturing sector in the face of a much slower rate of the primary sector (agriculture, forestry and fishing) resulted in a significant transformation of the Malaysian economy. The share of the latter declined from 29.0% in 1970 to 8.5% in 2000 while the share of the industrial sector (mining and quarrying, manufacturing, and construction) rose from 31.4% in 1970 to 40.3% in 2000.

The share of the services sector fluctuated between 36.2% and 54.6% over the period. It is increasingly obvious that the services sector has become increasingly important. The sector comprise government and non-government services. The latter includes electricity, gas and water; transport, storage and communications; wholesale and retail trade, hotels and restaurants; finance, insurance, real estate and business services; as well as other services (community, social and personal services, private non-profit services to households and domestic services of households). The growth rate of the government services has always been positive though it fell to only 1.1% in 1998. In the non-government services sub-sectors, strong average growth rates had been recorded in the last decade, particularly for the electricity, gas and water and transport, storage and communications sub-sectors

The growth and structural transformation of the Malaysian economy had wide implication on the growth of employment opportunities as well as the distribution of labour force by sectors. Table 1 shows that the employment share in the primary sector decreased from 53.5% to 15.2% while that of the industrial and services sector increased from 14.0% and 32.5% to 36.1% and 48.7% respectively over the thirty-year period. With this rise in the employment opportunities, the unemployment rate contracted, except for the mid-1980s, from 7.4% in 1970 to 2.8% in 1995 but has since then risen slightly to 3.1% by 2000. The labour market became so tight in the 1990s that some sub-sectors have to resort to imported labour from abroad. A worrying problem in 2001 is that the level of unemployment is creeping up to 3.7%

When the sectoral GDP and employment shares are compared, it can be seen that the structural transformation of the economy in terms of output has not been matched by the change in the employment structure. This unbalance share of output implies that there are sectoral disparities in labour productivity and earnings, and thus on the share of the poor. During 1970-80, productivity in the manufacturing sector grew at 4.6% per annum, exceeding that of the agriculture sector, which registered 2.4% growth. This resulted in the output per worker in the manufacturing sector being 2.4 times the productivity of the agriculture sector in 1980 compared to 1.9 times in 1970 (Malaysia 1981). Over the 1981-85 period, labour productivity in the manufacturing as well as agricultural sectors registered an annual increase of 3.0% while in the services sector it recorded an increase of 3.2% per annum (Malaysia 1986). Labour productivity for the whole economy grew at 3.3% during 1986-90 compared to 5.1% per annum during 1991-95. The agriculture, manufacturing and services sectors registered labour productivity growth of 6.1%, 3.9% and 5.9% per annum respectively during 1991-95. While productivity increased over the 1996-2000 period, it was at a slower pace than the first half of the decade. Labour productivity in the manufacturing sector grew at an average annual rate of 1.6%, while labour productivity in the agriculture sector and the services sector rose by 1.5% and about 3.0% respectively over the period.

A remarkable feature of the development process of the Malaysian economy is that the high growth rate throughout the period has also been accompanied by low inflationary rates. The inflation rates were stable except for 1973-74 and 1980-81 due mainly to the two oil price shocks of 1973 and 1979. After that the inflation rate did come down particularly during the mid-1980s recession. However, due to the tight factor and goods markets during the expansionary period of the 1990s, inflation had risen again but managed to be controlled at a relatively low level of below 5%, except during the crisis year of 1998 when an inflation rate of 5.2% was registered.

**Table 1: Composition and Growth Rate of the Gross Domestic Product and Employment Share By Industry of Origin (in 1978 Prices)**

<b>GDP Share (Employment Share)</b>	<b>1970</b>	<b>1975</b>	<b>1980</b>	<b>1985</b>	<b>1990</b>	<b>1995</b>	<b>2000<sup>1</sup></b>
Agriculture	29.0	27.7	22.9	20.8	18.7	10.3	8.5
Forestry and Fishing	(53.5)	(49.3)	(39.7)	(35.7)	(26.0)	(19.0)	(15.2)
Mining and Quarrying	13.7	4.6	10.1	10.5	9.8	8.2	6.9
	(2.6)	(2.2)	(1.7)	(1.1)	(0.6)	(0.5)	(0.4)
Manufacturing	13.9	16.4	19.6	19.7	26.9	27.1	33.4
	(8.7)	(10.1)	(15.7)	(15.1)	(19.9)	(25.7)	(27.6)
Construction	3.8	3.8	4.6	4.8	3.5	4.4	3.3
	(2.7)	(2.9)	(5.6)	(6.9)	(6.3)	(8.9)	(8.1)
Services	36.2	45.0	40.1	43.5	42.5	51.2	53.4
(Non-Govt.)	(20.5)	(22.5)	(23.6)	(26.2)	(34.5)	(34.6)	(38.1)
(Govt. Services)	(12.0)	(13.0)	(13.7)	(15.0)	(12.7)	(12.7)	(10.6)
Import Duty– Imputed Bank Service Charges	3.4	2.6	2.7	0.7	-1.4	-2.7	-5.4
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
(Unemployment : %)	7.4	7.0	5.7	6.9	5.1	2.8	3.1
<b>Per Capita GDP (RM)</b>	1932	<b>2367</b>	3038	3599	4426	5815	8899
<b>Average Growth Rate (%)</b>		1971- 1975	1976- 1980	1981- 1985	1986- 1990	1991- 1995	1996- 2000
Agriculture, Forestry and Fishing		4.8	3.9	2.7	4.6	2.0	0.7
Mining and Quarrying		0.4	8.9	5.9	5.2	2.9	1.1
Manufacturing		11.6	13.5	5.2	13.7	13.3	9.9
Construction		6.6	12.6	5.8	0.4	13.3	-0.1
Non-Government Services		8.5	8.4	5.4	6.9	10.4	6.0
Government Services		10.1	9.0	8.8	4.0	6.7	4.1
Total		7.1	8.6	5.1	6.7	8.7	4.9

Note: <sup>1</sup>In 1987 prices

Source: Malaysia (1971, 1986, 1991a, 1991b, 1996) and *Economic Report*, various issues. Ministry of Finance, Kuala Lumpur.

On the external front, Malaysia continued to register consistently positive balance on the merchandise account except for 1982. Prior to the early 1980s, this was largely due to Malaysia's strong commodity (including petroleum) export performance, particularly in terms of volume expansion as their prices were subjected to marked fluctuations. Hence, despite the continuing negative balance on the service account, Malaysia managed to register a positive balance on the current account. However, since the early 1980s, the merchandise account was also negative, thus exacerbating the deficit in the current account. While the merchandise account did register surpluses again after 1982, it generally could not offset the deficit in the service account except between 1987 and 1989. This problem was said to be the main reason for the speculative attacks on the Malaysian currency and stock markets that caused the financial turmoil in 1997-98. Fortunately, the depreciation in the Ringgit resulted in large positive net balance in the merchandise account since 1998 causing the overall balance of payments to be strongly positive in 1998 and 1999. In 2000, the overall balance was negative again due to the continued rise in the size of the negative balance on services as well as the voluminous net outflow of short-term capital. However, the overall balance turned positive again in the last two years mainly due to the surplus on the current account.

### **3. Data Sources, Comparability and Definition**

In order to have some idea about the quality of data employed in measuring poverty and equity, a brief description of the sources of household income data is deemed necessary. The income data used to estimate poverty incidence and income distribution in Malaysia are derived from several official surveys, namely the Post Enumeration Survey of the Population Census 1970 (PES 1970), Agriculture Census 1977 (AgCensus 1977, which used 1976 as the reference year), Household Income Surveys (HIS) of 1979, 1984, 1987, 1989, 1993, 1995, 1997 and 1999. These censuses and surveys were conducted and processed by the Malaysian Department of Statistics (DOS). Most are not available to the public except for summary data published in official documents. As such, it is not possible to use regression techniques to estimate the relationships between growth, poverty and inequality, or test whether the changes in the values of the measures are statistically significant.

The PES, which was conducted by DOS in conjunction with the 1970 Population and Housing Census, had three objectives (see Ragayah 1978; Jomo and Ishak 1986). The main purpose was to check the accuracy of the census data. Its second objective was to gather information on family planning knowledge, attitudes and practice while the final objective was to provide another measure of household income distribution. However, since the whole design of the survey was actually meant to check on the main census, the PES may not be the most appropriate for use in income studies. However, in the absence of any alternative, this data set had been widely used as it was made available to the interested public then (for example, Ragayah 1978; Ragayah and Ishak 1978; Snodgrass, 1980; Anand, 1983).

The PES used the household as the unit of analysis. It covered approximately 135,000 individuals that made up 26,310 households of Peninsular Malaysia (roughly 1.8% of the population), with about a 6% non-response rate. Income in this survey referred to the monthly household income for the "average month" and no particular reference month was specified. This implies that the problem of seasonal variations

of income had been taken into account. The household income is the sum of incomes of all individual earners which were collected in two ways: by simply asking and by probing through eleven categories of income so as to acquire complete and accurate data.

The Agcensus 1977 provided for the first time information on income distribution and poverty for Sabah and Sarawak. The Census covered rural and urban households in both agricultural and non-agricultural sectors. Household income referred to the average gross income earned by all income recipients of the household per month in 1976. This included earnings from paid employment, net income from agricultural holdings and other businesses, net property income and transfer receipts and was income before deductions for transfer payments such as income tax and other direct taxes.

The HIS employed a comprehensive definition, including cash and non-cash incomes of households from employment as well as transfers and value of owner-occupied houses (see Ishak and Ragayah 1990, Bhalla and Kharas 1992 and Shireen 1998 on the discussion of the data sources and comparability). The main objective of the HIS is to collect information on the pattern of income distribution classified by various socio-economic characteristics in Malaysia. These surveys also used the “household” as the unit of enumeration, defined as a “group of persons normally living together, pooling their financial resources and eating from the same pot.”

