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# 14 Changes in the Malaysian Economy and Trade Trends and Prospects

Chee Peng Lim

## 14.1 Introduction

The Malaysian economy has experienced a relatively rapid growth rate during the last twenty years and has also undergone a structural transformation. From a largely agriculture-based economy, diversification has proceeded to the extent that manufacturing is slowly emerging as a leading sector. Needless to say, this structural transformation has affected the product composition of Malaysia's trade as well as the structure of its trade with the United States, Japan, and Western Europe.

The main purpose of this paper is to focus on the trade trends and prospects of Malaysia following the economic changes described above. The paper will also focus on how the product composition of trade in manufactures has changed as development occurred in Malaysia over the last twenty years and will examine the salient determinants of those changes. The analysis of trade will be linked to an analysis of domestic development in Malaysia; the growth of manufactured exports and the changing structure of trade with Malaysia's leading trade partners will be discussed. Finally the paper will assess whether the pattern of rapid growth, expansion of manufactured exports, and increased industrial imports will continue; a discussion of the implications of this assessment will conclude the paper.

The main problem encountered in this study is the lack of adequate, accurate, and up-to-date data. Some of the data required for this study, especially data on specific manufacturing industries, are not available. Other data, such as the Index of Manufacturing Production, are not accurate because the 1968 weights used in the current production index

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do not represent the structure of production reflected by the 1973 manufacturing census. Finally, the 1978 manufacturing census has still not been published, so in many cases data from the 1973 census have to be used. Trade data are much better. Still there are some problems. A major problem is created by the changes in the SITC classification. Because of these changes there were some problems in comparing changes in the composition of exports and imports during the period under study. Another problem is the separation of the trade data of Sabah and Sarawak from those of Peninsular Malaysia.<sup>1</sup> Consequently in some cases we are able to present trade data only for Peninsular Malaysia and not the whole country.

The study is divided into eleven sections. Following the Introduction, section 14.2 discusses the rapid growth in the Malaysian manufacturing sector during the last two decades. Section 14.3 traces the structural changes which took place in the manufacturing sector during its rapid period of growth, and section 14.4 tries to distinguish the two stages of growth in the manufacturing sector. These discussions set the stage for the analysis of external trade patterns, which begins in section 14.5. Sections 14.6 and 14.7 examine the composition of and changes in Malaysian exports, while sections 14.9 and 14.10 do the same for imports. Section 14.8 focuses on the growth of manufactured exports. The concluding section tries to anticipate further changes in the Malaysian economy and to evaluate trade prospects for the rest of this decade and includes some implications of the assessment.

## **14.2 Growth of the Manufacturing Sector**

Since its independence in 1957, the Malaysian government has promoted the manufacturing sector with the aim of diversifying its agriculture-based economy and as a means of generating employment opportunities. More recently, industrialization has become an important vehicle to achieve the aims of the New Economic Policy, namely, the restructuring of employment and ownership of assets as well as the alleviation of poverty.<sup>2</sup>

Considering the various important objectives which the Malaysian government has laid down for the manufacturing sector, it is not surprising that this sector has received the policymakers' special attention. As early as 1958, the Pioneer Industrial Ordinance was introduced to provide fiscal incentives for industrial investments. This was replaced a decade later by the broader Investment Incentives Act.<sup>3</sup> In addition, the Malaysian Industrial Development Finance (MIDF) was set up in 1960 and the Malaysian Industrial Development Authority (MIDA) was established in 1965 to provide financial and other facilities for investors in the manufacturing sector. Also, in line with the New Economic

Policy, the Malaysian government began to participate more actively and directly in the industrialization process by investing in industries.

In 1975 the Industrial Coordination Act was introduced to accelerate the pace of industrialization and achieve the New Economic Policy objectives. Pragmatic changes in industrial sector policies reinforced by sustained political and price stability, a buoyant balance of payments, a favorable investment climate, abundant natural resources, and a fairly well-educated labor force have helped the Malaysian manufacturing sector achieve substantial industrial growth over the last two decades. The average annual growth rate in this sector of 12% has been consistently higher than that of any other sector in the economy during the last two decades. This growth rate is twice the 6% rate of average annual growth of GDP in the 1960s and one and a half times the high 7.5% per annum GDP growth in the 1970s (Chee 1982a).

The increase in value added is also another good indicator of the very rapid growth in manufacturing activity. Between 1959 and 1973, total value added arising from the manufacturing sector grew from M \$204 million to M \$2,060 million—an increase of more than tenfold.<sup>4</sup> This increase represents an average annual growth rate in the region of 18%. More significantly, the increase in gross value added exceeded the increase in gross output in the last twenty years. The result is a continuously rising ratio of value added to gross output during this period and indicates Malaysia's success in increasing the domestic value added content of its manufacturing gross output. In addition, when growth rates are calculated over different time periods, we observe that there was an acceleration in the increase in value added, particularly after 1968 (Chee 1982a). This spurt appears to coincide closely with the Malaysian government's increasing use of tariff protection as an instrument to advance industrial development. However, it was also during this period that manufactured exports began to achieve some measure of success.

In terms of number of establishments and employment, in the last twenty years, the total number of manufacturing establishments has more than doubled, while the total number of employees has increased from 61,597 to 377,719 (about six times).

In short, all indicators show that manufacturing has been by far the fastest growing economic activity on a sustained basis in the Malaysian economy. Available evidence shows that the sources for the substantial growth in the manufacturing sector in the past may be traced to the growth in domestic demand and import substitution (accounting for about 90% of industrial development during the 1960s (Hoffmann and Ee 1980, chap. 5). By the late 1960s and early 1970s, the scope of the "easy" or first, stage of import substitution was substantially reduced. Further, beginning around the mid-1960s, manufactured exports grad-

ually became an important direct source of growth, accounting for about a fifth of industrial growth. In more recent years, 1974–78, manufactured exports have maintained their contribution to growth at about 20%, and additional import substitution appears to have contributed 12%–13% to growth in those years.

The rapid growth in the Malaysian manufacturing sector has enabled it to make a significant contribution to the growth in the country's GDP (see table 14.1). This contribution of manufacturing to the growth in GDP has increased from nearly 20% in the early 1960s to nearly 26% in the late 1970s. Consequently the share of manufacturing in GDP has risen from less than 8% in 1960 to more than 20% two decades later, compensating for the declining share of the primary sectors (agriculture, forestry, and fishing).

Apart from the above, the rapid growth in the Malaysian manufacturing sector has also generated significant employment opportunities. The two leading contributors to direct employment creation were the wood-processing and electrical machinery industries—each providing 25,000–28,000 jobs during the decade 1963–73 (when the total increase in employment amounted to about 190,000 persons). The next in line were food products and textiles, each contributing about 21,000 jobs. Thus, these four subsectors together were responsible for almost half of the total jobs created in the entire manufacturing sector during 1963–73. Other leading industrial groups in generating direct manufacturing employment were fabricated metal products, followed by wearing apparel (excluding footwear), rubber products, machinery (except electrical and transport), and plastic products. These five groups together generated the majority of jobs created in the entire manufacturing sector.

### 14.3 Structural Changes in the Manufacturing Sector

Apart from a rapid growth in output, the manufacturing sector also experienced a structural change which is reflected in its pattern of production during the period under study. The shares of intermediate and capital goods industries in total value added have increased steadily at the expense of the food and wood products and printing industries, in particular (table 14.2). More specifically, in 1959 the food, wood products, and printing industries accounted for 26.0%, 16.1%, and 8.3% of total value added respectively, while the electrical machinery and basic metals industries accounted for less than 1% of total value added in manufacturing. By 1978 the shares of the food, wood products, and printing industries had declined to 20.8%, 9.7%, and 3.9% respectively, while those of the electrical machinery and basic metals industries had increased to 10.8% and 3.1% respectively.

**Table 14.1**                      **Malaysia: Gross Domestic Product by Sector of Origin**

Sector	Gross Domestic Product					Average Annual Growth Rate (%)				Share of GDP (%)				
	1961	1965	1970	1975	1980	1961–70	1971–75	1976–80	1971–80	1961	1965	1970	1975	1980
Agriculture, forestry, and fishing	2,684	2,675	3,797	4,804	5,809	5.3	4.8	3.9	4.3	38.5	31.0	30.8	27.2	22.2
Mining and quarrying	424	537	778	792	1,214	1.8	0.4	8.9	4.6	6.0	8.6	6.3	4.6	8.6
Manufacturing	591	655	1,650	2,850	5,374	10.9	11.6	13.5	12.5	8.5	10.2	13.4	16.4	20.5
Construction	235	294	475	654	1,186	7.3	6.6	12.6	9.6	3.4	4.1	3.9	3.8	4.5
Electricity, gas, and water	88	97	229	365	592	—	9.8	10.2	10.0	1.3	1.6	1.9	2.1	2.3
Transport, storage, and communications	343	366	581	1,071	1,696	—	13.0	9.6	11.3	4.9	5.0	4.7	6.2	6.5
Wholesale and retail trade, hotels and restaurants	1,338	1,399	1,633	2,219	3,295	5.1	6.3	7.3	13.3	19.2	18.2	13.3	12.8	12.6
Finance, insurance, real estate, and business services	—	—	1,036	1,468	2,155	—	7.2	8.0	7.6	—	—	8.4	8.5	8.2
Government services	1,269	1,299	1,367	2,210	3,398	—	10.1	9.0	9.5	18.2	21.3	11.1	12.7	13.0
Other services	—	—	306	478	657	—	9.3	6.6	7.9	—	—	2.5	2.8	2.5
Less: imputed bank service charges	—	—	117	211	308									
Plus: import duties	1,053	1,088	573	665	1,120									
Equals: GDP at purchasers' value	5,919	6,234	12,308	17,365	26,188	5.5	7.1	8.6	7.8					

Sources: Young et al. 1980, 322; Malaysia, *Fourth Malaysia Plan 1981–85* (Kuala Lumpur: Government Press, 1982), 11.

