

The Business of the Party:  
Developmental Transitions in Taiwan and Malaysia

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## Introduction

Democracy is under siege across the world. Political decay threatens established regimes while authoritarianism and patrimonialism halt democratization in its tracks. Despite these global struggles since the end of the 3rd Wave, East Asia remains a beacon of hope for liberal capitalist democracy, with Japan, South Korea, and Taiwan reforming authoritarian state-centric dictatorships by privatizing their economies and building accountable democracies. Not every developmental state in Asia has pursued political development in the form of liberalization. Malaysia, despite finding itself in a similar starting position to Taiwan with regards to geographical location, autocratic heritage, ethnic tensions, single party rule, Chinese capital, and use of state and party owned enterprises, has failed to liberalize politically. Taiwan was a colony of authoritarian Japan but has developed democracy from scratch whereas Malaysia, having inherited democratic institutions from the British colonial period, has not. Malaysia is “lagging behind” in terms of civil rights and freedoms as the United Malays National Organization (UMNO), the dominant political party in Malaysia since independence in 1963, continues its authoritarian illiberal government today. Freedom House gave Taiwan a 1.5/7, with 7 being unfree. Malaysia received a 4.0/7, which is classified as partly free. Both Taiwan and Malaysia have focused on economic growth for the past several decades, experiencing consistent growth of their economies, although Taiwan has averaged a higher rate in the last 30 years (8% vs 6.5%).

This paper builds a general framework for why a strong authoritarian regime may “concede to thrive” and give up its political monopoly voluntarily in a transition to democracy. To illustrate the model, this paper uses the cases of the KMT in Taiwan and UMNO in Malaysia. Although many factors have likely shaped this divergence, such as differing civil societies, the

geopolitical effects of the Cold War, colonial legacies, and ethnic tensions, this paper argues that a key difference in determining democratic outcomes in Taiwan and Malaysia is the state-business relationship. The KMT<sup>1</sup>, compared to UMNO, controlled a stronger developmental state and this increased autonomy<sup>2</sup> and capacity<sup>3</sup> allowed it to pursue a policy of “conceding to thrive” and embrace democracy, while retaining significant political influence.<sup>4</sup> The unique business KMT state-capital relationship, in terms of both State-Owned Enterprises (SOEs) and Party Owned Enterprises (POEs), made the KMT wealthy and autonomous and allowed it to maintain significant political power even after transitioning to democracy because of the victory<sup>5</sup> and stability<sup>6</sup> confidence afforded by the high autonomy and capacity of the SOEs and POEs.

This concede to thrive strategy never materialized in Malaysia, as a result of many different factors such as a weak civil society, differing geopolitical factors, colonial legacies, and ethnic tensions. This paper does not dismiss any of these arguments as they all have their merits but claims that a deciding factor was the dependent business-government relationship found in Malaysia, in terms of UMNO’s struggle to control the Chinese economic elite and raise up the Bumiputera (literally “son of the soil,” refers to native Malaysians). The decreased autonomy and capacity afforded the UMNO as a result of the complicated business connection precluded the concede to thrive strategy and thus UMNO has been unwilling and unable to make liberal reforms and persists as an illiberal authoritarian state. Even though UMNO grew into a position

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<sup>1</sup> Also known as the Kuomintang. Nationalist party from mainland China that fled to Taiwan after its defeat against the communists. Held authoritarian power from the late 1940s until the early 1990s.

<sup>2</sup> Autonomy refers to the ability of the ruling governmental organs to operate independently of internal forces within the state. In a democracy, autonomy is low because of representation and voting.

<sup>3</sup> Capacity refers to the ability of the government to implement and oversee policy and plans of action. OECD countries have high capacity while South Sudan has next to none.

<sup>4</sup> Slater, Dan and Joseph Wong, “The Strength to Concede.” *American Political Science Association*. September 2013. 11. 3. Pgs 717-731.

<sup>5</sup> Victory confidence refers to the expected success of the party if a democratic transition were to occur.

<sup>6</sup> Stability confidence refers to the belief that the state will survive the turmoil of democratic reforms. Leaders will not concede to thrive if they believe that the state will collapse since they may lose their elite status.

of dominance similar to the KMT in Taiwan, it never had the incentive to “concede to thrive” and thus never moved towards democracy.

This paper begins by highlighting some of the arguments for why Malaysia has struggled while Taiwan has excelled with authoritarian transition to democracy. The general model will be constructed in the next section. Following that, this paper uses the two cases to illustrate the model by addressing party formation, highlighting how autonomy and capacity were affected. The next section looks at the key role SOEs and POEs played in leading to the KMT being autonomous and capable while UMNO failed to do so. This paper concludes with how increased autonomy and capacity affect the democratic transition and applies these to the general model.

## **Literature Review**

In the 20th century Malaysia and Taiwan both possessed a “developmental state,” a regime that is focused on “facilitating the structural transition from a primitive/agrarian to a modern/manufacturing society.”<sup>7</sup> However, Taiwan and the Kuomintang (KMT) pursued political liberalization following the economic liberalization and transformation. Since independence, Malaysia under the direction of UMNO has seen consistent growth but a lack of political reform. So why did the KMT party-state allow for political reform while UMNO has retained persistent authoritarianism? There are a number of possible explanations to answer this question.

The first argument is that of a weak civil society in Malaysia. Scholars have noted that a comprehensive civil society has failed to develop in Malaysia in the way that one did in Taiwan. This means that the authoritarian government in Malaysia has not faced the same amount of scrutiny and civil disobedience by the citizens than that of Taiwan. The civil society in Taiwan,

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<sup>7</sup> “The Asian Developmental State and the Flying Geese Paradigm,” *United Nations Conference on Trade and Development*. November 2013. (Accessed December 11, 2014) [http://unctad.org/en/PublicationsLibrary/osgdp20133\\_en.pdf](http://unctad.org/en/PublicationsLibrary/osgdp20133_en.pdf).

despite being brutally repressed during the early rule of the KMT<sup>8</sup>, forced the hand of the KMT during liberalization and still checks the new democracy today. Tangwai representatives (Literally “Outside the Party”) were allowed by the KMT, demonstrating both a robust civil society and a tolerant state.<sup>9</sup> Other examples include the Taiwanization of the KMT in an effort to address the growing discontent found in the growing civil resistance groups. UMNO, using “the institutional framework of competitive authoritarianism, heavily restricts civic engagement and the establishment of civic associations.”<sup>10</sup> The lack of these groups and of opposition groups has led to “turnover without change” in Malaysia, prolonging the competitive authoritarian state.<sup>11</sup> Some of these scholars have argued that there may be a time gap between Malaysia and Taiwan but it is difficult to claim that Malaysia in the 2010s is in the same place that Taiwan was in the 1980s. These scholars concede that while this gap may exist politically, the economic gap is much smaller.

Another group of literature addresses the geopolitical Cold War factor. These arguments center around the role that the Cold War played in developing nations, with an especially important battleground being Asia. As such, Taiwan was of extreme significance due to the amount of support the United States gave the Nationalist Chinese. This support continued through the 1970s when the US turned toward the People’s Republic of China. The support consisted not only of funds and material, but of a form of legitimacy as any country promoted by

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<sup>8</sup> Events such as the 228 incident, where in 1947 the KMT killed an estimated 10,000-30,000 Taiwanese anti-government protestors.

<sup>9</sup> Yu-tzung Chang, Chu Yun-han, and Park Chong-Min. 2007. "Authoritarian Nostalgia in Asia." *Journal of Democracy* 18 (3): 66-69,71-80. (accessed October 15, 2014).

Moten, Abdul Rashid. 2011. "Changing Political Culture and Electoral Behavior in Malaysia." *Asian Affairs: An American Review* 38, no. 1: 39-56. *Political Science Complete*, EBSCOhost (accessed October 15, 2014).

<sup>10</sup> Giersdorf, Stephan, and Aurel Croissant. 2011. "Civil Society and Competitive Authoritarianism in Malaysia." *Journal Of Civil Society* 7, no. 1: 1-21. *Political Science Complete*, EBSCOhost (accessed October 15, 2014).

