Note for the reader

Dear reader,

First of all, thank you for taking the time to read my paper. I welcome and appreciate any kind of feedback and reaction to it at this stage.

I recently (09/07) presented this at an APSA Panel and got helpful feedback that I wanted to but was not able to incorporate in the past five days. Basically, as you will see from the introduction, the paper starts with a puzzle about the Political Economy of Malaysia *and then* connects this puzzle to larger questions about the relationship between states and IOs. I want to reverse this order, and re-write the introduction to first talk about what big questions about the relationship between states and IOs motivate this paper, and then present Malaysia as a good case to work through these questions and illustrate my theory.

I have one question for you, reader: what is the paper currently missing before I can submit it to a journal? (if you have recommendations about which journal I could submit to, those are appreciated too).

Thank you, and I look forward to presenting next Tuesday!

Aila

Making State Projects: Malaysia, the IMF, and the Puzzle of Self-Imposed Structural Adjustment

In 1970, Malaysia embarked on an ambitious distributional program - the New Economic Policy (NEP). The Policy was the cornerstone of the country's plan for national unity and development, the Second Malaysia Plan, and its main goal was to eliminate the identification of race with economic function. The component of socioeconomic restructuring permeated all processes of economic policymaking, and was implemented in different capacities until 1985, when it was abruptly terminated under puzzling conditions. First, the country had sustained high rates of economic growth throughout the 1970s, and – compared to other developing countries – it withstood the global recession of the early 80s with resolution. Second, the same administration that terminated the policy was governing at the heyday of the NEP and in fact relied on the popularity of the policy among voters. Third, the Malaysian government was enjoying a continuous (yet fluctuating) success towards the NEP equity-oriented goals, but it was far from having achieved them in 1985. Lastly – and again by international standards – Malaysia could afford the financial costs associated with some of the NEP's policies, and could certainly continue implementing some policies even under economic duress.

So what explains the abandonment of the NEP and the major shift to policies of liberalization with adverse effects on distributional outcomes? What prompted the renunciation of goals so central to not only the economic performance of the country, but more importantly her social basis of national unity? How did domestic officials become convinced that privatization, fiscal consolidation, and financial openness would serve the country better?

The stakes of these questions transcend Malaysia's case, and speak to broader issues about the power that developing countries hold in shaping and pursuing their independent path to economic development vis-à-vis order-building international economic organizations. What factors make these countries successful at following their own domestic priorities? And on the other side of the equation, how do International Organizations (IOs) exert their influence on this process outside of moments of crisis and without formal mechanisms such as loan conditionality?

The existing literature would consider this a case of transition to Neoliberal policy of a developing country who simply *had* to follow what the IMF dictated to remain competitive in the international capital markets[1]. At first sight, this story seems plausible. Yet, this view overlooks

[1] Ziya Önis (2006) Varieties and crises of neoliberal globalisation: Argentina, Turkey and the imf, Third World Quarterly, 27:2, 239-263; Julie L. Mueller (2011) The IMF, Neoliberalism and Hegemony, *Global Society*, 25:3, 377-402; Babb, S., & Kentikelenis, A. E. (2018). International financial institutions as agents of neoliberalism. *The SAGE handbook of neoliberalism*, 16-27.

two important peculiarities of this case that seek a more nuanced explanation. First, the termination of the NEP amounted to not only a change in *policy* (despite what the name itself might suggest), but, more profoundly, a change in *the configuration of goals and responsibilities of the state in the economy*. Second, the timing and mechanism of this transition, when looked at in detail, reveal that the Fund did not coerce Malaysia into restructuring, nor did the country suddenly reform in fear of capital flight. On the contrary, the IMF slowly transferred knowledge and technical tools that transformed the ideas and practices of domestic policymakers towards neoliberal ones. In sum, these literatures cannot fully explain how *long-term interactions between IOs and domestic institutions build the bureaucratic and knowledge infrastructures that shape states' posture towards the "economy"*. Thus, this case highlights how, from a theoretical point of view, we need a Processual/Relational (P/R) account of how states-IOs interactions constitute not only the "economy", but also the responsibilities and goals of the state towards it.

To get to the constitutive power strategies used by the IMF, this article offers evidence from previously un-consulted archival documents highlighting two non-coercive mechanisms of IO-country interaction: Technical Assistance (TA) and Routine Surveillance (RS). The evidence suggests that the Fund slowly pushed Malaysian authorities to abandon their distributional goals by teaching them what was economically appropriate, and in the process slowly detached economic policy from larger social issues, including inequality. Moreover, I argue that these interactions transferred new knowledge to key institutions in the country's government about not only *policy* but, more substantially, on what the state posture towards the economy ought to be. Yet, I contend that such knowledge only became relevant and actionable when unfavorable macroeconomic conditions (the global economic crisis of 1982-84) caused the balance of power between domestic institutions to shift in favor of IMF-trained (and thus like-minded) local officials. This new position then allowed some high-level officials to justify previously unpopular proposals for change, while enjoying the full endorsement – and at times with the help – of the Fund.

Malaysia is usually known in the literature on the IMF and capital controls because it defied IMF's advice and expectations in the wake of the 1997 Asian Financial crisis by introducing capital controls instead of liberalizing[2]. Yet this earlier, relatively overlooked period of Malaysia (the years between 1969 and 1986) is particularly meaningful to understand the opposite process: how

[2] Chwieroth, J. M. (2009). *Capital ideas: The IMF and the rise of financial liberalization*. Princeton University Press; Mohamad, A., Sifat, I.M., Mohd Thas Thaker, H. and Noor, A.M. (2021), "On IMF debt and capital control: evidence from Malaysia, Thailand, Indonesia, the Philippines and South Korea", *Journal of Financial Regulation and Compliance*, Vol. 29 No. 2, pp. 143-162

IOs *successfully influence* domestic economic restructuring *in the absence* of a major financial crisis or loan program.

The article builds on recent advances in the literature on the sociology of organizations that analyze non-coercive mechanisms of policy diffusion and brings these insights to larger questions of IO-state relationship in International Relations (IR). It lends credence and additional evidence to scholarly claims that the day-to-day interactions between IOs and country officials are a neglected avenue to seek for explanations about convergence over certain preferences and choices of economic policy. It also contributes to the emerging interdisciplinary literature on Neoliberalism which highlights how factors at both the domestic and international levels are responsible for its adoption by developing countries. In so doing, I position myself in line with a group of scholars in International Political Economy who study how the interaction between the global macro-economic environment and domestic social, political, and institutional factors shape the direction of economic policy. Nevertheless, I also point to the current limitations of these works, and I add three specific contributions that emerge from discussing Malaysia's case.

First, I argue that from a theoretical perspective, we need a P/R framework to fully grasp the co-constitution of the state and the economy, and the role played by IOs in this process. To this end, I introduce the concept of *State Projects*, a heuristic device that describes the dynamic configuration of ideas and practices that structures the goals and responsibilities of the state vis-a-vis other social spaces – in this case, the economy – and in so doing constructs the boundaries that make the two appear as self-sustaining entities. Focusing on State Projects allows us to study the deeper layer from which policy emerges, as an ever-changing process of co-constitution. Moreover, it creates a theoretical locus to analyze the productive power[3] of IOs on states and the economy *simultaneously*.

Second, I illustrate the productive power of IOs on State Projects by focusing on two of their routine interactions with states, namely Technical Assistance and surveillance. In so doing, I point to specific strategies through which IOs, and the IMF in particular, build economies: the knowledge transfer of statistical devices and economic models, and the diffusion of normative views about the state's role and responsibilities in the economy. Thus, I highlight processes that can ultimately lead to policy diffusion or restructuring in the absence of economic crises and more assertive mechanisms attached to lending, such as conditionality.

Third, I show the importance of taking into account global macroeconomic developments for the resulting power struggles among domestic institutions and the predominance of one set of ideas over the other. I thus highlight how the interpretation of "real" economic conditions can

[3] Barnett, M., & Duvall, R. (2005). "Power in International Politics." *International Organization*, *59*(1), 39–75.

become a key factor in catalyzing change in State Projects by lending credence to the reformist ambitions of particular groups and allowing them to leverage their access to IOs.

The article proceeds as follows. The next section (2) reviews the existing literature in IOs, IPE, and Neoliberalism, and identifies their strengths and blind spots in searching for answers to the presented puzzles. I then proceed to present how a focus on State Projects and on the relational evolution of the state-economy relationship can elucidate some of these mechanisms, and why archival research might be best positioned to study such relationship, especially at the intersection of states and IOs. Section 3 offers some historical background to ground Malaysia's New Economic Policy and distributional goals into the social, political, and economic development of the country. Section 4 focuses on the Malaysia-IMF relationship in the 1970s. Section 5 delves into the same relationship in the 1980s and thus deals head on with the puzzle presented above. Finally, in the Conclusion, I expand the implications of this article to the broader literature to which it contributes, pointing to the limitations of this study, and offering avenues for future research.