Several points regarding these surveys should be emphasized here. Firstly, the income concept used in the various estimates is the household income, not individual income. Anand (1983) explained that household income does not provide a good indication of inequality in the levels of living as it takes no account of the differences in household size and composition, and economies of scale in consumption. Secondly, by focussing on private households, individuals who are living in “institutional households,” such as those residing in police and military barracks, hotels, hospitals and welfare homes are left out. Third, the surveys used a comprehensive concept of income, which includes money income as well as income in kind, receipts that are of a recurring nature and accrue to the household or to its individual members regularly at annual or more frequent intervals. Hence, income includes earnings from paid employment, income from self-employment, rental income, property income, transfer receipts and transfer payments, but excludes income that does not accrue to households such as retained earnings of companies.

Finally, it is generally agreed that the census/surveys have employed a consistent and comparable income concept and approach in conducting the various surveys based on the guideline manuals issued by DOS. Each survey utilises the National Household Sampling Frame made up of Enumeration Blocks and adopted the same definition for enumeration unit, concept of income and classification of urban and rural areas. “Urban areas” were defined as those towns with at least 10,000 population while those areas with less than 10,000 were classified as “rural areas. The data were collected through personal interviews. Field edits at various regional centres and re-interviews were carried out to ensure the quality of the fieldwork. Moreover, DOS also evaluated the income data to check its reliability and claimed that the sampling errors were within the accepted level of precision required. Non-sampling errors arising from observational or response errors, defective frame, non-response editing or processing errors, were kept to a minimum. A 5-10% random check on completed

interviews were also carried out by the supervisors to ascertain that the response errors were minimized. Consistency checks with household income estimates from the National Accounts were carried out to assess the extent of bias and it was found that the degree of under-reporting of household income was not excessive. Thus, Bhalla and Kharas asserted that “the overwhelming result from cross-checks of the data is that these surveys have been extremely well conducted, and it is likely that they are amongst the most reliable of the surveys conducted in the developing world”.

#### 4. Trends in Income Inequality

The discussion in Section 2 reflects that Malaysia has experienced significant economic growth and structural transformation. This present section will discuss the impact of these changes on income distribution from the perspective of the overall, rural and urban as well as racial household incomes distribution.

##### 4.1. Overall Income Distribution

The impacts of these changes on income distribution on the overall, rural and urban household incomes distribution are shown in **Table 2**. Between 1970 and 1976, The Gini ratio rose from 0.513 to 0.529 while the share of the top 20% households rose from 55.7% to 57.7% and the share of the middle and bottom 40% households fell from 32.9% and 11.5% to 31.2% and 11.1% respectively. The trend in income inequality seemed to peak in 1976 since both indicators of inequality registered improvements after this year. The Gini ratio fell continuously till it reached 0.446 at the end of the NEP period. At the same time, the share of the top 20% households dipped to 50.4% and the share of the middle and bottom 40% households increased to 35.3% and 14.3% over the same period. However, the Gini ratio has shown a trend reversal in the 1990s when it rose to 0.459 in 1993, 0.464 in 1995 and 0.470 in 1997. Similarly, the income shares of the top 20 % of households increased to 51.3% in 1995 and 52.4% in 1997. On the other hand, the shares of the middle and bottom 40% decreased to 35.0% and 13.7% respectively in 1995 and to 34.4% and 13.2% respectively in 1997. This U-turn in income inequality almost wiped out all the gains that were made under the NEP. The mean monthly income of the Malaysian household has increased significantly and continuously from RM264 in 1970 to peak at RM2606 in 1997. However, the reduced business activities and retrenchment due to the financial crisis 1997-1998 resulted in the moderation of the mean income of the top 20% of households, particularly those in the urban areas. The mean income of the top 20% of households increased from RM5202 in 1995 to RM6854 in 1997, but fell by 8.6% to RM6268 in 1999. The crisis managed to bring down the Gini ratio to 0.443 in 1999.

**Table 2: Distribution of Household Income by Strata: Malaysia 1979-1999**

<b>Percentage of Households</b>	<b>Income Share (Percentage)</b>									
	<b>1970</b>	<b>1976</b>	<b>1979</b>	<b>1984</b>	<b>1987</b>	<b>1990</b>	<b>1993</b>	<b>1995</b>	<b>1997</b>	<b>1999</b>
<b>Overall</b>										
Top 20%	55.7	57.7	55.8	53.2	51.2	50.4	n.a.	51.3	52.4	50.5
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	5202	6854	6268
Middle 40%	32.9	31.2	32.4	34.0	35.0	35.3	n.a.	35.0	34.4	35.5
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1777	2250	2204
Bottom 40%	11.5	11.1	11.9	12.8	13.8	14.3	n.a.	13.7	13.2	14.0
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	693	867	865
Gini Ratio	0.513	0.529	0.505	0.483	0.458	0.446	0.459	0.464	0.470	0.443
Mean Household Income (RM)	264	514	763	1095	1074	1163	1563	2020	2606	2472
<b>Rural</b>										
Top 20%	51.0	54.5	53.2	49.5	48.3	47.1	n.a.	47.4	48.2	47.9
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	3153	4130	4124
Middle 40%	35.9	33.7	34.4	36.4	36.7	37.1	n.a.	37.1	36.6	36.5
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	1235	1564	1577
Bottom 40%	13.1	11.8	12.4	14.1	15.0	15.8	n.a.	15.5	15.2	15.6
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	515	649	670
Gini Ratio	0.469	0.500	0.482	0.444	0.427	0.409	n.a.	0.414	0.424	0.418
Mean Household Income (RM)	200	392	550	824	852	927	n.a.	1326	1704	1718
<b>Urban</b>										
Top 20%	55.0	55.9	55.6	52.1	50.8	50.6	n.a.	49.8	50.2	48.7
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	6474	8470	7580
Middle 40%	32.8	32.2	32.1	34.5	35.0	35.1	n.a.	35.7	35.6	36.5
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	2323	3000	2844
Bottom 40%	12.2	11.9	12.3	13.4	14.2	14.3	n.a.	14.5	14.2	14.8
Mean Household Income (RM)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	842	1193	1155
Gini Ratio	0.503	0.512	0.501	0.466	0.449	0.445	n.a.	0.431	0.427	0.416
Mean Household Income (RM)	407	830	975	1541	1467	1591	n.a.	2589	3357	3103
<b>Urban:Rural Disparity Ratio</b>	2.14	2.19	1.90	1.87	1.72	1.70	1.75	1.95	2.04	1.81

Sources: Anand (1983); Malaysia (1981, 1986, 1989, 1991, 1993, 1996, 1999, 2001a); mean household incomes of income classes for Malaysia, Urban and Rural were provided by EPU.

Note: n.a. : not available.

A more micro description of the impact of the crisis on income distribution is illustrated in **Table 3**, which shows the mean monthly gross households income by state and their respective Gini coefficients for selected years between 1970 and 1999. The figures in this table are constrained by the accessibility to the information and are limited to those published in public documents or released by the EPU. In 1970, there was no information on Sabah and Sarawak, and thus for Malaysia as a whole as the PES was only limited to Peninsular Malaysia. The mean monthly household income was only RM264. Selangor (which still included Kuala Lumpur then) had the highest mean of RM417 among the states, followed by Penang with RM299 and Negeri Sembilan with RM281 per month. States with the lowest mean monthly household income were Perlis with RM121, Kelantan with RM126, Kedah with RM184 and Terengganu with RM194 per month.

Examining the values of the Gini for the various states reveals that, with a few exceptions, there is a general positive correlation between the level of mean monthly household income and income disparity. In other words, the higher was the level of mean monthly household income, the more unequal was the income distribution. The most notable exception was Kelantan, which had the second lowest mean monthly household income but registered fourth place in terms of inequality. Similar situation seems to prevail in Terengganu. On the other hand, Johor and Malacca had relatively higher mean monthly household income but lower level of income inequality.

In 1985, Kuala Lumpur (by now a Federal Territory), Selangor, and Penang continued to have the mean monthly household income above the national average. Sabah was also in this group. The mean monthly household income for the whole country has risen to RM1098, while Kuala Lumpur, Selangor, Penang and Sabah had RM1920, RM1590, RM1183 and RM1212 respectively. Kelantan had the lowest mean monthly household income with RM625, followed by Kedah with RM690, Perlis with RM692 and Terengganu with RM756. Actually, the latter had the second highest per capita GDP after Kuala Lumpur as most of the oil and gas are found in this state, but most of the revenue had not trickled down to the residents in the state.

By 1990, all states have increased their mean monthly household income as well as their income distribution compared to 1970. It also remained generally true that states with higher mean monthly household income tend to be those with higher inequality, with the exception of Johor. Also, Terengganu remained as the rich state with the low mean monthly household income and high inequality.

Table 3 also shows the growth rates of these states for 1995/1997 and 1997/1999. Generally, states with already high mean incomes like the Federal Territory of Kuala Lumpur, Selangor, Penang and Johor had high rates of growth in mean monthly gross households income ranging between 12.6% for Selangor to 18.9% for Kuala Lumpur. Middle-income states like Negeri Sembilan and Perak also had growth in mean monthly gross households income of 16% and above. On the other hand, low-income states like Kelantan and Pahang had growth rates of only 7.0% and 6.6% respectively. Bucking the trend is Terengganu, which had 15.8% growth in mean monthly gross households income, probably due to an increase in oil revenue.

