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Economic Problems of Malayan Independence 16 pages

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Economic Problems of Malayan Independence

Robert B. Bangs

The Federation of Malaya becomes an independent nation within the British Commonwealth on August 31. Achievement of independence will confront the new nation with many political, organizational, and economic problems. This paper examines briefly some of the most pressing of the economic problems.

The Federation is composed of nine Malay states and two Settlements each having its own local government. Prior to World War II, the Malay states were protectorates of Great Britain with resident advisers whose advice was binding except in matters of local religion and custom. Four of the states were first federated in 1895 at which time legislative power was centralized in a Federal Council appointed by the British High Commissioner.

After World War II, a Malayan Union was formed including all the states and settlements except Singapore, which was administered as a Crown colony. The Union provided for a common citizenship not limited to Malays and for a highly centralized government.

In 1948, the Union became the Federation by revesting in the sultans or rulers of the Malay states most of the powers they had enjoyed before World War II. The agreement establishing the Federation contemplated eventual self government by transfer of power to a legislative council composed of both appointed and elected members. In 1955, the elected members came into the majority for the first time. A new constitution will go into operation with independence.

The Alliance party that will organize Malaya's first independent government is a coalition of the United Malays National Organization, the Malayan Chinese Association, and the Malayan Indian Congress. In the 1955 elections, this party polled nearly 80 per cent of the total vote. Voting was heavy among Malayans but it has been estimated that only one Chinese in 8 and one Indian in 7 voted.1/ In economic orientation, the Alliance is conservative, friendly to foreign capital, and less inclined toward socialism than some other Southeast Asian governments.

Problems of organization

Like any newly independent country the Federation will have problems in organizing the machinery of government. Especially important will be the maintenance of law and order and eventual suppression of the armed insurrection that has disrupted the country since 1948. The insurgents, some of whom are communist inspired and supported, number no more

1/ See F. G. Carnell, "The Malayan Elections" Pacific Affairs, December 1955 p. 315-330.

than 3500 at present according to Federation government claims; but due to the difficult jungle terrain, military operations have not yet succeeded in wiping them out. In September 1955, an amnesty was offered but few of the terrorists surrendered under the offered terms.

British and other commonwealth military forces have been responsible for Malaya's security and for dealing with the insurrection or "emergency." With British technical and financial help the Federation will gradually organize, equip, and train its own army and police establishment. Meanwhile British forces will remain for some time after independence.

The Federation also is faced with building its own civil service to replace the British colonial administration. At present about 75 per cent of the higher officers of civil government are British. Some are staying for temporary periods to ease the transition but the majority will be replaced by local people. Some loss of efficiency is inevitable.

Difficult as these organizational problems will be they are eased by the facts that preparations for independence have been underway for some years and also that the transition is occurring at a relatively peaceful and prosperous time, rather than in the midst of devastation following a war. Malaya is in a much better situation to be independent than was, for example, Burma in 1948.

Singapore will not join the Federation in independence at this time but will continue as a British crown colony. In the past, Singapore has been the trade and financial center for all Malaya; but important political differences now divide Singapore from the rest of the country. The Federation is primarily Malayan and Moslem while Singapore has a Chinese majority. Whether these political differences will interfere with continued economic integration between Singapore and the rest of Malaya remains a difficult problem for the future.

Major economic problems

The Federation's chief economic problems are (1) to organize and finance a program for economic development, (2) to create independent currency and central banking arrangements, (3) to maintain the competitive strength of its established industries, rubber growing and tin mining, and (4) eventually to grow more of its own food supply and diversify its export trade. Before examining these problems in more detail, some general features of the Malayan economy may be noted.

With an area of 32 million acres, slightly larger than that of New York state but nearly four-fifths covered by dense jungle, a population of more than 6 million which is growing rapidly, a fair transportation network, and a number of small, light manufacturing industries serving the local market, the Federation has reasonably good prospects for further development if political and financial stability can be maintained. Not the least of Malaya's advantages is the fact that it is not overpopulated as are several other Southeast Asian countries. For example, only about 5.4 million acres, or roughly 17 per cent of the total land area, are now cultivated in Malaya. Potentially a much larger area is capable of being put to agricultural use if land policies of long standing can be modified.

