SOJOURN: Journal of Social Issues in Southeast Asia Vol. 25, No. 2 (2010), pp. 281–87 DOI: 10.1355/sj25-2f

ISSN 0217-9520 print / ISSN 1793-2858 electronic

Book Reviews

Privatization in Malaysia: Regulation, Rent-seeking, and Policy Failure. By Jeff Tan. New York, NY: Routledge, 2007. 234 pp.

Malaysia took on one of the most extensive and ambitious privatization programmes in the world and wound up with a load of collapsed and renationalized projects. The debacles raise questions on why the country spectacularly failed in its mission to raise efficiency, attain self-sustainability, and foster entrepreneurial capacity through privatizing public entities. Jeff Tan's *Privatization in Malaysia: Regulation, Rent-seeking and Policy Failure* tackles the topic with an insightful and original combination of political economy perspective and detailed case studies. His framework and findings contribute richly to our understanding of Malaysia's privatization failures and challenge the continued propagation of such policies in developing countries.

The book poses three key questions to social science theory and to the Malaysian experience: Why privatize? Why may privatization fail? What is needed for privatization to work? In answering them, the author engages with conventional theory and critiques its inadequacies in predicting and explaining policy problems, and outlines alternate approaches to engage the subject with greater cogency and real-world relevance.

The conventional case for privatization revolves around three main contentions about the superiority of private ownership over public ownership. First, drawing on principal agent theory, private ownership provides incentives for the principal (owner) to monitor the agent (manager), because the owner controls and directly reaps profits. On the other hand, citizens are the ultimate principal of state-owned enterprises, and can only exercise indirect control through the government, and need to overcome a host of coordination problems to effectively monitor management. Second, public choice theory asserts that "the state is intrinsically inefficient and perpetually overburdened and underdisciplined", and public enterprises serve politicians' interests rather than maximizing efficiency (p. 11). Third, privatization alleviates the burden on public finance and mobilizes new sources of funding.

Following from the axiomatic efficient market basis of these rationales for privatization, failures are attributed to institutional shortfalls and political interference that vitiate otherwise sound policy. Corruption and cronyism compromise the integrity and transparency of contract allocation, while weak protection of property rights and poor governance permit business conduct to deviate from market norms. Such institutions are now considered preconditions for privatization.

The book's conceptualization of the processes and problems of privatization fundamentally differs from conventional theories. From the very start, Tan does not begin with dictums and preconditions, but with real-world situations, motivations, and constraints. The private sector, both in developed and developing countries, often finds projects with high capital costs too expensive and risky to finance, necessitating state intervention to share risks, even after privatization. Paucity of entrepreneurial capacity and experience limits competitive bidding; lack of information constrains the scope for devising contracts, which in any case can never complete, but in developing countries are more likely to need room for manoeuver and adaptation. Also, in the context of low income economies, transitioning away from publicly subsidized infrastructure and services to paying higher user fees encounters popular resistance.

In consequence, "privatization necessitates continued and often even greater state intervention in terms of maintaining some subsidies, perhaps creating new ones, devising new methods of regulation and coordinating certain sectors" (p. 3). Regulation is not restricted to instituting investor-friendly provisions and consumer protections, but also involves managing learning rents, or subsidies and conditionalities targeted towards acquiring technological and entrepreneurial expertise and attaining market competitiveness. In consequence, whether privatization leads to learning and efficiency gains hinges on the state's leveraging of subsidies to monitor and discipline the management of privatized companies.

Moreover, privatization programmes are embedded in political contexts and agendas, chiefly the cultivation of a domestic capitalist class and state patronage of political business elites. Expediency and vested interest will inescapably encroach on privatization of large public entities. However, conventional theory fails to adequately account for political motivations for privatization, preferring to assess, in retrospect, whether political conditions were up to the task of realizing the gains of privatization. This notion of preconditions, Tan argues, is profoundly ahistorical and exceedingly unrealistic to expect of developing countries. The question is not how good economic policies were derailed by bad politics, but how the political imperatives compelling privatization interrelate with the need to strike an appropriate, dynamic balance of state intervention and private sector effort.

The book frames its analysis around a distinction between ex ante and ex post failure, referring to policy failures that occur before and after privatization. Many things can go wrong before privatization, while contracts are drawn up, candidates are selected, and institutional frameworks are put into place. However, uncertainties and constraints of venturing into new territory with untested resources warrant an expectation that ex ante mistakes will occur, and decisions will be compromised to a significant extent by imperfect information and political interest. Thus, policies will need to be revised and contracts renegotiated, and privatized entities will need to be supervised and disciplined. The state's capacity to perform these functions after privatization has greater impact on the projects' outcome.

In sum, Tan argues that ex post failures have a greater impact than ex ante failures on the outcome of privatization projects. This diagnosis differs from convention which, applying his typology, focuses overwhelmingly on ex ante failures. Tan refers to the experience of high performing countries such as South Korea, which succeeded in capitalist development not by security of private property rights, transparent selection of licensees and contractors, and deregulation. Instead, the state's persistent role in pressuring firms to perform and credibly threatening to withdraw privileges — even while corruption and cronyism were rife — more decisively made successes out of projects that began with typical uncertainties and limitations.