2. IPE, International Organizations, and the diffusion of economic ideas

A vast literature at the intersection of Political Economy and International Organizations has focused on the analysis of processes of policy diffusion, especially in the case of liberalization. Scholars have traced how a new set of ideas emerged within the IMF (and the World Bank) about the need for free-market policies[4], and how such ideas were then spread globally, often with reluctance on the part of receiving countries[5]. The majority of this work focuses on two processes of diffusion to ultimately explain changes in state policy and behavior. First is *conditional lending* as a mechanism that forces countries to implement a set of reforms in fiscal policy, public spending, and capital controls in order to receive a loan from the IO[6], often in moments of crisis where the IO acts as a lender of last resort. Second, and at the more micro level, is the importance

[4] Abdelal, R. (2007) *Capital Rules: The Construction of Global Finance*. Cambridge, MA: Harvard University Press; Chwieroth, J. M. (2007) "Testing and Measuring the Role of Ideas: The Case of Neoliberalism in the International Monetary Fund" *International Studies Quarterly* 51: 5-30; Chwieroth, J. M. (2015) "Professional Ties that Bind: How Normative Orientation Shape IMF Conditionality" *Review of International Political Economy* 22(4): 757-787 + 2

[5] Simmons, Beth and Zachary Elkins (2004) "The Globalization of Liberalization: Policy Diffusion in the International Political Economy" *American Political Science Review* 98(1): 171-189; Woods, Ngaire (2006) *The Globalizers: The IMF, the World Bank, and their Borrowers.* Ithaca, NY: Cornell University Press; Nelson, S C. (2018) "International Financial Institutions and Market Liberalization in the Developing World" in *The Oxford Handbook of the Politics of Development* ed. C. Lancaster and N. van de Walle. 385-408; +2

[6] Vreeland, J. R. (2003). *The IMF and economic development.* Cambridge University Press; Chwieroth, J. (2010) *Capital Ideas: The IMF and the Rise of Financial Liberalization*. Princeton, NJ: Princeton University Press; Reinsberg, B., Stubbs, T., & Kentikelenis, A. (2022). Unimplementable by design? Understanding (non-)compliance with International Monetary Fund policy conditionality. *Governance*, 35(3), 689– 715. +2

of *professional training as* a mechanism of *socialization* among economists in IOs and transnationally[7].

A new strand of literature, which has much to owe to economic sociology, has shifted the focus on other interactions between IOs and domestic authorities to highlight the importance of more subtle mechanisms of technical assistance[8], surveillance[9], and training[10]. These scholars argue that focusing on the indirect effects of IOs sheds light on the gradual realignment of cognitive frameworks and policy preferences that happen over long periods of time, and that results in country authorities internalizing the advice of IOs and adapting it to the local context. This view is not just confined within the academic sphere but also shared by economists working within the Fund, as documented in recent publications on the delivery and reception of TA and capacity development[11]. Technical Assistance and surveillance, then, should be seen as tools of persuasion, rather than coercion. Through these tools, IOs can convince domestic policy makers that a particular course of action is preferable, but they do not openly impose it[12]. The contributions of this literature are valuable, as they enrich our understanding of how different mechanisms of IO influence operate routinely and cause gradual, long-run changes in state policy and behavior. Yet, this is exactly their current limitation: their explananda are restricted to state behavior and micro policy decisions.

Notwithstanding, I suggest that there is considerable scope for what the mechanisms of TA and surveillance can explain. It is especially fruitful to combine these new insights with research

[7] See for example Fourcade, M. (2006). The construction of a global profession: The transnationalization of economics. *American journal of sociology*, *112*(1), 145-194.; Chwieroth, J.M. (2010), *Capital Ideas;* Seabrooke, L. (2014). Epistemic arbitrage: Transnational professional knowledge in action. *Journal of Professions and Organization*, 1(1), 49-64; Ban, C. (2016). *Ruling ideas: How global neoliberalism goes local*. Oxford University Press; Harrington, B., & Seabrooke, L. (2020). Transnational professionals. *Annual Review of Sociology*, 46, 399-417; Babb, S., & Kentikelenis, A. (2021). Markets everywhere: The Washington consensus and the sociology of global institutional change. A*nnual Review of Sociology*, 47, 521-541.
[8] Alexander E. Kentikelenis, Thomas H. Stubbs & Lawrence P. King (2016) IMF conditionality and development policy space, 1985–2014, *Review of International Political Economy*, 23:4, 543-582; Babb, S. L. and Kentikelenis, A. E. (2023). 'International financial institutions as agents of neoliberalism', in D. Cahill, M. Cooper, and M. Konings (eds) The SAGE Handbook of Neoliberalism, Thousand Oaks: Sage
[9] Lombardi, D. and Woods, N. (2008) "The Politics of Influence: An Analysis of IMF Surveillance" *Review of International Political Economy* 15(5): 711-739; Abdelal (2007) makes a similar point on both surveillance and TA.
[10] See for example Broome, A., & Seabrooke, L. (2015). Shaping policy curves: Cognitive authority in transnational capacity building. Public Administration, 93(4), 956-972; Bazbauers, A. R. (2018). *The World Bank and transferring development*. Cham, Switzerland: Springer International Publishing, 10, 978-3.
[11] Fayad, M. G., Huang, C., Shibuya, Y., & Zhao, P. (2020). *How do member countries receive IMF policy advice: Results from a state-of-the-art sentiment index*. International Monetary Fund; Enoch, C. (2022). *The IMF and Capacity Development—Delivery*. IEO Background Paper No. BP/22-02/08 (Washington: International Monetary Fund).
[12] Smith, L. (2008) "Power and the Hierarchy of Knowledge: A review of a Decade of the World Bank's relationship with South Africa" *Geoforum* 39(1): 236-251

in constructivist IPE focused on the exercise of productive power by International Organizations[13]. If we employ this lens, we realize that these routine activities, and the economists who lead them, do not just suggest *policy* but they "create, teach, and disseminate… technical models of *how economies work* [and] normative conceptualizations of *how economies should be organized*"[14]. Macroeconomic frameworks and statistical standards developed at the Fund are part of a "constructivist strategy" insofar as they "reshap[e] the terms though which market participants will be able to interpret state actions, thus creating a new grammar of economic communication"[15]. The starting point of this literature, which I share in this article, is that real economic conditions do not have a self-evident interpretation, but their effects are instead mediated by how the economy is *imagined* as a result of historical, institutional, and cultural factors[16].

Constructivist IPE, then, has much to offer to the study of how IOs produce the economy. Nevertheless, it misses the other crucial part of the equation: the *state*; or to be more precise, the process of mutual constitution of state and economy which is in turn shaped through interaction with IOs. We need not only to bring the state back in[17], but to *open it up* to reveal how it is constructed in relation to these other two spaces. When scholars at the intersection of comparative and international political economy "opened up" the state, they did so to study how certain domestic groups can leverage their relationship with the IMF to push for unpopular policies[18]. What I want to highlight here, though, is a different way to open the state up: I want to emphasize how the constitutive effects of IOs do not just work on the economy and market participants, but end up shaping the state too, certainly in its actions (policies) but also, and more deeply, in how it understands and positions itself vis-à-vis the economy.

[13] Finnemore, M. (1996) National Interests in International Society. Ithaca: Cornell University press; Barnett, M., and Finnemore, M. (2004) Rules for the World: International Organizations in Global Politics. Ithaca: Cornell University Press; Barnett, M., & Duvall, R. (2005). Power in International Politics. *International Organization*, *59*(1), 39–75;

[14] Chwieroth, Jeffrey (2010) *Capital Ideas: The IMF and the Rise of Financial Liberalization*. Princeton, NJ: Princeton University Press, p. 12, added emphasis.

[15] Best, J. (2010) "Bringing Power Back In: The IMF's Constructivist Strategy in Critical Perspective," in *Constructing the International Economy*, ed. by Abdelal, R., Blyth, M., and Parsons, C.. Ithaca, Cornell University Press, 195-6

[16] Herrera, Y. (2010) "Imagined Economies: Constructivist Political Economy, Nationalism, and Economic-Based Sovereignty Movements in Russia," in *Constructing the International Economy*, ed. by Abdelal, R., Blyth, M., and Parsons, C.. Ithaca, Cornell University Press, 114-136

[17] Evans, P. B., Rueschemeyer, D., & Skocpol, T. (Eds.). (1985). *Bringing the state back in*. Cambridge: Cambridge University Press; Helleiner, E. (1995) Explaining the globalization of financial markets: Bringing states back in, *Review of International Political Economy*, 2:2, 315-341

[18] Nelson, Stephen C. (2017) *The Currency of Confidence: How Economic Beliefs shape the IMF's relationship with its borrowers*. Ithaca: Cornell University Press; see also Mukherjee, B. and Singer, D.A. (2010), "International Institutions and Domestic Compensation: The IMF and the Politics of Capital Account Liberalization". *American Journal of Political Science*, 54: 45-60; Cormier, B. (2021) "Interests over institutions: Political-economic constraints on public debt management in developing countries" *Governance*. 2021; 34: 1167–1191

Mechanisms of technical assistance, surveillance, and their agents within IOs hold and diffuse specific normative views about *when* the state should intervene in the economy, *how*, and to the pursuit of what *goals*. By identifying what is *ideal* (through normative views) and what is *real*[19] (through technical devices and knowledge transfers) their power extends beyond the suggestion of "policies" and into the production of state projects. Finally, their views about what is considered "political", "economic", or "social" reinforce the imaginary boundaries between these different realms of human activity, and emphasize that different state institutions are responsible for managing certain issues, but not others.

