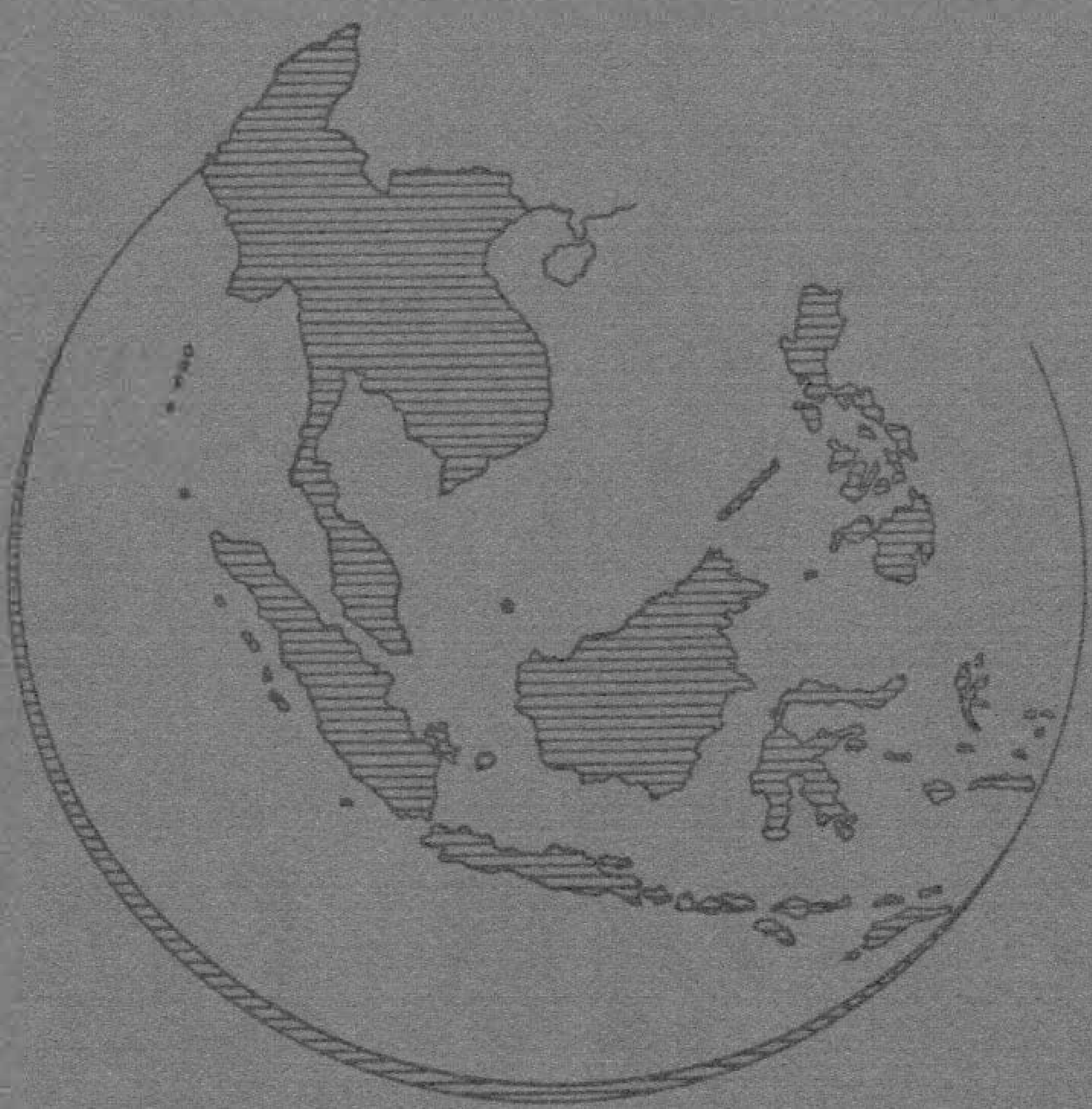
MALAYA: A STUDY OF GOVERNMENTAL RESPONSE TO THE KOREAN BOOM

JOHN PAUL MEEK



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PREFACE

Mr. John Paul Meek was Acting Program Planning Officer with the Foreign Operations Administration Mission in Indonesia during 1952-54. During the academic year 1954-55 Mr. Meek participated in the Cornell Southeast Asia Program, working on a study of the problem of maintaining continuity in governmental investment expenditures in underdeveloped countries. Indonesia serves as a case study for his examination of this problem.

The experience of Malaya during 1950-51 provides an outstanding example of the susceptibility of primary producing countries to wide fluctuations in export proceeds and levels of economic activity. The purpose of this study is to analyze the policies implemented by the Malayan government in an effort to minimize the impact of the huge export surplus on prices and hence on Malayan costs of production. In spite of the efforts of the Malayan Government, inflation with its usual unevenness and inequalities was very much present in Malaya during 1951.

The Malayan tax structure at the time of the Korean boom was poorly designed to tap the windfall profits arising out of the strong demand for Malayan exports. Moreover, Malaya's organized rubber growers successfully resisted the imposition of a progressive export levy which would have neutralized a portion of the export surplus. While government rationing and procurement and price control of consumer's staples had anti-inflationary effects, the principal contribution to control of inflation resulted from the extraordinary remission of profits and the massive exodus of private capital from Malaya during 1951.

As a result of his analysis of the Malayan experience, Mr. Meek concludes, first, that a sliding-scale system of export taxation can cushion the impact of an export boom and build up reserves which would then be available to sustain development activity in periods when budgetary and foreign exchange receipts are depressed. Second, the relaxation of import controls combined with procurement and rationing of consumer staples can materially contribute to the containment of inflation generated by an excess of foreign exchange receipts. Finally, if economic development is to be deliberately pursued, the governmental authorities can hardly permit unrestricted exodus of private capital such as occurred in Malaya in 1950 and 1951.

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INTRODUCTION

One of the most striking by-products of the Korean war which broke out in Korea in June 1950 was the spectacular rise in raw material prices. By February 1951 (see Chart 1) rubber prices had increased to three and half times and tin prices to two and half times their pre-hostilities level. However, by the third anniversary of the invasion of South Korea prices for both commodities had fallen back to the level of the first half of 1950. The entire movement presents a graphic demonstration of the rapidity and large amplitude of primary commodity price fluctuations which have caused such prices to be termed "excessively unstable" and have produced much concern over the adverse effects of such instability on the economies of the less developed countries in general, and their development efforts in particular.[1]

When the Korean War began, there was no international mechanism charged with the task of stabilizing the prices of strategic materials such as rubber and tin. Skyrocketing raw material prices greatly stimulated the interest of industrial consumers in achieving greater price stability -- a goal with which primary producers have traditionally been concerned. But general agreement on the principle of primary commodity price stabilization tends to conceal the difficulty of reaching agreement on the level at which to stabilize prices and on the machinery to be created to dampen the leaping and tumbling prices in the years ahead. Bulk purchasing which proved a stabilizing factor in the tin market during 1952 may continue to be significant from time to time, but is not likely to have sufficient continuity to constitute an effective and reliable instrument for coping with wide price fluctuations over any extended period of time.