Note: 1961–65 at current prices. 1970–80 at 1970 prices.

**Table 14.2 Peninsular Malaysia: Value Added by Industry**

Industry	Value Added (millions of ringgits)										Annual Growth Rate (%)				
	1959	%	1963	%	1968	%	1973	%	1978	%	1959-63	1963-68	1968-73	1963-73	1973-78
Food	53	26.0	65	17.5	140	17.6	239	11.6	1,101.4	20.8	5.2	16.6	11.3	13.9	16.6
Beverages	10	4.9	13	3.5	36	4.5	61	3.0	131.7	2.5	6.8	22.6	11.1	16.7	19.3
Tobacco	11	5.4	28	7.5	57	7.2	131	6.4	147.5	2.8	26.3	15.3	18.1	16.7	2.1
Textiles	<sup>a</sup>		4	1.0	20	2.5	104	5.0	346.2	6.5		38.0	39.1	38.5	38.8
Footwear and clothing	<sup>a</sup>		4	1.0	7	0.9	36	1.7	77.1	1.5		11.8	38.8	24.6	19.0
Wood products	33	16.1	49	13.2	94	11.8	304	14.8	514.3	9.7	10.4	14.0	26.5	20.0	11.5
Furniture	3	1.5	8	2.2	10	1.3	19	0.9	36.7	0.7	27.8	4.6	13.7	9.0	15.5
Paper	<sup>a</sup>		3	0.8	6	0.8	18	0.9	46.6	0.9		14.9	24.6	19.6	26.5
Printing	17	8.3	29	7.8	53	6.7	115	5.6	206.8	3.9	14.3	12.8	16.8	14.8	13.3
Leather	<sup>a</sup>		1	0.2	1	0.1	3	0.1	4.6	0.1		0	24.6	11.6	8.9
Rubber	15	7.4	23	6.2	51	6.4	82 <sup>b</sup>	4.0	526.4	9.9	11.3	17.3	9.7	13.4	90.3
Chemicals	15	7.4	42	11.3	79	9.9	175	8.5	302.1	5.7	29.4	13.5	17.2	15.3	12.1
Petroleum products	<sup>a</sup>		<sup>a</sup>		41	5.1	52	2.5	176.4	3.3			4.9		39.8
Nonmetallic minerals	13	6.4	28	7.5	62	7.8	122 <sup>c</sup>	5.9	208.6	3.9	21.1	17.2	14.5	15.9	11.8
Basic metals	<sup>a</sup>		9	2.4	21	2.6	135	6.5	166.4	3.1		18.5	45.0	13.1	3.9
Metal products	9	4.4	18	4.8	39	4.9	66	3.2	199.2	3.8	19.0	16.7	11.1	13.9	33.6
Machinery (except electrical)	6	2.9	15	4.0	25	3.1	87	4.2	153.9	2.9	25.7	10.8	28.3	19.2	12.8
Electrical machinery	<sup>a</sup>		5	1.3	21	2.6	189	9.2	572.2	10.8		33.2	55.2	43.8	33.8
Transportation equipment	8	3.9	6	1.6	19	2.4	62	3.0	160.7	3.0	-0.7	25.9	26.7	26.3	26.5
Miscellaneous <sup>d</sup>	11	5.4	23	6.2	14	1.8	62	3.0	223.5	4.2			34.7	10.4	43.4
Total/average <sup>e</sup>	204	100.0	371	100.0	797	100.0	2,060	100.0	5,302.3	100.0	16.1	16.5	20.9	18.7	26.2

Source: Department of Statistics, *Census of Manufacturing Industries*, various issues.

<sup>a</sup>Included in Miscellaneous.

<sup>b</sup>Excluding rubber remilling, latex processing, and smokehouses.

<sup>c</sup>Including pottery, china, and earthenware.

<sup>d</sup>The category Miscellaneous has included different industries during different census periods.

<sup>e</sup>Excluding off-estate processing.

Basic metals and electrical machinery increased their shares substantially because of the very rapid rate of growth achieved since 1959. This change reflects, on the one hand, the relative success of the early import substitution strategy and, on the other, the advent of the strong drive toward a greater export orientation in manufacturing activities. The increase of value added in the electrical machinery industry, for example, is the direct result of the encouragement of such industries in specially established Free-Trade Zones.<sup>5</sup> Among the first firms to be established within the Free Trade Zones were the electronic assembly firms, which still represent one of the largest components of Malaysia's nontraditional, non-resource-based exports. However, the net export earnings of the electronic industry are low compared with gross export earnings because of the large imports of component inputs that invariably take place in such industries.

Among the more serious criticisms of these industries, such as the electronics assembly industries, is the absence of substantial exploitation of backward linkages, which could contribute to the improvement of the quality of labor as well as raise the level of employment. The electronics subassembly industry has, in particular, been criticized for this shortcoming in a review of the Progress of the Second United Nations Development Decade in the Asian and Pacific Regions by the Economic and Social Commission for Asia and the Pacific (ESCAP) Secretariat.<sup>6</sup> The answer would lie, it seems, in an incentive system and an investment climate which would persuade transnational corporations to develop closer links with the Malaysian economy and involve greater transfers of technology than presently experienced.

The structural change which took place in the Malaysian manufacturing sector can also be seen by regrouping the twenty-seven industrial groups into two types: (1) consumer- and producer-oriented industries (which are further divided into two categories: consumer durables and nondurables) and (2) intermediate and capital goods industries. During 1963–68, the per annum growth rates of consumer durable, consumer nondurable, and intermediate goods were about the same (17% in current prices), with capital goods lagging behind but still growing at an impressive rate of 14% per annum. During the second half of the period consumer durables were increasing at a very high rate of 34% per annum, compared with about 20% annual growth registered in consumer nondurable and intermediate goods and 28% in capital goods. But it is important to look at the contribution that these various categories have made to increased overall value added because of their different initial bases. In this respect the contribution of nondurable consumer goods and intermediate goods declined from 37.3% to 33.7% and from 49.9% to 41.1% respectively from the 1963–68 period to the 1968–73 period. Over this decade the contribution of durable consumer



goods increased from 10.0% to 20.4% and that of capital goods from 2.8% to 4.8%. The smallness of the capital goods' contribution is as conspicuous as the substantial contribution made by intermediate products. Throughout the period, the production of consumer durable and intermediate products continued to account for about 60% of the total increase in value added in the manufacturing sector. This indicates that, despite the sluggish growth of the capital goods sector, some deepening of the manufacturing sector in the Malaysian economy has been achieved.

Yet another way of looking at the structural shift in the Malaysian manufacturing sector is to analyze the growth performance and the magnitude of the contribution made by the resource-based and non-resource-based industries. Given the rich resource base of Malaysia and the policymakers' natural preference for harnessing these resources, the resource-based industries (both agricultural and mineral) expanded rapidly during 1963–68 and contributed about 60% to the sector's overall growth during this period. This contribution fell to about 50% during the 1968–73 period. But most prominent is the increase in the contribution made by the so-called footloose industries (electronics, 36% during 1968–73). By the mid-1970s, the contribution made by these industries was catching up fast with the overall contribution made by the resource-based, agro-processing industries. It is clear that during the late 1960s and early 1970s the government shifted its emphasis from domestic-oriented, import substitution activities to export-oriented industrial development (Chee 1983c). Consequently, not only did the structure of manufacturing production shift in favor of non-resource-based industries, but among them it also shifted in favor of the export-oriented (even if footloose) industries mainly in the Free Trade Zones.

To sum up, we find that the structural changes that have taken place in the Malaysian manufacturing sector have been rather typical of the experience of other developing nations: at the initial stages of industrialization, import substitution was the primary objective, which in turn gradually gave way to the export growth targets of the present. The development of industries to supply the domestic market was nurtured primarily by the provision of attractive fiscal incentives to both indigenous and nonindigenous investors. The export growth anticipated in the eighties will have to rely upon additional incentives directed at export-oriented manufacturers.

#### **14.4 Stages of Growth**

As stated earlier, one can distinguish two stages in the growth of the manufacturing sector in Malaysia. The first stage centered on import

substitution and was the dominant source of industrial growth up to the end of the 1960s. The second stage depended on the export of manufactured goods and started in the mid-1960s.

