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Comment: Social foundations of an effective market
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THE New Economic Model (NEM) of the Malaysian government has been derided by critics as lacking in substance and being light on detail. There is undoubtedly a need for more details and while some may question the motives of certain criticism, it is true that the government is in the hot seat to deliver reform and do so effectively.

One phrase that has come under considerable censure in the current political climate is "marketfriendly affirmative action".

The phrase is found in NEM and detractors have lambasted it as lacking depth and an example of the spin that governments practise when they have no idea of how to proceed.

Some see the concept as an oxymoron, as contradictory. How can there be market-friendly affirmative action? Aren't these concepts in opposition? Indeed, it seems that critics may have a point.

You could argue that for markets to run effectively they must be free of affirmative action! Such a notion would be in keeping with neoliberal economic rationalist positions on economics that are currently popular. After all, what possible benefit can affirmative action provide in the proper function of markets?

Censurers of the phrase are too quick in their critique. Their assumption that the effective functioning of markets is inhibited by policies of affirmative action is overly simplistic and, in the case of Malaysia, politically and socially dangerous.

Why is this so? One reason is because of the history of horizontal inequality in Malaysia. Horizontal inequality is essentially disparity between different social or cultural groups in a society.

Malaysian economic development has in the past -- under the New Economic Policy (NEP) -- sought to address the fundamental problem of horizontal inequality in Malaysia.

While critics have attributed the problems of rent-seeking, allocative inefficiency and the failure to alleviate the plight of the poor to NPE, others have pointed out that under the NEP's regime of engaging horizontal inequality, Malaysia prospered and advanced economically at a considerable rate.

Frances Stewart writing for the Centre for Research on Inequality, Human Security and Ethnicity, at Oxford University argues that: "Pursuing horizontal equity may sometimes conflict with efficiency or even with vertical equity. These are trade-offs that may have to be accepted. In the
long-term, the benefits for both growth and poverty from the avoidance of conflict are likely to be greater than any losses from short-term output reduction that the policy might involve.

"Mostly, there would not be a significant trade-off with poverty reduction as balanced policies are also likely to be poverty-reducing, while extending education to the deprived would be likely to contribute to economic growth. Malaysia, for example, was remarkably successful in achieving economic growth and poverty reduction as well as horizontal equity through the NEP which effectively narrowed the gap in incomes, employment and assets among the major groups." (Oxford Development Studies, Vol. 28, No. 3, 2000, page 258)

The key points in Stewart's analysis are that alleviation of horizontal inequality through affirmative action can have long-term positive impacts on markets through the provision of social stability.

In the Malaysian case, economic growth was high during periods of governmental engagement with horizontal inequality. Such arguments should not be taken lightly as they point to the fact that affirmative action policies can coexist with markets. The success of Malaysian economic development repudiated the idea that they are utterly and always at odds.

It seems that the issue of effectively developing policies of market-friendly affirmative action are problems of pragmatic and balanced policy formulation. Markets and affirmative action are not in conflict with each other and critics who falsely posit them as incompatible offer a reductive and overly simplistic picture of the economic and social policy terrain in front of the Malaysian government.

Affirmative action in societies where horizontal inequality is prevalent may be an essential precondition for the successful functioning of markets.

Paradoxically, it appears that the amelioration of social division and the possibility of social conflict through addressing horizontal inequality may be the essential social basis of the effective functioning of a dynamic market economy.

Such an analysis may seem ironic to neoliberals. However, to economists who take the social and cultural basis of economic development seriously such conclusions are less controversial. Looking beyond simplistic neoliberalism to the social and cultural foundations of stability in markets provides a way to avoid the overly simplified binaries that characterise much of what passes for neoliberal market-oriented advocacy.

The aims of NEM to develop a policy framework committed to market-friendly affirmative action is a legitimate and necessary policy direction for Malaysia's economic development.

There is no doubt that important intellectual work needs to be done to give effect to the policy direction. There is, for example, a need to ensure that affirmative action actually aids those it is designed to help and does not simply lead to rent-seeking behaviour.

However, in societies where horizontal inequality is still a salient characteristic, addressing this
issue and finding the right balance between the market and affirmative action is unavoidable.

Failing to understand this essential point is not simply a failure to grasp the social and cultural prerequisites of the effective function of markets in Malaysia.

Failure to understand the necessity of addressing horizontal inequality in the context of economic development runs the risk of jeopardising the real and important economic goals that all Malaysians seek.


Recognising that advancing growth and developing Malaysia's economic prosperity requires policy makers to effectively address horizontal inequality in Malaysian society is critical for properly balanced public policy. Talk of merit and free markets must always be balanced against the realities of horizontal inequality.

Economic progress needs to be informed by social justice and social stability. These things are the prerequisites for sustainable and broadly based growth. We forget this at our peril.

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