In sum, the existing literature, with its predominant focus on *policy* and its treatment of the state as a self-contained static entity, has overlooked the deeper normative implications of IOs' actions in restructuring the state-economy relationship and in promoting certain state projects over others. As such, it is currently ill-equipped to explain the puzzle at hand: how do IOs influence countries' pursuit of their own domestic economic priorities outside of moments of crisis that trigger compliance mechanisms?

One reason for why IPE has remained on the level of policy lies in the methodological difficulties associated with finding clear evidence of changes in the state-economy relationship, especially in a field where quantitative causal inference has become the norm[20], and hypothesis testing is done with the help of large datasets, even in historical work[21]. How can we see changes in state projects? How can we "observe" a re-drawing of the boundaries and responsibilities between the state and the market? How should we trace the role played by International Organizations in these processes? First, the field currently lacks clear theoretical tools to answer these questions, but, as pointed out, could learn from a vast literature in economic sociology and the sociology of organizations, as well as by taking seriously the implications of the processual-relational turn for theorizing the state and its interactions with IOs. Second, and of more practical relevance, the "data" we should look for to study the influence of IOs on the evolution of state projects is highly qualitative in nature, often hidden in hefty collections of archival material (when even available), and thus difficult to retrieve.

[19] The *real* and *ideal* wording is Best's (2010), *Bringing Power Back In,* 202

[20] Best, J., et al. (2021) "Seeing and Not-seeing Like a Political Economist: The Historicity of Contemporary Political Economy and its Blind Spots," *New Political Economy*, 26:2, 217-228; Kotilainen, K., & Patomäki, H. (2022). From fragmentation to integration: on the role of explicit hypotheses and economic theory in Global Political Economy, *Global Political Economy*, 1(1), 80-107

[21] Dennison, T. (2021). "Context is Everything: The Problem of History in Quantitative Social Science." *Journal of Historical Political Economy* 1(1):105–26; Charnysh, V, E. Finkel, and S. Gehlbach. (Forthcoming) "Historical Political Economy: Past, Present, and Future." *Annual Review of Political Science* 26

On the theoretical side, I propose to study this important process by tracing changes in the *economic State Projects* of countries. I define State Projects[22] as *clusters of practices and ideas oriented to the achievement of a definite purpose through which the state appears as a self-constituted political organization, and gains legitimation as a regulatory social structure*. As such, State Projects are boundary drawing devices that not only establish what is "inside" and "outside" the state, but also structure the relationship between the state and other socially-constructed spaces, whether they are other states, "society" or the "economy"[23]. Here, I focus on economic state projects, i.e., those that prescribe and proscribe the ends towards which the actions of states in the economy are directed. These encompass all economic functions of the state at large, including fiscal and monetary policy, industrial organization, the regulation of asset ownership, and the provision of economic benefits (welfare, social security) to the population.

Overall, by focusing on state projects we extend our inquiry into the deepest level on top of which economic policy is structured. All decisions and practices of the state to (de-)regulate the economy are in fact traceable to a higher principle or overarching economic purpose – or set of purposes – shaping not only policy but the boundaries and legitimacy of the state itself. Thus, state projects allow us to focus on how the evolution of the state-economy relationship is tied to larger national policies that are constitutive of a particular idea, and identity, of the state. This is exactly what the current literature misses and what constitutes Malaysia's puzzle, highlighted above: how can we explain the abandonment of the NEP not as a policy change but as a change in the configuration of goals and roles of the state in the economy? To do so, we need a theoretical device that takes as a starting point neither of these two entities – even less so, their policies – but instead their unfolding relationship, and derives from this process the changes that we observe in their appearance as distinct entities.[24]

Employing state projects as a P/R understanding of the state has an additional benefit, crucial to get to the other part of our puzzle: how do IOs exert their influence on how states organize their role and goals in the economic sphere? Focusing on the unfolding of state projects opens up space for a variety of actors, IOs first and foremost, to partake in the development of their specific configurations. The technical devices and economic knowledge transferred by the

[22] The term State Project is borrowed from sociologist Jessop, B. (2016) *The State: Past, Present, Future*. Cambridge: Polity, although my definition differs from his. In IR, the only two works who engage with the notion of State Projects are Jackson, P.T. and Nexon, D. (1999) "Relations Before States: Substance, Process, and the Study of World Politics," *European Journal of International Relations* 5(3): 291-332; and Koivisto. M. (2012) *Normative State Power in International Relation*s, Oxford: Oxford University Press. Of the two, only Jackson and Nexon offer a definition of state projects as "a variety of principles, norms, and practices, which serve to authorize actions taken 'in the name of the state', and thus to demarcate a region of social life" (308)

[23] On this point, see Mitchell, T. (1991) "The Limits of the State: Beyond Statist Approaches and Their Critics." *American Political Science Review* 85(1): 77-93; and (1999), "Society, Economy, and the State Effect." in G. Steinmetz, ed. *State/Culture: State Formation After the Cultural Turn*. Ithaca: Cornall University Press, pp. 76-97

[24] Jackson and Nexon (1999) Relations Before States, 308

IMF to domestic institutions via TA and surveillance continuously re-shape how these institutions create the boundaries that demarcate them from their field of intervention.

On a methodological side, though, the P/R framework does not immediately point to a solution regarding *where* and *how* we should seek clues that state projects have changed or emerged, and what the evidence would look like. In this article, to get to how interactions between country authorities and IOs shape State Projects, I process-trace the relationship between IMF (and occasionally, World Bank) authorities and Malaysia's key economic institutions in search for evidence to explain my main puzzle: why did Malaysia overhaul the key objectives contained in the NEP, so crucial for the overarching goal of national unity, to follow more austere, at times even politically and economically damaging reforms that were *not* dictated by IMF conditionality or structural adjustments? The findings presented here rely on several months of archival research at the IMF utilizing previously un-consulted documents coupled with publicly available primary sources from the government of Malaysia, retrieved at times through the Rockefeller Archive center. I chose 1969 as the starting year for this research since it is events in that year (May 13th riot) that led to the formulation of the New Economic Policy in 1970, the state project at the center of my case. The archival strategy involved leaving the "end year" as open – eventually, I stopped at the end of 1986 since it became evident that, by that time, Malaysia's state project had changed and there would be no reversal of it[25]. I chose the IMF as the main site of archival research for several reasons: first, the main changes in the economic policy of Malaysia were shifts in fiscal policy, and the Fund is the primary international organization that provides advice and training in this field. Second, the IMF is one of the main actors studied by the literature on Technical Assistance, since it is a "focal organization in developing scripts to transform economies"[26], thus it held a lot of promise in finding key details about the mechanisms of persuasion within surveillance and TA. Third, despite the lack of available documentation on the Malaysian side, we can piece together the different perspectives held by bureaucrats in the country's economic institutions through the granular material collected by the IMF Archive. Correspondence, memoranda, statements, and all form of communication between domestic and Fund authorities specifies authorship (individual or at the very least institutional), and can be used to trace the distinct views of Malaysian policymakers during this time.

[25] As also corroborated by a plethora of secondary literature. See, for example, Heng, P-K. (1997) "The new Economic Policy and the Chinese Community in Peninsular Malaysia," The developing economies 35(3): 262-292; Chin, C.B.N (2000) "The State of the 'State' in Globalization: Social Order and Economic Restructuring in Malaysia," *Third World Quarterly* 21(6): 1035-1057

[26] Kentikelenis, A. and Seabrooke, L. (2017), *The Politics of World Polity,* 1071; see also Jupille, J., Mattli, and Snidal, D. (2013) Institutional Choice and Global Commerce. Cambridge, UK: Cambridge University Press.

Before I present such evidence, the next section introduces the New Economic Policy as a state project in the context of Malaysia's historical development and in relation to the country's goal of national unity.

3. The NEP in context

Rukunegara and the rationale for socio-economic transformation

To fully appreciate the importance of the New Economic Policy as a State Project that tied the goal of national unity to socio-economic restructuring, we should understand the historical context in which such project was born.

Malaysia emerged from the British colonial period (1824-1957) as a multi-ethnic society with strong inter-group divisions based on the socioeconomic role each group held under British rule. Malays or "Bumiputras" (making up 53% of the population[27]) were kept virtually outside of the colonial economy and when included they were occupied in the most underdeveloped sectors – rice cultivation or other types of peasantry, but in any case working for subsistence and not for profit. Chinese (36%) and Indians (10%) were mostly brought to Malaysia by the British as migrant laborers to work in tin mining and rubber plantations, two very lucrative sectors at the time, and were gradually included throughout the first half of the 20th century in the nascent capitalistic economy of the country, first as merchants, and later in the incipient industrial sector – from which Malays were practically excluded[28].

