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Water Privatization, Ethnicity and Rent-Seeking

Preliminary Evidence from Malaysia

Jeff Tan

This paper examines the ongoing promotion of infrastructure and water privatization in Malaysia despite the failure to increase capital investment and improve efficiency. It locates privatization within the process of capital accumulation, with rents and rent-seeking as an integral part of this. In this context, water privatization provides opportunities for the creation of entrepreneurs through the allocation of rents in the form of water-related contracts. The paper provides preliminary evidence, drawing from privatized water and sewerage projects in the state of Selangor to illustrate how this offers rents for both bumiputera *(Malay) and non-*bumiputera *entrepreneurs. Rent-seeking is driven by changes in social formations and specifically the emergence of a Malay middle class that needed to be politically accommodated.*

Keywords: Water, privatization, entrepreneurship, rent-seeking, Malaysia.

1. Introduction

An ongoing puzzle with water privatization is why it continues to be promoted despite the failure to improve capital investment and efficiency (Tan 2011). This is especially the case in Malaysia where the failure of water privatization resulted in the renationalization of water assets. However, despite this, water sector reforms continued to promote private sector participation including the renewal of contracts for concessionaires who had failed to deliver (Tan 2012). This paper attempts to explain this puzzle by examining the relationship between water privatization, ethnicity and rent-seeking in Malaysia. It argues that the continued promotion of water privatization despite its failure needs to be understood within the wider context of the role of rents as part of national accumulation strategies related to the creation of an ethnic Malay (or *bumiputera*) capitalist class. This in turn requires

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distinguishing between rents for accumulation and rents for political accommodation (or political stability). The ability of the state to efficiently allocate and manage these rents, including privatization projects, ultimately depends on a country's political economy, specifically the nature of class formations, the abilities and hence preferences of an emerging domestic capitalist class, the relationship of the state with this and other classes, and the balance of power between different social forces.

In Malaysia's case, political pressure from an emerging Malay middle class necessitated political accommodation in the form of redistributive rents under the New Economic Policy (NEP) in 1971. The subsequent expansion of this class intensified the contestation for resources with privatization replacing the NEP as the main vehicle for rent distribution. This was reflected in a series of leadership challenges, increasing fragmentation and factionalization within the United Malays National Organization (UMNO), the ruling Malay party, which compromised the government's ability to manage and withdraw rents because political leaders increasingly depended on the support of Malay businessmen and contractors (Tan 2008; Tan 2012). The failure of large privatizations and privatized projects, and Malay corporations linked with these, highlight the theoretical problems of privatization and the inability of Malay capitalists to compete in other sectors. This lack of competitiveness is reflected in ongoing rent-seeking in captive, non-tradable and protected sectors, specifically infrastructure and construction-related privatization, which has also been consistent with the abilities and preferences of many Malay entrepreneurs (Tan 2008; Tan 2011). The patronage system thus reinforces rent-seeking and investment preferences, and is in turn driven by rent-seeking by Malay businesses.

This paper focuses on water and sewerage projects in the state of Selangor to illustrate the relationship between privatization, ethnicity and rent-seeking. Section 2 outlines the problem of Malaysia's failed water privatization, contextualizes this problem, and offers an explanation based on an analysis of rent-seeking and the process of capital accumulation. Section 3 then examines recent data on water privatization projects (broadly defined in terms of contracting out) among large (G7) contractors in the state of Selangor to determine how water, infrastructure and other construction-related projects have been distributed, and what this distribution tells us about the nature of entrepreneurship and rent-seeking among *bumiputera* and non-*bumiputera* water contractors. Section 4 concludes.

2. Contextualizing Malaysia's Failed Water Privatization

Water privatization no longer centres on (public or private) ownership structures and instead broadly refers to private sector participation (PSP), private participation in infrastructure (PPI), and PPP (public-private partnerships). This was in response to the failure of private ownership and related to developments in privatization theory.[1] As such, the debate on water privatization now centres on whether the private sector can and has improved capital investment and efficiency.

In the case of Malaysia, the water sector has historically been decentralized and fragmented, with the thirteen state governments having control of, and responsibility for, water resources while the federal government provided financing, directly and through loans to state governments. Water privatization began in 1987 and was seen as a solution for state governments to meet growing demand and deal with escalating costs, poor efficiency, and low tariffs. Most states corporatized or privatized their water services, the latter in partnership with international water companies, although several states reverted to public ownership following the withdrawal of these private companies (Hall et al. 2004). Despite corporatization, state governments retained control of the various water authorities in Pulau Pinang (55 per cent state-owned), Terengganu (100 per cent), Kelantan (70 per cent) and Selangor (30 per cent).

A central feature of Malaysia's water privatization has been PSP, primarily in the production (treatment) of water as opposed to the

less profitable distribution of water, and consistent with the problem of "cherry picking" by the private sector (Tan 2011). With the exception of Johor, state water bodies distribute water in the remaining twelve states and provide water treatment in eight states. Furthermore, PSP in water treatment is highly selective and restricted to wealthier states (Negeri Sembilan, Perak, Selangor), urban centres (Miri, Bintulu, Limbang and Labuan in Sarawak; and Kota Kinabalu and Lahad Datu in Sabah), or highly developed tourist centres in the case of Langkawi in Kedah (Lee, Tan and Lee 2014, pp. 294, 295).

The debate on the performance of the public and private sectors in Malaysia's water and sewerage systems (WSS) has been well documented (Lee 2011; Lee, Tan and Lee 2014; Tan 2011; Tan 2012). This paper focuses instead on *why* water privatization continues to be promoted *despite* the poor performance of the private sector. The failure of the private sector to finance capital investment and improve efficiency of WSS (Lee 2011; Lee, Tan and Lee 2014; Tan 2011; Tan 2012) necessitated ongoing federal government subsidies for capital expenditure that culminated in Malaysia's water sector reforms where the federal government bailed out private water concessionaires, took over private sector debts, and renationalized water assets. Water assets were then leased back to private operators who were now only responsible for the operations of water assets (Chin 2008). This "asset light" model was designed to reduce the financial burden of capital expenditure for private water operators thereby reducing entry barriers and increasing competition and improving efficiency (Chin 2008). In practice, the government renewed the contracts of failed private water operators and subsidized operating expenditure and lease rentals of less efficient operators (Tan 2012).

The failure of the private sector here is part of the wider failure of a Malay capitalist class that the government sought to create. This was highlighted in the Asian Financial Crisis in 1997 where the government bailed out most, if not all, large *bumiputera* privatization beneficiaries and took over their companies or projects, mainly through government-linked corporations (GLCs) (Gomez 2009). As a result, by 2001, there was only one *bumiputera* company among the twenty largest companies in Malaysia, and none in the ten largest companies. Seven of the ten largest companies, including the four largest, were GLCs with the remaining three owned by ethnic Chinese (Gomez 2009). At the same time, Malay businesses continued to rely on, and demand, government patronage, in particular through privatization projects.

This makes the continued promotion of water (and infrastructure) privatization, not least by international development agencies such as the World Bank, especially puzzling. Why promote water privatization given the problems of privatization and failure of the private sector? The answer can in part be found in conventional (institutional) explanations that identify rent-seeking and corruption related to non-transparent procedures and weak regulation as the causes rather than symptoms of failure. This is compounded by fundamental flaws in the theory of infrastructure privatization, in particular very high capital costs that cannot be covered by politically acceptable tariffs (Tan 2011).

2.1 The Nature of Rent-Seeking

A proper analysis of water privatization failure will thus require an examination of the underlying causes of rent-seeking. This will in turn necessitate an understanding of the development process and a country's political economy — the intersection between economics and politics, and the recognition that economic decisions and outcomes are shaped by the nature of social forces and social relations. As the development process invariably involves social transformations and the emergence of new classes, the subsequent contestation for resources will drive accumulation strategies and outcomes. At the heart of this process is the distribution of rents. Rents in economics generally refer to super profits or incomes above what would normally be earned in a competitive market. Privatized water and sewerage projects and contracts may constitute rents insofar as they provide profit opportunities

that would not have otherwise been available. Rent-seeking thus refers to the pursuit of rents, both legally (e.g. through lobbying) and illegally (e.g. through bribery).