The initial industrial development strategy in Malaysia stressed the primary role of import-substituting activities. Changes in the values of the output-demand and trade ratios can usefully reflect the progress of import substitution within the economy. The output-demand ratio measures the extent to which domestic demand, defined as domestic production plus total imports minus total exports, is met by domestic production in each industry or group of industries. The trade ratio, which measures the foreign trade balance within the industry, is defined as  $(\text{exports} - \text{imports}) \div (\text{exports} + \text{imports})$ . The range of values which the trade ratio can take varies from +1 to -1. When the ratio is +1, it means that the industry or group of industries is exporting and there are no competitive imports. When the ratio is -1, there are no exports and only competitive imports are present. These two measures are complementary in their emphasis.

Production of all manufactured goods composed 43.8% of the domestic market in Malaysia in 1963 (table 14.3). By 1973 the proportion had increased to 75.3%. The trade ratio was -0.87 in 1963 but had declined to -0.41 in 1973 (table 14.4). By 1973 import substitution had almost been completed in the case of consumer and intermediate goods, although there was still wide scope for import substitution in the case of capital goods.

Resource-based industries appear to have progressed much faster in terms of import substitution than non-resource-based industries. For instance, as early as 1963, tobacco, furniture, rubber and rubber products, and wood and cork products accounted for more than 80% of domestic demand. By 1973 the ratio of domestic production to domestic market had risen in all four industries to well over unity.

Areas where import substitution has also been successful are food, beverages, wearing apparel, printing and publishing, motor vehicles, bicycles, plastics, leather and leather products, nonmetallic mineral products, and electrical machinery. We notice that those industries that produce more than 70% of market demand are those that produce consumer and intermediate goods.

The reason for this pattern is clear. There is an obvious and relatively large domestic market for finished consumer goods already in existence, and the cost disadvantages are normally less than for either intermediate or capital goods. This is particularly true where the manufacturing process consists primarily of the assembly of imported parts and components. It is clear that by 1973 the first easy period of import substitution was nearly completed; 89.5% of consumer nondurables,

**Table 14.3 Peninsular Malaysia: Production as a Percentage of Domestic Market**

	1963	1968	1973
<i>Consumer nondurables</i>	<b>50.7</b>	<b>70.5</b>	<b>89.5</b>
Foods	45.3	69.3	98.6
Beverages	48.9	77.5	104.6
Tobacco	83.7	91.3	101.7
Textiles	11.7	32.7	55.8
Wearing apparel and made-up goods	17.1	54.4	169.5
Footwear	a	a	a
Chemicals	74.5	77.4	73.2
Pottery, china, and earthenware	25.5	31.5	49.5
Printing and publishing	69.9	82.6	92.3
Plastics	a	a	104.2
<i>Consumer durables</i>	<b>21.1</b>	<b>47.1</b>	<b>94.8</b>
Furniture	96.0	100.0	106.6
Automobiles	5.9	42.5	98.4
Bicycles	2.8	8.8	52.8
<i>Intermediate goods</i>	<b>46.4</b>	<b>77.9</b>	<b>86.5</b>
Wood and cork	96.4	108.5	242.0
Paper and paper products	15.9	23.8	31.7
Leather and leather products	64.3	81.5	87.2
Rubber and rubber products	86.4	105.7	107.5
Industrial chemicals	23.8	48.6	46.1
Petroleum	b	84.1	45.5
Nonmetallic mineral products	53.4	84.6	86.3
<i>Capital goods</i>	<b>22.1</b>	<b>34.0</b>	<b>47.7</b>
Basic metals	22.3	28.9	54.8
Metal products	40.1	50.3	63.4
Nonelectrical machinery	16.3	22.3	25.9
Electrical machinery	10.7	34.0	63.5
Transport equipment	36.8	24.2	1.7
<i>Miscellaneous</i>	a	a	a
Total	43.8	162.4	75.3

Sources: Department of Statistics, *Census of Manufacturing Industries, Peninsular Malaysia, 1959, 1963, 1968, 1973* (Kuala Lumpur); idem, *External Trade of Malaya, 1959* (Kuala Lumpur, 1960); idem, *Annual Statistics of External Trade, 1964* (Kuala Lumpur, 1965); idem, *Monthly Statistics of External Trade, December 1968* (Kuala Lumpur, 1969); idem, *Annual Statistics of External Trade, 1973* (Kuala Lumpur, 1974).

Note: 1959 percentages cannot be calculated, because it is not possible to separate reexports from either imports or exports, and ratios based on available data are therefore inflated. Furthermore, in some cases, categorizations of production, import, and export data are not comparable.

<sup>a</sup>Ratio cannot be calculated, because production, import, and export data are not comparable.

<sup>b</sup>Ratio cannot be calculated, because production has been included in Miscellaneous category.

**Table 14.4 Peninsular Malaysia: Trade Ratios**

	1963	1968	1973
<i>Consumer nondurables</i>	<b>-0.79</b>	<b>-0.68</b>	<b>-0.26</b>
Foods	-0.78	-0.62	-0.13
Beverages	-1.00	-0.69	-0.36
Tobacco	-1.00	-0.99	0.07
Textiles	-0.93	-0.86	-0.64
Wearing apparel and made-up goods	-0.95	-0.55	0.48
Footwear	0.19	0.19	0.86
Chemicals	-0.35	-0.48	-0.38
Pottery, china, and earthenware	-0.95	-0.96	-0.93
Plastics	a	a	a
<i>Consumer durables</i>	<b>-0.93</b>	<b>-0.96</b>	<b>-0.17</b>
Furniture	-0.10	-0.29	0.36
Automobiles	-0.99	-0.98	-0.06
Bicycles	-1.00	-1.00	-0.76
<i>Intermediate goods</i>	<b>-0.89</b>	<b>-0.55</b>	<b>-0.18</b>
Wood and cork	-0.61	0.67	0.98
Pulp and paper products	-0.96	-0.92	-0.85
Leather and leather products	-0.78	-0.67	-0.49
Rubber and rubber products	-0.32	-0.07	0.23
Industrial chemicals	-0.92	-0.85	-0.74
Petroleum	-0.97	-0.25	-0.78
Nonmetallic mineral products	-0.95	-0.58	-0.45
<i>Capital goods</i>	<b>-0.97</b>	<b>-0.94</b>	<b>-0.79</b>
Basic metals	-0.98	-0.92	-0.77
Metal products	-0.93	-0.89	-0.64
Nonelectrical machinery	-0.99	-0.98	-0.85
Electrical machinery	-0.95	-0.91	-0.76
Transport equipment	-0.99	-0.85	-0.23
<i>Miscellaneous</i>	<b>-0.94</b>	<b>-0.85</b>	<b>-0.23</b>
Total	-0.87	-0.75	-0.41

Source: Table 14.3.

Note: The trade ratio is calculated as follows:  $\frac{\text{exports} - \text{imports}}{\text{exports} + \text{imports}}$ . 1959 ratios cannot be calculated, because it is not possible to separate reexports from either imports or exports, and ratios based on available data are therefore inflated. Furthermore, in some cases, categorizations of production, import, and export data are not comparable.

\*Ratio cannot be calculated, because import and export data are not available.

94.8% of consumer durables, and 86.5% of intermediate goods were being produced domestically.

The annual growth rates of the domestic market over selected periods are presented in table 14.5. Among the fastest growing are the markets for capital and intermediate goods. Though the growth in demand for consumer durables and nondurables has not been sluggish, their rates of growth are well below the average for the sector between 1968 and 1973. This tends to confirm our view that the possibilities of further

**Table 14.5 Peninsular Malaysia: Annual Growth Rate of Domestic Market**

	1959-63	1963-73	1968-73
<i>Consumer nondurables</i>	<b>12.6</b>	<b>9.1</b>	<b>11.1</b>
Foods	10.1	7.4	7.5
Beverages	11.4	10.5	11.5
Tobacco	10.4	5.4	7.1
Textiles	25.6	15.1	18.8
Wearing apparel and made-up goods	10.9	3.9	7.5
Footwear	n.a.	n.a.	n.a.
Chemicals	14.8	10.2	12.0
Pottery, china, and earthenware	15.1	15.0	23.0
Printing and publishing	15.3	12.1	15.2
Plastics	n.a.	n.a.	n.a.
<i>Consumer durables</i>	<b>12.3</b>	<b>9.1</b>	<b>6.9</b>
Furniture	15.4	11.1	16.2
Automobiles	11.6	9.4	4.3
Bicycles	12.0	5.2	10.3
<i>Intermediate goods</i>	<b>14.5</b>	<b>13.0</b>	<b>15.7</b>
Wood and cork	10.0	9.5	8.1
Paper and paper products	18.7	14.6	17.6
Leather and leather products	16.9	10.7	15.4
Rubber and rubber products	10.2	10.4	11.8
Industrial chemicals	16.5	14.8	19.2
Petroleum	17.8	16.3	20.1
Nonmetallic mineral products	15.5	10.6	14.7
<i>Capital goods</i>			
Basic metals	26.0	19.5	28.0
Metal products	14.9	9.0	13.9
Nonelectrical machinery	22.1	14.9	22.8
Electrical machinery	20.9	18.7	30.8
Transport equipment	17.0	15.8	22.3
<i>Miscellaneous</i>	<i>n.a.</i>	<i>n.a.</i>	<i>n.a.</i>
Total	14.6	11.7	15.3

Source: Table 14.3.

