

CHAPTER II

Progress of the Economy in Recent Years

52. Economic development in Malaysia in recent years has taken place in a context of profound and rapid political change. The new nation of Malaysia was formed in September, 1963, and subsequently found it necessary to defend itself against political and military confrontation. The separation of Singapore from Malaysia in August, 1965, led to a further change in political boundaries. These important political developments, however, did not disrupt the steady economic progress of Malaysia.

I.—THE GROWTH OF OUTPUT AND INCOME

53. Between 1960 and 1965 the Malaysian economy* experienced a rapid rate of economic progress measured in terms of the growth of output and income. This rapid growth took place in spite of adverse external circumstances beyond Malaysia's control, which produced a very slow rate of growth in the export sector. The economy's ability to grow in spite of virtual stagnation in its traditional leading sector is testimony to its increasing resilience. Furthermore, the fact that a significant increase in *per capita* output and income was achieved while population was growing at one of the highest rates in the world is also a considerable achievement.

54. Between 1960 and 1965 real gross domestic product in Malaysia grew at an average annual rate of 6.4%. All regions of Malaysia contributed to this rapid growth of output. Production in both Sabah and Sarawak appears to have grown at over 7% annually, while output in Malaya, by far the largest component of the aggregate, grew at 6.3%. This is a very satisfactory rate of economic growth by international standards. It has been estimated that output in the non-Communist World has been growing at an average

* This chapter presents an aggregate description and analysis of Malaysia's development over the past five years, despite the fact that Malaya, Sabah and Sarawak existed only as separate economic and political units during the first half of the period. In certain instances the review relies on data from Malaya alone, in the absence of the required information for Sabah and Sarawak.

rate of about 5% annually in recent years and at slightly less than 5% on the average in the developing nations. Malaysia's growth in output has been particularly rapid by Asian standards, especially for an economy which remains essentially agricultural in character. Among Asian countries this growth rate has probably been exceeded in recent years only by those of the more heavily industrialised economies of Taiwan and Japan.

55. The recent rapid growth of output shows a marked acceleration from the growth rate during the period of the Malayan First Five-Year Plan. Between 1955 and 1960 output in Malaya grew at only about 4% per year. The recent acceleration in the growth rate can be traced to investments in economic infrastructure and productive capacity made in the earlier period which began to bear fruit, as well as to an increased rate of domestic expenditure, particularly in the public sector.

56. The growth of output in an economy is not necessarily a good indicator of the growth of real income—the purchasing power of its citizens—because of changes in the value of exports on international markets in terms of the imports which may be bought in exchange. Income growth in Malaysia has always been sensitive to changes in the prices of Malaysian export goods, especially rubber and tin, on the world market and, to a lesser extent, to changes in the prices of Malaysian imports. Over the 1960-65 period Malaysian real income grew at 5.8% annually, which was somewhat slower than the rate of output growth. This is due to the fact that the steady decline in the price of rubber and a small decrease in round timber prices have more than offset the sharp rise in the price of tin, while the prices of Malaysian imports, on the average, have remained relatively stable. Because of the extraordinarily high rubber price in 1960, the 1960-65 experience may slightly overstate the divergence between the long-term growth rates of output and income. Nevertheless, because of the secular decline in rubber prices, Malaysian income has in general grown less rapidly than output in the period since the 1950s.

57. The rise in individual incomes within an economy is determined, of course, not simply by the growth rate of income, but by the rate of population growth as well. Population in Malaysia has been growing at 3.0% annually. As a result, *per capita* income in Malaysia grew at less than half the rate of total income during the 1960-65 period, or at a rate of 2.7%. Thus, in spite of a high rate of population growth, Malaysia managed to produce a growth of *per capita* income which is quite high by international standards, especially in comparison with other developing countries with rapidly growing populations.

58. This rise in *per capita* incomes was translated into a higher level of *per capita* private and public consumption—higher living standards—for the

Malaysian population, in spite of the large amount of resources which went into capital formation. Private and public consumption expenditure in real terms grew at about the same rate as income, or 5.9% annually. Real consumption *per capita* thus rose at 2.8% a year. There are many tangible indications of this rise in living standards. In 1960 there were on the average 82 persons for each private motor vehicle and 24 for each wireless set, whereas in 1965 there are 56 persons per private motor vehicle and 21 per wireless set. *Per capita* annual domestic electricity consumption increased from 31 to 44 kilowatt-hours, a rise of 42%.

59. The broad outlines of the changes in output and income which have been described above are presented in Table 2-1.

TABLE 2-1

MALAYSIA: GROWTH OF PRODUCT AND INCOME, 1960-65

(\$ millions, 1960 prices)

	1960	1961	1962	1963	1964	1965 (preliminary)	Annual growth rate (%)
Gross domestic product (at factor cost) ...	5,929	6,263	6,623	7,054	7,563	8,078	6.4
Gross national income* ...	5,660	5,623	6,041	6,235	6,711	7,522	5.8
Total consumption ...	5,022	5,307	5,604	5,898	6,284	6,692	5.9
Population (thousands) ...	8,108	8,363	8,631	8,896	9,137	9,411	3.0
<i>Per capita</i> product ...	731	748	767	792	827	858	3.3
<i>Per capita</i> income ...	698	672	699	700	734	799	2.7
<i>Per capita</i> consumption ...	619	634	649	662	687	711	2.8