The colonial legacy thus left in its wake uneven economic development across the races and a strong identification of ethnicity with class, occupational positions, and ownership of productive assets (or lack thereof)[29]. Moreover, both inter- and intra-ethnic inequality increased from 1957 until 1970, leading to soaring inter-class tensions[30]. The pressure was compounded by the fact that political mobilization in the country is also structured along ethnic lines, with the bulk of state institutions being controlled by a Malay led multi-party coalition (the Alliance, and, since 1973, *Barisan Nasional*), but especially UMNO, *United Malay's National Organisation*, the dominant party within the ruling coalition.

[27] The data is from Hirschman, C. (1980). Demographic Trends in Peninsular Malaysia, 1947-75. *Population and Development Review 6(*1): 103–25. These percentages refer to the year 1970, but they stay roughly the same throughout the entire period analyzed here.
[28] Jomo, K.S. (1990) *Growth and Industrial Change in the Malaysian Economy*, London: Palgrave MacMillan; Chin, C. B. (2000). The state of the'state'in globalization: social order and economic restructuring in Malaysia. *Third World Quarterly*, 21(6), 1035-1057.
[29] Jomo, K.S. (1990) *Growth and Industrial Change in the Malaysian Economy,* 92
[30] Athukorala, P. and Menon, J. (1997) Export-led Industrialisation, Employment and Equity: The Malaysian Case. *Agenda: A Journal of Policy Analysis and Reform* 4(1): 63-76

Racial tensions erupted into violent riots on May 13th, 1969 after the general elections on May 10th delivered a large setback for the ruling, Malay-led coalition. The riots led the government to declare emergency powers, temporarily suspend parliament, and establish a National Operations Council (NOC, or MAGERAN) led by the elected Prime Minister Tun Abdul Razak. The priority for the NOC, and for the country as a whole, was to move past the May 13 incident and to re-establish a strong sense of national unity based on racial harmony. For Razak, such endeavor "would be won or lost in the economic and social restructuring of the nation"[31].

The leader interpreted the riots as a clear sign that the former economic strategy of including Malays via trickle down growth had failed, preventing Malaysia from achieving national unity on the basis of equality and balance between the races. The solution to this problem was to devise a comprehensive plan of socio-economic restructuring that, through affirmative action led by state intervention, would lift the Bumiputera community up and reduce inter-ethnic inequality. Such plan was the *New Economic Policy* (NEP).

The NEP was devised to be the most important arm of the Second Malaysia Plan, put forward in 1971. It was a far-reaching program, providing guidelines to be "fully and explicitly reflected in all policies, programs, and projects under [the] responsibility" of all government departments and agencies[32]. The policy followed the principles of the *Rukunegara*, a philosophy that oriented state action towards the pursuit of five fundamental objectives: national unity; democracy; the creation of a just society in which the wealth of the nation was equitably shared; tolerance of cultural diversity; and building a progressive society oriented towards modern science and technology. Thus, it is important to stress that the NEP wasn't just an economic policy but a policy of nation-building that reflected a particular idea of nation and the role of Bumiputera in the nation. In pursuing it, the Malaysian government implicitly acknowledged the nation-building role that certain economic policies carry, and the government duties that result from this interpretation. As such, Malaysia's NEP should be viewed as the country's dominant State Project.

At its origin, the NEP was formulated in seven points: 1) Poverty reduction; 2) Reduction in racial economic imbalances in terms of income, employment, and wealth; 3) A target growth rate of 6.4% annually through 1985; 4) Policy of full employment; 5) Interventionist role of government to achieve Malay equality; 6) Social policies to avoid communal conflict and achieve unity; 7) Enhance data collection to make sure that all programs are in conformity with state

[31] Faaland, J., J.R. Parkinson, and R. Saniman (1990) Growth and Ethnic Inequality: Malaysia's New Economic Policy, London: Hurst & Company, 25

[32] Malaysia, Department of National Unity (1970) The New Economic Policy. Kuala Lumpur: Government Publication.

objectives. The first two were considered as overarching objectives, and points three to seven were thought of as ways to achieve them[33].

These hefty objectives set out an important role for the state in national development, as it emerges from some of the documents published by the Department of National Unity (DNU)[34]. The directive "The New Economic Policy", issued by DNU to all other departments to give guidelines to realize the Second Malaysia Plan is very clear on the role of the state, both as an aspiration and in practice. It explicitly posited a renewed role for the state in the steerage of the economy, by stating, for example, that "The government will use its licensing authority, budget, and tax structure, financial incentives, specific regulations and other systems of incentives and control to ensure that the private sector development reflects the objectives and needs of the country"[35]. The directive was also very specific about the areas of the economy that needed government intervention to yield pro-Malay distributional results, and clearly stated that public sector ownership was the key to unlock this goal.

Disagreements over the NEP's direction and implementation

Despite the broad endorsement enjoyed by the NEP, it would be naïve (and inaccurate) to say that it remained uncontested throughout its implementation. After all, the demise of this state project in 1985 originates exactly in the diverging views that key officials in Malaysian economic institutions held about the policy, its goals, and actualization strategies.

A useful way to map the different visions about the NEP is Snodgrass's categorization of them in two conflicting school[36]. One prioritized growth over redistribution and believed in the logic of "trickle down". The other prioritized redistribution over growth and believed in an interventionist government strategy. The Minister of Finance/Treasury, the National Bank of Malaysia (Bank Negara), and the Federal Industrial Development Authority (FIDA) have since the beginning emphasized growth and trickle down – I refer to them as the "Fund club" since it is with the IMF that their ideas most aligned. The Prime Minister's (PM) department, including the Economic Planning Unit, the Home Department, and the DNU have always put redistribution first and embraced an interventionist role for the state. For convenience, I refer to them as the "PM club".

[33] This is noted by Faaland, J. et al (1990), but it also emerges from the practices of Malaysian officials as reported in the numerous exchanges with the IMF.
[34] Ibid., 56-57
[35] Malaysia, DNU (1970) *The New Economic Policy*, 310
[36] Snodgrass, D. R. (1980) *Inequality and Economic Development in Malaysia: A Study Sponsored by the Harvard Institute for International Development*. Kuala Lumpur: Oxford University Press

The PM club was firm on the idea that the overall objective of the NEP was national unity for the survival of the nation. They maintained that if a trade-off was necessary, the objective of improvement in the economic balance between major ethnic groups would not be sacrificed in favor of growth, other things being equal[37]. In their view, the government held a key role in directing and coordinating the industrialization effort; in the planning of a long-term development strategy based on land reform and investment in education and industrialization for exports; and in the implementation of short terms measures aimed at encouraging Malay participation in the formal economy.

The Fund club, on the other hand, maintained that the government should have minimal interference in the market. They supported conservative fiscal and monetary policy and hailed a balanced budget as the primary objective of economic policy. Employment and inequality (between or within the races) were for them residual concerns that in no way must interfere with the pursuit of balanced growth.

It should be made clear that the two clubs, or schools, did not only diverge on policy but started from a fundamentally different social philosophy and idea of State Project for Malaysia, which resulted in competing plans for the national development of the country based on vastly dissimilar ideologies. Such plans were extensively tested (statistically and manually) at the time of the NEP formulation, and the Prime Minister's strategy emerged superior to the one proposed by the other institutions. At the same time, the PM club was reliant on the same institutions for the implementation of the NEP, since it did not have the power (de jure and de facto) to carry out an alternative economic policy on its own.

The tension between these two views was present since the NEP's inception and shaped the implementation of Malaysia's State Project throughout the years. The Prime Minister was well aware that it could not give too much leeway to the other institutions' agenda, warning that "If the Government were to err on the side of financial and monetary caution, then the basic political as well as economic potential for creating a foundation for national unity during the [Second Malaysia Plan] would definitely be lost without hope"[38]. Considering the actual developments in fiscal and monetary policy of a decade later, this prescription sounds eerily accurate.

Finally, we should not regard the views of the IMF's and PM's clubs as static, but as developing according to the interactions that individuals within them had with outside actors (especially IOs), to the feedback received from their implementation, and to how much these views

[37] Faaland et al. (1990) *Growth and Ethnic Inequality*, 99

[38] Malaysia, Department of National Unity (1970) *Employment, Production, and Racial Economic Balance Targets for the Second Malaysia Plan*. Kuala Lumpur: Government Publication, 10

conformed to the economic reality experienced by the country. Faaland, for example, notices that the views held by most technicians at Bank Negara and the Treasury, who were already akin to the Fund's intellectual tradition, "were reinforced by their further training with either the World Bank, the IMF, the Bank of England, or other central banks," and that "any substantive change in policy contemplated was preceded by consultation with the staff of the World Bank or the IMF"[39].

