

Introduction

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INTRODUCTION

Malaysia is made up of two distinct regions; Peninsular Malaysia and East Malaysia (Sabah and Sarawak). The two regions are separated by the South China Sea and the West Coast of Peninsular Malaysia faces the Straits of Malacca. The topography and climatic factors have provided the environmental convenience for the growth of natural resources; tropical plants or mineral resources in Malaysia.

In addition, the strategic location has helped Malaysia to establish a central position for trade between the East (China or Japan) and the West (including Southern or Western Asia). In fact, this position was established as early as the fifteenth century. Consequently, trade development in the country has resulted in the building up of a plural society, comprising of 60 per cent Malays, 30 per cent Chinese, 8 per cent Indians and 2 per cent of others.

Since Independence in 1957, the factors stated above have encouraged the government to play an important role in constructing and forming a new national economy. However, the economy has shown close relationship to the rapid change and uncertainty of world trade. In order to respond appropriately as well as promptly to changes of external environment, the government has been introducing measures through its monetary and fiscal instruments. The government had to consider the equity problem among the different races as early as the beginning of Independence.

As one of the late comers to world trade, the government has initiated the process of industrialisation. The active role of the government can be seen in the changing consumption and investment shares of the public sector in the Gross National Product (GNP) profile; from less than 20 per cent in the late 1950s to more than 30 per cent in the early 1980s (see Table 1). The government has also guided the economy with five year plans, together with long run economic plans e.g. the New Economic Policy (1971-1990) or the Industrial Master Plan (1986-1995). The performance under each of the five year plans is listed in Table 2.

Table 1
Expenditure of Gross National Product (GNP) at Current Prices

	Percentage of GNP						
	1956-60 ¹	1961-65	1966-70	1971-75	1976-80	1981-85	1986-88
Consumption:	79.2	80.5	80.2	77.7	69.5	72.5	69.0
Private	64.5	64.5	62.5	60.2	53.1	55.1	52.2
Public	14.7	16.0	17.8	17.5	16.4	17.4	16.8
Investment	12.6	18.9	16.7	24.4	27.4	36.3	27.5
Private ²	9.9	10.5	10.3	16.6	17.4	19.0	16.3
Public	2.7	8.4	6.4	7.8	10.0	17.3	11.2
Net Foreign Trade	8.2	0.6	3.1	- 2.1	3.1	- 8.8	3.5
Gross National Product	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: ¹Peninsular Malaysia only.

²Include inventories.

Source: Bank Negara Malaysia, *Money and Banking in Malaysia*, Kuala Lumpur, 1989 and *Annual Report 1989*, Kuala Lumpur, 1990.

Table 2
Annual Growth Rates of Gross Domestic Product (at constant prices)

Years	Malaya ¹	Malaysia	Malaysia: 5-year Plans				
	1956-60 (1960=100)	1961-65 (1965=100)	1st 1966-70 (1965=100)	2nd 1971-75 (1970=100)	3rd 1976-80 (1970=100)	4th 1981-85 (1978=100)	5th 1986-89 (1978=100)
	Percent growth rate						
1	2.9	1.4	6.2	10.0	11.6	6.9	1.2
2	2.5	6.9	1.0	9.4	7.8	5.9	5.3
3	0.5	5.5	4.2	11.7	6.7	6.3	8.7
4	4.5	5.8	10.4	8.3	9.3	7.8	8.5 ²
5	9.9	5.6	5.0	0.8	7.8	-1.0	
Average	4.1	5.0	5.4	8.0	8.6	5.2	5.9

Notes: ¹Peninsular Malaysia only.

²Preliminary.

Source: See Table 1.

Table 2 shows that the Malaysian economy had accelerated from an average annual growth rate of 4.1 per cent in the late 1950s to 8.6 per cent in the second half of 1970s. Though the growth rate had slackened to 5.2 per cent during the first half of 1980s, it managed to recover steadily to 8.7 per cent in 1988.

During this process of economic development and structural change in the Malaysian economy, two noticeable changes are the share structure of each industry in Gross Domestic Product (GDP) (Table 3) and the share structure of export commodities (Table 4). In the 1950s, agriculture, forestry and fishing accounted around 40 per cent of GDP, while that of the manufacturing industry was less than 10 per cent. Since then, the former's share has been declining to 20.6 per cent in 1989, while the latter has caught up and surpassed the former to achieve one-fourth of GDP in 1989. Nevertheless, agriculture, forestry and fishing sector still remain important, accounting for about 20 per cent of GDP and more than 30 per cent of employment. Similar structural changes took place within the agricultural output: as can be seen in Table 4, rubber was the most important export earner in the 1960s. But since the 1970s, palm oil and timber have contributed equally to export earnings, thus diversifying the agricultural output structure.

However, the most remarkable fact in Table 4, is the expansion of manufactured exports to capture more than 50 per cent of total export earnings in 1989. In the 1960s, however, most of the manufacturing industries were inclined toward the domestic market. But since the beginning of the 1970s, the government has introduced various measures to promote manufactured exports and to attract foreign investments. During this period manufactured exports have been expanding at two-digit growth rates annually, having caught up with the share of exports of the major primary commodities in 1987. The leading manufacturing industries were electrical/electronic products, processed agricultural products, and textile/apparel.

This volume reviews the Malaysian economy since Independence based on the development discussed above, the role played by the government to promote industrial development through both monetary and fiscal policies and how the real sector has been responding towards the rapid structural change of industrialisation. The first two chapters review the role of monetary and fiscal policies in industrialisation respectively. The third chapter overviews the structural evolution of the Malaysian industrialisation process, while the remaining chapters explain the role of the agricultural sector, the external sector and the establishment of linkages among industries in Malaysia.