The nature of rent-seeking will be related to the type of rents being allocated, and it is therefore important to distinguish between them. As a capitalist class did not always exist, its emergence needs to be explained rather than assumed or taken as a starting point. Two types of rents have historically been associated with the emergence of a capitalist class by promoting wealth creation (capital accumulation) and creating the conditions necessary for the growth of this class. This has historically involved the process of "primitive accumulation" through the transfer of rents that formed the basis of subsequent capital accumulation (Marx 1887). Examples include the enclosures of common land in England from the sixteenth to eighteenth centuries that created a class of capitalist farmers, land appropriation by European settlers in America, and the privatization of state-owned enterprises (SOEs) to selected families in South Korea (Tan 2010).

As accumulated capital does not necessarily mean that it will be invested productively, rents have also been needed to provide the space for learning and (technological) catching up for a nascent capitalist class. This has most notably been in the form of infant industry protection that originated in the United States and has also been a key feature in Europe, and more recently, in the newly industrialized East Asian economies (Amsden 1989; Chang 1994; Chang 1999; Gerschenkron 1962; Shefaeddin 2000; Wade 1990). Rents for learning thus usually involve state attempts to create an environment to foster learning and catching up necessary for the emergence and growth of a competitive domestic capitalist class through targeted subsidies, access to subsidized credit, protection, privatization, and other business opportunities. These rents will entail short-term costs in anticipation of long-term economic gains through technological catching up. Learning rents are thus theoretically productive rents but can easily become unproductive and costly if poorly managed.

As rents by definition cannot be widely distributed, rent-seeking becomes a key feature of capitalist development as various groups contest for the privilege to become part of a new capitalist class. The emergence of a dynamic capitalist class will then depend on how these rents are distributed and managed, and more crucially on the nature of class formations, the abilities and hence preferences of an emerging domestic capitalist class, the relationship between the state and this and other classes, and the balance of power in society (Tan 2010). Specifically, the state's capacity to allocate and, more critically, withdraw rents if performance targets are not met will depend on which classes it is connected to, the nature and economic orientation of these classes, and the balance of power between the state and these classes. Where these classes constitute potentially dynamic capitalists, then rents for accumulation and learning are more likely to be productive provided these are contingent on performance targets being met and depending on the state's disciplinary capacity to withdraw and reallocate rents. Where the state is more reliant on economically unproductive classes for political support, there is a greater likelihood that these rents will become unproductive, especially if the state is unable to withdraw rents and discipline rent recipients (Khan 2004).

In addition to rents for accumulation and learning, a third type of rent may be identified. Unlike the first two rents that are primarily economic in nature, the third rent is purely political, involving the political transfer of resources to accommodate specific groups or classes (Khan 1998; Khan 2004). As the transition to capitalism and the creation of a domestic capitalist class, entails both winners and losers, there will be heightened contestation by various groups for resources in the form of rent-seeking. As not everyone will benefit from rents for accumulation and learning, losers are very likely to seek recourse and recompense through some form of benefits. These groups usually include those left behind in the development process, and who are economically unproductive or unable to compete but who are also politically organized and may thus threaten political stability

if not accommodated. The ability of losers to secure these political transfers or rents for political accommodation will ultimately depend on the nature of the relationship and balance of power between them and the state. Thus the stronger these groups are, the more difficult it will be for the state to ignore them.

Rents for political accommodation thus serve no economic purpose and are unproductive by definition but may be politically necessary and expedient. These rents can include cash transfers to specific groups or communities and public employment opportunities, but also government contracts through privatization. There is thus some degree of overlap between rents for accumulation and rents for political accommodation but with potentially different economic outcomes. Rents for accumulation, in tandem with rents for learning, may be associated with attempts to create a capitalist class. In contrast, rents for political accommodation represent purely political transfers to essentially economically unproductive but politically mobilized groups that are disconnected from productive economic sectors. All rents thus involve the redistribution of resources directly or indirectly.

Privatization functions as a vehicle for the distribution primarily of rents for accumulation and political accommodation, the former through the transfer of assets, and both through privatization contracts. This means that rents for learning in the case of industry (manufacturing) cannot be applied in the same way to water privatization, particularly as the private sector is theoretically no more efficient than the public sector and has in fact failed to improve efficiency and increase capital expenditure (Tan 2011). As there is thus no real case for learning rents in the context of water privatization, the focus of this paper is specifically on rents for accumulation and rents for political accommodation.

2.2 The Political Economy of Rent-Seeking in Malaysia

The analysis of rents, rent-seeking and accumulation, along with an understanding of the social relations that characterize Malaysia's political economy, can help explain the nature of rent-seeking and its relationship with water privatization and ethnicity. The emergence of rent-seeking in Malaysia is usually traced back to the NEP which greatly increased rents to Malays through education, public employment, and business opportunities. However, the NEP was itself the direct outcome of pressure from small Malay businessmen, through the Bumiputera Economic Congress (BEC), who threatened political instability unless accommodated (Lim 1985). The failure of rents for accumulation and learning to create a competitive Malay capitalist class was due to the state's inability to withdraw rents as a result of increased rent-seeking and heightened political contestation within the ruling Malay party UMNO from the mid-1980s (Khoo 1992; Crouch 1992; Aziz 1997). This was in turn related to the rapid growth of, and differentiation within, the Malay middle class that compromised the leadership's ability to impose discipline because rents were needed to secure votes in party leadership contests (Ahmad 1985; Crouch 1993; Khoo 1992). Political contestation has led to outbreaks of violence at the branch level (Shamsul 1986) while leadership contests and disagreements over the allocation of rents resulted in party splits in 1987 and 1999, and the formation of alternative (Malay) political parties.

Subsequent government attempts since 2000 to impose discipline and withdraw rents have been threatened by economically unproductive or uncompetitive Malay groups, including right-wing Malay organizations, Malay NGOs, and even the youth wing of UMNO (O'Shannassy 2013). The rapid growth and changing composition of the Malay middle class as a direct result of the NEP can thus be seen to have shaped the types of rents and their allocation, with broad-based subsidies and cheap credit under the NEP in the 1970s and early 1980s replaced by privatization projects and contracts that benefitted segments of Malay businessmen, specifically those closely associated with parts of the party leadership from the 1990s (Felker 1998). Since then, privatization contracts have increasingly provided rents for political accommodation to small Malay businesses. As a

result, privatization has remained the main vehicle for rent distribution by increasing *bumiputera* participation through contract works, vendor development, and equity ownership, and reflected in the substantial increases in government development expenditure for infrastructure and roads (Economic Planning Unit, Malaysia 2006).

3. Water Privatization, Contractors and Rent-seeking in Selangor

Having discussed and contextualized the problem of water privatization failure in Malaysia, we can now examine the relationship between water privatization, rent-seeking and entrepreneurship in the state of Selangor. This section will discuss data and methodology before examining the evidence on privatized water and sewerage projects among G7 WSS contractors in Selangor.

3.1 Data

There are two main databases for water- and sewerage-related projects in Malaysia. The first is from Suruhanjaya Perkhidmatan Air Negara (SPAN), or the National Water Services Commission, a statutory body created in 2006 under two separate legislations as part of Malaysia's water sector reforms: SPAN Act (Act 654 outlines the roles, functions and scope of SPAN's work) and the Water Services Industry Act (WSIA, Act 655 covers economic, technical and social regulation, including protection of consumer interests). SPAN's compulsory licensing means that it provides an extensive and theoretically complete list of companies in WSS. Licensing under WSIA covers facilities and services for owners of water supply and sewerage systems, and services for water and sewerage service providers. Construction-related privatized water and sewerage projects are regulated by SPAN's permit registration for the provision of services (IPA Types A–E), and the supply of equipment requires SPAN certification (Supplier A and B for water and sewerage) (Table 1).

The SPAN database provides some useful information. The largest number of contractors can be found in IPA Type C permits (3,377 registered sole proprietorships and companies in 2014) and IPA Type A permits (2,332 sole proprietorships) (Table 1). These are also the two categories with large numbers of sole proprietorships (exclusively so for Type A permit holders) as opposed to businesses registered as companies, and relates directly to registrations by individual contractors. The most relevant SPAN permit category in terms of privatized water projects is IPA Type C for "works contractors" which covers construction, installation or modification to any part of a water supply system or sewerage system. Type C permit holders are also overwhelmingly concentrated in the state of Selangor (Figure 1). Unfortunately, the SPAN database only provides details of registered water and sewerage contractors but not actual projects. Furthermore, the large number of IPA Type C contractors makes it unfeasible to examine water projects for each individual contractor.

