CHAPTER V

THE DEVELOPMENT ASPECTS

In this chapter we will consider the new fiscal relationships and their implications for the different relative levels of Public Development expenditure in the different regions; the allocation of financial resources among the regions; the problems and strategy for the development of the Malaysian economy and the effects of economic integration of the three territories on this process of economic development.

Fiscal Relationships

The fiscal relationships of Malaya vis-a-vis - the Borneo states have been discussed in an earlier chapter. Here it will be only necessary to consider the revenue implications of the harmonisation of the tax structures of the three territories and the bearing this would have on the overall financing problem under the 1st Malaysia plan.

Like most underdeveloped countries, customs revenue forms a major source of governmental revenue. As such progress towards the harmonisation of import duties (non-protective tariffs) and export duties are essential. As we have seen in an earlier chapter, the common market arrangements cover only those goods which are domestically produced and which are also consumed in significant quantities in Malaysia. "But for a number of years to come, the single market would include only part of the total trade and, for the products which will continue to be supplied from abroad and not significantly from domestic sources, the tariff policy would not be determined on protective grounds, but mainly on the basis of revenue consideration".[1] This harmonisation of tariffs would be essential if all internal barriers to the free circulation of goods within the Federation of Malaysia were to be achieved. If such harmonisation of non-protective tariffs is not achieved it would give rise to inequalities in production costs which would necessitate measures designed to bring about equality.

Prior to the formation of Malaysia agreement had been reached that "the level of Federal taxation in the Borneo States should be brought up to Federation of Malaya levels in graduated stages over a period of years and steps should not be grossly

[1] Reuff report, Page 61.

disproportionate"[2].

The first step in the harmonisation process has been taken with the announcement of changes in import duties in the 1966 Budget. These changes were primarily for the purpose of harmonising rates in Sabah and Sarawak with those in Malaya. The import commodities affected were fruits and nuts, sugar, coffee, beverages, tobacco, textile yarn and thread, cotton and fabrics and clothing. These changes were expected to yield an additional $4 million in revenue.

There are also substantial differences in export duties which would have to be harmonised. "A substantial part of the revenue of North Borneo and Sarawak is derived from export duties applied to commodities which are not dutiable in the Federation, and conversely, they do not levy duties on products which are dutiable in the Federation. The only items which appear in all export duty schedules are rubber, certain oil seeds and bauxites".[3]

There are, in addition, other differences in the tax structure which it would be desirable to incorporate within the overall harmonisation process.

In a statement of Government policy and proposals regarding tax changes within Malaysia it was reiterated that the principle of graduation, agreed to in the Inter-Governmental Committee report, would be adhered to but the government would work towards the aim of ensuring "that within the four regions of Malaysia there should be equality of taxation between persons in similar financial circumstances".[4]

In respect of Income taxes the changes are mainly directed to harmonisation between Sabah and Sarawak at a lower level than in Malaya. Company income tax will become identical when the income of Sabah companies will be taxed at the uniform rate of 40% as in the other regions.

Tax exemptions and reliefs for Pioneer Industries were also declared to be in need of harmonisation and the Pioneer Industries Ordinance of the States of Malaya was amended and extended to Sarawak from January 1966 and the corresponding legislation in Sabah was amended in conformity with the above aim.

---

[2] Report of the Inter-Governmental Committee 1962. Page 13. (Kuala Lumpur, Government Printers 1963)

[3] Reuff report. Page 67.

[4] "Tax changes within Malaysia" - a Paper presented to Parliament on 25th November, 1964. Page 1.

Personal Income Tax will also be brought closer into line with tax levels in Malaya by a reduction in the proportional of chargeable income eligible for exemption from income tax. The personal reliefs applicable in Sabah and Sarawak are $3,000 for a single taxpayer and $2,000 for a wife whereas in Malaya the corresponding reliefs are $2,000 and $1,000 respectively. The same tax rates would be applicable in all regions but in the case of Sabah and Sarawak, the effects of the new scale of rates would be mitigated by the 40% discount or rebate which applies to the first $50,000 of the chargeable income. Thus complete harmonisation still remains to be achieved gradually.

The payroll tax,[5] introduced in Malaya in the 1965 budget was extended to Sabah and Sarawak in January 1966 and this change was expected to yield an additional $2 million. This tax is payable at a rate of 2% on the total payroll of a trade, business, profession or vocation carried on in Malaysia.

