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Basic Readings in Malaysian Economics

PETER LIM
M. P. NATHAN





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BASIC READINGS

IN

MALAYSIAN ECONOMICS

BY

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The ideas of economists..... are more powerful than is commonly understood. Indeed the world is ruled by little else.....

Lord John Maynard Keynes
(1883–1946)





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PREFACE

ECONOMICS is a subject that has gained increasing popularity not only among Higher School Certificate and University students in Malaysia, but among students preparing for professional examinations and the general public as well. In the face of growing interest in economics, which undoubtedly reflects the increasing consciousness of students and the general public of the importance of economics in the life of the nation, it is disheartening to observe the general paucity of economic works by Malaysian authors. Admittedly some serious start has been made in this direction, but the present output of economic literature is far from adequate to meet the needs of our growing society. Although it is well over a decade since we achieved Independence, there is not a single book which can give both our students and the general public a basic understanding of the nature and functioning of the Malaysian economy. It is to fill this gap that Modern Education Publishers have launched Basic Readings in Malaysian Economics.

Altogether eighteen topics are covered in Basic Readings in Malaysian Economics. Every one of the topics is complete in itself and may be read "piecemeal". However, they may also be read as parts forming the fabric of the overall economy and derive their full meaning when viewed critically against the general background of the Malaysian economy. There is therefore a unity in the book in that the aim is to enable students and general readers to have an insight into the nature and functioning of the Malaysian economy, the major problems faced and the strategies to be adopted to sustain social and economic development in the country. The authors have adopted a simple, direct and matter-of-fact approach without sacrificing subject matter, accuracy and clarity. We believe that this book will have a wide appeal among students and the general public alike. With the launching of Basic Readings in Malaysian Economics, Modern Education Publishers believe that they are making a modest contribution to the teaching and understanding of Malaysian economics in this country.

The Publishers.





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CONTENTS

	Page
PREFACE	vii
I The Economic Framework	1
II Economic Planning	5
III The Second Malaysia Plan	12
IV National Income.....	20
V Agricultural Development.....	27
VI Agricultural Marketing	33
VII Land Development	36
VIII Industrial Development	40
IX Infrastructure for Development.....	45
X Manpower for Development	49
XI Population and Employment	54
XII Trade Unionism.....	59
XIII Social Services.....	68
XIV Money and Banking	71
XV Money Market and Capital Market.....	77
XVI Public Finance.....	86
XVII Trade and Balance of Payments.....	96
XVIII Foreign Investment	101
XIX Public Enterprises	106
XX Regional Economic Co-operation.....	115
XXI The Economic Challenge of the Seventies	122
Glossary of Economic Terms	127
Some useful References	132
Questions and Assignments	135



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I THE ECONOMIC FRAMEWORK

Malaysia comprises the Federation of Malaya (now officially known as West Malaysia) and the Borneo States of Sabah and Sarawak (now officially known as East Malaysia). It covers an area of 127,670 square miles made up as follows: West Malaysia, 50,840 square miles and Sabah and Sarawak 28,490 square miles and 48,340 square miles respectively. In other words. West Malaysia covers about 40% of the total land area of Malaysia.

Malaysia has a population of 10.6 million. 8.95 million (84.4%) of the population live in West Malaysia, 627,000 (5.9%) in Sabah and 1.03 million (9.7%) in Sarawak. The population of West Malaysia is centered round the West Coast region, while populations in East Malaysia are scattered over a wide area. The density of population of West Malaysia (176 persons per square mile) is eight times as great as Sabah (22 persons per square mile) and Sarawak (21 persons per square mile), which gives an interesting comparison of man/land ratio in the three States.

The States of Malaysia differ in their endowment of natural and manpower resources and are at different stages of social and economic development. West Malaysia's economic wealth is derived mainly from rubber and tin, and that of East Malaysia from timber. East Malaysia is critically short of labour, both skilled and unskilled, but not West Malaysia where there is still a large number of persons who are un-employed. The modern sector of Malaysia is located in the West Coast region of West Malaysia where there has been marked progress in industrialisation, construction and services such as banking and insurance. The structural switch from a predominantly agricultural to an agro-industrial economy is apparent in West Malaysia. Industrialisation has, however, made little headway in East Malaysia.