Note: n.a. = not available.

expansion of import substitution in Malaysia are becoming increasingly limited. The fastest growing market is for capital goods, at 24.6% per annum; within this group, basic metals, nonelectrical machinery, electrical machinery, and transport equipment experienced increases in domestic demand of more than 22% each year between 1968 and 1973. This fact combined with the finding that domestic production is still less than 50% of domestic demand for these products suggests that future import substitution has to take place to a larger extent in the capital goods sector.

Trade ratios computed for 1963, 1968, and 1973 give us a clear indication of the direction in which import substitution has been taking

place and the growth of exports (table 14.4). There are only six industries with positive ratios: tobacco, wearing apparel and made-up goods, footwear, furniture, wood and cork, and rubber and rubber products. The very high negative ratios indicate that many industries were not exporting very much in 1973. This picture is confirmed by the export-output ratios contained in table 14.6. Only two industries exported

**Table 14.6 Peninsular Malaysia: Exports as a Percentage of Domestic Production**

	1963	1968	1973
<i>Consumer nondurables</i>	<b>13.2</b>	<b>11.4</b>	<b>17.3</b>
Foods	16.8	13.4	14.7
Beverages	0.0	6.4	15.4
Tobacco	0.0	0.0	12.4
Textiles	27.8	17.0	21.3
Wearing apparel and made-up goods	13.9	38.3	63.2
Footwear	a	a	a
Chemicals	34.5	21.9	30.0
Pottery, china, and earthenware	7.1	4.0	3.6
Printing and publishing	2.3	4.0	3.5
Plastics	a	a	11.2
<i>Consumer durables</i>	<b>11.2</b>	<b>2.5</b>	<b>13.3</b>
Furniture	18.2	5.3	11.8
Automobiles	2.0	1.4	13.7
Bicycles	0.0	0.0	14.0
<i>Intermediate goods</i>	<b>7.1</b>	<b>12.7</b>	<b>35.5</b>
Wood and cork	1.2	9.3	59.2
Paper and paper products	11.1	14.8	19.7
Leather and leather products	11.1	5.7	3.4
Rubber and rubber products	17.0	10.8	18.4
Industrial chemicals	14.2	10.5	14.7
Petroleum	b	23.7	16.5
Nonmetallic mineral products	2.3	8.3	9.5
<i>Capital goods</i>	<b>5.6</b>	<b>6.6</b>	<b>14.4</b>
Basic metals	2.8	6.9	6.7
Metal products	5.2	6.3	16.5
Nonelectrical machinery	3.1	3.9	25.2
Electrical machinery	22.6	9.5	9.2
Transport equipment	1.2	4.8	40.8
<i>Miscellaneous</i>	a	a	a
Total	10.4	10.9	23.7

*Note:* 1959 percentages cannot be calculated, because it is not possible to separate reexports from either imports or exports, and ratios based on available data are therefore inflated. Furthermore, in some cases, categorizations of production, import, and export data are not comparable.

<sup>a</sup>Ratio cannot be calculated, because production and export data are not comparable.

<sup>b</sup>Ratio cannot be calculated, because production has been included in Miscellaneous category.

more than 50% of output in 1973. These were wearing apparel and made-up goods and wood and cork.

For the manufacturing sector as a whole, the export-output ratio changed little between 1963 and 1968. However, by 1973 the ratio had more than doubled. The intermediate industry group had a higher ratio than the other three product groups in 1973 primarily because of the wood and cork industry, which was mainly import-substituting until 1973. However, for the older established consumer goods industries there appears to be a tendency for their export-output ratios to increase as the limits of the domestic market are reached. Examples of such industries are beverages, tobacco, and wearing apparel.

Between 1963 and 1968 the export-output ratio fell or remained unchanged for twelve industries. This is indicative of an increasing bias against exporting that was probably fostered by protection (which tended to encourage production for the domestic market at the expense of exports) during that period. Notable drops in the ratio were evident in the cases of textiles, chemicals, electrical machinery, and furniture. Thus, there appears to be room for further expansion of these industries if they can reorientate themselves to the export market. In 1973 the situation had changed: seventeen industries had experienced a rise in domestic output of less than 20%. At present, with much of the import substitution potential utilized, particularly among consumer and intermediate goods, future growth will have to take place through export expansion.

Another good measure of the possibility of future import substitution is the import-demand ratio (table 14.7). For the sector as a whole, the import-demand ratio has been falling steadily since 1963, indicating the success of the import-substituting manufacturing industries. When we examine this ratio by individual industries, we notice that it has been falling for all industries except chemicals, rubber and rubber products, industrial chemicals, petroleum, nonelectrical machinery, and transport equipment. In the case of petroleum this development is not surprising. Because of the quality of her oil resources, it pays Malaysia to export her output and import what she needs for domestic consumption. The other industries for which the import-demand ratio has been rising are mainly within the intermediate and capital goods groups. Such an increase in the import-demand ratio for capital goods is not unexpected during a period of rapid industrial growth in an economy with a small capital goods sector.

We conclude this section by looking at the growth scenario in the Malaysian manufacturing sector in recent years, during the period 1974–78. According to the Index of Industrial Production, the manufacturing sector grew at an annual real rate of 13% in the second half of the 1970s, showing a growth elasticity with respect to GDP of over 1.5.

**Table 14.7 Peninsular Malaysia: Imports as a Percentage of Domestic Market**

	1963	1968	1973
<i>Consumer nondurables</i>	<b>56.0</b>	<b>41.9</b>	<b>25.9</b>
Foods	62.3	40.2	18.4
Beverages	51.3	2.2	27.6
Tobacco	16.3	13.6	11.0
Textiles	91.6	73.4	56.1
Wearing apparel and made-up goods	85.3	71.8	37.6
Footwear	a	a	a
Chemicals	53.3	47.6	48.8
Pottery, china and earthenware	76.4	69.6	52.3
Printing and publishing	31.7	21.3	11.0
Plastics	a	a	7.5
<i>Consumer durables</i>	<b>82.0</b>	<b>54.9</b>	<b>17.7</b>
Furniture	21.5	9.6	6.0
Automobiles	94.3	58.2	15.1
Bicycles	97.2	92.1	54.4
<i>Intermediate goods</i>	<b>69.8</b>	<b>33.9</b>	<b>44.2</b>
Wood and cork	4.8	2.0	1.3
Paper and paper products	86.0	80.3	74.6
Leather and leather products	50.0	23.1	15.8
Rubber and rubber products	28.4	12.1	12.3
Industrial chemicals	79.8	60.9	63.1
Petroleum	b	33.4	62.0
Nonmetallic mineral products	47.8	26.1	21.9
<i>Capital goods</i>	<b>79.2</b>	<b>69.7</b>	<b>59.2</b>
Basic metals	78.3	65.7	52.0
Metal products	62.2	54.4	47.1
Nonelectrical machinery	84.3	79.5	80.6
Electrical machinery	91.8	71.2	42.3
Transport equipment	63.6	77.8	91.9
<i>Miscellaneous</i>	a	a	a
Total	62.7	46.6	41.0

*Note:* 1959 percentages cannot be calculated, because it is not possible to separate reexports from either imports or exports, and ratios based on available data are therefore inflated. Furthermore, in some cases, categorizations of production, import, and export data are not comparable.

<sup>a</sup>Ratio cannot be calculated, because production, import, and export data are not comparable.

<sup>b</sup>Ratio cannot be calculated, because production has been included in Miscellaneous category.

During this period manufacturing activities contributed 26% to GDP growth, twice the contribution of the primary sector. The main sources of growth sustaining this expansion during 1974–78 were domestic demand expansion (contributing about two-thirds to overall growth), an increase in manufactured exports (about one-fifth), and additional import substitution (about 12%–13%). With sustained rapid growth of



the domestic market and a widening of the industrial base, the manufacturing sector appears to have acquired during the last five to six years a favorable environment for the next phase of import substitution.

At the disaggregated level, the fastest growing manufacturing industries during the 1974–78 period were electrical machinery and electronics, textiles, and rubber products. The slowest growing industries (some of which even declined) were remilling and latex processing of rubber and the food industries (mainly estate processing/refining of coconut oil, rice milling, and canning of pineapples). Other industries which showed considerable deceleration in growth rates were the plywood, hardboard, and particle board industries and, to a lesser extent, the food, beverage, and tobacco industries. Most of these are resource-based manufacturing or processing activities.

### **14.5 External Trade Pattern**

The discussion so far has been aimed at providing the background to describe and analyze the development and changes in Malaysia's external trade pattern during the last twenty years. Briefly, we have described the rapid growth and structural changes in Malaysia over the last two decades. We have seen how the first stage of import substitution was quickly achieved and how the manufacturing sector subsequently moved on to the export market and the second stage of import substitution. In recent years the main sources of growth have been largely domestic demand expansion followed by manufactured exports and additional import substitution.

Obviously changes in the manufacturing sector would be reflected in Malaysia's external trade pattern. In this and the following sections we will try to analyze the impact of the above changes. We begin by noting the steady increase in the volume of Malaysia's external trade over the last twenty years. In 1960, total gross exports and imports were valued at M \$6,419.0 million (table 14.8). In 1980 the figure had increased to more than M \$50,000 million, or an eightfold increase in twenty years. Another interesting point to note is that Malaysia enjoyed a favorable trade balance every year during this twenty-year period.