<sup>11</sup> Pepinsky, Thomas. 2007. “Malaysia: Turnover without change.” *Journal of Democracy* 18.1: 113-127. *National Endowment for Democracy*, EBSCOhost. (accessed October 15, 2014).

the United States was perceived as one of the “good guys.”<sup>12</sup> The support was controversial as in 1950, Chiang Kai-shek took office in Taiwan under the “Temporary Provisions Effective During the Period of Communist Rebellion,” which declared martial law and suspended many democratic processes and institutions.<sup>13</sup> The United States, in other words, supported many authoritarian countries to prevent communism from spreading, rather than attempting to spread democracy. With the fall of the Soviet Union and the end of the Cold War, many of the authoritarian governments that had previously had a blind eye turned to them were pushed to reform. Malaysia was never close enough to an epicenter of conflict to receive this treatment and never got the Western incentive to reform politically. This western influence can partially explain why Taiwan liberalized while Malaysia did not.

A third explanation is that of the “colonial legacy” theory. Malaysia went through a period of British colonialism that directly influenced its current political systems. This body of literature claims that the British system that Malaysia inherited has led to decreased state autonomy and capacity, especially with regard to constitutional reform. The KMT, having established a new and powerful state upon their arrival in Taiwan, avoided this problem of inheriting institutions that hurt its ability to centralize political power. The colonial experience helped the KMT because the Japanese colonial government eliminated or crippled any landed or urban elite and enacted land reform, removing significant social and economic barriers to the KMT’s political strength. In this light, it is interesting to note that Malaysia, possessing democratic institutions developed by the British, may have been made worse off because of the difficulty in overcoming the elites heavily invested in maintaining the status quo. This led to a

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<sup>12</sup> Gray, Kevin. 2011. “Taiwan and the geopolitics of late development.” *Pacific Review* 24, no. 5: 577-599. *Military & Government Collection*, EBSCOhost (accessed October 15, 2014).

<sup>13</sup> Feldman, Harvey, ed. (1991). *Constitutional Reform and the Future of the Republic of China*. Taiwan in the Modern World. M.E. Sharpe. pp. 1, 3–7, 39. (accessed October 15, 2014).

developmental focus not on the entire country but rather the bumiputera in an attempt to overcome the interest of the landed and economic elites, who were primarily Chinese. UMNO believed that in order to ensure stable and significant growth the inequality between ethnic groups had to be reduced. Some have even argued that a strong state can actually facilitate transition rather than prevent it like the conventional wisdom suggests.<sup>14</sup>

Another body of literature discusses the differing ethnic tensions and how the KMT and UMNO have responded to these challenges. The ethnic Chinese-dominated KMT has had to either repress the native Taiwanese, a sub-ethnic Chinese group or, as done during liberalizing, make an effort to include them in high levels of government, a process known as Taiwanization. This was done in order to create more legitimacy for the KMT and ensure a solid new cadre generation to carry on the legacy of the party. Malaysia, on the other hand, has a multi-ethnic, multi-cultural, and multilingual society. UMNO was originally formed in order to help the majority native Malays and is still seen as the best method by the bumiputera to climb the social and political ladder. UMNO has focused on raising the living standard of the bumiputera and reducing poverty, two key goals outlined by the New Economic Policy in 1969, in an effort to stimulate national economic growth. This separates Taiwan and Malaysia as the KMT focused on economic growth immediately after consolidating political power in the late 1940s. In addition, most of the wealth and private businesses in Malaysia were owned and often operated by Chinese. Another element of the NEP was to include a quota of bumiputera that all businesses had to meet. There are significant numbers of indigenous tribespeople, Malays, Chinese, Indian, Persian, Arabic, and British present in Malaysia. There has been minimal cultural assimilation of

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<sup>14</sup> Fukuyama, Francis, *The Origins of Political Order: From Prehuman Times to the French Revolution* (New York, Farrar, Straus, and Giroux, 2011).

ethnic minorities, mainly due to the structure and goals of the Malay-dominated government.<sup>15</sup> In 1971, this tension led to the creation of a “National Cultural Policy,” officially defining Malaysian culture and stating that indigenous Malay culture was the most important. This created significant resentment from non-Malays who felt that their culture was underrepresented and their cultural freedom was lessened but the order was accepted as UMNO agreed to not interfere with the minorities’ economic interests.<sup>16</sup> This tension, these scholars argue, created lackluster support for democracy by the regime, as worry about losing political power in a democracy prevents a concede to thrive strategy to seem appealing. In addition, the Chinese economic elite have impeded the move towards democracy as it would undermine their interests and their political interests are often overlooked.

Modernization theory was the traditional explanation for how democratic transitions occur. This paper demonstrates that the theory is too broad and simple to apply to all countries, although it can be a valid foundation to build upon. Modernization theory states that economic changes occur (growth and wealth), which leads to social changes (urbanization, education, etc), which lead to political changes (democratic reforms), as a wealthy and educated populace are more likely to want a say in the government.

This essay does not dismiss these arguments, as it is clear that the question of political liberalization is extremely complicated and influenced by many different variables. However, this paper argues that the unique state-business relationship found in Taiwan led to its successful democratization from a position of authoritarian strength. This state-business relationship fostered a developmental mindset as argued by Evans has led to the ability of the KMT to reform

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<sup>15</sup> R. Raghavan (1977 (No. 4)). "Ethno-racial marginality in West Malaysia: The case of the Peranakan Hindu Melaka or Malaccan Chitty community". *Bijdragen tot de Taal-, Land- en Volkenkunde* 133 (Royal Netherlands Institute of Southeast Asian and Caribbean Studies). pp. 438–458 (accessed October 15, 2014).

<sup>16</sup> Cultural Tourism Promotion and policy in Malaysia". *School of Housing, Building and Planning*. 22 October 1992. (Accessed October 16, 2014).

gradually and maintain political power.<sup>17</sup> The additional autonomy and capacity afforded to the KMT because of its economic power and influence allowed reform to occur in a gradual and peaceful method. The “concede-to-thrive” strategy was only an option because of the unique relationship between the KMT and Taiwanese businesses, the KMT’s significant economic holdings, and how Taiwanization combined the KMT organs with the Taiwanese.<sup>18</sup> The Malaysian authoritarian party state has not had the economic resources to have enough victory and stability confidence and hence been unwilling to reform. Rather than focusing on economic growth UMNO has focused on equality, attempting to overcome the disparity between the Chinese and Malays in an effort to stimulate stable economic growth. In addition, the KMT’s promotion of a wide variety of exports and industries has created a more stable economy and has allowed the KMT to maintain a large coin purse. Malaysia, however, has focused more on raw materials as its exports base and thus UMNO has not been able to benefit as much and when the markets for these resources sour, the entire country is affected, as was the case in the mid-1980s. UMNO recognized the curse of the resource trap and used SOEs to try and combat it, finding limited success with endeavors such as the Proton car project. The autonomy and capacity afforded the KMT via its unique state-business relationship allowed the party to “concede-to-thrive” and maintain significant political influence while democratizing whereas UMNO focused on affirmative action first and then economic growth, diminishing its autonomy and capacity and making a democratic transition unlikely.

### **Model Introduction**

Authoritarian regimes are overcome in many different ways. This paper is primarily concerned with the “concede to thrive” paradigm, in which the authoritarian party gives up

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<sup>17</sup> Evans, Peter B., *Embedded autonomy : states and industrial transformation* (Princeton, Princeton University Press, 1995).

<sup>18</sup> Slater and Wong, “The Strength to Concede,” 717.

power willingly to democratic forces often without bloodshed or disorder in order to retain political power longer. The authoritarian party will only do this if it has a significant amount of victory and stability confidence, which is a reflection of autonomy and capacity that this paper argues is created in part by POEs and SOEs. Victory confidence is the authoritarian party's belief that it will do well in democratic elections, while stability confidence is the party's belief that the country and government can withstand the transition. In other words, the type of electoral system does not matter if the country falls into civil war or chaos.

Political parties, no matter what sort of government they participate in, have a utility function. All parties wish to maximize this utility and this is done by having political power (1).

$$(1) U_{\text{PARTY}}(\text{Political Power})$$

where (political power)=holding the dominating positions of the regime.

Political power is not a one time calculation. Parties have to consider the future when making decisions in the present. The decision to democratize may help the party in time 1 but if it loses power in time 2, its objective to maximize its political power was not met. The decision to maintain authoritarianism may help the party in the short term but if it results in a coup or a revolution, the party's objective was not met as it is out of power in time 2. This is why victory and stability confidence are so important for this calculation. Expected utility is an important element of making the decision in time 1 (2).