Malaysia has had an impressive growth rate judged by Asian and world standards. The present per capita income of about \$1,000 is one of the highest in Asia. The annual growth rate of gross national product at constant prices for 1961-65 was 6.2% (matched by a slightly lower rate of private and public consumption in real terms), while for 1965-68, the figure was 6.7% or 0.5% higher than the rate achieved in 1961-65. Production in West Malaysia grew at 6.3% annually over 1961-65 compared with over 7% annually in both Sabah and Sarawak over the same period. Over 1966-68, exports in Malaysia grew annually by 7.6% in volume and production for domestic use by 5.8% annually. Against the background of economic growth was the rapid development of social services and facilities.

Malaysia is basically an agricultural export-oriented economy. Traditionally its economic prosperity has been constructed out of export earnings from its exports, mainly rubber. Rubber is still the country's mainstay, accounting for over 12% of the country's gross domestic product or nearly half the contribution of agriculture in 1967. Agriculture provided some 56% of the country's export earnings in 1967 of which a third was provided by rubber alone. The other exports of the country are tin, timber, palm oil and kernels, pepper, copra and coconut oil. In West Malaysia, agriculture (including forestry and fishing), manufacturing, wholesale and retail trade and services are the major sectors of the economy. The economic wealth of Sabah is derived mainly from logs which account for half of the State's gross domestic product. Sarawak is also heavily dependent on logs, for log exports constitute some 12% of the State's gross domestic product, while another 15% is accounted for by manufacturing, large sawmilling and oil refining. The West Malaysian economy is therefore more diversified than the East Malaysian economy.

A major objective of the First Malaysia Plan (1966-70), and certainly also of the second and subsequent plans, is social and economic integration of the peoples of Malaysia. This necessitates the launching of an integrated social and economic programme designed to promote balanced growth in all the States. Among the major economic problems facing the country is the need to develop Sabah and Sarawak. There is the urgent need to provide in these two States more infrastructure to stimulate new forms of economic activity in order to broaden the economic base; to train and provide more labour, both skilled and unskilled, to cope with the critical shortage; to grant concessions for the establishment of manufacturing industry and also the need for close and effective economic co-ordination of development efforts between the Central Government and the respective State Governments.

Another major problem facing the country is the economic imbalance between the urban population and the rural population as well as the imbalance existing among various social groups. The development strategy of the Government is to strengthen agriculture through the opening of new areas such as under the Federal Land Development Authority and to offer incentives and assistance to farmers in the form of guaranteed minimum price for padi, fertiliser subsidies, free seeds, credit and technical assistance and guidance. At the same time, priority is given to social and economic development. In the First Malaysia Plan, agriculture and rural development have been given the largest financial allocation. The First Malaysia Plan has overtly stated that a major social and economic problem facing

the country is the "unequal distribution of income, which involves wide disparities between rural and town dwellers and between inhabitants of Malaya and the Borneo States, as well as among various social groups". This is undoubtedly one of the most pressing problems facing the country which calls for careful planning and initiation of specific development efforts to reduce income inequality in order that the fruits of prosperity may be more evenly shared by Malaysians as a whole. Clearly such a gigantic problem cannot be tackled within a short compass of time but requires deliberate, sustained and patient efforts over several years.

The inherent weakness of the Malaysian economy is its excessive dependence on the earnings of its major exports, especially rubber and tin, which renders the economy extremely vulnerable to the influence of external forces. It is therefore necessary for the country to broaden and strengthen its economic base by both agricultural and industrial diversification. Malaysia has already made some headway in agricultural diversification. The most successful structural change in the agricultural sector is in the oil palm industry. The area under oil palm in 1968 was 447,893 acres compared with 259,000 acres in 1965 and 193,000 acres in 1963. Export earnings from palm oil in 1968 amounted to \$124.3 million compared with \$107.3 million in 1965 and \$60.5 million in 1960. Other crops introduced under the agricultural diversification programme include maize, sorghum, pepper, tapioca, sugarcane and pineapple. Unprecedented growth has also been recorded in the fishery and livestock industries. Progress in diversification in the agricultural sector will give greater resilience to the Malaysian economy.