**Table 3: Mean Monthly Gross Households Income (RM) and Gini Coefficient by State: 1970 – 1999**

State	1970		1985	1990		1995		1997		1999		Rate of Growth %	
	Mean Income	Gini Ratio	Mean Income	Mean Income	Gini Ratio	Mean Income	Gini Ratio	Mean Income	Gini Ratio	Mean Income	Gini Ratio	95/87	97/99
Johor	259	0.4308	1065	1148	0.3855	2,138	0.399	2,772	0.397	2,646	0.386	13.9	-2.3
Kedah	184	0.4375	690	748	0.3830	1,295	0.406	1,590	0.429	1,612	0.409	10.8	0.7
Kelantan	126	0.4861	625	708	0.4064	1,091	0.442	1,249	0.442	1,314	0.424	7.0	2.6
Melaka	272	0.4667	1040	1088	0.4001	1,843	0.399	2,276	0.371	2,260	0.399	11.1	-0.4
Negeri Sembilan	281	0.5072	1039	1078	0.3683	1,767	0.384	2,378	0.408	2,335	0.392	16.0	-0.9
Pahang	247	0.4547	960	956	0.3508	1,436	0.373	1,940	0.359	1,743	0.332	6.6	-4.7
Perak	251	0.4729	883	972	0.4210	1,436	0.405	1,507	0.398	1,431	0.399	16.2	-5.2
Perlis	121	0.4003	692	831	0.3861	1,158	0.397	1,507	0.381	1,431	0.387	14.1	-2.6
Penang	299	0.4929	1183	1332	0.4069	2,225	0.379	3,130	0.412	3,128	0.394	18.6	0.0
Selangor	417	0.5153	1590	1659	0.4476	3,162	0.424	4,006	0.409	3,702	0.394	12.6	-3.9
Terengganu	194	0.4775	756	756	0.4572	1,117	0.464	1,497	0.466	1,599	0.440	15.8	3.4
K. Lumpur	-	-	1920	1875	0.4435	3,371	0.423	4,768	0.417	4,293	0.414	18.9	-7.2
Peninsular Malaysia	264	0.5063	n.a.	1163	0.4448	2,066	0.457	2,687	0.469	2,567	0.444	13.7	-2.8
Sabah <sup>1</sup>	n.a.	n.a.	1212	1148	0.4589	1,647	0.448	2,057	0.454	1,905	0.448	11.8	-3.8
Sarawak	n.a.	n.a.	1033	1208	0.4484	1,886	0.440	2,242	0.447	2,276	0.407	9.0	0.8
<b>Malaysia</b>	n.a.	n.a.	1098	1167	0.4464	2,020	0.464	2,606	0.470	2,472	0.443	13.5	-2.6

Source: 1970: Compiled from Ragayah 1978; 1985: Malaysia 1991; 1990: Ismail (2002); the rest provided by the Economic Planning Unit.

Notes: <sup>1</sup> Sabah includes Labuan Federal Territory (FT).

However, these high growth states were also the ones most badly affected by the crisis. Kuala Lumpur's mean income growth rate dashed to  $-7.2$ , Selangor to  $-3.9$  and Johor to  $-2.3$ . Only Penang's mean income remained constant. Perak's mean income also contracted by  $5.2$  and poor Pahang lost  $4.7\%$ . One would have expected Pahang, with its wide acreage of oil palm plantations, to survive the crisis better. Apparently, large tracks of the oil palm plantations underwent a replanting program during this time and the state could not take advantage of the sharp rise in palm oil price then. Low-income states like Kelantan, Terengganu, Kedah managed to register positive mean income growth during the crisis.

In terms of inequality, states with higher mean household income and higher growth rates tend to have higher Gini ratios. However, there are exceptions, as demonstrated by Terengganu, which is expected due to the presence of the oil community there, and Kelantan, which is unexpected since one would think that the households are more homogeneous there. All the states experienced a reduction in the values of the Gini coefficient except for Melaka, whose Gini ratio rose from  $0.371$  to  $0.399$ , and Penang whose Gini ratio remained constant between 1997 and 1999.

#### 4.2. Rural and Urban Income Distribution

The state of income distribution both in the rural and the urban areas also exhibit similar trends over the NEP period. It can be seen that the Gini ratio for rural households rose from  $0.469$  to  $0.500$  between 1970 and 1976 but thereafter fell to  $0.409$  by 1990. At the same time, the income share of the top 20% households first rose from  $51.0\%$  to  $54.5\%$  and then contracted to  $47.1\%$  in 1990. The share of the middle and bottom 40% households fell from  $35.9\%$  and  $13.1\%$  to  $33.7\%$  and  $11.8\%$  and then increased to  $37.1\%$  and  $15.8\%$  respectively. In the urban areas, the Gini ratio first rose to  $0.512$  in 1976 from  $0.503$  in 1970 and fell thereafter to reach  $0.445$  in 1990. The top 20% of households managed to raise their income share from  $55.0\%$  to  $55.9\%$  but this share dropped to  $50.6\%$  in 1990. On the other hand, the share of the middle and bottom 40% households fell from  $32.8\%$  and  $12.2\%$  to  $32.2\%$  and  $11.9\%$  but rose again to  $35.1\%$  and  $14.3\%$  respectively over the same period.

However, the trends in income distribution in the rural and the urban areas diverged during the 1990s. The trend in the rural areas replicates the overall trend, where there is also a U-turn in income inequalities when the Gini ratios crept to  $0.414$  in 1995,  $0.424$  in 1997 but moderated to  $0.418$  in 1999. The income share of the top 20% households rose slightly to  $47.4\%$  in 1995,  $48.2\%$  in 1997 and then contracted to  $47.1\%$  in 1999. In contrast, the trend in income inequality continued to fall in the urban areas where the values of the Gini ratio contracted to  $0.431$  in 1995,  $0.427$  in 1997 and  $0.416$  in 1999. The income share of the top 20% of urban households fell to  $49.8\%$  in 1995, rose marginally  $50.2\%$  in 1997 and then contracted to  $48.7\%$  in 1999. The share of the middle and bottom 40% households respectively increased to  $35.7\%$  and  $14.5\%$  in 1995, but fell marginally to  $35.6\%$  and  $14.2\%$  respectively in 1997 and then rose again to  $36.5\%$  and  $14.8\%$  respectively in 1999.

The mean income of the top 20% group of households in the urban areas rose to RM6474 in 1995, RM8470 in 1997, but fell rather significantly (by  $10.5\%$ ) to RM7580 in 1999. In fact, it was the income contraction of this group that caused the mean income of the top 20% of households to fall since the mean income of this

group in the rural areas remained constant during the crisis period, falling by a mere RM6 from RM 4130 to RM4124. On the other hand, mean income of the middle and bottom 40% fell at much lower rates of 2.0% and 0.2% respectively. This is because their mean incomes dropped more moderately by 5.2% and 3.2% respectively while those in the rural areas bucked the trend by experiencing a rise in incomes of 0.8% and 3.2% respectively. This is due to the fact that agricultural income expanded at a faster rate than in 1997 owing to higher prices of palm oil and increased production of food crops in response to the higher costs of imports. Moreover, rural households have greater ability to diversify their sources of income that helped to cushion the full impact of the recession (see Ragayah 2002a).

The Gini for the urban areas continuously improved throughout the second half of the 1990s, falling from 0.431 in 1995 to 0.427 in 1997 and 0.416 in 1999. However, rural income inequality worsened from 0.414 to 0.424 between 1995 and 1997, but improved slightly to 0.418 after the crisis. Income disparity between the urban and rural areas rose from 1.95 in 1995 to 2.04 in 1997, but moderated to 1.81 in 1999. While the crisis puts a break to the rising inequality of the 1990s, this improvement comes with a reduced size of the economic pie.

#### 4.3. Ethnic Income Distribution

This is the most sensitive issue in Malaysian income distribution. In order to prevent abuses in the interpretations of the data, the Government has classified all data relating to ethnic income distribution as confidential, particularly since the end of the NEP. Hence, these are the most difficult data to obtain. Occasionally there may be some “leakage” and an attempt has been made here to assemble these scarce information in order to be able to have some idea on the income distribution situation between the three main ethnic groups in Malaysia.

The patterns and changes in income distributions for the three main ethnic groups in Peninsular Malaysia during the period under considerations are shown in **Table 4**. In 1970, the degree of inequality among the major ethnic group in Peninsular Malaysia was highest among the Indians, followed by the Malays and lowest among the Chinese. Between 1970 and 1976, the Gini coefficients indicate that the income distribution of all the three ethnic groups deteriorated, with the inequality among Chinese households exceeding that of the Malay and Indian households. The income shares of the first two ethnic groups show that while the top income groups increased their shares of the total income, the lower two groups suffered losses. While inequality also deteriorated among the Indian households, as indicated by the rise in the Gini coefficient, it was the middle 40% of households that gained at the expense of the other two groups. Hence, inequality among Chinese households has switched its ranking from the least unequal in 1970 to the most unequal in 1976.

**Table 4** also reflects that values of the Gini shrank for all the races between 1976 and 1979, but for the Malays and the Chinese, these were not sufficient for them to regain their 1970 levels. The shares of the middle income groups all rose while the shares of the top income groups all fell. Among the lowest income groups, only the Malays managed a marginal increase.

