

BOOK REVIEW

Khalid, M.A. (2014). *The Colour of Inequality: Ethnicity, Class, Income and Wealth in Malaysia*. Kuala Lumpur: MPH Publishing.

by R. Thillainathan^a, *Malaysian Economic Association* and
Kee-Cheok Cheong^b, *University of Malaya*

For a book that speaks to one of the most debated topics in Malaysia, the above has not been the subject of many critical reviews. Perhaps under a regime in which any discussion of the New Economic Policy (NEP) was deemed 'sensitive', the tenet of the book, in providing strong support of the NEP, made criticism a risky business. Nevertheless, given the amount of evidence it amassed in defence of its position, it deserves careful review.

As an essay that strongly defends the ethnicity-grounded NEP, it makes interesting reading, with a mass of data to support its arguments. However, as an academic exercise, it falls short for a number of reasons.

The focus of the book is on wealth and not on income inequality. And on the between-race component of inequality and not just on inter-personal or within-race inequality. Khalid attempts to make a case for this change in focus on wealth inequality. Typically, wealth is more unequally distributed than income. And unlike income distribution, as there was no enquiry into the state of wealth distribution in Malaysia, this was a compelling reason for his decision to be a pioneer in undertaking such a study. He embarked on his enquiry into the extent and causes of inequality in wealth in the country versus that in other countries. But there was an equal or even greater focus on the between-race disparity in wealth holdings and in particular on analysing the factors that account for such disparity. In what follows we critically review Khalid's findings as well as the policies he advocates.

The wealth holdings Khalid uses in his study are imputed from data on interest, dividend and rental income given in the 2009 Household Income Survey (HIS). From this data base he finds that both the within- and between-race inequality in wealth is significantly higher than in income. The inter-personal inequality in income in Malaysia was 0.44 (in terms of the Gini coefficient) whereas that for wealth was 0.56 (as compared to 0.38¹ and 0.83 in the US). However, of the overall inequality, the between-race component only accounted for 3 percent of the total inequality in income and for 7.5 percent of the total inequality in wealth.

^a Malaysian Economic Association, c/o Faculty of Economics and Administration, University of Malaya, 50603 Kuala Lumpur, Malaysia. Email: rthilli@gmail.com

^b Institute of China Studies, Deputy Vice Chancellor (Research & Innovation) Office, University of Malaya, 50603 Kuala Lumpur, Malaysia. Email: cheongkeecheok@um.edu.my, keecheok1@yahoo.com

¹ The Gini coefficient for income distribution in the US is taken from the World Bank, *Malaysian economic monitor: Towards a Malaysian middle class society*, December 2014, p. 44. The World Bank's corresponding number for Malaysia is 0.41.

The first issue we raise is the definition of wealth in the book which is derived indirectly from the 2009 HIS. Only three categories of wealth are identified: deposits (derived from interest income); shares (derived from dividend income) and rental income (derived from ownership of property). Even if we ignore human capital which makes up a significant proportion of total capital, the above definition omits retirement funds with the Employees Provident Fund (EPF) and the government's Pensions Department as well as land that has not been developed into real estate. The book's finding of low savings of 8 percent of total wealth held in financial assets (i.e. in the form of deposits or shares) is almost meaningless. Given mandatory contributions to EPF is 23 percent of an employee's salary, one should not be surprised by the low level of voluntary savings. In the book the bulk of the wealth is made up of property assets (no doubt mostly of residential houses). And much of property would have been mortgage financed. This means net holdings of property will be a lot less than claimed. If Khalid is aware of these omissions and their impact on his analysis, he has made no attempt to take these into account. The impact of including human capital and compulsory savings would be to significantly lower the inter-ethnic wealth gap given the substantial expansion of education, health and employment access among *Bumiputera* in the post-independence period.

