



REPORT ON THE
ECONOMIC ASPECTS OF
MALAYSIA

by a Mission of the
INTERNATIONAL BANK FOR RECONSTRUCTION
AND DEVELOPMENT

July 1963

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Under the Chairmanship of
MR JACQUES RUEFF

July 1963

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STATEMENT BY THE GOVERNMENT OF THE FEDERATION OF MALAYA

The Federation and Singapore Governments jointly requested the World Bank to provide a Mission to report and make recommendations on the economic aspects of merger. The Mission under the chairmanship of Mr J. Rueff has completed its report which was submitted to the Governments concerned in the first week of July.

The Report is divided into two parts: Part I sets out the major economic effects of merger while Part II contains the recommendations for action. The Federal Government, in consultation with the other Governments concerned, will give careful consideration to the recommendations presented in the Report and where feasible and practicable they will be adopted.

Attention is invited to the fact that common market and entrepot trade arrangements with Singapore have already been agreed upon and the terms of the agreement are being published separately. Other recommendations regarding the co-ordination of public development and the implementation of industrialisation programmes will be given immediate consideration.

In publishing this Report the Government of the Federation of Malaya wishes to record its appreciation of the valuable assistance of the World Bank and members of the Mission for undertaking the assignment.

FOREWORD

1. The present Federation of Malaya, the State of Singapore and the colonies of Sarawak and North Borneo plan to form a new Federation, to be known as "The Federation of Malaysia," by 31st August, 1963.* The proposed Federation will arise when constitutional links are established between the Federation of Malaya and the State of Singapore on the one hand, and between the Federation of Malaya and the new States of Sarawak and North Borneo on the other.
2. The constitutional framework to effect the merger of Singapore with the Federation of Malaya was established in November 1961 with the publication of the "Heads of Agreement" prefaced by an exchange of letters between the two Prime Ministers.† The exchange of letters points out that the memorandum contains an agreement laying down the "State and Federal responsibilities, whereby Singapore will retain responsibility over Education and Labour, and enjoy local autonomy in certain agreed matters as set out therein, without prejudice to the basic principle that there should be a strong Central Government for the Federation of Malaysia as a whole." Discussions between the Federation and Singapore Governments on the constitutional details of merger are still proceeding at the time of writing.
3. Regarding the Colonies of Sarawak and North Borneo, a Commission under the chairmanship of Lord Cobbold visited the territories between February and April 1962 and heard the views of representative groups. All members of the Commission came to the conclusion that a Federation of Malaysia would be in the best interests of North Borneo and Sarawak, and that a decision in principle should be reached as soon as possible.‡
4. The report of the Cobbold Commission was considered in detail by British and Malayan Ministers in a series of meetings in London in July 1962. A joint public statement issued by the United Kingdom and Malayan Governments on the 1st August 1962 announced that "subject

* If agreement is reached on the admission of Brunei, this Federation will also include that State. At the time of writing this report, the IBRD Mission has not been informed that agreement has been reached. As a result, no discussion on the State of Brunei is included here.

† "Memorandum Setting out Heads of Agreement for a Merger between the Federation of Malaya and Singapore," published in Singapore as a White Paper—Cmd. 33 of 1961.

‡ "Report of the Commission of Enquiry, North Borneo and Sarawak, 1962" Cmd. 1794. London H.M.S.O., August 1962.

to the necessary legislation, the proposed Federation of Malaysia should be brought into being by 31st August, 1963.”

5. The two Governments then established an Inter-Governmental Committee, on which the British, Malayan, North Borneo and Sarawak Governments were represented. Its task was to work out the future constitutional arrangements, including safeguards for the special interests of North Borneo and Sarawak, to cover such matters as religious freedom, education, representation in the Federal Parliament, the position of the indigenous races, control of immigration, citizenship and the State constitutions. Its conclusions, including the proposed constitutional arrangements, were published in Malaya under the title of “Malaysia: Report of the Inter-Governmental Committee, 1962”, on 27th February, 1963.

The World Bank Mission

6. The economic unification of territories which were formerly independent from one another both politically and economically raises some complicated problems, and in order to assist in their solution the International Bank for Reconstruction and Development, at the request of the Governments of Malaya and Singapore, organized a Mission under the chairmanship of Mr Jacques Rueff.