Manufacturing industry offers yet another effective avenue for diversifying the Malaysian economy. Traditionally the industrial sector has been small compared with the agricultural sector, but with numerous incentives being offered to investors, there has recently been an upsurge of industrial activity in the country. The manufacturing sector now contributes some 12% to the country's gross domestic product. With steady progress in the future, manufacturing industry will be able to make more substantial contributions to gross domestic product and employment. The country has been able to conserve foreign exchange through import-substitution and earn foreign exchange through the establishment of export-oriented industries.

Unemployment in Malaysia is a serious problem. According to the First Malaysia Plan, the unemployment figure is 5%. The unemployment situation is particularly acute in the major towns. It is estimated that urban unemployment in Malaysia is as high as

* P. 1.

12%. The emphasis is on agriculture as the primary source of employment. Emphasis is also given to manufacturing industry as another avenue for absorbing a larger number of workers. The manufacturing sector is expected to provide some 36,000 additional jobs between 1966-70. Tackling the unemployment problem is a challenging and arduous task but the Government has geared its machinery towards solving the problem through a variety of measures including the encouragement of labour intensive industries, agriculture-based industries, rural industries and so on. The solution of the unemployment problem must necessarily take time. According to official statistics, some reduction in employment is envisaged by 1970.

So much said about the major economic problems facing the country. What can one conclude about the general state of the Malaysian economy? Although the downward swing in rubber price is a cause for serious concern, the Malaysian economy is basically sound and is likely to continue to grow at a rapid rate. There is political and economic stability which makes growth possible. The preservation of the free enterprise system will continue to stimulate both local and foreign investment which has a key role to play in the Malaysian economy. The economic base of the country has been broadened through greater efforts in both agricultural and industrial diversification. The Malaysian currency is one of the soundest currencies in the world and the country has enough reserves to maintain the stability of the dollar. The monetary policies of the country are sound and have successfully maintained the internal and external value of the dollar. Malaysia has an efficient Government administration and a hardworking labour force. These are some of the factors which will ensure the maintenance of steady economic growth in the country.

II ECONOMIC PLANNING

The idea of planning the development of a country's economy is of comparatively recent origin. Nevertheless, many governments today are concerned with the task of formulating effective economic plans. Planning can be defined as "an institutionalised, previously quantified, rationalised process of economic development, over a definite period of time." The main thing to note about planning (and also development) is that they are organised processes.

Economic planning had its origins in the Union of Soviet Socialist Republics. Today economic planning exists not only in the Soviet Union, but also in the People's Democracies of Central and Eastern Europe and the Chinese People's Republic. It also prevails in countries with a centrally planned or directed economy. At the same time, it is an integral technique of economic development in countries subscribing to socialist ideologies such as India. Economic planning techniques are being increasingly utilised even in Western capitalist economies as tools of economic advancement.

It must be observed from the outset that there is a difference in economic planning techniques employed by Communist countries and those employed by non-Communist countries. The distinction is between an "indicative" and a "controlling" plan. Economic plans of Communist societies (i.e. "controlling" plans) are "documents of authorisation". These plans dictate to each industrial unit what it must produce and how much it may invest. A development plan, (or an "indicative" plan) however is not a "document of authorisation". Another difference is that a "controlling" plan is more comprehensive in its resource allocation, while in an "indicative" plan, public expenditure is authorised not by the plan but only by the Annual Budget passed by Parliament. Malaysia's economic plans have been "indicative" and not "controlling" plans.

The immediate post-World War II period saw most countries of Asia, Africa and Latin America launch what are known as "development plans". In developing economies, the issue as regards planning is not "to plan or not to plan," but rather "how much to plan," and "how to plan."

According to Professor W. Arthur Lewis, a development plan may contain any or all of the following parts:

- (i) a survey of current economic conditions;
- (ii) a list of proposed public expenditures;

- (iii) a discussion of likely development in the private sector;
- (iv) a macro-economic projection of the economy; and
- (v) a review of government policies.