General features of Malayan economy

The economy of Malaya is primarily agricultural. More than 60 per cent of gainfully occupied persons are engaged in agricultural pursuits. Exports consist almost wholly of raw materials of agricultural origin and of minerals. Rubber and tin account for about 85 per cent of export earnings and for about 20 per cent of the national income. Rubber alone occupies 65 per cent of the cultivated area in Malaya, employs at least 25 per cent of all gainfully occupied labor in the country, and contributes 60 per cent of total export earnings. Malayan rubber production is exceeded in the world only by that of Indonesia while its export trade in rubber is the world's largest because a substantial amount of Indonesia's rubber is handled through Singapore. After rubber the main crops are rice, coconuts, oil palms, fruits, and vegetables.

Malaya has, by Asian standards, a relatively high per capita income, estimated at about U. S. $250 in 1953. Nevertheless, the country's prosperity has, in the past, been quite unstable because of its dependence on world markets for its primary products. At the present time, with both tin and rubber prices fairly high, the economy is reasonably prosperous; this prosperity is evidenced by a construction boom and by a high level of imports for consumption. However, during 1957 rubber has been declining in price; moreover, the long-range outlook for this commodity is uncertain because of the growing competition from synthetic rubber.

Tin is in oversupply in the world while future growth in demand for this metal is likewise uncertain. Malaya must reduce its tin production under the international agreement now in effect,

In both rubber and tin, therefore, the Federation faces the possibility of declining export earnings at a time when import needs, both for investment and consumption, are virtually certain to rise. Practically every Asian country that has undertaken an economic development program has sooner or later had to face heavy imports, loss of foreign exchange reserves, and growing inflationary pressure at home. To judge whether and when the Federation may encounter similar difficulties, we need only to examine the nature and financial implications of present development plans against the outlook for lower export earnings.

Planning for economic development

Malaya's best opportunities for economic development in the near future lie in improving and diversifying her agricultural output. This will involve opening up more land for cultivation, building roads, and strengthening the agricultural extension and credit services. The country is not well situated nor equipped with resources to conduct extensive manufacturing operations; it is a tribute to the good sense of the Malayan leaders that they have recognized this fact in formulating their development plans.

One of the areas in which change is most needed if Malaya is to develop economically is in land policy. Much of the presently uncultivated area of Malaya could be put to use, either for rubber or other agricultural crops, but title to the land is vested in the rulers of the Malay states. When land is alienated, or made available for cultivation, the crop is specified and both a capital sum (alienation premium) and an annual quit rent are charged. These charges do not vary with location or fertility.

Virtually no land for rubber planting has been alienated for 25 years, largely because of the restrictions on rubber production that were in effect during the 1930's. This restrictive policy has prevented smallholders from opening up new land to agriculture and has held back the development of the country along agricultural lines.

In addition to this traditional policy of not allowing rubber acreage to grow, large areas in Malaya are reserved for Malayan nationals with ownership prohibited to non-nationals (Chinese and Indians). This has also limited land use.

Finally, operation of Moslem laws of inheritance, which specify precise rules for distribution of a decedent's property, have resulted in excessive fragmentation of landholdings into uneconomically small units, often separated from one another.

One of the top priority tasks the new Government should undertake is to reexamine land policy and modify it to allow increased scope for private initiative in clearing and cultivating land. Peasant agriculture can compete successfully with plantation agriculture as experience in other countries such as Indonesia has demonstrated. Besides access to land the Malayan farmer needs only better credit facilities and some technical advice in order to accomplish a considerable increase in production through his own efforts.

In formulating its development plans Malaya has received good advice. A survey mission from the IBRD which visited Malaya in 1954 and published its report in 1955, recommended the main lines along which efforts to develop should be concentrated and the role government should play in the process. This report advised public capital expenditures during the five year period 1955-59 averaging only slightly above U. S. $50 million per year - a comparatively slight increase over the nearly $40 million per year spent for similar purposes in 1952 and 1953. The Malayans accepted this conservative program, at least initially as a basis for their financial discussions with the U. K.; but they have since indicated they want to extend and speed up the plan as much as possible and have already gone 50 per cent above the total cost recommended by the IBRD.

