CHAPTER IV

THE COMMON MARKET AND ECONOMIC INTEGRATION

Prior to the formation of Malaysia, the governments of Malaya and Singapore sought the assistance of the International Bank for Reconstruction and Development in studying the economic aspects of Malaysia. The Report of the I.B.R.D. mission under the chairmanship of Mr. Jacques Rueff was published in July 1963. The report set out the major economic effects of political unification and also made various recommendations for action by the Malaysian Government.

The terms of reference of the mission had been, among other duties,

> "1. To examine and report on the feasibility of, and problems inherent in, closer economic co-ordination among the prospective Malaysia territories with special reference to:
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> > (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".

The mission was also expected to study the impact of present differences in tariff and trade policies among the territories and the differences in competitive position and the industrial promotion aims and policies among the territories. It was also asked to recommend concrete steps to "effect such economic co-ordination so as to produce the maximum advantage to all territories" and for "integrating development planning including industrial development".[1]

It will be seen that one of the key components to complete economic integration among the territories is the establishment of a common market for Malaysia. The free flow of goods between the territories is essential and the common external tariff for such a common market would be an important factor in promoting the necessary diversification and growth in the economy. Thus although the terms of reference covers the whole question of economic integration, this chapter will give special emphasis to

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[1] "Report on the Economic Aspects of Malaysia" IBRD Mission Page vi & vii.

the question of the Malaysian common market.

The Economic 'Rationale' for a Common Market

The arguements for a common market are broadly two.

Firstly the establishment of a common market would mean a significant broadening of the economic base. "The economy of Malaya can soon become substantially stronger than the sum of its present parts ..... A larger economy which is more economically diverse than any of its component parts".[2] Thus at the very minimum this bigger and more diverse economy will be more stable than each of the component economies which are over dependent on a few export products and are vulnerable to fluctuations in total income induced by exogenous economic factors. The greater opportunities for transferring incomes and employment within the economy would also be another stabilising factor. But this additional element of stability would not in itself solve the basic economic problems of Malaysia.

Secondly the expanded market would provide a sharp stimulus for economic growth within Malaysia. The common market would result in a greatly increased demand for domestic products which are also consumed in significant quantities in Malaysia. This would be especially so in the case of commercial agriculture where there will be an expanded market for producers of vegetables, fruits, sugarcane, maize, fish and livestock products. There would thus be an expansion in this sector.

With the dismantling of internal barriers to trade within Malaysia there would be a vitally needed expansion of the domestic market for her manufacturing industries and would also provide a powerful means of stimulating the much-needed growth of this sector through the use of protective external tariffs. The Reuff Report points out that a rapid expansion of manufacturing is overdue in Malaysia in view of the long-run uncertainties affecting the Rubber, Tin and entrepot services industries, "Thailand and the Philippines, with average per capita incomes half that of Malaysia (and with total markets of about the same size) have developed manufacturing sectors which are significantly larger than that of Malaysia".[3] It is thus this great promise which the common market holds out for the rapid growth of the manufacturing sector that constitutes the single most convincing arguement for the establishment of the common market.

Moreover the potential economic disadvantages can be avoided through judicious applications of economic policy. There is the potential danger that, given the present differences in

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[2] Ibid. Page 8.

[3] ~~Op cit~~ Ibid. Page 9.

the stages of development of the various territories, the growth would be concentrated in territories with stronger competitive positions at the expense of the other territories. This need not be inimical to any of the component territories since "as the experience of European economic integration shows, total growth will almost certainly proceed faster in the larger market than it otherwise would; moreover, in all probability the growth rate in each of the territories is likely, in time, to prove faster than it would if each had remained isolated by national tariff barriers".[4] Transfer of income and manpower could ensure that even territories with relatively slower growth rates would benefit from the faster overall growth. There is also the danger that protective tariffs would turn out to be a shelter for economic lethargy and inefficiency. But this could be avoided if protective tariffs are used selectively and encourages expansion only in those activities which promise to be efficient while at the same time not extending these facilities to inefficient producers. It is also possible to avoid the undesirable effects of unduly raising the cost of primary production or disrupting the entrepot trade if care is taken to encourage and safeguard these activities. In short"there is no contradiction between the establishment of a common market, the increase of public revenue, and the preservation of entrepot trade on condition that transitions are allowed to be smooth. In other words, it is essential to provide for periods of adaptation and for special arrangements which will serve to reconcile temporary divergences of interest".