Before presenting the case studies, the book surveys the Malaysian context of privatization and evaluations of its overall performance. The momentum pushing privatization was overtly and decidedly political, as policy priority swung in the 1980s away from state-owned enterprises towards private Malay capitalists, to be created by transferring state assets into their hands. Public enterprises had performed poorly on the whole, while the growth of the Malay middle class and shifts in the balance of power in political constituencies further compelled privatization. The Mahathir administration's pursuance of a capitalist development agenda fused with demands for wealth transfer from an ascendant Malay political-business elite, which had established personal connections with key United Malays National Organization (UMNO) leaders and overtaken the bureaucracy as the dominant political force.

Evaluating the outcomes of privatization is fraught with difficulties. The effect of private ownership is difficult to isolate from other factors, such as business cycles. In addition, projects officially classified as privatization do not technically qualify as such, since they do not involve a transfer of ownership and control. This pertains particularly to the creation of new, mostly construction, projects and the government's retaining majority shareholdings in publicly listed, formerly state-owned enterprises. These analytical issues notwithstanding, Tan collates research and sparse evidence of Malaysia's privatization programme, spanning financial, output, and efficiency criteria, arriving at a broad conclusion that it is "mixed at best and clearly failed to meet long-term [New Economic Policy] objectives of creating an independent Malay capitalist class" (pp. 64–65). The book draws out institutional and political failures that compromised the state's capacity to coordinate policies and discipline firms, foreshadowing the themes to be fleshed out in case studies.

The book's case studies engage with four projects and sectors that underwent a clear public to private transfer of ownership and control but were eventually renationalized: Indah Water Konsortium (IWK) (national sewerage system), Kuala Lumpur Light Rail Transit (LRT), Malaysia Airlines, and Proton (automobile manufacturing). Tan lucidly and methodically outlines common and unique circumstances of these projects, helpfully explaining both the challenges faced by private owners and the necessary interventions by government. These are judged by sector-specific parameters and competitive benchmarks, and situated in the context of inherited problems and macroeconomic conditions. Tan compiles data from a range of sources, demonstrating how these projects fell short, whether due primarily to failure to collect tariffs (IWK), to match regional competitor performance (Malaysia Airlines), or to surpass sales thresholds and sustain business viability (LRT and Proton).

More important to the overarching argument is Tan's discussion of ex ante and ex post failure, and the greater magnitude of the latter. On the whole, the ex ante/ex post distinction holds, setting apart this study from the associated literature. Certain information constraints, lack of experience, and inherited inefficiencies plagued the projects at their inception. Ex ante failures thus revolve largely around deficiencies in policy design, coordination, and institutional frameworks. Ex post failures are cogently discussed in terms of government delinquencies in disciplining beneficiaries of privatization, in intervening to restructure debt (Malaysia Airlines), and in enforcing conditional learning rents (Proton). Intimate political relations and patron-client linkages clearly compromised the state's disciplinary capacity. Short-term interest and rent-seeking undermined the potential for long-term productivity gains, evidenced by a succession of changes in ownership in IWK and the reaping of construction rents in the LRT projects, to the neglect of operational efficiency.

However, the ex ante/ex post classification is disputable and the argument that ex post failures are greater is less persuasive in some cases, particularly related to the LRT. This sub-sector arguably stands out from the other three for being exceedingly dependent on complementary service providers. The need to integrate LRT lines with each other and with bus routes, and to expand public transportation and reduce private car usage, are certainly pieces of information, involving massive, long-term developments, that warranted strenuous consideration prior to project initiation. While the book considers state ineptitude in integrating the LRT and developing public transportation as ex post failures, there are grounds to place these main causes of project failure in the ex ante category. Also, it is inadequate to maintain that ex ante mistakes are inevitable — and to assume that they are correctable ex post — without case-by-case assessing whether projects should have been forestalled, postponed, or publicly owned, based on what the government should have and could have known. This study could also allow for the possibility that the government did not seek or consider available, relevant information.

Another area of omission is the broader debate over public versus private ownership. Upon reviewing Malaysia's failures, the book asks how might privatization have succeeded? It seems equally relevant and important to enquire: how might these projects have fared under public ownership? This is a hypothetical question requiring a counterfactual answer, but so is the question of how privatization could have been successful. Readers might expect more engagement with public ownership, given the point made on the first page that there is no conclusive evidence of public ownership performing worse than private ownership. Moreover, while Tan maintains that "renationalization represents the ultimate failure of privatization" (p. 28), he also notes that, in the cases of Proton and Malaysia Airlines, changes towards greater efficiency were implemented after renationalization. These apparent paradoxes stimulate interest in whether Malaysia could have done better without pursuing privatization, or if this answer varies by sector and time.

Privatization in Malaysia: Regulation, Rent-seeking and Policy Failure makes a substantive and important contribution to our ways of thinking about the subject and understanding what happened. Malaysia, and developing countries in general, gain from taking political economic realities and non-ideal market conditions as starting points, as opposed to the assumptions and frameworks of conventional theory. This study accounts for both the crucial role of state regulation after privatization as well as the negating effects of cosy relations between political leaders and state-sponsored capitalists.

However, questions remain that hopefully will be taken up in further research. Theoretically, the argument that ex post failures exceed ex ante failures might be reconsidered on a conditional basis, instead of holding it as a general rule. Empirically, the blurred boundaries between ex ante and ex post failures partly stem from absence of data that may only be obtainable through interviews with decision makers and accessing internal documents.

This book sheds valuable light in retrospect on why privatization failed. Given that Malaysia has come full circle with the renationalization of major projects, it is becoming exceedingly vital to inform whether Malaysia should pursue privatization again.

Hwok-Aun LEE

Lee Hwok Aun is a lecturer in development studies at the Faculty of Economics and Administration, University of Malaya.