**Table 4: Distribution of Household Income by Ethnic Groups, Malaysia\*: 1970-1997**

% of Households	Percentage of Income Share											
	Malay/Bumiputera				Chinese				Indian			
	1970	1976	1979	1984	1970	1976	1979	1984	1970	1976	1979	1984
Top 20%	52.5	53.9	52.6	51.9	52.6	56.1	52.8	51.1	54.2	52.6	50.8	48.4
Middle 40%	34.8	34.3	35.5	34.8	33.5	31.3	35.3	34.9	31.3	32.7	36.3	35.3
Bottom 40%	12.7	11.8	11.9	13.3	13.9	12.6	11.9	14.0	14.3	14.7	12.8	16.3
Mean Income <sup>1</sup> (RM per month)	172	345	513	852	399	787	1094	1502	310	538	776	1094
Median Income <sup>1</sup> (RM per month)	122	233	332	581	269	480	636	1024	196	360	522	770
Gini Ratio : Overall	0.466	0.494	0.470	0.469	0.455	0.505	0.473	0.452	0.463	0.458	0.460	0.417
Rural	0.419	0.471	n.a.	0.447	0.399	0.486	n.a.	0.412	0.363	0.388	n.a.	0.347
Urban	0.445	0.478	n.a.	0.462	0.474	0.507	n.a.	0.456	0.502	0.504	n.a.	0.441
% of Households	1987	1990	1997		1987	1990	1997		1987	1990	1997	
Top 20%	50.2	49.5	n.a.		49.2	48.9	n.a.		47.2	47.7	n.a.	
Middle 40%	35.7	35.7	n.a.		35.7	36.0	n.a.		35.9	35.8	n.a.	
Bottom 40%	14.1	14.8	n.a.		15.1	14.2	n.a.		16.9	16.5	n.a.	
Mean Income <sup>1</sup> (RM per month)	868	931	2052		1430	1582	3743		1089	1201	2887	
Median Income <sup>1</sup> (RM per month)	612	677	n.a.		1021	1137	n.a.		799	881	n.a.	
Gini Ratio: Overall	0.447	0.429	0.448		0.430	0.419	0.416		0.402	0.390	0.409	
Rural	0.426	0.410	0.408		0.399	0.392	0.420		0.350	0.341	0.362	
Urban	0.437	0.435	0.431		0.440	0.428	0.402		0.435	0.424	0.403	

Note: Figures from 1970-1987 refer to Peninsular Malaysia only.

Sources: Compiled from Ishak and Ragayah (1990); Kumpulan Penelitian Sosial UKM (1990); Ishak (2000) and Ismail (2002).

Between 1979 and 1984, the income shares of the top and middle income groups of all races fell while that of the lowest 40% income group rose. Similar changes were registered for all the racial groups between 1984 and 1990, except now only the share of the top income group shrank while those of the two lower income groups increased. This means that income inequalities among the major ethnic groups were decreasing, as indicated by the Gini coefficients for 1984, 1987 and 1990 for all the racial groups. However, income inequality reduction proceeded extremely slowly for the Malays, resulting in this group having the most unequal distribution in these years.

As shown in **Table 2**, following the liberalization of the economy and the end of the NEP in 1990, the Gini coefficients have been rising in the 1990s reflecting the widening of income disparity during this decade prior to the Asian financial crisis. Thus, it is not surprising to note that all the three races experienced rising inequalities, with the Malays/Bumiputeras having the highest level of inequalities. Their value of the Gini in 1997 was 0.448 as opposed to 0.416 for the Chinese and 0.409 for the Indians, implying that income distribution is most unequal among the Malays/Bumiputeras<sup>1</sup>.

**In the 1970s when it was still possible to access the data, Ragayah (1978) and Ragayah and Ishak (1978) undertook a study to decompose the income inequalities into the “within” and “between” group components. The decompositions of the inequality measures into these components utilising the PES data indicate that the latter contributed only a small proportion of the total inequality of incomes in the country and most of the inequality is apparently due to inequalities within each group. There is no reason to believe that this situation has changed since then.**

**Table 4** also illustrates that non-Malay mean incomes continue to outstrip that of the Malay/Bumiputera mean income. However, while the growth rate of non-Malay household incomes far exceeded that of the Malays prior to 1970, this trend was reversed in the post-NEP period. The later disparity in relative growth rates meant that inter-ethnic group gap in incomes had narrowed. This amelioration in the disparity ratios can be seen from the bottom of **Table 2**. The income disparity ratios between Chinese and Bumiputera households fell from 2.29 in 1970 to 1.90 in 1980 and 1.74 in 1990. In contrast, the Indian-Malay disparity ratio fell from 1.77 in 1970 to 1.29 in 1980 and remained at that level till 1990. This decline in inter-ethnic income disparity, together with the reduction in inequalities within all major ethnic groups, accounted for the overall improvement in the size distribution of income during the period under study. Nevertheless, in the 1990s the speed in the rate of increase of household income among ethnic groups changed again. As a result, the disparity ratios between the Bumiputeras and the Indians and the Chinese widened again in 1990s, to be moderated only by the financial crisis.

**Table 5** and **Table 6** shows the outcome of the uneven speed in the rise of household income among the three major ethnic groups, resulting in inequitable distribution among these groups. **Table 5** indicates that in 1997, 70.2% of the households in the bottom 40% income group (with mean income of RM840 per month) were Bumiputeras. On the other hand, 62.7% of the households in the top 20% income

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<sup>1</sup> Literally means “son of the soil”

group (with mean income of RM7200 per month) were non-Bumiputeras. **Table 6** illustrates that the Indians were the main gainers in the top 20% income bracket. Bumiputeras constitute 48.6% of the bottom 40% income group, 38.5% of the middle 40% income group and only 12.9% of top 20% income group.

**Table 5: Ethnic Composition of Households in the Top 20%, Middle 40% and Bottom 40% Income Groups, 1997**

	Bottom 40%	Middle 40%	Top 20%
Bumiputera	70.2	55.6	37.3
Chinese	14.4	33.1	47.3
Indians	5.3	8.7	8.8
Others	10.1	2.6	6.5
Mean Monthly Income	840	2002	7200

Source: Samsudin Hitam, "Pencapaian Bumiputera Dalam Bidang Ekonomi," paper presented at the Fourth Bumiputera Economic Congress, 10-11 September, 1999.

**Table 16: Income Strata According to Ethnic Group, 1990-1997**

Income Group	1990			1997		
	Bumiputera	Chinese	Indian	Bumiputera	Chinese	Indian
Top 20%	13.2	34.1	21.1	12.9	33.2	24.1
Middle 40%	37.2	44.8	47.4	38.5	46.5	47.3
Bottom 40%	49.6	21.1	31.5	48.6	20.3	28.6

Source: Samsudin Hitam, "Pencapaian Bumiputera Dalam Bidang Ekonomi," paper presented at the Fourth Bumiputera Economic Congress, 10-11 September, 1999.

## 5. Impact of Development Policies on Income Distribution

The discussions on the relationship between growth and inequality in Malaysia indicate that income inequality did rise in the early stage, that is, up to 1976, and fell thereafter till 1990 after which it rose again in the 1990s. This section uses the simple technique of logical deduction to find causal relationships between the various development policies and the distribution of income.

### 5.1 Major Changes in Domestic Policies

Since attaining independence in 1957, the country had undergone four major changes in domestic policies that would have impact on growth and equity. These can be broadly classified into the following phases.

#### 5.1.1 Prologue to the NEP, 1957-1970

This subperiod can be described as the market-led development phase. After independence, the government pursued *laissez-faire* policies for industrial development, but intervene extensively to promote rural development and provide a social and physical infrastructure. A number of policies were implemented to encourage the diversification of the economy, including measures to influence prices, subsidies on agricultural inputs, the provision of extension services, and technological and research support. The objective was to diversify the economy in order to reduce the economy's dependence on rubber and tin through the provision of infrastructure and amenities that would promote other forms of private sector production. Interventions were biased towards the rural areas. Agricultural and infrastructure projects were a large proportion of the Bumiputeras dwelled. Import substitution industrialization was promoted, but not at the expense of agriculture. Primary commodities were the main export earners during this phase.

Although the policies pursued yielded a rapid rate of growth, at an average of about 6%, there was relatively little reduction in the level of absolute poverty since the poor, particularly the Bumiputeras, remained trapped in their traditional, low-productivity rural occupations. On the other hand, the Chinese largely had moved out of the lower paid occupations in the agriculture and low-skill service industries into the more highly paid ones while the Indians tend to fall in between. Income inequality data also suggest a widening gap between the rural and urban household incomes for the same period. The urgency of the Malaysian inequality problem was not that it was particularly skewed or it was rising too rapidly, but like the incidence of poverty, it was due to its close correspondence with ethnicity in the country. This inequality and widespread poverty together with high unemployment and underemployment contributed to the worst racial riots experienced by the country in May 1969.

#### 5.1.2 The NEP, 1970-1990

Most of this phase, that is, between 1971-1985, can be described as exhibiting state-led development. The aftermath of the riots saw a fundamental shift in public policies with the enunciation of the NEP in 1970. National unity was stated as the overriding goal, to be attained through the two-pronged strategy (Malaysia, 1976: 7). The first is to eradicate poverty by raising income levels and employment opportunities for all Malaysians irrespective of race and the second is to restructure society so as to eliminate the identification of race with economic functions and geographical locations. The premise of the NEP is that it would be implemented in the context of a rapid expansion of the economy so as to ensure no particular group will experience any loss or feel any sense of deprivation.

In pursuing growth, the government emphasized on the diversification of agriculture and more intensive use of natural resources. At the same time, the industrial policy shifted from import-substitution to export-oriented manufacturing after 1968 which

encouraged the production of light manufactures and the rise of the semi-conductor industry. While government intervened via licensing and quotas (mostly through the Industrial Co-ordination Act) and regulated prices, private sector development was encouraged in these export-oriented industries through the provision of various incentives. Since 1972, Free Trade Zones and Licensed Manufacturing Warehouses were set up to promote these export-oriented industries. A very significant role in industrial development was undertaken by state enterprises based on the premise that private enterprise development would result in inequity. Thus existing agencies were strengthened, public enterprises, trust agencies and regional authorities (to push for regional balance), were established. Import substitution was reintroduced in the third phase of industrialization when the government established the Heavy Industries Corporation of Malaysia (HICOM) in 1981 to promote heavy industries in Malaysia.