Clearly, similar professional training and the socializing experience of Bank Negara's and the Treasury's staff through the Fund's Technical Assistance can partially account for shared normative conceptualizations and "cognitive worldviews" guiding economic policy-making[40]. But, as I show below, the Fund did not, as we would expect, push for the IMF's club policy preferences at all times. Only a significant change in the global macroeconomic environment shifted the IMF's fundamental view of Malaysia to fully endorse the already fiscally conservative domestic policymakers. In this way, this case adds nuance to the claim that shared cognitive orientations condition the relationship between IOs and domestic policy reform. It is true that "IOs shape economic and political outcomes by empowering reformers and marginalizing opponents"[41], yet different economic conditions under which such influence happens also shape its results.

4. Malaysia and the IMF in the 1970s – a success story to emulate

Throughout the 1970s, Malaysia enjoyed an excellent relationship with the Fund, characterized by two important elements: a continuous provision of Technical Assistance, and a substantial margin of action enjoyed by local authorities to pursue their distributional goals.

Technical Assistance

TA has been a consistent feature of the IMF-Malaysia relationship in this period. Malaysian economic institutions, especially Bank Negara, frequently solicited TA with the aim to learn from the Fund state-of-the-art knowledge and practices in monetary and exchange rate policy; tax collection; data collection for macroeconomic analysis; balance of payment statistics; national accounting techniques; and more. The governor (1962-1980) of Bank Negara, Tun Ismail, was particularly keen to demand both direct assistance from IMF personnel and additional training for his staff from the one already provided by the Fund. His deputy, Lin See Yan, who remained at Bank Negara after Ismail's departure in 1980, continued in this tradition. It is telling that for five

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[39] Faaland et al. (1990) *Growth and Ethnic Inequality*, 29

[40] Johnston, Alastair I. (2005) "Conclusions and Extentions: towards Mid-Range Theorizing and Beyond Europe" *International Organization* 59(4): 1013-1044

[41] Chwieroth, Jeffrey M. (2015) "Professional Ties that Bind: How Normative Orientation Shape IMF Conditionality" *Review of International Political Economy* 22(4): 779; see also Vreeland, J. (2003) *The IMF and Economic Development;* Dai, X. (2007) *International Institutions and National Policies*. Oxford: Oxford University Press.

years (1969 to 1973) the position of Deputy Chief Economist of the Economic Research Department of the Bank was filled by Dietmar Klein, a senior economist at Bundesbank on loan via an IMF TA mission, followed by Sydney Shepherd from Bank of Canada the following year. During the same time, Ismail requested several other missions and experts from the IMF, Bank of France, the Federal Reserve Banks of Chicago and San Francisco, and the London School of Economics with the aim to equip Malaysia with cutting-edge knowledge and techniques of monetary and exchange rate policy.

The influence held by foreign economists in the development of Malaysia's economic institutions and practices in these years cannot be overstated. Each mission provided in-depth guidance, training, analytical support, and policy recommendations that were welcomed and usually diligently followed by local staff and management. Experts on missions were tasked with gargantuan responsibilities. Dietmar Klein, operating as the *de facto* chief economist of Bank Negara, was directly responsible for the entire organization and early development of the Research Department[42]. The same can be said for other economists who worked on TA missions in national accounting and statistics. In addition, the scope of these experts' work was often extended beyond their assigned role to help with the formulation and assessment of broader economic plans. While a joint mission of the IBRD and the IMF was visiting for research purposes in 1975, for instance, the economists on the mission were requested to comment and assist with the drafting of the full Third Malaysia Plan[43].

Another important area where foreign TA continued to shape the Malaysian state project is national statistics. From 1968 onwards the country had a constant influx of expert statisticians in each of their economic institutions who introduced a plethora of new knowledge and tools for the government to read and track economic activity. On one hand, these tools made Malaysia more legible[44], compliant with international standards which, at the time, were in the process of being transferred from International Organizations to the developing world[45]. But on a deeper level,

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[42] Malaysia: Reports – Klein [Dietmar], 1970-1973, CBDAI Technical Assistance Files, Monetary and Capital Market Department Records, Box 68 File 9, International Monetary Fund.

[43] Malaysia - Second plan performance and third plan issues (Vol. 2) : Annexes 1 to 5 (English). Washington, D.C. : World Bank Group. http://documents.worldbank.org/curated/en/562371468045084098/Annexes-1-to-5

[44] Scott, J. C. (1998). *Seeing like a state: How certain schemes to improve the human condition have failed*. New Haven: Yale University Press.

[45] On the diffusion of statistical and accounting standards to the developing world, see Ward, M. (2004). *Quantifying the world: UN ideas and statistics* (Vol. 3). Bloomington: Indiana University Press; Herrera, Y. (2013). Accidental hegemony: How the system of national accounts became a global institution. in Berk, G., Galvan, D.C., and Hattam, V., *Political Creativity: Reconfiguring Institutional Order and Change*, Philadelphia: University of Pennsylvania Press: 167-87. Herrera, Y. M. (2017). *Mirrors of the economy: National accounts and international norms in Russia and beyond*. Ithaca: Cornell University Press; Sinclair, G. F. (2017). *To reform the world: International organizations and the making of modern states.* Oxford University Press. Mügge, D. (2022) Economic statistics as political artefacts, *Review of International Political Economy*, 29:1, 1-22; Van Heijster, J. & DeRock, D. (2022) How GDP spread to China: the experimental diffusion of macroeconomic measurement, *Review of International Political Economy*, 29:1, 65-87;

statistics *defined* the boundaries of the economy by suggesting what transactions were financial or non-financial, what expenditures were public or private, what activities were productive or non-productive, and so forth. In doing so, statistics do not only perform a technocratic endeavor, but they are inherently political: accounting numbers and techniques "set out to quantify and compare things which, by their very nature, are neither quantifiable nor directly comparable", and in doing so, they provide new foundations around which social and political relations are structured[46]. As such, the adherence to these new international standards and the statistical tools that were introduced, as Didier put it, "performed" the economy[47], and they concomitantly produced the state.

IMF economists reshaped the *cognitive infrastructure* used by local officials by spreading a particular style of reasoning and equipping institutions with sociotechnical tools that allowed policymakers to see (and rule) the world in certain ways[48]. It is no exaggeration to say that these missions are in great part responsible for how the NEP as Malaysia's state project was constructed during these years, with their frequent comments about the roles that the public and private sector ought to play in the economic development of the country, and on the definition of what constituted the public sector itself[49]. In other words, IMF officials on TA, surveillance, and other missions exercised a lot of productive power in establishing the targets, practices, scopes, and categories of action for the functioning of these institutions.

This vast power held by overseas economists had three main sources of legitimation. First, legitimation derived by professional authority[50] and the "power of expert knowledge"[51] and by what the IMF represents as the International Organization tasked with diffusing (and ruling with) this expert knowledge[52]. Second, as highlighted above, the missions were not imposed by the Fund

[46] Perry, J. & Nölke, A. (2006) The political economy of International Accounting Standards, *Review of International Political Economy*, 13(4): 559

[47] Didier, E. (2007). "Do statistics 'perform'the economy?." in MacKenzie, D. Muniesa, F. and Siu, L. *Do economists make markets? On the performativity of economics*, Princeton University Press: 276-310; see also Best, J. (2010) *Bringing Power Back In*

[48] Hirschman, D. A., & Berman, E. P. (2014). Do economists make policies? On the political effects of economics. *Socio-Economic Review*, *12*(4), 779–811; on sociotechnical tools as ordering devices, see Jasanoff, S. (2004) *States of Knowledge: The Co-production of Science and Social Order*. London: Routledge

[49] As evidenced in *Memorandum. O.J. McDiarmid and Townsend Swayze to Parvez Hasan. April 30, 1975, Malaysia – 1975 IBRD Mission, ASDAI country files, Asia and Pacific Department Records, Box 78 File 3, International Monetary Fund; Report on Mission to Malaysia. August 17, 1983. Malaysia Technical Assistance Reports, 1974-1985, BURAI TA Reports, Bureau of Statistics Immediate Office Records, Box 31 File 5, International Monetary Fund*

[50] Hirschman, D. A., & Berman, E. P. (2014). *Do economists make policies?*

[51] Stehr, N., & Grundmann, R. (2011). *Experts: The knowledge and power of expertise* .London: Routledge; Tsingou, E. (2015). Club governance and the making of global financial rules. *Review of International Political Economy*, *22*(2), 225-256.

[52] Barnett, M. and Duvall, R. (2004) *Power in Global Governance*; Broome, A. (2008) The Importance of Being Earnest: The IMF as a Reputational Intermediary, *New Political Economy*, 13:2, 125-151; Nordström, L., &

but instead invited, requested by Malaysian officials, who used them to solve local problems at no cost. This granted IMF economists a key institutional position within the country's policymaking apparatus. Yet a third factor can also explain the *extent* of their impact on Malaysia's economic institutions: the lack of "capacity" on the part of the local staff, emphasized by virtually all IMF economists in their mission reports, who, for this reason, reported a general lack of confidence about the extent to which TA missions could bring tangible benefits to Malaysian institutions[53].

Yet on most occasions during these years, suggestions made during technical assistance were met with positive reception and swift implementation on the part of local authorities. In the communication between Malaysian officials and the IMF, the eagerness of the formers to impress the latter and maintain a steadfast working relationship is tangible[54].