II.—THE SOURCES OF GROWTH: THE EXPORT SECTOR

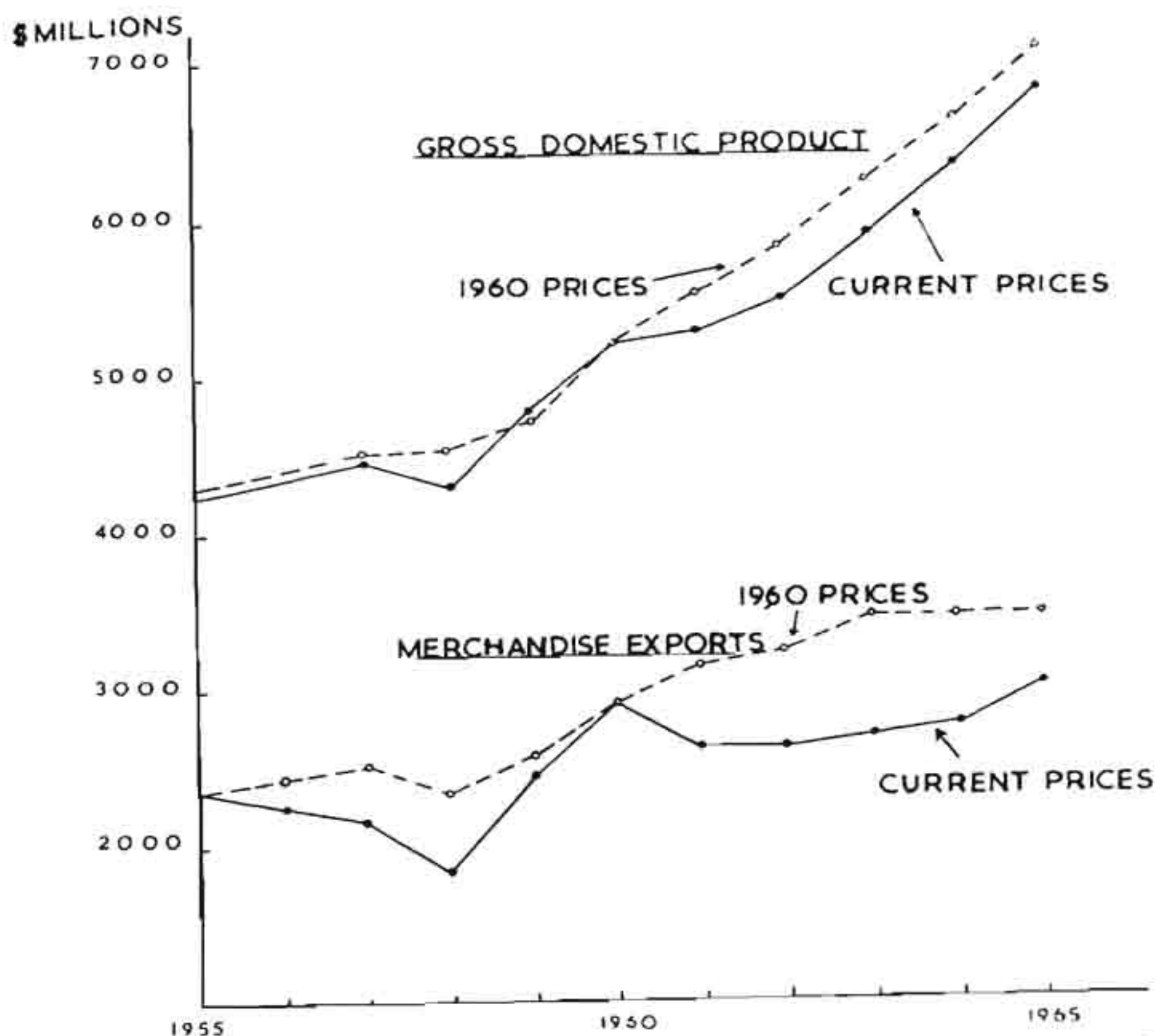
60. Malaysia is often classified as an "export economy", implying that the performance of the economy is governed in large part by the performance of the export sector. This characterization has undoubtedly been true historically for Malaysia as a whole and even today applies with particular force to the Borneo States, where production for the domestic market is less significant than in Malaya. However, the striking characteristic of the expansion of output in Malaya during the 1960-65 period is that, in contrast with other periods of expansion in recent history, rapid growth occurred in spite of a stagnant level of export earnings and a sluggish rate of

* Gross national income is the purchasing power, in 1960 prices, of the current value of the national product. It is obtained by adjusting gross domestic product in 1960 prices for changes in the terms of trade and for net factor incomes paid abroad.

expansion in export volumes. The contrast between the 1955-60 period, when the growth of total product was closely governed by export performance, and the 1960-65 period is apparent in Figure 2-1.

FIGURE 2-1

MALAYA: MERCHANDISE EXPORTS AND GROSS DOMESTIC PRODUCT, 1955-65



61. The lack of external stimulus to Malayan development during the past five years can be traced in large part to the declining price of natural rubber. This was due to increasing competition arising from the expansion of capacity for synthetic rubber production in the industrial countries and the increasing substitution of synthetic for natural rubber. The rubber price

fell from its 1960 peak of 107 cts per lb and a 1956-60 average of 95 cts to a level of about 69 cts in 1965 and a yearly average over the period 1961-65 of 74 cts. This sharp drop in price more than offset the 12% expansion in the volume of Malayan rubber exports over the period which resulted from the far-sighted replanting programme begun in the early 1950s. 62. In addition to the stagnation of earnings from rubber there were other less important causes of the slow growth of exports. Iron ore, Malaya's third largest export, failed to expand its export volume or value after 1963, when its period of rapid production growth came to an end. Exports of copra and coconut oil continued to decline rapidly over the entire period. In addition, there was a sharp decline in value-added from the entrepot trade, largely as a result of the termination of imports of rubber and tin from Indonesia after 1963. These unfavourable developments were offset by more favourable performance in other export products. The tin price rose sharply in 1964-65 as a reflection of continued world shortage but although over 400 new mines have been opened since 1960 in response to rising prices, production has not been able to surpass the levels of the mid-1950s due to exhaustion of reserves. Timber exports grew rapidly in both volume and value and certain less important exports such as oil palm products and pineapple products continued to expand. Exports of services by Malaya expanded by about 44%, in large part due to increased expenditure by Commonwealth Governments. Nevertheless, the net result of these developments was that the export sector achieved scarcely any expansion of its foreign exchange earnings. In 1965 merchandise exports are at approximately the 1960 level after slow recovery from the sharp drop in 1961, while the total value of goods and services exports grew at a rate of less than 1% per year.

63. In Sabah the export sector has performed quite differently as a result of the timber boom. The production of round timber grew by about 95% from 1960 to 1965 and the value of forest product exports approximately doubled. As timber is by far Sabah's most important export product, this rate of expansion was more than sufficient to offset the declining value of rubber and copra exports, with the result that the value of total exports from Sabah grew at an annual rate of 6.4% between 1960 and 1965.

64. Sarawak's export sector also responded to growing world demand for timber. However, timber plays a much smaller part in Sarawak's exports than in those of Sabah, as Sarawak's major export product is rubber, produced almost entirely by smallholders. Rubber export volume declined in response to the falling price, with the result that the value of rubber exports decreased by about 40% from 1960 to 1965. Thus, in spite of increases in the value of exports such as pepper and sago flour and a sharp rise in exports of

services as a result of Indonesian confrontation, Sarawak's exports as a whole in 1965 were at about the 1960 level. In sharp contrast with Sabah, therefore, the export sector in Sarawak acted as a drag upon the growth of both private incomes and government revenue.