The World Bank program for Malaya was a balanced one covering transport and communications, the extractive industries, electric power, social services, and public construction. About 25 per cent of the investment recommended was in agriculture, with 20 per cent on transport and communications, and 11 per cent on power. The largest single projects within the plan were rubber replanting and road construction. However, the Bank's recommendations, although accompanied by proposals for increased taxation, involved prospective budget deficits of approximately U.S.$10 million per year which it was believed Malaya could finance without serious inflationary consequences. Actual budget revenues in 1955 and 1956 have exceeded the World Bank estimates by a good margin, due principally to better rubber prices than the IBRD forecast.

In its own development planning for the period through 1960, the Malayan Government has followed fairly faithfully the recommendations of the IBRD mission of 1954 as to priorities but has added a number of additional projects and has stepped up expenditure in several areas well beyond what the Bank considered feasible.1/ The IBRD report visualized a total public capital outlay during the 1955-59 period of M$776 million, (U.S.$258 million) whereas the Government's plan, as reported early in 1957, following the London financial talks, totals M$1.1 billion (U.S.$370 million) for the period 1956-60.2/ This figure excludes capital outlay for the armed forces and for certain financial items that make no contribution to future production - such as pensions for former Colonial officers. The total cost including these items is in excess of M$1.35 billion (U.S.$450 million).

The Government's plan provides somewhat less than the IBRD recommended for general agricultural development but somewhat more for rubber replanting and for mineral development, primarily surveys. The plan also provides larger outlays than the Bank recommended for transportation and power development, and for education, health, and public welfare. But, by and large, it is a reasonably modest plan with major emphasis on the productive sectors of the economy rather than on expansion of social services, and with expenditure schedules not too far out of key with the limited financial and technical capabilities of the Malayan Government.

Malaya's capacity to finance economic development would be greatly enhanced if the emergency could be ended soon. In both 1955 and 1956, expenditures attributable to the emergency were in excess of M$700 million. The bulk of these costs were financed by the U. K., but in each year the Federation contributed about one-fifth of its revenue to this campaign. Total costs of the emergency to both the Federation and the U. K. roughly equal total current government expenditures in the Federation.

1/ Cf. The Economic Development of Malaya, IBRD, 1955.
2/ Cf. <u>Report on Economic Planning in the Federation of Malaya in 1956</u>, Government Press, Kuala Lumpur.

It is probable that once the country actually becomes independent, pressure to proceed even more rapidly with economic development will intensify; the plan may be accelerated accordingly. Already there is evidence of a desire to proceed roughly twice as fast with rubber replanting (and at double the annual cost) as recommended by the IBRD mission. This is understandable in view of the urgency of the problem.

The methods proposed by the Federation Government to finance the development program are of particular interest. In January 1957, loan negotiations were concluded in London between the U. K. Government and a delegation representing the Federation of Malaya. Under this agreement the U. K. will grant to the Federation £3 million pounds a year during the first three years after independence to help defray the cost of the emergency. At the end of that time a review of the situation will be made and a further sum of not more than £11 million pounds may be granted or loaned for the two subsequent years. The U. K. will also contribute £13.3 pounds toward building up the Armed forces of the Federation.

For economic development purposes, the British agreed to provide whatever unspent balance remains of the Federation's colonial development and welfare allocations at the time of independence. These allocations amounted to £4.4 million pounds at the beginning of 1956. The Malayans are reported to have asked for a total of more than £90 million pounds for development purposes and to have been greatly disappointed by the small amount of assistance the British agreed to furnish.

The present financial arrangements for economic development call for a long-term loan of M$500 million to be raised in Malaya by the sale of government securities to banks, insurance companies, other business firms, and individuals and for currency reserves to be drawn down to the extent of perhaps M$250 million. The assistance offered by the British Government comes to roughly M$150 million and a long-term loan of £10 million or M$85 million is expected to be raised in the London money market.