The history of economic planning in Malaysia can be summarised as follows. The first formal plan was the Draft Development Plan, sometimes called the **Yellow Book**, which extended from 1950 to 1956, inclusive of both years. This was essentially a listing of all the development projects for which the various Government departments were responsible and which they hoped to implement during the Plan period. Co-ordination of projects was absent and the private sector was neglected. Even important public enterprises such as the Central Electricity Board (as the National Electricity Board was then known) and the Malayan Railways were not included in the Plan. There were reasons for the ill-formulated nature of the Plan. Malaya was then still under colonial rule. The British Administration in Malaya wanted to put up proposals to the British Colonial Office in order to obtain an assessment and allocation of grants under the Colonial Development and Welfare Act. Under this Act the United Kingdom Government had set aside a sum of £120 million for the development of British Colonies and dependencies. The Draft Development Plan was essentially a hastily put-up collection of proposals designed to gain a share of the £120 million.

The next phase of economic planning in Malaya took the form of the **Report on Economic Planning in the Federation of Malaya**. This was later known as the **First Five-Year Plan**. The First Five Year Plan (1956-60) was essentially based on the report and recommendations of the World Bank mission to Malaya in 1954. Again the Plan was primarily a summary of the various departmental projects for the years 1956-60.

The **Second Five-Year Plan** was launched in 1961 to end in 1965. The end of 1965 saw the advent of a new comprehensive and integrated Plan for the development of all the constituent States of Malaysia. This is the **First Malaysia Plan** for 1966-70.

The administrative machinery for planning and implementation consists of the National Development Planning Committee (NDPC) and the Economic Planning Unit (EPU) of the Prime Minister's Department. The final responsibility for economic planning rests with the Cabinet. The NDPC is responsible for the formulation, implementation, progress, evaluation and revision of development plans. The EPU acts as the secretariat of the NDPC.

The present composition of the NDPC is made up of the Permanent Secretary of the Prime Minister's Department, the Governor of Bank Negara, representatives from the Treasury, Ministry of Commerce and Industry, Ministry of National and Rural Development, the Economic Planning Unit and the Department of Statistics. There are also representatives from both Sabah and Sarawak in the Committee. All the major ministries have their own planning and research divisions to provide support to the deliberations of the NDPC.

Development programmes are reported and controlled through the National Operations Room in the Ministry of National and Rural Development. There are up-to-date reports on development projects classified according to state and district in the Operations Room. The technique of the National Operations Rooms has also been instituted at State level. As such there are State Operations Rooms and Rural Development Committees at State level. Further, at District/Divisional level there are District/Divisional Rural Development Committees and District Operations Rooms.

According to the drafters of the First Malaysia Plan the main socio-economic problems* facing the nation at present are:-

- (i) A heavy dependence upon two export products: rubber and tin;
- (ii) A high rate of population growth, leading to employment problems and the need for better social welfare services;
- (iii) An uneven distribution of income, creating economic disparities between urban and rural dwellers; and
- (iv) A relatively low level of human resource development.

The objectives of the First Malaysia Plan are:

- (i) To promote the integration of the peoples and States of Malaysia by embarking upon a development plan explicitly designed to promote the welfare of all;
- (ii) To provide steady increases in levels of income and consumption per head;
- (iii) To increase the well-being of Malaysia's rural inhabitants and other low-income groups, primarily by raising their productivity and thus their income-earning capacity;

*** See page 1 of the First Malaysia Plan
f See page 2 of the First Malaysia Plan**

- (iv) To generate employment opportunities at a rate sufficient to provide productive work for new entrants to the labour force and lower the rate of unemployment;
- (v) To stimulate new kinds of economic activity, both agricultural and industrial, so as to reduce the nation's dependence on rubber and tin;
- (vi) To educate and train Malaysians from all walks of life in order to equip them for effective participation in the process of economic and social development;
- (vii) To lay the groundwork for less rapid population growth by instituting an effective programme of family planning;
- (viii) To open for development sufficient new land to keep pace with the formation of new farm families and reduce the number of landless people desiring land for agricultural purposes;
- (ix) To provide electric power, transportation facilities and communication services adequate to keep ahead of foreseen demands; and
- (x) To progress with health and social welfare development, low-cost housing and a wide range of other projects.

The strategy for rapid economic growth adopted in the First Malaysia Plan includes the rationalisation of the rubber industry, the exploitation of potential mineral resources, expansion of oil palm production, agricultural diversification and industrialisation. Industrialisation will be basically oriented on import-substitution.

The framework of the First Malaysia Plan has indicated the following:

- * The prospective economic setting, 1966-70.
- * The investment targets.
- * Output and income growth targets.
- * Employment growth targets.
- * The growth of consumption and savings.