In these circumstances efforts should, and doubtless will, continue to develop international measures capable of effecting greater price stability for raw materials without sacrificing long-run price movements necessary to secure "the most efficient allocation of productive resources in a changing world."[2] Nevertheless, it would appear that the less developed countries should seek to increase the effectiveness of internal policies for mitigating the effects of fluctuations in their export proceeds on their economies and development programs -- policies within their national power of decision -- rather than to pin their hopes on stabilization action involving the reconciliation of the divergent views and interests of sovereign states. Further, as the U. N. committee of experts has pointed out, it is doubtful whether international measures will in fact be taken unless governments accord the objective of stability a high priority

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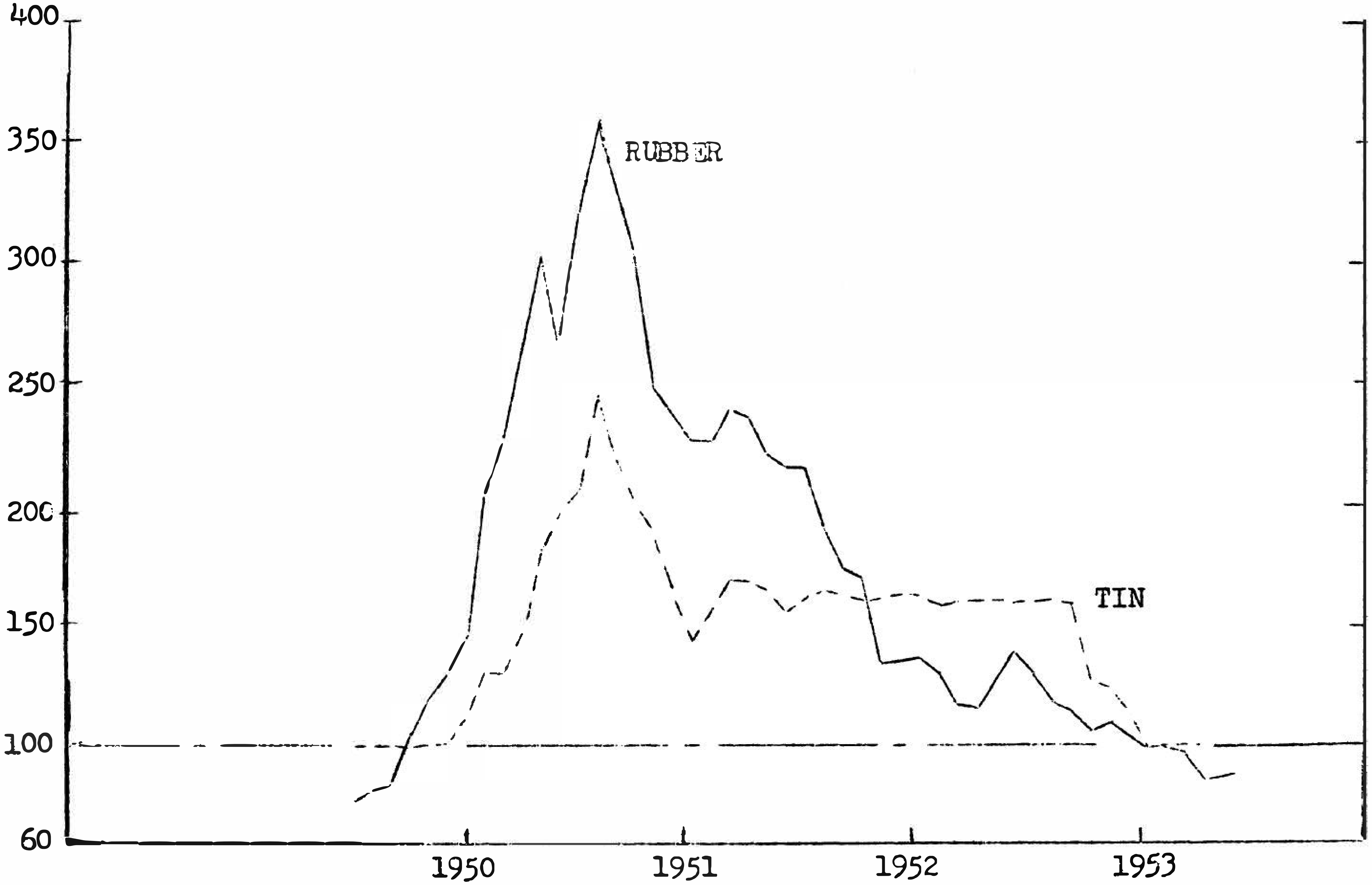
1. Commodity Trade and Economic Development, U. N. Doc. E/2519, (New York, 1953), p. 14 et seq.

2. Ibid., p. 3. The International Tin Agreement which was opened for signature in December 1953 was signed before the June 30, 1954 deadline by all producing countries and by consuming countries representing 40 per cent of the vote allocated in the Agreement. Its activities are in process of organization. The Economist, July 3, 1954, p. 58. See also Review of International Commodity Problems, 1953 (New York, 1954), pp. 3-4, 82-93, for comments and the text of the agreement.

INDEX NUMBERS OF RUBBER AND TIN PRICES
(January-June 1950=100)



Sources: Rubber - RSS Std Quality, Singapore, Malayan Statistics.
Tin - Cash, London, Economic Bulletin for Asia and the Far East.

in their domestic, as well as in their foreign, economic policies.[3]

But can the domestic policies of national governments cushion appreciably the impact on their economies of such spectacular price movements as characterized the Korean boom-bust, or must economic distress and dislocation follow inevitably unless assistance or stabilization is forthcoming from outside? To what extent were primary producers able to protect themselves against inflationary pressures of the boom and the deflationary impact of later price declines during the 1950-53 period? Were they able to sustain and advance their programs of economic development and diversification? What lessons can be learned from their successes and failures? This paper is the first part of a study which it is hoped will cast some light on these questions by examining the responses of the governments of Malaya and Indonesia to the Korean boom and its aftermath. The present paper traces the response of the Malayan government during late 1950 and throughout 1951 to the economic forces generated by the rapid and steep rise of rubber and tin prices.

Perhaps nowhere were the effects of the phenomenal price rises set off by the Korean war as pronounced as in Malaya and Indonesia where exports of rubber and tin constituted 60 per cent and 50 per cent, respectively, of export proceeds in the United States recession year of 1949.[4] Foreign trade has long played a key role in the economies of both countries. In 1949 Malaya's gross exports by value amounted to 50 per cent of its estimated gross national product while Indonesia's exports in the pre-war year of 1938 were 22 per cent of gross national product.[5] Not only is the level of foreign trade an important determinant of the level of economic activity in the two countries, it also affects significantly the revenues available to the governments for financing ordinary and developmental expenditures. In 1949 export and import duties provided 69 per cent of the tax revenues and 53 per cent of the total national government revenues for Malaya, and 44 and 34 per cent, respectively, for Indonesia.[6]

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3. Ibid., p. 73.

4. Yearbook of International Trade, 1950 (New York, 1951). Except where noted otherwise, the term Malaya as used in this study includes the Federation of Malaya and Singapore. Indonesian exports in this calculation exclude sales of petroleum and its products since the receipts from them do not, under the postwar "let alone" agreements with the oil companies, accrue to the foreign exchange authorities.

5. Total foreign trade (gross exports plus gross imports) was 104 per cent of gross national product for Malaya in 1949 and 38 per cent for Indonesia in 1938. Figures for Malaya calculated from Frederic Benham, The National Income of Malaya, 1947-49 (Singapore, 1951); for Indonesia from Yearbook of International Trade, 1950, p. 167, and National Income Statistics of Various Countries, 1938-48 (Lake Success, 1950), p. 98.