The weakened demand of the OECD countries following the second oil price shock resulted in a recession in 1985-86. In order to get out of the recession, the Promotions of Investments Act 1986 was introduced and the government began earnestly implementing privatization programme adopted in 1983. Hence, there was increased liberalization in the approach to industrialization and a greater emphasis on exports. Since the private sector was promoted as the engine of growth for the economy, the public sector was downsized, focusing mainly on providing the infrastructure and conducive environment required for private enterprise to thrive.

#### 5.1.3 The National Development Policy, 1991-2000

The NDP's objective is to attain *balanced development* in order to create a more united and just society (Malaysia 1991: 4). Based on the NEP objectives of eradicating poverty and restructuring society, it still emphasizes the strategy of *growth with equity*. It encompasses, among others, the need to strike an optimum balance between growth and equity, ensure a balanced development of major sectors to optimize growth as well as reduce inequalities between regions and among Malaysians. However, it relies more on the private sector to be responsive and proactive in attaining these objectives. Hence, the private sector remains as the engine of growth in the 1990s, with the public sector playing a supportive and complementary role. Moreover, in view of the establishment of the ASEAN Free Trade Area (AFTA) in 2003 and the implementation of the WTO agreements, the government has also been reforming the tax structure to increase Malaysia's international competitiveness.

#### 5.1.4 The National Vision Policy, 2001-2010

The NDP has been succeeded by the current National Vision Policy contained in the Third Outline Perspective Plan 2001-2010 (NVP). In essence, the NVP represents the consolidation of all past development efforts (NEP and NDP) to attain a united, progressive and prosperous Malaysian society. The quest of the nation is to become a developed nation in its own mould, and in meeting the challenges towards this end the same strategies expounded in the NEP and NDP of building a resilient, competitive nation and an equitable society to ensure national cohesion and social stability will also be emphasized in the NVP.

The NVP involves several critical thrusts (see Malaysia 2001) including, first, building a resilient nation by fostering national unity, inculcating the spirit of patriotism, nurturing political maturity, cultivating a more tolerant and caring society with positive values, and raising the quality of life as well as increasing economic resilience. Second, it seeks to promote an equitable society by eradicating poverty and reducing imbalances among and within ethnic groups as well as regions. Third, it aims at sustaining high economic growth by strengthening the sources of growth, the financial and corporate institutions as well as macroeconomic management. Fourth, it promotes the enhancement of competitiveness to meet the challenges of globalization and liberalization. Fifth, it involves developing a knowledge-based economy as a strategic move to raise the value added of all economic sectors and optimizing the brainpower of the nation. Sixth, it also aims at strengthening human resource development to produce a competent, productive and knowledgeable workforce. Finally, its objective is also to pursue environmentally sustainable development to reinforce long-term growth.

## 5.2 Impact of Development Policies and Programmes During the NEP on Income Distribution

The impacts of the various policies on growth and poverty as well as equity during the NEP period have been widely discussed in works such as Ishak and Ragayah (1990, 1995), Bhalla and Kharas (1992), Zainal Aznam (1994), Ragayah (1994, 1998, 1999, 2000), Ragayah Haji Mat Zin and Muhammad Haji Alias, 1996, Shireen (1998), and Ishak (2000). This section will draw heavily from their findings.

Bhalla and Kharas (1992) have characterized the various policies and programmes implemented to reduce poverty and improve income distribution during this period as supply and demand side policies. On the supply side, this policy includes, first, the strategy of maintaining an open economy with export promotion and imposing low tariff rates. Malaysia is one of the countries that did not tax heavily its primary sector in order to finance its growth. Second, the government played a major role particularly in providing infrastructure, education and health facilities. On the demand side, appropriate policies, such as controlling the rate of inflation and fostering foreign direct investment, were also able to decrease poverty and narrow income inequality. A more detailed discussion regarding specific policies and programmes implemented will illustrate how government interventions complement market forces in reaching these two objectives. Specifically, the discussion will focus on those interventions that are said to have the most impact, that is, rural development, education and employment, industrialization and structural change, and restructuring of equity ownership and asset accumulation.

### (a) Rural development

The May 1969 racial riots was attributed to the existence of inequality that had important ethnic parallels which was accompanied by racial specialization in economic activities. In particular, the incidence of poverty in Malaysia had always been predominantly rural and as the majority in the rural areas are Bumiputeras, then it was critical that poverty redressal and income improvement programmes be implemented. As such, high priority has consistently been placed on agricultural and

rural development throughout the NEP period. The various Malaysia Plans have emphasized on rural development to raise the income of the rural poor and alleviate poverty. The core of the Malaysian rural development strategy lies in “area” or “in situ” development, which encompasses two components—the Intergrated Agricultural Development Programmes (IADPs) and the regional development strategy. The IADPs was designed to revitalize and rehabilitate in situ or existing agricultural areas that face problems of low productivity and poverty. This strategy centres on a more integrated and comprehensive programme of agricultural, socio-economic and institutional development. The various development agencies specific to the IADPs would provide an integrated and co-ordinated package comprising basic physical and economic infrastructures and social amenities. Regional development includes regional and land development as well as land consolidation and rehabilitation. The former is undertaken by regional and land development agencies such as Federal Land Development Authority (FELDA), while Federal Land Consolidation and Rehabilitation Authority (FELCRA) undertake the latter. Regional Development is targeted at redressing economic and structural imbalances between regions, slowing down rural-urban migration and promoting agricultural and industrial development.

The second category of rural development strategy is the provision of institutional and agricultural support services and subsidies. Among these are extension services research, training, subsidized credit and other essential farm inputs as well as price subsidies, processing and marketing to reduce real costs of production and to increase efficiency in production. Other strategies to raise farmers’ incomes include providing replanting grants and subsidies to rubber, pineapple and coconut smallholders and traditional farmers, promotion of rural industrialization to generate employment as well as to supplementing rural incomes. Finally, social development programmes complemented these strategies. These programmes include the provision of basic social amenities, community development through which positive values and self-help among rural households and youths are being instilled and the provision of better food and nutrition to rural households in order to improve their health conditions and nutritional standards.

Generally, these rural development programmes have reduced poverty by raising rural income and welfare. However, since the general programmes have little targeting component, they probably benefit the non-poor more than the poor. Similarly, specific programmes like the IADPs also have the same impact since the benefits tend to favour households with greater amount of land. To the extent that this criticism is valid, this programme was not able to mitigate rural inequality much. An examination of the experience of the rice and rubber smallholding sectors will elucidate the inefficacy of this policy as an instrument to reduce inequality.

Pverty incidence among rice farmers was among the highest in the country. The average farm size for rice is about 1.6 hectares<sup>2</sup> and has remained quite stable since 1955 despite several major changes in the rice sector such as the opening of large irrigation schemes, introduction of the HYV technology and increased mechanization. In addition to these large investments in physical infrastructures, the government also

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<sup>2</sup> The small size of paddy farms had been identified as one of the major causes of the high poverty incidence in the rice sector. Farm-size growth has been constrained by factors such as multiple ownership, policy interventions favouring retention of land ownership and cultural attachment to land.

introduced the GMP for the purchase of paddy and introduced several subsidy schemes that comprised price subsidy and subsidies for fertilizer, seeds, credits and pesticides. Padzim (1992) argued that the buying price for paddy have remained almost static since 1972 while farmers have to shoulder continuous increase in production costs, particularly that of labour. Although there were slight adjustments in the price subsidy, the subsidy of RM16.54 per 100 kg offered during the second planting season of 1973 remained almost unchanged for almost 20 years. Upward revision to RM24.81 per 100 kg. was done only from 1 July 1990. In 1998, there were some demonstrations in a few of the main rice producing areas concerning the price of paddy since farmers could no longer absorb the rising costs and it was reported that the government has agreed to give another upward revision of the subsidy.

While the paddy support policy has succeeded to a certain extent in raising the farmers' incomes and reducing risks of paddy growing, it has resulted in two unintended effects on inequality. First, since the cash subsidy has made farming more profitable, it has encouraged larger farmers to buy up small farms, thus displacing both owner-operators and tenants and thereby raising the number of landless labourers. Jomo and Abdul Aziz (1996) have quoted Tan S. H. 1987 study which has found that the distribution of the price subsidy has been skewed with 61% of the beneficiaries receiving only 12.5% of the total subsidy paid out. Tan found that the Gini ratio has increased from 0.45 in 1981 to 0.5 in 1984. Jomo and Abdul Aziz also quoted another study by Fatimah carried out in 1983 illustrating the skewed distribution of price subsidy. Second, the cash subsidy resulted in a substantial rise in the marketable surplus since farmers would sell all their paddy to obtain the cash subsidy and then buy their own requirements from the market. Prior to the cash subsidy, farmers would retain up to 60% of their produce for their own consumption, which they would process at the small village rice mills as and when required. With farmers selling all their produce to the National Padi Board, many of these small rice mills had to close for lack of business.

According to Jomo and Abdul Aziz, Fatimah's 1991 analysis showed that overall the price subsidy scheme has raised profits by 28.2% while the fertilizer subsidy 11.9%. However, the benefit/cost ratios of implementing the fertilizer subsidy scheme for a number of states are well below one. For Peninsular Malaysia, the ratio is only 45% in the fertilizer subsidy scheme and 67% in the price subsidy scheme. Tan (1987) had advocated a re-look of the national paddy policy that puts the interests of less than 16% above all other consumers, particularly the poor ones, and yet has so limited success in achieving its goals. The protection of the rice sector is a regressive tax on the poor; in the absence of protection rice price would have been 19% lower and in effect imposed a tax of about 5% on the average household in the poverty group. The paddy farmers are locked in by a policy that institutionalized their dependence on subsidies. Their dependence on a single crop has manifested itself in the persistence of hardcore poverty in many rice areas.