- * Financing private investment.
- * Balance of payments prospects.
- * An outline perspective plan for 1965-85.

The overall objective of the First Malaysia Plan is to create the most favourable environment possible for accelerated development by measures designed to stimulate investment and encourage the best possible use of Malaysia's human and natural resources.

Total development expenditure by the public and private sectors under the Plan is estimated at \$10,500 million. Out of this amount the public sector is expected to take up \$4,550 million and the private sector \$5,950 million. The target capital formation is \$9,730 million.

The plan envisages the annual growth rate of production for domestic use to be about 7% in real terms or 8% at current prices. Export production is estimated to grow at a rate of 2.4% per annum. The overall growth rate of real Gross National Product will therefore be in the region of 5% per annum over 1966-70.

The employment growth targets aim at creating 380,000 new jobs in West Malaysia and 80,000 in East Malaysia. If the employment targets are achieved, the unemployment rate in West Malaysia would be reduced from an estimated 6.0 % of the labour force in 1965 to 5.2% by 1970.

The resources for the financing of public development expenditure for the period 1966-70 are expected to be derived from government surpluses, public authorities surpluses, domestic non-bank borrowing, bank credit and government accumulated assets, foreign borrowing and foreign grants.

The sectoral development programmes in the First Malaysia Plan have been worked out under the following categories:-

- (1) Agriculture and Rural Development.
- (2) Manufacturing, Construction and Mining.
- (3) Transport and Communications.
- (4) Public Utilities.
- (5) Education and Training.

- (6) Health and Family Planning.
- (7) Social and Community Services.
- (8) General Administration.

Agricultural development has been given the highest priority in the Plan as agriculture is the key sector to be relied upon to generate increases in national income and employment. Some of the agricultural programmes under the First Malaysia Plan include agricultural research, extension, education, credit and marketing.

In so far as industrial development policy is concerned the Government has decided to play a secondary role in relation to private enterprise. To ensure leadership and co-ordination, a Federal Industrial Development Authority has been created.

The First Malaysia Plan has not gone uncriticised. According to Dr. Lim Chong Yah, some of the major weaknesses of the Plan are:

- (1) The absence of phasing or programming. Although the Plan sets out targets to be achieved by the end of 1970, it does not state clearly what development projects are to be completed by the end of each calendar year.
- (2) The Plan does not indicate priorities of projects to be carried out during the five year period.
- (3) The Plan does not provide adequate statistical data. It is more qualitative than quantitative.

The planning process in Malaysia has evolved from a capital budgeting technique to one that is aimed at the overall development of the economy. Planning has taken into account not only public investment but also government policies in relation to the private sector.

The problems and prospects of the implementation of the Plan have been laid out in the Mid-Term Review of the First Malaysia Plan. This exercise was completed in 1968. In the Mid-Term Review innovations are suggested as regards the administrative machinery for planning and implementation. Some of these innovations relate to administrative improvement, the establishment of planning and management units in ministries, personnel administration, performance budgeting and regional development.

The First Malaysia Plan represents only the initial phase of a long-term programme of social and economic development. The objectives of the 20 year Perspective Plan are to achieve by 1985 a per capita income level of \$1,500 or more, full employment, a more equitable distribution of income, greatly improved social and community services, a highly developed economic infrastructure and a lower rate of population growth.

Basic Readings in Malaysian Economics is written primarily for students who wish to acquire a basic understanding of the Malaysian economy. It contains twenty-one articles covering the major aspects of the Malaysian economy. The approach of the authors is simple and direct, but there is no sacrifice of subject matter and clarity.

The articles covered in the book are:

- * The Economic Framework
 - * Economic Planning
 - * The Second Malaysia Plan
 - * National Income
 - * Agricultural Development
 - * Agricultural Marketing
 - * Land Development
 - * Industrial Development
 - * Infrastructure for Development
 - * Manpower for Development
 - * Population and Employment
 - * Trade Unionism
 - * Social Services
 - * Money and Banking
 - * Money Market and Capital Market
 - * Public Finance
 - * Trade and Balance of Payments
 - * Foreign Investment
 - * Public Enterprises
 - * Regional Economic Co-operation
 - * The Economic Challenge of the Seventies
- The book also contains a Glossary of Basic Economic Terms.