65. These recent developments in various export products taken together have resulted in the stagnation of Malaysian merchandise exports since 1960, as shown in Table 2-2, although a slow process of recovery in total export value took place after 1961.

TABLE 2-2

MALAYSIA: EXPORT PERFORMANCE, 1960-65

		1960	1961	1962	1963	1964	1965 (preliminary)	Annual growth rate (%)
<i>Rubber</i>								
Volume ('000 tons)	...	838.8	861.1	857.2	907.5	922.1	941	2.3
Price (cts/lb)	...	106.5	81.2	76.9	72.6	67.6	69	
Value (\$ millions)	...	2,000.6	1,566.9	1,476.9	1,475.7	1,395.9	1,454	- 6.2
<i>Tin</i>								
Volume ('000 tons, metal content)		76.6	74.2	81.4	84.6	71.1	70	- 1.8
Price (\$/ton)	...	6,623	7,414	7,571	7,539	10,166	11,760	
Value (\$ millions)	...	507.3	550.1	616.3	637.8	722.8	823	10.2
<i>Round timber</i>								
Volume ('000 tons of 50 cu ft)		1,451.6	1,815.7	2,053.3	2,551.4	2,808.5	2,924	15.0
Price (\$/ton)	...	79.1	74.1	78.4	79.9	72.6	77	
Value (\$ millions)	...	114.8	134.6	161.0	203.8	204.0	225	14.4
<i>Sawn timber</i>								
Volume ('000 tons of 50 cu ft)		401.7	317.5	332.4	379.7	502.7	619	9.0
Price (\$/ton)	...	186	159	148	168	181	190	
Value (\$ millions)	...	74.9	50.5	49.3	63.6	90.8	118	9.5
<i>Iron ore</i>								
Volume ('000 tons)	...	5,500.0	6,435.0	6,441.0	6,582.0	6,317.0	6,500	3.4
Price (\$/ton)	...	25.5	25.5	25.8	26.8	25.7	25	
Value (\$ millions)	...	140.2	163.8	166.1	176.3	162.5	163	3.1
<i>Palm oil</i>								
Volume ('000 tons)	...	96.0	93.4	105.7	114.9	124.1	132	6.6
Price (\$/ton)	...	631	655	616	601	654	726	
Value (\$ millions)	...	60.6	61.2	65.1	69.0	81.2	96	9.6
<i>Palm kernels</i>								
Volume ('000 tons)	...	25.2	21.2	20.3	19.5	18.1	23	- 1.8
Price (\$/ton)	...	440	341	320	374	392	417	
Value (\$ millions)	...	11.1	7.2	6.5	7.3	7.1	10	- 2.1
<i>Canned pineapple</i>								
Volume ('000 tons)	...	32.8	32.2	35.0	38.0	44.9	49	8.4
Price (\$/ton)	...	793	755	766	741	750	750	
Value (\$ millions)	...	26.1	24.3	26.8	28.2	33.7	37	7.2
<i>Pepper</i>								
Volume ('000 tons)	...	4.6	12.2	14.5	13.3	9.6	12.4	21.9
Price (\$/ton)	...	4,174	2,525	2,034	1,962	2,031	2,030	
Value (\$ millions)	...	19.2	30.8	29.5	26.1	19.5	25	5.4
<i>Copra</i>								
Volume ('000 tons)	...	103.7	110.2	65.3	65.8	39.1	37	- 18.4
Price (\$/ton)	...	516	418	424	465	491	608	
Value (\$ millions)	...	53.5	46.1	27.7	30.6	19.2	22	- 15.9

	1960	1961	1962	1963	1964	1965 (preliminary)	Annual growth rate (%)
<i>Coconut oil</i>							
Volume ('000 tons) ...	28.1	45.2	36.7	32.4	15.7	11	17.2
Price (\$/ton) ...	852	659	649	715	822	1,017	
Value (\$ millions) ...	24.1	29.8	23.8	23.8	12.9	11	-14.5
<i>Major merchandise exports</i>							
Volume (\$ millions, 1960 prices) ...	3,032	3,152	3,201	3,380	3,343	3,433	2.5
Volume (1960=100) ...	100	104	106	111	110	113	
Value (\$ millions) ...	3,032	2,665	2,649	2,742	2,750	2,984	- 0.3
Value (1960=100) ...	100	88	87	90	91	98	
Export prices (1960=100)* ...	100	85	83	81	82	87	
Value lost from price decline post-1960 (\$ millions)† ...		487	552	638	593	449	
<i>Minor merchandise exports</i> (\$ millions) ...	590	547	587	559	617	640	1.6
<i>Total merchandise exports</i> (\$ millions) ...	3,622	3,212	3,236	3,301	3,366	3,622	—
<i>Service ("invisible") exports</i> (\$ millions) ...	324	365	390	412	478	493	8.8
<i>Total exports (\$ millions) ...</i>	3,946	3,577	3,626	3,713	3,844	4,115	0.8

III.—THE SOURCES OF GROWTH: DOMESTIC DEMAND

66. Although Malaysia did not enjoy an export-oriented stimulus for growth, a rapid rise of domestic demand provided the impetus for the expansion of output. This expansion was characterised by a significant shift in the composition of output away from production for export and towards production for the domestic market. Between 1960 and 1965 exported output grew at only 2.8% annually, while output for domestic use increased at 9.2%; consequently exports fell from 55% to 48% of total output over the period. Table 2-3 summarises this recent change in the structure of the Malaysian economy.

TABLE 2-3
MALAYSIA: GROWTH OF EXPORTS AND PRODUCTION
FOR DOMESTIC USE, 1960-65

	(\$ millions, 1960 prices)						
	1960	1961	1962	1963	1964	1965 (preliminary)	Annual growth rate (%)
Gross domestic product (in market prices) ...	6,918	7,136	7,529	8,005	8,567	9,182	5.8
Exports of goods and non- factor services ...	3,824	3,919	3,999	4,184	4,256	4,381	2.8
Exports as % of GDP ...	55	55	53	52	50	48	
Gross domestic product for domestic use ...	3,094	3,217	3,530	3,821	4,311	4,801	9.2
Domestic use as % of GDP ...	45	45	47	48	50	52	

67. The increasing importance of production for the domestic market can be traced in large part to the rapid rise in domestic investment between 1960 and 1965. Current investment serves a dual function for the growth

* Implicit export price deflator obtained by dividing exports in current prices by exports in 1960 prices. It is therefore equivalent to an export price index of the Paasche type with current quantum weights.