Another group that also experienced high poverty incidence is the rubber smallholders. Rubber is mostly planted on smallholdings and becoming increasingly so because the estates are more able to convert rubber to the more lucrative oil palm. The larger area under smallholdings implies that more people are employed in this

sub-sector where the average rubber yield is also consistently lower than that of the estate. The estate sector, due to the volume and organizational structure, was able to channel their output directly to wholesalers, manufacturers and exporters. Hence, the estates could capture a substantial amount of the value-added, although a number of the estate labourers are categorized as poor. Hence, all these mean that most of the poor rubber growers were the smallholders, who produced mainly unsmoked sheet and scrap rubber, which was subject to excessive margins charged by the “middle-men” dealers. The situation was worsened by the necessarily arbitrary assessment of quality and moisture content of these products.

As part of intensified efforts to overcome these problems and eradicate poverty among rubber smallholders, the government established the Rubber Industry Smallholder Development Authority (RISDA) in 1972. RISDA provides replanting grants, eligible at a frequency of not less than 20 years. The grant may be utilised for replanting old rubber trees with improved clones, either with rubber or any of 18 other crops. This assistance programme again gave rise to inequality and they relate to the replanting cess collections (for replanting and research), replanting grants and rubber export duties. These taxes are regressive since the smallholders were taxed at the same rates as the estates. The benefits of the research cess accrue mainly to the estates that have the capacity to utilise the research findings. Similarly, the replanting grant also favoured the estates that receive a full refund of their paid-out replanting cess. On the other hand, the smallholders are entitled to a grant only after they actually replanted and, even then, they are repaid in annual installments (Mehmet, 1986). Moreover, smallholders who do not replant (and own on average about 0.2 hectare) because of individual circumstances relating to loss of income or lack of land titles are perpetually subsidizing those who replanted and obtained the replanting grants.

In order to overcome the problem of landlessness, the Malaysian government did not pursue the traditional land reform approach of redistributing existing cultivated land, but instead developed large tracts of new lands, undertaken mainly by the Federal Land Development Authority (FELDA). Holdings of economic size were distributed to the landless for cultivating high value crops utilizing modern production techniques. In terms of developing new lands, there was little dispute on FELDA's ability for it has achieved or exceeded its land development targets in all the five-year plans since 1970. It is thus able to raise the income of the poor households (those with one hectare or more are not eligible) who were lucky enough to be selected, resulting in reduced poverty incidence and improve income distribution in the rural sector throughout the period. However, the FELDA model, which is packaged as a new self-sufficient community relying on a large bureaucracy and use of private land contractors, is a high-cost method of reducing rural poverty and the number of beneficiaries seems small for the amount of funds invested. At the end of 1981, with only 70,000 settlers, FELDA's cumulative drawings from the government already stood at RM3.0 billion.

Overall, despite facing problems of high cost, substantial wastage of resources resulting from weak implementation capacity and considerable leakages of benefits to the non-poor, these programmes did raise the incomes of the poor and eradicate poverty. As most of these programmes benefit the rural rich more, particularly in the

early years, then inequality tend to rise. This probably accounted for the upward trend in inequality before 1976. Moreover, when the NEP was first implemented its benefits were not widespread. Some of the programmes that could help improve income distribution like the paddy fertilizer subsidy scheme was introduced only in 1980 whereby farms whose size did not exceed 2.4 hectares could get 100% subsidy. The limit on farm size was to ensure that only small farmers would benefit from the scheme. Likewise, the rubber export tax was reduced only in 1977, 1980 and 1981, while others like the FELDA schemes bear fruits only after several years since rubber and oil palm take time to mature. Over time, with increased allocation and implementation of the various programmes, the trickle down of benefits was enhanced and became more widespread.

On the whole, it can be said that while rural development programmes do improve the income and welfare of the rural households, their efficacy in achieving this objective as well as redistribution of income can still be improved. Moreover, while these programmes helped in poverty eradication, studies have shown that they were not as effective in redistributing income among the rural households since their benefits are rather unequally distributed. It was other measures discussed below that were more responsible for the drop in the Gini ratio in the rural areas.

#### (b) Education and employment

Two of the strategies employed to tackle poverty and restructure society were the provision of better and more efficient services in education and the accelerated creation of productive employment opportunities in the secondary and tertiary sectors. The first relates to human resource development while the second is associated with the restructuring of the economy. These were also the central elements in the strategies for attacking urban poverty as well as restructuring of employment in various sectors of the economy and at all levels of occupations.

Recognising the role of education in raising productivity and income levels. As such, the NEP focussed on education as a means to eliminate poverty and restructure society. The first target of the restructuring prong was the restructuring of employment, which aimed at increasing the representation of Bumiputeras in the modern sector to reflect the social composition of the population at all levels. This was to be attained through the development of appropriate education and training programmes to raise the supply of trained manpower and direct incentives as well as administrative measures to boost their participation in the modern sector. Two types of training programmes for the Bumiputeras, namely, training with the immediate objective of augmenting the number of skilled and professional Bumiputeras so as to facilitate employment restructuring, and training with the objective of creating and developing a Bumiputera commercial and industrial community (BCIC) were carried out. While the Chinese and Indians also advanced in their educational attainment, the two decades particularly saw a tremendous growth of Bumiputeras being educated at all levels—primary, secondary and tertiary—and in all fields. Educational programmes, which include university enrolment quotas, scholarships and other educational subsidies, aided the Bumiputeras to improve their wage earning capacities. Hence, these interventions contributed to reducing inequality by expanding the size of the Bumiputera middle class. By 1990, Bumiputera employment in the

secondary and tertiary sectors rose to 26.5% and 40.1% from 18.5% and 15.3% in 1970 while that in the primary sector fell to 33.4% from 66.2%.

The increase in human capital formation coupled with the increase in physical capital contributed to a rapid wage growth. Bhalla and Kharas (1992: 77) have shown that the quality of the labour force has risen at the rate of 1% per annum over the 1973-1987 period. At the same time, they argued that productivity had also increased with capital deepening, resulting in about another 1% per annum wage rise. The remaining wage increase was attributable to total factor productivity growth. Overall, they found that wages have risen as a share of household income with the distribution of wage earnings becoming more equal because of the growing equality of education opportunities. **Table 7** shows the population was becoming better-educated over the years.

Prior to 1976, the benefits from education had not yet permeated through society and only a handful of Bumiputeras was able to gain from the employment restructuring in the job market following the implementation of the NEP. As such, inequitable access to high paying jobs and business opportunities contributed to increasing inequality. Over time, the education policy was able to generate more and more qualified Bumiputeras to take advantage of the NEP target of creating a BCIC. By the end of the NEP period, the proportion of Bumiputeras almost equal non-Bumiputeras in the secondary sector and exceeded that of the non-Bumiputeras in the tertiary sector.

**Table 7: Rising Educational Attainments in Malaysia, 1984-1997,**  
(Percentage of population aged 14 and above)

School level	1984	1989	1997
Primary	35.96	33.22	26.78
Junior High	21.18	22.92	21.36
Senior High	17.87	20.61	28.74
University	4.84	6.21	11.19
Religious education only	20.15	17.94	11.93
Total	100	100	100
Average years if schooling, excluding religious education	1984	1989	1997
Men	7.07	7.50	8.61
Women	5.60	6.25	7.60
All	6.32	6.86	8.10
Average years of schooling including religious education	1984	1989	1997
Men	8.03	8.35	9.27
Women	7.80	8.20	9.12
All	7.92	8.28	9.20

Source: Fields and Soares (2002).

## (c) Industrialization and structural change

Growth can lead to inequality if individuals move from low productivity jobs into a few high-paying modern sector jobs, leaving large pockets of poverty. To a certain extent, this scenario was true in the early years of the NEP. However, since then, the labour markets were not as fragmented but became relatively flexible. Significant degree of migration occurred in Malaysia, between rural and urban areas and within these areas across states, as demonstrated by Mazumdar (1980) leading to wage diffusion and thus poverty alleviation.

Bhalla and Kharas (1992) stressed that Malaysia's development strategy that created opportunities for all, including the disadvantaged groups, played a major role in alleviating poverty. The rapid growth during the NEP period, particularly the export-oriented labour intensive manufacturing sector, as well as the Government sector<sup>3</sup>, provided employment for many. The absorption of the rapidly growing rural labour into the higher income occupations in the urban industrial and service sectors was a major avenue to reduce rural poverty. A significant point to note here is that not only did more people become employed over the period, but also significantly more people were employed full time. This increase in labour force participation included a substantial number of Malay women who were employed in the free trade zones and various industrial estates set up around the country. Industrial development was promoted to provide greater employment and improve incomes of the urban poor. The tightening of the labour market in the late 1970s and early 1980s together with increased productivity of a more educated labour force led to rising wage rates. Moreover, proportionate increases in government sector wages were inversely related to the salary levels. All these developments meant that the rise in the share of wages in household income has been fastest among the low-income groups in the urban areas, thus lowering inequality and poverty incidence in the urban areas. Transfer incomes remitted to the rural households by family members that have migrated to the urban areas played a significant role in mitigating inequality and poverty incidence. In fact, it was the ability of the rural labour force to find jobs in the modern sector and the subsequent income transfers that helped to improve the distribution of income in the rural areas since quite a number of the rural development programmes had proven to be income inequalizing.

During the recession of the mid-1980s, rural poverty declined at a faster rate than urban poverty due to the resurgence of rural income, which was brought about by three factors. First, external price declines of commodities produced by the rural households were mitigated by changes in the exchange rates that increased the ringgit price of commodities. Moreover, the lowering of taxes and other export duties on rubber and oil palm raised the take-home income. Second, the fall in the price was compensated, to a certain extent, by the increase in output. Finally, rural households could diversify their income sources more easily than urban households could by increasing self-employment. On the other hand, urban households had no such protection. Profits had to bear the brunt of the recession since wages tend to be relatively inflexible downwards.