The second set of issues is, given Khalid's own admission that the between-race component only accounts for a small proportion of both income and wealth inequality, what purpose is served by the book's strong advocacy of continued and more effective implementation of the race-based affirmative action agenda of the NEP? Even if Khalid's prescriptions bear fruit, what difference does it make to reducing overall inequality? Does not the predominance of within-race inequality, known since the mid-1980s (see Anand, 1983) suggest the focus should be on need-based affirmative action? There was a strong case back in 1970 for the implementation of the NEP. But the continued harping of race and failure to focus on a need-based affirmative action program will only diminish the likelihood of achievement of the objectives of national unity and development of a national identity (Cheong, Hill, & Leong, 2016).

In its eagerness to defend the status quo, Khalid has made efforts to dismiss criticisms of the NEP without careful consideration of arguments on both sides. The most obvious example of this tendency is his argument that the implementation of the NEP did not lead to any trade-off between growth and distribution. The basis for this view was simply that growth remained high throughout the period the NEP was implemented. No argument was made beyond this growth performance. In a published paper that considers the country's performance in different sub-periods, we demonstrated the adverse impact of the NEP on growth (Thillainathan & Cheong, 2016). In this paper, we showed the existence of a trade-off as demonstrated by the decision of the government to substantially alter the stance of the affirmative action agenda especially after the economy collapsed in the mid-1980s.

In making the above assertion, Khalid implicitly assumed that the NEP alone was responsible for eradicating poverty and raising incomes of all ethnic groups and not only that of the *Bumiputera*. It is well-known that eradication of poverty and raising of incomes have been made substantially more possible by the growth of the economy as

the government switched strategy from import substitution to export promotion and not solely by the distribution agenda of the NEP.

As another important example, a key factor identified by Khalid to explain the observed disparity in between-race wealth holdings is job market discrimination against the *Bumiputera*. But is this observed hiring pattern in favour of non-*Bumiputera* indicative purely of job market discrimination? In a study of employers' perceptions of the graduates of various higher education institutions (HEIs), Cheong, Hill, Fernandez-Chung and Leong (2016) found employers to prefer hiring graduates of private HEIs over those of public HEIs. Since private HEI graduates are mostly non-*Bumiputera*, this can help explain the hiring preferences as much as discriminatory practices. Also, as the book finds that the disparity in wealth is also high between the *Bumiputera* and Indians, and as Indian ownership of business is insignificant, what is the likelihood that job market discrimination is a key cause of wealth inequality? The readiness with which Khalid is willing to arrive at a conclusion of his liking suggests a mind-set that is already made up.

Another key factor identified by Khalid to explain such disparity is inter-generational transfer of wealth. Again this explanation for the findings in the book can be challenged. The book identifies property as the key component of wealth (accounting for 92 percent of total wealth) and further that the extent of disparity is most pronounced among the poorer households. Most households with the exception of the really rich (within which category the disparity is the lowest as the book itself found) are unlikely to own more than one property. In any case the book states that of the HIS respondents, no fewer than 25 percent had zero property assets. This being so, any inter-generational transfer is likely to entail the sale of the property (where an individual owns one) and splitting of the sale proceeds among the children. And as property is the dominant component of wealth and as cash or shares are only a minor component (8 percent) of wealth, inter-generational transfer is unlikely to be the key factor for the observed pronounced inequality in property and hence in wealth holdings in the country.

More serious than errors of omission are errors of commission. It is disingenuous to lump together students from private and public HEIs to show that non-*Bumiputera* enrolment is again beginning to outpace *Bumiputera* tertiary education enrolment. Whereas students in public HEIs benefit substantially from the government's heavy subsidy of tertiary education, students in private HEIs have to pay in full what the tertiary education market will bear, which is many times what public HEI students pay. Indeed, the appropriate interpretation of the growth of private HEIs with mainly non-*Bumiputera* students is of the latter increasingly being squeezed out of the public tertiary education sector. With the bulk of student loans going to *Bumiputera* students², poor non-*Bumiputera* students, unable to pay private HEI fees, are excluded even from this sector. One consequence of a race-based affirmative action program is to deny education access to a group of students in need.

² In response to a question in Parliament in October 2013, then Deputy Prime Minister said that Malays formed the largest number of defaulters (328,550), with Chinese (55,445) and Indians (28,250) far fewer (Chu, 2013).