We will now take a closer look at the pattern of Malaysia's external trade, beginning with the composition of exports.

### **14.6 Composition of Exports**

In the last twenty years, Malaysian exports of merchandise have been equal to about 40% of GNP. This percentage has increased slightly in recent years, and it shows that Malaysia's heavy dependence on

**Table 14.8** Malaysia: External Trade (in millions of ringgits)

Year	Gross Exports (f.o.b.)	Gross Imports (c.i.f.)	Sum of Gross Imports and Exports	Trade Balance
1960	3,632.6	2,786.4	6,419.0	846.2
1961	3,238.3	2,815.7	6,054.0	422.5
1962	3,259.6	3,056.3	6,315.9	203.3
1963	3,330.0	3,192.6	6,522.6	137.4
1964	3,381.9	3,205.3	6,587.2	176.6
1965	3,782.5	3,356.1	7,138.6	426.4
1966	3,845.8	3,379.9	7,225.7	465.9
1967	3,723.7	3,235.0	6,958.7	398.7
1968	4,122.6	3,551.6	7,674.2	571.0
1969	5,045.7	3,605.0	8,650.7	1,449.7
1970	5,162.4	4,323.3	9,485.7	839.1
1971	5,016.8	4,413.4	9,430.2	603.4
1972	4,854.2	4,461.9	9,316.1	393.2
1973	7,373.3	5,938.5	13,311.8	1,434.9
1974	10,194.7	9,891.2	20,085.9	303.5
1975	9,231.1	8,530.4	17,761.5	700.5
1976	13,442.9	9,721.8	23,164.7	3,721.1
1977	14,959.1	11,164.7	26,123.9	3,794.5
1978	17,073.9	13,645.9	30,719.8	3,428.0
1979	24,222.0	17,161.1	41,383.1	7,060.9
1980	28,171.6	23,451.0	51,622.6	4,720.6

Source: Department of Statistics, unpublished data; Bank Negara Malaysia, *Quarterly Economic Bulletin*, various issues.

Notes: Data have been adjusted to exclude intraregional trade. Data on gross imports from 1970 on, published beginning with the March/June 1978 *Quarterly Economic Bulletin*, are a revised series. They exclude military imports and imports for offshore installations of the petroleum industry. Quarterly totals may not necessarily add up to annual totals because of revisions and rounding.

merchandise exports has not lessened over the last two decades. What has changed has been the composition of exports.

Inedible crude materials accounted for nearly 68% of Malaysia's total gross exports in 1960, but by 1980 the percentage had been reduced by half to 32% (table 14.9). Inedible crude material exports are comprised mainly of rubber, tin, sawlogs, and sawn timber. Among these, rubber and tin declined drastically in relative terms, while the reverse was true of sawlogs and sawn timber (table 14.10).

Two other primary products registered relative increases in export earnings, and these were animal and vegetable oils and fats and mineral fuels (table 14.9). The exports of oils and fats are mostly palm oil. Malaysia became the largest producer of palm oil in the midseventies; this probably helped to increase the contribution of animal and vegetable oils and fats from 2.3% in 1960 to 11.1% in 1980.

**Table 14.9 Malaysia: Gross Exports by Commodity Groups (in millions of ringgits)**

Year	Food & Live Animals	Bev. & Tobacco	Inedible Crude Materials	Mineral Fuels	Animal & Veg. Oils & Fats	Chemicals	Manu- factured Goods	Mach. & Trans. Equip.	Misc. Manuf. Articles	Other Exports	Total	Annual Growth Rate (%)
1960	129.5 (3.6)	13.6 (0.4)	2,462.3 (67.8)	290.1 (8.0)	87.1 (2.3)	18.5 (0.5)	546.8 (15.1)	34.2 (0.9)	17.9 (0.5)	32.6 (0.9)	3,632.6	—
1961	148.0 (4.6)	21.3 (0.7)	2,017.4 (62.3)	225.2 (7.0)	91.3 (2.8)	20.8 (0.6)	613.4 (18.9)	44.2 (1.36)	20.9 (0.6)	36.5 (1.1)	3,238.2	-10.9
1962	151.8 (4.7)	34.4 (1.0)	1,944.9 (59.7)	237.3 (7.3)	90.2 (2.8)	21.6 (0.7)	669.4 (20.5)	53.4 (1.6)	22.2 (0.8)	34.4 (1.0)	3,259.6	0.7
1963	146.9 (4.4)	43.7 (1.3)	1,999.8 (60.0)	209.8 (6.3)	93.0 (2.8)	28.9 (0.9)	686.5 (20.6)	53.6 (1.6)	25.9 (0.8)	41.9 (1.3)	3,330.0	2.2
1964	163.5 (4.8)	27.3 (0.8)	1,921.2 (56.8)	235.7 (7.0)	95.2 (2.8)	35.1 (1.1)	779.0 (23.0)	57.8 (1.7)	27.0 (0.8)	40.1 (1.2)	3,381.9	1.6
1965	198.8 (5.3)	41.5 (1.1)	2,067.0 (54.6)	244.1 (6.5)	125.7 (3.3)	37.1 (1.0)	931.4 (24.6)	65.7 (1.7)	26.9 (0.7)	44.3 (1.2)	3,782.5	11.8
1966	203.7 (5.3)	19.2 (0.5)	2,177.3 (56.6)	275.5 (7.2)	142.2 (3.7)	35.2 (0.9)	854.3 (22.2)	67.4 (1.8)	24.1 (0.6)	46.9 (1.2)	3,845.8	1.7
1967	207.5 (5.6)	21.5 (0.6)	2,061.2 (55.4)	295.5 (7.9)	141.7 (3.8)	34.3 (0.9)	827.2 (22.2)	56.5 (1.5)	29.6 (0.8)	48.7 (1.3)	3,723.7	-3.2
1968	220.5 (4.6)	11.0 (0.3)	2,259.7 (54.8)	351.0 (8.5)	165.4 (4.0)	37.5 (0.9)	918.3 (22.3)	73.6 (1.8)	31.3 (0.8)	54.3 (1.3)	4,122.6	10.7
1969	233.7 (4.6)	16.9 (0.3)	3,004.4 (59.4)	339.4 (6.7)	177.6 (3.5)	38.7 (0.8)	1,071.0 (21.2)	83.7 (1.7)	33.8 (0.7)	55.5 (1.1)	5,054.7	22.6

1970	284.0 (5.5)	21.7 (0.4)	2,777.5 (53.8)	365.6 (7.1)	309.8 (6.0)	36.4 (0.7)	1,182.8 (22.9)	84.1 (1.7)	43.4 (1.0)	57.8 (1.4)	5,163.1	2.1
1971	315.9 (6.3)	23.4 (0.5)	2,392.2 (47.7)	502.5 (10.0)	422.8 (8.4)	38.7 (0.8)	1,111.8 (22.2)	83.6 (1.7)	48.5 (1.0)	77.4 (1.4)	5,016.8	-2.8
1972	360.8 (7.4)	27.7 (0.6)	2,249.1 (46.3)	319.5 (6.6)	411.5 (8.5)	46.4 (1.0)	1,217.5 (25.0)	90.9 (1.9)	72.3 (1.5)	58.3 (1.2)	4,854.0	-3.2
1973	440.9 (6.0)	21.3 (0.3)	4,156.7 (56.4)	371.5 (5.0)	559.6 (7.6)	66.7 (0.9)	1,317.6 (17.9)	142.0 (1.9)	225.7 (3.0)	70.1 (1.0)	7,372.1	51.9
1974	513.7 (5.0)	24.4 (0.2)	4,515.8 (44.3)	832.9 (8.2)	1,370.0 (13.4)	79.8 (0.8)	1,966.2 (19.3)	399.4 (3.9)	395.9 (3.9)	96.6 (1.0)	10,194.7	38.3
1975	593.1 (6.4)	27.7 (0.3)	3,231.4 (35.0)	967.1 (10.5)	1,508.5 (16.3)	79.4 (0.9)	1,624.3 (17.6)	573.0 (6.2)	529.3 (5.7)	97.1 (1.1)	9,230.9	-9.5
1976	799.1 (5.9)	27.9 (0.2)	5,668.3 (42.2)	1,905.4 (14.2)	1,378.2 (10.3)	82.0 (0.6)	2,132.7 (15.9)	739.6 (5.5)	608.5 (4.5)	100.3 (0.7)	13,442.0	45.6
1977	826.9 (5.5)	23.4 (0.2)	5,975.7 (40.0)	2,101.1 (74.0)	1,979.4 (13.2)	86.8 (0.6)	2,324.3 (15.5)	1,001.2 (6.7)	545.4 (3.7)	95.0 (0.6)	14,959.2	11.3
1978	872.3 (5.1)	15.7 (0.1)	6,360.1 (37.3)	2,342.7 (13.7)	2,105.7 (12.3)	102.3 (0.6)	2,825.4 (16.6)	1,816.1 (10.6)	495.5 (2.9)	138.1 (0.8)	17,073.9	14.1
1979	1,081.9 (4.5)	20.9 (0.1)	9,024.9 (37.2)	4,345.8 (17.9)	3,016.4 (12.5)	131.0 (0.5)	3,314.5 (13.7)	2,535.4 (10.5)	603.8 (2.5)	147.4 (0.6)	24,222.0	41.9
1980	1,013.2 (3.6)	29.1 (0.1)	9,105.3 (32.3)	6,898.4 (24.5)	3,131.3 (11.1)	171.5 (0.6)	3,690.7 (13.1)	3,238.4 (2.6)	737.7 (2.6)	156.0 (0.6)	29,171.6	16.3

Source: Bank Negara Malaysia, *Quarterly Economic Bulletin*, December 1982.