Progress towards a Common Market

In the light of these arguements, the mission recommended the establishment of a Tariff Advisory Board to advice on the implementation of the policy of eleminating internal barriers to trade in Malaysian products destined for local consumption and the establishment of a common external tariff where necessary to protect these Malaysian products. The recommendations of the mission were substantially accepted by the Malaysian Government and the Tariff Advisory Board Act, 1963 was passed on 16th September, 1963. By the terms of the Act, the general powers of the board are:

> 1. "to take into account, and to make recommendations to the Federal Government on, customs imports duties chargeable in Malaysia and the alteration of those duties or the imposition of new ones and matters connected with the operation of these duties or any proposals for new duties".[5]

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[4] ~~Op cit.~~ Ibid. Page 10.

[5] Tariff Advisory Board Act, 1963, Section 5(1).

2. To consider applications from "persons engaging or about to engage in the production or manufacture in Malaysia of goods and products which are or are to be produced or manufactured and <u>used and consumed there in significant quantities</u> ..... and consider the alteration of any protective duty, on the imposition of new protective duties or the giving of other advantages or facilities in relation to any protective duty, with a view to promoting or expanding the production or manufacture of the goods or products in Malaysia".[6]

3. To advise the Federal Government on the establishment of a common market in Malaysia for all goods and products produced in significant quantities in Malaysia except goods of which the principal terminal markets lie outside Malaysia and on the establishment and maintainance of protective tariffs.

It will be noted that the definition of a protective tariff is one which applies to domestic products which are consumed in significant quantities locally.

In drawing up its recommendation the board is also expected to take into account and to report on the effects of their recommendations on:

(a) the need for a balanced industrial development throughout Malaysia;

(b) the interests of the entrepot trade of Singapore, Penang and Labuan;

(c) the interests of existing industries and of consumers in Malaysia, including cost of living, cost of production of industries and in particular of export industries and cost of development works in the public sector of the national economy;

(d) employment and National Income in Malaysia;

(e) Federal and State revenues.

The Act also takes into account the fact that producers in a region may enjoy direct or indirect advantages because of existing differences in customs imports duties chargeable in two regions. Is is therefore provided in section 6 (5) of the Act that in such cases "unless the Board recommend the removal of those differences, their recommendations shall include provision for offsetting that advantage by means of a production tax or otherwise ..... or alternative provisions for offsetting the

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[6] Tariff Advisory Board Act 1963, Section 5(2).

advantage.

There is also provision for a review of the protective tariffs in force by the Board at such intervals as they think fit or as the Federal Government may require. This provision is important in that it is an important safeguard against prolonged sheltering of inefficient industries behind tariff walls. It is necessary that infant industries be given a firm guarantee for a certain number of years and the Rueff report suggested a period of 3 to 5 years as the interval between the introduction of the tariff and the review.[7] The fact that no time periods are specified means that there is greater flexibility for the board to conduct its reviews of existing tariffs.

The Act also gives recognition to the fact that the Board would have to reconcile a diversity of interests in the formulation of its recommendations. Section 5 (3), as has been pointed out, ensures that the economic effects of the recommendations of the board would be given careful consideration. In particular the interests of the entrepot trade and the weaker competitive position in industrial development of the Borneo States are taken into account. The Chairman of the Board could only be appointed with the concurrence of the Yang di-Pertuan Negara of Singapore. There is also provision within the first 5 years for Singapore to request for the imposition of any protective duties in that state which it may consider to be injurous to its entrepot trade. Likewise in the case of the Borneo States their interests are recognised by the stipulation that one of the 3 deputy chairmen shall be a person nominated jointly by the Yang di-Pertua Negara of Sabah and the Governor of Sarawak.

