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THE ROLE OF INSTITUTIONS AND INDUSTRIAL POLICY: THE CONSTRAINTS OF INDUSTRIAL DEVELOPMENT IN SABAH

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ABSTRACT

This article examines the role played by institutions in Sabah's industrial development. Industrialisation is widely acknowledged as the key to pursuing structural change and attaining an economy-wide accumulation of capabilities because it involves capital-intensive activities that require investments in physical capital, human capital and technological advancement, all of which lead to the modernisation of the state's economy. Thus, the configuration of a nation's industrial policy is central to expanding and diversifying downstream activities. Nonetheless, effective industrial policy implementation depends on the role played by institutions that take elite policy actors into account when configuring economic interests and priorities. In the case of Sabah, although the state is rich in resources, the implementation of its industrial policy seems to have been impeded by certain factors. Political influence is embedded in existing institutions, and there are uneven power relations, patronage and rent-seeking behaviours. These have collectively constrained industrial policy arrangements and implementation.

Keywords: political economy, institutions, industrial development, industrial policy, Sabah

INTRODUCTION

One of the key issues in the political economy of development is the question of what causes the differences in economic growth and economic development between different states. Economic growth and development are associated with the human capital, physical capital, savings and investment, resources and technology that workers and firms have access to. However, the capacity to configure and coordinate these factors for growth and development lies in the hands of institutions (Acemoglu and Robinson 2008). Institutions have been, and continue to be, the central focus when differences in developmental outcomes are examined (Acemoglu and Robinson 2008; Chang 2011; Chang and Andreoni 2019; Steinmo 2008), whether these are studied across countries or even among individual states in a federation like Malaysia (Suffian 2019).

Institutions have an effect on economic development, which, in general, is a process of structural change. Industrialisation is the key to structural change because it involves the process of transforming production, accumulating technological capabilities, creating capital-intensive activities and modernising the economy (Best 2020; Rasiah 2011; Chang 1999; Jomo and Wee 2014). Hence, a nation's industrial policy plays a crucial role in facilitating structural change. An industrial policy is a government's strategy of stimulating specific economic activities in productive sectors to achieve structural change. The configuration of such policies largely depends on the role of institutions, which are influenced by historical specificity, political demands and norms.

This paper examines Sabah's industrial development and the institutional constraints of implementing a coherent industrial policy. Sabah, one of the thirteen states in the federation of Malaysia, is a resource-rich state. The primary sector comprising agriculture, plantation, forestry and petroleum is one of the main contributors to the economy. Given its resource abundance, Sabah contributes significantly to the country's gross domestic product (GDP), and Sabah is ranked the fifth highest contributor to the Malaysian GDP, however attempts to pursue structural change through industrialisation appear to be limited. The state's institutions appear to be encumbered by political and private interests, and this has affected the state's ability to implement industrial policy, causing the state to fall behind in many economic development aspects despite being rich in resources.

The rest of this paper is structured as follows: the next section presents the theoretical framework that describes the role of institutions and the industrial policy; the subsequent section discusses Sabah's industrial development; the section after that provides an analysis of institutional constraints for industrial development in Sabah; and the final section concludes the arguments of this paper. The analysis presented in this study was done using the qualitative method. Primary data was collected through 26 elite interviews with key policymakers, namely politicians, heads of public sectors, corporates, business associations and think tank groups. Data was also collected using a wide range of secondary data and government reports from published and unpublished materials. This research uses thematic analysis to analyse data collected which processes involves identifying common themes, analysing, and interpreting the meaning and responses of the interviewees.

THE ROLE OF INSTITUTIONS AND THE INDUSTRIAL POLICY

Institutions drive economic growth and development but are also the source of economic decline (Acemoglu and Robinson 2008; Whitely 2003; North 1990; Scott 2008; Rodrik 2000; Chang and Andreoni 2019; Kar et al. 2019; Suffian 2021). It is known that different countries have different institutional setting, even among individual states in a federation like Malaysia. The institutions for every state can be differed in many ways due to historical specificity, power relations, political economy demands and norms. Given the important role played by institutions when analysing economic growth and development, this study will examine the political economy of industrial policy in Sabah by utilising institutional theory to understand the progress and constraints of Sabah's industrial development.

Institutions are widely known as 'rules of the game' in a society (North 1990). Institutions shape, facilitate, constrain and guide the interaction between economic actors to determine a developmental outcome or decline (North 1991). North (1990) coined the term 'humanly devised constraint' and argued that devised constraints determine how things can or cannot be done in certain institutions.

Central to institutional analyses is the fact that institutions are not homogenous; each country's institutions differ significantly (Whitely 2003; Witt and Redding 2013; Rodrik et al. 2004). Institutions are nationally bound because institutions are constructed through specific formal (e.g., law, constitutions and policy) and informal rules (e.g., norms, values and conventions). Both formal and informal institutions give idiosyncratic phenomenon as to how institutions are formed (Rodrik 2000) because institutional set-ups have their root in historical specificity, political and economic demand, power relations and culture. Therefore, institutions affect the interactions between economic actors in areas of collective decision-making and the configuration of economic interests in economic policies.

The heterogeneous nature of institutions means that the interaction among elite political actors is structured differently in every context. This is linked to certain legacies, which are products of historical specificity. Historical episodes can have a 'distributional effect of power', which causes asymmetrical power plays between groups in the society (Thelen 1999). The uneven balance of power between political actors and other groups will be institutionalised and become part of embedded conventions. Actors will adapt and reinforce the uneven power relations as a logic of systems in institutions. This structures the interaction between political actors and other groups and leads to an unneutral coordinating mechanism in institutions. The distribution of power in political institutions affects policy outcomes (March and Olsen 1984). For instance, in the centralised federation setting in Malaysia, the political actors in the central government are given more authority to decide on economic development while state government has less autonomy. Even though states in the federation are allowed to express policy demands in the policy decision-making process under the National Development Council, uneven power relations can impose institutional constraints and circumscribe the advancement of the state governments' interests (Hutchinson 2014).