6. For Malaya: Federation of Malaya Annual Report, 1949 (Kuala Lumpur, 1950), p. 30, and Colony of Singapore Annual Report, 1949 (Singapore, 1950), pp. 41-44. For Indonesia: Sumitro Djojohadikusumo, "The Budget and Its Implications," Ekonomidan Keuangan Indonesia, Tahun Ke 6 (Sixth Year), No. 1, pp. 3-5. Included here among foreign trade taxes is the free profits tax on free list imported goods from Java Bank Report, 1950-1951, (Djakarta, 1951), p. 48.

I. THE PRE-KOREAN WAR SETTING

A. Production

Rubber is the crop around which the economy of the Federation of Malaya is organized. In 1947 some three fifth of the cultivated land and 500,000 of the country's 1,200,000 agricultural workers were required for its cultivation.[7] As can be seen from Table I, rubber production recovered

TABLE I

Postwar Production of Selected Commodities in the Federation of Malaya (thousands of metric tons)

Commodity	1934-1938	1947	1948	1949	Jan.-June 1950[a]	Jan.-June 1950 as % 1934-38
Rubber:	423	657	709	682	650	154
Estate	264	366	410	407	364	138
Smallholders	159	290	299	275	286	180
Tin in concentrates[b]	55.4	27.4	45.5	55.7	58.8	106
Rice available for consumption	848	503	805	816	861	102
Production[c]	308	261	348	312	443	144
Net imports	540	242	457	504	418[d]	77

a. At annual rate.
b. Metal content.
c. For year in which harvest is completed. (January-June 1950 figure is total 1949/50 crop; pre-war figure is for 1935-39 on this basis).
d. Gross imports.

Sources: Tin -- International Tin Study Group Statistical Yearbook, 1949, pp. 20-21. Malayan Statistics, General Section, December 1950, p. 28.
Rubber -- Yearbooks of Food and Agriculture Statistics, Part I, 1949, 1950, and 1951, pp. 113, 109, and 103, respectively. Malayan Statistics, General Section, December 1950, p. 14.
Rice -- Annual Reports of the Federation of Malaya, 1950 and 1951, pp. 79 and 98, respectively. Monthly Bulletin of Food and Agriculture Statistics, March 1952, p. 16.

7. E. H. G. Dobby, Southeast Asia (New York, 1950), p. 111.

rapidly after the war reaching 657,000 metric tons in 1947 -- 55 per cent above 1934-38 production which was limited by the prevailing rubber restriction scheme. Despite the forays of communist marauders in the countryside, output remained remarkably stable during the next two and a half years. Interestingly enough, small holders rubber production in the postwar period expanded more rapidly than did estate production, reaching 180 per cent of pre-war in the first six months of 1950 as compared with 138 per cent for the estates.[8] The production of tin, Malaya's second largest earner of foreign exchange, recovered more slowly. The government provided, through loans, much of the capital investment required for rehabilitation. However, it was not until 1949 that output reached the 1934-38 level of 55,000 metric tons (metal content). Production edged up to an annual rate of 58,800 tons in the January-June 1950 period, but there appeared little prospect of any additional important increases as long as the emergency made it practically impossible to prospect for new areas.

Malaya's specialization in the production of industrial raw materials has meant that she has been relatively dependent on foreign supplies of food. The 308,000 metric tons of milled rice produced annually from 1934 to 1938 constituted only 36 per cent of her requirements. Since the war, production has exceeded this figure since the 1947-48 crop, and in the very favorable crop year ending in 1950, reached a peak of 443,000 metric tons -- 44 per cent above pre-war and 51 per cent of rice availabilities.[9] Retained imports, allocated by the International Emergency Food Council, remained low so that the total available for consumption did not reach the 1934-38 average until 1950's first half. Even then, per capita consumption was still well below pre-war inasmuch as the population had increased about 18 per cent since 1939.[10] Rice rationing remained in effect to assure a basic ration for all.[11]

B. The Balance of Payments

In pre-war days Malaya ordinarily enjoyed a substantial positive balance of trade, the average for 1936-38 being US 76 million, but in the postwar era, as shown in Table II, there were significant deficits on trade account in both 1947 and 1948 followed in 1949 by a relatively large deficit of US$ 68 million.[12] However, large expenditures by the United Kingdom for

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8. This tends to confirm the impression that the pre-war restriction scheme may have borne more heavily on smallholders than on the estate interests. See P. T. Bauer, The Rubber Industry, (Cambridge, 1948), pp. 208-215.

9. Approximately two-thirds of this increase resulted from expanded acreage, the remainder from the higher yields of a good year.

10. Demographic Yearbook, 1953, (New York, 1953), pp. 108-9.

11. Federation of Malaya Annual Report, 1950, p. 71.

12. The conversion of trade values into U.S. dollar-equivalents masks divergencies between the movements of export and import values expressed in Malayan dollars during the period. Thus the Malayan dollar value of imports rose 3 per cent between 1948 and 1949 while export proceeds declined slightly, and payments for imports during the first half of 1950 were 21 per cent above 1949 while export proceeds spurted 43 per cent. In approaching Table II the reader should realize that the trade figures are probably far more reliable than the estimate for net services even though Benham has sought to make the latter as accurate as possible.

TABLE II

Malaya: General Trade and Balance on Current Account
(millions of U. S. dollars)

	1936-38	1947	1948	1949	Jan.-June 1950[c]
Exports (f.o.b.)[a]	413	621	830	734	800
Tin	83	51	101	117	--
Rubber	201	368	410	311	--
Other	129	202	319	306	--
Imports (c.i.f.)[b]	337	656	864	802	734
Tin	20	5	8	13	--
Rubber	60	84	81	54	--
Other	257	567	775	735	--
Balance of trade	+76	-35	-34	-68	+66
Net services	n.a.	+15	+15	+35	--
Balance on current account	--	-20	-19	-33	--

a. Includes parcel post and sales of bunker fuel and ships stores.
b. Includes parcel post.
c. At annual rate.
Conversion rates (U.S. cents per Malayan dollar): 1936 - 58.4; 1937 - 58.0; 1938 - 57.0; 1947-8 - 47.0; 1949 - exports and net services 42.8, imports 43.3; 1950 - 32.7.

Sources:
1936-8 totals and conversion rates - Yearbook of International Trade Statistics, 1951, (New York, 1952), pp. 163-5.
Net services, 1947-9. Benham, op. cit., p. 252.
January-June 1950 - Economic Bulletin for Asia and the Far East, Vol. II, No. 1, p. 40.
Rubber and Tin, 1936-38 - International Trade Statistics, 1938, (Geneva, 1939), pp. 175-6.

the maintenance of its forces in Malaya combined with the earnings of the entrepot trade and servicing facilities of Singapore and Penang produced a net return on service account which almost cut in half the trade deficits in each of these three years.[13]

Contributing to the postwar trade deficits were substantial capital

13. United Kingdom military expenditures were equivalent to US$ 80 million, US$ 70 million and US$ 70 million in 1947, 1948, and 1949, respectively.

imports required for rehabilitation,[14] and a deterioration of about 20 per cent in Malaya's terms of trade compared with the recession year of 1938 when export prices were already probably depressed relative to import prices. (See Table III).[15] The somewhat greater increase in export than

TABLE III

The Postwar Movement in the Volume, Unit Value and Terms of Trade of Malaya's Foreign Trade
(1938=100)

	1947	1948	1949	Jan.-June 1950
Quantum Indices				
Export	122	137	134	150
Import	106	124	125	150
Unit Value[a/]				
Export	197	227	225	291
Import	249	276	280	278
Terms of Trade[b/]	79	82	80	105

a. Calculated in Malayan dollars.
b. Here the terms of trade is defined to be 100 times the ratio of the unit value of exports to the unit value of imports, and indicates the volume of imports obtained with a unit volume of exports. Thus, when the terms of trade is 80, a unit volume of exports would buy only 80 per cent as many imports as in 1938.