Finally, these missions also had a long-lasting effect on the economic policy views of key officials, whose priorities started to shift towards the narrow maintenance of price stability over the larger political goals established by the NEP. Some of them, even this early on, sought the support of the IMF and voiced their concern with the country's Executive Director when internal disagreements prevented the implementation of their policy preferences[55]. They also made it a point to reiterate their commitments to growth and price stability as soon as the Fund started to more openly acknowledge Malaysia's complex distributional goals. It is telling that at a time when even the IMF's Executive Board was praising the country for her equity-oriented efforts, some Malaysian officials pressured their Executive Director to rectify the Article IV to state that Malaysia was attaching *equal importance to growth and equitable distribution*, and, in the implementation of these objective, *great importance to price stability as well*[56].

IMF posture on distributional issues

In the 1970s, the IMF was not directly opposed to the distributional reforms enacted by the Malaysian government as a core component of the New Economic Policy, giving the country leeway to pursue their own strategy and goals. Fund officials held generally positive views about

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Teivainen, T. (2022). IMF expertise in the eurozone crisis: from stimulus talk to austerity policy. *Global Political Economy*, 1-22.

[53] *Correspondence, André Robert to J.V. Mladek, November 28, 1974, Malaysia: Robert André – Reports, CBDAI Technical Assistance Files, Monetary and Capital Markets Department Records, Box 69 File 5, IMF Archives*. Translation by author.

[54] See for example Technical Assistance Mission for Malaysia, December 5, 1973. ASDAI Country Files. Asia and Pacific Department Records, Box 77 File 12. IMF Archives; Tan Siew Sin to the Managing Director, December 21st, 1973. Ibid.

[55] Statement by Mr. Kharmawan on Malaysia EBM/74/143, November 11, 1974. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125010895

[56] Statement by Mr. Kharmawan on Malaysia EBM/80/101, July 9, 1980. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125019138

the policy, since they resonated with the goals of high growth and low unemployment included in the plan. Towards the socio-economic egalitarian goals pursued by the government, on the other hand, their stance is better characterized as one of "qualified indifference". That is to say, policies to reduce inequality (either within or between the races) were simply noted or acknowledged with no strong opinion about their desirability, *unless* they were deemed to put the growth prospects and the stability of the Malaysian economy at risk.

For once, the prevailing view within the Fund in this period saw distributional issues as lying outside the purview of the organization's work and even expertise, even when directly connected with the goals and policies pursued by the IMF. Economists at this time were not at all concerned about analyzing the distributional implications of both their own suggestions and of domestic macroeconomic policies. For example, when the IBRD requested a Fund expert to join their Basic Economic Mission to Malaysia in 1975, and suggested that their IMF colleague should conduct research on the "examination of the distributive aspects of expenditure and revenues" in the Third Malaysia Plan, the Fund's Fiscal affairs department proclaimed itself "unhappy" with the request, resulting in the dropping of this topic from the final IBRD mission report[57].

This is not wholly surprising, since IOs can prove reluctant to expand "[w]here new initiatives are not consistent with the skill-set and expertise of an organization's staff"[58]. Remarkably, though, it stands in stark contrast to the approach held by the IBRD in the same years, which was instead keen on studying the distributional implications of Malaysia's development plan and its execution. The Bank's approach was sensitive to how local institutions and cultural heritage could shape the pursuit of the country's own socio-economic objectives, and proposed to include in their mission report a section on "the importance of ethnic divisions in the occupational breakdown, income distribution, and the duality of the economy" [59]. Indeed, they were deeply aware of the complex intersection between the issue of racial and economic equality in the country, and how that was reflected in the hierarchy of national goals. The draft of the mission report is telling in this regard, recognizing that

> "In Malaysia… the reduction in income differentials, particularly among the ethnic groups, *takes precedence over economic growth per se*. […] However, Malaysia recognizes that the economic position of the poor… should be improved by insuring [sic] that they get a larger share of future economic growth, rather than through measures to redistribute current wealth or reduce some present incomes."[60]

[57] Memorandum. T.S. Swayze to P.R. Narvekar. April 29, 1975, Malaysia – 1975 IBRD Mission, ASDAI country files, Asia and Pacific Department Records, Box 78 File 3
[58] Chwieroth, *Capital Ideas*, p. 15
[59] *Memorandum. O.J. McDiarmid and Townsend Swayze to Parvez Hasan. April 30, 1975, Malaysia – 1975 IBRD Mission, ASDAI country files, Asia and Pacific Department Records, Box 78 File 3*
[60] Ibid. Emphasis added

The IMF, on the other hand, completely failed (rejected?) to acknowledge the importance of Malaysia's distributional goals for their development plan and prospects throughout the 1970s. Overall, in discussing the economic position of the country, Fund officials rarely mention any concern with distribution, and when they do so it is only in relation to growth, leaving the larger socio-economic imbalances out of the picture[61].

The stance of IMF officials towards the equity-oriented goals of Malaysia's NEP started to gradually change in the second half of the 70s. In the 1976 Article IV discussions, several Executive Directors described themselves as "impressed" by the results of Malaysia's distributional policies, with ED Tilakarna justifying his praise by saying that policies aimed at the weaker part of the population are "an essential element of development policy if socially balanced economic growth is to be achieved" [62]. Directors (and staff) were well aware of the heavy hand the Malaysian government had in steering economic development, but they express confidence in the country's policy choices, and they praised the government's decision to step in when private investment was lacking. In the 1978 Article IV discussion meeting, ED Pieske even commented that he "sympathized with the Bumiputra community" regarding their lack of ownership vis-à-vis other communities, and proposed that the Malay government "could acquire equity shares in private enterprises and eventually sell them to Bumiputras… thereby promoting a relatively broad distribution of ownership"[63]. Some EDs even referred to Malaysia's redistributive socioeconomic goals as "fundamental", and wished the country continued success in their achievement[64].

All in all, by the end of the 1970s the IMF had a much deeper understanding of how the issue of racial harmony intersected with the larger developmental goals of the country[65]. Finally, the 1979 Article IV acknowledged that "the [Malaysian] authorities attach more importance to the equitable distribution of the benefits of development than to the growth of aggregate output as such"[66] . Moreover, staff (and at times EDs) often made comments about how fiscal policy could be used as a tool towards the achievement of distributional objectives. For example, during the 1980 Article IV consultation, the IMF team suggested a tax break directed towards the poorer segments of society, justifying it not on economic terms, but by saying that "such a course of action

[61] See for example *Malaysia – Staff Report for the 1972 Article VII Consultation, June 21, 1972. Executive Board Documents* *https://archivescatalog.imf.org/Details/archive/125016738*, and *EBM/72/71, July 7, 1972. Executive Board Documents* *https://archivescatalog.imf.org/Details/archive/125016574*
[62] EBM/76/3, January 16, 1976. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125007672
[63] EBM/78/31, March 8, 1978. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125026132
[64] EBM/81/95, June 22, 1981, Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125003743
[65] See for example Malaysia 1979 Article IV Consultation—Briefing Paper. January 19, 1979. Malaysia – Missions. Asia and Pacific Department Records. Box 78 File 7. IMF Archives.
[66] Malaysia – Staff Report for the 1979 Article IV Consultation, March 19, 1979. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125022948

seems to us a *natural complement* to expenditure policy in attaining your objective of poverty eradication”[67]. As I will show, this is not only diverging from the “qualified indifference” of the 70s, but also in stark contrast to the firm stance of fiscal austerity that the Fund would start showing only a few years later.

Finally, in contrast to what happened during the 1975 IBRD mission when the Fiscal Affairs Department refused to consider the distributional implications of fiscal policies, in December 1981 FAD sent a mission of five economists[68] under the direct supervision of the department’s director, Vito Tanzi, with the aim to find new avenues of taxation, especially in income and sales taxes, compatible with the goal of improved racial equity[69]. They subsequently produced a report, “Malaysia: Restructuring the Tax System for Growth, Exports, and Equity”, which heavily comments on the distributional aspect of the country’s fiscal structure. [70]

This more affirmative stance of the Fund on equity issues reflects the broader endorsement and admiration expressed towards Malaysia’s macroeconomic policies and achievements throughout the entire 1970s. Malaysia was hailed as a “success story” and her policies considered lessons for other developing countries[71]. More broadly, the sympathetic view towards distributional issues parallels the renewed attention to social issues in the process of development which was gaining traction in international organization since the mid-70s, especially at the World Bank[72].

5. The 1980s – "structural problems” and the ending of the NEP

Technical assistance and the redefinition of the public sector

The 1980s saw the continuation of TA missions between the IMF and Malaysia. The issues and fields of policy remained mostly the same, but for one important trend: an increase in TA over government finance statistics, spurred by inconsistencies in the reporting of balance of payment

[67] Preliminary Conclusions of the Staff Team during Malaysia’s 1980 Article IV Consultation. April 15, 1980., Malaysia – Missions. Asia and Pacific Department Records. Box 78 File 7. IMF Archives.

[68] This is a high number for a Technical Assistance mission since, usually, TA involves one to three people. The only missions where it is customary to send five or more people are Article IV missions (usually termed surveillance missions), where the entire team of economists who has worked year-round on the country participates in meeting the domestic authorities.

