

BOOK REVIEW

Economic Growth and Development in West Malaysia, 1947–1970 by David Lim, Kuala Lumpur, Oxford University Press, 1973, xvi + 346 pp.

This is an analysis of the economic development of West Malaysia (peninsular Malaysia) in the fifties and sixties, with emphasis on the program of economic diversification. The economy of West Malaysia has traditionally depended on primary commodity exports, particularly rubber and tin. However, there have also been policy measures for economic diversification in order to remove the disadvantages of monoculture. This book cites a more advanced structure of employment and income (lower share of primary industries) and structural change in the composition of exports and imports as achievements of economic diversification. At the same time, the book is an evaluation of diversification policy in the context of major objectives for national economic development. Of the four major objectives—economic growth, economic stabilization, employment creation, and equitable income distribution—repeatedly been a part of economic plans of West Malaysia, diversification was originally intended to reduce instability in exports, but the author's evaluation of the diversification program is that it serves other development objectives as well. After an examination of the Malaysian economy he concludes that while diversification served the first two objectives, it contributed almost nothing to the last two.

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I

The book consists of five parts. Part I is a discussion of the factors that promoted diversification—decline in prospects for rubber and tin, instability of primary commodity trade, the political background, and population and employment dynamics. Part II reviews the concept of diversification using the framework of economic development provided by the present literature on the subject, and links the concept to the ideas of economic growth, employment creation, economic stability and equitable distribution, and the objectives of economic planning for West Malaysia up to the 1970s. Part III evaluates the progress of diversification and its contribution to the above four objectives on the basis of the West Malaysian experience in the years 1947–70. Part IV reviews diversification in agricultural and industrial development, and Part V is the conclusion of the argument and gives policy recommendations for the future.

The author points out, first of all, that in the background of changes in West Malaysia's development strategy for diversification was the long-term declining trend of trade in the country's major export products, rubber and tin. The invention of

synthetic rubber was a threat to natural rubber production. The Japanese occupation of the Malay Peninsula during the Pacific War led to experimentation in synthetic rubber production in the United States and Europe. Synthetic rubbers such as IR, BR, and EPR are highly competitive with natural rubber in quality. Synthetic's share in the world's industrial consumption of rubber rose from 27.2 per cent in 1948 to 65.9 per cent in 1969. This trend is expected to continue and natural rubber's share will probably decline, though for the present, the production costs are higher for synthetic rubber. It is also feared that the known tin reserves are beginning to be mined up, and that the increase in the world's demand for tin will remain fairly constant. Hence, West Malaysia faces the need to come up with new primary products or manufactured exports to earn foreign exchange.

Primary producers are affected by conditions in the export market and have the disadvantage of not being able to domestically control the market. Consequently, the price fluctuations of export goods directly affect the domestic economy. The author demonstrates by using the works of G. F. Erb and Schiavo-Campo and J. C. Leith that in the export sector the instability index is higher in West Malaysia than other countries. He explains that for primary goods like rubber and tin, price elasticity of demand and supply is low. Next, he discusses the effects of fluctuations in the export market on the economy as a whole and on economic development. The author stresses that the detrimental effects cannot be ignored and explains that West Malaysia has tried to remove this instability through diversification.

The pressure for changes dictated by the dynamics of politics and demography reflects the complex racial problems of the country. Generally speaking, the Chinese Malaysians enjoy higher incomes and are concentrated in urban areas. On the other hand, the Malays are predominantly in rural areas and have low incomes. However, the Malays hold the political power and have attempted by political means to reorganize economic activities. This can be seen in the move to hand over large-scale government-led land development projects and other economic activities to the Malays. Next, the high rate of population growth aggravates the unemployment problem even further. In Malaysia, in addition to underemployment in rural areas, unemployment has been high in the cities, particularly in younger age-groups.

Part II views the diversification program not merely from the standpoint of developing the industrial and employment structure, but also within the framework of West Malaysia's economic development. In other words, the form of diversification and its rate of progress are closely related to the strategic objectives outlined in the development plans.