† Exports in current prices minus exports in 1960 prices.

of output by both stimulating current production and providing the capacity for future increases in output. This rise in investment demand took place in both the private and public sectors. Private fixed capital formation, responding to the growth of the economy and the increasing potential of the domestic market, increased at about 8% annually, while total private investment rose at over 5% per year. Investment in the public sector was an even stronger stimulus for economic growth. As a result of the implementation of the development plans of Malaya, Sabah and Sarawak, public investment rose at the rapid rate of almost 28% annually. This rise in private and public investment expenditure led to a sharp increase in the proportion of gross domestic product devoted to capital formation, from about 14% in 1960 to 19% in 1965. This allocation of resources to capital formation is quite high in comparison with that of most other countries at a similar stage of development. The emphasis upon capital accumulation offers perhaps the most dramatic illustration of Malaysia's development effort. Table 2-4 presents the relationship between domestic capital formation and domestic product in Malaysia. It is interesting to note not only the increase in the Malaysian investment ratio after 1960 but also the marked contrast in Malaya between investment ratios of recent years and that of 1955, before the increased emphasis on the development effort had begun.

TABLE 2-4
MALAYSIA: CAPITAL FORMATION AND INVESTMENT RATIOS,
1955-65

				(\$ millions, current prices)							Annual growth rate, 1960-65 (%)
				1955	1960	1961	1962	1963	1964 (preli- minary)	1965 (preli- minary)	
MALAYSIA—											
Gross investment				n.a.	997	1,121	1,369	1,444	1,594	1,715	11.5
Private				n.a.	789	797	825	882	950	1,010	5.1
Public				n.a.	208	324	544	562	644	705	27.6
Gross domestic product (at market prices)				n.a.	6,918	6,851	7,192	7,637	8,232	8,932	5.2
Gross investment/GDP ratio				n.a.	.14	.16	.19	.19	.19	.19	
MALAYA—											
Gross fixed investment				460	755	906	1,130	1,194	n.a.	n.a.	n.a.
Planting of perennial crops ...				88	169	196	219	228	193	203	3.7
Machinery and equipment ...				124	255	309	380	360	372	408	9.9
Construction and other works ..				248	331	401	531	606	817	854	n.a.
Increase in stocks				13	120	80	78	64			
Total gross investment				473	875	986	1,208	1,258	1,382	1,465	9.0
Private				n.a.	669	650	728	769	820	860	5.2
Public				n.a.	206	336	480	489	562	605	24.0
Gross domestic product (at market prices)				4,992	6,134	6,102	6,367	6,782	7,272	7,841	5.0
Gross fixed investment/GDP ratio				.09	.12	.15	.18	.18	n.a.	n.a.	
Total gross investment/GDP ratio				.09	.14	.16	.19	.19	.19	.19	

68. Estimates of the pattern of private capital formation in Malaya reveal a steady growth of investment in perennial crops (predominantly composed of the rubber replanting programme) from 1955 to 1963, followed by a decline in 1964. The declining rate of investment in rubber replanting reflects the rapid rise in the proportion of total acreage under high-yielding varieties. Residential construction exhibited a rate of investment growth slightly lower than that of the private sector as a whole. The dynamic components of private investment were non-residential construction and investment in manufacturing, forestry, transport, commerce and other service industries. The growth of private investment may be traced in part to the increased need for plant and equipment to keep pace with the general growth of the economy over the period; however, it also reflects investment undertaken in the process of import substitution. In certain sectors of the economy domestically produced goods have begun to replace those previously imported from abroad. Some evidence of this type of structural change is presented in Table 2-5, which shows the rise in the domestically produced share of consumption of a number of manufactured commodities between 1960 and 1965. The table also indicates that for some industrial products Malaya has already become a net exporter.

TABLE 2-5

MALAYA: DOMESTIC PRODUCTION AS PROPORTION OF TOTAL
CONSUMPTION, SELECTED INDUSTRIAL
PRODUCTS, 1960 AND 1965

	1960	1965 (preliminary)
Cigarettes	.60	.90
Manufactured tobacco	.69	.75
Biscuits	.93	1.08*
Soap	1.06*	1.20*
Bicycle inner tubes	.97	1.25*
Cement	.89	1.08*

69. The process of import substitution has also been illustrated by the development of petroleum refining in Malaya in recent years. Whereas in 1960 all imports of petroleum fuels entered in product form, by 1964 only 41% entered as petroleum products, while the remaining 59% entered as crude petroleum for domestic refining.

* Net exporter.

70. Despite the emergence of import substitution in a few areas, however, it is clear that only the initial movement in this direction has been made. Malaysia's high level of consumer goods imports offers ample opportunity to accelerate the private investment effort in import-substituting industries.

71. The dramatic rise in public investment during the past five years has been a result of an accelerated effort to provide the Malaysian economy with the infrastructure of transport, power and communications and with the trained workers, productive land and efficient capital equipment necessary to make rising levels of output and income possible in the future. The allocation of public development expenditure in Malaya is summarised in Table 2-6, which compares target and estimated expenditure under the Second Five-Year Plan, 1961-65 with actual expenditure under the First Five-Year Plan, 1956-60.

72. Table 2-6 reveals two major characteristics of the development expenditure programme in Malaya under the Second Five-Year Plan. First, investment was concentrated in projects which provide a firmer infrastructure for the economy, such as transport and communications, or which will improve the long-run productivity of resources, such as education, drainage and irrigation, rubber replanting and land development. The public investment programme thus concentrated upon laying the foundation for a steady long-run increase in economic welfare. Second, the public investment programme placed a strong emphasis on rural development. The substantial increases in expenditure on drainage and irrigation, land development, rural industry and certain social services, such as schools and rural health centres, will have direct effects in raising the productivity of resources in the rural economy. In addition, much of the investment in roads and bridges, utilities and community facilities will provide benefits for the rural population. The purpose of the emphasis on rural development in the public investment programme has been to provide a more balanced distribution of economic benefits and opportunities between the rural and urban sectors of the economy.

73. It must be emphasised, however, that the welfare of the rural population will be improved not only by rural development projects but also by public and private investment which stimulates growth and employment opportunities in the urban areas of the economy.