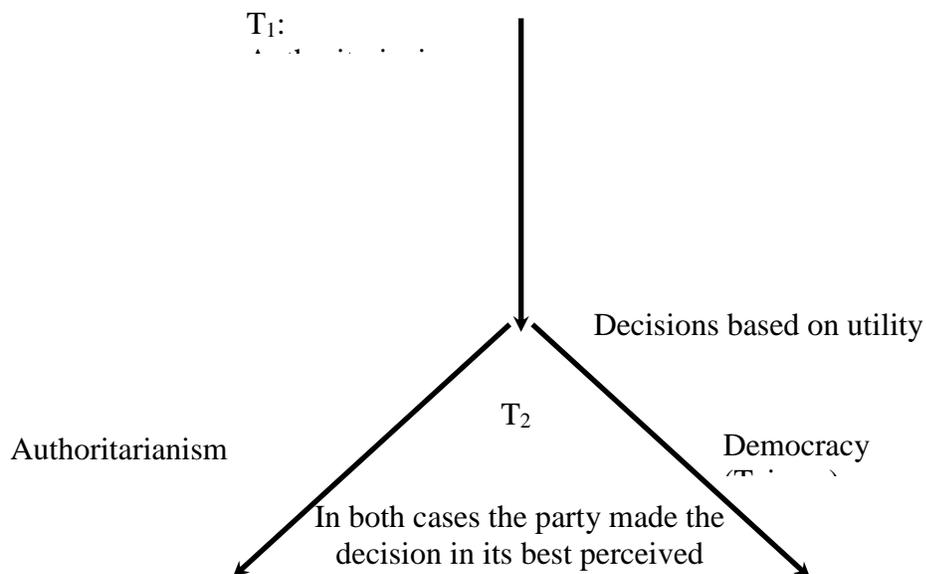
$$(2) E(U_{\text{PARTY}}(\text{democracy})) > E(U_{\text{PARTY}}(\text{authoritarianism}))$$

where victory confidence and stability confidence are established.

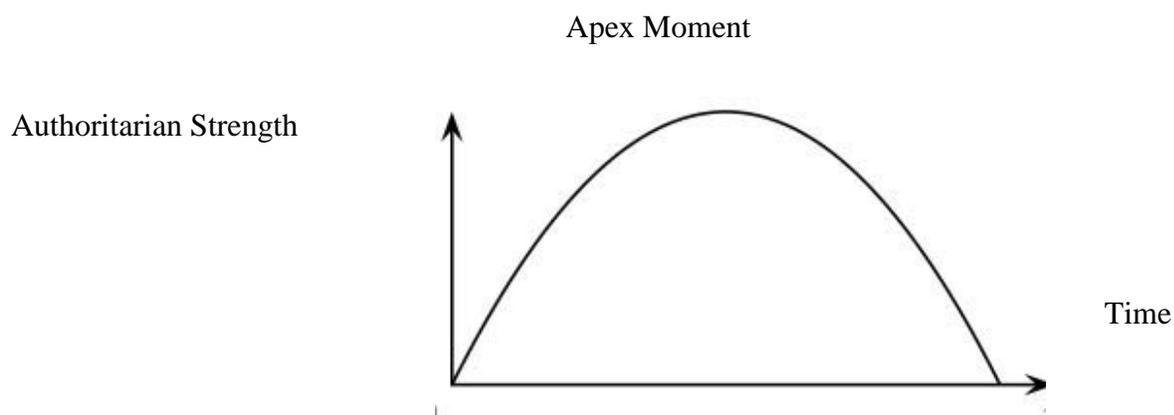


If the party believes it will maintain power longer if it slowly transitions to democracy than if it sticks to authoritarianism the party should transition. This, of course, assumes that there is high stability confidence and that the party has a strong hold on the system. This model applies to countries that have dominance over the country. In other words there cannot be large factions that operate with some degree of autonomy within the governmental structure. This is why the bittersweet moment is important to a successful transition. When a party recognizes that its survival is being challenged, that they are no longer in complete control, it is more willing to

Chart 1--Authoritarian Decision Making



make concessions that start the transition toward democracy. If a party can recognize that it has moved past its apex moment and realize that its strength is on the decline, a democratic transition is more likely, especially if there is a high degree of victory and stability confidence. This model predicts that if a party can recognize that it has reached its apex moment it can delay the authoritarian decline by transitioning to democracy. The lifespan of authoritarianism is shown in graph 1 below. As time passes the authoritarian party becomes more established and develops an increasing amount of autonomy and capacity. However, history has shown that there is a lifespan



to all authoritarian governments and so eventually the authoritarian party starts to decline after reaching its apex moment.

This decision is illustrated in chart 1. At the decision node the party decides what path to take given expected utility, a function of maintaining political power. This decision point may not be an exact day and time--in other words the central leadership may not sit down and say “lets be a democracy tomorrow.” Rather it is more likely a series of small decisions and realizations that perhaps it is time to start the wheels of political change in motion. In these one party systems there is not just one person in power. The elites or a portion of the elites control the political and also often the economic system.

This model works against the conventional wisdom of modernization theorists that claim most transitions occur when the party is weak, as was the case with the Soviet Union. Any reforms enacted in the 1980s were too little too late for the survival of the USSR. The successful case study this paper looks at, the KMT in Taiwan, has managed to hold on to political power for thirty years after starting democratic and liberal reforms. There is merit to this question and this paper attempts to make the model general enough to apply to other rising authoritarian countries, such as China. The remainder of this paper addresses two specific cases and how these successful authoritarian parties approached the decision to democratize and to what degree they succeeded.

	<b>Party Would Allow Democracy Because of Victory and Stability Confidence</b>	<b>Party Fights Democracy Because it Fears Losing Power</b>
<b>People Demand Democracy</b>	Democracy formed relatively peacefully	Conflict and violence -Revolution -Civil war -Repression
<b>People Don't Demand Democracy</b>	Soft Authoritarianism Persists: -Lack of civil society -Lack of democratic institutions	Hard Authoritarianism Persists -Repression -Corruption -Violence

## **CASE STUDIES**

This section of the paper addresses Malaysia and Taiwan's experiences with regard to their democratic transition. The development of the party state is addressed first, as the origins of the source of power can cause E(U(Party)) to differ. Next, the different developmental strategies and the nature of the party-business relationship is analyzed as Malaysia and Taiwan followed different strategies in their pursuit of economic growth. The types of state that these countries are also matters and so the next section covers how the type of state might affect democratization. This paper wraps up with a discussion of the process of democratic transition and where the countries are today, proving the general model in the process.

### **The Development of the Party State**

UMNO faced greater obstacles to overcome to assume leadership of Malaysia's developmental state compared to the KMT's relative ease, after losing the Chinese Civil War and mainland China, of becoming the over-developed state in a one-party system in Taiwan. Some of the problems UMNO faced include: overcoming British colonialism and the colonial legacy, the unification of Malaysia, and ethnic conflict, all of which led to differing victory and stability confidence which would tilt the party's decision to remain authoritarian.

After the end of the Second World War, the British returned to its colony in Malaysia, previously occupied by the Japanese Imperial Army. The British attempted to create the Malayan Union, a federation of Malay states that was the successor of British Malay and tried to unify the peninsula under a single government, but faced heavy resistance because it was perceived to threaten Malay sovereignty over Malaysia. The British approached all of the local Malay state rulers in an attempt to get them to agree to the Union. Despite the loss of political power for these local leaders, they agreed quickly. Many scholars argue that this was because these rulers

were worried about being accused of collaboration with the Japanese during the Second World War.<sup>19</sup>

As a response to the threat of losing political power via the Union, a number of congresses were held by Malays, fostering the creation of UMNO in May of 1946. Malays were also worried about the growing Chinese threat, as the British extended citizenship to them, making up about 22% of the population versus the 50% of the population that was ethnically Malay. This demonstrates that even at its inception, UMNO was distrustful of the minority Chinese economic elite. UMNO was a civil group that was strongly opposed to the Malayan Union but not at first politically active. In 1948 the Malayan Union became the Federation of Malaya, made up of 11 Malay states on the peninsula. Taiwan's struggle with decolonization went smoother (although the threat from China was still present) and thus could focus on developmental issues much earlier.

The British, after getting the agreement of local leaders, started to reform many of Malaysia's political institutions before their departure. One key aspect of these reforms was the loss of power of the Sultans, the traditional rulers of the Malay states. The Sultans conceded all of their powers to the British Crown except for religious authority. Following this, the Malaysian Union was assigned a British Governor. The British attempted to extend citizenship rights to many non-Malay immigrants, sparking anger from the native Malays. Groups like UMNO practiced civil disobedience to British rule and the authorities of the Crown recognized the situation they were in and the reforms slowed. Because of the opposition from these Malay-centric groups, the Union was destroyed by the British and replaced by the Federation of Malaya,

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<sup>19</sup> Haggard, Stephan and Kaufman, Robert, *The Political Economy of Democratic Transitions* (Princeton: Princeton University Press, 1995), 277.

a weak state. In the 1960s, the KMT was already well established and consolidated on Taiwan and was turning its attention to economic development.