Note: Figures in parentheses are percentages.

**Table 14.10** Composition of Malaysian Exports by Commodity or Group of Commodities (percentages)

Commodity or Group of Commodities	Average 1960-64	Average 1965-69	Average 1970-74	Average 1975-79	Average 1980-81
Rubber	47	37	30	21	15
Palm oil products	2	3	8	10.8	10
Sawlogs	5	11	12	10.4	9
Sawn timber	2	3	5	5.1	14
Tin	18	20	17	11.1	8
Petroleum and petroleum products <sup>a</sup>	3	3	5	13.5	25
Subtotal, principal commodities	77	77	77	71.9	71
Manufactures	4	6	10	19.9	22
All other merchandise	19	17	13	8.2	7
Total merchandise	100	100	100	100	100

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

<sup>a</sup>Includes reexports of crude petroleum imported from Brunei and exports of liquefied natural gas.

An even more significant increase was shown by mineral fuels, comprised largely of crude petroleum, which increased its share of total exports from 8% in 1960 to 24.5% in 1980. This increase can be attributed largely to the discovery of offshore oil along the northeast coast of Peninsular Malaysia. The oil discovery and buoyant prices for crude petroleum enabled mineral fuels to become one of Malaysia's leading exports in the last few years. (Since 1980 crude petroleum has been the leading single export commodity in Malaysia, topping rubber, which has traditionally been the top export earner.)

However, the most significant change in the composition of Malaysia's exports is in manufactured products. If we take all manufactured products (i.e., manufactured goods, machinery and transport equipment, and miscellaneous manufactured articles—SITC 5-8), the share of these products totaled less than 17% in 1960 but increased to more than 27% of total exports in 1980, an increase of nearly 60%. Given the importance of manufactured exports in view of Malaysia's small domestic market and also in view of the country's objective of becoming an industrialized country by the end of this decade, the growth in manufactured exports will be discussed further in the following section.

## 14.7 Growth in Manufactured Exports

One of the most important features of the changing trade structure in Malaysia is the steady increase in the share of manufactured exports

and the corresponding decline in the share of nonmanufactured exports during the last twenty years. Manufactured exports, as a percentage of total merchandise exports, have increased, from an average of 4% in 1960–64 to 22% in 1980–81 (a more than fivefold increase) (table 14.10). Equally significant is the export of items, virtually nonexistent in the 1960s, such as textiles, clothing, electronics, and electrical machinery and appliances. On the other hand, Malaysia's traditional non-manufactured exports, namely, rubber and tin, registered a significant decline in terms of percentage contribution to total merchandise exports (table 14.10).

Most of the growth in Malaysian manufactured exports took place between 1970 and 1975. Before 1970 the growth of Malaysian manufactured exports was slightly below the average for all developing countries, but between 1970 and 1975, manufactured exports increased more than 24% a year in real terms (table 14.11), and the share in total exports of merchandise increased from 7% in 1970 to 17% in 1975 (Young et al. 1980, 287).

The remarkable rate of growth in Malaysian manufactured exports during the 1970–75 period may be largely attributable to the establishment of Free-Trade Zones in the country in 1970. These zones persuaded multinational corporations from many developed countries to set up offshore processing plants to manufacture various goods for exports and thus helped to boost the value of Malaysia manufactured exports.

Four industries—wood products, textiles and clothing, rubber products, and electronics components and assembly—were responsible for nearly all the growth in manufactured exports. These four industries have two things in common. First, they are relatively labor-intensive, a highly desirable characteristic, since they were established at a time when Malaysia urgently required greater job opportunities for its expanding labor force. Secondly, the four industries are non-resource-based, a contrast to traditional Malaysian exports, which were generally resource-based. Thus the rapid growth in these four industries

**Table 14.11** Rates of Growth of Manufactured Exports from Malaysia and from All Developing Countries, 1960–75, and Projections for 1975–85 (average annual percentage rates)

Exporting Country or Group of Countries	1960–70	1970–75	1960–75	1975–85
Malaysia	10.6	24.5	15.1	12.2
All developing countries	11.0	14.9	12.3	12.2

Source: Young et al. 1980, 288.

has changed the composition of Malaysian exports from the resource- to the non-resource-based. Obviously this has also affected the pattern of imports—particularly, the import content of manufactured exports.

Table 14.12 shows the present composition of manufactured exports in Malaysia. The table shows that of the four industries which had been responsible for most of the growth in manufactured exports during the period 1970–75, textiles and clothing, electronics components (classified under electrical machinery, appliances, and parts), and wood products still compose a significant proportion of total manufactured exports. In fact, in 1980 these three groups accounted for more than

**Table 14.12** Malaysia: Gross Exports of Manufactures

	1980	
	Millions of Ringgits	%
Food	422.0	7.1
Canned pineapple	55.0	0.9
Animal feed	69.1	1.2
Other	297.9	5.0
Beverages and tobacco	35.0	0.6
Textiles and footwear	787.0	13.3
Textiles, cotton fabrics, and yarn	365.5	6.0
Clothing	321.3	5.4
Footwear	86.5	1.5
Other	22.7	0.4
Wood products	443.0	7.5
Veneer	26.5	0.5
Plywood	268.0	4.5
Chipwood	24.0	0.4
Wooden moldings	62.0	1.0
Other	62.5	1.1
Rubber	83.2	1.4
Chemicals and petroleum	323.0	5.4
Nonmetallic mineral	55.0	0.9
Manufactures of metal	265.0	4.4
Electrical machinery, appliances, and parts	2,790.0	47.0
Other machinery and transport equipment	312.8	5.3
Other manufactures	419.1	7.1
Subtotal	5,935.0	100.0
Palm oil and other oil products	3,183.0	
Total	9,118.0	

Source: Bank Negara Malaysia, *Annual Report 1980*, p.1.

60% of all manufactured exports. Only the rubber products industry lost its significant position, accounting for only 1.4% of total manufactured exports, well behind food (7.1%), chemical and petroleum products (5.4%), and other machinery and transport equipment (5.3%).

#### **14.8 Changes in Export Market**

Changes in the composition of Malaysian exports were accompanied by changes in the direction of exports in the last two decades. Briefly, efforts were made to diversify the Malaysian export market, but despite these attempts, Malaysia is now even more dependent on its three leading trade partners, namely, the United States, Singapore,<sup>7</sup> and Japan. These three countries still continue to take about 55% of Malaysia's exports.

In the early sixties, Malaysia's three leading export markets were Singapore (21.5%), Japan (17.3%), and the United States (11.7%). These three countries accounted for 50.5% of Malaysian exports. In 1981 these three countries still topped the list of Malaysian exports, with their positions unchanged. All three countries increased their share of Malaysian exports, with Japan accounting for the largest relative increase (nearly 4%). These increases were made largely at the expense of Western Europe and the rest of the world. In short, despite the change in export composition and Malaysia's efforts to diversify its export market, the country is now even more dependent on its three leading export markets.

While Japan has registered the largest increase in the Malaysian export market during the last twenty years, the United Kingdom has registered the sharpest decline. In 1961 the United Kingdom accounted for more than 16% of Malaysia's exports, but in 1981 its share had fallen to less than 3%. This may be attributed to the erosion of Commonwealth preferential tariffs on trade with the United Kingdom and the increasing competitive pressure from Japan, the United States, and other countries.

But although Japan is one of the leading customers of Malaysia's merchandise exports (buying more than one-fifth of its total exports), most of the exports to Japan are nonmanufactured goods. More specifically, manufactured products composed only 15.1% of total Japanese imports from Malaysia in 1980. The percentages were much higher in the case of Malaysia's two other leading importers. For example, manufactured products accounted for 44.4% of U.S. imports, while in the case of Singapore, they accounted for 18.8%. Netherland's manufactured imports from Malaysia accounted for 51.2% of its total imports, making it the country with the largest percentage of Malaysian manufactured imports in 1980.



In terms of region, more than half of Malaysia's exports go to the OECD countries (Organization for Economic Cooperation and Development) (table 14.13). Within the OECD market, Western Europe remains the principal trading partner of Malaysia, but it is significant to note that Western Europe's share of Malaysian exports has declined from 24.1% in 1961–64 to 16.4% in 1981. Still, Western Europe remains one of Malaysia's leading export markets. More important, considering that more than half of Malaysia's exports moved into OECD markets, the economic situation and policies in these countries have a strong influence on Malaysian exports. Finally, because Malaysia depends heavily on exports, changes in the OECD demand for imports affect all sectors of the Malaysian economy.