In addition a single-stage turnover tax on sales of imported goods, a Capital Gains Tax were to be introduced on a Malaysian wide basis and the Estates duties ordinances were also to be harmonised by the introduction of a new Malaysian Bill.

It has been pointed out that this harmonisation in the tax rates is necessary in order to attain complete economic integration. The harmonisation of tariff levels, both protective and non-protective, is necessary to ensure a complete free flow of goods amongst the three territories and the attainment of complete harmonisation would eliminate any relative regional advantages which arise from divergences in fiscal structures in the various regions. Equality in incentives and tax liability is an imperative prerequisite for the attainment of balanced development in the various regions.

The harmonisation process would result in some revenue increases since it involves the raising of the lower tax rates in Sabah and Sarawak to relatively higher levels and at the same time involves the extension of taxation coverage by the introduction of new taxes like the Payroll and Turnover taxes which were initially introduced in Malaya. Such increases are however marginal - the first changes in import duties yielded only an additional $4 million and the extension of the payroll tax to Sabah and Sarawak was expected to yield only an additional $2 million.

Revenue increases will have to be seen in the context of the 1st Malaysia plan where it has been projected that revenue would increase only at annual rate of increase of about 5%[6]. This

---

[5] For more information see Finance Act 1965, No: 2 of 1965.

[6] 1st Malaysia Plan. Page 73.

is because of the key role which has been assigned to private investment in the development plan and the consequent necessity to avoid adopting a tax burden so heavy as to have a detrimental effect on such investment.

Allocations of Federal Funds

The constitutional arrangements with regard to finance have been outlined in the first chapter but it will be necessary to briefly recapitulate the salient features. The agreement incorporated in the Inter-Governmental Committee 1962, provides for financial provisions which are to be advantage of the Borneo states and at the expense of Malaya. The revenues assigned to Sabah and Sarawak encompass several other items in addition to those assigned to the states of Malaya.[7] This implies that the Borneo states would retain a larger share of Revenues for themselves relative to the states in Malaya. In addition, there are also provisions for special financial grants to be made by the Central Government to these states. Sabah and Sarawak, in common with the states in Malaya, will receive Capitation grants each year which are based on the populations of each state. The rates for this grant are fixed at $15 per person for the first 50,000 persons, $10 per person for the next 200,000 persons and $4 per person for the remainder.[8] The Borneo states are also given favoured treatment in respect of State Road Grants. These grants for Sabah and Sarawak in 1964 and 1965 was at the rate of $4,500 per mile for Sabah, with the provisio that mileage elible for this grant should not be less the 1,151 miles (representing the total road mileage). The rate for Sarawak was to be fixed by agreement between Sarawak and the Central Government and the Borneo states have the added concession of having lower standard of roads than those in other states and roads maintained by local authorities qualifying for the road grant.

The Borneo states would also each receive an "annual balancing grant" equal to the estimated state revenue in 1963 and the estimated cost of State Services in 1963. In addition Sarawak receives an "escalating annual grant" during the 1st ten years of Malaysia. This sum would be sufficient to meet the annual increase in the State's services plus any sum required to offset any decrease in the States revenue.[9] It is intended that these grants should assure an expansion of the relatively lesser developed State Services of Sarawak at a rate of not less than 10% per annum. Sabah would also receive each year a grant equal to 40% of any increase in Federal Revenue derived from Sabah and not assigned to it, over the Federal re-

---

[7] See Inter-Governmental Committee Report. Page 14.

[8] See Federal Constitution. Page 142.

[9] Inter-Governmental Committee Report. Page 15.

venue which would have accrued in 1963 if these financial arrangement had been in force in that year.

These financial commitments to Sabah and Sarawak results in an additional strain on the financial resources of Malaya in the area of recurrent expenditure. The extension of free primary education to these states also increases the strain. These responsibilities, and the added defence and internal security requirement and the fact that in the period 1961-1965 the recurrent expenditure of the government of Malaysia increased by 67% has resulted in the fact that a surplus of only $200 million would be available for development expenditure during the period of the first Malaysia plan 1966 - 70.[10]

In respect of Development expenditure, Malaya is also committed to ensuring specified levels of expenditure in Sabah and Sarawak. In the case of Sarawak, the Malaya government undertook "to the best of its endeavours" to ensure that $300 million was expanded or economic development in that state during the first 5 years after the establishment of Malaysia. The corresponding figure accepted for Sabah was $200 million in order to enable it to enjoy a satisfactory rate of economic growth.

The following tables would show the flow of Federal Funds to the Borneo States in 1964 and give an indication of the 'net liability' which Malaya is bearing in respect of the Borneo States.