A gap of about M$230 million exists between the costs of the development plan and the other capital budget items and the means of financing in sight; this sum will have to be raised by other methods. Moreover, the estimated overall cost of development has not been broken down as between foreign exchange and local currency needs. It is probable such an allocation, if made, would not be far from 50-50. Although Malaya's foreign exchange position is good, it is likely that appeals will be made for Colombo Plan aid, for U. N. assistance, and possibly also for U. S. Government assistance, although an appeal to the U. S. is said not to be contemplated in the immediate future.

It is not apparent from the development plans outlined by the Malayan Government whether the various projects included have been well engineered and whether the cost estimates are firm. Some cost increases over the life of the plan may reasonably be expected if present price trends continue. On the other hand, it is by no means certain that actual capital expenditure can be carried out at the rates forecast in the program. Some projects will undoubtedly lag and some appropriations will be underspent.

Moreover, expenditure schedules are not really firm for more than one or two years in advance. The program could in practice extend well beyond 1960.

Malaya is almost unique among Asian countries in that the development program seems to have been worked out with a fairly realistic view of financial limitations rather than in terms of ambitious goals as to the amounts by which production and incomes should be raised. If the plans as they now stand are adhered to, not too serious financial limitations are likely to be encountered in the near future unless tin and rubber prices fall below the conservative levels that have been used to estimate revenue yields. There may, however, be some necessity for increases in the privately held money supply from budget deficits not offset by foreign exchange deficits. This process probably will not go so far as to weaken confidence in the Malayan currency or to cause it to lose its "hard" character. However, the plan to substitute local for sterling securities in the currency cover may have more serious implications.

The development plan will be put into effect through the regular annual budgets of the Government and through supplementary capital budgets from time to time as financial resources are in sight. In this way expenditure plans can be reviewed periodically and adjusted as required. For an indication of the pace of development outlays in the near term future a brief look may now be taken at recent budget events.

Budget prospects

The Federation budget for 1957, the first to be prepared by the Alliance Government elected in 1955, contemplates revenue of M$688 million, (U.S.$229 million) nearly 7 per cent less than 1956, and total expenditure of M$1,117 million (U.S.$372 million) of which M$752 million is on ordinary account, M$221 million is on capital account, and M$134 million is expenditure attributable to the emergency. The apparent deficit of M$384 million (U.S.$128 million) will be financed in part by grants from the U. K. (about M$12 million)[1/] but primarily by internal borrowing.

Revenue derives 60 per cent from customs duties, among which the export taxes on rubber and tin are the most important. Together these two export duties account for about one-third of Federation budget receipts. Moreover, they are the most volatile items. Rubber exports are taxed from 5 to 17 per cent *ad valorem* depending on price.

In 1956, the export duty estimates were based on M$1 per pound rubber; although the price fell slightly below that level the quantity exported was greater than forecast for budget purposes. As a result revenue

1/ The stated deficit is only M$110 million but this is because capital expenditures and expenditures for the emergency are not included but are charged directly against borrowing. However, M$45 million of capital expenditure is covered in the regular budget so the apparent deficit is not M$429 (1117-688 but M$45 million less or M$384 million.

exceeded expectations slightly. The price assumed for 1957 is M75 cents (U.S.$.25) well below the average of M97 cents for 1956, and comparable with the price of synthetic rubber. So far in 1957 rubber prices have averaged above M90 cents. Thus the revenue estimates for 1957 appear to be conservative. Export duty collections in the first quarter of 1957 were running about 15 per cent below the first quarter of last year.

Ordinary expenditures in 1957 are scheduled to rise slightly because of a wage boost for the government clerical staff and provision for more social services, implementing the Alliance political platform. About 17 per cent of ordinary expenditure is attributed to the emergency (insurrection) while another 23 per cent represents grants to state and local governments. The capital budget covers construction, development programs in agriculture, irrigation, transportation, etc., as well as some emergency outlays for equipment of the Armed forces.

The 1956 budget as originally drawn contemplated a M$90 million deficit on current account; however, preliminary actual results now indicate a M$50 million surplus was realized - principally because expenditures lagged behind appropriations. If a similar pattern is repeated this year no current account deficit may appear, especially as the revenue estimates appear more conservative than last year.

In May 1957, a supplementary capital budget was presented, calling for M$100 million in new projects of which M$39 million will be spent this year. Thus the 1957 capital budget has been raised to nearly M$260 million (U.S.$87 million) nearly all of which will be deficit financed.