This brings us to the second database from the Construction Industry Development Board (CIDB), another statutory body set up in 1994 to promote the development, improvement and expansion of the construction industry through accreditation, registration and suspension of contractors. Like SPAN, registration is compulsory, which means that the database should provide a comprehensive and complete list of all contractors, including those registered with SPAN to undertake construction-related work. CIDB categorizes contractors into seven grades based on paid-up capital that determines the maximum project value contractors are allowed to bid for, with G1 being the lowest grade (RM5,000 in paid-up capital and restrictions to projects under RM200,000) and G7 (and "foreign") the highest with RM750,000 in paid-up capital and no limit on the value of projects they bid for.

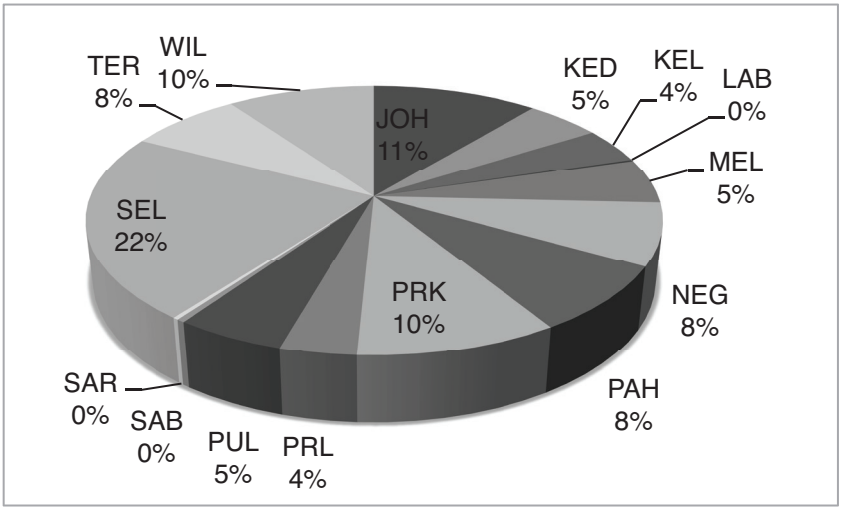
CIDB's grading of contractors is similar to the classification of contractors by the Contractor Service Centre (PKK) at the Ministry of Works where Class F is the lowest (RM5,000 minimum paid-up capital and projects up to RM200,000) and Class A the highest (RM600,000 minimum paid-up capital and projects over RM10 million). The key difference is that Class F contractors

TABLE 1
SPAN Water and Sewerage Contractor Licence Categories and Registrations

Permit/Certification	*Registered Contractors*
IPA Type A permit (water plumbers): construction, connection, modification or repairs to water pipes and water fittings that will convey water from public mains	2,332 sole proprietorships
IPA Type B permit (sewerage plumbers): any works to connect a private connection pipe to a sewer or sewage treatment works	155 companies
IPA Type C permit (works contractors): construction, installation or modification to any part of a water supply system or sewerage system	3,377 entries
IPA Type D permit (O&M contractors): maintenance services for a water supply system or sewerage system but not operations	1,247 entries
IPA Type E permit (desludging contractors): sewerage desludging services	40 entries
Supplier A + B (water)	305 companies
Supplier A + B (sewerage)	208 companies

NOTES: Registered contractors as at October 2014.
SOURCE: Suruhanjaya Perkhidmatan Air Negara (SPAN).

FIGURE 1
SPAN Type C Permits by State, 2014 (%)



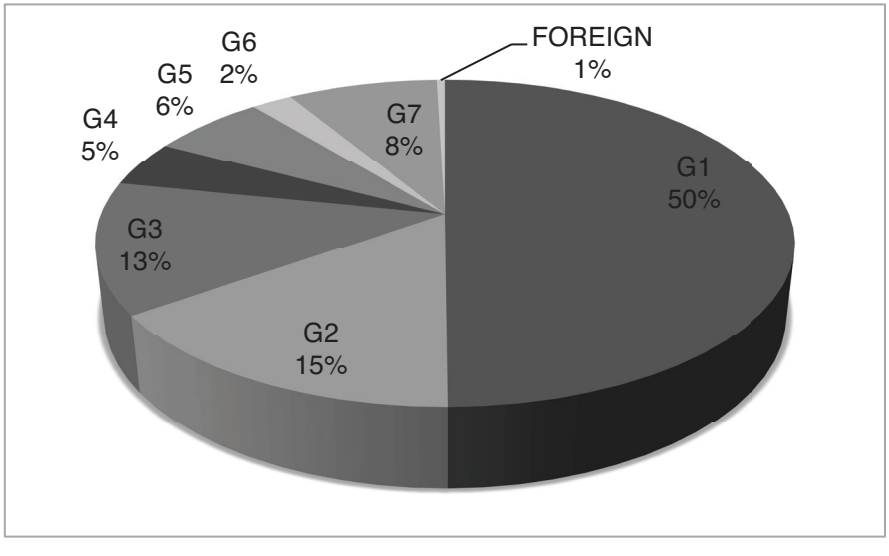
NOTES: JOH (Johor), KED (Kedah), KEL (Kelantan), LAB (Labuan), MEL (Melaka), NEG (Negeri Sembilan), PAH (Pahang), PRK (Perak), PRL (Perlis), PUL (Pulau Pinang), SEL (Selangor), TER (Terengganu), WIL (Wilayah Persekutuan, mainly Kuala Lumpur but also includes Putrajaya).
SOURCE: Calculated from SPAN data.

are exclusively *bumiputera* and the Class F Bumiputera Contractors Association (Perkobf) has opposed government efforts to merge Class F into CIDB's G1 category. However PKK data on Class F contractors and projects are not available. CIDB provides data on aggregate and contractor levels, which includes project details for each contractor, project description, location, value and date. This means that we can get an overall view of contractors and construction-related projects in Malaysia, including details of water and sewerage projects.

From the CIDB database, G1 has the highest number of contractors among all categories, comprising half of the 67,833 registered contractors in Malaysia in 2014 (Figure 2) (roughly the same as the approximately 28,000 exclusively *bumiputera* Class F contractors in the same year). However, only 0.1 per cent of G1 contractors secured projects in 2014 (Figure 3). In contrast, G7 contractors comprised only 8 per cent of all contractors but secured 36 per cent of construction-related projects. More significantly, G7 contractors accounted for over 70 per cent of total project value compared to 0.1 per cent for G1 contractors (Figure 4). Foreign contractors (who make up only 2 per cent of contractors with projects) accounted for over 20 per cent of project value. The data suggests that the focus of investigation should then be on G7 contractors.

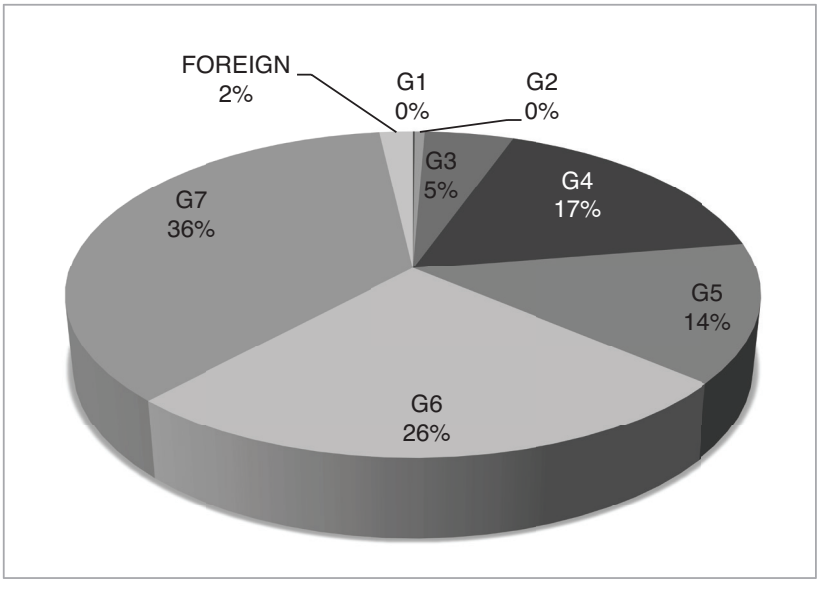
However, the CIDB data so far is too broad and needs to be narrowed down to water projects. We can do this by looking at CIDB's specification of "project category" and "work specialization". CIDB specifies four project categories: "residential"; "non-residential"; "social amenities"; and "infrastructure". Water-related work may be undertaken as part of infrastructure projects but also residential, and non-residential (commercial, industrial, plantations) projects. However, as this paper seeks to understand privatization, we need to distinguish between public and private projects. This provides us with the following categories: (private) residential; (private) non-