---

[10] First Malaysia Plan. Page 71.

TABLE 5-1

FLOW OF FEDERAL FUNDS TO SABAH AND SARAWAK
1964+

	Sabah	Sarawak
1. **Statutory Grants & Assignments**		
- Capitation Grant	3,567,684	4,728,116
- Road Grant	5,179,500	3,393,000
- Annual Balancing Grant	-	5,800,000
- Annual Escalating Grant	-	3,500,000
- Grant equal to cost of maintaining State Road Transport Departments	113,763	91,496
- Assignment of proportion of Export duty on Minerals	-	147,649
- Growth Revenue Grant, Sabah	2,437,732	-
- 30% of Net Customs Revenue, Sabah	9,313,090	-
- Proportionate Share of Sabah Public Debt.	330,467	-
TOTAL STATUTORY GRANTS	38,602,499	
2. **Federal Expenditure in Sabah and Sarawak**	37,961,627	53,955,964
3. **Development Expenditure Federal Projects**	16.839,166	37,453,992
4. **Pensions**	3,480,470	4,783,685

+Source: Financial Statements for 1964, Federation of Malaysia. (Kuala Lumpur: Government Printers).

TABLE 5-2+

FEDERAL REVENUE 1964 : CONTRIBUTIONS AND SHARES BY REGIONS ($ million)

	Contributions to Revenue	Share of Total Federal Expenditure
Sabah	57.6	79.1
Sarawak	59.3	127.5
TOTAL	116.9	206.6

Table 5-2 would show that the Financial arrangements are to the benefit of Sabah and Sarawak since they enjoy a net gain of $89.7 when their share of Federal expenditure is compared with their contributions to Revenue.

The levels of expenditure in the three regions that have been spent since the formation of Malaysia and the amounts ear-marked under the 1st Malaysia Plan are illustrated in the table below.

TABLE 5-3

MALAYSIA : PUBLIC DEVELOPMENT EXPENDITURE(a)

	$ MILLION		
	1963 Actual	1964 Actual	1965 Estimated
Malaya	574.9	560.5	635.0
Sabah	40.1	50.5	61.4
Sarawak	55.3	51.1	66.8
TOTAL	670.3	662.1	763.2

+Source: Financial Statements for 1964, Federation of Malaysia.

(a)Source: Bank Negara Malaysia - 1965 Annual Report.

The geographical distribution of economic and social development expenditure for the period of the Malaysia plan would be about $3,110 million for Malaya, $300 million for Sabah and $400 million for Sarawak.[11] The factors taken into account included the "populations, development potentials, needs for economic and social infrastructure investment, financial capacities and the ability to implement expanded development programmes without inflationary consequences" of the three regions. The plan also stated that these figures represented a greater relative increase in development expenditure for Sabah and Sarawak as compared to Malaya. The amount for Sabah and Sarawak represent increases of 47% and 57% over the amount expanded during 1961-65 whereas the increase in the case of Malaya was only 32%. These greater relative increase is claimed to be "indicative of the governments determination to ensure that as large on allocation is provided as can be expected to be achieved <u>within the technical and administrative capacities of these states</u>".[12]

Examining the factors which were taken into account it will be seen that the proportions of public development expenditure allocated between the three regions approximate the respective population figures. Sarawak's population is 8.9% of the total population of Malaysia and the amount of development expenditure alloted to her is about 10% of the total development expenditure. Sabah's population is 5.5% of the total population and her share of development expenditure amounts to 8% of the total development expenditure.

<u>Relative needs for Development</u>

The other factor taken into account in determining the regional allocations was stated as "needs for economic and social infrastructure development". Due regard has been given to this factor - "while in Malaya the basic transport and communication systems are for the most part now well established, they are only partially developed in Sabah and Sarawak" and "substantial improvements and extensions to the transport and communication systems in Sabah and Sarawak form an essential part of the long-term effort to exploit the considerable economic potential in these states".[13] The following table will show the special emphasis being given to this aspect of development in the Borneo states.

Whereas there is a decrease of 26% in the projected expenditure on transport and communications for 1966-70 as compared to the previous five years in the case of Malaya, there is a corresponding increase of 31% in the case of Sabah and Sarawak.

---

11 1st Malaysia Plan: Page 71.

12 1st Malaysia Plan: Page 71

13 ~~Op. cit.~~ Ibid. Page 139.