After the switch from the Union to the Federation, UMNO became more active in politics, shifting its focus to governance rather than civil disobedience. By the 1951 elections under British control, UMNO, along with its coalition partner the Malayan Chinese Association (MCA), carried 9 of the 12 seats of the municipal council elections. By 1954, this coalition was formalized into the “Alliance.” In the 1954 elections, the Alliance won 226 of the 268 seats, signaling the start of UMNO’s dominance. Independence from Britain would follow soon after in 1957.<sup>20</sup>

Malaysia’s struggle for statehood was more difficult than the KMT’s struggle to consolidate power in Taiwan. Following the KMT’s retreat to Taiwan in the second half of the 1940s, Chiang Kai-shek passed the “Temporary Provisions Effective During the Period of Communist Rebellion”, which declared martial law in Taiwan, destroying any possible democratic development. This was in response to Taiwanese unrest with the occupying mainlanders as demonstrated through incidents such as the 228 incident.<sup>21</sup> In addition, the Nationalist KMT was well supported by the United States in an effort to beat the Communists.

Two million mainland Chinese retreated to Taiwan (a population of 6 million) and installed themselves on top of the political hierarchy with threat of force and declared martial law, furthering the grip of the KMT on political power and creating a barrier between the mainlanders and native Taiwanese. A tacit agreement between the two groups was quickly established, creating a separation of power. The native Taiwanese were forced by the KMT to

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<sup>20</sup> Gomez, Edmund and Sundaram, Jomo, “Malaysia,” in *Democracy, Governance, and Economic Performance: East and Southeast Asia*, ed. Ian Marsh, Jean Blondel, and Takashi Inoguchi (New York: The United Nations University, 1999), 247.

<sup>21</sup> In 1947 the KMT killed an estimated 10,000-30,000 Taiwanese anti-government protestors.

accept a KMT possession of a political monopoly if the mainlanders were left the bulk of the economic sector. This created separation between the Taiwanese and the KMT which would later help democratization in Taiwan. In addition, the KMT was Leninist in structure and possessed direct control over the state and was able to reorganize the party structure upon arrival in Taiwan.<sup>22</sup> A network of military and security agencies designed to keep the people and the party in line, rooting out any opposition. With the tacit division of labor and the security state, the KMT enjoyed significant autonomy. There were few landed elites present on Taiwan that could pose a threat to the KMT. This was a result of the Japanese occupation that wiped out the landed elite and urban elite and because of the KMT's total dominance over the remaining local elite allowed the KMT to finish any necessary reforms.<sup>23</sup> The KMT was also financially independent, with significant ownership of both SOEs and POEs. The party managed to establish top-down control over not just the political system but also "all social organizations, including unions, farmers, and student groups."<sup>24</sup> These factors demonstrate how the formation of the parties created significant foundational differences leading to the KMT possessing greater autonomy and capacity when compared to UMNO, which would allow it to make a strong authoritarian transition to democracy in the 1990s.

While the KMT quickly gained the upper hand and focused on industrial policy and creating capacity and autonomy, UMNO's struggles were just beginning. The Federation of Malaya became independent on August 31, 1957, after the Reid Commission, had drafted a constitution. This constitution, although supporting both federalism and a constitutional monarchy, gave special provisions to Malays. Examples include quotas in education and civil

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<sup>22</sup> Gold, Thomas B. "State Capacity in an Asian Democracy: The Example of Taiwan," in *State Capacity in East Asia: Japan, Taiwan, China, and Vietnam*, ed. Kjeld Erik Brodsgaard and Susan Young (Oxford: Oxford University Press, 2000), 94.

<sup>23</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 277-285.

<sup>24</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 277-278.

service, declaring Islam the official religion, and making Malay the official language. These affirmative action provisions, which were heavily supported by UMNO, were meant to be temporary.<sup>25</sup> UMNO's focus on affirmative action while simultaneously trying to stimulate economic growth undercuts state capacity and autonomy, making an eventual concede to thrive strategy less appealing to UMNO.

The Malay favoritism in the constitution turned violent. Anti-Chinese protests raced through the capital Kuala Lumpur following the May 1969 general election. The Race Riot was a response to the failure of the state to serve interests of various groups and classes.<sup>26</sup> Several hundred Chinese nationals died (the exact number is disputed) as did roughly 25 Malays. The army was dispatched to resume order but, comprising mainly of Malays, only made the situation worse. In response to this crisis, the government, headed by UMNO and the Alliance, a declaration of national emergency was issued, which suspended the Parliament, established the National Operations Council, and forced PM Rahman to resign, bringing Tun Razak to the PM position. In response to the Race Riot, UMNO "authorized widespread arrests, twenty four hour curfews, censorship of radio, television, and newspapers, and a ban on all political activities."<sup>27</sup> In 1971, PM Razak released the New Economic Policy in response to the underlying ethnic tension in the country. This was the first step toward creating a developmental state in Malaysia, as it allowed UMNO to consolidate its control of different branches of the state and start to develop SOEs. This allowed them to be less cautious when it came to advancing Malay economic interest over the Chinese economic elite.<sup>28</sup> Whereas before 1969, the government was

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<sup>25</sup> Gomez, Edmund, "Malaysia," in *Political Party Systems and Democratic Development in East and Southeast Asia*, ed. Wolfgang Sachsenroder and Ulrike E. Frings (Aldershot: Ashgate Publishing Company, 1998), 230-45.

<sup>26</sup> Alatas, Syed Farid, *Democracy and Authoritarianism in Indonesia and Malaysia: The Rise of the Post-Colonial State* (New York: St. Martin's Press, INC., 1997), 134.

<sup>27</sup> Bowie, Alasdair, *Crossing the Industrial Divide: State, Society, and the Politics of Economic Transformation in Malaysia* (New York: Columbia University Press, 1991), 82.

<sup>28</sup> Bowie, *Crossing the Industrial Divide*, 93.

primarily concerned with regulation and infrastructure, after the NEP the state took an increasing role in the economy thus cementing UMNO's political and economic influence, solidifying Malay-centric autonomy and capacity.

The creation of these states in the post-war period varied and this would create significant differences in autonomy and capacity of these nations. Because Malaysia struggled during this time period, UMNO developed less autonomy and capacity and had a difficult time stabilizing its hold power when compared to the KMT and its relatively smooth consolidation of power. The foundation of UMNO's persistent authoritarianism can be seen at this time and would later affect the party's expected utility calculation and make sticking with authoritarianism more appealing. The KMT takeover of Taiwan went smoothly and mostly unchallenged. This led to the KMT developing autonomy and capacity at an extremely early stage and thus had more time to develop the state and party apparatus that would generate victory and stability confidence.

### **Development Strategies: Nature of Businesses**

#### *The New Economic Policy*

The NEP, as proposed and passed by Razak and his government, had several goals in an effort to address ethnic tensions in Malaysia. These goals were to increase Bumiputera corporate equity ownership to 30% and to reduce poverty from 50% to 15% by 1990.<sup>29</sup> This was to be done by improving access to training, capital, and land for the poor by changing education and employment patterns by giving out scholarships and requiring quotas in upper education, by forcing companies to have 30% Bumiputera ownership, by establishing trust agencies to allow for Bumiputera to take out loans and get social security, and by creating publicly owned enterprises which would be a new engine of growth. These SOEs were focused on "modern-sector" activities like finance, commerce, and industry. The equity holdings of these companies

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<sup>29</sup> Gomez and Sundaram, "Malaysia," 245-9.

were either fully or partially held by the state.<sup>30</sup> Razak (and later Mahathir), thought that by reducing the inequality between the Chinese economic elite and the Bumiputera, ethnic tensions would decrease and national unity and stable economic growth would result.<sup>31</sup> UMNO was able to pass the NEP by claiming that it did not hurt the non-Bumiputera as redistribution would be occurring in a growing economy so no one would feel deprived. Only with a more equal society could true growth occur. Mahathir once said that “[the NEP’s] formation was made necessary by the economic needs of the nation as much as its politico-social needs. There can be no economic stability without political and social stability. Thus the NEP is also a formula for economic growth.”<sup>32</sup> The NEP signaled UMNO’s first foray into state-led development which would blossom throughout the ‘70s and ‘80s, although it was perceived to benefit the bumiputera primarily, as it was a Malay response to the ethnic tensions in Malaysia that benefited non-Chinese almost exclusively.<sup>33</sup>

The unequal distribution of wealth that in part prompted the NEP was a result of the import substitution industrialization strategy that Malaysia had been pursuing from the end of the Second World War to 1971, with the passing of NEP. ISI had been registering 6.4% growth on average by producing tin and rubber, but caused income inequality and intra-ethnic inequality to increase.<sup>34</sup> This inequality was a catalyst for the Race Riots discussed above. In response to these problems, the government extended public enterprise which led to growing concern among the politically excluded Chinese. Throughout the 1970s under the NEP, Chinese-Malaysian relations soured. The Chinese believed that the UMNO dominated government was undermining their interests and “saw this state intervention as infringing on their freedom to conduct business

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<sup>30</sup> Gomez and Sundaram, “Malaysia,” 248.