FIGURE 2
Total Contractors in Malaysia by Grade, 2014 (%)



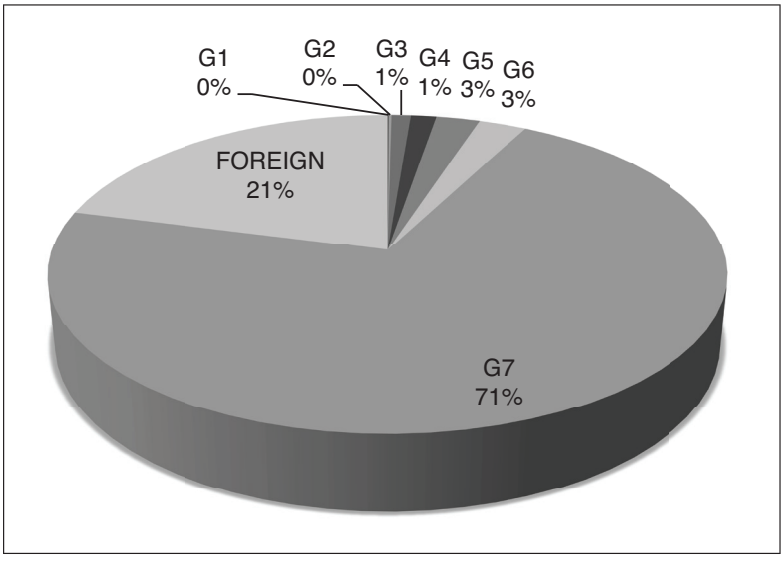
SOURCE: Calculated from Construction Industry Development Board (CIDB) Malaysia data.

FIGURE 3
Total Contractors in Malaysia by Projects Secured, 2014 (%)



SOURCE: Calculated from CIDB data.

FIGURE 4
Total Contractors in Malaysia by Project Value, 2014 (%)



SOURCE: Calculated from CIDB data.

residential; (public) residential; (public) non-residential; (public) social amenities; and (public) infrastructure. This automatically excludes water-related works (e.g. plumbing, water and sewerage connection) undertaken as part of new (private) residential and (private) non-residential projects. Likewise, infrastructure development related to (private) residential and (private) non-residential projects (e.g. new roads to housing developments) can be included under these categories, leaving infrastructure largely under the public sector.

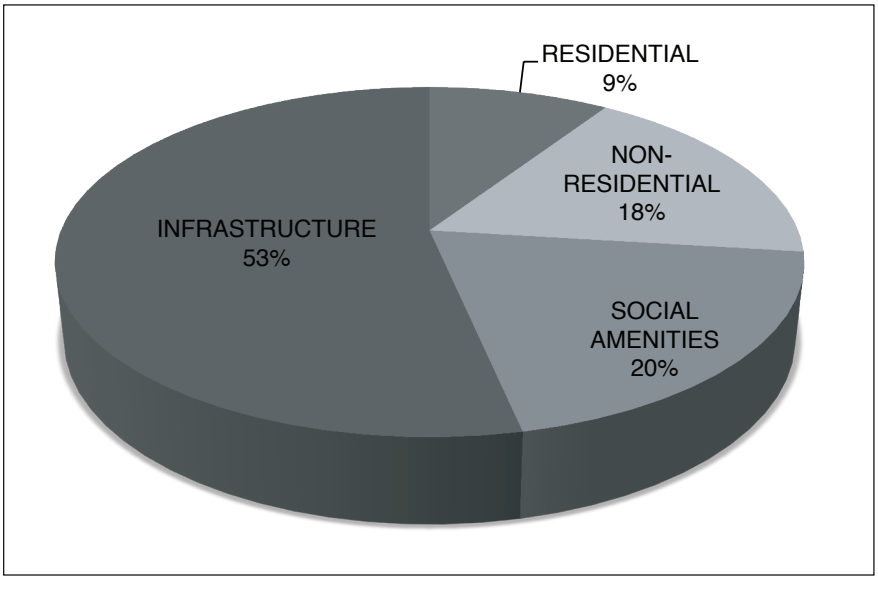
3.2 Contracts and Contractors in the Water Sector

With the focus on government projects, infrastructure accounts for over half (53 per cent) of the value of this followed by social amenities (20 per cent), (public) non-residential (18 per cent) and (public) residential (9 per cent) (Figure 5). Of the twelve largest projects in terms of value in 2013, seven were public infrastructure, four were (public) non-residential (commercial, industrial), and one was social amenities (hospital). Given that water privatization will be part of infrastructure projects, our focus then needs to be on public infrastructure.

We can further narrow down infrastructure projects according to CIDB's classification of work specialization: "building", "civil engineering", "electrical" and "mechanical". The work specialization most relevant to water is civil engineering. While the private sector accounts for more civil engineering projects there is little difference between government and private projects in terms of the value of civil engineering projects (Figures 6 and 7).

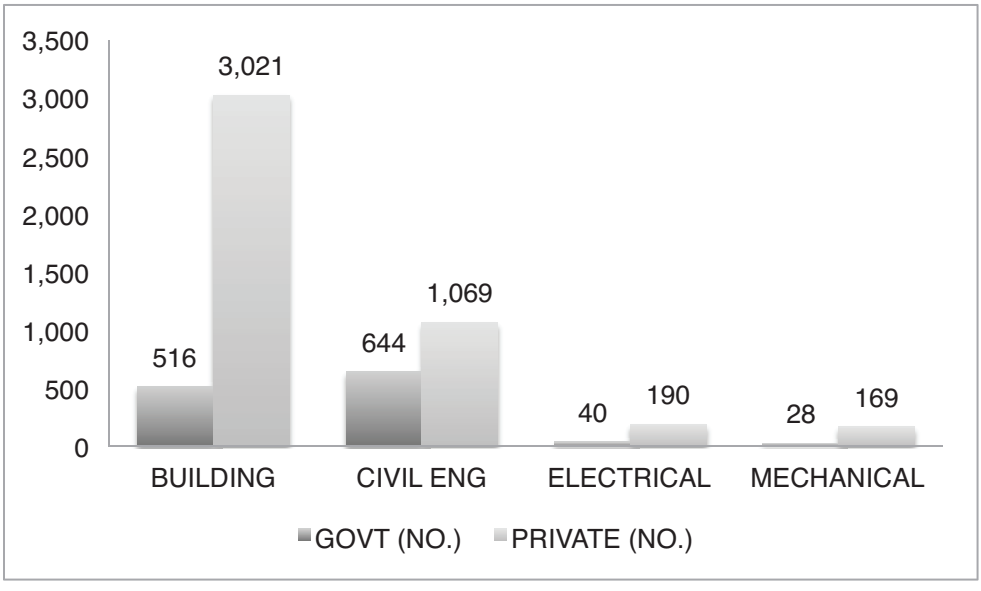
We then need to work out the water component of civil engineering projects. The CIDB data on civil engineering construction covers the total number of civil engineering contractors. From here, two sub-categories relate directly to water: CE19 (sewerage systems, comprising 1,302 contractors) and CE20 (water supply systems, comprising 7,474

FIGURE 5
Government Project Value by Project Category, 2014 (%)



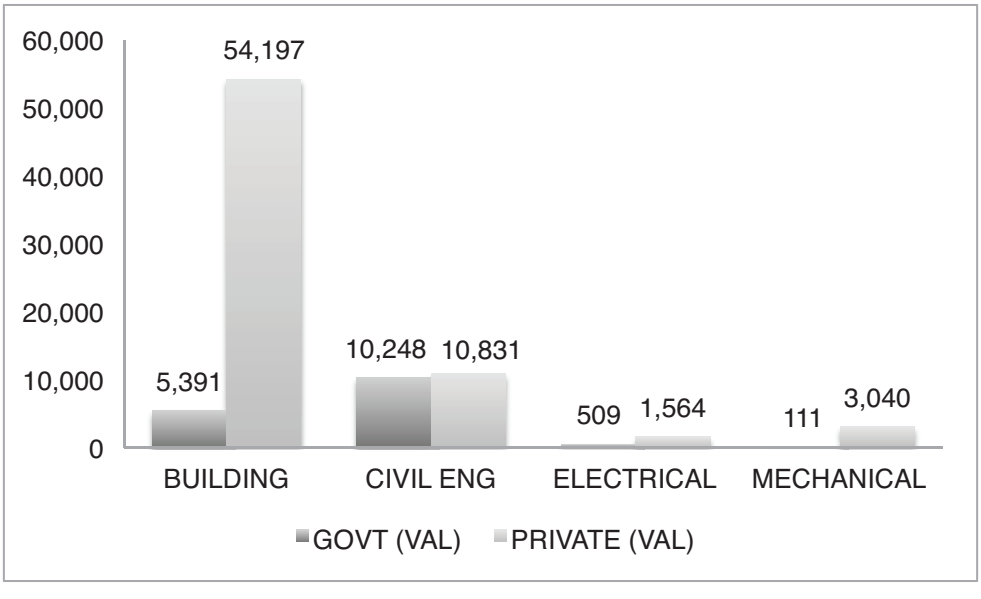
SOURCE: Calculated from CIDB data.