The Federation treasury plans to borrow about M$157 million on short term by issuing Treasury bills during this year. Some of these bills will be taken by the Currency Board which is gradually modifying its traditional policy of holding only sterling assets in anticipation of the fact that a new central bank will eventually be established. The remaining deficit, which may well be far smaller than anticipated, will be financed by drawing on external assets accumulated from surpluses of prior years.

While past budgets have often overestimated expenditures and understated revenues, the present budget clearly contains a large enough deficit to add somewhat to money supply and to inflationary pressure this year, even if spending lags considerably behind appropriations.

Foreign trade and payments

Malaya has traditionally enjoyed an active trade balance and has been a major contributor of dollars to the sterling pool.

Malaya's contribution to the dollar pool may be seen in the fact that in 1956 total dollar earnings were nearly $270 million, whereas direct payments to the dollar area were only slightly in excess of $40 million.

Trade earnings, however, have fluctuated violently as seen in the fact that they reached a peak of more than M$2 billion in 1951 and fell to half that amount two years later. Since 1953, export earnings have risen somewhat but are still well below the peak reached during the Korean war. In 1956, trade earnings were less than M$1.4 billion, about the same as in 1955. During the first four months of 1957, export earnings have been quite close to the corresponding period for 1956.

Imports recently have been rising more rapidly than exports; in 1956 the trade surplus was extremely small, less than M$20 million. So far in 1957, the prospect is that a small deficit in the trade account will occur.

Between two-thirds and three-fourths of total Malayan external trade moves through Singapore but there is evidence that when the Federation becomes independent it hopes to cut down on this proportion by developing its own port facilities. It will take a number of years, however, before the Federation's ports can be full developed so the present trade pattern is likely to persist for some time.

No balance of payments data are currently available for Malaya but rough estimates covering the years 1949-53 were made by the World Bank. These estimates show a substantial volume of payments for dividends and profits remitted abroad, amounting in 1951 to nearly U.S.$250 million; but they also show a steady accumulation of sterling balances - amounting in all to approximately U.S.$2.1 billion at the end of 1953. More than one-third of these sterling balances were held by the Currency Board as backing for the Malayan note circulation but substantial amounts were also held by the commercial banks, most of which are branches of British firms.

Additional balance of payments data for 1955 were given recently in connection with the application of the Federation Government for membership in the International Monetary Fund following independence. These data show (for both the Federation and Singapore) the following: (in millions of Malayan dollars)

Exports	f.o.b.	$4,032 1/
Imports	c.i.f.	3,821
Trade balance		+$ 211
Services and donations		+ 236
Current account balance		+$ 446

Excluding Singapore, Federation exports in 1955 were M$2,370 million or 59 per cent of the figure for both areas and imports were M$1,543 million or 40 per cent of the total.

1/ Of which rubber represents about 58 per cent.

Malaya's sterling assets have grown rapidly since 1953 and are now substantial, amounting at the end of 1956 to £369 million (U.S.$3,163 million). This figure also includes Borneo, which is part of the currency area, but accounts for only about 10 per cent of the total. The overall figure includes currency board and government sterling assets as well as the balances of Malayan banks. With such large sterling assets there is finance for a considerable part of the foreign exchange cost of a development program even without a trade surplus. However, it should be noted that the bulk of bank sterling assets are in Singapore rather than in the Federation and that some capital flight from the Federation to Singapore has recently occurred in anticipation of independence. Moreover, the Federation cannot easily tap the sterling reserves of British banks operating in Malaya.

The central bank question

At present, Malaya operates under a British-colonial type currency board arrangement in which sterling assets, including British Treasury securities, are held in London as 100 per cent cover for the local currency.1/ In practice, the Currency Board stands ready to issue Malayan dollars against sterling assets and to redeem local currency for sterling on demand. Dealings are exclusively with banks. This system has been suitable in the past because of the importance of foreign trade to the Malayan economy and the absence of a local money market.