Since independence in 1957, Malaysia has had four economic development plans. Their major objectives, though changing slightly over time, can be summarized as high rate of economic growth, removal of economic instability, lowering unemployment, and equitable distribution of income. These policies were formulated in response to the problems that Malaysia faces, as dealt with in Part I. However, the author points out that the diversification program is affected when these objectives are not complementary, or even in conflict with each other.

Part III empirically reviews the progress of the diversification program. First, with respect to changes in the country's industrial structure in relation to the GNP, the

share of primary industries (agriculture, forestry, and fisheries) declined from 47 per cent in 1947 to 37 per cent in 1970, and that of the manufacturing industries rose from 11 per cent to 17 per cent during the same period. In terms of employment, the share of the primary industries declined from 69 per cent in 1947 to 52 per cent in 1970 while the manufacturing's share rose from 7 per cent to 13 per cent. The import substitution policy taken in the process of industrialization reduced the share of consumer goods in the country's imports from 69 per cent in 1950 to 52 per cent in 1965, and achieved favorable results in soap, cement, cigarettes, and nonferrous metal goods.

The share of rubber and tin in export value declined from an average of 83 per cent for the 1947–50 period to 69 per cent for the 1966–69 period. In terms of the growth rate of export volume, the annual growth rate of rubber between 1947 and 1965 was 1.3 per cent, that of tin 2.4 per cent. On the other hand, iron ore recorded a growth rate of 19.4 per cent, timber 11.4 per cent, and palm oil 6.6 per cent. In other words, these commodities became predominant in the process of export commodity diversification. The industrial goods enlarged their shares from 13.6 per cent in 1958 to 26.6 per cent in 1969 in the nation's export.

Next, the author evaluates the major objectives of the economic plans. First, looking at economic growth, the gross domestic product grew at fairly satisfactory rates of 3.2 per cent between 1956 and 1960, 5.3 per cent between 1961 and 1966, and 4.2 per cent between 1966 and 1970. The author attributes this growth to the success of import substitution in the light industries and consumer goods sectors, to the increase in the export of primary commodities such as palm oil, timber and iron ore, and light industrial goods, and to the expansion of the domestic market from the gradual success of rural development projects.

With regard to economic instability, the lowering of the Coppock Index indicates that West Malaysia's commodity exports have become far more stable in 1957–67 as compared to 1948–58. This can be attributed to the diversification of export goods composition and trading partners. The fluctuations in GDP have also been reduced and the author cites as some of the causes stabilization of exports and expansion of domestic demand. The share of exports in the country's GDP declined showing that until 1970, the economy of West Malaysia had an inward-looking development, particularly in the manufacturing sector.

Turning to the shifts in the employment rate, unemployment in West Malaysia has grown steadily from 2.0 per cent in the 1957 census, 6.0 per cent in the 1962 employment survey, to 7.3 per cent in 1970 as compared to the target figure of 5.2 per cent given in the First Malaysia Plan, 1966–70. Factors responsible are the failure of land development projects in agriculture to effectively create employment except marginally, the tendency in the rubber and tin industries to restrict labor costs and the relative ease with which capital-intensive techniques have been adopted in the manufacturing sector. Capital-intensive techniques were selected because: (1) even though labor was abundant, skilled labor was extremely limited; (2) the productive export sector tended to push up the wage level in the other sectors; (3) the share of foreign capital was large (60 per cent in the manufacturing sector in 1970) and as foreign firms employed capital-intensive techniques and paid high wages, they tended to push up

the general wage level; and (4) the government's investment incentive policy has worked favorably toward capital, and as the payroll tax was not abolished until 1971, the firms tended to cut employment down.

The problem of equity created rise in the Malay income and made the Malays participate in modern economic sectors. The government intended to encourage the double cropping of rice and planting rubber trees and oil palm in land development projects in order to increase productivity. Moreover, so that the Malays may participate in a wide range of economic activities, public corporations were required to implement preferential policies for them. The outbreak of racial violence in May 1969 made it very clear that in the final analysis, these equity objectives were not accomplished and the gap in the distribution of wealth between the races had grown.

Part IV discusses development in agriculture and industries and closely follows the process of diversification. Lim concludes that the economic diversification program in West Malaysia between 1947-70 succeeded from the standpoint of structural change. But in the light of development objectives, the problems of unemployment and racial economic imbalance have not been solved. These are objectives that were carried over into the Second Malaysia Plan (1971-75) with special emphasis on the problem of equity.