<sup>31</sup> Gomez and Sundaram, “Malaysia,” 248-50.

<sup>32</sup> Bowie, *Crossing the Industrial Divide*, 90.

<sup>33</sup> Bowie, *Crossing the Industrial Divide*, 91-2.

<sup>34</sup> Gomez and Sundaram, “Malaysia,” 238.

unimpeded by burdensome regulation, a freedom they believed guaranteed by the ethnic settlement underpinning communal relations.”<sup>35</sup> However, the Chinese resistance only served to rally more Bumiputera support to UMNO, who they viewed as a protector. The NEP was not the first economic policy designed to benefit the bumiputera, as small local initiatives had been developed throughout the 1960s, but it was the first that was resented by the minority groups. In addition, the NEP targeted new sectors of the economy. Whereas in the ‘60s state intervention was primarily in agriculture, the NEP was focused on the industrial and commercial sectors. The beginnings of state-led development were put in place by the NEP which created the first SOEs, providing employment, advice, training, and loans to the bumiputera.<sup>36</sup> Throughout the 1970s, UMNO moved toward a state-led industrial strategy which would be fully realized by 1980. This was the first step toward establishing autonomy and capacity in Malaysia and the first time the party started to get involved into economic policy.

### *Heavy Industry in Malaysia-1980s*

While during the 1970s UMNO focused on creating equality of opportunity for the bumiputera through the use of SOEs, by 1980 Malaysia was fully committed to an industrial growth strategy. In November of 1980, Malaysia’s Minister of Trade and Industry announced the Heavy Industries Policy, which was “designed to give state agencies the leading role in establishing operating a new stratum of large-scale, capital-intensive, import-substituting industries which would make use of indigenous resources to produce intermediate industrial goods and consumer durables for the domestic market.”<sup>37</sup> The most important industries included iron, steel, automobiles, cement, and internal combustion engines. UMNO planned to use SOEs funded with primarily Japanese foreign private capital. The Proton Saga is the best example of

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<sup>35</sup> Bowie, *Crossing the Industrial Divide*, 83.

<sup>36</sup> Bowie, *Crossing the Industrial Divide*, 91-95.

<sup>37</sup> Bowie, *Crossing the Industrial Divide*, 111.

what Malaysia was able to achieve during this time by focusing on industrial growth with capable state leadership. The Malay dominated government ignored and disregarded any possible contribution from the Chinese economic elite, demonstrating that UMNO was more concerned with raising the well-being of the bumiputera rather than the entire country, unlike Taiwan under the KMT. The evolution of Malaysia's developmental policies since independence reflect the state's growing awareness of the importance of stability and equality necessary for consistent economic growth and its increasing willingness to ignore the interests of the non-Malay businesses (see Table 1). This led Malaysia to pursue two goals in the 1980s that often were at odds with each other: (1) attempting to accelerate the rate of economic growth and (2) improving the well-being of the bumiputera. This second goal was more than economics, "it was also a recipe for political change, and among the principal political factors motivating the new initiative was the changing nature of the communal settlement in Malaysian society."<sup>38</sup> This demonstrates the foundation for Malaysia's struggle with persistent authoritarianism under UMNO and its disrespect for the large minority populations. UMNO become autonomous from all non-Malay groups in society: "the state was therefore effectively autonomous from those groups which in any other society might have been able to obstruct economic initiatives such as those of the heavy industries policy."<sup>39</sup> It took well into the '80s for UMNO to develop significant autonomy and capacity. This means the party has had less chance to become established and develop enough victory and stability confidence in order to make a democratic concession likely.

<b>Decade</b>	<b>Strategy</b>	<b>Motivation</b>
1960s	No state-intervention	Development should be private sector

<sup>38</sup> Bowie, *Crossing the Industrial Divide*, 113.

<sup>39</sup> Bowie, *Crossing the Industrial Divide*, 124.

Decade	Strategy	Motivation
1970s	How to produce (NEP) not what to produce	Ethnic tensions and realization of power of SOEs to reduce inequalities
1980s	Heavy industries policy	Increase pace of economic growth and improving the bumiputera's position-- compatible goals?

*State Business in Taiwan*

The Malaysian focus on SOEs in the name of the bumiputera differed from Taiwan's situation. The KMT focused on creating separation from the Taiwanese and used economic policy to help in this goal. In this sense, state capacity was extremely important and the KMT possessed a great deal of it. Several factors contributed to the KMT's capacity. First, of the two million mainlanders that made the trip to Taiwan, many of them were highly qualified bureaucrats that had worked in effective institutions in China. This capable bureaucracy started with a fresh slate in Taiwan because of the Japanese vacuum and quickly developed into an effective arm of the KMT. Many of the institutions the Japanese created were useful and the KMT and their skilled bureaucrats filled the seats of the revenue, banking, and SOEs institutions.<sup>40</sup> In addition to these established institutions, the KMT created a series of economic planning boards such as the Taiwan Production Board, the Economic Stabilization Board, and the Council on US Aid, among others. These programs created a series of bureaucratic regulations that were often only enforced when the regime felt threatened by the prospect of losing political control or economic/financial stability.

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<sup>40</sup> Fields, Karl J, *Enterprise and the State in Korea and Taiwan* (London: Cornell University Press, 1995), 82.

The KMT was, after dealing with rampant inflation during the Chinese Civil War, terrified of it. Inflation was tightly controlled for a variety of economic, political, and social reasons and SOEs, including the banking system, were used to combat it.<sup>41</sup> The KMT believed that inflation creates instability, stunts economic growth, and shakes investor confidence and used conservative monetary and fiscal policy and efficient reactions to external economic shocks to reduce the impact of inflation. Thus the KMT, in a conservative manner, followed a developmental path focusing on growth with stability and growth with equity in order to remain legitimate in the eyes of the Taiwanese by appearing capable and successful, with whom they had a tacit agreement dating back to the late 1940s with to provide the political foundations for successful economic growth. The KMT also had a division of power with the economic policymakers within the state structure.<sup>42</sup> Unlike in Malaysia with the constant tension between Chinese and Malay businesses, the KMT could tolerate and largely ignore the private Taiwanese business sector: “the KMT did not depend on the business community for political support, and business had little formal representation in the tightly organized ruling party. Technocrats were also generally insulated from business interests. . . By allowing the private sector’s share of total economic activity to expand, the KMT created a check on its own policies, which were broadly favorable to the private sector.”<sup>43</sup> Any large enterprises were controlled, owned, or watched closely by the KMT. These large state and party owned enterprises created autonomy from the native Taiwanese, who were left with small and medium businesses that had little influence, if any, on the political machine. The autonomy created by the specific policies chosen by the KMT also contributed to its significant capacity. This coupling led to, when the demand for democracy was high, a concession toward democracy from a place of authoritarian strength rather than

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<sup>41</sup> Fields, *Enterprise and the State*, 84.

<sup>42</sup> Haggard, *Political Economy of Democratic Transitions*, 277-80.

<sup>43</sup> Haggard, *Political Economy of Democratic Transitions*, 279.

repression and resistance. Autonomy and capacity generated enough victory and stability confidence to convince the KMT that the transition toward democracy would not hurt their hold on power in the future.