TABLE 2-6

MALAYA: PUBLIC DEVELOPMENT EXPENDITURE, 1956-65

First Five-Year Plan, 1956-60		Second Five-Year Plan, 1961-65				% Fulfilment	
	Actual Expenditure		Original Targets		Estimated Expenditure		
	\$ millions	% of total*	\$ millions	% of total*	\$ millions		% of total*
Agriculture	..	..	..	..	..	..	85.9
Rubber Replanting	..	..	..	..	..	..	79.3
Drainage and Irrigation	..	..	..	..	..	..	108.5
Land Development	..	..	..	..	..	..	68.0
Animal Husbandry	..	..	..	..	..	..	113.0
Forestry	..	..	..	..	..	..	132.0
Fisheries	..	..	..	..	..	..	34.7
Other	..	..	..	..	..	..	122.8
Transport	..	..	..	..	..	..	145.0
Roads and Bridges	..	..	..	..	..	..	186.0
Railways	..	..	..	..	..	..	78.3
Ports	..	..	..	..	..	..	110.9
Civil Aviation	..	..	..	..	..	..	114.6
P.W.D. Plant and Equipment	..	..	..	..	..	..	92.6
Communications	..	..	..	..	..	..	154.7
Telecommunications	..	..	..	..	..	..	169.8
Broadcasting	..	..	..	..	..	..	460.0
Posts	..	..	..	..	..	..	27.4
Utilities	..	..	..	..	..	..	133.2
Electricity	..	..	..	..	..	..	138.8
Water Supply	..	..	..	..	..	..	124.9
Sewerage	..	..	..	..	..	..	100.0
							0.3

<i>Industry</i>	..	12.1	1.3	..	27.0	1.3	..	59.1	2.5	..	218.9
Site Development	..	11.1	1.2	..	7.5	0.4	..	5.7	0.2	..	76.0
Other	..	1.0	0.1	..	9.5	0.5	..	43.4	1.9	..	456.8
Rural Industry	..	n.a.	—	..	10.0	0.5	..	10.0	0.4	..	100.0
<i>Social Services</i>	..	138.8	14.4	..	491.0	23.9	..	413.6	17.6	..	84.2
Education	..	60.9	6.3	..	260.0	12.6	..	236.5	10.1	..	91.0
Health	..	12.7	1.3	..	145.0	7.1	..	101.9	4.3	..	70.3
Social Welfare	..	n.a.	—	..	6.0	0.3	..	5.8	0.2	..	96.7
Housing	..	65.2	6.8	..	80.0	3.9	..	69.4	3.0	..	86.8
<i>General Government</i>	..	65.0	6.7	..	88.1	4.3	..	167.1	7.1	..	189.7
Municipal Development	..	14.2	1.5	..	16.7	0.8	..	35.0	1.5	..	209.6
Government Buildings	..	48.8	5.1	..	38.8	1.9	..	41.8	1.8	..	107.7
Miscellaneous	..	2.0	0.2	..	32.6	1.6	..	90.3	3.9	..	277.0
<i>Total Non-Security</i>	..	964.0	100.0	..	2,057.0	100.0	..	2,344.4	100.0	..	114.0
<i>Security</i>	..	43.0	..	..	93.0	..	..	307.3	..	..	330.0
Defence	..	35.0	..	..	60.0	..	..	244.7	..	..	407.2
Police	..	8.0	..	..	33.0	..	..	62.6	..	..	189.7
<i>TOTAL</i>	..	1,007.0	..	..	2,150.0	..	..	2,651.7	..	..	123.3

* % of Total Non-Security expenditure only.

74. Public investment in both Sabah and Sarawak was concentrated upon transport and communications, as these States do not yet have the relatively developed economic infrastructure which exists in Malaya. Educational investment was also heavy in these two States, as the level of educational opportunity in the past has been low and an increase in literacy and skills will prove necessary for further economic development to take place.

75. An important determinant of Malaysian economic growth, in addition to the increasing levels of private and public investment, was the steady rise in public consumption expenditure in recent years. This component of expenditure rose at an average annual rate of 12.5% during 1961-65. To a large extent this was an inevitable corollary of the large capital expenditure on development programmes; higher capital expenditure on rural development, transport and education in particular has required an increase in current operating expenditure for the projects involved. In addition, however, current expenditure on government services has risen, particularly as a result of the increasing costs of defence and internal security made necessary by Indonesian confrontation.

76. As might be expected during a period in which an increasing proportion of expenditure in the economy was being channelled into capital formation, the growth of real private consumption, at an annual rate of 4.3%, was somewhat lower than that of national product. Nevertheless, this rate of growth was sufficient to allow private and public consumption *per capita* to grow at an average annual rate of 2.8% between 1960 and 1965. Thus living standards in the economy continued to rise despite the increased emphasis upon the use of economic resources to build up the potential for long-term growth.

IV.—FINANCING ECONOMIC GROWTH

77. When measured in current market prices, public and private consumption expenditure grew at an annual rate of 6.4% between 1960 and 1965. Meanwhile total investment expenditure was rising at the impressive rate of 11.5% annually. Thus total expenditure in the economy rose more rapidly than gross national product, which expanded at 5.6% per year. This necessitated a shift in the balance of payments on goods and services account such that a change in the net flow of goods and services between Malaysia and the rest of the world would provide the extra resources required by the rapid growth in total expenditure.

78. Malaysia has been in a favourable position to allow such a shift in the external balance to take place. In 1960 Malaysian output exceeded total expenditure, so that there existed a considerable surplus on goods and services account. Exports grew extremely slowly during the period 1960-65;

the value of imports, however, grew at the rate of 3.5% because of the increasing food requirements of the growing population and, especially, the rapidly growing requirements for foreign-produced capital goods for public and private capital formation. As a result, total expenditure rose to become approximately equal to output in 1963-64 and the initial surplus was eliminated, although a small surplus has appeared again in 1965. This tendency towards diminishing surpluses is a natural one for a developing economy engaged in a vigorous development programme. Previous to this change, Malaysia was in the anomalous position, for a developing nation, of being a substantial net creditor in the world economy, in effect lending her sizeable trade surpluses abroad. Now, however, Malaysia is shifting away from the position of a net creditor towards that of a net borrower. This shift characterised most of the developed economies during the early period of their own development. These recent trends in national expenditure and product and the accompanying changes in savings and the foreign balance are shown in Table 2-7.