At the end of 1955, the Currency Board's holdings of sterling were just short of £100 million.2/ At that time, the active circulation of currency notes, that is the gross amount issued less the amounts held by Government treasuries and by banks, was M$825 million; thus the currency circulation is somewhat more than 100 per cent backed by sterling. According to the statute under which the currency board operates when sterling assets exceed 110 per cent of the note circulation, a distribution of earnings is made to the Singapore, Federation, and Borneo governments.

At the end of 1956, the net currency circulation had increased to M$899 million. Demand deposits with banks were M$914 million (excluding Borneo).

The IBRD Malayan survey mission recommended that the currency board system be replaced by a central bank that would endeavor (a) to reduce the impact of foreign trade fluctuations on the country's internal

1/ For a more detailed description of British colonial currency board arrangements see G. L. M. Clauson, "The British Colonial Currency System," Economic Journal, April 1944, pp. 1-25. The Malayan system dates from 1906.

2/ Annual Report of the Commissioners of Currency, 1955.

economy and (b) to develop a wider local market for government securities.[1] This recommendation was well received by the Malayans who commissioned a followup report from two distinguished Britishers well acquainted with central banking and with Malaya.[2]

Their report, published in 1956, contained draft statutes for a central bank and a discussion of the main problems that would be involved in establishing such an institution.[3] The chief question was whether there should be one institution serving both Singapore and the Federation or separate institutions for each of the two areas. The report strongly favored a unitary system, or if necessary, separate banks that would move in step on all matters of policy and procedure. For political reasons, however, the Alliance leaders in the Federation have been reluctant to accept this recommendation despite its economic logic; instead they have expressed an interest in establishing their own central bank independent of Singapore. To a certain extent this view merely gives expression to the divisive forces now operating between Singapore and the Federation and finding expression in such other measures as the emergence of Federation tariffs against Singapore products. However, the central bank plan also occupies an important place in the Federation's financial planning since some use of currency reserves to finance economic development is contemplated.

The central bank discussions all contemplate the emergence of a fiduciary issue of local currency not backed by sterling assets but by local securities. How large this issue would be and whether Malayan treasury bills would be forced into the proposed central bank on terms that would weaken the currency and deprive the central bank of any independent influence in pursuing a monetary policy aimed at stability are unresolved problems.

If a separate central bank for the Federation is established, as evidence now seems to indicate, the Currency Board assets will be divided in roughly the proportions of 60 per cent to the Federation and 40 per cent to Singapore. The Federation could therefore count on about £60 million or M$510 million in sterling assets to back its local currency which presumably would be separate from that of Singapore.

The present view is to make about half this amount a fiduciary issue and thus to dilute the currency cover from 100 per cent to roughly 50 per cent in foreign exchange. This undoubtedly goes beyond the Watson-Caine recommendation which, while contemplating a fiduciary issue, was not specific as to its amount - merely saying that notes or coin should

1/ For a view in opposition to the idea that a central bank is needed in Malaya, or that one can be effective in dealing with inflation or deflation deriving primarily from movements in rubber prices see F. H. H. King, Money in British East Asia, HMSO, 1957. This author puts primary emphasis on a counter-cyclical fiscal policy.

2/ Mr. G. M. Watson of the Bank of England and Sir Sydney Caine, Chancellor of the University of Malaya and former economic adviser to the Malayan Government.

3/ Cf. Report on the Establishment of a Central Bank in Malaya, Kuala Lumpur 1956.

be covered "as to a high percentage" by sterling assets and that the amount of the fiduciary issue should be reviewed by a government commission after 5 years of experience with the new central bank had accumulated.

It is plain that use of a portion of the currency cover to finance part of the foreign exchange cost of a development program is merely a one-time expedient that cannot be repeated without destroying confidence in the financial integrity of the new government. It is also fairly clear that the Alliance government wants a central bank, partly as a symbol of independence, but primarily for this wrong reason of temporarily financing development rather than for the sounder reasons of providing an appropriately elastic currency and moderating the impact of trade fluctuations.