In addition to the 4 full-time members there is also provision for the appointment of 8 to 20 part-time members. The work of the Board is to be discharged through committees consisting of the whole-time members of the board together with not less than 2 nor more than 4 part-time members and Section 8 (2) provides that "the part-time members of the board to serve on any committee shall be selected by the Chairman, who in making the selection shall have regard to the areas and interests involved."

The board is expected to hold inquiries on members referred to it or on applications received. The inquiries are to be held in public and there is provision for publicity three weeks in advance. "For the summoning and examination of witnesses, for the administration of oaths and for compelling the production of documents the Board shall have the powers of a Court".

The Act gives due recognition to the fact that it was imperative that the common market be set up as soon as possible

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[7] "Report on the Economic Aspects of Malaysia". Page 84.

after Malaysia day and Section 6 (3) specifies that "the first report of the Board on the imposition of protective duties with a view to the establishment of the common market shall be made not later than 6 months after the coming into operation of this Act".

Having outlined the legislative provisions for the speedy establishment of a Malaysian common market it now remains to examine the progress that has been made thus far towards the implementation of the common market and the effect this has had on inter-regional trade (which is discussed in Chapter III) and on overall economic integration.

The Rueff report had suggested that the first task of the Board should be to determine the scope of the initial common market and recommend a schedule of protective tariffs, applicable to the whole of Malaysia, on the basis of the existing situation in the various states. We have already noted that this definition of the scope of the initial common market should be completed within 6 months. But this deadline has not been met with and the 1st list of goods which the Board would inquire into was only announced on the 24th of October 1964, and it was only in October 1965 that the first 160 items of goods manufactured in Malaysia were allowed duty-free movement within the country.

Subsequent lists which the Board announced that it would inquire into were announced in 29th May 1965, 15th January, 1966, 31st March, 1966 and 17th May, 1966. It will be seen that the process of public inquiry has speeded up after the initial hold up. The early extension of the common market has been stressed by the Rueff report as imperative for the future development of the Malaysian economy and the sooner this can be achieved the better, provided, of course, that all other interests are not adversely affected.

A brief enumeration of the lists of goods that have been the subject of inquiry by the board will give a fair indication of the extent[8] of the coverage of the common market that is envisaged so far.

The first list covered products like cotton, wool, rubber hoses, tyres and tubes, plywood, sanitary towels of paper, galvanised iron and steel sheets, flashlight batteries, batteries, accumulators, sanitary and plumbing fixtures and fittings of plastic materials. In addition, the following extra goods were announced in the list for Sabah and Sarawak: - Dental pute and powder, plastic and rubber flooring tiles, plastic goods, wire and netting fencing. In the case of the free-ports of Labuan

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[8]For the full lists refer to the Government Gazette notifications on the dates of announcements of these lists which has been mentioned above.

and Penang a list of 92 items was announced and represents the initial step towards integrating them into the common customs area while at the same time preserving their entrepot trade. The procedure followed is that the imports of all the goods announced is prohibited except by licence from the Comptroller-General of Customs. There is thus a quantitative control in operation which safeguards against any speculative imports.

The second list covered food products like beer and stout, milk products, bread and confectionary, noodles, preserved fruits, cocoa and chocolates. It also included building materials like roofing tiles, flooring and wall tiles, bricks, glass plates, paints, distempers, pre-fabricated windows and door-frames and sanitary ware. Other items were footwear, leather and skins, furniture (including matresses, cushions etc), tubes and pipes of iron, laminated boards, fuel wood and charcoal, sawn wood and logs, glassware, electrical bulbs and wires, electrical kettles and air-conditioners, paper board, printing ink, vacuum flask, tooth-brushes, stockings and imitation leather goods.