FIGURE 6
CIDB Work Specialization, Government and Private, 2014 (Total)



SOURCE: Calculated from CIDB data.

FIGURE 7
CIDB Work Specialization, Government and Private, 2014 (Value, RM million)



SOURCE: Calculated from CIDB data.

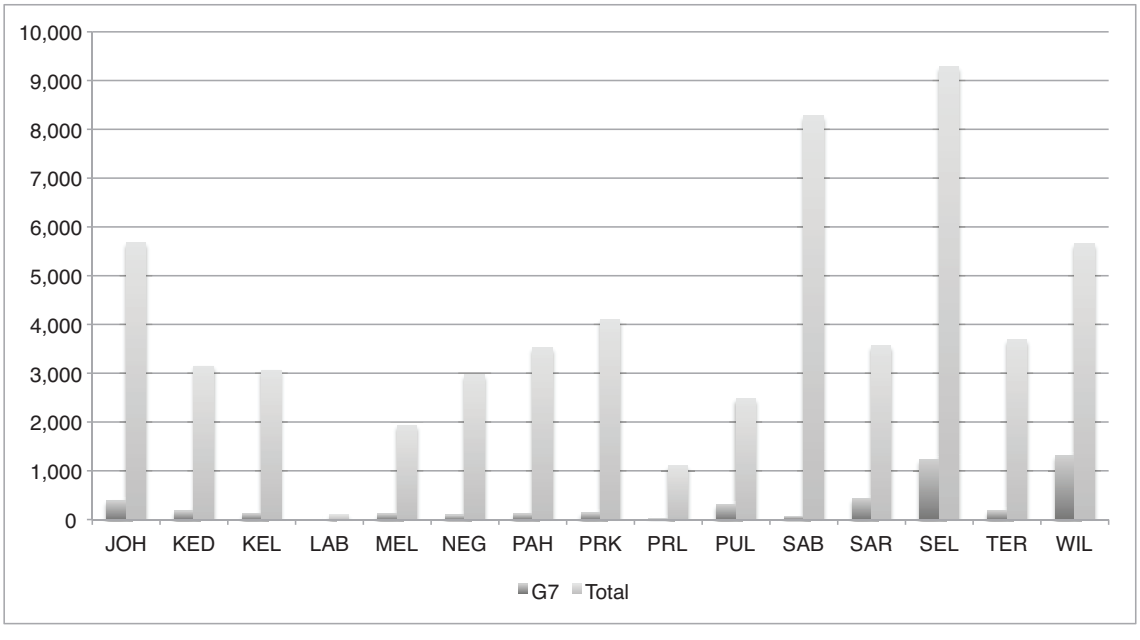
contractors). This brings the number of water- and sewerage-related (civil engineering) contractors to 8,774, which is simply too large to manage. Concentrating just on G7 contractors allows us to reduce the number of contractors from 8,774 to 1,574. We can further narrow down the number of contractors by focussing on the state with the highest number of total and G7 contractors, and the highest value of infrastructure projects.

Selangor has the highest number of total registered contractors (9,288) and second highest number of G7 contractors (1,237) after Wilayah Persekutuan (mainly Kuala Lumpur) (1,308) (Figure 8). Selangor and Johor have by far the most number of projects (around 1,100, which is over twice as many as the next state) (Figure 9). More importantly, CIDB-registered contractors in Selangor secured the highest value of infrastructure projects (RM3.13 billion) compared to Johor (RM2.33 billion) and Wilayah Persekutuan (RM3.09 billion). Note that these projects are not necessarily based in Selangor but rather awarded to contractors registered in Selangor. By focussing on G7 contractors in CE19 (sewerage systems) and CE20 (water supply systems) in the state where contractors have secured the highest value of infrastructure projects and with the highest number of G7 contractors, we are left with 217 G7 contractors and 4,732 projects.

3.3 Bumiputera and Non-Bumiputera Participation

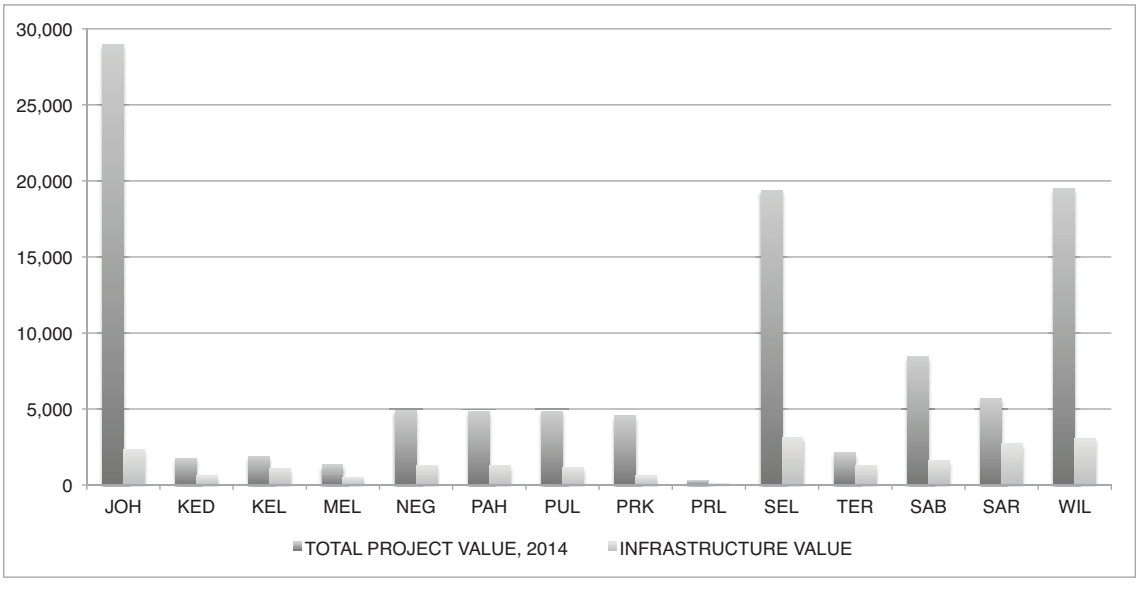
As we are interested in the nature of rents and rent-seeking that is officially allocated along ethnic lines, G7 contractors can be divided into *bumiputera* and non-*bumiputera* based on CIDB's current certification of *bumiputera* status that needs to be renewed every two years. We can now turn to the results.

FIGURE 8
Contractors by Grade and State, 2014 (Total)



SOURCE: Calculated from CIDB data.

FIGURE 9
Infrastructure Projects by State, 2014 (value, RM million)



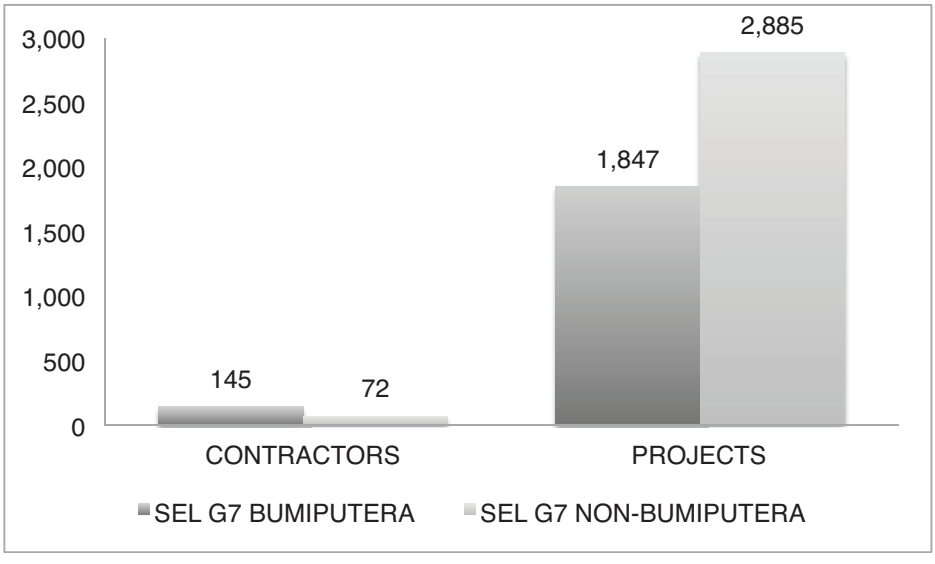
SOURCE: Calculated from CIDB data.