There is a broad consensus among scholars that institutions can affect economic development. In general, economic development is a process that is linked to industrial development along with an economy-wide accumulation of capabilities and structural change (Cimoli et al. 2009; Andreoni and Chang 2017). Industrialisation is the key to structural change because it involves the process of transforming production, accumulating technological capabilities, creating capital-intensive activities and modernising the economy (Rasiah 1996; Chang 1999; Chang and Evans 2005; Jomo 1993). Industrial development has wide sectoral inter-linkages that have the capacity to pull the rest of the economy (primary, secondary and tertiary sectors) (Kaldor 1967; Myrdal 1957). However, the industrialisation process does not occur spontaneously through market forces (Amsden 2001; Weiss 1995). It requires strategic intervention—such as subsidies, infrastructure development, mitigation of trade-offs and a reallocation of resources—to spur structural change. In this sense, an industrial policy is crucial in attempts to industrialise the state.

A nation's industrial policy refers to the government's strategy of stimulating specific economic activities in productive sectors to achieve structural change (Chang 1994; Rodrik et al. 2004; Whitfield & Buur 2014). Related policies target specific sectors that qualify for incentives and other policy arrangements to prioritise the sector's interests. This includes adjustments to the macroeconomic policy, allocation of resources, and the configuration of new economic rules (that govern land, labour and capital) and learning rents (Whitefield & Buur 2014). The policy is devised to form a comparative advantage for certain sectors so that they can be competitive in the market. Modernising an economy requires the state to engage in industrial activities, and the industrial policy is the key to guide, facilitate and shape industries from low value-added to high value-added activities (i.e., research and development, and capital-intensive activities). The key to moving up the value chain is through the development of the manufacturing sector. It means that the economy must invest in downstream industries, which are manufacturing-based. Industrial development with an expansive manufacturing sector can 'pull the rest of the economy' (Kaldor 1967). This is because industrial development can increase productivity, diversify an economy, improve employment, and increase income and value-added activities.

Additionally, as the export-oriented industry starts to grow, it will improve the state's balance of trade.

The primary actors in industrial policymaking institutions are political elites, bureaucrats, selected enterprises, and business organisations (Hollingworth 2000; Whitely 2003). Deliberations between these actors are crucial in devising strategies for industrialising the state. The process of deliberation is usually done to decide which sectional interest should be prioritised for industrial development and thus, receive preferential access to resources. However, the deliberation process is subject to the distribution of power structured by the institutions (Leftwich 2010). The balance of power between political institutions and society can impact the configuration of economic preferences in policymaking institutions. In the context of uneven power relations, where non-state actors are weak (e.g., peak organisations and landlords), political institutions will have more power to decide how to use the state's resources. Since industrial policy implementation is a political process that involves the transfer of the state's resources, political elites usually have more bargaining power to define preferences for development.

An industrial policy also features the joint efforts between the state and 'selected' private enterprises. These enterprises are backed by state resources, which serve as a 'big push' so that they can grow in the marketplace (Athukorala 2014). In the absence of or having a weak industry, access to resources relies on the political elites' economic preferences. The patron–client network will facilitate interactions between political elites and 'selected' private enterprises. Enterprises that have close connections with political elites will have the advantage to access state resources. Conventionally, an industrial policy should aid private enterprises based on their merits (Jomo 2007; Amsden 2001) to enable them to strengthen their domestic technology and learning capabilities. The result, after relying on state resources, is to be competitive in the market. If they fail to do so, the state rents will have to be replaced with other productive producers (Jomo et al. 1997).

However, when existing institutions favour the patron–client network, it will easily be susceptible to collusion (Suffian 2021). Once collusion occurs, 'selected' local enterprises and political elites will tend to seek mutual benefits by accessing state resources (McNamara 2012). The elites provide access to rents while the enterprises are likely to provide political-based support and funding (Tan 2009). Replacing unproductive producers is difficult as the patronage system has been embedded in the institutional setting. The ideal practice in an industrial policy is to allow private enterprises access to resources. Preferential access to resources helps selected private enterprises grow competitively. If the local enterprises fail to perform—especially in areas of manufacturing, export and technological upskilling—then, the government needs to replace them with other more productive producers (Jomo 1993). However, patronage embedment in institutions can interfere in the process of replacing unproductive producers. This leads to institutional constraints in coordinating and implementing a coherent industrial policy.

Patronage embedded in institutions can also breed rent-seeking behaviours as players scramble to secure economic rents. Those who obtain economic rents (e.g., subsidies, licenses and quotas) will have excess profits. The problem with rent-seeking behaviours is that the rent created by elite political actors for selected enterprises is based on political considerations instead of economic rationale. This leads to politically captured state resources being used to serve narrow political interests and the interests of the selected few who are connected to the political elite. Furthermore, once unproductive groups who have considerable political influence and personal connections have control over state resources, they can organise resistance (Alavi 1982; Khan 1998). Unproductive groups can threaten policy changes that undermine their own interests (Estache and Foucart 2013). Once this rent is captured by means of patronage, it is difficult for the economy to diversify. Attempts to diversify the economy will be hindered by political elites and the selected few enterprises if the diversification of business activities can undermine their interests. Although diversification will improve economic growth, if such an agenda is brought up in economic policymaking institutions, it can be conveniently hijacked by political elites.