7. In order to consult with the Governments on the terms of reference and to prepare the groundwork for the Mission, Mr Jacques Rueff, assisted by Mr William M. Gilmartin, Economic Adviser of the Far East Department of the IBRD, paid an initial visit to Malaya and Singapore from October 23rd to November 1st, 1962.

8. The task of the Mission was defined in the following agreed “Terms of Reference”:

“1. To examine and report on the feasibility of, and problems inherent in, closer economic coordination among the prospective Malaysia territories with special reference to:

(a) the feasibility of common market arrangements among the territories of Malaysia, taking into account the importance of preserving the entrepot trade of Singapore, Penang and Labuan, and the public revenue implications of such arrangements;

(b) the impact of present differences in tariff and trade policies among the territories;

(c) differences in competitive position and the industrial promotion aims and policies of the territories;

(d) other economic areas of possible conflicts or overlapping interests.

2. To recommend concrete steps which should be taken in the fields of economic policy to effect such economic coordination so as to produce the maximum advantage to all territories.

3. To recommend administrative arrangements for coordinating and integrating development planning including industrial development.”
9. In addition to Mr Jacques Rueff, the Mission consisted of a vice-chairman, Mr Leonard Rist, the Bank’s Special Adviser, who was responsible for coordinating the Mission’s work in the absence of Mr Rueff, and of Messrs John A. Edelman, Economic Adviser of the Far East Department of the Bank, Thomas R. McHale, an American economist specializing in industrial development, Jean Royer, a French expert on trade and tariffs and former Deputy Secretary General of GATT, Marcel L. E. Schmidlin, an official of the General Customs Administration at the French Ministry of Finance, B. S. van Deinse, a Dutch expert on ports and transportation, E. Bevan Waide, an economist in the Far East Department of the Bank, and Arthur C. Wigan, an Australian expert on problems of industrialisation. The Mission was assisted by a secretariat consisting of Miss M. Major and Miss A. Turner.
10. The members of the Mission arrived in Kuala Lumpur on the 7th of February 1963 and were joined by their chairman on March 31st. They stayed until the 16th of April. During that period members of the Mission visited the Federation of Malaya, North Borneo, Sarawak and Singapore, and were able to gather information upon which to base their recommendations. In carrying out their task they have the benefit of advice and assistance from members of the Governments concerned, their officials, and representatives of private interests. They wish to take this opportunity of expressing to them their deep appreciation.

The Mission’s Approach

11. In order to obtain perspective on the specific issues raised by the terms of reference, the Mission first took a broad look at the economies of the various territories and at their key development problems. This examination confirmed the conclusion—which is already reflected in government policies—that greater economic diversification is essential in the territories of Malaysia. Merger in itself will help achieve this goal by significantly broadening the economic base. But, equally important, the establishment of a common market within Malaysia for domestically produced goods would be a major stimulus to diversification and economic growth.
12. The Mission then considered the first specific point (1 *a*) in the terms of reference, namely “to advise on the feasibility of common market arrangements taking into account the importance of preserving the entrepot trade” Its conclusion was that common market arrangements can be worked out in a manner which will preserve the

entrepot trade, provided that a clear distinction is made between the treatment of import duties designed to protect domestically produced goods and the treatment of non-protective duties which would not affect such goods directly.

13. The terms of reference also request the Mission to examine "the public revenue implications of (common market) arrangements." The Mission is convinced that the stimulus which a common market will provide to economic activity will result in a significant increase in public revenue. Public revenue should also increase to the extent that it is possible to extend and harmonize non-protective duties, say at the Malayan level, without disrupting the entrepot trade. This does imply that, in time, there should be a considerable reduction in the "present differences in tariff and trade policies among the territories" (point 1 *b*). After the transition period necessary to get the common market arrangements started, we suggest a review be carried out to determine whether complete harmonization of tariffs would be possible, and if not, to decide on means for offsetting the impact of remaining differences.

14. The Mission found no significant differences in the industrial promotion aims and policies of the territories (point 1 *c*). It has suggested federalization of various aspects of industrial promotion, and federal coordination of those promotion techniques which would remain state matters, so as to discourage undue competition for industrial investment among the territories. In other economic areas, it found no important instances of possible conflicts or overlapping interests (point 1 *d*).

15. Finally, the Mission has made recommendations, as requested in point 3, on administrative arrangements for coordinating and integrating development planning, including industrial development planning. The main suggestion here is, in effect, to build up stronger Federal institutions for these purposes on the basis of existing agencies which have already developed particular effectiveness in their respective fields.