Source:
Malayan Statistics, General Section, December 1950, p. 47. Figures in table are averages of quarterly figures.

in import volume was not sufficient to offset the shift in the terms of trade. A surplus on trade account which was characteristic of the pre-war period did not re-emerge until the terms of trade shifted sharply in the first half of 1950 to 5 per cent above the 1938 level. This favorable shift resulted when the unit value of exports rose 29 per cent above 1949 (thus making good the September 1949 devaluation) in response to a rising

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14. K. E. MacKenzie, Malaya, (London, 1952), pp. 94-95. Information on capital movements is very limited, but net sterling assets of Malayan residents (other than securities), banks and government organs declined £ 10 million in both 1947 and 1948 but did not change during 1949. Arthur Hazlewood, "Colonial External Finance Since the War," Review of Economic Studies, Vol. XXI (1953-54) No. 54, p. 31.

15. The recession year of 1938 would seem to be a poor choice for the base year inasmuch as the value of exports was 18 per cent below the 1936-38 level while imports lagged only 5 per cent behind the 3 year average. The indices of quantum and value in Table III are computed on the basis of gross exports and imports and do not clearly indicate significant shifts in the role of the re-export trade such as occurred during the boom when the portion of gross imports retained for home use fell from 64 per cent in 1949 to 50 per cent in 1950. (Calculated from Benham, op. cit., pp. 185-192, 235-240).

demand for rubber which followed the end of the U. S. recession. The unit value of imports remained steady, despite the devaluation partly because of a worldwide easing of prices but largely because imports as a result of controls originated in the main from countries which also devalued and whose export prices in terms of devalued currencies changed little.

The pre-Korean shift to a positive trade balance of pre-war magnitude (amounting, at an annual rate to US$ 66 million) does not imply that something approaching balance of payments equilibrium had been achieved. Malaya is the sterling area's largest dollar earner but the dollar gains from her trade are not the product of the unfettered action of market forces. As soon as the postwar recovery of production in the United Kingdom and other soft currency areas gave promise of sufficient supplies, restrictions were imposed by Malaya on dollar area imports to enhance the net dollar gain from trade. A ban was imposed on the importation of U. S. textiles in mid-1948 and during the sterling area crisis of 1949 new controls were imposed to bar virtually all except essential commodities unavailable in the sterling area.[16] Imports from the United States, Canada, and the American account countries consequently declined from M$ 243 million in 1948 to M$ 136 million in 1949 and M$ 109 million in 1950.[17] However, since most non-luxury commodities could be imported fairly freely from soft currency areas, controls were probably more important in determining the source of basic consumer imports than their quantity. The level of such imports was probably more dependent on the level of income extant in Malaya than on the controls. Among the higher income groups import controls very likely resulted in an unsatisfied demand for semi-luxury and luxury goods.

C. The Price Level

Money incomes in Malaya apparently remained relatively stable in the three full years preceding the Korean war. Dr. Frederic Benham estimates the national income of Malaya at M$ 3,196 in 1947, M$ 3,221 million in 1948 and M$ 3,022 million in 1949 (corresponding to an estimated gross national product in those years of M$ 3,511, M$ 3,580 million and M$ 3,426 million respectively).[18] Given the decline in the cost of living noted below, real income probably rose appreciably in 1948 over the previous year and declined slightly during 1949. The Malayan money supply during this 1947-49 period also exhibited great stability as shown in Table IV.[19]

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16. U. S. Department of Commerce, Bureau of Foreign and Domestic Commerce, "Economic Review of Malaya, 1949," International Reference Service, VII, No. 43, p. 8.

17. Federation of Malaya Annual Report, 1951, p. 85.

18. Benham, op. cit., pp. 24, 89, 119.

19. Malayan currency notes in circulation rose sharply during the wartime Japanese occupation from M$ 165 million at the end of 1940 to M$ 406 million on the first day of 1946.

TABLE IV

Money Supply in Malaya
(millions of Malayan dollars)

	1947	1948 (end of period)	1949
Currency notes (net active)[a/]	296	303	312
Deposits	564	598	576
Money supply[b/]	860	901	888

a. Includes British Borneo. Net active notes equals the total of notes in circulation less cash on hand in all banks.
b. Does not include subsidiary coins in circulation in the amount of M$ 28.8 million, 28.7 million, and 31.0 million at end of 1947, 1948, and 1949, respectively.
Source:
Malayan Statistics, December 1952, pp. 138-9.

When the end of the war came, prices in Malaya were considerably higher than pre-war. The cost of living of European families was more than double the 1939 level in 1948 and 1949 while the cost of living of Malay clerks had more than tripled. This situation not only reflected the wartime inflation in the money supply, but also the unit value of imports which had risen to more than two and a half times the pre-war level and the short supplies of many commodities -- especially foodstuffs. As domestic production of foodstuffs expanded and imports of textiles increased, the cost of living showed a considerable decline from the high levels of early 1947 for the Chinese and Indian laborers and the Malayan clerks in whose patterns of

TABLE V

Cost of Living in the Federation of Malaya

	1947	1948	1949	Jan.-June 1950
European (1939=100)	...	232	234	239
Malay clerical (1939=100)	...	340	323	332
Chinese laborers (January 1947=100)	92	87	82	83
Indian laborers (January 1947=100)	99	96	90	91

Source:
Federation of Malaya Annual Report, 1950, p. 31.

expenditures these commodities loom large.[20] In the first half of 1950, however, the cost of living began to rise perceptibly as increases in the price of rubber following devaluation and United States recovery from the 1949 recession led to higher incomes to rubber producers. Moreover, the increased income derived from rubber exports was diffused by a wage rise of 12 per cent for estate rubber workers negotiated in April 1950.[21]

D. Public Finance

The requirements of post-war rehabilitation led immediately to large expenditures by the Federation of Malaya while the revenue of the government increased more slowly as the tax administration was reorganized and new taxes (especially a personal income tax) were introduced. The result was a series of declining budget deficits, (Table VI), financed from pre-war reserves, internal loans in the amount of M$ 64.5 million in 1946 and a loan of just over £ 8 million floated on the London money market in 1949.[22] By 1949 the Federation's budget was virtually in balance thanks to contributions of M$ 42.6 million and 4.3 million, respectively, by the United Kingdom and the Colony of Singapore.[23]

TABLE VI

Federation of Malaya: Gross Revenues and Expenditures
(millions of Malayan dollars)

	1947 actual	1948 actual	1949 actual	1950 budget est.
Revenue	130	260	345	274
Expenditure	223	326	347	281
Surplush(+) or Deficit (-)	-93	-66	-2	-7

Sources:
1947 and 1948 - Economic Survey of Asia and the Far East, 1950 (New York, 1951), pp. 420-21.
1949 - Economic Survey of Asia and the Far East, 1953 (New York, 1954), p. 100.
1950 estimates - Minutes of the Legislative Council of the Federation of Malaya, Third Session, (Kuala Lumpur, 1954), pp. 619-23.

20. The price of free market rice, for example, declined from an index value of 1181 (1939=100) in January 1948 to 724 a year later and to 610 in January 1950.