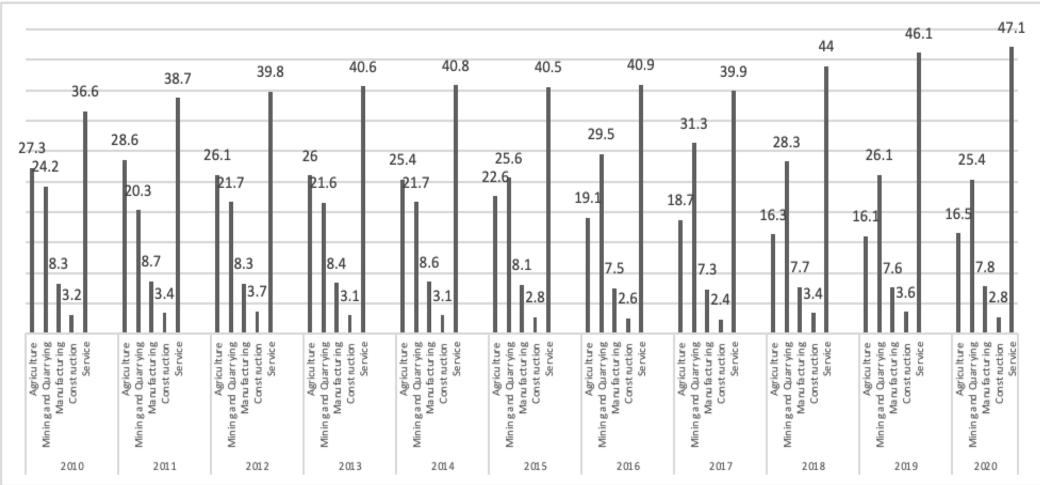
Institutional arrangements in a nation’s industrial policy also evolve around the bureaucracy. The state’s institutions are deemed crucial in the configuration of a coherent policy (Evans 1995; Wade 2018; Johnson 1999). An autonomous bureaucracy that is insulated from private interests is important to allow economic technocrats to independently develop economic rules, implement and design policy, and allocate resources. Autonomy also translates into the freedom for bureaucrats to work and cooperate with productive industrial groups without interference from private political players. The reason the bureaucracy needs to be insulated from political interference is to let the technocrats who have the knowledge in a particular sector devise strategic plan. However, once the bureaucracy is affected by political interests, it loses its autonomy to formulate and implement policies (Tan 2009). The political elites and selected enterprises can then assert their interests in the bureaucracy. Once this occurs, the bureaucrats will do what is necessary to retain political elites and the selected enterprises’ interests (Gomez 2018). This leads to situations where the tweaking of policy terms becomes the norm to serve the interests of the ruling elites and selected enterprises. As a result, meritocratic assessments of economic development, such as diversification, can be hindered if the political elites and selected enterprises feel that their private interests are undermined.

Institutional arrangements in an industrial policy are crucial to push for industrialisation and nurture dynamic local enterprises. Economic diversification relies heavily on coherent industrial policy arrangement, coordination and implementation. An industrial policy is seen as an ‘enabler’ to divert resources to productive groups in a society so that comparative advantage can be formed while simultaneously expanding the manufacturing sector and moving up the value chain.

INDUSTRIAL DEVELOPMENT IN SABAH

Sabah is a rich resource state in Malaysia. Ever since the formation of Malaysia, this state has achieved commendable economic development, improvement in trade, expansion of economic activities and physical infrastructure, better road connectivity, an increase in income per capita, and poverty reduction. After the formation of Malaysia, initially, Sabah’s economic structure was mainly agriculture-based, derived from activities such as timber, rubber, cocoa and copra. All these were activities inherited through colonial legacy (Sabah 1963). In the late 1960s, oil palm became a key industrial crop and has remained so until today. In the mid-1970s, the oil and gas sector rose to become the main resource-based sector and has continued to dominate the state economic activities.

For the past decades, the industrial sector has contributed only single-digit to the Sabah’s Gross Domestic Product (GDP), on average 8.8 per cent between 2010 – 2020 (see figure 1). This indicates that there is limited diversification in the manufacturing sector. Sabah industrial sectors mainly focus on low-mid value-added activities, such as food processing, wood and furniture, petroleum and chemical, and textiles. There are no new industrial sectors were introduced for the past 10 years to expand manufacturing activities. Though the effort to broaden industrial activities is in place but budget allocated to facilitate the growth of the activities such, incentives, grants, R&D, promotion, improve entrepreneurial activities for upskilling remains small as compared to the agriculture sector. On average the national budget for industrial between 2010 – 2015 sector is around RM 2 – RM2.5 billion while the state budget allocation is RM136,640 million and between 2016 – 2022 there is slight increase of national budget allocation for industrial sector which is RM 2.5 - 3 billion similar trend for state allocation which is RM143,124 million. In contrast to the agriculture sector, the national budget for this sector is around RM3.5 – RM4 billion between 2010 – 2015 and continue to increase up to RM5.3 billion in 2022. While the state received on average RM 287,074 million between 2010 – 2015 and increased closed to double between the year 2016 – 2022 which accounted for RM506,812 million.[1]



Source: Department of Statistic Malaysia 2010–2020.

Figure 1: Sabah GDP for the year 2010–2020.

Sabah has sought to industrialise and modernise the state by expanding industrial development. Given the centralised feature of the Malaysian federation, the industrial policy and master plan are formulated at the federal level. The country's development planning is under the purview of the federal government. This includes the financing of development activities, which is under the National Finance Council (Hutchinson 2014; Loh 2010). The Sabah state industrial policy is usually an extension of the federal policy (McMorrow and Talip 2001). Although the industrial policy, to a certain extent, is centralised, the state has policy space to produce its own industrial plan, particularly to develop strategic sectors that the state has a locational advantage in. The State Development Department or Economic Planning Units of the Chief Minister's Office, Ministry of Industrial Development, formulate Sabah's industrial policy. In this regard, the Chief Minister's Office holds considerable power over policy priority and decisions, particularly in matters related to the industrialisation of the state.

Phases of Industrial Development

Phase I (mid 1960s–1985)

In the mid 1960s, Sabah's industrial development was limited to simple processing activities, such as shoe or slipper-making, plastic, basic wood and food processing. Import substitution industrialisation (ISI) was introduced as part of a strategy to expand industrial development. The overall ISI strategy emphasised the promotion of industrial development via the private sectors and addressed the weak industrial-based economy. Prior to this most of the activities promoted by the state characterised low value-added activities. However, the Sabah ISI strategy to expand its manufacturing sector had limited success due to various infrastructure problems and lack of skilled labour. Underdeveloped infrastructure and logistical problems became a hindrance for Sabah in its ISI expansion. Abdullah (2003) points out that the price, quantity and variety from ISI were no match to those of Peninsular Malaysia's. However, despite the limitation of ISI in Sabah, the Sabah government continued to emphasise the resource-based industrialisation approach in efforts to build linkages between the agricultural, mining and quarry sectors with manufacturing activities.

The Berjaya government focused on building linkages between extractive and manufacturing activities to expand industrial development. The government designed investments climate for resource-based industry, agro-based for food processing, labour intensive industry with a condition 'learning by doing' to enhance export-oriented industry. The Berjaya government adopted a friendly approach with the federal government to obtain substantial support. According to Hoyle (1980), the Industrial Coordination Committee was set up in 1976 to oversee and regulate the pace and pattern of industrial development in Sabah. This gave the government the edge to set the tone for industrialising the state by utilising state resources.