[69] Malaysia – Missions. ASDAI Country Files. Asia and Pacific Department Records. Box 78 File 9. IMF Archives.

[70] Office memorandum by N Choudhry to Mr. Ghandi. June 11th, 1982. Malaysia – Correspondence. ASDAI Country Files. Asia and Pacific Department Records. Box 76 File 7. IMF Archive

[71] See for example Memorandum. B. Aghevli to Finch and Palmer. September 3, 1980. Malaysia – Correspondence and Memos. Exchange and Trade Relations Department Records. Box 160 File 5. IMF Archives.

[72] A cornerstone publication of this new meaning of development at the World Bank is Chenery et al. (1974) *Redistribution with Growth*. Washington, DC: Oxford University Press for the World Bank Group; for an analysis of inequality in the Bretton Woods institutions, see Ferreira, F. H. (2022). The analysis of inequality in the Bretton Woods institutions. *Global Perspectives*, *3*(1), 39981.

statistics in 1980-81, which prompted a series of visits and trainings in 1983-84 with the aim to develop a "consistent concept and classification of the public sector"[73].

The key issue around which the definition of what constituted the "public" or the "private" sector centered was the statistical classification of Off Budget Agencies (OBAs, also referred to as Non-Financial Public Enterprises, NFPEs). TA and routine surveillance missions found out that the main discrepancy in Malaysia's balance of payment in the early 80s was due to a misclassification of these agencies' finances, recorded under *private* sector accounts rather that under *public* ones. This constituted a problem not only for the calculation of public finances but also because, as government agencies, OBAs were supposed to be subject to an audit by the auditor general, under request of the Yang di-Pertuan Agong (the supreme king of Malaysia)[74], but the audit never happened. This lack of revision resulted in a huge problem of accountability in public finances, since OBAs were operating on both taxpayer money and on money from commercial loans.

While Fund officials were not concerned with the accountability issue, for them, the siphoning of money into OBAs constituted a problem of economic efficiency, and about the size and role of the public sector. The problem of OBAs became ever-present in the IMF's internal discussions and in meetings with local officials, and TA missions were sent each year to give advice on the subject. By 1984, the Malaysian view of the role of the public sector had changed: "Heightened awareness of the economic size and role of the public sector since 1979 appears to be one of the more important outgrowths of the NEP review in 1983, which is now manifested in the *goals for the privatization policy* outlined in the plan review. Concurrently, *there has emerged a recognized need* to reformulate the classification of entities in the public sector [according to] the effective control which government is able to exercise over their investment, production, and pricing policies. We warmly support such a redefinition."[75]. This "need" referenced during the Article IV consultations was admittedly *not* new. Some Malaysian officials had in fact been putting forward a different interpretation of the public sector's role in the economy since 1980. At a time when government investment and steerage of the economy was very high – as recognized, but not sanctioned, by the IMF too – the ED for Malaysia was pressured to convey that the view of the

[73] Memorandum – Malaysia – Meeting on Macroeconomic Data of September 29 1983. October 6, 1983. Malaysia – Correspondence. Asia and Pacific Department Records. Box 76 File 9. See also Malaysia Technical Assistance Reports, 1974-1985, BURAI TA Reports, Bureau of Statistics Immediate Office Records, Box 31 File 5, International Monetary Fund

[74] *The New Strait Times* April 11, 1984.

[75] Concluding Statement by Douglas A. Scott. Malaysia 1984 Article IV consultations. Malaysia – Missions. Asia and Pacific Department Records. Box 78 File 11. IMF Archives.

public sector was seen as that of *fully supporting the development of the private sector*, and not of stimulating the economy on its own[76].

The issue of the rise in expenditure of OBAs throughout the 80s should thus not only be seen as a mere inefficient choice of government expenditure, as the prevalent interpretation within the IMF seems to suggest. Instead, this development should be viewed as a last attempt by the PM Mahathir and his administration to continue the same state project that had worked in the past, with its attendant view of the state's role in the economy, including the core component of pro-Malay economic restructuring. In fact, as Jomo points out, the "development of these public enterprises [was] ostensibly [carried out] on behalf of the Malay" population[77] to meet the requirement of 30 percent Malay ownership and control of commercial and industrial activities set out in the NEP[78]. Pushed by the Fund since 1982 to cut government expenditure, it is telling that Malaysian officials chose to first cut development expenditure for the following years, and only in 1985 to start tightening the finances, supervision, and monitoring of off-budget agencies. Although this choice is questionable from a social equity perspective, it highlights the importance of OBAs as not only an economic but also as a political promise to the Bumiputera population.

Recessionary pressures and self-directed structural adjustment

As an open economy with high reliance on exports to boost economic growth, Malaysia suffered recessionary pressures as a result of the 1980-81 global economic downturn. The first externally induced shock of 1981 was cushioned by increasing government spending, financed mostly by external borrowing. This was *not* a new strategy, as Malaysia did the same during the 75-76 economic downturn. What was new was the magnitude of the borrowing (although this was simply a reflection of the magnitude of the market downturn), and the relative inefficient management, from a narrow economic perspective, of some of the borrowed money, funneled to long-gestation projects with lower returns and to OBAs.

Yet this increase in foreign borrowings to finance government spending and the concomitant global economic downturns have not only put the Malaysian economy under strain, but they have also put the country in a structurally more vulnerable position to foreign pressures and influence, especially the ones by international organizations, such as the IMF and WB, who can affect Malaysia's international credibility vis-a-vis its investors[79]. At the same time, they have

[76] Statement by Mr. Kharmawan on Malaysia – EBM/80/101, July 9, 1980. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125019138
[77] Jomo, K.S. (1990) *Growth and Structural Change in the Malaysian Economy,* 155
[78] Malaysia (1971) *Second Malaysia Plan, 1971-1975.* Kuala Lumpur: Government Printer
[79] This point was also noted by Jomo, K.S. (1990), 236. On how this argument works for IMF borrowers at large, see Vreeland, J. (2006) *The International Monetary Fund*

put officials in the Fund club in a stronger position to exercise their preference vis-à-vis the PM club, giving them the opportunity to on one side justify their choices in terms of economic necessity, and on the other seek an easy approval for their policies from the IMF itself, as already seen in the above case of OBAs.

It is in fact in these years that we start observing a deeper rift between different interpretations of the state project in Malaysian institutions. Whereas most officials, for example, expressed the view that the government deficit should be viewed as countercyclical during meetings with the IMF, the head of the 1982 mission Bahram Nowzad reported that "privately, some officials did express a degree of concern about the rise of government expenditure" [80]. Nowzad also observed that officials strongly disagreed over the amount of defense expenditure and to what extent the country should follow an expansionary economic policy[81]. One year later, Douglass A. Scott (Nowzad's successor) documented similar disagreements, noticing that if on one side the Minister of Finance was convinced about the need to cut back expenses and had scheduled talks with the Prime Minister to decide what should be prioritized in expenditure reductions, "the senior staff of the EPU, a key unit in the Prime Minister's office... is not yet fully convinced of the need to retrench public expenditure"[82]. The resistance on the part of Mahathir and the EPU was clear: expenditure cuts would be determined to "minimize disruptions to the economy *without sacrificing the economic and social objectives of the NEP*" – in other words, there would *not* be a reordering of basic priorities in the country's state project[83].

The balance tilted in favor of structural cutbacks from the second half of 1983 following Article IV consultations in September. In a letter to the Malaysian ED, the deputy Governor of Bank Negara Lin See Yan stated that Malaysian officials recognized that their fiscal imbalances were not just of cyclical nature but instead suggestive of "deeper structural problems within the domestic economy". He also made explicit a commitment of the government to "greater efforts to reduce and reschedule public sector expenditures", emphasizing that

> "the *objective of Government* has been to make a significant reduction in public sector development expenditure. […] The latest adjustments… represent the first phase of the Government's overall strategy to reduce the size of the public sector and its fiscal deficit, and to strengthen the balance of payments. The review of expenditure programs will be a continuous process, and sustained efforts

[80] Memorandum. Bahram Nowzad to the Managing Director and Deputy Managing Director. May 3, 1982. Country Debt Situation – Malaysia. Exchange and Trade Relations department records. Box 12 File 4. IMF Archive.
[81] Ibid.
[82] Memorandum. Douglass A. Scott to the acting Managing Director. May 13th, 1983. Malaysia – Missions. Asia and Pacific Department Records. Box 78 File 10. IMF Archives.
[83] Malaysia – Recent Economic Developments, June 27, 1983. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125067894

> will be made to reduce further the size of the public sector expenditure, while also improving the overall efficiency, productivity, and external competitiveness of the economy."[84]

