



Trade, Economic Policy and Diversification: the Malaysian Experience

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Abstract

The purpose of this paper is to provide a policy perspective on Malaysia's attempts at economic diversification. It is argued that the need to diversify has been of interest to Malaysian policy makers from the early years of post-colonial independence. Economic diversification has taken a different flavour in more recent years. While initial efforts were aimed at moving from export-dependence that relied on agricultural commodities, more recent initiatives have been directed at shifting towards knowledge-based economic activities. The recent global financial and economic crisis emphasises that it is necessary to review Malaysia's reliance on exports. In particular, it is necessary to reduce the dependence on a narrow range of manufacturing industries 

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1.0 Introduction

During the colonial period in Malaya, international trade was centred around tin and rubber. The production of these commodities was largely the monopoly of British producers since the Europeans dominated the plantation sector from the 1930s. British involvement in the tin industry was as significant as that in rubber. The British invested actively in rubber plantation and tin mines because both sectors were then growing at an encouraging rate. There were no attempts made in the pre-independence years to develop the growth of domestic manufacturing industries because of the economy's reliance on primary commodities. Indeed, given the stage of the country's economic development at that point in history, it would not have been feasible to develop a manufacturing sector. 


Foreign investment in the years prior to Malaysia's independence came in the form of foreign ownership of plantations and tin mines. During this time, up to 75 per cent of export trade and about 65 per cent of import trade were in the hands of European companies. In keeping the vested interests of the Europeans, the agricultural sector was developed during that time, and there was little interest in economic diversification. Accordingly, two important institutions were established to drive the agriculture sector, viz. the Rural and Industrial Development Authority (RIDA) and the Federal Land Development Authority (FELDA). These institutions were set up in 1950 and 1956, respectively, reflecting the needs of the time.


The pattern of economic activity in the Malaysian economy has changed in the years following its independence. There has been a continuing quest to transform the economy, and it has been successful, although not complete at the present time. In discussing these issues, the present paper will trace the historical roots of the quest for economic diversification and transformation in the next section. The third section will briefly examine the recent global financial and economic crisis because it stresses the need for diversification. This will be followed by a discussion of some of the recent government attempts to restructure the economy. Finally, some concluding remarks will be made.

2.0 Trade and Transformation of the Malaysian Economy

In the first two decades after independence, Malaysia was very dependent on the export of primary commodities (Ariff and Zainal-Abidin, 1998). In 1947, for instance, earnings from the export of rubber and tin amounted to RM701 million (see Table 1). It is instructive to note that this amount formed about 84 per cent of Malaya's total exports (RM835 million) at that time. The situation was not substantially better in the early years after independence. In 1950, export earnings from rubber and tin amounted to RM2,508 million, which was 85 per cent of the country's total export earnings. The heavy dependence on rubber and tin as export earners was reduced by 1970. In 1970, rubber and tin accounted for a mere 53 per cent of total export income. This illustrates the shift from primary commodities, as a consequence of the industrial policies that Malaysia had undertaken in the two decades after independence.

Table 1.  **Gross Export Earnings and Rubber and Tin Earnings (RM million)**

Year	Gross export earnings	Rubber and Tin Earnings
1947	835	701
1950	2608	2252
1955	2372	2018
1960	292 	2508.7
1965	3782.5	2333.6
1970	5163.1	2729.3

Source: Department of Statistics Malaysia,  Economic Statistics (various years)

There has actually been a shift in the types of primary commodities that Malaysia has been exporting over the years. As Table 2 indicates, in 1960, rubber accounted for about 55 per cent of total exports and tin contributed 14 per cent of total exports. There was a gradual decline in the contribution of rubber to total exports from 1965 to 1973, after which the plunge was more drastic. In the case of tin, it constituted about 20 per cent of total exports till 1970 and dropped to about 10 per cent by 1979.

By contrast, timber has featured more predominantly in the late 1970s, while logs assumed a more significant role since the late 1960s. In 1960, timber accounted for about two per cent of exports and rose to about three per cent in 1967. However, the export of logs jumped from about three per cent in 1960 to about 13 per cent in 1967. Similarly, palm oil exports have also compensated for the decline in the exports of rubber and tin. More importantly, there has been a drastic shift from primary commodities to exports from the manufacturing sector.

Table 2.