In mid of 1970s, resource-based industrialisation came about through the agro-based processing of commodities such as palm oil, cocoa, coconut and rubber. In fisheries, the focus was prawn processing for food manufacturing. Food processing started to grow in this period, as this was heavily emphasised by the state government (Second Malaysia Plan 1971–1975). The timber sector saw the rise of the integrated wood-based industry. Wood-based products manufactured were plywood, lumber core and construction plywood. Meanwhile, in the mineral sector, copper processing was the primary focus. The timber industry was the most important export income earner for Sabah during the early period of industrialisation (Lim 2008). The initial stage of industrialisation coincided with the grand Malaysian policy that is known as the New Economic Policy (NEP). The NEP sought to maintain national unity through economic distribution programmes to attain its twin-pronged objectives: to eradicate poverty and restructure the society to eliminate the identification of race according to economic functions.

Effort to restructuring the society the government policy in favour of state intervention in public resources allocation into public sector ownership and control of business enterprises (Rasiah and Shari 2001). The state established a considerable number of public enterprises (sometimes in collaboration with the private sector) as part of accumulating *Bumiputra* industrial groups. Under the banner of 'national interest' to help the *Bumiputra* lead industrial development in Sabah (Hoyle 1980), state-owned enterprises became the primary vehicle to increase participation of the *Bumiputra* community in industrial activities. The Sabah Economic Development Corporation (SEDCO) was established to plan and accelerate activities in the manufacturing sector in Sabah simultaneously to accommodate the 'restructuring agenda' for the *Bumiputra* in Sabah. This was a critical juncture for the formation of state-owned enterprises, where the overarching agenda was to assist the *Bumiputra* to grow in industrial activities in a state that focused on resource-based industrialisation. Thus, racial considerations became embedded in policies when planning industrial development.

Phase II (1985–1995)

The period between 1980 and 1985 was a boom period for the Sabah economy (Lim 2008). The expansion of a resource-based industry backed by state-owned enterprises[2] led to a diversification of downstream industries. The industrial enterprises established at the time were sugar refineries, flour mills, food processing plants, integrated wood-based industries, coconut oil and palm oil refineries, battery assemblies, and simple motor vehicle assemblies, among others. Between 1980 - 1985 signs of the economic transition into industrial activities were seen, and diversification started to grow gradually, but most manufacturing activities involved low value-added activities. This is common in any transitional economy in a developing country. Structural change remained limited. Although the state attempted to pursue industrial development, domestic and foreign investments tended to gear towards extractives activities. The petroleum industry was supposed to be the linchpin of Sabah's expansion in the manufacturing sector. However, after the state signed one of the most controversial agreements in the history with the federal government, which gave birth to the Petroleum Development Act 1974, considerable authority was given to Petronas (a national oil company) to regulate the exploration concession system and production activities related to oil and gas; hence, the state was left with a limited purview over its own oil and gas sector.

Then, the federal government introduced the first industrial master plan (IMP), the IMP I (1986–1995), along with a heavy industrialisation program. The IMP I aimed to lay the foundation for manufacturing industries, particularly non-resource-based industries, for industrial development. Technological acquisition and upgrading to enhance production, processing and value addition become the central agenda. This policy was a turning point for industrial development in Malaysia, especially with the formation of the Heavy Industries Corporation of Malaysia Berhad (HICOM), which was one of the strategies to expand the industrial-based economy through the promotion of intermediate and capital goods (Jomo 1993; Suffian 2021). This brought new development to most states under the Locational Incentive Scheme, and the federal government provided tax relief for private enterprise ventures that utilised the locational advantages of the state to embark on industrialisation projects. The industrial projects established in Sabah under the heavy industrialisation policy of the Fifth Malaysian Plan 1986 - 1990 were a methanol plant and a hot briquette iron plant (Ministry of International Trade and Industry 1986). Although heavy industrial projects were introduced in the state, the overall contribution to manufacturing remained meagre, and the manufacturing sector only grew to 4.6 per cent in 1987 from 4 per cent in 1980 (Ministry of Industrial Development 1996), while the country's manufacturing sector recorded 20 percent in 1987 ever since IMP I was introduced.

Recognising the significant role of industrial development, the Sabah government under Parti Bersatu Sabah (PBS) introduced the Sabah Action Blueprint 1987. This blueprint can be deemed an industrial policy for the state and provided a framework for industrialising the state. The blueprint acknowledged that the Sabah economy depended heavily on resources from extractive activities and planned to initiate structural change (Ministry of Industrial Developen 1987). The overarching objective of the Sabah Action Blueprint was to transform the state economy into a more diversified one and to expand value-added activities. The strategies emphasised linking agro-based sectors with manufacturing and high value-added activities. Resource-based industrialisation remained the primary focus, and the focus during this period was on technological upgrading, private sector initiatives and infrastructure development. In 1990, due to political circumstances PBS withdraw from Barisan Nasional which made Sabah was under opposition rule hence, there was limited support for industrial development as well as a lack of federal support in many aspects, especially infrastructure development and financial assistance (Wee 1995). During this period, the industrial development in Sabah was focused on wood products and timber processing. There was no significant change in industrialisation projects due to a limited fiscal capacity and the fact that the federal government did not prioritise the Sabah state government's industrialisation projects (Loh 2010; Agus 2001). Eventually, the state government turned to the agriculture sector, particularly on the timber industry, and made an effort to revitalise and promote village industries using simple technology and traditional skills.

The transition into an industrial-based economy remains uncertain in Sabah. There has not been any significant transition from a dependence on resource extractive activities to wider industrial-based activities. Industrial development was slow, with a very narrow-based industry characterised by low value-added activities, for example simple food processing and packing, timber processing, simple petrochemical processing etc. In his analysis, Kaur (1998) demonstrated that the economic structure and the pattern of growth that were established earlier remained unchanged for Sabah while the economic structure in Peninsular Malaysia experienced a massive transformation, especially in the manufacturing sector. The limited expansion of the manufacturing industry in Sabah meant that it had to rely heavily on the import of consumer products from Peninsular Malaysia.

