DIVERSIFICATION AND EXPORT EARNINGS INSTABILITY IN MALAYSIA, 1968-1991

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To my husband, Kuen Lin,
and my children, Zhao Hong and Yi Ann

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ABSTRACT

When it is found that many less developed countries which are principally exporters of a few primary commodities experience high export earnings instability, calls to diversify are naturally intensified. The contention is that: (i) a high degree of primary commodity concentration implies high export earnings instability, and (ii) diversification, particularly into the export of manufactured goods would help stabilise export earnings.

Malaysia presents an ideal case study as it represents a classic primary commodity, export-oriented economy which has undergone a process of diversification over the last three decades. Malaysia, however, remains a small but highly open-economy. Gross exports accounted for 76.5 per cent of GNP in 1991.

Between the 1960s and early 1970s, exports of primary commodities constituted more than 85 per cent of the country's export earnings. Over 70 per cent of export earnings were derived from natural rubber, tin, timber and palm oil. Various studies attribute the high degree of export instability experienced during the period to this specialization in the export of primary commodities; particularly natural rubber and tin.

From the mid-1970s, Malaysia's export structure has shifted away from concentration on the few primary commodities (particularly rubber and tin) towards a more diversified basket of exports, notably manufacturing exports. During the 1980s, the share of rubber, tin, timber and palm oil in total export earnings saw a decline from 44.9 per cent in 1980 to 12.3 per cent in 1991. On the other hand, export of manufactured goods rose from 22.4 per cent to 64.9 per cent over the same period.

This study evaluates Malaysia's diversification efforts. In particular, we examine whether diversification has been of the right kind and/or in the right direction in terms of the impact on export earnings instability. The study covers the period from 1968 to 1991. Unlike earlier empirical studies for Malaysia, the approach employed here presents a more detailed analysis of export earnings instability. The study examines the three principal components of export earnings instability: (i) the level of commodity/geographic concentration, (ii) the average instability level of individual commodity/export market, and (iii) the relationship between the commodities/export markets.

An attempt is made to identify export commodities that have contributed to export instability with respect to their relative share in total export earnings. Our findings indicate that diversification has not been so much of the "wrong" kind, but that external influences have exerted a stronger influence on total export earnings instability. This has resulted in an inconsistent decline in the export instability index despite a consistent fall in commodity concentration over the 1968-91 period.

The assessment of price and quantity fluctuations shows that manufactured goods, in general, displayed lower price and export value instability than non-fuel primary products and fuel products. Among the five major primary commodities under study (rubber, palm oil, saw logs and sawn timber, tin and petroleum), it was found that instabilities in price, quantum and export values among the commodities were not highly correlated. The study finds that export instability would have been worse had Malaysia not diversified its production and export of primary commodities.

Geographic concentration remained relatively high during the entire period of study. The non-traditional export markets exhibit larger instability compared to the traditional ones. The results point to further research into the source(s) of instability in non-traditional countries. This is, however, beyond the scope of the present study.

The final part of the study focuses on the *a priori* argument that export instability has adverse effects on economic development. The study of the effects of export instability on economic development is confined to short-run impacts within the Harrod-Domar framework. The argument rests on the idea that imported capital goods and domestic investment goods augment potential output and thus the pace of economic growth. The study, therefore focuses on the impact of export instability on the flow of imported capital goods, and on domestic investment. The results indicate that imports of capital goods in particular, and domestic investment to a lesser extent, appear to move together with export earnings instability during the 1972-1991 period. The implication is that export instability exerts an unfavourable impact on the pace of economic development in Malaysia.