

THE GROWTH AND STRUCTURE OF THE MALAYSIAN ECONOMY  
- AN OVERVIEW

by

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## Chapter I

### INTRODUCTION

This study attempts to present an overview of the growth and structure of the Malaysian economy since the time of British intervention in 1874. The year of the beginning of British intervention was selected to be a starting point of this report, since historians have made available a fuller account of events since that date.

The growth and structure of the economy of Malaysia needs to be viewed within a broad historical, political as well as social perspective. It should be viewed in such a manner because of the fact that Malaysia has special and unique characteristics that have never been confronted by other developing nations before. First, the country has a complex multi-racial society where economic classifications run along racial lines. Secondly, the Malaysian Government is pursuing development objectives such as economic growth, employment creation and equitable distribution of income and wealth which may not be completely complementary. Thirdly, the role of the Malaysian Government in the economic development of the country has been undergoing very rapid change. For a very long period of time the government adopted the laissez-faire philosophy with only limited intervention to the extent of providing law and order and infrastructural facilities. Recently, and in particular since the acceptance



of the New Economic Policy, the government has decided to play a more active and direct part in the development process. The analysis of development problems therefore must be judged on an overall basis.

The early development of the economy of the country began sometime in the second half of the nineteenth century and was closely connected to the discovery of tin ore and the introduction of rubber. Rubber and tin were much needed natural resources of the western world at that time. Since then rubber and tin industries have become leading export sectors of the economy.

The export sector has always played an important part in the development of the Malaysia economy. In the colonial era Malaysia specialized in the production and processing of rubber and tin for export in return for the import of essential foods and manufactured goods.

The effect that development through trade had on the economic structure of the Malaysian economy can be seen from the fact that in 1957, the year of independence, the primary sector accounted for over 45% of the gross domestic product (GDP). The tertiary sector, which consisted mainly of supporting activities for the primary sector, accounted for about 44% while manufacturing activities made up the other 11%.

In the same year gross export proceeds constituted nearly 47% of the GDP, which was dominated by the rubber and

the tin industries. Earnings from these two industries accounted for 85% of the gross export earnings or 40% of the GDP.<sup>1</sup>

The composition of the country's imports also demonstrates the essential nature of the economy. In 1955 consumer goods made up no less than 66% of the total imports while capital goods accounted for only 8%. The overall picture then of Malaysia before 1957 was of a highly trade-oriented economy exporting mainly rubber and tin and dependent on outside sources for essentials foodstuffs and manufactured products.

One of the economic consequences of such a structure is a high degree of economic instability and the adverse great effect that this may have on the rate of growth of the economy. The supply and demand of rubber and tin are subjected to fluctuation as are their prices. The result is a fluctuating export sector which may cause instability to the rest of the economy.

To remedy this instability Malaysia needs to diversify the economy. Moreover, since the introduction of synthetic rubber, the future prospects of natural rubber industry have become bleak so that further reliance on it as a source of economic growth is no longer warranted. The difficulty of tin, on the other hand, lies in the rapid depletion of known

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<sup>1</sup>David Lim, ed., Readings on Malaysian Economic Development (Kuala Lumpur: Oxford University Press, 1975), pp. 1-11.

tin deposits. Thus as far as Malaysia is concerned there has been a need to look for other sources of growth.

Malaysia's rice policy has evolved naturally out of the role rice plays in the national economy as a staple food and source of employment. The average Malaysian spends 21.5% of his income on rice. Rice production employs 20% of the total economically active population in Malaysia and 32% of those in the agricultural sector. 14% of all acreage under crops is devoted to rice, second only to rubber.<sup>2</sup> Malaysia is placing a great deal of emphasis on developing the padi economy through World Bank-financed irrigation schemes which will permit double-cropping. An effort also has been made in all padi growing areas to improve the techniques of production.

In the drive to diversify the economy, Malaysia has undertaken to emphasize both the industrial and agricultural sectors of the economy. The commonly accepted reason for the choice of an agricultural strategy of development is the political influence of the rural population. The emphasis is on raising the standard of living and eradicating poverty in the rural areas, where most of the poor live. In line with the government approach to rural development, the direct involvement of government in agriculture under the First and Second Five-Year Malaya Plans (1956-1960 and 1961-1965)<sup>3</sup> was

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<sup>2</sup> Ibid., p. 97.

<sup>3</sup> "Malaya" is used instead of "Malaysia" because the Plans were formulated before the formation of Malaysia (1963).

limited to the extension of economic infrastructure, especially roads and irrigation, and community development. The government's involvement in rural development was more direct and deeper in subsequent Five-Year Malaysia Economic Plans.