From the discussion of Malaysia's political economy in the previous section, we would expect *bumiputera* G7 contractors in Selangor (145) to outnumber non-*bumiputera* contractors (72). However, rather surprisingly, non-*bumiputera* contractors, despite being fewer in number, secured more projects — 2,885 compared to 1,847 for *bumiputera*. This is reflected in the higher value of projects for non-*bumiputera* contractors (RM67.2 billion compared to RM47.1 billion for *bumiputera*) (Figures 10 and 11).

However, these projects are heavily concentrated in the private sector, namely in the residential and non-residential categories (RM37.3 billion compared to RM12.6 billion for *bumiputera*), and traditionally dominated by ethnic Chinese contractors, which skews the data. Focussing on just (public) infrastructure (minus WSS) and WSS separately provides a better idea of the distribution of WSS projects. Here, the value of infrastructure (RM16.5 billion) and WSS (RM6.2 billion) projects secured by the 72 non-*bumiputera* contractors was still higher than the value of projects secured by *bumiputera* contractors (RM15.8 billion and RM5.3 billion respectively). However, both infrastructure and especially water account for a relatively small share of total project value for both *bumiputera* (33 and 11 per cent respectively) and non-*bumiputera* (24 and 9 per cent) contractors (Figure 11), in part because not all G7 contractors (*bumiputera* and non-*bumiputera*) registered under CIDB's CE19 and CE20 categories are engaged in water projects.

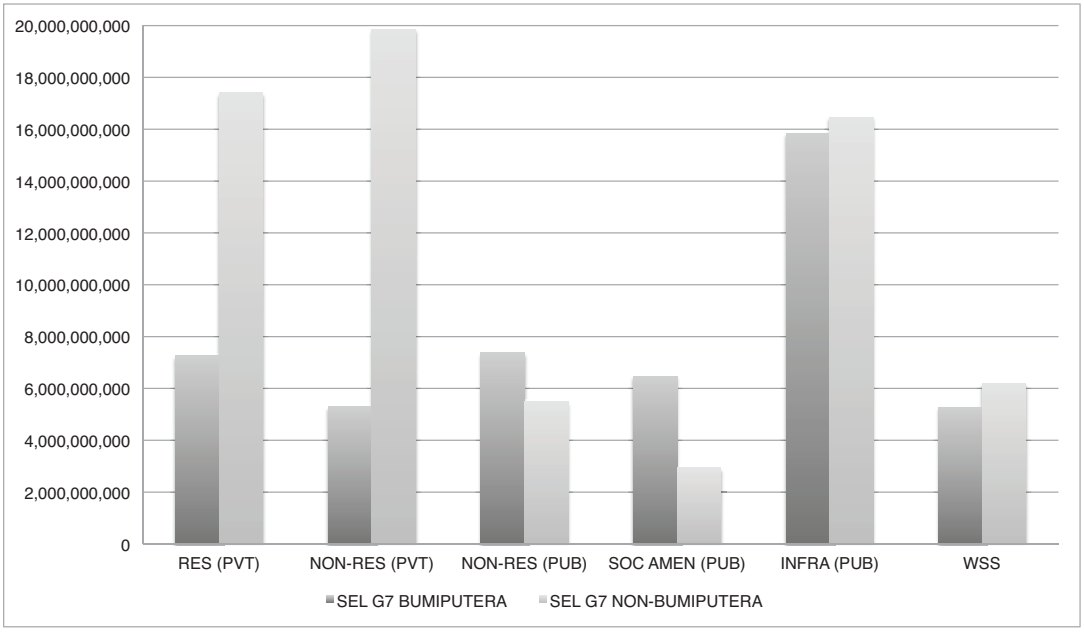
Once we remove all contractors without water- and sewerage-related projects (including private water projects that are part of new private residential and non-residential developments) we are left with 56 *bumiputera* and 36 non-*bumiputera* water contractors. Again, project value is higher for non-*bumiputera* water contractors in total (RM35.5 billion compared to RM24.5 billion for *bumiputera*) and in all sectors except for public

FIGURE 10
G7 *Bumiputera* and Non-*Bumiputera* Contractors in Selangor, 2014 (Total)



SOURCE: Calculated from CIDB data.

FIGURE 11
G7 Contractors by Project Category in Selangor, 2014 (Project Value, RM)



NOTES: Private residential [RES (PVT)]; private non-residential [NON-RES (PVT)], public non-residential [NON-RES (PUB)]; water and sewerage systems [WSS]; Selangor [SEL].
SOURCE: Calculated from CIDB data.

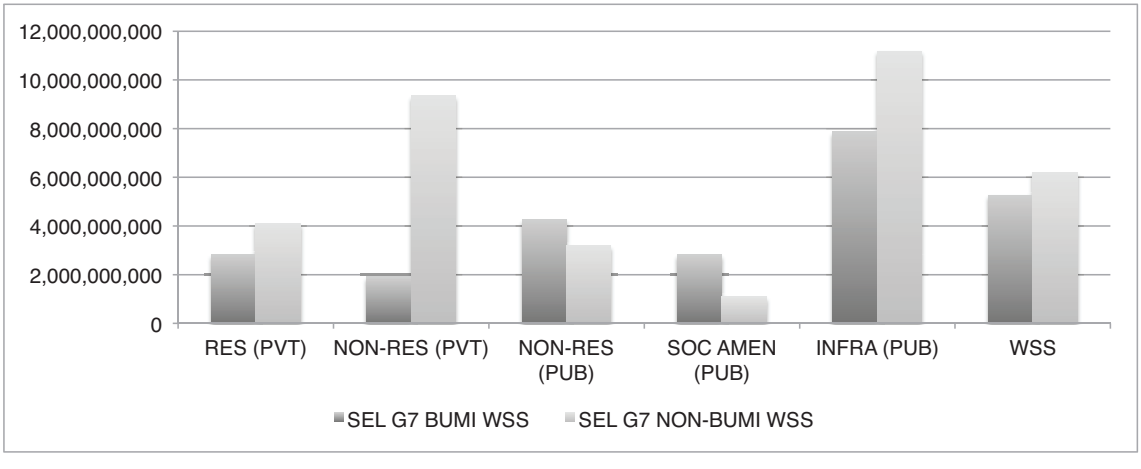
non-residential and social amenities (Figure 12). However, this is once again skewed by private residential and private non-residential projects (RM13.5 billion for non-*bumiputera* compared to RM4.8 billion for *bumiputera*). Furthermore, both *bumiputera* and non-Bumiputera contractors appear to be involved more in non-water projects, in particular infrastructure where the value of projects (RM11.2 billion for non-*bumiputera* and RM7.9 billion for *bumiputera*) are significantly higher than in water- and sewerage-related projects (RM6.2 billion for non-*bumiputera* and RM5.3 billion for *bumiputera*).

What we can do is to further break down G7 water contractors by their degree of specialization by calculating the value of water projects as a share of total project value. This separates specialist water contractors (with over 50 per cent of total project value in water or where the value of water projects is higher then the value of projects in the other project categories) from non-specialist water contractors (where the value of water projects is less than 50 per cent of total project value). As we are interested in the nature of entrepreneurship in terms of specialization, the main distinction here is in terms of the share of water projects rather than absolute amounts. This means that larger non-specialist water contractors may still have water- and sewerage-related projects of higher value than smaller specialist water contractors as will be illustrated later.

This leaves us with thirteen *bumiputera* and sixteen non-*bumiputera* specialist water contractors, and forty-three *bumiputera* and twenty non-*bumiputera* non-specialist water contractors (Figure 13). The results show that the value of water projects is now a significant share of total project value for both *bumiputera* and non-*bumiputera* specialist water contractors, totalling RM3.8 billion and RM16.7 billion, and accounting for 80 and 95 per cent of total project value respectively.