21. Federation of Malaya Annual Report, 1950, p. 31.

22. MacKenzie, op. cit., pp. 72-77. The budgets of the Colony of Singapore were in approximate balance from 1946-49.

23. Federation of Malaya Annual Report, 1949, p. 31.

The budget estimate for 1950 ostensibly forecast a continuation of this balance, but this happy state of affairs was more apparent than real since the expenditures figure did not include expenditures in connection with the military emergency which had amounted to M$ 85 million (one-fourth of gross expenditures) the year before.[24] On the other hand , the projection of receipts was very conservative being 20 per cent less than the 1949 realized figure so that a continuation of the existing level of foreign trade (with export duties contributing 25 per cent and import duties 39 per cent of gross revenues in 1949)[25] would tend to keep the budget deficit to M$ 20 to M$ 40 million. All in all, despite the sizable postwar deficits of the early postwar years, the Federation of Malaya had achieved a fair balance between revenue and expenditure by 1950 and could anticipate a higher level of receipts should the level of trade expand.

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24. Ibid.

25. Tax figures from Economic Survey of Asia and the Far East, 1950, p. 437.

II. THE KOREAN BOOM

A. Response of Government Policy

As the price of rubber in the Singapore market shot up from 27.6 U.S. cents per pound in June to 47.9 cents in September and on to 64.9 cents in November,[1] it became apparent that, whatever the length of the boom, it would give a substantial boost to incomes in Malaya and could lead to a snowballing inflation unless the government acted fairly promptly to keep inflationary pressures under control. Also at issue was the question whether the government would seek to capture a sizable share of the windfall profits resulting from the extraordinary, war-generated demand for rubber and tin in the interest of building up reserves for financing future economic development.

In the eighteen months after the war broke out the Malayan government undertook a number of measures designed to help contain the export inflation and/or appropriate an increased share of rising incomes. Among the more important of these were: (1) the institution of a sliding-scale of export duties on rubber, (2) an increase in indirect levies and company income taxes, (3) the public sale of bonds and a stepped-up postal savings campaign, (4) the easing of import controls, and (5) rationing and price control of basic consumer commodities. Furthermore, the government was able in both 1950 and 1951 to show sizable budget surpluses although this seems to have been less the product of conscious policy than of revenues which greatly exceeded expectations.

In early November 1950 the government announced that beginning January 1, 1951, the 5 per cent *ad valorem* export duty on rubber would be replaced by a levy calculated to take 20 per cent of price rises in the neighborhood of 60 Malay cents per pound (19.6 U.S. cents) and increasing progressively until it would claim 65 per cent of price rises at the 250 Malay cents per pound (81.8 U.S. cents) level.[2] This announcement produced a terrific protest from Malaya's organized rubber growers which caused the government to modify the proposed tax rate until it took only a flat 20 per cent of price rises above 60 Malay cents per pound.[3] Approximately four-fifths of the proceeds of this tax were credited to revenue, the remainder

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1. Prices calculated from *Malayan Statistics*, December 1950, p. 110.

2. *The Economist*, November 11, 1950, pp. 768-9. This was equivalent to a rate ranging from 5 to 32.6 per cent *ad valorem* over this price spread.

3. Equivalent to a rate ranging from 5 to 16.4 per cent over this price spread. *The Economist*, November 18, 1950, p. 833, and December 9, 1950, pp. 1022-23. Further government proposals for sterilizing the inflationary impact of high rubber prices were rejected in mid-1951 by the rubber planters and the government did not change the rate scale until April 1952 when it introduced a cess of 4½ Malay cents per pound. *Foreign Commerce Weekly*, September 10, 1951, p. 13.

to a special fund for rubber replanting.[4] Levies were also raised in April 1951 on certain luxury and semi-essential imports and on similar locally produced commodities.[5] The rate of tax on companies was also increased from 20 to 30 per cent with effect from January 1, 1951, but the income tax rates on individuals remained unchanged.[6] An intensified Post Office Savings campaign which raised net deposits M$ 20 million during 1951 and the flotation of a 3-3/4 per cent "tap" Development loan which was taken up in an amount of M$ 14.8 million by the end of 1951 made modest contributions to efforts to mop up liquid funds.

Although by early October 1950 a buying spree was reported to be gathering momentum in Malaya,[7] there appears to have been only a slight relaxation of import and exchange controls relating to soft currency areas during late 1950.[8] However, beginning with the first half of 1951 restrictions were eased considerably on imports from hard-currency areas -- especially for foodstuffs and textiles -- to help satisfy the inflationary demand.[9] The government negotiated purchases of Thai rice, prohibited exports of rice, guaranteed a minimum price to farmers for domestically produced rice, and continued its rationing system which supplied all with a basic ration. Rationing and price control were reinstituted for sugar in September 1950 and price controls were imposed on bread, milk, and cigarettes during 1951.[10]

B. Production

Rubber production reacted promptly to the booming prices which followed the Korean War. As Table VII shows, estate production despite a few strikes for higher wages increased 10 per cent in the last half of 1950 over the rate prevailing in the first half, and smallholders by overtapping (with the aid of labor drawn from the estates and elsewhere by "fifty-fifty" sharecropping) were able to boost production 25 per cent during the second half of the year. This accelerated rate which, thanks to the smallholders increase, brought 1950 output almost to the 1948 level could not be maintained and in the first half of 1951 despite peak prices production by both by both estates and smallholders fell about 17 per cent.[11] During the whole of 1951 estate production stabilized at about 334,000 metric tons well below

4. Federation of Malaya Annual Report, 1951 (Kuala Lumpur, 1952), p. 67, and Malayan Statistics, December 1951, p. 73. A small levy was also paid into the Malayan Rubber Fund for publicity and research.

5. Federation of Malaya Annual Report, 1951, p. 82.

6. Ibid., p. 72.

7. Foreign Commerce Weekly, November 6, 1950, p. 14.

8. Cf. Federation of Malaya Annual Report, 1950, pp. 67-8.

9. Foreign Commerce Weekly, September 10, 1951, p. 13.

10. Federation of Malaya Annual Report, 1951, pp. 88-9.

11. This decline was partly seasonal.

TABLE VII

Production of Selected Commodities in the Federation of Malaya, 1950-51
(thousands of metric tons; at annual rate)

Commodity	1950 I-VI	1950 VII-XII	1950 I-XII	1951 I-VI	1951 VII-XII	1951 I-XII
Rubber	650	758	704	626	604	615
Estate	364	400	382	333	335	334
Smallholders	286	358	322	293	269	281
Tin in concentrates[a]	58.8	58.2	58.5	56.9	59.3	58.1
Rice available for consumption	...	...	887	...	...	957
Production[b]	...	...	443	...	...	450
Net imports	418[c]	556[c]	444	380[c]	674[c]	507

a. Metal content.
b. For year in which harvest is completed.
c. Gross imports.

Sources:
Tin - Malayan Statistics, December 1951 and December 1952, p. 31.
Rubber - Malayan Statistics, General Section, December 1950, p. 14; Malayan Statistics, December 1951, p. 14; Federation of Malaya Annual Report, 1951, p. 95.
Rice - Federation of Malaya Annual Report, 1951, p. 98. Monthly Bulletin of Agricultural Economics and Statistics, May 1952, p. 32.

the 1948 and 1949 level of 400,000 tons, while smallholders' output declined throughout 1951 in large part because of the previous overtapping of old trees already declining in yield.[12] The year's production of 615,000 metric tons was fully 13 per cent below the 1948 output, chiefly because estate production was almost 20 per cent below that achieved in the earlier year.