Table 3
Composition of Gross Domestic Product (GDP) by Industry of Origin

	1955 ¹ (1960=100)	1965 ¹ (1960=100)	1975 (1970=100)	1985 (1978=100)	1989 ² (1978=100)
Percentage of GDP					
Agriculture, forestry and fishing	40.2	31.5	27.7	20.8	20.6
Mining and quarrying	6.3	9.0	4.6	10.5	10.8
Manufacturing	8.2	10.4	16.4	19.7	25.2
Construction	3.0	4.5	3.8	4.8	3.2
Services	42.3	44.6	47.5	44.2	40.2
Total	100.0	100.0	100.0	100.0	100.0

Notes: ¹Peninsular Malaysia only.

²Preliminary.

Source: See Table 1.

Table 4
Structural Share of Export Commodities

	1961-65	1966-70	1971-75	1976-80	1981-85	1986-88	1989
Rubber	43.6	35.8	27.8	20.4	10.3	9.0	5.8
Tin	20.0	19.7	15.4	10.6	5.1	1.8	1.7
Saw Logs	5.7	12.1	9.4	10.4	8.8	8.3	6.4
Sawn Timber	2.1	3.2	5.5	5.5	3.7	3.6	4.3
Palm Oil	2.2	3.4	9.3	10.0	10.3	8.0	8.0
Petroleum	2.8	3.5	6.4	16.2	24.4	13.4	11.6
Manufacturing	—	11.9 ¹	16.1	20.1	29.0	45.6	54.1
Others	24.6 ²	10.3	8.2	6.8	8.3	10.4	8.1
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: ¹For 1970 only.

²Includes manufactured exports.

Source: Bank Negara Malaysia, *Quarterly Economic Bulletin*, various issues.

Monetary aspects are treated in *Chapter 1*. It surveys the major development within the financial system covering its institutional structure and money/capital markets. After reviewing financial institutions since Independence, the gradual liberalisation of foreign exchange and interest control system is pointed out, under the environment of volatile international trade with counter cyclical fiscal stance. The financial system is assessed to have attained a stage which is comparable to most developed and emerging countries in the world. Still, some areas are still on need of satisfactory resolution; the long-term market for Malaysian Government Securities and the separation between the Stock Exchange of Singapore and Kuala Lumpur Stock Exchange. Major features of the new act in 1989 and the exchange control system are summarised in the appendices.

In *Chapter 2*, fiscal policies are reviewed and the possible direction of their role are discussed. Reviewing the role of the public sector in the industrialisation process since Independence, more direct involvement for the social and economic development are observed in the 1970's, compared to the launching efforts in the 1950's and 1960's to increase social productive capital. And, because of the world recession in the first half of the 1980's, further increase in public expenditure is introduced as counter-cyclical intervention. This continuously expanding fiscal stance is blamed for the public debt problem in the middle of the 1980's, and therefore, an adjustment programme which works through budget cuts or liberalisation was initiated towards the end of 1980's.

Further, the high Incremental Capital Output Ratio (ICOR) of public investment, the crowding-out effects, or the structure of revenue/expenditure are discussed. Finally, some measures are proposed for strengthening fiscal stance as widening revenue base or reforming public enterprises.

Chapter 3 reviews structural changes experienced by the Malaysian economy since Independence. Dividing into three phases of industrial development, Import-substitution, Export Expansion and Second-round Import-substitution, characteristics of each phase are summarised together with the policy programmes implemented. The analysis is based on input-output tables to investigate structural change of output, final demand, primary input, technology and linkages. Significant structural changes are observed such as the diversification of agriculture and the increasingly dominant position of manufacturing and services industries. Changes in production techniques and industrial share of primary inputs and final demand are also pointed out.

Though the agriculture sector share to GDP has been decreasing, its share hovered

around 20 per cent and is still the largest provider of employment in the country. Therefore in *Chapter 4*, the contribution of the agriculture sector to structural changes within the Malaysian economy is discussed. The rubber industry since the colonial era is first reviewed, followed by the policies implemented to diversify and increase productivity. Then, production factors determining the growth of agriculture are discussed as well as their contributions to the other sectors through forward/backward linkage or resource transfers as savings or taxes.

In comparing the differential of employment growth and productivity of the agricultural sector to that of the non-agricultural industry, it is pointed out that the "structural transformation turning point" (when the agricultural work force begins to register absolute declines) has not been reached. Rather the Malaysian economy now is suggested to be in a transition period towards the turning point.

Export structure is overview in *Chapter 5* from two dimensions; commodity composition and export direction. Dividing the phases of industrialisation since Independence into three different time span as in *Chapter 3*, the change of relative shares of each export commodity and export direction (market) is reviewed based on Standard Industrial Trade Classification (SITC). During these phases, the export share of primary commodities decreased from more than 80 per cent in 1960 to less than 50 per cent in the late 1980s, paving way to manufactured exports to emerge as the major export earner. Within the exports of primary commodity, substantial diversification is observed, while for manufactured exports, concentration is in electrical/electronic machinery items. No significant shifts in the direction of exports are reported especially in manufactured exports.

The structure of resources together with the linkages established amongst the industries are analysed in *Chapter 6*. Input-output tables are adopted through-out the analysis. For 1970 and 1975, Malaysia is revealed to have been relatively more endowed with natural resources compared to other Pacific-rim countries. In addition, it is observed that Malaysia has been relatively more abundant with natural resources, labour and capital in this order, based on the factor contents used by Leontief and Leamer. Estimating the basic linkage indices for 1970, 1975, 1978, and 1983, it is shown that primary and food processing industries still play an important role in terms of share contribution to the manufacturing sector and linkage, and that most of the resource based and textile industries are categorised as industries which have the highest linkage, while electric machinery industries are those with the lowest linkage group.

Editor