The formulation of the First Malaysia Plan 1966-70, the first Five-Year Development Plan after the formation of Malaysia in 1963, marked a shift of concentration towards more industrialization especially manufacturing sector. This was evidenced from the fact that by 1970 the manufacturing sector's share in the GDP increased to 13% from 8% in 1957. The type of industries had also expanded considerably. For example, in 1957 the manufacturing sector consisted largely of the processing of estate-type agricultural products in factories off estates and wood and rattan products. But by 1970 newer industries such as chemical products, printing and publishing and non-metallic mineral products were beginning to play an important part.<sup>4</sup>

Like most other developing countries with an unemployment problem, Malaysia should primarily look at labor-intensive lines of production and make sure that labor costs remain competitively low. Malaysia has comparative advantages in processing the country's natural resources (e.g., timber processing and export of wood products, rather than exporting

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<sup>4</sup>Lim, p. 132.

the raw materials; rubber processing). Another promising avenue for industrialization seems to be in labor-intensive, intermediate industrial products such as electronics or specific car parts. Labor cost in Malaysia was rather stable throughout the 1960s. This had made Malaysia an internationally very attractive location for investors.

There is much interest in and concern for the distribution of income and wealth in Malaysia today among politicians and planners. This distribution in Malaysia is no more uneven than that in many other less developed countries. However, it has greater political significance because of ethnic aspect of the problem. It so happens that the least economically advanced group is also the group with the most political influence. The Malaysian Government has been concerned with rural development since the year of its independence, with its land development schemes and programmes for improving rural infrastructural facilities. However, it would be true to say that the problem did not emerge as an issue that would occupy the full attention of politicians and planners until after the 1969 General Elections. The racial disturbances which broke out in the wake of the elections were a reminder that things were not what they seemed. Thus, the Second Malaysia Plan 1971-75, had as its main objectives, therefore, the creation of greater employment opportunities and a more equitable distribution of income and wealth.

When the term of the Second Malaysia Plan expired in 1975, the unemployment problem and the problem of distribution of income still remained the national issues of the country. When the Third Malaysia Plan 1976-80 was first formulated in 1976, it aimed at accelerating the goals of the previous Second Malaysia Plan. Today, the Third Malaysia Plan is in its final year of implementation.

## Chapter II

### SOME FACTS ABOUT MALAYSIA

#### 1. Position

Peninsular Malaysia is situated in Southeast Asia on the southern most part of the peninsula below Thailand and Burma, bounded on the east by the South China Sea and on the west by the Straits of Malacca. The country is less than 500 miles north-south and 200 miles east-west at its widest point, the southern tip is only a degree of latitude north of the equator. (see figure 1)

#### 2. Country

Malaysia is an independent country within the British Commonwealth, with its own King, the Yang di-Pertuan Agong. The country is a federation of eleven states in Peninsular Malaysia, while Sabah and Sarawak on the island of Borneo are the two states of Malaysia. The Peninsular Malaysian states are (from north to south) Perlis, Kedah, Penang, Perak, Selangor, Negeri Sembilan and Malacca on west coast; and Kelantan, Trengganu and Pahang on the east coast. (see figure 2). Individual states have their own rulers and certain rights.

From its early development to its independence in 1957, the country was under the influence of the British. British control began as early as in 1874.