TABLE 2-7
MALAYSIA: EXPENDITURE AND SAVINGS, 1960-65
(\$ millions, current prices)

	1960	1961	1962	1963	1964	1965 (preliminary)	Annual growth rate (%)
Consumption expenditure ...	5,022	5,308	5,618	6,052	6,439	6,855	6.4
<i>Private</i>	4,141	4,357	4,586	4,864	5,074	5,267	4.9
<i>Public</i>	881	951	1,032	1,188	1,365	1,588	12.5
Investment expenditure ...	997	1,121	1,369	1,444	1,594	1,715	11.5
<i>Private</i>	789	797	825	882	950	1,010	5.1
<i>Public</i>	208	324	544	562	644	705	27.6
Gross national expenditure	6,019	6,429	6,987	7,496	8,033	8,570	7.3
Foreign balance on goods and services	630	217	57	-16	12	159	
Gross national product ...	6,649	6,646	7,044	7,480	8,045	8,729	5.6
Less: Net foreign transfers...	215	195	204	214	135	126	
Less: Consumption expenditure	5,022	5,308	5,618	6,052	6,439	6,855	
<i>Equals:</i> Gross domestic savings	1,412	1,143	1,222	1,214	1,471	1,748	4.1
Savings/GNP ratio	.21	.17	.17	.16	.18	.20	

79. The rapid mobilisation of resources for the development programme, with the shift in the resource balance just described, has had important counterparts in the development of the balance of payments and public finance.

80. The declining surplus on goods and services, combined with the continuing high level of private transfer payments abroad, has led to a reversal in the balance of payments on current account from a sizeable surplus in 1960 to a deficit for the years 1964-65 taken together. There has been a substantial increase in the net inflow of private long-term capital over the period for investment both in the agricultural sector and in industrialisation. Official loans from governments and international organisations and borrowings in markets abroad have also increased. The growth in all these sources of external finance, however, has not been sufficient to match the change in the current account balance, with the result that a moderate draw-down of total foreign assets was required after 1962. Table 2-8 summarises the balance of payments position for Malaysia over the period.

TABLE 2-8
MALAYSIA: BALANCE OF PAYMENTS, 1960-65

				(\$ millions)					
				1960	1961	1962	1963	1964	1965 (preliminary)
<i>Current account</i>									
Exports f.o.b.	...	...		3,622	3,212	3,236	3,301	3,366	3,624
Imports f.o.b.	...	...		2,613	2,642	2,888	3,016	3,066	3,155
Merchandise balance	...	...		1,009	570	348	285	300	469
Invisibles (net)	...	...		-388	-353	-291	-301	-287	-310
Transfers (net)	...	...		-197	-195	-204	-214	-135	-126
Current account balance	...			+424	+ 22	-147	-230	-122	+ 33
<i>Capital account</i>									
Long-term capital (net)	...			n.a.	212	293	404	269	367
<i>Private</i>	...	...		—	180	235	320	250	260
<i>Public</i>	...	...		—	32	58	84	19	107
Short-term capital (including errors and omissions) (net)				n.a.	-142	- 98	-252	-268	} -400
Net use of foreign assets*	...			—	- 92	- 48	+ 78	+121	
Capital account balance	...			-424	- 22	+147	+230	+122	- 33

81. The financial position of the public sector, like that of the balance of payments, moved from one of substantial financial resources to increased financial stringency under the impact of the development programmes. In 1960 the public sector showed a considerable surplus on current account and

* — denotes accumulation and + denotes draw-down.

the level of development expenditure was not large enough to exhaust this surplus. During the course of 1961-65 recurrent expenditure grew rapidly. Government revenues, however, remained heavily dependent upon the taxation of the export sector, the income of which did not expand significantly during the period. As a result, revenues did not keep pace with current expenditures and the substantial surplus on current account which existed in 1960 was steadily reduced in size. When combined with the extremely rapid growth in development expenditure, this has led to a growing public sector deficit, which has been financed largely by continued domestic borrowing and by the liquidation of part of the government's accumulated assets. In the face of stagnant export earnings, it has been this increasing deficit in the public sector which has provided the main stimulus to the growth of aggregate demand in recent years. These major trends in public sector finance are shown in Table 2-9.

TABLE 2-9

MALAYSIA: CONSOLIDATED PUBLIC SECTOR FINANCE, 1960-65
(\$ millions)

	1960	1961	1962	1963	1964	1965 (preliminary)	Cumulative total, 1961-65
Government current revenue ...	1,304	1,356	1,418	1,500	1,574	1,671	7,519
Government recurrent expenditure ...	973	1,033	1,120	1,253	1,420	1,626	6,452
Government current surplus ...	331	323	298	247	154	45	1,067
Surplus of public corporations ...	31	33	33	33	36	49	184
Public sector current surplus ...	362	356	331	280	190	94	1,251
Development expenditure* ...	244	401	606	662	661	779	3,109
Overall surplus (+) or deficit (-) ...	+118	- 45	-275	-382	-471	-685	-1,858
<i>Sources of financing—</i>							
Net domestic borrowing† ...	196	148	160	236	183	311	1,038
Net foreign borrowing ...	52	28	51	91	16	119	305
Foreign grants ...	51	45	28	26	66	90	255
Use of accumulated assets‡ ...	-320	-114	+ 55	+ 98	+226	+ 51	+ 316
Other ...	- 97	- 62	- 19	- 69	- 20	114	- 56
TOTAL ...	-118	+ 45	+275	+382	+471	+685	+1,858

82. This concludes the analysis of the important changes which have taken place in the major economic aggregates for Malaysia as a whole. However, inasmuch as important differences exist between the different regions of Malaysia, it is important to examine the major developments in each of these regions during the last five years.

* Includes security capital expenditure.

† Includes increase in assets of the Employees Provident Fund.

‡ - denotes accumulation and + denotes draw-down.

V.—PLANNED OBJECTIVES AND PROGRESS IN MALAYA

83. In Malaya substantial economic progress occurred in both the public and private sectors of the economy, as public expenditure replaced external demand as the major expansionary force. Domestic capital formation advanced at a very rapid rate. The private investment target of \$2,900 million set in the Second Five-Year Plan was achieved and the initial public development expenditure target of \$2,150 million was considerably exceeded, despite the fact that these targets were far higher than the levels achieved under the First Five-Year Plan. It now appears that public development expenditure under the Second Five-Year Plan will reach a figure of approximately \$2,650 million.