This continuing downward trend in production in the face of unparalleled high prices was in part attributable to unusually bad weather during the 1951 season, terrorist activity and the resettlement of squatters,[13] but in part it was also due to the declining yields of aging trees. Aging and low-yielding capital is a fundamental long range problem of Malaya's rubber industry. New planting and replanting on estates since the war proceeded at a rate of about 50,000 acres per year compared with a total planting of 2 million acres, yet only a third of estate acreage was devoted to high yielding varieties which produce 3 to 4 times as much per acre as the ordinary types.[14] The high level of rubber prices, the very moderate

12. Federation of Malaya Annual Report, 1951, p. 96.

13. Ibid., pp. 89-90.

14. Federation of Malaya Annual Report, 1953 (Kuala Lumpur, 1954), p. 110.

level of government taxation, and the success of the estates in delaying and keeping within bounds wage rises not only provided estates with an opportunity to accumulate large reserves as well as to pay large dividends but also permitted a 25 per cent increase in planting in 1951 over 1949 despite labor shortages, high costs, and terrorist activities. Smallholders, whose acreage was long overdue for replanting, sought to obtain new land for planting since with existing methods they could not replant a part of their small holdings and could certainly not forego income for the seven years required for new plantings to come into production. This was not permitted by the authorities who preferred to seek new small-scale replanting methods in order to avoid an expansion of rubber acreage.[15] The government's concern over this problem had led to the imposition of a special replanting cess on rubber exports (equal to about one-fifth of total rubber export taxes) which had yielded about M$ 50 million by the end of 1951.

Tin production remained very stable over the 1950-51 period despite the great boom in the price of tin. This was in part the result of the necessity of making major repairs on a number of dredges during 1951, of labor shortages, and of electric power shortages.[16] However, the basic limitation which continued to restrict the expansion of output was the impossibility of prospecting new areas to replace the high grade areas being gradually exhausted.[17]

As was noted in the introductory section, rice production in the 1949/50 season reached a new peak of 443,000 metric tons. Production in 1951 was maintained at this high level by virtue of the very favorable season despite a decline of 6 per cent in the actual acreage under cultivation because of the greater attraction of rubber-tapping.[18] The total rice available for consumption was 887,000 metric tons in 1950 and 957,000 tons in 1951 as rice imports were at first reduced below the 1949 level as a result of the good 1949/50 harvest and then returned to the 500,000 metric ton level in 1951 to provide for the increased consumption made possible by boom incomes. Nevertheless, even at the height of the boom, the per capita consumption of rice apparently remained below the 1934-38 level and may indicate a shift in food preferences as compared to the earlier period.[19]

C. Response in the Balance of Payments

The skyrocketing prices of rubber and tin were immediately reflected in Malaya's foreign trade. Exports shot up in value from an annual rate

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15. This probably led to a dissipation on consumption of a considerable part of the high smallholdersprofits which might otherwise have gone to replanting investment. Cf. "Smallholders' Crisis in Malaya," The Times Review of the British Colonies, Winter 1951, p. 5.

16. Economic Bulletin for Asia and the Far East, Vol. II, No. 1, p. 6.

17. Federation of Malaya Annual Report, 1951, p. 92.

18. Ibid., p. 97.

19. Ibid., p. 98.

of U.S.$ 800 million in the first six months of 1950 to U.S.$ 2,140 million in the last quarter of the year, then pushed on to a U.S.$ 2,280 million rate during the first half of 1951 (Table VIII). Imports, boosted initially by the increased volume and price of tin and rubber imports for re-export

TABLE VIII

Malaya's Balance of Trade During the Korean Boom
(millions of U. S. dollars)

	1949	1950			1951	
		I-II	III	IV	I-II	III-IV
Exports (f.o.b.)	734	800	1,510	2,140	2,280	1,690
Imports (c.i.f.)	802	734	1,040	1,310	1,630	1,480
Balance of trade	-68	+66	+470	+830	+650	+210

Conversion rates (U.S. cents per Malayan dollar): 1949 - exports 42.8, imports 43.3; 1950-51 - 32.7.
Source: Economic Bulletin for Asia and the Far East.

and later by the higher prices of an expanded flow of consumer goods, also spurted in value from the rate of U.S.$ 734 million in 1950's first two quarters to a peak rate of U.S.$ 1,630 million in the same period a year later. The resultant balance of trade which had become positive in early 1950 for the first time since the war catapulted from an annual rate of U.S.$ 66 million in the first half of 1950 to U.S.$ 830 million in the fourth quarter and maintained a rate of U.S.$ 650 million during the first half of 1951. During 1951's second half, however, rubber and tin prices surrendered one-third their maximum gains under the impact of reduced U.S. stockpiling, stepped-up synthetic and natural rubber production, the United Nations embargo against shipments to Red China, and an improvement in the Korean war outlook. Malaya's export proceeds followed the declining price. Import payments receded slightly as a result of the lower value of imports of rubber and tin for re-export but the swelling tide of consumer imports kept the general level of imports high. Consequently the favorable balance on trade account dropped back to an annual rate of U.S.$ 210 million in the last two quarters of 1951.

Turning to Table IX, one can see not only how great was the expansion in trade values during the boom period but also how rubber, supplemented by tin, dominated this movement. In 1950 exports were 82 per cent larger in value than they had been in 1949 and rubber alone accounted for over four-fifths of this increase.[20] Export proceeds in 1951 were 175 per cent higher than in 1949 and again rubber accounted for about four-fifths of the increase

20. The year 1949 although it was a depressed year for Malaya's exports has been chosen for comparison purposes in the interest of achieving greater comparability with Indonesia in the larger study of which this is a first installment since Indonesia's trade and the statistical record thereof did not begin to approach "normality" until then because of the revolution. Compared with 1948, Malaya's export proceeds were 58 per cent higher in 1950 and 138 per cent higher in 1951.

TABLE IX

Malaya: General Trade and Balance on Current Account
(millions of U. S. dollars)

	1949	1950	1950 increase over 1949	1951	1951 increase over 1949
Exports (f.o.b.)[a/]	734	1,312	+578	1,985	+1,251
Rubber	311	800	+489	1,290	+ 979
Tin	117	155	+ 38	190	+ 73
Other	306	357	+ 51	505	+ 199
Imports (c.i.f.)[b/]	802	954	+152	1,554	+ 752
Rubber	54	200	+146	410	+ 356
Tin	13	20	+ 7	22	+ 9
Other	735	734	- 1	1,122	+ 387
Balance of trade	-68	+358	+426	+431	+ 499
Net services[c/]	+35	(0)	(-35)	- 85	- 120
Balance on current account	-33	(+358)	(+391)	+346	+ 379
Change in net sterling assets[d/]	0	+165		+240	

a. Includes parcel post and sales of bunker fuel and ships stores.
b. Includes parcel post.
c. Net services have been adjusted to exclude ships stores and parcel post. Further, in the absence of official figures the author, by making a rough projection of Benham's 1947-49 figures, has estimated net services at zero for 1950 on the rough assumption that receipts on service account of the order of M$ 350 to 400 million (vs. M$ 286 million in 1949) were just balanced by payments, including the remission of M$ 150 to 200 million in profits, dividends, and interest. Benham, op. cit., p. 172, guesstimates this transfer figure at about M$ 120 million.
d. Includes Borneo territories.

Conversion rates (U. S. cents per Malayan dollar): 1949 - exports, and net services 42.8, imports 43.3; 1950-51 - 32.7.