The third list consisted of cement, aluminium slugs and cans, matches, batek, jute material, isopropyl alcohol, paper and stationery products, pulp for the production of paper news-print, and printed matter.

The fourth list includes meal and flour of meat, bron and animal foodstuffs, soap, marble and alabarter, road and paving setts, cubs and flagstones, building stone. Toilet papers, wires, rods, tubes, electrodes and plates.

The fifth list deals specifically with the goods for the proposed car-assembly plants.

It will be noticed that these lists are fairly comprehensive and exceed the list in the Reuff Report which was suggested as the goods to constitute the initial Common Market.[9]

In most cases the lists were compiled from the applications for protection from local manufacturers. It would be noted that some food products are included in the list but the substantial part of the goods itemised are the products of the manufacturing sector. This sector stands to gain most from the Common Market and it would be relevant to consider their aspect in a little more detail.

On the 10th of March, 1966[10] all goods of Malaysian origin, with two exceptions were exempted from Customs duties

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[9] Reuff Report: - Appendix A on Page 59.

[10] Customs Duties (Exemptions) (Goods of Malaysian Origin) (States of Malaya) Order 1966, made under the Customs Ordinance 1952.

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when moved within Malaysia. This greatly expands upon the 1st step taken on the 9th October, 1965 when 160 goods were freed from regional customs duties and thus virtually creates a single customs area for Malaysian-made goods. The exemptions were mainly those items which were manufactured in Sabah and Sarawak like soap, rubber, footwear, samsu, aerated waters, cigarettes and matches. These exceptions were designed to protect these Borneo industries from similar goods manufactured in Malaya. To quality for exemption, however, at least 25% of the value of the finished product should be the result of labour performed and materials produced in Malaysia.

The previous chapter has pointed out the paucity of the trade flows between Western Malaysia and Eastern Malaysia. To date the common external tariffs have been mainly imposed only on the 160 items which was announced on the 9th October.[11] This was the result of the 1st and 2nd common market inquiry lists. The items under the 3rd, 4th and 5th common market list have not had the tariffs announced on them yet although the recommendations of the Tariff Advisory Board have been submitted to the Minister. As has earlier been pointed out, either import prohibition orders or quantitative restrictions on imports have been imposed on those goods which have been subject to inquiry by the Tariff Advisory Board.

The primary economic effect of the formation of a Customs Union in this case is to shift the sources of traded goods. One member region would now import from another member region commodities previously exported from the rest of the world. Customs Unions also tend to increase economic specialisation within the Customs Union boundaries and create conditions conducive for the creation of diversified, industrialised economies.

Notwithstanding the meagre trade flows between East Malaysia and West Malaysia, the volume of trade has shown a steady increase since 1962. With the free movement of domestically produced goods being permitted within Malaysia this trend will be expected to be accentuated. Increasing amounts of the goods manufactured in Malaya, especially the products of her pioneer industries, will find an outlet into the Eastern Malaysian Market. The exemption from Customs duties would improve their position against foreign competition and there would thus be a shift in the sources of traded goods; the Borneo states would be consuming increased amounts of those manufactured goods which are produced in Malaya instead of importing these goods from foreign suppliers. The import prohibition orders and quantitative restrictions on foreign imports would reinforce this tendency of increased imports by the Borneo states from Malaya.

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[11] See Federation Government Gazette, 9th October, LN 369/65.

As in other aspects, the separation of Singapore has made the situation less definite and there is uncertainty over the future arrangements. The compelling economic arguements for the inclusion of Singapore cannot be over emphasised and it is hoped that political separation will not baulk this goal. The Rouff report points out that approximately one-third of Malaya's manufacturing output was exported and two-third of these exports were to Singapore, where most of it was retained.[12] The report also attributed the slowing down of industrialisation in Singapore to the gradual adoption of protective tariffs by Malaya. "Singapore by itself is not a sufficient market to serve as a base for large-scale industries, even if the market were adequately protected ..... For Singapore the need for a common market is probably even more imperative than it is for the Federation".[13] Moreover, including the entrepot trade Singapore is a very important trading partner for each of the three regions. Trade between them and Singapore is of much greater magnitude than the trade amongst themselves.