Only in 1984 the Fund managed to corner Malaysia into accepting a *de facto* structural adjustment in public expenditure and fiscal policy without any official IMF program or loans[85]. Yet without the support of a large group of officials in Malaysian economic institutions who already sympathized with the reforms proposed by the Fund, it is hard to imagine that the latter would have simply "had its way". The Fund Club, now boosting a generation of economists trained by the Fund's technical assistance, facilitated the process of the NEP's virtual demise and the transition to a neoliberal economy. First, the director of FAD Vito Tanzi was *invited* by the Malaysian government on a "conciliatory mission", to on one side receive assurance that Scott's advice during the previous mission was being followed, and on the other provide additional backing to his policy instructions by relating Malaysia's experience to the one of other countries. In Tanzi's words, "my visit helped reassure the Malaysian officials that *their* proposed conservative stance on fiscal policy *is the only reasonable one* under current circumstances"[86]. Second, the pressure was put on the Executive Director for Malaysia, Mr. Jaafar, to convey to Malaysian authorities that they should promptly take the necessary adjustments[87]. Third, on September 25th a delegation from Malaysia was "invited" to the IMF to give updates on the adjustments to the Managing Director, where they reported on a plethora of measures aimed at reducing the balance of payments problem, and expressed "deep appreciation" for the technical assistance received and the forthcoming missions in central banking[88]. Lastly, even after the measures had already been taken, IMF missions made it a point to promote their preferred policy positions with arguments that would appeal not only to like-minded Malaysian officials but also to the PM club. Mission Chief Scott put it as such: "I tried to impress on all officials and the Governor just how unforgiving an external debt problem can become – particularly its costs in terms of sustaining the social and political consensus needed to preserve effective political leadership, without which social and economic conditions can deteriorate rapidly."[89]

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[84] Correspondence. Lin See Yan to J.E. Ismael. September 16, 1983. Malaysia – Correspondence and Memos. Exchange and Trade Relations Department Records. Box 161 File 4. IMF Archive.

[85] As one Executive Director put it, "the Malaysian authorities would be taking austerity measures resembling those under a stand-by arrangement, without the benefit of such an arrangement with the Fund", EBM /84/105, July 13, 1984. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125071799

[86] Notes from Vito Tanzi to the Managing Director and Deputy Managing Director. March 21st, 1984. Malaysia – Missions. Asia and Pacific Department Records. Box 78 File 11. IMF Archives.

[87] Confidential Memorandum. P.R. Narvekar, July 6, 1984. Malaysia – Correspondence. ASDAI Country Files. Asia and Pacific Department Records. Box 77 File 1. IMF Archives.

[88] Memorandum. Malaysia, Meeting with the Managing Director, September 25, 1984. *Ibid.*

[89] Memorandum. Douglas A. Scott to the MD and deputy MD. September 6, 1985. Malaysia – Correspondence and Memos. Exchange and Trade Relations Department Records. Box 161 File 4. IMF Archive.

The dissolution of the NEP and the series of "structural adjustments" should not be interpreted as the emergence of a new, widely-endorsed state project in Malaysia. Instead, it shows how one group of officials in key institutions – Bank Negara and Ministry of Finance – were able to prevail on the Prime Minister's office by attaching themselves to the narrative of sound economic policy and "no alternatives" provided by the Fund. Throughout this time, as Fund officials report in the 1984 Article IV, Malaysian authorities were all in agreement with "what needs to be done", *except at the highest political level*, i.e., Mahathir and his entourage at the EPU[90]. Even in 1985, after virtually accepting the structural adjustment measures, the PM's club was still pushing for policies consistent with the NEP; as the alternate Executive Director reported, "*for both political and social reasons*" Malaysian authorities would not allow development cutbacks to grow any further[91]. The way in which the Article IV describes this year's visit to Malaysia is revealing:

> "Political leaders are pushing for [a] 7 percent [growth rate] to give credibility to attaining [redistributional] targets of the NEP […]. [On the other hand,] key officials have been arguing for more emphasis on slower growth and more adjustment – and a growth target of about 4.5%. The Minister of Finance has recently announced the aim of relaxing more administrative impediments to private investment... This rethinking of earlier policies of economic nationalism, with its attendant costs, is to be welcomed." [92]

The "rethinking" referenced here represents a clear victory on the part of the Ministry of Finance and Bank Negara not only over the policy direction of the country, but over its all-encompassing state project. As reflected in the Fifth Malaysia Plan, published in 1986, privatization, rationalization, efficiency, fiscal restraint, and financial liberalization supplanted socioeconomic restructuring as the ultimate goals towards which government activity in the economy should be directed – *even if doing so entailed a lower rate of economic growth*[93]. The role of the public sector as an engine of growth, moreover, would be substantially reduced. There is a noticeable irony in this outcome: whereas the Fund club was pushing the narrative of "growth first" throughout the entire 1970s, they also ended up prioritizing other goals – yet, in this, case, much less socially beneficial – at the expense of higher rates of growth.

Conclusion

[90] Malaysia – Recent Economic Developments, June 22, 1984. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125071995
[91] EBM/85/111, July 24, 1985. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125075667
[92] Memorandum. Douglas A. Scott to the MD and deputy MD. September 6, 1985
[93] Malaysia – Staff Report for the 1985 Article IV consultation, June 26, 1985. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125076010

Overall, the effects of the New Economic Policy on the reduction of (inter-ethnic) inequality have been mixed. Some studies contend that the tax structure and policy of Malaysia had very limited re-distributional impact and has maintained regressive components even throughout the seventies[94]. Others suggest that the pattern of public expenditure, on the other hand, has improved the distribution of income and welfare through transfer payments and investment projects aimed at lower-income groups[95].

Yet what this article has illustrated is that for more than a decade the Malaysian government has successfully upheld ethnically based redistribution as the foremost goal of its national economic policy and development plan. For the longest time, Malaysia's economic state-project, the New Economic Policy, carried out a vision where the economic, political, and social sphere were entangled under the aegis of a philosophy of national unity, the *Rukunegara,* and governed by it. And they were able to do so for several reasons. First, favorable global markets (for the most part) for Malaysia's exports contributed to high and sustained rates of growth and a balance of payment in order. Second, Malaysian officials, aware of the ideological environment in which their reforms had to take place, underscored to International Organizations that redistribution would happen only through a more equitable share of the returns from growth, and not from a reorganization of existing wealth. Third, a strong political will based on a broad, multi-ethnic coalition coming out of the 1969 riots, coalesced around the realization that the socio-economic restructuring of the country was a necessary component for the maintenance of political stability, overshadowing opposing views in key economic institutions and virtually forcing their officials to carry out the NEP in practice.

At the same time, though, I have shown how the country's core economic institutions were being gradually transformed by external intervention into a bureaucratized machine that prioritized efficiency, productivity, and stability, and superimposed a narrow economic logic over larger national goals. When unfavorable macroeconomic conditions, and their prevalent interpretation, shifted the balance of power in favor of the Fund club of bureaucrats, and the domestic political will to continue following the *Rukunegara* faded, Malaysia's economic state project left its distributional component behind, with its attendant ambitions of socio-economic restructuring. Not only that: the preponderant view that the state should steer the economy and lead economic development was repudiated, entrusting the growth prospects of the country to the free market.

94 Jomo, K.S. (1990) *Growth and Structural Change in the Malaysian Economy,* 98

95 Snodgrass, D.R. (1975) The Fiscal System as an Income Redistributor in Malaysia, in Lim, D. (ed.) *Readings in Malaysian Economic Development*. Kuala Lumpur: Oxford University Press; Meerman, J. (1979) *Public Expenditure in Malaysia: Who Benefits and Why?* New York: Oxford University Press for the World Bank; Shari, I. (2000) Economic Growth And Income Inequality In Malaysia, 1971–95*, Journal of the Asia Pacific Economy*, 5:1-2, 112-124

The effects of this second wave of proto-neoliberal economic restructuring that happened from 1983 onwards were disheartening. The retrenchment in public expenditure, privatization, and rising fiscal pressure led to a deterioration in mass living standards, rising unemployment, and a cutback in much needed social services, especially for the poorer strata of the population. The lone view expressed by ED Jayawardena in 1986 is sobering: "once again, we see a country following sound economic policies and strong adjustment, yet being thwarted in its efforts by external shocks. [T]he Fund must contemplate seriously the problem of how to underpin and support worldwide adjustment when external shocks… tend to thwart that adjustment. *Questions arise about whether our policies are adequate to respond to this problem*, which underlies many of the problems facing developing countries in Asia, Africa, and South America."[96]

Similarly to how in the case of the Asian Financial crisis of 1997, IMF economists failed to identify causes that lied outside of domestic economic, policy, and institutional factors, i.e., wider and more pervasive market failures led by wrong expectations[97], economists, and especially board members, working on Malaysia in the mid 1980s failed to acknowledge the decisive role played by external factors in precipitating the country's debt "crisis". This is telling when considering that less than a decade earlier, other economists in the same positions were the first to point to structural problems in the international economy as most responsible for Malaysia's weak economic performance. And it is even more poignant when we realize that a large group within Malaysia, the Fund club, held the same distorted view and was able to reform the country's trajectory by closely following them.

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[96] EBM/86/138, August 27, 1986. Executive Board Documents. https://archivescatalog.imf.org/Details/archive/125079487

[97] Chwieroth, *Capital Ideas,* p. 208