Phase III (1995–2005)

In the 1994 state election, the PBS government lost in the election by defections, hence this enabled Barisan Nasional (BN) gained control of the state. In 1995, the Sabah state government under BN introduced its first Sabah Industrial Master Plan (SIMP), and this plan provided guiding principles to industrialisation. Sabah wanted to move up the value chain from resource extraction activities to capital intensive activities that involve expansion of the manufacturing sector and technological advancement. The SIMP was more rigorous in accelerating the rate of industrial growth. The objective was to aggressively revitalise industrialisation and industrial development to generate a high level of economic growth, improve the standard of living and move up the production value chain. The plan identified key growth areas for industrialising the state and attempted to widen the manufacturing sectors not just in resource-based industries but also in non-resource-based industries, such as the electrical and electronics, machinery, mould and die, and food processing industries.

A special task force was set up to plan and coordinate industrial projects with the private sector. Deliberation between the state and private enterprises enabled a joint effort to be made to spur industrialisation in the state. This was an important feature in the industrial policy. The state–private collaboration was to reduce asymmetrical market information, allocate sufficient resources and adjust the policy to help the targeted industry to grow (Rodrik et. al 2004). Institutional arrangements between the state and the private sector provided incentives to the private sector to participate in industrial activities (Suffian 2021). The SIMP had similar characteristics with the IMP II (1995 – 2006), which were to increase productivity, broaden manufacturing activities and build competitiveness using domestic technology. The SIMP set the target of a 35 per cent contribution from the manufacturing sector to the Sabah state GDP in 2020.

Manufacturing started to expand, and there was gradual diversification in downstream industries. The first Kota Kinabalu Industrial Park (KKIP) was set up in 1994. The KKIP serves as an integrated industrial park and catalyst to pursue industrialisation in the state. The Sabah manufacturing sector recorded double-digit contribution to the GDP in 1995, accounting for 14 per cent of the GDP, compared to 8.9 per cent in 1990. It reached a peak of 15 per cent in 1996, prior to the Asian Financial Crisis (AFC). More than 9,000 jobs were created during the expansion period (Abdullah 2003; Ministry of Industrial Development 1996). Post AFC, domestic and foreign direct investments declined significantly (Athukorala 2011). Not only Sabah but the entire nation suffered a contraction in the manufacturing sector due to declining exports. In 2000, the state government introduced the Sabah Industrial Action Plan (SIAP) (2000–2005) to revitalise the industrialisation development. The plan was to carry out ‘implementable action plans’ (Ministry of Industrial Development 2000) that focused on two industrialisation projects, namely, resource-based industrialisation and non-resource-based industrialisation. The primary objective was to seek feasible industrial development to revive the state economy. To this end, several fundamental problems had yet to be addressed in terms of the high cost of business due to a lack of infrastructure, poor logistics and connectivity, and the unstable supply of utilities (Malaysia Productivity Corporation 2016; Rafiq and Mansur 2020). The minimum threshold of infrastructure to support industrial development was inadequate. Subsequent state and private sector pro-growth arrangements were insufficient. For example, a site in KKIP costs around RM10 per square foot compared to a site in Pasir Gudang (in Peninsular Malaysia), where it costs around RM4.50 per square foot. Different in pricing shows there is no serious afford to attract investors. There was a lack of assertive priority setting for the industrialisation project by state policy actors in state economic policymaking institutions. All these factors eventually hampered industrial development during this period which in turn agriculture, mining and tourism dominate the economic policy agenda

Phase IV (2006–2018)

Under the IMP II, the federal government introduced regional economic corridors. The IMP II acknowledged the importance of industrial catch-up, technological upscaling, and improvements in innovative activities to create economic corridors to utilise regional advantages, such as resources, infrastructure, logistics and port facilities in Sabah (Suffian 2021; Athukorala and Narayan 2017). Sabah has it own locational advantage such as palm oil, oil and gas, timber, port facilities, food production, among others. The overarching purpose of economic corridors is to utilise locational advantage, reduce transaction cost, expand shared inputs, increase productivity and promote public–private partnerships (Athukorala and Narayan 2017). With the new industrial cluster-based approach, the Sabah government introduced the Sabah Development Corridor Blueprint 2006–2025, under the purview of the Sabah Economic Development Investment and Authority (SEDIA), a federal agency that oversees the Sabah economic development, coordinating domestic and foreign investment and other development projects. The purpose of SDC was to move up the industrial activities value chain in the downstream industries. Initiatives focused on creating new industries, upskilling human resources, and advancing technology and research and development (Sabah Development Corridor 2006). Under the SDC, value-added downstream industries focused on palm oil, wood processing, biotechnology, and oil and gas. The SDC gave rise to the Kimanis Power Plant, Sabah Oil and Gas Terminal (SOGT), and the Sabah Ammonia-Urea Plant (SAMUR) (Mulok et al. 2015).

This industrial corridor basically revisited the initial industrialisation strategy, which was resource-based industrialisation with the intention of moving up the value chain in the downstream industries. While industrial clusters have their merits for increasing productivity, expanding downstream industries, and ultimately improving industrial development, the fact remains that infrastructure gaps and inadequate skilled human resources have not really helped the industrialisation plan. Furthermore, substantial investment had been targeted at the resource-based industry (i.e., oil and gas, and palm oil) because this sector was more lucrative and easier than downstream industries. Policymakers from political elites also tended to give this sector priority due to economic rent, as securing certain concessions will provide windfall profits to those powerholders. This included activities from the construction industry (e.g., mega infrastructure projects) that local small- and medium-sized enterprises (SMEs), especially subcontractors, could participate in with less high-technological requirements. According to Mulok et al. (2015), the total cumulative investment from 2008 to 2015 was RM147.28 billion after the SDC was introduced, but less than 10 per cent of this investment was channelled to downstream industries. Although there were inflows of investment in downstream industries, most of these were from low value-added activities. The manufacturing sector has never seen double-digit growth, even though this was stressed under the SDC; the sector recorded 8.9 per cent growth in 2008 and 7.8 per cent in 2017. The oil and gas industry that was supposed to spur economic activities for downstream industries retained low value-added activities, while most of the related value-added activities were based in Sarawak instead. The widely-acclaimed SOGT became just a storage and processing terminal for liquid gas and nitrogen (LNG), which would later be transported to Petronas' LNG Complex at Bintulu in Sarawak for downstream activities (Hydrocarbon 2008). Most of the local Sabahan SMEs serviced businesses under the oil and gas sector but were not involved in capital-intensive activities. Overall, the SDC does not really achieve its objectives to industrialise the state by moving up the value chain