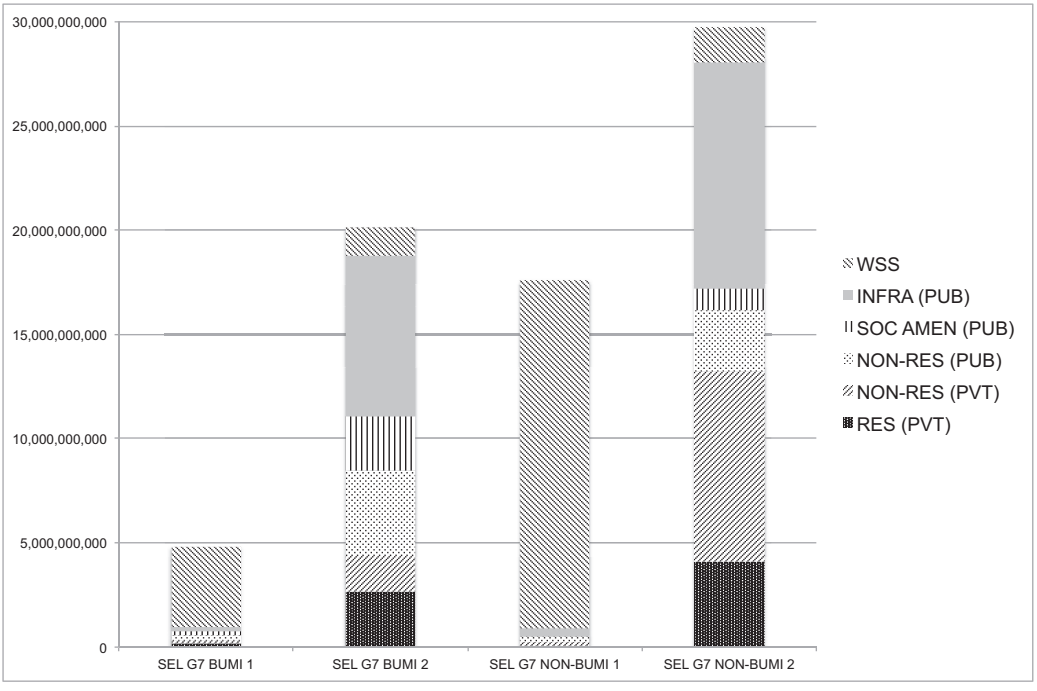
As this is a smaller than expected number of water contractors, the findings can only be preliminary and will require additional data on G7 water contractors from more states. Nonetheless, the process of identifying specialist water-related contractors is in itself revealing of the relationship between water privatization, ethnicity and rent-seeking. Non-*bumiputera* specialist water contractors (SEL G7 non-Bumi 1) secured over

FIGURE 12
G7 Water Contractors by Project Category in Selangor, 2014 (Project Value, RM)



Notes: Private residential [RES (PVT)]; private non-residential [NON-RES (PVT)], public non-residential [NON-RES (PUB)]; water and sewerage systems [WSS]; Selangor [SEL].
Source: Calculated from CIDB data.

FIGURE 13
G7 Specialist and Non-Specialist Water Contractors by Project Category in Selangor, 2014
(Project Value, RM)



SOURCE: Calculated from CIDB data.

four times more in total project value in water than *bumiputera* contractors (SEL G7 Bumi 1) despite being only 23 per cent more in numbers. Based on the criteria employed here for water specialization, non-*bumiputera* specialist water contractors are also noticeably more specialized, focussing almost entirely on water- and sewerage-related projects. In contrast, water- and sewerage-related projects only account for 7 and 6 per cent of total project value for *bumiputera* (SEL G7 Bumi 2) and non-*bumiputera* (SEL G7 non-Bumi 2) non-specialist water contractors respectively. However, non-*bumiputera* non-specialist water contractors secured more water projects (1,384) of higher value (RM1.7 billion) despite being less than half the number of *bumiputera* non-specialist water contractors (1,050 projects worth RM1.4 billion).

3.4 Rent-Seeking and Ethnicity in the Water Sector

How then do we explain the evidence so far? And what does it tell us about the nature of rents and rent-seeking in relation to water privatization contracts? Rent allocation through water privatization can be better understood by distinguishing between rents for accumulation and rents for political accommodation discussed in the previous section. The allocation of water and sewerage projects primarily to non-*bumiputera* G7 contractors suggests that water privatization has benefitted this group the most. The fact that non-*bumiputera* specialist and non-specialist water contractors both secured more and/or higher value water projects than *bumiputera* contractors also indicates that they have been more successful

in securing these rents but does not tell us why this might be the case. To try to explain this, we need to look more closely at the composition of privatization projects for *bumiputera* and non-*bumiputera* contractors.

The only two project categories consistently dominated by *bumiputera* contractors are public non-residential and social amenities regardless of whether these are measured more broadly or by looking at only privatization projects. Hence, (public) non-residential projects accounted for 15.7 per cent of total project value secured by all G7 *bumiputera* contractors, 17.4 per cent for all *bumiputera* water contractors, 20.5 per cent for *bumiputera* non-specialist water contractors and 5.4 per cent for *bumiputera* specialist water contractors in Selangor. In comparison, the equivalent shares for non-*bumiputera* contractors are 8.2 per cent, 9.0 per cent, 9.8 per cent and 4.6 per cent respectively. Similarly, social amenity projects account for a significantly higher share of total project value for *bumiputera* contractors, between three and seven times higher than for non-*bumiputera* contractors.

This is significant because it suggests two possibilities: (1) that *bumiputera* water contractors are unable to secure water and sewerage projects and/or (2) prefer projects in the public "non-residential" and "social amenities" categories. This is despite government policy stipulating a percentage of project value (e.g. 10 per cent of the value of all Public Works Department contracts worth more than RM10 million) to be reserved for *bumiputera* G1/Class F contractors, and policies to ensure sufficient rents so that all *bumiputera* contractors earn a reasonable margin. Why might this be the case? There are several possible and related explanations. First, water and sewerage projects are fairly specialized and capital and scale intensive. Second, non-*bumiputera* (mainly ethnic Chinese) contractors may have significantly more experience given their history in water- and sewerage-related work as part of private residential and private non-residential projects that they have dominated historically and continue to do so. Third, there are limited opportunities in the water sector in terms of the number and value of projects, and employment. WSS accounts for only 1 per cent of Malay employment. At the same time other project categories offer greater, easier and quicker profit opportunities. In this case, participation in water privatization can provide opportunities for easy rents, especially for non-specialist water contractors who by definition do not necessarily have a specific area of focus or expertise.

Rents can typically be obtained by: (a) securing a contract for a project, usually without open tender; (b) related to this, inflating or overstating costs; and/or (c) sub-contracting to someone else for less than the contract is worth. Table 2 provides an example of two projects originally secured by a Selangor *bumiputera* G7 non-specialist water contractor (on the left column) that were then sub-contracted to a Selangor non-*bumiputera* G7 specialist water contractor (right column). Contractor and project names have been omitted but the details of the projects and the dates remain the same. Only the value of both projects once sub-contracted to the non-Bumiputera contractor is lower, particularly for the second project. The difference of around RM2.5 million constitutes rents obtained by the *bumiputera* contractor for just two projects.

The contractor in question had ninety projects worth RM900 million secured between 1996 and 2013, with the bulk being in social amenities (namely building schools) and public buildings (mainly building service stations for Petronas, the national petroleum company). Although the value of water and sanitation projects only accounted for 1.5 per cent of total project value for this non-specialist water contractor, this still amounted to RM13.6 million which is higher than the value of water projects of two *bumiputera* and three non-*bumiputera* specialist water contractors. In other words, water privatization provides significant profit opportunities even for non-specialist water contractors. Rather than a genuine, capacity-building partnership, this also suggests that the relationship between *bumiputera* and non-*bumiputera* water contractors is closer to that of patron and client (or contractor and

TABLE 2
Rent-seeking and Sub-contracting

Original Contract (Bumiputera G7 Non-specialist Water Contractor)	*Sub-contract (Non-bumiputera G7 Specialist Water Contractor)*
Installation of pipes and pump systems for groundwater	Construction and Completion of Pump House including Supply Installation and Commissioning Pump Sets
28 Nov 1998	Oct 1998–July 1999
RM5,540,611.20	RM5,100,000
Proposed Distribution Works Const. of 2 Nos. 2.5 ML Reservoir & 1 No. 6.0 ML Suction Tank With Booster Pumping Station Complete With Pumping Plant & Ancillary Works	Construction 2 Nos. 2.5 ML Reservoirs and 1 No. 6.0 ML Suction Tank With Booster Pumping Station Complete With Pumping Plant And Ancillary Works
29 Aug 2003	Nov 2003–June 2006
RM13,629,908.80	RM 11,600,000.00

SOURCE: CIDB and contractor websites.

sub-contractor) and earlier "Ali-Baba" (Malay–Chinese) partnerships (Bruton 1992).