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<sup>3</sup> Through the implementation of "*Operasi Isi Penuh*" (Full Employment Operation) that raised the public sector workforce from 398,000 in 1970 to 804,000 in 1983.

It can be summarized that rapid growth brought about by industrialization and structural change provided employment for both the rapidly increasing rural labour as well as the urban poor. Moreover, the tightening of the labour market in the late 1970s and early 1980s as well as the revision of the government sector salary structure that proportionately favoured the lower income groups resulted in reducing the poverty incidence and improving income distribution in the urban areas. The restructuring of society that favoured the Bumiputeras also contributed to lowering inequality. The slowing of growth due to the recession in the mid-1980s did not affect the progress of poverty eradication and income redistribution due to the resurgence of rural income.

(d) Restructuring of equity ownership and asset accumulation

Other than restructuring society through eliminating the identification of ethnicity with employment, the second prong of the NEP also sought to redress the imbalances in the ownership of assets and wealth in all sectors of the society. The NEP envisaged the creation of the BCCI in order that within one generation they would own and managed at least 30% of the total commercial and industrial activities so as to become full partners in the economic life of the nation. Restructuring of the ownership of assets included all financial and physical assets in all sectors of the economy. This was being attained through enhancing the ownership and utilization of land by Bumiputeras for productive development as well as the provision of financial assistance to Bumiputera entrepreneurs to gain access to the ownership of other productive assets. However, as the economy developed and modernized, the role of the corporate sector would expand, and as the country's financial structure became sophisticated the key to the ownership and control of wealth will be through the ownership of equity capital. Hence, the main control of assets would be through the ownership of share capital and effective management of various enterprises. The acquisition of equity ownership by Bumiputeras was realized from the enlarged size of the economic pie and not through the redistribution of non-Bumiputera wealth to the Bumiputeras.

The ownership of Bumiputera share capital was targeted to increase to 30% by the end of 1990, but the amount actually attained fell short at 20.3%. This was attained through various means. Firstly, individual Bumiputeras have managed to step up their savings and acquired equity in the corporate sector. Secondly, the Government set up the Bumiputera Investment Fund to acquire shares reserved for the Bumiputeras. These shares were later redistributed to the individual Bumiputeras when they could afford through the purchase of unit trust, known as the National Unit Trust (or Bumiputera Unit Trust after 1990) set up specifically for this purpose. Finally, the remaining amounts of capital stock meant for the Bumiputeras were acquired by the public sector agencies that were set up to create and/or purchase stock in trust for the eventual sale to them.

The rapid expansion of the modern commercial and industrial sector enabled the number and quality of Bumiputera entrepreneurs to be increased. Various programs were formulated for this purpose including training, credit assistance, advisory and extension services, technical assistance, administrative support and direct government participation in the private sector. One of the ways to develop the BCIC is through the

promotion of the small and medium scale industries (SMIs) since SMIs could play an important role in the development of entrepreneurship, creation of employment, mobilization of individual savings for investment, broadening the industrial base of the Bumiputeras and providing input and supportive services to large scale industries as well as improving the distribution of income.

The declining trends in income inequality after the mid-1970s could also be attributed to some compulsory saving schemes, such as the Employment Provident Fund, and voluntary schemes like the National Unit Trust (ASN), MARA Unit Trust, *Lembaga dan Urusan Tabung Haji* and the like, which helped to foster the savings habit among the poor. These savings schemes which attempt even to reach the smallest savers help to build up the asset base of the rural as well as the Bumiputera households. Prior to 1990, the ASN has a RM50,000 upper limit to prevent it from being concentrated in a few hands. With the building up of savings over time, low-income households would also be deriving income from capital ownership to supplement their labour income. After 1990, the ASN became ASB (Bumiputera Unit Trust) with an upper limit of RM100,000, which was revised to RM200,000 in the mid-1990s. The latter development is also likely to contribute to the U-turn in the Gini ratio.

(e) Other policies and programmes

*i. Provision of basic services and infrastructures*

Basic services such as education and training (already discussed above), health and family planning, social and community services, and utilities as well as infrastructures continued to be provided to all communities throughout the period. However, poor households were either subsidized or provided free. The Applied Nutrition Programme to reduce both the infant and maternal mortality rates was also implemented. Urbanization of rural areas was later stressed in order to ease the facilitation of these services. These assistance helped to improve the quality of life of the poor by raising their real income as well as their productive capacity.

The coverage of basic amenities and services were extended, particularly to the rural areas where most of the poor lived. Consequently, by the end of the 6MP, about 88% of the urban and 72% of the rural poor households had access to electricity. Moreover, 92% of the urban poor and 65% of the rural poor households had access to safe drinking water, while 88% of the urban poor and 77% of the rural poor were within nine kilometres of either a government or private clinic. Rural areas were also served by mobile dental teams and dispensaries, village health teams and the flying doctor service to remote and outlying areas.

*ii. Tax structure and incidence*

To the author's knowledge, no recent study on the distribution of tax burden has been done. However, Ismail (1977) has examined the tax burden distribution in Peninsular Malaysia and found that the overall tax structure in 1973 exhibited a U-shaped curve, with a greater burden being imposed on the lower and upper income groups than the middle. Regressivity at the lower end was contributed mainly by export duties (rubber and palm oil) and indirect taxes while progressivity was generated by direct

taxes. In the 1980s the amount of export duty collected from the export of rubber was dwindling due to low rubber prices. Hence, this together with the regressivity of the export duty resulted in the removal of the tax after 1990. Similarly, since 1980 the government has been reforming the export tax structure of palm oil to alleviate the incidence of producer taxes on smallholders and promote further value added processing. With the ever-increasing reliance on direct taxes that are more progressive, this regressivity at the lower end is likely to be ameliorated in later years.

In order to promote the private sector to be the engine of growth, the government has been reducing the rates of several taxes since the mid-1980s. However, the more significant reductions were those announced throughout the 1990s, including the provision of concessions, removal of the development tax and tariff on thousands of items, reductions in the corporate and individual income tax rates. Many of these were undertaken with the view to the establishment of the ASEAN Free Trade Area (AFTA) and the implementation of the WTO rulings.

### *iii. The NGOs*

While government was the main force in eradicating poverty, some NGOs played quite a significant role in cutting poverty incidence. AIM is the most well-known NGO involved in reducing the hard-core poverty incidence by providing interest free micro loans to the poor to undertake income generating activities under close supervision. As in the Grameen Bank case, most of the beneficiaries are women. During the 6MP, the government provided RM20 million loan to AIM, while AIM provided interest-free loans worth RM77.1 million to about 36,200 poor and hardcore-poor households to enable them to venture into poultry and livestock rearing and small-scale businesses such as retailing of groceries, and the servicing and repairing of vehicles. Most of these ventures were successful, as reflected in the increased household income of the participants and the loan repayment rate of almost 100%. Recognizing the effectiveness of AIM in providing loans to the hardcore poor and the shortage of its capital fund, the government would provide it with an interest-free loan of RM200 million during the 7MP, which would enable it to expand its lending activities to cover another 57,930 hardcore poor.

Another NGO is the state-based *Yayasan Basmi Kemiskinan* (YBK)<sup>4</sup>, with the support of private companies, also complemented the government's efforts to eliminate hardcore poverty. YBK programmes focused on skill training with guaranteed employment, educational assistance and better housing. The private sector provided support to NGO programmes through financial contributions and skill training. Among these NGOs are YBK Selangor, *Yayasan Kemiskinan Kelantan* and *Yayasan Membasmi Kemiskinan Kedah*.

### 5.3 Impact of Development Policies and Programmes During the NDP on Income Distribution

The trend of Malaysian income inequality as indicated by the Gini ratio has also taken a U-turn since 1990, so much so that it almost wiped out the gains made during the

<sup>4</sup> Which can be translated as Poverty Eradication Foundation

NEP before for the crisis. The urban-rural income disparity ratio which had been falling from 2.14 in 1970 to 1.70 in 1990 rose again to 2.04 in 1997. The financial crisis of 1997/98 managed to bring it down to 1:1.81. Earlier attempts to explain this phenomenon emphasise on the hypothesis that the source inequality lies in the urban areas. Although the results of the Ishak Shari et. al (2000) study supported the hypothesis, macro data recently available show that the trend of the Gini ratio for the urban sector continuously decreased since the mid-1970s. On the other hand, the trend of the Gini ratio for the rural sector has experienced a *U-turn* similar to the national trend. While the Gini coefficients are not additive, these trends seem to imply that the explanation for the *U-turn* occurs in the rural sector, not the urban sector.

Although some may argue that the increase is small and nothing to worry about, but it is important enough to be investigated due to the following reasons. First, a study by ESCAP (1999) emphasised that the stability of distribution within the broad trend is important for even if the broad direction of change over time is towards improvement, policy makers could benefit from knowing whether there have been major reversals during a given period. This could then form the basis of a more detailed investigation of the factors causing such a reversal and the steps to be taken to correct the situation. Second, it is of great importance in a racially sensitive country as Malaysia. As such, this issue needs to be studied further in order to identify the real causes of the widening inequality so that appropriate policy prescriptions can be formulated. Third, the question of income inequality is so important to Malaysia that it became one of the three strategies in the 2002 Budget, that is to reduce the urban and rural inequities, between households and between more developed and less developed states.

Ragayah (1998, 2002a) therefore tries to explain the widening of income inequalities in the 1990s by looking at urban and rural factors. These include the decline in the agriculture sector, the trend of wages and salaries in the manufacturing sector, the changing of land status from agriculture to housing and industrial land in the rural areas and back migration.