In an economy as dependent as Malaya's on world price trends for basic materials, a central bank can at best only cushion partially the effects of gross changes in export earnings on domestic prices and incomes. However, the bank can, if properly managed, during prosperity absorb some of the foreign exchange arising from an active trade balance and partially sterilize the accompanying increase in the cash reserves of commercial banks by a restrictive credit policy; similarly when trade earnings are falling it can temporarily help relieve the credit shortages that have often hampered Malayan business during such periods in the past. Whether the proposed bank will in practice be endowed with the necessary independence from political domination to pursue proper policies, however, remains to be seen.

Along with the central bank Malaya needs a new statute to regulate commercial banking. The country is well served at present by 18 overseas banks with 71 offices and by 13 local banks with 38 offices. The overseas banks control 85 per cent of all deposits and 87 per cent of net overseas balances. The head offices of most banks operating in Malaya, however, are in Singapore which has been the trade and financial center of the country under colonial status. The federation proper has only 15 banks operating 67 offices. Whether the commercial banks will be willing to shift head offices to Kuala Lumpur or will centralize their reserves in Singapore and maintain only minimum working balances in the Federation is one of the difficult questions raised by the proposal for a Malayan central bank that would exclude Singapore.

There are no legal reserve requirements for commercial banks now operating in Malaya. The overseas banks have concentrated on financing foreign trade and have kept their surplus funds mainly in sterling deposits with head offices or correspondents, using the currency board facilities for conversion into and out of local currency as required. Some system of reserve requirements will be necessary if the proposed central bank is to function effectively, especially as its scope for open market operations will be quite limited for some time to come.

The position of Federation commercial banks at the end of 1956 is summarized in the following table.

Combined Balance Sheet of Federation of
Malaya Commercial Banks, December 31, 1956
(millions of Malayan dollars)

Assets			Liabilities		
Cash		52	Deposits (nonbank)		746
Due from banks		491	Due to banks		105
Singapore	266		Singapore	13	
Federation	71		Federation	74	
Abroad	154		Abroad	18	
Loans and advances		252	Other liabilities		46
Investments (in Malaya)		53			
Other assets		49			
Total assets		897	Total liabilities		897

Source: Monthly Statistical Bulletin, Federation of Malaya, March 1957, pp. 116-117.

It is apparent from this table that net sterling balances were only about 18 per cent of deposits on this date. Singapore banks, which are not included in the above table, customarily keep higher overseas reserves, some of which are available to banks in the Federation.

Because existing banking arrangements for Malaya center on Singapore, it would be most unfortunate if the Federation persists in its threat to exclude Singapore from whatever new monetary arrangement is set up.

Maintaining the established industries

Malaya's economic progress to date has rested primarily on production for export of rubber and tin. Unfortunately traditions of output restriction underlie both industries and demand for both products is threatened by substitutes.

The Federation is source for about 30 per cent each of the world's tin and rubber. In 1956, rubber production was 625,000 long tons while tin production was more than 62,000 long tons of tin-in-concentrates. Exports of both products exceed local production. Rubber from Indonesia is handled through Singapore and concentrated tin ore is imported from Thailand for smelting.

Rubber exports from Malaya earned foreign exchange equivalent to U.S.$685 million in 1956 (of which only 16 per cent was to the U. S.) while tin exports earned U.S.$158 million (60 per cent to the U. S.).

While world demand for natural rubber is growing, this growth is threatened by rapid expansion in synthetic rubber capacity, not only in the U. S., but also in the U. K., Canada, West Germany, France, Italy, and Japan - as well as within the Soviet bloc. By 1960 or shortly thereafter world synthetic rubber output will exceed natural rubber production.

Synthetic is cheaper than natural rubber so costs of the latter material must be reduced if it is to maintain its market. Cost reduction is possible by replacing old rubber trees with improved high-yielding stock. This can be done either on newly cleared land or by replanting acreage already devoted to rubber. In Malaya, since land is still not being alienated for rubber, existing acreage must be replanted. This is expensive but is being assisted by Government subsidies financed by export duties on rubber.

Rubber replanting has lagged in Malaya for many years but efforts are now being made to catch up some of the backlog. Replanting is proceeding faster on large estates (generally foreign owned) than on smallholdings.

Because it takes rubber trees 7 years to mature enough for tapping, production in Malaya will not increase rapidly for some years; but costs should then be much lower than at present. Malayan rubber should be able to compete with synthetic but export earnings from this material will undoubtedly decline. Natural rubber is now bringing about 30 cents per pound while synthetic is available in the U. S. for 23 cents.