Sources:
Trade, 1949-51 - Yearbook of International Trade Statistics, 1951, pp. 163-5.
Net Services, 1949 - Benham, op. cit., p. 252.
Net Services, 1951 - Second Annual Report of the Consultative Committee of the Colombo Plan (New Delhi, 1953), pp. 93-4. Net services adjusted to exclude ships stores and parcel post which are included with merchandise trade.
Changes in Sterling Assets - Hazlewood, op. cit., p. 31.

-- tin accounting for about 6 per cent of the gain in both years. The balance on trade account which had turned positive to the extent of U.S.$ 33 million in 1950's first six months finished finished the year U.S.$ 358 million in surplus and in 1951 exports exceeded imports by U.S.$ 431 million. The full impact of the export surplus was not carried over to the balance on current account, however, for the net positive balance on service transactions which had hitherto helped offset the sizable trade deficits of the postwar period probably disappeared in 1950 and did, according to official figures, become negatively quite large in 1951. This was largely the result of an increase in profits remitted abroad from about U.S.$ 16 million in 1949 to in the neighborhood of U.S.$ 50 to 65 million in 1950 and to at least U.S.$ 130 million in 1951, and was achieved despite a considerable increase that probably occurred in receipts accruing to Malaya from her entrepot trade.

These anti-inflationary private transfers -- large as they are -- are not particularly surprising, but the same cannot be said for the movement of capital, in so far as one can deduce from the changes in Malaya's sterling balances.[21] During 1950 sterling assets rose only U.S.$ 165 million compared with a surplus on current account of U.S.$ 358 million; in 1951 sterling assets rose U.S.$ 240 million while the current account surplus was U.S.$ 346 million. Thus, over the two-year period some U.S.$ 300 million of current account surplus of U.S.$ 705 million is not to be explained by the rise in sterling assets as here defined. During the period sterling reserves against Malaya's currency rose some U.S.$ 122 million and net overseas assets of the banking system increased U.S.$ 90 million[22] while the addition to the government's holdings of sterling securities is not likely to have exceeded the combined Federation and Singapore budget surplus of U.S.$ 133 million (including M$ 50 million accumulated in the rubber replanting fund). The private non-banking sector, therefore, evidently accumulated sterling assets of at least U.S.$ 60 million and was responsible for a wholesale capital exodus involving another U.S.$ 300 million (M$ 920 million).[23] This compares with a figure of M$ 1,320 million for the total capital at the end of 1949 of companies incorporated outside the Federation of Malaya but having investments in the Federation in rubber estates, tin mines, and merchandising.[24] Given the private character of this accumulation of external assets, it

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21. Malaya's sterling assets which are here netted include sterling bank assets of residents, Malayan banks and government organs; sterling reserves against the currency issue; sterling securities held by official bodies; and United Kingdom government securities held by Malayan banks. Private holdings of sterling securities are not included. Hazlewood, op. cit., p. 32.

22. As will be noted in the next section the increases in these two items are behind some 70 per cent of the expansion which took place in the money supply in 1950-1951.

23. Hazlewood, whose article called the writer's attention to this capital flow, suggests a repatriation of Indian capital and an accumulation of sterling securities by the private sector as the means whereby this capital export was accomplished. Malayan exchange controls require the surrender of non-sterling area export proceeds to the banking system, but controls on the accumulation of transfer of sterling within the Sterling Area are apparently minimal. MacKenzie, op. cit., pp. 67-8, 82-84.

24. Ibid., pp. 81-82.

cannot be considered as an addition to foreign exchange reserves available to the government in less prosperous times.

The very marked growth in export values during the boom was accomplished in part by an increase in the quantity of rubber exported from 914,000 metric tons in 1949 to 1,124,000 tons in 1950 and 1,173,000 in 1951. However, this was due to expanded imports and re-exports of rubber from neighboring countries. Indonesia which supplied about 370,000 metric tons in 1950 and 480,000 tons in 1951 compared with some 150,000 in 1949 accounted for over four-fifths of the increase in rubber imports.[25] Indeed, Malaya's net exports of rubber declined from 690,000 metric tons in 1949 to 669,000 in 1950 and 617,000 in 1951.[26] Tin exports, on the other hand, increased from 55,700 metric tons in 1949 to 83,100 in 1950 -- a rise in volume of almost 50 per cent while the U.S. dollar-equivalent of proceeds rose only 32 per cent reflecting the decline in prices below 1949 levels.[27] This high export rate, made possible by drawing down tin stocks and increased imports from Burma and Thailand for re-export, could not be maintained in the face of the plateau reached in Malayan tin production so that export volume in 1951 fell back to 66,000 metric tons, (18 per cent above 1949) even though export proceeds, buoyed up by good prices throughout the year, reached 62 per cent above 1949.

On the import side it is apparent that rubber and tin, drawn from nearby countries and intended for re-export, were responsible for all of the U.S.$ 152 million increase in imports during 1950. The relaxation of controls by the government in the following year led to an expansion of import values (excluding rubber and tin) by 50 per cent in 1951 over 1949. Imports from the United States, Canada, and the American account countries rose from a low of U.S.$ 36 million in 1950 to U.S.$ 84 million in 1951[28] and imports from Japan expanded five-fold between 1949 and 1951 to U.S.$ 80 million in the latter year. Retained imports of cotton and artificial silk piece goods jumped from 111 million square meters in 1949 to 172 million in 1951 while imports of passenger and motor vehicles went up from the 1948 high of 6,000 to over 19,000 in 1951.[29] Construction materials also entered in larger quantities, cement imports alone nearly doubling between 1949 and 1951.

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25. Malayan Statistics, General Section, December 1950, p. 54; Malayan Statistics, December 1951, p. 65 - January-October 1951 ratio projected; and Summaries of Malayan Foreign Trade, December 1949, p. LXXIII.

26. Yearbook of International Trade Statistics, 1951, pp. 164-5.

27. International Tin Study Group, Statistical Supplement, 1953, p. 89. It was not until a year after the September 1949 devaluation that tin prices rose above their pre-devaluation dollar level.

28. Federation of Malaya Annual Report, 1951, p. 85.

29. Yearbook of International Trade Statistics, 1951, pp. 163-5. Retained imports of textiles per head in 1951 were about the 1938 level but semi-luxuries including radios and sewing machines were apparently more plentiful. Federation of Malaya Annual Report, 1951, p. 80.

The prices of Malaya's imports during the Korean boom rose substantially as can be seen in Table X, but the relative increase was much less

TABLE X.

Changes in the Volume, Unit Value and Terms of Trade of Malaya's Foreign Trade During the Korean Boom (January-June 1950 = 100)[a]

	1950		1951			
	III	IV	I	II	III	IV
Quantum indices						
Exports	132	133	125	127	119	120
Imports	125	128	155	157	142	147
Unit Value						
Export	144	202	235	226	174	180
Import	114	141	148	142	141	142
Terms of trade	125	143	159	159	123	127

a. Indices have been adjusted to comparison base of January-June 1950 but original computation is on basis of 1938 weights -- i.e. trade pattern -- so that indices reflect undetermined shifts in trade pattern as well as unit volume and value.

Source: Malayan Statistics, December 1953, p. 61.

than in the prices which she received for her exports. The result was a very marked and favorable rise in the terms of trade which enabled Malaya to buy some 60 per cent more gross imports, roughly speaking, for each unit of exports in the first half of 1951 than she could have done a year earlier. The decline in rubber and tin prices in the last half of 1951 was reflected in a corresponding deterioration of the terms of trade from its peak level as the unit value of imports leveled off.[30] The volume of trade also reflects in large measure the changing level of trade in raw materials with export volume rising a third in the latter part of 1950 but declining during 1951 as raw material prices declined and with import volume rising to 55 per cent above the pre-Korean era during the first semester of 1951 and slipping backward in the second semester even though imports of food and manufactured goods remained high.