The Value of Exports of Selected Commodities as a Percentage of Total Exports (%)

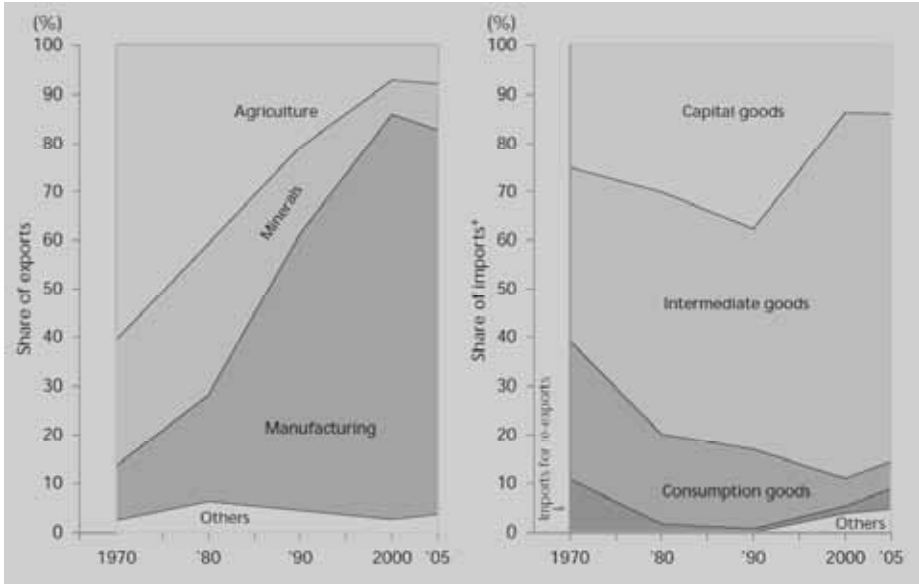
Year	Rubber	Tin	Timber	Palm Oil	Logs
1960	55.1	14	2.1	1.7	3.3
1963	44.3	19.3	2	2.1	6.2
1965	38.6	23	2.6	2.8	7
1967	34.2	20	2.8	5.1	12.8
1970	33.4	19.5	4	7.8	12.5
1973	34	12.2	3.9	6.3	13.4
1975	23.8	14.1	6	15.5	7.9
1977	30.3	15.3	7.6	15	13.6
1979	18.5	9.6	11.9	5.5	11.9
1980	19.7	9.9	5.7	11.1	11.2

Source: Department of Statistics Malaysia, Economic Statistics (various years)

The change in the profile of exports is more striking if one were to examine the structure of merchandise trade. In 1970, manufacturing constituted about 10 per cent of total exports and it increased more markedly subsequent to the mid-1980s (Figure 1). In the late 1990s, manufacturing accounted for about 80 per cent of total exports. Exports emanating from the agriculture sector have demonstrated a performance that is quite the reverse of that shown by manufactured exports. In 1970, the two biggest contributors to exports were agricultural goods and minerals. Agriculture, at that juncture, contributed about 60 per cent of total exports, and minerals (principally tin) comprised more than 25 per cent of total exports. However, agricultural exports have, over the years, come to play a diminished role. In 2005, exports from agriculture accounted for less than 10 per cent of total exports.

Figure 1.

Structure of Merchandise Trade, Malaysia, 1970-20



Source: Bank Negara Malaysia, Annual Report (various years)

The changing structure of Malaysia's imports over the years demonstrates how trade policy and industrialisation programmes have had a definite and positive impact on the trade pattern (see Ariff, 1984). It also provides evidence as to how industrial policy has been successful in achieving economic diversification. In 1970, imports were divided more or less equally between capital goods, intermediate goods and consumption goods. At that point in Malaysia's trade history, capital goods were the least important (25 per cent) of imports. Also, in 1970, intermediate goods (35 percent) and consumption goods (30 per cent) enjoyed roughly the same share.

By the late 1980s, the pattern of imports changed dramatically, with capital goods enjoying almost 40 per cent of the total, and intermediate goods accounting for almost as much. The increasing share of capital goods, understandably, increased significantly at this time due to the greater emphasis on heavy industrialisation, something that stretched well into 1990. As for intermediate goods, it is hardly surprising that its share of imports should have been increasing over the last fifty years. This has been

market solutions should be explored and expanded as it allows the greatest amount of flexibility for firms and consumers to make adjustments. The fourth is that any solution must account for all stakeholders to reach more acceptable solutions. The last is that societies must establish for themselves acceptable environmental standards based on community preferences which may change as quality of life changes. The different expected standards may be manifested via market forces but that is only if society periodically takes stock of natural assets. There is hence a need for environmental accounting if a successful green policy is to be pursued.

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