TABLE 5-4

PUBLIC EXPENDITURE ON TRANSPORT AND COMMUNICATIONS+

	1961 - 65	1966 - 70	% charge
Malaya	702	522	-26%
Sabah & Sarawak	175	229	+31%

The data given in the Appendix would also give a clear indication of the extent of the disparity between Sabah and Sarawak in the degree of development of the basic economic and social infrastructure.

The Borneo States are less developed than Malaya in transport, communications, utilities, education and health services.

The greater relative need for development in Sabah and Sarawak is also shewn by the lower level of per capita income and structure of the economy. In fact one of the four major socio-economic problems facing Malaysia listed in the 1st Malaysia plan reads "An uneven distribution of income, which involves wide disparities between rural and town dwellers and between inhabitants of Malaya and the Borneo states, as well as among various social groups".

MALAYSIA : GROSS NATIONAL PRODUCT 1965
(At Market Prices)

	Total	Per Capita
Malaya	7,663,000	952
Sabah	448,000	862
Sarawak	618,000	737

In the Borneo States 80% of the economically active population is engaged in Agriculture whereas in Malaya it is only 58%. Moreover there is relatively little estate agriculture in the Borneo States and agricultural techniques are poorer and yields are consequently lower. Shifting agriculture is still widely prevalent especially in Sarawak and the fact that there is

+Source: 1st Malaysia Plan.

more land per person in use in the Borneo states suggests less advanced agricultural techniques. The per capita acreage of Rubber is only slightly lower in the Borneo States as compared to Malaya but the yields per acre are much lower.

In Malaya 11% of the economically active population is engaged in manufacturing and construction and 30% in Trade, Transport and Services, whereas the corresponding percentages for the Borneo states are 6% and 13% respectively.

The economies of the Borneo states are also relatively more "open" and export orientated as indicated by the fact that the Gross Export proceeds form more than 50% of the Gross National Product, whereas in Malaya it forms only 40%.

Having indicated that the Borneo states are at a comparatively lower level of development and consequently need special emphasis in development, it is necessary to look at the overall strategy for development. But it should be noted that a major limitation on greater economic growth in Sabah and Sarawak is their limited technical and administrative capacities. Even in Malaya there is the problem of "skill bottlenecks" and this limitation is more acute in the case of the Borneo states.[14] This problem has been focussed in recent press reports when the Minister of Finance of Malaysia reiterated the claim that Sarawak would receive favoured tretment in the allocation of developmental expenditure but drew attention to the problem that these allocations had not been fully spent because of administrative limitations.

It is also pertinant to note here that the greater relative need is recognised by the Federal Government for political reasons as well. Cabinet Ministers have spoken of the urgency of reducing the economic imbalance in order to check the threat of Communist subversion in the Borneo states.

First Malaysia Plan

The strategy for bringing about economic growth in the Malaysian economy in the next 5 years (1966-70) is charted out in the 1st Malaysia Plan. The plan calls for a development expenditure of $10,500 million of which $4,550 million will be expanded by the public sector and $5,950 by the private sector. Because of the free enterprise nature of the economy the role of the government will be confined to providing physical and human pre-requisites for growth and to implement policies which will guide the activities of the private sector towards certain assigned goals.

The plan aims at securing an annual growth rate of 1.1%

[14] See Chapter V, 1st Malaysia Plan on the shortage of skilled personnel.

in per capita income growth over the next 5 years and the strategy adopted is conditioned by the virtual stagnation in export income growth (the annual rate of increase is anticipated to be only 0.6%), the high rate of population growth (3% per annum) and the low level of human resource development prevailing in the economy. The strategy has been summed up as "to promote traditional and new export possibilities, stimulate domestic food production and to exploit to the fullest extent the excellent possibilities for industrial production catering for the domestic market".[15] Thus despite the prospects of a continued secular decline in rubber prices Rubber replanting would continue at the same time as diversification of agricultural crops, especially oil palm, will be encouraged. Thus this diversification in agricultural crops would have only a very small impact. In short "Export growth will be inadequate to finance import needs and maintain overall economic growth, even after allowance is made for export promotion and diversification".[16]

During the last 5 years economic growth was not export induced but was the result of an expansion of production for the domestic market. In the next 5 years the reliance will also have to be on an expansion of production for the domestic market. In view of the stagnant export growth measures for import substitution will have to be implemented. This will involve import substitution of food requirements and also of imported manufactured goods. The stimulation of food production and the manufacturing sector are thus urgent tasks. With the high level of consumption of imported manufactured goods prevailing at present and the realisation of the expanded Malaysian Common Market ensures good prospects for development in manufacturing.