84. The progress of recent years can be assessed in terms of the declared objectives of the Second Five-Year Plan. These were:

- (i) *"To provide facilities and opportunities for the rural population to improve its levels of economic and social well-being."*

The high levels of investment on projects specifically designed to raise the productivity and incomes of the rural population have been noted above. Many of the physical results of this investment have materialised: the completion of a large number of irrigation projects and drainage schemes raised the padi acreage capable of being double-cropped from 38,000 acres in 1960 to about 193,000 acres in 1965, while total planted acreage increased from 941,000 to 980,000 acres. An estimated 760,000 acres of smallholder rubber had been planted and replanted with high-yielding varieties, bringing the acreage under high-yielding varieties to 890,000 acres or about 50% of the total smallholder acreage. The number of rural health centres rose from 8 to 39, the number of sub-centres from 8 to 140 and mid-wives clinics from 26 to 671 during the Plan period. Rural school enrolments also expanded rapidly. Despite such gains, however, it must be recognised that the most significant benefits to the rural population from these recent investments will accrue only in the future. Just as the returns from rubber replanting do not begin to be realised for five to seven years, the increases in productivity and income for rural youth who receive better education and medical care lie in the future, although the personal benefits of better health and improved literacy are received immediately.

85. While the Second Five-Year Plan achieved important results for the rural population, it also encountered difficulties in the implementation of some programmes, which caused certain activities to fall short of expectations and Plan targets. Despite the substantial progress made by the Federal Land Development Authority in opening up 145,000 acres of new land, not as much land was opened for new settlement as was originally envisaged. Some other land development schemes under the authority of state governments encountered similar difficulties. As these difficulties are resolved and

as new administrative skills in the implementation of rural development programmes are acquired, the long-term goal of increased well-being for the rural population will come closer to realisation.

86. (ii) *"To provide employment to the country's population of working age, which is likely to increase by about 15 per cent during the Plan period."*

Present estimates suggest that employment increased at approximately the planned rate in 1961-65, although, as indicated in Table 2-10, the distribution of employment is somewhat different from that which was projected in 1960. There appears to be a slightly lower level of employment than projected in high-productivity sectors such as construction, transport and utilities, mining and manufacturing and estate agriculture, whereas employment in government and private services appears to be in excess of that planned. Rapid productivity gains in estate agriculture and perhaps in mining and manufacturing may have held down the rate of labour absorption in these sectors while increasing governmental activity in defence, development activities and general services absorbed more manpower than anticipated. Despite this increase in total employment in line with the Plan objective, unemployment in Malaya remains at about 6% of the labour force and the high proportion of young urban workers in this group constitutes one of Malaya's most urgent problems.

TABLE 2-10
MALAYA: EMPLOYMENT GROWTH, 1960-65
(thousands)

Sector	1960	Target*	1965		Annual growth rate (%)
			Actual (preliminary)		
Agriculture	1,277	1,417	1,388		1.7
Mining and manufacturing ...	196	235	234		3.6
Construction, transport and utilities	150	219	210		7.0
Government services ...	200	236	257		5.1
Other trade and services ...	351	393	429		4.1
Total Employment	2,174	2,500	2,518		3.0
Unemployed	138	—	160		
Total labour force ...	2,312	—	2,678		
Unemployment ...	6.0%	—	6.0%		

* The 1965 targets listed in the Second Five-Year Plan have been re-calculated on the basis of the original sectoral percentage growth targets relative to revised base estimates of 1960 employment.

87. (iii) *"To raise the per capita output of the economy and to protect per capita living standards against the adverse effects of a possible decline in rubber prices."*

As indicated in Table 2-1, *per capita* output grew from \$731 in 1960 to \$858 in 1965, an annual growth rate of 3.3%. While consumption *per capita* grew less rapidly at 2.8% per annum due to the increased proportion of resources devoted to capital formation, the economy was not only able to protect living standards but in fact raised the level of *per capita* consumption by almost 15% over the period.

88. (iv) *"To widen the variety of Malayan production, emphasising the development of other suitable agricultural products in addition to rubber, and giving every reasonable encouragement to industrial expansion which in the long-term offers perhaps the greatest promise for sustained development and diversification of the Federation economy."*

Some signs of diversification in Malaya have been evident. Output of forest products, both for domestic use and export, grew rapidly. Livestock products, fish and palm oil and kernels all increased their contribution to total agricultural production, although the growth of rice production lagged behind that of total agricultural output. These recent trends in the agricultural sector are discussed in greater detail in Chapter VII.

89. Given the long life-span of past investment in rubber and the continued profitability of high-yielding rubber, however, a rapid change in the structure of the agricultural sector is not a feasible objective. To some extent diversification has of necessity been subordinated to the conflicting objective of increased productivity in the rubber industry, as higher levels of rubber production have emerged from the replanting programme. Diversification into other crops such as oil palm has also been hindered by limitations placed upon land alienation. In other areas the basic agricultural research preliminary to the cultivation of new crops has yet to be undertaken. As a result, the predominant role of rubber in the agricultural sector has not substantially changed; rubber continues to represent about 63% of total agricultural output.

90. The diversification of the economy as a whole, as seen in changes in the composition of physical output among industries, was also relatively small, although the contribution of the agricultural sector fell from 38% to 34% of total output and that of rubber from 24% to 21%. The sectoral contributions to output are shown in Table 2-11. The construction industry expanded most rapidly, growing at about 18% annually under the impact of the public expenditure programme. Other sectors which grew more rapidly than the average were government services; banking, insurance

and real estate services; and electricity, water and sanitary services. The fishing industry also expanded its share in the national product. Manufacturing output, excluding rubber processing, grew at almost 12% annually. While some evidence of structural change in the Malayan economy is therefore visible, the dynamic non-agricultural sectors remain a small proportion of the total economy and thus substantial transformation of the economic structure will require their continued growth for a long period.