### 5.3.1 Decline in the agriculture sector

One of the explanations forwarded to explain the re-emergence of rising inequality is the difference in the growth rates of incomes of the rural and urban areas due to the lag in the growth of the agriculture sector (Ragayah 1998). Although there are attempts to revitalize this sector, as stated in the National Agricultural Policy 1984 and New National Agricultural Policy 1992, productivity growth of the sector is still sluggish. As this is where most of the low income households, particularly those involved with the unorganized smallholding sub-sector, are found, poverty incidence is still relatively high compared to the urban areas. This sub-sector continues to face the problems of uneconomic farm size that hinders technology transfer as well as labour shortage, ageing farm labour and declining competitiveness of the smallholder unit of production. This has resulted in large areas (about 22% of the total cultivated land in Peninsular Malaysia) of cultivable land being left idle (Ishak 1998). During the Sixth Malaysia Plan, the agriculture sector was targeted to grow at 3.5% (later revised to 2.1%) per annum. Yet the achieved growth rate during this period was only 2% per annum. With the other sectors, particularly manufacturing and construction,

surging ahead the Malaysia (1996) has attributed this factor as the main explanation for the reversal of the inequality trend.

Unfortunately, there are no readily available data to support the argument at this stage. The Seventh Malaysia Plan--7MP (1996:89) explains that rural household income grew by 5.3% per annum from RM951 per month in 1990 to RM1300 in 1995. This rate was slower than the growth of the urban monthly household income, which rose by 8.2% per annum, from RM1617 in 1990 to RM2596 in 1995. Consequently, the income disparity ratio between rural and urban households also widened from 1:1.7 in 1990 to 1:2.0 in 1995. The 7MP goes on to state that the lower growth rate of the rural household income was partly attributed to the redefinition of urban areas in 1991, which now included built-up areas adjoining urban centres, previously considered as rural. To some extent, this affected the growth of the rural household income, as households in the built-up areas had a relatively higher income. While this explanation helps, it would have been more enlightening if we know something about the degree in inequality among agricultural households as well as vis-à-vis the non-agricultural households, particularly in view of the fact that the trend of rural inequalities followed the same pattern as the overall trend.

### 5.3.2 Trends of wages and salaries in the manufacturing sector

Assuming that changes in the manufacturing sector wages and salaries can be regarded to reflect that of urban areas, it was found that the shares of earnings for the lower income groups have been increasing relative to the professional group in the managerial and professional category throughout the 1990s (see **Table 17**). This implies that income disparity among workers in this sector has been narrowing. Moreover, this outcome is in line with that of Ragayah's (1998) study and supports the government data of falling urban inequality.

### 5.3.3 Changing of land status

With the rapid growth of industrial development, coupled with the policy of rural industrialisation and the expansion of the population, the various state governments (land is a state matter in Malaysia) had been allowing the conversion of agriculture to housing or industrial land to accommodate the ever-increasing demand. Similarly, the construction of various infrastructure projects, particularly roads and highways, increased the accessibility and value of strategically located rural lands. As such, those who were lucky enough to own these lands managed to make big capital gains. While not widespread, there were cases reported in the newspapers around the mid-1990s where Federal Land Development Authority (FELDA) settlers had become overnight millionaires since their lands were located in the vicinity of the new international airport, Kuala Lumpur International Airport. Less dramatic were the cases of those agriculture landowners whose lands were converted into industrial and housing estates. These were common occurrences in the highly industrialised states like Selangor, Negri Sembilan, Penang and Johore.

Looking at **Table 3** above, it can be seen that in 1997 inequalities are highest in the states of Terengganu, followed by Kelantan, Kedah, Wilayah Persekutuan Kuala

Lumpur, Johore, Selangor, Negeri Sembilan and Perlis. Interestingly, Terengganu, Kelantan and Kedah are agricultural states with not much industrial development in the first two (except for the Petronas plant in Terengganu). However, Kedah is seeing quite a lot of industrial development with the development of Kulim Technology Park and Sungai Petani as industrial centres. Thus, there is not much support for this hypothesis and it requires further investigation the Gini ratios are relatively low in the industrialised states.

#### 5.3.4 Back Migration

What about the phenomenon of back migration? With over-crowding in the urban areas, the government has been encouraging the construction of high density living quarters, such as apartment and condominium complexes for the middle and upper income groups and low-cost flats for the lower income groups. For those who prefer spacious living with substantial land areas around their houses, they are encouraged to move out of the city centres to areas in the periphery. The development of complementary infrastructures mentioned above enabled the high-income households to do this. Thus, new housing areas for the wealthy started to sprout around major urban centres.

An examination of the internal migration data shows that the percentage of urban-rural migration in the two top occupational categories, the professional, technical and related workers as well as the administrative and managerial workers generally exceed the percentage of rural-urban migration, resulting in a net urban rural migration of these groups. In addition to the working professionals and administrative and managerial workers who back migrated, there were also high-income retirees who moved out to the rural areas as well as some who returned to their villages. At the same time, the migration direction of the lowest occupational category, the production and related workers, transport equipment operators and labourers, indicates that the percentage of rural-urban migration exceeded the percentage of urban-rural migration for all the years except for 1997. This means that there are net inflows into the urban areas of this category of workers. These people are not the poorest in the rural areas, but are more likely to be relatively young, have certain abilities and educational attainment as well as some resources to support them while they look for work. This process would then leave on average the aged, those with less ability and without resources in the rural areas. Thus, combined with the inflow of the professional, technical and related workers into the rural areas would surely widen the income disparities there. Still, further investigations and more evidence are necessary in order for the findings to be conclusive.

## 6. Concluding Remarks

The discussions on the relationship between growth and income distribution in Malaysia indicate that high economic growth during the NEP period contributed to attaining growth with equity. Education and human resource development together with the creation of employment opportunities, mainly through export-oriented industrialisation, during this period. Although inequality re-emerged in the 1990s, its causes are yet to be ascertained. Nevertheless, poverty incidence continued to be reduced except for the glitch during the East Asian financial crisis. Still, the intensity

of the negative impact of the crisis was less severe compared to the experience of other affected countries. This could be attributed, first, to the government's relatively high social expenditure and pro-poor programs since the implementation of the NEP rather than short-term, transitory poverty reduction programs. Thus, the government ensured that the budget shares for social services, particularly health and education, in 1998 remained at their 1997 levels and maintained the public expenditure on major anti-poverty programmes despite the reduction of its total development expenditure (see Bank Negara Malaysia 1999). Second, Malaysia was facing a very tight labor market prior to the crisis. With an unemployment rate of 2.4 percent and the presence of almost two million foreign workers, the impact of the crisis on employment opportunities for Malaysians had been relatively moderated. The brunt of unemployment was mostly borne by the foreigners whose 'reverse migration' in 1998 meant that over 350,000 persons including dependents returned to Indonesia and other countries (Zainal Aznam, 2001). Finally, the reversal of the tight monetary policy kept many firms from closing down and thus put a brake on further retrenchment.

In a globalized world the ability of a country to protect itself from external shocks has been minimized. As such, there is an urgent need to put social safety nets in place. It is important to note two observations highlighted by Tabb (1998) concerning the recent crisis in Asia. First, the crisis reflects the tendencies of unregulated capitalist markets in which speculative excess is part of the very nature of the system. Second, such crisis provides opportunity for stronger capitalists to profit from the problems of those unable to withstand the downturn. This implies that the creation of the global economy, the advance of technology and the concentration of power promote instability and insecurity. Therefore, the likelihood of the crisis reoccurring in the region cannot be ruled out. It is therefore important to devise comprehensive strategies so that the country is more prepared to face adverse consequences should a similar crisis occur again in the near future. The need to develop cost-effective social safety net programmes to help those adversely affected by the crisis becomes more urgent.

As Malaysia had experienced, unequal income distribution is not conducive for promoting social cohesion and providing an acceptable level of quality of life for all Malaysians. It is also not consistent with our national development strategy of growth with equity. Moreover, although in the past it has been argued that there is a trade-off between growth and equity, Somavia has claimed that more and more research is showing that inequality reduces growth, and thus our ability to improve the quality of life. In other words, redistribution is no longer a trade-off but is complimentary to growth.

In dealing with the rising inequality, the government also faces the challenges of globalisation, which could impede its redistributive efforts. First, the ASEAN Free Trade Area (AFTA) was created in order to have access to bigger markets. While this strategy will give opportunities to established entrepreneurs with large enterprises that are ready to face competition from other producers, small and medium producers in the rural areas might not be ready to compete with other producers from ASEAN. There is a possibility that they might not be able to compete with the more efficient producers from the neighbouring countries. This possibility has serious implication for employment opportunities in the rural areas and efforts to eradicate poverty as

well as on rising rural income disparity. For example, the efforts by AIM to assist the poor might be jeopardised when free trade could result in the output of AIM members not being able to compete with the same products produced by the competitors but sold at a lower price. Efforts must be undertaken to ensure that this situation is monitored in order to avoid any negative impacts.

While the government is expected to play a big role in eliminating poverty and narrowing inequality, globalisation requires the government to reduce its role and increase that of the private sector in economic development. In order to attract foreign direct investment and to improve competitiveness, the government has to scale back on labour rights and welfare, which are regarded as costs that erode a country's competitiveness. At the same time, the government is also pressured to reduce the progressive and corporate tax rates, provide various incentives, for example, tax holidays, exemptions, etc., provide infrastructure (both physical and human resource training), resulting in what is known as the "budget squeeze". This means that there is less resource to be spent on redistribution, that is, on social expenditure including education, health and housing. For example, the total government expenditure for health services jumlah as a percentage of the gross national product (GNP) rose from 1.5 percent in 1970 to 3.5 percent in 1980, but contracted thereafter to 1.4 percent in 1997/8. This percentage is lower than what the World Health Organisation has recommended, where a country like Malaysia should allocate about 5 percent of its GNP health services. Fortunately, this falling trend has been arrested in recent years when the government realised the serious implications on social developments and efforts to improve the welfare of the lower income groups, particularly those in the rural areas.

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