In view of the heavy dependence of Malaysian exports on the OECD countries, the government has tried to find new export markets, especially in other Asian countries. Unfortunately most Asian countries (except Japan) have similar resources and exports, so the diversification policy has not been very successful. Nevertheless, Malaysian exports to other Asian markets have increased from 4.2% in 1961–64 to 19.2% in 1981 (an almost fivefold increase). Most of the increase was accounted for by India and the other ASEAN (Association of South East Asian Nations) countries (excluding Singapore).<sup>8</sup>

## 14.9 Composition of Imports

Table 14.14 shows the pattern of Malaysian imports over the last twenty years. In 1960 the three most important imports were food (23.4%), manufactured goods (15.2%), and mineral fuels (14.9%). These three items accounted for more than 53% of total imports. By 1980 the pattern had changed. Food was no longer the leading import item. It

**Table 14.13** The Direction of Malaysian Exports (percentages)

Country or Region	1961–64	1965–69	1970–74	1975–80	1981
United States	11.7	14.4	12.9	17.0	13.1
Western Europe	24.1	18.0	21.9	20.4	16.4
Japan	17.3	18.3	17.7	21.5	21.2
Australia and New Zealand	3.0	2.8	2.4	2.3	2.0
Canada	<sup>a</sup>	2.0	1.9	0.7	0.6
Total, OECD countries	56.1	55.5	56.8	61.9	53.3
Singapore	21.5	22.6	22.4	17.8	22.8
Other Asian markets	4.2	4.4	8.5	15.2	19.2
Total, Asia, excluding Japan	25.7	28.0	30.9	33.0	42.0
Rest of the world	18.2	16.5	12.3	5.1	4.7

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

<sup>a</sup>Zero or negligible.

**Table 14.14**      **Malaysia: Gross Imports by SITC Group**

SITC Group	Import Share <sup>a</sup>					Average Annual Growth Rate (%)			
	1960	1965	1970	1975	1980	1960–65	1965–70	1970–75	1975–80
Food	651.9 (23.4)	613.9 (23.5)	786.7 (18.3)	1,401.5 (16.4)	2,444.3 (10.4)	6.6	–2.6	18.4	5.9
Beverages and tobacco	109.3 (3.9)	60.7 (2.3)	92.9 (2.1)	119.4 (1.4)	221.3 (1.0)	1.7	–4.2	6.5	10.7
Inedible crude materials	378.7 (13.6)	229.4 (8.8)	322.1 (7.5)	554.1 (6.5)	1,052.8 (4.5)	–14.9	9.3	14.3	9.8
Mineral fuels, lubricants, etc.	416.2 (14.9)	174.2 (6.7)	517.5 (12.0)	1,021.1 (12.0)	3,554.4 (15.2)	–3.0	6.1	28.4	16.6
Animal and vegetable oils and fats	15.4 (0.6)	14.8 (0.6)	23.8 (0.5)	26.0 (0.3)	29.7 (0.1)	0	7.1	19.9	–4.1
Chemicals	164.9 (5.9)	208.3 (8.0)	312.5 (7.3)	711.8 (8.3)	2,022.4 (8.6)	5.3	6.3	27.9	16.8
Manufactured goods	423.7 (15.2)	510.2 (19.6)	770.2 (18.0)	1,389.4 (16.3)	3,849.2 (16.4)	6.6	2.9	26.0	11.4
Machinery and transport equipment	395.8 (14.2)	580.2 (22.2)	1,197.3 (27.9)	2,774.1 (32.5)	9,105.3 (38.8)	12.6	6.2	33.2	15.4
Misc. manufactured articles	150.1 (5.4)	165.3 (6.3)	199.9 (4.7)	465.3 (5.5)	975.0 (4.2)	6.3	–0.8	28.9	8.1
Other imports	80.4 (2.9)	51.3 (2.0)	65.5 (1.5)	66.9 (0.8)	196.6 (0.8)	–4.3	–1.4	9.7	22.0
Total	2,786.4 (100.0)	2,608.3 (100.0)	4,288.4 (100.0)	8,530.4 (100.0)	23,451.0 (100.0)	3.6	2.4	24.4	12.4

Source: Department of Statistics, *Annual Statistics of External Trade*, various years.

<sup>a</sup>In millions of ringgits and (in parentheses) percentages.

had been replaced by machinery and transport equipment. This item (38.8% of total imports), together with manufactured goods (16.4%), and mineral fuels (15.2%), accounted for more than 70% of total imports.

Food imports declined during the period 1965–70, coinciding with the initial phase of import substitution (see section 14.4 above). On the other hand, there was a dramatic increase in the annual rate of growth of the importation of machinery and transport equipment, averaging 33.2% during the period 1970–75. This was the period when investment activities were intensified and the manufacturing sector was gearing production toward the export market.

Another way of analyzing the changing composition of Malaysian imports is to classify the imports by economic function. Using this classification, in 1961 consumption goods accounted for 46.7% of total imports, while intermediate and investment goods accounted for 44.9% (table 14.15). By 1980 the share of consumption goods had dropped to 18.4%, and the share of intermediate and investment goods had risen to nearly 80%. In short, the data in table 14.15 confirm that Malaysia has more or less completed the first stage of its industrial development and is now preparing for the second stage of industrialization.

#### 14.10 Changes in Import Market

Along with the changes in the composition of imports over the last twenty years we can also perceive corresponding changes in the direction of imports. In the initial period, 1961–64, Western Europe (11.0%), especially the United Kingdom, Japan (8.6%), and Singapore (9.2%) were the main sources of Malaysian imports (table 14.16). Since then the ranking and sources have changed slightly. Thus in the last period, 1975–80, Malaysian imports came mainly from Japan (22.4%), Western Europe (19.5%), and the United States (13.8%). The emergence of Japan as Malaysia's leading source of imports is not surprising in view of the competitiveness of Japanese products.<sup>9</sup> Similarly, it is not surprising that Western Europe should lose its top position following the withdrawal of Commonwealth tariff preference for British goods. Also losers in the Malaysian market are the other Asian countries, excluding Japan. In the initial period, imports from these other Asian countries were valued at nearly 60% of total imports. In the last period, these imports had fallen to less than 25%, a drastic decline of more than 50%. The other Asian countries include the other ASEAN countries, and these, too, showed a significant decline in their exports to Malaysia. Finally it should also be noted that imports from the OECD countries as a whole showed a steady increase, from 30.2% in the 1961–64 period to 64.0% in the 1975–80 period. This trend may be expected to continue in view of Malaysia's continued efforts to develop the economy and upgrade the manufacturing sector.

**Table 14.15 Malaysia: Imports by Economic Function**

End Use	Import Share (millions of ringgits)						Import Share (%)					Average Annual Growth Rate (%)		
	1961	1964	1969	1974	1975	1980	1961	1964	1969	1974	1980	1964-69	1969-74	1974-80
<i>Consumption goods</i>	<b>1,315</b>	<b>1,484</b>	<b>1,139</b>	<b>2,160</b>	<b>1,720</b>	<b>4,325.4</b>	<b>46.7</b>	<b>46.3</b>	<b>31.6</b>	<b>21.6</b>	<b>18.4</b>	- 5.2	<b>13.7</b>	<b>16.7</b>
Food	594	723	461	925	615	1,177.0	21.1	22.6	12.8	9.2	5.0	08.6	11.7	4.5
Beverages and tobacco	128	136	71		85	a	4.5	4.2	2.0		a	-12.1		a
Consumer durables	169	227	133	295	260	992.3	6.0	7.1	3.7	2.9	4.2	-10.1	17.3	39.4
Other	424	398	474	940	760	2,156.1	15.1	12.4	13.1	9.4	9.2	3.6	14.7	21.6
<i>Investment goods</i>	<b>480</b>	<b>582</b>	<b>742</b>	<b>3,370</b>	<b>2,740</b>	<b>7,169.6</b>	<b>17.1</b>	<b>18.2</b>	<b>20.6</b>	<b>33.6</b>	<b>30.6</b>	<b>5.0</b>	<b>35.4</b>	<b>18.8</b>
Machinery	127	182	290	1,170	950	2,577.9	4.5	5.7	8.0	11.7	11.0	9.8	32.2	20.1
Transport equipment	117	91	64	195	250	919.4	4.2	2.8	1.8	1.9	3.9	-6.8	25.0	61.9
Metal products	122	155	203	920	550	1,906.4	4.3	4.8	5.6	9.2	8.1	5.5	35.3	17.9
Other	114	154	185	1,085	990	1,765.9	4.1	4.8	5.1	10.8	7.6	3.7	42.5	10.5
<i>Intermediate goods</i>	<b>784</b>	<b>885</b>	<b>1,357</b>	<b>4,056</b>	<b>3,726</b>	<b>11,550.0</b>	<b>27.8</b>	<b>27.6</b>	<b>37.6</b>	<b>40.5</b>	<b>49.3</b>	<b>8.9</b>	<b>24.5</b>	<b>30.8</b>
For manufacturing	220	309	725	2,373	2,017	6,531.0	7.8	9.6	20.1	23.7	27.8	18.6	26.8	29.2
For construction	87	116	73	185	170	580.4	3.1	3.6	2.0	1.8	2.5	-8.9	20.4	35.6
For agriculture	80	118	146	375	330	892.9	2.8	3.7	4.0	3.7	3.8	4.4	20.8	23.0
Petroleum	190	183	228	518	665	1,890.3	6.7	5.7	6.3	5.2	8.1	4.5	17.8	44.2
Other	207	159	185	605	544	1,655.4	7.4	5.0	5.1	6.0	7.1	3.6	26.7	28.9
<i>Imports for reexport</i>	<b>237</b>	<b>235</b>	<b>340</b>	<b>429</b>	<b>405</b>	<b>406.0</b>	<b>8.4</b>	<b>7.3</b>	<b>9.4</b>	<b>4.3</b>	<b>1.7</b>	<b>7.7</b>	<b>4.8</b>	<b>-0.9</b>
Tin ore	—	105	127	231	265	—	—	3.3	3.5	2.3	—	3.9	12.7	—
Natural rubber	—	53	74	58	40	—	—	1.7	2.1	0.6	—	6.9	-4.8	—
Petroleum	—	77	139	140	100	—	—	2.4	3.9	1.4	—	12.5	0.1	—
Total	<b>2,816</b>	<b>3,205</b>	<b>3,605</b>	<b>10,015</b>	<b>8,591</b>	<b>23,451.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>100.0</b>	<b>2.4</b>	<b>22.7</b>	<b>22.4</b>

Source: Bank Negara Malaysia, *Quarterly Economic Bulletin*, March 1982.