Tin has been in oversupply in the world for some years, although U. S. stockpiling has helped to maintain demand. Tin prices are declining but an international buffer stock plan aimed at price maintenance became effective last year. The U. S. is not a party to this agreement although 15 other nations are.

Malaya's quota under the tin agreement is such that output must be held below recent levels. Prospecting for new sources of tin in Malaya has lagged for many years.

In both rubber and tin, therefore, Malaya stands to earn less in the world economy than it has recently. New exports must be developed and imports restricted, especially imports of consumer goods. Capital goods imports will inevitably grow as the development program moves forward.

Longer range problems

Apart from the problems of development and of financial arrangements and capabilities, which are pressing, the longer run economic issues in Malaya concern growing more of food consumption at home and diversifying exports. Both these objectives constitute announced goals of future Federation economic policy.

The food problem can be illustrated by the country's position in rice. Rice is the staple food of Malaya and accounts for between 30 and 40 per cent of all food consumption. About 1½ million Malayans, or

25 per cent of the total population, are solely engaged in rice growing; they exist for the most part on a bare subsistence level. The average rice farm is less than 4 acres in size. Rice is grown on about 880,000 acres (16 per cent of the total cultivated acreage) in Malaya and the 1955/56 crop was about 425,000 long tons of milled rice. The 1956/57 crop may reach 450,000 tons. Production is less than one half the country's requirements as 539,000 long tons of rice were imported in 1955 and 570,000 tons in 1956, primarily from Thailand and Burma.

Rice production is concentrated in the river valleys of Northern and Eastern Malaya where for the most part only one crop per year is grown. A small area is double cropped in irrigated areas. While rice production has increased steadily during recent years, prospects for attaining eventual self sufficiency in this commodity, a goal of the Government's agricultural policy, are dim. Only a limited area of additional land can be put into rice without further extensive investment in irrigation works. Higher yields per acre are possible through improved seed and more extensive use of fertilizer; limited campaigns in both these areas are now going on.

Rice consumption is increasing with population at a rate of about 3 to 4 per cent per year and it is doubtful whether production can keep pace with this rate of growth over the next few years.

To encourage rice cultivation, the Federation Government fixes minimum prices and maintains a stockpile of imported rice to ensure stable supplies. To rotate this stockpile importers must buy from it quantities in proportion to their imports. Normally the stockpile is maintained at a level of between 2 and 3 months supply.

The Malayan Government has encouraged the growing of rice on old rubber plantations with suitable land and water supplies but relatively little conversion has taken place because rubber is generally a more profitable crop.

It is difficult to see how Malaya can become self-sufficient in rice within the foreseeable future. To attain this goal would require very heavy investment in land reclamation and irrigation that would probably not be economically justified. However, until a more liberal policy of land alienation is tried, no one can say that the practical limit of rice cultivation in Malaya has been reached.

Conclusion

To diversify export trade will take a long time indeed. Yet in a real sense success in this effort would be a proper measure of Malaya's achievement in economic development. This is not to imply that diversification is always desirable or that in itself it aids economic growth. On the contrary, Malaya has in the past grown richer than some of her neighbors precisely because production was specialized. But the established industries of Malaya do not have bright prospects for future growth. New industries with better potentials for future expansion in output and earnings must make their appearance.

What these industries will be is not yet clear, but they will probably be extractive, i.e., mining of metals other than tin, logging and lumbering, perhaps oil, and some processing of agricultural materials.

Maintenance of financial stability over the next several years will be extremely important to Malaya's development efforts. Much of the country's progress to date has been due to the import of foreign capital. The political uncertainties accompanying independence have retarded capital inflow temporarily but this can be resumed if the Alliance Government demonstrates the will to follow conservative financial and other policies. There is reason to hope this will be done.

The political forces tending to divide the Federation and Singapore could have unfortunate economic consequences for both areas. At the moment the issue centers on the proposed central bank. It is to be hoped that the plan finally evolved will allow both areas to participate and will not mean a liquidation of the present monetary arrangements.