TABLE 2-11

MALAYA: GROSS DOMESTIC PRODUCT BY INDUSTRY OF ORIGIN, 1960 AND 1965

(in 1960 prices)

	1960		1965 (preliminary)		Annual growth rate (%)
	\$ millions	% of total	\$ millions	% of total	
Agriculture, forestry and fishing	1,976	38	2,406	34	4.0
Rubber	1,233	24	1,504	21	4.0
Agriculture and livestock ...	568	11	647	9	2.6
Forestry	85	2	125	2	8.0
Fishing	90	2	130	2	7.5
Mining and quarrying	306	6	382	5	4.5
Manufacturing	453	9	766	11	11.1
Construction	158	3	360	5	17.9
Electricity, water and sanitary services	70	1	123	2	11.9
Transport, storage and communications	189	4	247	3	5.5
Wholesale and retail trade ...	817	16	1,100	16	6.1
Banking, insurance and real estate	71	1	116	2	10.3
Ownership of dwellings	245	5	305	4	4.5
Public administration and defence	339	6	425	6	4.6
Other services	596	11	853	12	7.4
Gross domestic product at factor cost	5,220	100	7,083	100	6.3

91. (v) *"Finally, while stressing the importance of development which will meet production and employment requirements, to improve and expand the social services needed to provide educational opportunities for the rapidly growing school-age population, to extend the public health services over a wider coverage of the rural as well as urban population, to assist in large measure in the provision of housing and to provide more adequately for rural and urban utilities."*

The expansion of social services under the Second Five-Year Plan was extremely rapid, as development expenditure in this area totalled over \$500 million, more than three times the 1956-60 level. Educational expansion resulted in an increase in classrooms and teachers of more than 35%. The rapid development of rural health centres and mid-wives clinics and a considerable expansion of hospital capacity brought further improvement in health facilities, especially in the rural areas. The number of rooms available through public housing schemes more than tripled between 1960 and 1965, helping to meet the heavy demand for housing created by the rapid increase in urban population. Thus Malaya, which has enjoyed a high standard of social services in the past, expanded these services further and made their benefits increasingly available to the rural as well as the urban population.

92. In general, then, the Malayan Second Five-Year Plan succeeded in meeting its objectives. Output and income grew more rapidly than had been planned and employment increased at about the projected rate. Public services were expanded and distributed more equitably among the rural and urban populations. The initial steps towards diversification of the economy and improvement of productivity and incomes in the rural sector were taken, although these objectives must be viewed as part of a long-term process of change and growth in the economy.

VI.—ECONOMIC PROGRESS IN THE BORNEO STATES

93. The Sabah Development Plan for 1959-64 was simply a programme of public investment expenditure, rather than a comprehensive development plan with explicit economic targets. It emphasized the development of infrastructure, in order to improve transport and communication services linking Sabah's scattered population centres. Heavy investment was also made in education to deal with the rapid increase in the school-age population and to broaden the coverage of the educational system.

94. Estimates for recent years suggest that output in Sabah has been increasing at a rate of over 7% annually, the highest rate of growth among the regions of Malaysia. However, this development has been due in large part to the very rapid expansion of round timber production for export and the growth of the economy has been somewhat imbalanced. Rice production appears to have grown rather slowly since 1960, averaging 2.8% annually. Rubber output has virtually stagnated as a result of previous delays in replanting and labour shortage on the estates, although the increased attention given to new planting and replanting in recent years should result in rapid growth in the immediate future.

95. Sabah's economic growth has also been stimulated by investment in construction, both private and public, which has been financed largely by revenues from timber proceeds. Considerable investment has also been made in the agricultural sector; in addition to the rapid expansion of rubber acreage, there has been extensive planting of oil palm.

96. The impact of the public investment programme upon Sabah's infrastructure is evident. Road mileage grew from about 770 to 1,400 between 1960 and 1965 and electricity generating capacity rose from 7,849 kilowatts (kw) to about 18,700 kw in the same period. In the field of education, school enrolments rose from 51,000 to more than 80,000 in those years. Other significant improvements occurred in port facilities, medical and health services and water supplies, all of which are required to equip Sabah with an economic base adequate for the emergence of a modern economy.

97. The main limitation upon Sabah's rate of development, other than the lack of an integrated economic infrastructure, has been the appearance in recent years of an acute labour shortage. Most of Sabah is underpopulated and the availability of labour is further limited by the youthful distribution of the population. The needs for labour in forestry and estate agriculture were formerly met by immigration from Indonesia and the Philippines but political developments in the last two years have impeded this inflow of labour. The shortage of skilled labour for building construction and engineering has been particularly acute. These shortages have clearly slowed down the pace of development and led to the bidding up of wages. The wage increases, coupled with the rapid growth of earnings from the timber boom, have introduced an element of inflation into Sabah's monetised economy which may impede the development process. Public officials are presently examining policies for the alleviation of the labour shortage and the inflationary pressures which it generates.

98. Sarawak's Development Plan for 1959-63 was also essentially a public investment programme directed at the development of infrastructure, mostly road building, and the improvement of productivity in the backward agricultural sector.

99. Economic progress in Sarawak has been distributed quite unevenly among its various sectors. Timber production has grown at about 9% annually but timber is not as important to Sarawak's economy as to Sabah's. Progress in other parts of the agricultural sector has been much less satisfactory. The fundamental agricultural problem is the inefficient system of shifting cultivation, which is widely practised. Rubber output has stagnated in recent years, as the predominantly smallholder industry has failed to replant with high-yielding varieties, and may have contracted

output in response to the downward trend in rubber prices. Rice production has also nearly stagnated as a result of continued low yields from shifting cultivation.

100. Growth in the non-agricultural sector in Sarawak appears to have been considerably more rapid than in agriculture. The stimulus for this growth was provided by a rapid expansion of government current and capital expenditure and private investment expenditure. Military activities have also stimulated construction and some forms of local trade and other services, although there has been some interference with production and commerce in limited areas.

101. Some of the results of the public investment programme are currently appearing. Road mileage expanded from 603 to 970 during 1961-65 and electric generating capacity rose from 16,400 kw to about 26,000 kw. The Sarawak Government has also invested heavily in agricultural programmes designed to promote an efficient system of settled cultivation and to encourage rubber replanting. However, the large public investments in the agricultural sector, the transformation of which is the crucial requirement for Sarawak's future development, have not as yet had a marked effect upon output and productivity.

V.—CONCLUSIONS

102. In summary, Malaysia has experienced a period of rapid growth of output, income and employment in the last five years and this progress has been shared among its different regions. For the economy as a whole this growth may be attributed largely to the growth of domestic demand for output, since export demand as a whole has been sluggish, although timber exports have had a pronounced effect upon development in Sabah. This period of rapid growth has been marked by a substantial rise in the investment rate, especially in the public sector. While stimulating current economic growth, this investment has concurrently broadened and strengthened the economic base for future development. Despite the increased emphasis on capital formation and the rapid rise in population, *per capita* income in Malaysia has continued to increase and efforts have been made to bring about a more equitable distribution of both private and public consumption among different sections of the population. This period of rapid growth has produced some evidence of structural change in the economy but diversification has not as yet substantially reduced the heavy dependence of the economy upon agriculture and, in particular, upon the production of natural rubber.