To explain the persistence of between-race inequality, Khalid cites the replacement of NEP quotas by 'meritocracy' and poor implementation of the NEP. On meritocracy, it is well-known that this is a myth (see, for instance, Pak, 2013). To gain entry into university, a segment of the *Bumiputera* students go through matriculation programs, with examinations set, managed and marked internally by the schools. Non-*Bumiputera* students, however, had to sit for the more difficult STPM examinations which are national and multi-racial in coverage. On poor implementation, Khalid's judgment is based on a small number of select interviews. While he dismisses some findings of the World Bank on brain drain on the grounds that they were based on an opinion survey of a sample of only 200, he has no qualms drawing conclusions from a much smaller sample.

Ironically, on suggested causes of NEP failure highlighted by many scholars, Khalid chose to remain silent. The book makes no reference to the phenomena of rent-seeking, crony capitalism and money politics that the NEP has spawned. And interestingly, despite the call for a more race-based affirmative action agenda, the silence of the book as to what needs to be done to curb rent seekers and crony capitalists from capturing the race-based affirmative action agenda is nothing short of deafening.

Evidence of the above actually exists in the book. But silence also greets its finding that the between-race per capita wealth disparity is much higher among the poor, i.e. among those households whose wealth holding is below the median compared to those households whose wealth is above the median (see table in Appendix 2, pp. 200-202). The percentage of disparity (between the Chinese and *Bumiputera*), in fact declines progressively from the poorest to the richest households, from 112 percent to 27 percent. The NEP has been in force for about 50 years from 1971. Does this mean that the rich and more prosperous *Bumiputera* households have benefited disproportionately from the NEP?

Further, by focusing on between-race differences, the book obscures important details both of between-race and within-race inequality. First by lumping together the predominant Malay *Bumiputera* group and the smaller non-Malay *Bumiputera* group which is much worse-off than their Malay peers, the overall *Bumiputera* group's situation appears worse compared to the non-*Bumiputera* group than if comparison is made between the non-*Bumiputera* and Malay *Bumiputera* groups. The Malay-non-Malay *Bumiputera* divide is clear from any examination of the economic performance of the Malay and non-Malay *Bumiputera* when a breakdown of the data is available as in the case on education. At the same time, the extent of intra-*Bumiputera* inequality is not addressed. This obfuscation, not only introduces a bias into the data and hence its analysis but also likely results in not dealing with the real problem of inequality.

From the preceding discussion, it is clear that there is a strong case for the policy-makers to distinguish between the Malay and non-Malay *Bumiputera* groups in designing the affirmative action program, if the program is to be more equitable and more targeted. From a close reading of the work of Jacob Meerman, an old Malaysia hand, there is an equally strong case to distinguish between rural and urban Malaysia in looking at trends in the inter-racial income ratio (IIR), which has played a key role in the design of distribution policies in the post-1970 period. According to Meerman (2008: 102), the IIR which was 2.25 in 1970 for the economy as a whole has come down but

over the two decades between 1984 to 2004 it has persisted within a range of 1.6 to 1.8 with no time trend. Meerman contends that “the persistent discrepancy in mean incomes across ethnic groups is in large degree due to the concentration of poverty in rural Malaysia and to relatively low civil servant salaries. It may also be over-estimated, because of failure to adjust for various subsidies received largely or exclusively by the *Bumiputera* that are not included in the household income calculation” (Meerman, 2008: 104-5). He estimates that presently the actual disparity in income between the non-*Bumiputera* and *Bumiputera* in the modern sector only ranges between 1.306 to 1.153 depending on specific assumptions³. He is of the strong view that in looking at the IIR we should exclude those who are living in rural areas as the much lower rural income and much higher incidence of rural poverty “may now be the result of inability to work rather than scarce work opportunities” (p. 103). This being the case the need for the affirmative action agenda to target rural Malaysia and in particular the rural poor is obvious.

So far, we have alluded to Khalid’s failure to address the limitations of his study that resulted from his omission of key components of wealth. Even with respect to his contention that the wealth disparity is due to job market discrimination and inter-generational wealth transfers, we have used the findings of his own study to challenge these inferences.