II

Lim's book, as explained above, follows the economic development of West Malaysia within the framework of the diversification policy and evaluates that policy in relation to the major objectives of economic development. Few works have comprehensively dealt with Malaysian economic development, and since this one delves into the system of economic development it is invaluable to those studying the Malaysian economy. In what follows, the reviewer would like to offer some comments on the book.

The author evaluates the diversification program in relation to the four objectives of economic development—(1) growth, (2) stability, (3) employment, and (4) equity. However, to me, this analytical frame is not clear. Aside from the problem of stability, if diversification as policy instrument for development is to promote economic growth, expand employment and improve equity, it is necessary to explain this mechanism. What is more, as Lim points out, development objectives incorporate mutually conflicting concepts making the problem even more complex. For example, where the quality of labor is not homogeneous and the supply of high-quality labor is limited, economic growth would only have negligible employment creation effect. Higher priority should be placed on the training and education of labor.¹ Moreover, growth and distribution are not objectives that can be achieved simultaneously, particularly when racial problems further complicate the situation. When normative criteria enter, growth (efficiency) would have to be sacrificed to some extent. The problem was not that the diversification program was ineffective for employment creation and for correcting the unequal distribution of wealth. These had little to do with the

¹ Pointed out in *1973 nenji keizai hōkokusho—Marēshia*—[Annual economic report on Malaysia, 1973] (Tokyo: Institute of Developing Economies, 1974) by the reviewer.

diversification program as such but required other policies that would affect the structure of Malaysian society.

Even though there has been diversification of primary export commodities, the share of rubber and tin is large, and it was not until after 1970 that it dropped below 50 per cent. The export of timber, palm oil, and palm kernel began to increase only after the large-scale land development projects took effect in the late sixties and early seventies. In that respect, the diversification of export products can be evaluated after the 1970s. Incidentally, the export of iron ore reached its peak in 1965 at 6,740 thousand tons but has since declined as iron is mined up.

I would question the so-called transmission hypothesis that says that economies heavily dependent on foreign trade are economically unstable. According to the reviewer's calculation,² Malaysia's primary exports in the 1960-74 period have a lower instability index³ in terms of volume, value, and unit price relative to other primary exporters (Philippines, Thailand, and Indonesia). It is possible to cite the diversification of goods and diversification of trading partners as reasons for this phenomenon, but there seems to be still room for research.

Next, the mechanism has not been clearly explained which causes instability in the export sector to have an impact on the rest of the economy. The author should put more stress on the works of MacBean and Ariff.⁴ According to their findings which are based on international cross-section data, the relationship between growth rate of GDP and instability of exports is statistically insignificant, so that the long-term impact of export instability on the domestic economy may be much smaller than the *prima facie* case.

It seems inappropriate as well to approach the problem with a single equation. One alternative would be to build a macro-model of the West Malaysian economy in order to quantify the impact of trade on the economy to study its repercussions or compute the trade multiplier.

The economic development of West Malaysia has two outstanding characteristics—the absence of inflation right up to 1972 (in the sixties the consumer price index moved at an average annual rate of 1 per cent) and there was a surplus in the international balance of payments so that the lack of foreign exchange did not put constraints on the country's economic development. The book neglects these two points. I look forward to Lim's follow up study, particularly in regard to structural changes accompanying the shift in the country's policy from import substitution to export orientation with the promulgation of the Investment Incentives Act of 1968 and the progress of inflation after 1973.

(Mitsuhiro Kagami)

² See M. Kagami, "Export Fluctuation in Primary Commodities and Related Policy Measures," Paper presented to the final symposium on the "Asian Economy in Perspective," held by Institute of Developing Economies, November 1975.

³ Index of instability can be derived from, for example, Coppock Index, percentage deviation from trend, and standard error.

⁴ As cited in the book, A. I. MacBean, *Export Instability and Economic Development* (London: Allen & Unwin, 1966) and K. A. M. Ariff, *Export Trade and the West Malaysian Economy* (Kuala Lumpur: University of Malaya, 1972).