Phase V (2018–2020)

In 2018, after the Pakatan Harapan political coalition ousted the BN government, the Warisan government in Sabah wanted to transform the state into an industrial hub. The Warisan government acknowledged that a lack of industrialisation strategies and poor infrastructure did not help downstream industries to move up the value chain. This had discouraged domestic and foreign investments in manufacturing and caused high unemployment in the state (WIEF 2020). The government set another ambitious target where the manufacturing sector will contribute more than 35 per cent to the state GDP in 2030. This was another ambitious plan, but there was no concrete industrial master plan—except for the Sabah Agriculture Blueprint and Sabah Timber Industrial Master Plan—to reinvigorate resource-based industrialisation. The state government banned log exports to ensure that there was an adequate supply of wood for downstream industries, especially for the furniture-making business (Malaymail 2018). However, the short-lived Warisan government was unable to carry out its industrialisation plan due to the pandemic-induced economic crisis along with the political crisis, which led to a change of government in the 2020 Sabah state elections.

After the state general election in 2020, the newly elected government rolled out another grand policy, which was Sabah Maju Jaya (SMJ). The SMJ focused on creating new industries and expanding downstream industries as a new source of economic growth. This time, the plan stressed the importance of digitalisation and technological upgrading along with an emphasis on the skilled worker. The SMJ was designed against the backdrop of a pandemic-induced crisis, which had compelled the government to navigate its way around new sources of economic growth, including incorporating digitalisation and technological advancements into the manufacturing sector. The existing plan does not really depart from the previous SIMP, as the state has retained the resource industrialisation strategy since this is the locational advantage of Sabah.

INSTITUTIONAL CONSTRAINTS TO INDUSTRIAL DEVELOPMENT IN SABAH

Despite the introduction of various industrial plans over the past few decades, the transition into industrial-based activities is still unsuccessful, and there has been no significant industrial deepening. To a large extent, the state still depends on extractive activities but has expanded its focus to the service sector (especially the tourism sector) as a source of economic growth. The limited structural change has been blamed on incoherent industrial policy planning and implementation. Policy inefficacy lies in the institutions. While the state promotes the industrialisation program, the institutions end up constraining industrial policy initiatives. Institutions embedded with patronage, rent-seeking, and uneven power relations can hinder industrial policy implementations. Though policymakers design strategies for industrialising the state but the interpretation of interest tends to derail from the objective of industrial policy. Resources channel for industrial development tends to have political consideration due to political patronage. Priority for development has strong political interference due to economic rents in which the elite policymakers wish to distribute to a selected enterprise, accentuated by the existing political patronage. The uneven power relations embedded in the institutions constrict policymakers to carry out industrial policy, furthermore, a strong political grip over the bureaucracy in Sabah has made the state bureaucracy lesser autonomous in making decisions and most policy decisions are likely to favour political master interests.

The institutional setting in Sabah economic policymaking process accentuates the tripartite relationship between political elites, bureaucrats and 'selected' local enterprises—in this case, the government-linked companies (GLCs) and SMEs linked to the GLCs—play a significant role in carrying out the industrial policy. In the context of Sabah's policymaking institutions, the political elites play a dominant role in policy arrangements, and closed politico-bureaucratic ties have made the state bureaucracy subservient to demands from political elites. The state bureaucracy's role as technocrats, who should be autonomous in planning and carrying out policies, has been compromised by demands from their political masters. 'Selected' GLCs and SMEs linked to the GLCs are dependent on state rents and likely to be susceptible to political interference. Overall, the policymaking process is dominated by the political elites' interests and preferences; hence, political consideration is likely to precede economic rationale.

Political Elite and Industrial Policy Arrangement

The political elites play a strategic role in industrial policy arrangements. The interpretation of interests and priorities by political elites has had a significant impact on the direction of the industrial policy. Industrial development in Sabah is constrained by the priority set by these political elites. Industrial deepening depends on an expansion of downstream industries, chiefly on the development of the manufacturing sector, with value-added activities. However, such a sector is not really a priority or concern in policymaking processes.[3] Most of the state resources are focused on developing the agriculture, construction and tourism sectors. There is less effort to develop industrial activities because it requires hard work.[4] This includes coming up with competitive products and requires highly paid workers and substantial investments in research and development. Since a long gestation period is required for growth, SMEs may take some time to be competitive in the manufacturing sector.[5] The long gestation period for return on investment does not really incentivise elite policymakers to seriously venture into industrial deepening. The political elites prefer the 'low-hanging fruits' sector, which can make them quick money.[6] The agriculture and construction sectors are deemed 'easy' projects because they do not really involve high-technology capacities, and economic rents can be easily distributed to politically linked individuals.[7]

The uneven power relations between the federal and state governments have somehow skewed the priority of the state agenda for industrial development.[8] Most decisions regarding investments for foreign and domestic industries lie in the hands of the federal government, especially the Ministry of Industrial Trade and Industry (MITI). For example, the recent widely publicised deal with South Korea Nexilies, a copper foil manufacturer worth RM2.3 billion, is a federal government initiative.[9] Peninsular Malaysia usually has the upper hand when it comes to receiving investments from industrial projects with more value-added activities, while Sabah is more likely to receive investments for resource-based or low value-added manufacturing activities. The reason Sabah is missing out in the priority list is due to its inadequate infrastructure to support industrial development. Infrastructure problems, such as inadequate power supplies, poor internet connectivity, water supplies, road connectivity and port facilities,[10] have been perennial problems that have impeded industrial development.