We now turn to Khalid’s key policy proposals to reduce wealth inequality:

- First, Khalid has advocated the setting up of asset specific accounts to reduce the gap in education and house ownership. These non-taxable investment accounts of individuals earning an income below a certain threshold envisage matching deposits by the government. In respect of the housing accounts for instance, the proposal envisages deposit of up to RM5,000 per annum by those eligible with the matching grants to continue so long as the accumulating sum does not exceed “20% of an average home price” (p. 181). As Khalid states that about 50 percent of urban households and 67 percent of rural households have no financial assets and hence no financial savings, no one may be able to take advantage of this plan. There is of course the opportunity for those who are eligible and who are EPF contributors to participate in the plan. The reason Khalid gave for not considering retirement savings as part of one’s financial assets in his book is that such savings are not within the control of an employee. This is certainly not correct. Contributors are eligible to withdraw up to 30 percent of their accumulated savings with the EPF on a regular on-going basis to meet their big-ticket expenditures on housing, education and healthcare.
- Second, Khalid has also expressed concern that wealth inequality is now a more serious problem than income inequality. As there is no estate duty and as there is no capital gains tax on share market transactions, he rightly contends that the current tax regime favours the rich and makes for inequality in opportunities. Such concerns have been raised for a long time and by many

³ See Meerman’s Annex Table, 2008, pp. 109-110.

including the World Bank. But taxing inheritance and capital gains as well as in raising the income tax rate may drive capital and talent to more tax friendly jurisdictions. The real challenge is to design a tax regime that raises revenue to fund development as well as a need based program to improve the well-being of the poorer households without ending up impoverishing the country.

- Third, Khalid is also strongly advocating the setting up of an Equal Opportunity Commission to deal with the problem of discrimination in the job market. Based on the experience in the US (see Sowell, 2004), one has to proceed with extreme caution. Discrimination can be difficult to establish in a court of law. Thus opinion and decision makers as well as those who are entrusted with the responsibility of dealing with discrimination may take the easy way out and handle the issue by mounting prosecution based on the observed disparity in the composition of population and employment. But disparity there will always be especially if we examine disaggregated data by occupations given the obvious differences between individuals in their preferences, in the level of their education and experience, as well as in their willingness and ability to take risk or face challenges and hardships. In attempting to equalise opportunities, we may end up equalising the outcomes and in the process undermine the very competitive position of a firm, an industry or even that of the economy and hence of our capacity to be resilient and grow.
- And fourth, as set out in the earlier part of this review, Khalid has argued forcefully for the re-imposition of race based education quotas. However, contrary to what he contends, we submit that *Bumiputera* students are still enjoying preferential access to public universities due to the use of the dual pathway for admission into such universities. If Khalid is also looking at the imposition of education quota for admission into private HEIs by race, we support it provided there is no preferential treatment based on lower entry requirements or lower fees and provided the imposition of such a quota does not cause a contraction or stifle the growth of the private HEIs.

Surprisingly, despite Khalid's concern for inequality, he has not questioned Malaysia's continued reliance on the import of cheap unskilled foreign labour to drive growth. This strategy has led to a near stagnation in the real income of the less skilled Malaysian workers and has thus reduced their opportunity to share in the country's rising prosperity. A longer term plan to restrict the import of cheap unskilled foreign workers is a more important policy initiative to improve the livelihood of local unskilled workers as well as in building their savings whether it is to buy a house or support them in retirement. Such a policy initiative has to be combined with a more concerted effort at training local workers if they are to keep pace and adapt to the expected upgrading of the Malaysian economy towards lower labour-intensity and hence rely less on unskilled labour.

Overall, then, what could have been a promising narrative of one of Malaysia's most discussed topics has been found wanting. Superficial reading of data that lead to unconvincing arguments in defence of the NEP, overzealousness in dismissing critics of the NEP while remaining silent on selected major challenges all reveal a rush to

judgment that weakens the arguments of the book and any claims it may have to analytical objectivity.

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