16. In short, the recommendations of the Mission have tended to conform to the second point of the terms of reference, namely "to recommend concrete steps which should be taken in the field of economic policy to effect such economic coordination so as to produce the maximum advantage to all territories." In the course of its work the Mission became convinced that this could and should be interpreted to mean "so as to produce the maximum advantage to Malaysia." This the Mission has taken as its basic guide, bearing in mind that this objective involves taking due account of the particular needs and problems of the various territories.

17. The President of the International Bank transmitted the report to the governments of the Federation of Malaya, North Borneo, Sarawak and

Singapore in July 1963. The letter of transmittal noted that since the report had not been discussed by the Executive Directors or reviewed by the Management of the Bank, the report as transmitted represented the views of the Mission rather than positive recommendations of the Bank. The letter added, however, that the Bank believed that the findings of the report deserve careful consideration and discussion.

PART ONE

THE MAJOR ECONOMIC EFFECTS OF MERGER

TABLE XI

SINGAPORE—ESTIMATE OF VALUE ADDED BY THE ENTREPOT
TRADE, BY PRINCIPAL COMMODITIES*

(1958-1961 M\$ millions)

<i>Commodity</i>	<i>Commodity Classification</i>	1958	1959	1960	1961
Rubber	Group 231	102.2	133.4	125.5	133.0
Rice, wheat flour and meal	Groups 042, 046	4.6	5.1	8.9	5.3
Coffee, raw	Group 071	20.7	18.2	17.9	24.1
Spices and tea	Group 074-075	18.2	25.5	24.6	14.0
Fish and fish preparations	Groups 031-032	4.9	4.8	5.1	7.6
All oils, oilseed, etc.	Groups 221, 412	9.6	15.3	9.0	6.2
Rattan	Groups 292 032-3	4.4	5.1	6.3	5.2
Wood and wood products	Groups 242-243	2.7	2.2	5.3	1.9
Beverages and tobacco	Section 1	8.8	6.6	8.8	8.0
Other foods and food products	Section 0 (remainder)	18.6	15.5	16.6	12.7
Mineral fuels	Section 3	20.8	18.5	18.7	17.7
Road vehicles, parts, tractors	Groups 732-3, 713	11.3	14.0	20.2	19.3
Textiles and clothing	Groups 651-6, 841	18.2	16.7	18.0	20.8
Machinery and other transport equipment	Section 7 (remainder)	7.9	7.4	16.9	20.9
Chemicals	Section 5	6.9	6.9	7.7	7.7
Tin and tin-ore	Groups 283 060 and 687 011	6.6	0.2	0.2	8.6
All other manufactured goods	Sections 6 and 8 (remainder)	14.6	15.4	19.6	22.3
Other crude materials, both vegetable and mineral	Sections 2 and Group 661 ...	8.9	8.6	9.7	12.0
Other items†	—	42.8	47.1	51.4	50.8
TOTAL		332.6	366.5	390.4	398.1
Of which:					
Value added by processing‡		160.1	188.9	182.9	196.7
Value added by other trade activities		172.5	177.6	207.5	201.4
		332.6	366.5	390.4	398.1

* The value added data presented in this table are lower than the implied value added figures which are derivable from Tables IX and X. This is because the statistical techniques used in the compilation of this table take account of year-to-year stock changes and also tend to reduce, but do not eliminate, the errors resulting from unrecorded transactions.

† Comprising items of which the value of re-exports is less than M\$5 million on the group level. "Special transactions" are also included.

‡ Mainly rubber, coffee and spices.

Source: Derived from data supplied by Chief Statistician, Singapore.

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STATISTICAL APPENDIX

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CHAPTER I

The Economic Framework of Malaysia

The General Setting

1. The component territories of the forthcoming Federation of Malaysia are already united by a common currency system, and by many similar institutions. Each country has an important immigrant community of fairly recent origin, but Malay and English are widely used as common languages. However, the dissimilarities are also many. The new Federation will in fact consist of countries which are at significantly different stages of economic and social development and with substantial differences in human and natural resources.
2. The population of these territories together is now about ten and a half million. It is made up from roughly equal proportions of Malays and other indigenous races, and of other ethnic groups, mainly Chinese and Indian. However, the proportions in the various territories differ substantially. The total population is now growing at over 3% per annum, with the population of Singapore rising at 4.4% including 0.9% due to immigration, while in the Borneo States the natural growth rate has probably just begun to exceed 3% following the stepped-up public health activities in the past decade. The population is distributed very unevenly; average density per square mile is only 16 in both North Borneo and Sarawak, but 143 in Malaya, and in predominantly urban Singapore it is 7,800. Literacy rates also vary widely; among those over 10 years of age, only 25% are literate in both Borneo States, as compared with somewhat over 50% in Malaya and Singapore.
3. Despite the fact that only about 3% of the land in Sarawak and North Borneo is under settled cultivation for food or commercial crops, there is more such land in use per person than in Malaya (where 17% is under cultivation), indicating less advanced agricultural techniques and poorer