Figure 1

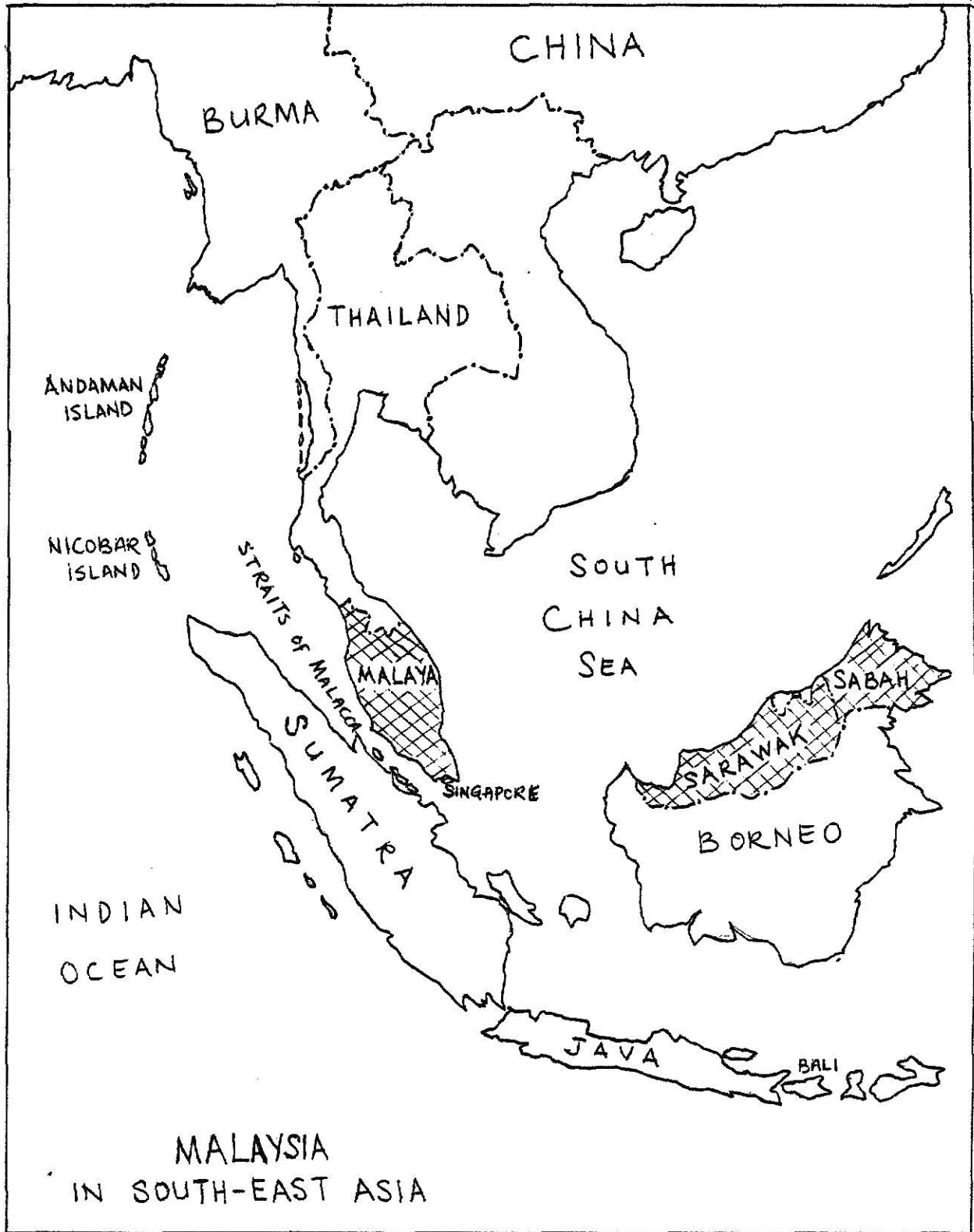




Figure 2



### 3. Climate

Average daily temperature is 70° to 90°F with little seasonal variation, and rainfall is heavy - 100" per year on average. The east coast is subject to monsoon rains from November to March, while rainfall on the west coast is relatively even.

### 4. Formation of Malaysia

Malaysia was formed in 1963 out of the federation of eleven states of Peninsular Malaysia with Singapore, Sabah and Sarawak (the two Borneo states). Singapore left in 1965.

### 5. Population

The estimated population of Malaysia grew from 12.3 million in 1975 to 14 million in 1980, an average annual rate of growth of 2.6%. Of the total population, about 85% resided in Peninsular Malaysia, 6% in Sabah and 9% in Sarawak. By 1980, the ethnic composition of the population in Malaysia will be about 54% indigenous (Malays in Peninsular Malaysia and other tribal groups of Sabah and Sarawak), 35% Chinese, 10% Indians and 1% others.<sup>1</sup>

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<sup>1</sup>The Government of Malaysia, Mid-term Review of the Third Malaysia Plan 1976-1980, (Kuala Lumpur: Government Printers, 1979), p. 59.

## Chapter III

## THE DEVELOPMENT OF THE ECONOMY PRIOR TO 1920s

1. Mininga) The Growth of the Tin Industry

At the time of British intervention in 1874 the country was almost entirely covered by jungle, with agricultural activity still confined to shifting cultivation of such crop as rice, pepper, gambier and tapioca.

The early development of the economy, in the second half of the nineteenth century, was closely connected with tin. Tin had been produced in Malaya (as it was called before the formation of Malaysia) since the ninth century, but its large-scale exploitation dates from the discovery of the Larut tin field (named after the district where tin was found; it is one of the district in the State of Perak) in 1848 and an accompanying influx of Chinese immigrants from China. By 1870, 40,000 Chinese were mining tin in the district. Exports of tin from Larut reached a peak of approximately three-quarters of Perak's output in 1884. In Selangor tin was also mined around Kuala Lumpur (Malaysia's capital) in 1874.<sup>1</sup>

The Kinta Valley around Ipoh (the capital of the State of Perak), the center of the present-day tin industry,

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<sup>1</sup>John T. Thoburn, Primary Commodity Exports and Economic Development; Theory, Evidence and a Study of Malaysia. (New York: John Wiley and Sons, 1977), p. 58.

began to rival Larut as the main tin area in the mid-1800s. In 1885 the residents of Perak noted an extensive migration of Chinese miners from Larut to other parts of the state which would have been mainly to Kinta. By 1889 Kinta's output surpassed that of Larut, and in 1910 its output was nearly seven times that of Larut.<sup>2</sup> Indeed, this was the start of a strong regional bias in tin mining which continues to the present day, with the bulk of output coming from Perak and Selangor. See table 1.