\*Included in Other.

**Table 14.16** The Direction of Malaysian Imports (percentages)

Country or Region	1961-64	1965-69	1970-74	1975-80
United States	4.8	6.8	8.9	13.8
Western Europe	11.0	16.9	20.1	19.5
Japan	8.6	14.6	21.6	22.4
Australia and New Zealand	5.4	7.1	7.5	7.2
Canada	0.5	0.8	1.1	1.1
Total, OECD countries	30.2	46.2	59.2	64.0
China	5.0	7.1	5.1	3.1
Hong Kong	n.a.	2.0	1.8	1.7
Singapore	9.2	9.7	7.8	9.5
Other Asian markets	59.7	42.8	29.6	24.3
Other ASEAN markets	n.a.	10.8	7.0	5.5
Total, Asia, excluding Japan	68.9	52.5	37.4	33.8
Rest of the world	0.9	1.3	3.4	2.2

Source: Department of Statistics, *Annual Bulletin of Statistics*, various years.

Note: n.a. = not available.

## 14.11 Conclusion

The available statistics show that the Malaysian manufacturing sector made considerable progress over the last two decades, in terms of both overall growth rate and structural changes. The manufacturing sector grew at an accelerated pace of 12% during the last two decades. Apart from its rapid growth, the Malaysian manufacturing sector has also undergone a structural change. After beginning mainly with the production of consumer nondurables for the domestic market during the initial phase of import substitution, the manufacturing sector has now entered a new phase of production aimed at the export market. At the same time there has also been a perceptible growth in the production of consumer durables and intermediate goods. It would thus appear that industrial policy should aim at strengthening the above developments, namely, export promotion and secondary import substitution.

However, it should be remembered that Malaysia's success in achieving an accelerated growth rate was facilitated to a considerable extent by a favorable world economic environment owing to a buoyant demand for Malaysia's commodity exports (petroleum, timber, rubber, palm oil, etc.), a rapidly expanding market for non-resource-based footloose manufactured exports (textiles, clothing, electronics, etc.) from developing economies, a ready access to an urban, easy-to-train labor force, and ample natural resources. These favorable factors can no longer be taken for granted. The present recession has put an end to the buoyant demand for Malaysia's commodity exports, while protectionism in the developed countries has reduced the market for Malaysia's manufactured exports. Even if the world economy were to recover

by the end of this year, the volatile and uncertain economic situation as well as the vulnerability in the present set of export-oriented manufacturing industries makes one wonder whether Malaysia should continue to depend on the export of non-resource-based footloose manufactured goods. Many of these goods are low-value items and are the favorite targets of protectionist groups in the developed countries. For this reason it may be better for Malaysia to encourage the manufacturers concerned to develop their products for the high-value end of the market. For example, instead of simply producing textiles, manufacturers should be encouraged to go into fashion-designed clothing.

Another alternative is to encourage backward and forward linkages in the electronics and other industries located in the Free-Trade Zones instead of allowing these industries to develop in segregated enclaves isolated from the rest of the domestic economy. An appropriate incentive system should be designed to encourage the transfer of technology from these relatively technologically sophisticated industries.

As for the production of consumer durables and intermediate goods, top priority must be given to the question of competitiveness. Unlike the labor-intensive manufactured exports such as textiles and electronics for which Malaysia has a comparative advantage, there are very few consumer durables and intermediate goods which Malaysia can produce at competitive world prices. This means that such goods have to be sold in the domestic market. Because of the limited size of this market, production will only be viable if it is heavily protected. If this is the price for secondary import substitution, it is certainly not worth paying.

Instead of blindly pursuing a policy of secondary import substitution to the limit, a suitable policy should be formulated to encourage the development of the capital goods industry. Malaysia is one of the largest producers of several primary commodities, such as rubber, tin, and palm oil. The production and processing of these commodities require a variety of machinery and equipment. Some of this machinery and equipment is produced locally. Why not encourage the production of more of this machinery and equipment locally and subsequently the export of these items? The production of this machinery and equipment does not require a high level of skill or technology, and given the relatively large domestic market, Malaysia should have some comparative advantage in their production. In short, with suitable government encouragement and incentives, Malaysia can become a leader in the manufacture of agricultural machinery.

Another suggestion is to pursue the policy of promoting resource-based industries with greater effort and enthusiasm. These are also industries in which Malaysia has some comparative advantage, so they should be given greater priority than heavy industries in which Malaysia

has absolutely no comparative advantage. A good example of the latter type of industry is the proposed made-in-Malaysia car. At a time when Japan has already revolutionized and dominated the motor vehicle industry, it is folly for Malaysia to think about producing its own cars, especially when the proposed industry will always require a relatively high level of protection to survive (see Chee 1983a, b).

Instead of paying so much attention to "prestigious" industries, Malaysia should concentrate on the resource-based industries. But apart from lip service, nothing much has been done to promote such industries. Not surprisingly, as our study pointed out earlier, resource-based industries have failed to establish a firm foothold in the Malaysian manufacturing sector. More aggressive policies should be pursued to develop resource-based industries not only because such industries increase value added but also because they stimulate the demand for primary commodities. Thus even if firms are reluctant to set up such industries in Malaysia, we should explore the possibility of investing in such industries abroad. In this connection, the proposed Malaysian *sogo shoshas* should consider investing in existing natural-resource-based industries in the developed countries (see Chee 1980a).

The Malaysian manufacturing sector has reached a crucial stage in its development. The current recession has exposed some of the weaknesses in the structure of the manufacturing sector. In this sense the recession may be a blessing in disguise, especially if it alerts policy-makers to the dangers of fostering vulnerable or noncompetitive industries. In short, there is a need to chart new directions for the further development of the Malaysian manufacturing sector. We have suggested the new directions which the manufacturing sector should follow. With a rational industrial policy and suitable incentives, Malaysia should be able to join the ranks of the newly industrialized countries well before the end of this decade.

As for its external trade pattern and prospects it may be assumed that the present trend will continue. Malaysia will continue to export relatively more manufactured goods and less primary products. On the other hand, imports of consumption goods will continue to decline, while imports of intermediate and investment goods may be expected to increase even further. These developments will naturally favor Japan, which is already Malaysia's leading trade partner, but there is no reason why they should diminish the trade prospects of other countries, especially those in the OECD group. The complementary nature of the OECD and Malaysian economies will continue to foster closer mutual trade relationships. However, given a higher level of industrialization in the Malaysian economy, the country's efforts to diversify its export market may be more successful. At present, nontraditional export markets in the Pacific region, West Asia, Latin America, and Africa are

still at a minimal level of development. The production of a wider range of manufactured products should help Malaysian exporters in their efforts to penetrate these markets.

## Notes

1. Malaysia was formed in 1963 and comprises the eleven states in Peninsular Malaysia, together with the Borneo states of Sabah and Sarawak. Although Peninsular Malaysia constitutes a little less than 40% of the total land area, it has over 80% of the population and GNP and an even greater proportion of the manufacturing activities. Thus, although some data are restricted to Peninsular Malaysia because many statistical series cover only this area, the exclusion of Sabah and Sarawak is not too damaging.
2. For further details of the New Economic Policy, see Malaysia 1971. For a critical analysis of the New Economic Policy, see Young et al. 1980, chap. 3.
3. For further details of the Malaysian government's policies to promote industrialization, see Young et al. 1980, chap. 7, and Hoffmann and Ee 1980, chap. 3.
4. The Malaysian ringgit (M \$) is approximately equal to U.S. \$0.45 (U.S. \$1.00 equals M \$2.20).
5. For further details of the Free Trade Zones in Malaysia, see Chee 1980b.
6. See also Datta-Chaudhuri 1982.
7. Since Singapore is a free port and a regional trade center, most of Malaysia's exports to the republic are reexported to other countries.
8. On the whole, intra-ASEAN trade is at a relatively low level, accounting for less than 15% of the region's total trade. See Wong 1979, chap. 2.
9. Japan has managed to capture not only the Malaysian but also the ASEAN market, mainly at the expense of the Western countries, especially the United States. See Chee 1982b.

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