The federal government has overall responsibility to promote industrial development through domestic and foreign investment. There is less priority to develop the industrial sector in Sabah. The federal government tends to focus on industrial development such as Selangor, Penang and Johor because such states already have more diversified industrial activities. Such inequitable treatment was due to 'taking for granted' the need for Sabah economic development, as recently raised by many Sabahan politicians, especially in development funds. This does not commensurate with the resource contribution (e.g., oil & gas, palm oil, timber, rubber) by Sabah state to the national GDP.[11] Furthermore, there is also a minimal representation of Sabahans in the federal policy-making which includes top officials in the federal ministries. There is also a lack of understanding of the need for the Sabah economic development at the federal agencies. Unsympathetic towards Sabah's needs, most policymakers do not pay serious attention to the stumbling block for industrialising the state hence this does not put pressure on federal policymakers to push for industrial development agenda.[12] The federal government has little interest develop the state or at times does not prioritise the need for industrialising the state.[13] In the context of uneven power relations between the federal and state government, the federal government can easily shift considerable attention to Peninsular Malaysia industrial sector development.

However, although uneven power relations can be problematic in prioritising the state's industrial sector, the problem can also be attributed to the state's policymaking institutions. As a state, Sabah needs to assert its interest in industrialising the state beyond its resource-based industries.[14] There is not enough pressure asserted by the political elites to push the state's industrial development agenda up the priority list at the federal government level. There is no constant pressure by the political elites to push strategic sectors (e.g., the oil and gas, mineral, food production, wood processing and rubber industries) that the state intends to focus on for moving up the value chain. Furthermore, infrastructure projects that are supposed to facilitate the growth of industrial development are likely to be 'politically captured', and politically linked individuals are likely to obtain project approvals instead of the most competent supplier. Therefore, the planning and implementation of infrastructure projects tend to have sub-optimal or fail-to-deliver outcomes.[15]

A mismatch of priorities in political institutions has made industrial development a secondary agenda. This has caused the KKIP to be underutilised and infrastructure in KKIP underdeveloped. The KKIP was introduced to aid industrialisation but has found it difficult to find investors because its existing facilities do not really meet manufacturer expectations. Hence, KKIP has become a 'real estate agent', leasing land to the market instead of becoming a facilitator of industrial activities.[16]

Subservient State Bureaucracy

The industrial policy depends on an autonomous state bureaucracy to monitor the direction of industrial development and allocate state resources—such as subsidies, concessions and licences—to local enterprises so that they can grow in the market. However, strong politico-bureaucratic ties have compromised the ability of the state bureaucracy to act independently in implementing the industrial policy. The head of the state bureaucracy tends to follow the demands of the political elites.[17] Development agenda is asserted at the state bureaucracy by political elite sometimes without consulting the state bureaucracy. Even if consultation has occurred with state bureaucrats, state civil servants usually act as the 'implementor'. The advisory role played by the civil servants is more like helping political elites safeguard their interests by tweaking policy terms.

Strong politico-bureaucratic ties have led to the introduction of various industrial plans that come from political elites based on the advice of politically linked business groups. Then, these plans and development agenda are asserted into the state bureaucracy, which top public officials just follow because their 'hands are tied'.[18] Many policy arrangements have been made without considering the state bureaucracy's technical advice or understanding existing rules. Eventually, the state bureaucracy needs to tweak terms of policies to meet demands from political elites. For example, considerable funds were channelled into developing the Sabah Agro Industrial Precinct (SAIP), a Tenth Malaysian Plan project to upscale the food industry and technology. Supervision of this project was supposed to be done by the Ministry of Industrial Development because it is part of the industrial project for the state, but due to political reasoning, the project is parked under the Sabah Economic Development and Investment Authority, even though there is a lack of human resource capability and authority to coordinate SAIP there.[19]

A lack of autonomy in the state bureaucracy has had constraining effects on policy changes. Economic rents (e.g., licences, concessions, financial grants, subsidies and quotas) obtained by certain politically linked businesses have made it difficult for bureaucrats to adjust policy terms. Patronage embedment in policymaking institutions has sometimes prompted the bureaucracy to either adopt a 'keep quiet' or 'go with the flow' attitude.[20] This has created policies that tend to give too much consideration to political agenda rather than economic rationale. For instance, the setting up of a clinker for cement production is an important manufacturing activity, and Sabah depends heavily on cement import, which makes the cement price higher in Sabah than in Peninsular Malaysia. While many suggestions have been put forward by the state government to have its own clinker for cement production, the setting up of a clinker plant tends to be 'hijacked' by political elites because Cement Industries (Sabah) Sdn Bhd is the company that benefits from the import licence.[21]

Political influence in the bureaucracy that involved securing economic rents for certain domestic enterprises may not be easily removed or changed. Patronage and rent-seeking behaviours are deeply embedded in policymaking domain. Local enterprises that benefit from concessions, subsidies and licences through patronage can hinder implementation of industrial policy. Those local enterprises who obtained the government support supposedly should invest and expand downstream industries but turn out to be benefitting the economic rents in extractive activities.[22] The bureaucrats always face this difficulty when implementing the industrial policy, especially in planning and expanding manufacturing activities.[23] Existing rents secured by politically linked individuals may have implications on decisions to expand manufacturing because the ministry is unable to channel sufficient resources or provide access to downstream industries, which are usually those that are involved in extractive activities like minerals, timber, and oil and gas. For instance, timber concessions that give export rights have reduced domestic enterprises' access to quality wood in the furniture and carpentry industries.[24]

A Derailed Government-Linked-Companies

The role of GLCs is to spur industrial activities. It plays the 'big push' role by investing in manufacturing activities to expand downstream industries. GLCs have a close relationship with the state government, which means that deliberation can take place to design and implement a coherent industrial policy. GLCs also have unique access to state resources such as loans, subsidies, state grants and licenses. GLCs can have a substantial start-up capital to venture into downstream industries;[25] hence, this special vehicle to the state can be like a state entrepreneur and absorb higher risks compared to private enterprises.[26] Furthermore, they are able to 'send a signal' to the market to encourage SMEs to participate in a business. However, the role of GLCs in Sabah has somehow been derailed. The GLCs have become profiteering enterprises, and most of these companies have ventured into industries where it is easy to make a profit or into established markets, such as those in tourism, retail, resource-based industries, logistics, real estate, telecommunication, and other service-oriented industries. These businesses have relatively minimal risk compared to capital-intensive industries.