### *Corruption and Patronage*

Malaysia struggled with corruption and economic rents after its focus turned to SOEs starting in the late 1970s. Rather than keep a developmental focus like Taiwan, UMNO was quickly perceived to be a source of rents and political advancement for individuals and elites as the party acquired more assets; the second goal of state industry, improving the status of the bumiputera, overshadowed the first goal of economic growth and the party reflected this dominance. Throughout the 1970s and 1980s, politics became highly monetized.<sup>44</sup> Many Chinese and Indian businessmen became directly or indirectly linked to UMNO leaders in order to receive rents from the party. In other words, the party is buying the support of the elite in order to keep itself in power. The party also used patronage (via jobs, rents, or subsidies) to develop a grass-roots base in Malaysia.<sup>45</sup> This outflow of wealth from the party to patrons was paid for using deficit financing and oil exports (oil was discovered offshore in the mid-70s). UMNO was not as autonomous as the KMT was. While the KMT came to authoritarian strength in a power vacuum with few elites left, UMNO was dealing with entrenched interests and an undisciplined party. UMNO started to overstep its agreement with the minority groups by focusing only on the bumiputera and it used SOEs to buy political favors to maintain strength. The KMT suppressed the Taiwanese at first and turned to a policy of Taiwanization to solve the problem of the threat of non-elites. In other words, because the KMT was autonomous and capable, its SOEs were free

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<sup>44</sup> Gomez, Edmund, "Political Business in Malaysia: Party Factionalism, Corporate Development, and Economic Crisis," in *Political Business in East Asia*, ed. Edmund Gomez (London: Routledge, 2002), 98.

<sup>45</sup> Gomez and Sundaram, *Malaysia*, 236.

from societal pressures to benefit one group over the other while UMNO was challenged by the Chinese and other minority groups.

The SOE system was a form of patronage in Malaysia. From 1971 when NEP was started until 1983, public sector employment increased fourfold, from 140,000 to 522,000, with much of the benefit going to the bumiputera.<sup>46</sup> This growing state intervention in the economy led to access to state rents which UMNO used to develop its party base. This rent seeking soon spiraled out of control as UMNO fractured among those with access and those without and the party's favoritism of the bumiputera increased. As UMNO strength increased during the 1980s due to increasing SOEs, rents, and significant constitutional reform giving Mahathir an increasing amount of power, Chinese and Indian businessmen started to support the party in order to secure rents and personal benefits. Many of these men were well connected to Malay leaders, including PM Mahathir and Deputy PM Ibrahim.<sup>47</sup> These developments only served to decrease state capacity and autonomy, which again, hurt UMNO's expected utility of moving toward democracy. The party would rather repress and resist the limited forces demanding greater representation and reform away from the illiberal system in Malaysia.

#### *Struggling SOEs: Political Effects*

The SOEs were neither competitive nor profitable and were heavily dependent on government funds and preferential access to business opportunities.<sup>48</sup> These giant firms were propped up by the government and were immune from financial discipline and market forces. In 1984, SOEs directly owned by the Ministry of Finance lost RM 137.3 million and by the 1985

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<sup>46</sup> Gomez and Sundaram, *Malaysia*, 248.

<sup>47</sup> Gomez, *Political Business in Malaysia*, 84.

<sup>48</sup> Gomez and Sundaram, *Malaysia*, 249.

recession, there was an estimated RM 5.5 billion in business liabilities owned by the state.<sup>49</sup> This is compared to Taiwan's SOEs, which by this time were already looking to expand overseas.

During the mid '80s, the government could no longer absorb these high costs as the economy slipped into a recession and government revenues fell. Oil prices steadily fell from 1982 through 1986. The tin market, one of Malaysia's biggest exports, collapsed in 1985. The rest of Malaysia's major exports, rubber, cocoa, and palm oil, were declining in price as well. Tax revenues, both income- and export-, fell, while government expenditures continued to climb to 58% of GNP in 1982. The 1982 federal deficit rose to five times that of 1975, 19% of GNP, one of the highest globally at this time.<sup>50</sup> This caused a crisis in Malaysia. In 1985 the economy registers a -1% growth rate, negating Mahathir's comment "no one cares about human rights so long as you can register annual growth rates of 8.5%."<sup>51</sup> The economic crisis caused capital flight away from Malaysia, private investment to fall, and unemployment to skyrocket. Prime Minister Mahathir decided to compensate for this declining private sector investment with even more state owned enterprises, especially focusing on heavy industry.<sup>52</sup> Autonomy was decreased with this move as UMNO had to borrow money from foreign investors and look to the Chinese economic elite within Malaysia. State capacity was developing at this time. This move drew protest from all across Malaysia and even from Mahathir's Cabinet. Businesses, policy makers, and bureaucrats were all worried about the huge capital costs, long gestation period, lack of technological experience, and the expected reliance on government protection and subsidies. The Chinese economic elite were especially concerned with this decision because Mahathir seemed reluctant to involve the Chinese and established, with the help of mainly Japanese businesses, the

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<sup>49</sup> Bowie, *Crossing the Industrial Divide*, 137.

<sup>50</sup> Bowie, *Crossing the Industrial Divide*, 135.

<sup>51</sup> Gomez and Sundaram, *Malaysia*, 253.

<sup>52</sup> Gomez and Sundaram, *Malaysia*, 248-53.

Heavy Industries Corporation of Malaysia (HICOM) to develop a wide range of industries such as steel, cement, and automotive.<sup>53</sup> HICOM received as much funding as did all other social programs combined, including welfare, housing, health, and education, demonstrating just how important development was to UMNO at this time.<sup>54</sup> Mahathir's solution to the recession caused its own share of problems and by 1987, the country was on the brink of financial disaster. Leaders recognized this and government policy was again adjusted to a neo-liberal model based on the reforms occurring in the USA and UK under Reagan and Thatcher.

The regime liberalized the economy by privatizing some of the SOEs, increasing support for the private sector, created investment incentives, and relaxed some NEP requirements. In a speech, PM Mahathir blamed Malay civil servants for running the SOEs into the ground, signaling that the regime was reconsidering its commitment to the NEP's requirement for Malays in high positions of leadership.<sup>55</sup> This led to UMNO to hand over leadership of its flagship enterprises to private businessmen, both foreign and local. Within 24 hours of Mahathir's speech, the Deputy Chairman of Proton resigned and was replaced by Japanese executives from Mitsubishi Motors Corporation. Perhaps most significantly, Malaysian Chinese entrepreneur Heng Keah Yong was named manager of HICOM's Kedah Cement, one of the first times UMNO was willing to cooperate with the Chinese in Malaysia. Desperate times forced UMNO to turn to those it had previously shunned in an effort to survive. However, this focus on privatization was not a total shift of motivation, as UMNO maintained majority shares in most of the companies it opened to private investors. "Privatization thus far has simply entailed the piecemeal and ad hoc selling of portions of the public sector to stem losses and reduce the public

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<sup>53</sup> Gomez and Sundaram, *Malaysia*, 249.

<sup>54</sup> Bowie, *Crossing the Industrial Divide*, 111.

<sup>55</sup> Bowie, *Crossing the Industrial Divide*, 137.

debt,” rather than a fundamental belief in restructuring the entire system.<sup>56</sup> Politically, this restructuring decreased autonomy, as an increasing number of foreigners and Chinese-Malays were involved with the state.

During this time the value of the Yen was rapidly increasing against the US dollar, driving foreign direct investment into Malaysia as many of the businesses were heavily involved with the Japanese. From 1986-89, FDI increased by four times from RM 1.262 billion to 4.518 billion and by 1991 FDI inflows were at RM 11.2 billion. The lowering of the ethnic requirements of the NEP suggests a change of motivation within UMNO. Inter-ethnic economic cooperation gave Mahathir electoral support from non-Bumiputera as with the decline of the enforcement of NEP there has been a greater tolerance of non-Malay culture. However, there was a growing worry that if Malaysia became a democracy, pro-bumiputera voices would be ignored because of the lack of wealth and influence the group had and so the pro-bumiputera UMNO was even more hesitant to transition toward democracy, as their largest support group would severely harm their chances of winning a democratic election against Chinese influence and money as well as foreign meddling. This decreased victory confidence in UMNO and so the party doubled down its efforts to resist reforms, which would set it on a path moving away from democracy.

### **Types of State**

The KMT was a Leninist one party system with a “leaderist” system, which helps with collective action problems found in systems with multiple positions of power and also sends a clear message from the top, reducing ambiguity of intent. Leaderist systems allow the center to have direct control over appointments, policy, and systems of monitoring and coercion. The defeat of the Nationalists in the Chinese Civil War allowed Chiang Kai-shek to “increase his

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<sup>56</sup> Bowie, *Crossing the Industrial Divide*, 140.

personal power, purge rival faction leaders, and streamline party organization.”<sup>57</sup> This increased the party state’s power to remain autonomous and still maintain significant capacity, with most of the decision making power centered around Chiang and less around the bureaucracy. This is not to say that the bureaucracy did not play an important role, as economic decision making was controlled by a few pilot agencies that reported to Chiang, such as the Central Bank and the Council on Economic Planning and Development. The KMT controlled the state organs for social control and the agencies that made economic policy reported directly to the center.<sup>58</sup> This control enabled the KMT to create victory and stability confidence which assuaged its worry about losing power if democratic reforms were implemented.