soils in the Borneo States. Shifting cultivation is still widespread, particularly in Sarawak. Again, the acreage of rubber *per capita* is only slightly lower in the Borneo States than in Malaya, but the yield per acre is considerably lower. On Singapore Island, 27% of the very limited land area is devoted to intensive food production.

4. There are important differences in the structure of economic activity. In both Borneo States, 80% of the economically active population is engaged in agriculture, forestry and fishing, as compared with 58% in the Federation and only 8% in Singapore. Conversely manufacturing and construction occupy 20% of the labor force in Singapore, but only about 11% in Malaya and less than 6% in the Borneo States. Trade, transport and other services account for nearly 70% of employment in Singapore, about 30% in Malaya and 13% in the Borneo States.

5. Levels of income also show significant contrasts. On a *per capita* basis, Sarawak has the lowest—about M\$550, while North Borneo probably has M\$700 or more, the present Federation about M\$800 and Singapore around M\$1,300. Of course, there are also significant differences within each of these territories. It is not unlikely, for example, that some parts of the Federation have about the same average income as Sarawak, while others, e.g., the prosperous regions around Kuala Lumpur and Penang, may be as high as Singapore. These income levels, even in Sarawak, are significantly higher than the rest of South East Asia. The M\$860 average for Malaysia as a whole is probably about twice the *per capita* income level of Thailand or the Philippines.

6. The prosperity of these territories compared with surrounding countries is in large part based upon their specialization in a number of profitable export products and trade services. For Malaysia as a whole, exports of domestic goods and services amounted to about M\$4,000 million in 1961 or over 45% of the combined national products. The ratio of export income to GNP in Malaya is about 40%, while in all the other territories it is 50% or more. There are significant differences in the structure of export earnings, but rubber plays a major role in all of them, accounting directly for about 40% of total earnings and also contributing significantly to Singapore's entrepot income. However, timber is the mainstay of North Borneo's external income, while in Singapore external earnings derive mainly from a variety of entrepot activities and, to a lesser extent, from domestic exports and from expenditures by United Kingdom forces.

Recent Trends in Output and Investment

7. For most of the past decade there has been a healthy rate of economic expansion in all these territories. North Borneo's growth rate has been the

highest in recent years mainly because of the great expansion in timber production. In the Federation and Sarawak, growth has been less spectacular, and has been subject to fluctuations because of changes in prices of the main export commodities. However, expansion of real output has been substantial and *per capita* incomes are undoubtedly higher now than in the mid-1950's. In Singapore, economic growth levelled off in the 1958-60 period, after buoyant development in the earlier part of the decade, but growth has recently resumed.

8. The rate of investment has risen significantly during the past few years in all the territories, both in the private and public sectors. In 1962, it is estimated that total investment rose to around 18% of the national product in the Federation, North Borneo and Sarawak, as against 15% or less in the 1956-59 period. In Singapore the rate has recovered after a sharp drop in 1959 and 1960 but remains less than 15%. Private investment amounts to over half the total in all the territories except Singapore, where it was roughly 40% in 1962.

9. Reliable data are not available on the distribution of private investment by sector in any of the territories. However, it is clear that a good part of the increase during the past several years in the Federation and the Borneo States has been in planting or replanting of rubber and oil palm, in development of forestry (especially in North Borneo), in residential and commercial building and in manufacturing, mainly in the Federation. These increases have undoubtedly been fostered to a significant degree by the direct incentives provided by the public sector (planting grants, loan funds for housing, tax exemptions and industrial site development for manufacturing); but the indirect stimulus provided by generally high incomes from exports and from rising total government outlays has probably been at least equally important.

10. In the public sector, outlays on education and health, both current and capital, have more than doubled in the last five years in all the territories. Expenditures on low-cost housing have been substantially expanded in the urban areas of the Federation and Singapore. In total, outlays on such social services have recently accounted for between one-quarter and one-third of public investment expenditures in each of the territories except Singapore, where the proportion has been around 40%.