Table 1

Exports of Tin from Malaya 1875-1915, Selected Years

	(tons)			
	<u>Perak</u>	<u>Selangor</u>	<u>N.Sembilan</u>	<u>Pahang</u>
1875	1,762	N.A.	N.A.	N.A.
1880	5,247	3,007	N.A.	N.A.
1885	9,680	4,935	1,264	N.A.
1890	14,117	10,389	2,142	327
1895	23,960	21,515	2,332	407
1900	21,166	16,041	4,301	936
1905	26,594	17,254	5,067	2,077
1910	25,080	14,297	2,065	2,421
1915	27,771	13,938	1,244	3,808

Sources:

- (1) All 1915 figures from Fermor (1939, p. 58)
- (2) All other figures from Wang (1965, p. 249)

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<sup>2</sup>Ibid., p. 59.

The labor force of Chinese miners was drawn directly from China. Immigrants first came mainly under indenture system, whereby their passage was paid by prospective employers, with whom they had to work off their debt. Later, workers were drawn from a pool of people who had paid off their indentures or who came from China under their own finance. By 1914 the indenture system was officially prohibited. Participation by Malays and other indigenous groups as either owners or workers was practically non-existent.

At the turn of the century, when Malaya was already supplying over half of world tin output, European firms were beginning to show interest in industries not dominated by Chinese. In the early stages of their intervention in this industry Western firms had not been successful in their attempts to establish themselves in Malaya. While easily accessible high-grade ground was being mined by labor-intensive Chinese methods, Western firms proved unable to compete, being encumbered by a top-heavy administrative structure and inappropriate equipment. Moreover secret society pressures made it difficult for them to hire Chinese labor. It was only in the 1890s onwards that the Western firms managed to operate quite successfully.<sup>3</sup> Their success was much attributed to the subsequent suppression of secret societies by the government coupled with the drainage problems. The difficulties

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<sup>3</sup> Ibid., p. 60.

of raising ore-bearing earth to the surface from deep mines made the use of foreign mechanical equipment more appropriate. It was European experimentation in Malaya first with hydraulic methods, and then with dredging, which formed the basis for the growth of Western firms. Dredges required large capital outlays which the Chinese could not finance. By the late 1930's the European dredging firms were producing half of Malaya's tin output.

b) Other Mining Industries

Gold had been worked in Pahang from at least the sixteenth century, and it may have been worked near Malacca in neolithic times. The quantities were not large, and extraction of the gold was a slow and laborious process. Many efforts were made to expand the industry but ended in failure due to poor management and lacked of large capital equipment.

Early in the twentieth century coal-mining began at Batu Arang in Selangor through western enterprise. The coal mined here was not for export but its main uses were for railways, power stations, and dredges. For various reasons, notably the increasing competition of fuel-oil, coal production was a failure.<sup>4</sup>

Iron-ore had been worked by Japanese enterprise in Johore, Trengganu, and Kelantan, since shortly after the First World War, for export to Japan, where it was smelted. The

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<sup>4</sup>J. Kennedy, A History of Malaya A.D. 1400-1959 (London: St. Martin's Press, 1962), p. 191.

industry has never expanded into large scale operation.

A number of other mining operations had their origins in the early twentieth century. Of these, the mining of bauxite (aluminum) had the largest output, and it was, like iron-ore, originally in Japanese hands. The mines were in Johore, and nearly all production was for the Japanese market. Bauxite mining continues on an expanding scale at the present time.

## 2. Agriculture

### a) The Introduction of Rubber

The first commercial planting of rubber in Malaya as a separate crop was thought to date from 1896, when five acres of rubber were planted on a European coffee estate in Selangor. By 1922, the estate sector had already swelled to considerable size.

Experimental work pre-dated commercial planting by twenty years. In 1877 rubber seeds sent from the Kew Gardens, England were planted at Botanical Gardens and at the experimental gardens at the Residency at Kuala Kangsar, Perak, started by Sir Hugh Low in that year. By 1896 seeds of the trees at Kuala Kangsar were being planted experimentally at a number of sites in Malaya which yielded a good crop of seeds for further cultivation. By 1897 the so-called herring-bone tapping was devised, an important technological innovation which greatly facilitated the development of commercial growing.<sup>5</sup>

The year 1896 saw the falling of coffee prices

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<sup>5</sup>Thoburn, p. 62.