The sectorial allocations of public development expenditure are a reflection of these policies. Twenty-three point nine per cent is allotted to agriculture and rural development, 9.7% for education and training while 33.7% is devoted to Transport, Communications and Utilities. Compared to the allocations during the previous five years, expenditure on agriculture and rural development has shown a marked increase over the 15.3% which was allotted then, expenditure on Education has increased slightly from 8.9% to the present 9.1% while expenditure on Transport, Communications and utilities dropped from 45.2% to 33.7%. The drop is the expenditure on Transport, Utilities and Communications result from the fact that the basic economic infrastructure in Malaya has reached a satisfactory level of development although the situation is different in the case of the Borneo states. The per cent spent on Industriql Development showed only a slight increase from 2.2% to 2.5%, an indication of the small base from which the present industrial sector has to develop. Expenditure on defence and

---

[15] 1st Malaysia Plan. Page 9.

[16] 1st Malaysia Plan. Page 8.

internal security has climbed from 10% to 16.1%, and this means a significant diversion of resources away from social and economic development.

In the case of Sabah and Sarawak the overall increase in development expenditure, as previously mentioned are 47% and 57% respectively. The sectors which have received the greatest relative allocations are Agriculture and Communications which have both shown a 3-fold increase. The allocation for transport increased only slightly in the case of Sabah and by 30% in Sarawak. The allocation for utilities increased only slightly in the case of Sarawak while it doubled in the case of Sabah. There are also net increases of \$75.9 million and \$59.4 million in expenditure on Defence and Internal Security. Apart from \$4.1 million on internal security in Sarawak during 1961-65, there had previously been no other expenditure on these items. These increases represent 20% of the total development expenditure allocated to Sabah and 12.9% of the total for Sarawak. The allocation for industrial development has decreased by half in the case of Sabah and Sarawak compared with the expenditure in the previous five years. This indicates that only a very small degree of manufacturing development is expected in the Borneo states during the next five years.

The 1st Malaysia plan represents the first attempt to plan for Malaya, Sabah and Sarawak together. Although there exists relatively well developed planning machinery at the Federal level and representatives of Sabah and Sarawak have been appointed to the National Development Planning Committee, "because of the geographical spread of Malaysia, with the Borneo states being over 1,000 miles from Malaya, the different levels of development in the various states and the increasing range of government responsibilities, the task of co-ordinating the implementation of the plan will be difficult".[17]

In conclusion it is necessary to consider the question of the implications of economic integration and joint planning for the three regions on their economic development.

The lower level of social and economic development in the Borneo states has resulted in the need to give special emphasis to their development in the formulation of the 1st Malaysia plan. This would entail a sacrifice of some of Malaya's financial resources which she would be needing herself in view of the stagnation in the level of her export earnings. There would thus be an initial disadvantage to Malaya in this respect. The Borneo states would also stand to benefit from the experience and expertise which Malaya has gained from the implementation of her 1st two development plans. This is particularly true in view of the fact that both the Sabah Development Plan of

---

[17] 1st Malaysia Plan. Page 89.

1959-64 and the Sarawak Development Plan of 1959-63 were simply programmes of public investment expenditure and not the more comprehensive planning with the specific attention to the formulation of programmes for individual sectors and incorporating policies designed to guide the public sector activity towards certain defined targets as had been practiced in Malaya.

But the benefits are not entirely one-sided. The integrated economy with a common market offers a much wider market for Malaya's developing manufacturing industries and the wider economic base offers greater opportunities for implementing the import substitution which is necessary in the face of stagnation in the growth of export incomes and in order to reduce the vulnerability of the economy to instability induced by exogenous factors. In the long-run, the rise in the levels of income in the Borneo territories would also contribute to the expansion of the domestic market.

Lastly there is the problem of the geographical maladjustment in the distribution of Labour. In the Borneo states, particularly Sabah the capacity for further development is limited by the shortage of Labour. "In geographic terms, the maladjustment of labour supply to demand in the aggragate limits economic growth in the Borneo states and swells the major towns of Malaya with a surplus of inexperienced young workers".[18] There is thus scope for the siphoning off of surplus Labour in Malaya to Sabah where there is a labour shortage. With special assistance and incentives and a modification of entry controls, this transfer of Labour would enable Sabah to achieve the level of development contemplated under the 1st Malaysia Plan and at the same time relieve the unemployment pressure in Malaya.

---

[18] 1st Malaysia Plan. Page 80.