11. While investment in social services has been important, the main emphasis of public sector investment has been in basic economic facilities or directly for productive purposes. In the Federation, North Borneo, and Sarawak, the largest single component of public investment has been for land development. These efforts have taken various forms, including expansion of land settlement projects for smallholders, grants to small-

holders and estates for replanting rubber and other crops, extension of the road network to open up new land and expansion of research and agricultural extension services.

12. In addition to extension of rural roads, there have also been substantial increases in other transport and communication facilities. There have been major investments in civil aviation both for internal and foreign travel, in telecommunications and in port facilities. Another major portion of public investment funds has been devoted to expansion of public utilities, especially electric power, where demand has been increasing very rapidly throughout the region, and in water supplies both in the major towns and increasingly in the rural areas.

13. The programs to encourage industrialization have begun to absorb a significant amount of public funds in Singapore and the Federation. The main direct expenditures for this purpose have been for development of industrial sites, and the provision of loan funds for industry, although the latter have been quite limited to date. In addition, all territories have adopted the practice of giving income tax exemption for new industries under "pioneer status" programs, and in the Federation and Singapore, and to a lesser extent in the Borneo territories, a start has been made on using protective tariffs.

The Present Financial Position

14. Despite the expansion in investment over the past several years, the Malaysian territories have maintained and even improved their sound financial position. Total foreign exchange reserves of the four territories rose to about M\$3,800 million in 1962 or the equivalent of nearly one year's imports of goods and services. Of this, less than half was held by the Currency Board and banks, the remainder being held directly by the governments of the territories and various public agencies. At the end of 1962, government holdings amounted to about M\$1,100 million in the Federation, M\$700 million in Singapore and about M\$120 million in the Borneo States combined. At the same time, the public external debt of the territories remained quite small, around M\$700 million altogether, most of which was owed by the Federation.

15. An important factor in the maintenance of this sound external position has been the relatively high level of public revenue achieved in all the territories. Combined Federal and State revenues, together with the net earnings of government corporations, amounted in 1962 to about 21 % of the national product in both the Federation and Sarawak, and probably even more in North Borneo. In Singapore, the ratio was around 19%. In addition, both the Federation and Singapore have been able to draw on substan-

tial local borrowings from their public provident funds, and to a lesser extent from the private sector. Together with moderate foreign borrowings, these sources of finance have been sufficient for most of the period since 1957 to meet the public sector's requirements for both current and *capital* outlays, and still leave a surplus which has gone into reserves. In 1962, however, the reserves of the Federation and Sarawak did not increase, as rising expenditures coincided with a levelling off in revenues.

The Main Development Problems

16. Economic progress in the Malaysian territories during the past decade, and particularly in the past several years, has been impressive. However, these territories will be faced with difficult problems in the years ahead. Most of these are not new, but they are becoming more pressing.

17. First there are pressures arising from the increase in the population and labor force. The present population growth rate of over 3% compares with one of around 2% or less ten to fifteen years ago in most parts of Malaysia. In Singapore and the Federation, this increase is now being reflected in a parallel rise in the growth rate of the labor force, so that there are now approximately 50% more new job-seekers each year than was the case several years ago. In both territories, but particularly Singapore, there are signs of growing unemployment. In some urban areas of Sarawak, a similar pattern is developing; population growth in Sarawak has also led to a serious overworking of land in many areas of shifting cultivation. In North Borneo, by contrast, there is no significant unemployment and, if the present boom continues, a serious labor shortage may develop.

18. An equally important problem in both Sarawak and North Borneo arises from the sharp increase in the size of the younger age groups and the growing burden that this implies for expanding education and other social services. This is also a problem for the Federation and Singapore, especially at the secondary school level.

19. In short, the problems of merely keeping unemployment from rising and keeping *per capita* standards of social services and incomes from falling will be substantial. In addition, there is a need to achieve improved standards of living. From a social and political standpoint, this is particularly urgent in those areas of the economy which have been largely by-passed by the increase in prosperity of the past decade. All the territories of the future Malaysia include widespread areas of poverty and economic backwardness. These are most pronounced in the north and east sections of Malaya and the interior of the Borneo territories. Expanded efforts in resettlement, education and other aspects of rural development will be needed to cope with these needs. In addition, there are in some of the main