Unlike the KMT, UMNO was not in direct control of Malaysia’s bureaucracy. In Taiwan, party members often held positions in the bureaucracy. UMNO was not as lucky because much of the bureaucracy was independent. An “administrative state,” the precursor to the developmental state, peaked in the early 1970s which was checked by UMNO’s power and wealth. The struggle between the party and bureaucracy continued until Mahathir’s appointment as Prime Minister in 1981, as he quickly established think tanks controlled by his position and party that were designed to trump the bureaucracy and other policy makers outside of UMNO control.<sup>59</sup> The relatively late taming of the bureaucracy meant that UMNO’s roots were not as deep and thus had less victory and stability confidence as a result of less autonomy and capacity.

In addition, many bumiputera view UMNO as a protector of their interests and many are employed by UMNO sponsored or owned businesses. The rest of the bumiputera, however, lived in rural areas and supported UMNO early on to reduce inter-ethnic wealth and political differences. As UMNO shifted to industrial development strategies with a focus on raising all

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<sup>57</sup> Haggard and Kaufman, *The Political Economy of Democratic Transition*, 271.

<sup>58</sup> Haggard and Kaufman, *The Political Economy of Democratic Transition*, 274.

<sup>59</sup> Haggard and Kaufman, *The Political Economy of Democratic Transition*, 252.

ships, these supporters become increasingly unhappy and during the late 1980s with UMNO dropping many of the NEP requirements, many of these people dropped their support altogether. This suggests that Malaysia may be simply lagging behind Taiwan by a few decades. This may be true of economic development (albeit development has met more challenges in Malaysia), but in terms of political development, UMNO does not have a tight enough grip on power to follow the KMT's path of conceding to thrive and so expected utility of authoritarianism is high and Malaysia is stuck with persistent authoritarianism.

### **UMNO factionalism in the 1990s**

Due to the economic hardships and recovery strategies implemented during the 1980s, UMNO in the 1990s became increasingly factionalized and intra-ethnic tensions among bumiputera increased. High level members of UMNO had strong business connections that made them wealthy and able to seize a political position. People such as Daim Zainuddin, who was finance Minister from 1984-1991, benefited from partnering with UMNO. Daim was an UMNO member, a government employee, and owner of several family companies.<sup>60</sup> Rents were funneled into the private economy by these individuals with a special relationship with the state, which was a main reason why UMNO did not try to curb them. These rents were reinvested in capital or stocks and contributed to Malaysia's growth. Financial institutions controlled by the state were used to funnel funds to a privileged few, who often served in office later in their careers.

From 1990 on, business ties became personalized rather than party based because the economic struggles of the 1980s caused the number of party rents to decrease and there was concern over party ownership of assets. These were dumped to individuals starting in 1992 in order to remove the party from any economic negatives generated by them. In Taiwan, POEs

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<sup>60</sup> Gomez, *Political Business in Malaysia*, 92.

were dumped in the early 2000s under similar circumstances, but to avoid political negatives rather than economic, demonstrating the KMT's capacity for economic success and decreasing autonomy as the democratic transition succeeded. UMNO did not discriminate over the recipients of these assets meaning that some Chinese gained control of previously UMNO controlled businesses furthering the Bumiputera's unhappiness with UMNO and each other.<sup>61</sup> These practices continued until the 1997 Financial Crisis when the controllers of businesses connected to the state were hit hard. UMNO announced another wave of Chinese takeovers after the crash in an effort to save the companies, many of whom were already well connected to the state. Whereas in the past UMNO was willing to prop up failing or uncompetitive bumiputera-controlled firms while ignoring successful Chinese ones, such as the Malaysian Car Project-Proton, after the Crisis this practice was largely eliminated. In addition, in 1998 Mahathir implemented new capital controls in an attempt to prevent more financial trouble. These included making the Ringgit illegal tender outside of Malaysia, fixing the Ringgit to the US dollar at a ratio of RM3.8 to \$1, making it necessary to get approval to transfer more than RM 10,000 abroad, lowering interest rates, and lowering reserve requirements from 6% to 4%.<sup>62</sup> The above demonstrates how unsuccessful the developmental state was in Malaysia when compared to the Taiwan case. Whereas the KMT had the capacity and autonomy necessary to run SOEs efficiently and independently, UMNO used SOEs to buy political partnerships and allies and to develop its party base, a result of UMNO's lacking autonomy and limited capacity. The use of economic institutions for political reasons also diminished UMNO's victory and stability confidence, which again led to the expected utility of a democratic transition to be less of sticking with authoritarianism.

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<sup>61</sup> Gomez, *Political Business in Malaysia*, 97.

<sup>62</sup> Gomez, *Political Business in Malaysia*, 103-106.

## Democratic Transition

### *Taiwan: Towards Democracy*

The KMT had autonomy and capacity from its use of SOEs to ensure it a position of strength while UMNO had autonomy from segments of society but was increasingly tied down to its commitment to the bumiputera. At first glance, Taiwan seems to be a textbook example of Modernization Theory, with three decades of economic growth that led to significant social changes and the emergence of civil society and demand for democracy. This bottom-up story has its merits but does not tell the entire story. The success of Taiwan's democratization depended on the authoritarian party allowing liberal reforms, only possible because of the KMT's substantial autonomy and capacity: "In Taiwan, successful economic performance and centralized control of the state allowed the KMT to maintain its hold on political power while undertaking a gradual electoral opening."<sup>63</sup> The two most important of these were "Taiwanization" of the KMT and allowing elections. In other words, democracy was a choice made by the party in an effort to prolong its control of the political sphere in Taiwan. The KMT believed it would do better for longer in a democracy rather than try to resist the appeal of liberalism. The party's expected utility was greater with a democratic transition because of the victory and stability confidence generated by high autonomy and capacity.

The KMT's initial response to these modernization developments was the Taiwanization of the party and bureaucracy, lowering some of barriers between the mainlanders and Taiwanese. Chiang Kai-shek's son, Chiang Ching-kuo, inherited the position of President in 1972 and continued the Taiwanization policies his father had started at the local level, extending them into the upper divisions of the KMT. This co-optation of the Taiwanese was designed to "create a

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<sup>63</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 268.

cadre of younger leaders with a stake in the party's image and performance."<sup>64</sup> The KMT aggressively recruited college students by offering lucrative positions within the party or state owned enterprises. Mainlanders were in dominant positions in the highest ranks of the party until the early 1980s. In 1985, Chiang proclaimed that his succession would follow constitutional rules, eliminating any prospect for a dynasty in Taiwan. This would make the Taiwanese vice-president, Lee Teng-hui, the president, which occurred in 1988.<sup>65</sup> In 1993, Lee appointed the first Taiwanese premier. Only the military remained decidedly mainlander in the early 1990s, the last stronghold of the KMT in the state apparatus.<sup>66</sup>

Along with Taiwanization, the KMT slowly allowed elections to increase its legitimacy. The KMT allowed provincial, county, city, and township elections as early as 1950. During the struggle to expand the voting, both the regime and opposition groups fractured into hard liners and moderates. The opposition moderates formed the Association of Public Policy Studies, despite the KMT outlawing such organizations, which would later turn into the Democratic Progressive Party (DPP) after the "government chose not suppress the new illegal entity."<sup>67</sup> The KMT prevailed in 1985 elections despite scandals and the same economic downturn affecting Malaysia at this time. Later in 1986, the KMT formally allowed political opposition through a series of constitutional reforms and the DPP emerged as the first legal challenger to the KMT's rule. A few short months later, the KMT lifted martial law. What followed was a party managed gradual opening of the political system, including the renewal of all three legislature branches, the complete freedom of the press, and the decision to have the president directly elected. During the process of opening, KMT leaders relied on institutional benefits and its massive ability to

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<sup>64</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 292.

<sup>65</sup> Gold, *State Capacity in an Asian Democracy*, 93-99.

<sup>66</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 293.