Other Measures Towards Economic Integration

In 1964 legislation was passed setting up the Federal Industrial Development Authority which would have an important role to play in bringing about the necessary co-ordination of industrial development policies in Malaysia. F.I.D.A. is entrusted with the task of undertaking economic feasibility studies of industrial possibilities, vigorous promotional work, recommending policies on the development of industrial sites, evaluation of applications for pioneer status and the facilitating of the exchange of information and co-ordination among institutions engaged in industrual development.

The activities of the Malayan Industrial Finance Limited (M.I.D.F.L.) have also been expanded and its coverage extended to the Borneo states.. This would be particularly beneficial to these states since their only existing source of Industrial Finance had been the Borneo Development Corporation Limited which has capital resources of only $4 million.

Steps have also been taken to unify the Pioneer Industries legislation in Malaya, Sabah and Sarawak. On the 1st January, 1966 the Pioneer Industries (Relief from Income Tax) Ordinance 1958 was amended and extended to Sarawak and changes were made in the corresponding legislation in Sabah.

All these will ensure a uniformity in the industrial development policies of the three regions. But this uniformity would not in itself ensure a regional balance of industrial development. Given the comparative natural advantages and dis-

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[12] "Report on Economic Aspects of Malaysia", Page 41.

[13] "Report on Economic Aspects of Malaysia", Page 42.

advantages the possibility exists that there may develop a tendency towards heavy concentration in one area. Thus the industrial promotion policies should aim at an equality of incentives throughout Malaysia and the Reuff report is of the opinion that "should such a tendency (of concentration in one area) became apparent after 4 or 5 years, special measures might then be justified to encourage industrial dispersal by means of differential incentives"

Another important aspect of economic integration is the co-ordination of Public Development Programmes and this has to a large measure been achieved in the 1st Malaysia plan which will be discussed in a later chapter. Political unification has meant that Sabah and Sarawak stand to benefit from the existing institutions for economic development in Malaysia and the expansion and strengthening of these institutions would constitute a strong integrating factor. The Economic Planning Unit of the Prime Minister's Department, The Treasury and its economic division and the department of Statistics are among the more important institutions.

Another recent step towards economic integration has been with regard to the mobility of Labour amongst the three regions. It was pointed out in the first chapter that the Borneo States are vested with powers over the question of Immigration and this would constitute an institutional barrier against the movement of Labour into the Borneo states from Malaya. Workers from Malaya were required to obtain work permits before being granted employment in the Borneo states and internal travel documents were necessary for entry into the Borneo states. The acute shortage of Labour is a serious brake on the future development potential of Sabah ~~but~~ up to May 1966 only 425 workers from Malaya had migrated to Sabah.[14] However on the 8th of August the first formal scheme offering positive incentives to migration was implemented with the setting up of a statutory body known as the Malaysian Migration Fund Board.[15] The scheme which the Board will implement provides for incentives to migrants in the form of the cost of passage, a disturbance allowance/of $100 per family, and wages of 20% higher than the prevalent Malayan wages for similar jobs performed by them. In addition the migrant workers would be permitted to stay permanently in Sabah after 2 years of employment and would be eligible for land offered by the Sabah government. With this new scheme it is expected that the annual intake of migrant workers would be at least 1,000 per year and estate agriculture and the oil palm industry will be given first priority in the scheme in view of the fact that their labour shortage is the most pressing.

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[14]Monthly report of the Ministry of Labour, Malaysia, May 1966 issue.

[15]Siaran Akhbar (Jabatan Penerangan Malaysia) 8th August, 1966.