Industrial activities are usually associated with high risk and a long gestation period to achieve maturity. The state GLCs could buffer and take high risks if any adverse events were to impact the market.[27] In the absence of or having weak industrial-based activities, strategic role of the GLCs can orchestrate the market and coordinate resources faster than market mechanisms.[28] GLCs play a strategic role in the manufacturing sector to help SMEs participate in the industries. This is the reason why state GLCs are crucial to provide a jump-start to industrial activities. For the past few decades, GLC ventures in Sabah have not corresponded with the risk and substantial resources that they have access to. GLCs are more comfortable investing in businesses that are deemed safe or those that already have economies of scale and a clear scope.[29] These can provide better a return on investment for these state-owned enterprises.

GLCs are also espoused with the *Bumiputra* agenda, that is, to increase the participation of *Bumiputra* entrepreneurs in industrial activities. This 'restructuring of society' agenda is one of the overriding concerns of GLCs (i.e., to help *Bumiputra* entrepreneurs). One way to help increase *Bumiputra* involvement in business activities is to venture into something 'safer' or into an established market.[30] The ethno-economic development agenda tends to intertwine with political interests, and this creates opportunities for rent-seeking to SMEs that are politically linked. Politicians tend to use their influence on GLCs to enable favoured SMEs to obtain business contracts.

Political interference in ‘chairmanship’ appointments, seen as a political reward, can eventually also affect the role of GLCs,[31] particularly the CEO’s direction in managing the state-owned enterprises. Interference by a politically appointed chairman is inevitable, especially in GLC business operations[32] and other management affairs, including the awarding of contracts. While the role of GLCs is to push the transition of the economy into industrial activities, interference of politically appointed individuals can hinder this process. They can influence the GLCs to venture into businesses that favour their interests. Since GLCs have preferential access to the state coffers, politically appointed leaders may take this opportunity to create rent for profiteering purposes. Although this may be against a CEO’s interests, since most of these heads of GLCs want to secure their positions, they will eventually give in to the political demand. Political consideration can compromise the technocratic role of the CEO in managing the GLCs; hence, the head of GLCs to expand in industrial activities can be limited due to political interference, which will eventually cause the GLCs to deviate from their initial priorities.

CONCLUSION

Although various policies have been introduced by the Sabah state government to industrialise the state, industrialisation projects were not able to expand the state’s downstream industries or move up the industrial activities value chain. Industrial policy implementation has been derailed, and intentions to modernise the state through industrialisation and industrial deepening have not occurred in this resource-rich state. This is due to existing institutions that have ended up constraining industrial development initiatives.

Existing institutions are important to political elites, a subservient state bureaucracy and dependent domestic enterprises in terms of economic rents. Thus, the institutional arrangement on the industrial policy is heavily influenced by the priorities and preferences of political elites. In the case of Sabah, there is a strong influence that political elites have over the state bureaucracy has made public officials subservient to political demands. Industrial development and strategies are guided by political considerations rather than economic rationale. This departs from the ideal implementation of an industrial policy, where the state bureaucracy should have sufficient autonomy to design and execute a coherent industrial policy. Strong political influence in GLCs has also affected the industrialisation of the state. Political appointees have used state-owned enterprises for profiteering purposes and created economic rents for favoured politically linked individuals. Economic rents that are politically captured tend to be unproductive and not easily removed; hence, this has impeded industrial development initiatives. Lastly, uneven power relations between federal and state governments have resulted in the state getting lesser access to policymaking activities at the federal level, resulting in the state being unable to advance its interests or industrial development. Due to the existing problem, Sabah has an insufficient infrastructural threshold to support industrial development, poor planning for setting up an eco-system to industrialise the state and a skewed priority in industrial planning and implementation. All in all, uneven power relations, a compromised state bureaucracy, patronage, rent-seeking behaviours, and political influence embedded in existing institutions have all contributed to impeding industrial policy implementation; hence, the transition into industrial-based activities in Sabah has stalled.

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NOTES

1. The allocation of budget refers to Sabah state and national annual budget allocation from 2010 to 2022.
2. State owned enterprises sometimes refer to government-linked companies in which government has a direct or indirect controlling stake and the companies have commercial and social objective (Gomez, 2014)
3. Interview with the Member of Parliament, on 29 June 2021.
4. Interview with the former head of Sabah state public sector,
5. Interview with head of business association, on 21 April 2021.
6. Interview with the Member of Parliament, on 29 June 2021.
7. Interview with the former head of Sabah state agency, on 19 April 2021.
8. Interview with the Member of Sabah State Legislative Assembly, on 29 June 2021.
9. Interview with the head of federal ministry in Sabah, on 26 April 2021.
10. Interview with the head of Sabah GLC, on 20 April 2021.
11. Interview with the Member of Sabah State Legislative Assembly, on 29 June 2021. Sabah is among the top contributor to the country's GDP for the year 2015 – 2022, key contribution comes agriculture (industrial commodities) and mining & quarry based on Department of Statistic Malaysia
12. Interview with the Member of Parliament, on 29 June 2021
13. Interview with the Member of Parliament, on 29 June 2021

14. Interview with the former head of Sabah state public sector, on 3 April 2021.
15. Interview with the Member of Sabah State Legislative Assembly, on 29 June 2021.
16. Interview with members of the Sabah economic think tank group, on 6 February 2021.
17. Interview with the former head of Sabah state public sector, on 3 April 2021.
18. Interview with the former head of Sabah state public sector, on 7 April 2021.
19. Interview with the principal researcher of a think tank group, on 23 June 2021.
20. Interview with the head of federal ministry in Sabah, on 26 April 2021.
21. Interview with a member of the Sabah economic think tank group, on 6 February 2021.
22. Interview with the former head of Sabah state public sector, on 4 April 2021.
23. Interview with the head of Sabah state agency, on 19 April 2021.
24. Interview with the Member of Sabah State Legislative Assembly, on 29 June 2021.
25. Interview with the head of Sabah GLC, on 16 April 2021.
26. Interview with the head of Sabah GLC, on 6 April 2021.
27. Interview with a member of the Sabah economic think tank group, on 6 February 2021.
28. Interview with a member of the Sabah economic think tank group, on 6 February 2021.
29. Interview with the head of Sabah GLC, on 20 April 2021.
30. Interview with the head of Sabah GLC, on 20 April 2021.
31. Interview with the former head of Sabah state agency, on 19 April 2021.
32. Interview with the head of Sabah GLC, on 16 April 2021.

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