<sup>67</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 294.

rally support, via its successful economic policies and popular foreign policy: “Once the KMT committed itself to some form of political change, its overwhelming dominance and the absence of significant mass protest permitted the party to make piecemeal concessions.”<sup>68</sup>

In order to pursue a viable democratic transition, the ruling party needs both victory and stability confidence. It is clear that the KMT possessed both of these and as a result saw hugely successful democratic returns: “consistently retaining a national legislative majority and only losing the presidency by the slimmest of margins in 2000 and 2004.”<sup>69</sup> High victory confidence was a result of widespread popular support and a massive pool of resources from the SOEs and POEs, as the KMT managed to extract a sizable amount of the wealth generated by the developmental state.<sup>70</sup> High stability confidence was a result of “Taiwan’s developmental state experience and the role the KMT played in steering Taiwan’s modernization.”<sup>71</sup> By conceding from a position of authoritarian strength, the KMT was able to dictate the process of democratic reform in a way that benefited it by increasing the amount of time the KMT has spent in power. There have been claims of corruption and collusion brought against the KMT, but as of yet, no charges have been upheld. There are many challenges that Taiwan and the KMT face when it comes to a newly democratized country, but most signs today point to a consolidated democracy.<sup>72</sup> The peaceful transition of power from KMT to DPP in the 2000 presidential election demonstrated how far the country has come.<sup>73</sup>

### *Malaysia: Persistent Illiberalism*

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<sup>68</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 295.

<sup>69</sup> Slater and Wong, *The Strength to Concede*, 722.

<sup>70</sup> Gold, *State Capacity in an Asian Democracy*, 91.

<sup>71</sup> Slater and Wong, *Strength to Concede*, 724.

<sup>72</sup> Paolino, Philip and Meernik, James, “Conclusion,” in *Democratization in Taiwan: Challenges in Transformation*, ed. Philip Paolino and James Meernik (Vermont: Ashgate Publishing Company, 2008), 183.

<sup>73</sup> Wang, T.Y., “Democratic Commitment in Taiwan: An Analysis of Survey Data,” in *Democratization in Taiwan: Challenges in Transformation*, ed. Philip Paolino and James Meernik (Vermont: Ashgate Publishing Company, 2008), 87.

Malaysia's democratic path from a position of strength has not materialized. UMNO has held power in an illiberal system by a variety of means, including gerrymandering, control of the press, the use political favors for electoral support, patronage, requiring all candidates to be vetted by the center, limits on campaigning, and strict limits on financing campaigns. These barriers to competitive elections have allowed UMNO to remain in power handily from the first elections in the 1950s through the present day. In 1955, UMNO won 51 of the 52 federal legislature seats and in 1995 won 162 of the 192 seats. This has led experts to claim that "despite the existence of a multiparty system in Malaysia, and although the ruling coalition comprises of more than a dozen political parties, most analysts view Malaysia's political system as being dominated by one party: UMNO."<sup>74</sup> While democratic institutions exist on paper in Malaysia UMNO has constitutionally made itself the dominant power center without fear of democratic accountability. Elections are not fair, the press is not free, and minorities are excluded. The government creates rules to keep itself in power every time its hegemony is threatened. For instance, in 1987 Mahathir almost lost the position of Prime Minister but with the legalization of coercion such as the Internal Security Act, which allows the government to detain individuals without charging them, Mahathir was able to arrest political opponents and keep himself in power.<sup>75</sup>

UMNO has not had the lengthy drive for development as has the KMT, with its developmental state forming in the mid-1970s whereas Taiwan has focused on development since its inception as a country. UMNO has had difficulties with autonomy as it is focused on a majority segment of the population while separating itself from the rest. It has had difficulties with capacity as the party fractured throughout the 1990s and lost its direction. Economic

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<sup>74</sup> Gomez, *Political Party Systems in Asia*, 260-271.

<sup>75</sup> Gomez, *Political Party Systems in Asia*, 273.

performance has, at times, failed to keep up with expectations, and “weak performance increases the risks associated with political opening.”<sup>76</sup> The major reason why UMNO strength has not been challenged is because the party enjoys a high degree of popular support from the bumiputera. Its recent economic performance, reduction of poverty, and lowering inter-ethnic wealth inequality have all legitimized the regime. However, there is a possibility that UMNO hegemony will be destroyed in the future. Growing intra-ethnic divides and factionalism within UMNO are early signs of fragility. The bumiputera are “assessing UMNO’s performance not only in terms of economic growth, but also by its capacity to prevent or deal with social ills and maintain a more decent level of probity and transparency.”<sup>77</sup> New bumiputera economic elites have emerged through extensive state patronage and through SOEs. These signs are weak currently, however, and UMNO does not see the value of conceding political liberalization: “democracy is possible if UMNO becomes open and internally democratic, which may force the government to be more responsive and accountable. . . however it is unlikely that much reform will occur within the Malaysian political system.”<sup>78</sup> If the regime does not see the value of concession because of low victory and stability confidence and a high probability that it can maintain the current system there is no incentive to liberalize and thus democracy will not come to Malaysia. The party believes it is on a downward trajectory and while democratization may have been a solution to these problems at one point, the moment has passed. If and when UMNO collapses, it will most likely be in a violent revolution or coup attempt that will bring hardliners to power, a total loss for pro-democratic forces in Malaysia.

### **Towards Democracy?**

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<sup>76</sup> Haggard and Kaufman, *The Political Economy of Democratic Transitions*, 291.

<sup>77</sup> Gomez, *Political Party Systems in Asia*, 277.

<sup>78</sup> Gomez, *Political Party Systems in Asia*, 279.

Malaysia and Taiwan make for an interesting comparison. These cases demonstrate how the formation of comparable parties and states can nonetheless create significant differences between countries that had key similarities, such as ethnic tension, a developmental motivation, and significant state-business connections. Whereas Malaysia focused on the plight of the bumiputera while fostering development which hurt the economic elite Chinese, the KMT focused on gaining legitimacy for an imposed one party state through economic growth that benefited greatly the native Taiwanese as well as the mainlanders and created autonomy and capacity which in turn developed victory and stability confidence. These different focuses and motivations have led these countries to be in different places in terms of consolidated democracy today. Taiwan's democracy is by all measures healthy and competitive with the opposition winning the elections of 2000 and 2004, although the KMT currently controls the democratic government, including the presidency and a majority in the Yuan. UMNO has held on to illiberal control of the state and appears ready to do so for the indefinite future. Both of these parties made a rational choice in an effort to prolong their grasp of political power.

Why Malaysia and Taiwan differed is a fascinating question. This paper argues that the different state-business relationships have been a reason why Taiwan has democracy today while Malaysia does not. Malaysia, led by UMNO, has focused on the plight of the bumiputera in its developmental strategy. UMNO is perceived to be on the side of the Malays in the struggle against vested interests and elites, often ignoring Chinese and Indian minorities, and using SOEs to create separation from the minority groups while benefiting the bumiputera. This is compared to the KMT, who have lived in relative harmony with the native Taiwanese based on a tacit division of power agreement and the Taiwanization of the party and its SOEs.

The policies followed by these countries in order to achieve these goals has led to different outcomes for democracy. UMNO did not develop significant autonomy from elites in the party, elites outside the party, Chinese economic elites, or from the bumiputera. Capacity was developed slowly over time but with the lack of autonomy the Malaysian state has struggled with persistent illiberalism. The KMT developed significant autonomy and capacity during its tenure at the helm of Taiwan. This autonomy and capacity led to greater victory and stability confidence during the period of democratic concession. UMNO and the KMT both chose the path that would allow them to maintain political power for the longest amount of time. The model developed in this paper and demonstrated by the case studies of Taiwan and Malaysia proves that a democratic transition can occur from a position of strength and that liberalism does not have to originate from the masses. In other words, top down democracy can be implemented successfully. This conclusion raises important questions about the future of democratic transitions. There is significant literature on the future of China and whether it will remain authoritarian or transition to democracy. The conclusion of this paper suggests that given China's significant capacity and autonomy, a gradual liberal reformation could occur like seen in Taiwan. However, China is a vast country with minority groups such as the Tibetans and the Uyghurs, suggesting that state favoritism could play a role in the lack of a democratic transition as is the case in Malaysia. China is still a poor country in terms of per capita GDP but as this changes and the middle class continues to grow, democracy may become more desirable. Whether the CCP will give up its hold on political power is another question, however. Taiwan can even be seen as a petri-dish research project for China. So far, it appears that Taiwan has done well with democracy but the Malaysian case does suggest that even if democratic institutions exist there is no guarantee that a transition has occurred.

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