Opportunities for easy rents thus reinforce the main features of the water sector and *bumiputera* accumulation strategies. This pursuit of easy rents is itself a legacy of rent distribution policies under the NEP and privatization, and the outcome of non-*bumiputera* rent-seeking strategies in response to the NEP. Non-*bumiputera* small and medium enterprises (SMEs) sought silent Malay partners while medium and larger companies partnered with, or appointed Malay politicians and bureaucrats to gain access to state rents (e.g. licences, contracts, credit, etc). This practice is reflected in a surprisingly large number of water-related companies where the chairman or managing director posts are filled by senior former civil servants, usually from a related department (e.g. water board or public works). This includes the non-executive director of Puncak Niaga Construction (previously from the Public Works Department and former director of a state waterworks department); the CEO of Trans Resources Corporation (previously from the Public Works Department); and a director at Mahkota Technologies (former director of the Economic Planning Unit in the Prime Minister's Department, and Secretary of the Contract and Supply Division in the Ministry of Finance).

Furthermore, although *bumiputera* contractors have been certified by CIDB, in reality there is no way to determine whether a contractor (registered as a sole proprietorship, partnership or company) is genuinely *bumiputera* or otherwise as contracts could easily be sub-contracted or sold. This means that the number and value of water projects for *bumiputera* (and non-*bumiputera*) contractors is likely to be overestimated (and underestimated). This raises questions about the viability of a Malay entrepreneurial class with only 17,000 of some 40,000 *bumiputera* Class F actually active in 2009, the remainder being part-time contractors or contract brokers who either earned commissions as sub-contractors or who sold off government contracts for quick profits (Shafie and Fakhrul 2011).

Bumiputera accumulation strategies are also closely tied up with politics and the contestation for resources within UMNO. Underlying this conflict are patron-client networks — repeated (but not stable) relationships between political patrons and their clients or supporters — and the need for patrons to distribute rents for political accommodation to secure the support of party members. Hence, privatization projects and contracts are distributed to large clients (usually big business) and politicians/party members lower down the hierarchy who act as both client (by delivering political support in the form of votes) and patron (by subsequently dispensing these rents further down the line to state and divisional heads) (Tan 2014). Rent-seeking here is usually most visible on the ground where *bumiputera* contractors are the most numerous (G1 and Class F). They put pressure on party leaders to allocate rents.

For example, in August 2014, UMNO announced on its website[2] that the government would "provide more small-scale infrastructure projects in rural areas throughout the country … to cater to the needs of the 28,000-strong *bumiputera* Class F contractors" with the Prime Minister assuring Perkobf that "the government would continue to assist its members". This is consistent with previous sub-contracts allocated to Class F contractors in more rural states, in particular Terengganu and Sabah, which constitute part of UMNO's support base.

However, the sums involved are not necessarily large once divided among individual contractors. At the 2006 UMNO General Assembly, the then Prime Minister (and UMNO president) announced the allocation of RM600 million in small contracts to be allocated to all 191 UMNO divisions, amounting to around RM3 million per division. In contrast, RM4.4 billion was allocated between 2001 and 2005 to twenty-seven *bumiputera* contractors (Economic Planning Unit, Malaysia 2006, p. 228). The main difference here is that the RM600 million constituted rents for political accommodation and the RM4.4 billion (or an average of RM162.9 million per contractor) are more likely to be rents for accumulation.

UMNO grassroots members or supporters can be seen to drive rent-seeking insofar as the increased political conflict and party fragmentation makes their support critical in leadership contests and the pattern of subsequent rent allocation. However, the relationship between the creation of rents in the form of projects and the growth of contractors and subsequent demand for more contracts is dialectical, with contractors driving rent-seeking and rent distribution and rents increasing the number of rent-seekers who then push for even more rents. Nonetheless, this dialectical relationship between rents and rent-seeking/contractors can be grounded in social forces and changes in social relations. Hence, while the NEP is largely responsible for the creation of a rent-seeking culture, it was itself the outcome of an emerging Malay business class demanding economic redistribution with threats of violence (Puthucheary 1984; Lim 1985; Ho 1988; Jesudason 1989).

4. Conclusion

This paper started by asking why water privatization continued to be promoted in Malaysia despite the failure to improve efficiency and capital investment. To answer this, we examined the relationship between water privatization, ethnicity and rent-seeking, where privatization provides rents for accumulation and rents for political accommodation. Both types of rents may be traced to political pressure from a rapidly growing Malay middle class, specifically small businesses unable to compete in other economic sectors.

Given official redistributive policies in favour of *bumiputera*, we would expect that the bulk of water privatization contracts would be allocated to Malay contractors. However, despite the dominance of *bumiputera* G1 and Class F contractors numerically, water privatization projects are in fact dominated by G7 contractors, with non-*bumiputera* G7 water contractors in the state of Selangor securing more water privatization contracts and of higher value. In contrast, *bumiputera* G7 specialist and especially non-specialist water contractors have focussed primarily on securing public "non-residential" and "social amenities" projects. This is likely to

be related to the limited experience and abilities of *bumiputera* contractors, particularly given the fairly specialized and technical requirements of water and sewerage services. At the same time, the continued subcontracting of projects by *bumiputera* to non-*bumiputera* suggests that *bumiputera* participation in water may be even lower, and that there is a preference for quick rents in relatively easier project categories consistent with the evidence of sectors in which *bumiputera* G1 contractors are concentrated.

G1 privatization contracts may be seen to primarily constitute rents for political accommodation, with little evidence to suggest entrepreneurial abilities or ambitions. For example, only 47 of nearly 29,000 Class F contractors managed to upgrade to Class E between 2010 and 2011. Furthermore, rents for accumulation in the form of privatization projects allocated to *bumiputera* G7 contractors do not appear to be qualitatively different and suggests that many G7 contractors have hardly graduated from G1 status in terms of project choice. This preference is related to the failure to secure higher value projects, for reasons described earlier, which in turn restricts (G7) *bumiputera* contractors to smaller, simpler and/or lower-value projects.

We may predict several possible and related outcomes as a result. First, *bumiputera* accumulation strategies will continue to mainly centre on unproductive sectors and relatively simpler and lower value projects. Second, this will only increase rent-seeking in these sectors as uncompetitive *bumiputera* contractors, both big and small, seek continued business opportunities. Third, there will be even more contractors chasing fewer, and smaller projects that will in turn increase the competition for rents. Fourth, this competition for rents is very likely to be manifested in the increased political contestation within UMNO and greater fragmentation of patron-client networks with uncertain political consequences.

The failure to promote entrepreneurship in more productive sectors such as industry, along with pressure for greater economic redistribution from the new Malay middle class, has thus led to the creation and pursuit of rents in water privatization. This however does not mean that any drastic reduction of Malay participation in unproductive or protected sectors will be politically untenable. Rather, successful policy reform will depend on how the balance of social forces plays out as this was the case when the privatization programme was introduced to benefit a new class of (large) Malay businessmen and former managers of SOEs at the expense of (small and medium) Malay businessmen dependent on NEP-style handouts (Jomo 1993; Felker 1998).

The continued promotion of water privatization remains highly questionable in the context of these outcomes and the failure of water privatization to deliver capital investment and efficiency gains in Malaysia and generally. However, the reasons for the failure (and ongoing attraction) of water privatization can only be understood within the wider context of national accumulation strategies, the types of rents necessary for accumulation and political accommodation, and how these are shaped by social forces.

NOTES

1. See Kessides (2005) for an example of theoretical developments in privatization theory in response to the failure of private ownership.
2. See <http://www.umno-online.my/2014/08/19/more-small-scale-projects-will-be-provided-to-bumiputera-class-f-contractors/> (accessed 7 August 2015).

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