D. The Price Level

The phenomenal increase in Malaya's export proceeds which followed

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30. The use of gross import and export values in the computation of the unit value indices (rather than that portion of export values originating in Malaya and the value of retained imports) underestimates the fluctuation in the terms at which goods produced in Malaya are exchanged for those Malaya imports and consumes. Thus, much of the initial rise in the unit value of imports was due to the higher prices of the rubber and tin imported into Malaya for re-export so that Table X understates the improvement in the terms of trade.

the Korean War was reflected almost immediately in an expansion of the money supply. By the end of 1950 the money supply stood at M$ 1,408 million -- 59 per cent above a year before -- and in the first quarter of

TABLE XI.

Banking and Finance in Malaya: 1949-51
(millions of Malayan dollars; end of period)

	1949	1950	1951 March	1951 June	1951 Sept.	1951 Dec.	Change 1949-51
Currency notes (net active)[a]	312	521	607	628	645	650	+338
Demand deposits of commercial banks	576	887	1066	1112	1124	1077	+501
Money supply[b]	888	1408	1673	1740	1769	1727	+839
Minimum sterling reserve against currency[c]	434	670	n.a.	n.a.	n.a.	809	+375
Commercial bank assets,							+522
Net overseas assets[d]	62	217	254	402	414	337	+275
Loans and advances	386	551	721	617	611	633	+247

a. Includes British Borneo. Net active notes equals the total of notes in circulation less cash on hand in all banks.
b. Does not include subsidiary coins in circulation in the amounts of M$ 31.0, 36.2, and 44.6 million at the end of 1949, 1950, and 1951, respectively.
c. 100 per cent of coin and currency outstanding.
d. Excess of domestic liabilities over domestic assets of commercial banks.

Source: Malayan Statistics, December 1952, pp. 138-9.

1951 it rose an additional M$ 265 million to 88 per cent above the December 31, 1949 level. Thereafter, it increased at a slower rate reaching 100 per cent above the earlier figure at the end of September and then receding somewhat because of a fall in demand deposits. Currency notes in active circulation rose 108 per cent over the two year period while demand deposits, posting a rise of 87 per cent, were not far behind.

That this spectacular rise in the money supply was largely attributable to the export surplus is to be seen in the fact that roughly 70 per cent of the rise was attributable to the automatic rise of sterling assets required as a backing for the currency by a rigid sterling exchange standard, and to the increase in the overseas assets of commercial banks. Since the Malayan Currency Board is required to maintain sterling assets valued at 100 to 110 per cent of the Malayan currency outstanding, its sterling holdings of necessity kept pace with the continual rise in coin and note issue.[31] Changes in the volume of deposit currency reflected the increase of net overseas assets of the commercial banks of M$275 million and the increase in domestic assets -- loans and advances -- of M$247 million. The rise in loans and advances contributed only 30 per cent to the increase in the sterling currency reserves and commercial bank assets which roughly speaking were responsible for the expansion of the money supply by M$839 million during 1950 and 1951. The total expansion in the money supply was only a fraction of the current account surplus of M$2,156 million due to the large private capital outflow mentioned previously.

This overall look, however, conceals a very interesting movement in bank assets during the period. During 1950 commercial credit expanded by M$165 million compared with a M$520 million increase in the money supply but during 1951's first quarter they expanded M$170 million while the money supply was increasing only M$265 million. Since the commercial banking system is so largely oriented toward the short-term financing of exports and imports,[32] it appears probable that this was primarily the result of (a) financing of consumer imports, made possible by the high level of incomes and the substantial relaxation of import controls, and (b) continuing heavy demand for export financing as rubber and tin prices reached their peak.[33]

It has been estimated by Benham that Malaya's Gross National Product rose some 60 per cent between 1949 and 1950 as a result of the boom.[34] The distribution of this higher income was unequal but general. The boom in rubber prices led to a rapid rise in wages paid by the smallholders of Malaya as they sought to cash in through tapping as intensively as possible. Considerable skilled labor was initially attracted away from the estates by earnings three to four times the prevailing rate for estate labor which was established by agreement among the estate owners.[35] A fairly large number of unskilled laborers also was drawn from other jobs to rubber tapping by the high wages. The estates granted a 12 per cent pay boost in September, but negotiations on further hikes were deadlocked until an arbitration board in May 1951 established, with effect from January 1, 1951, a "prosperity award" with a sliding scale tied to the rubber price. Thisaward raised

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31. In fact, since there was an increase in coins outstanding and since a portion of the rise in total currency outstanding was absorbed in larger cash holdings by banks, the increase in sterling reserves was somewhat larger than the rise in notes in active circulation. (Table XI). (In passing, it must be noted that the sterling exchange system effectively sterilizes a considerable share of the foreign exchange holdings of dependent areas.)

32. MacKenzie, op. cit., pp. 82-83.

33. Interest rates were not raised by the banks until December 1951 so that their influence on the credit picture remained unchanged throughout the boom period. Economic Survey for Asia and the Far East, 1951, (New York, 1952), pp. 196-7.

34. Benham, op. cit., pp. 119 and 172.

35. Federation of Malaya Annual Report, 1950, pp. 27-32. This led to various forms of bonus pay being given to estate workers by many of the plantations.

wages during 1951 about an average of 50 per cent above December 1950.[36] Meanwhile, the tin mining industry in September 1950 raised wages under a prosperity bonus scheme scaled to the price of tin, and wages during 1951 were about 10 per cent higher on the average than in December 1950. As the cost of living rose, substantial wage increases were granted at the turn of the year in other industries and by the government, but thereafter the wage level remained relatively stable throughout the year. A similar trend in wage rises appears to have taken place in Singapore but with more unevenness (increases varying from 10 to 150 per cent in June 1951 over the levels of a year earlier) so that the real wages of some workers probably declined.[37] The incomes of rice producers were substantially higher in 1950 and 1951 than in 1949 because of the bumper crops harvested and the good prices received throughout the period.

The following table shows vividly the rise in the cost of living of the three nationalities comprising the bulk of Malaya's population. The rise

TABLE XII

Cost of Living in the Federation of Malaya
(January-June 1950 = 100)

	Sept. 1950	Dec. 1950	March 1951	June 1951	Sept. 1951	Dec. 1951
Malay laborers	113	121	135	135	137	141
Chinese laborers	109	117	136	140	143	146
Indian laborers	106	114	133	139	141	145

Source: Federation of Malaya Annual Report, 1951, p. 40.

was initially greatest among the Malay smallholders and rice farmers -- amounting to 21 per cent by December 1950.[38] As the rubber plantations were forced by smallholder competition to pay bonuses of one sort or another for the limited labor supply and as other laborers were successful in their wage demands, higher incomes became general throughout the economy. However, as imports expanded as a result of the easing of controls and as the incomes of smallholders and the wages of rubber workers declined with the price of rubber in the last half of 1951, the rate of increase slowed -- the maximum increase in the last nine months being the 9 per cent rise in the cost of living of Indian laborers.

A considerable share of the higher incomes generated by the boom seems to have found its way into higher expenditure on better food and more

36. Federation of Malaya Annual Report, 1951, pp. 36-37. An interim award was made in March and incorporated in the May award.

37. Colony of Singapore Annual Report, 1951, (Singapore, 1952), pp. 36-38.

38. The cost of living of Malay workers was already 5 per cent above the January-June average in June 1950 -- probably because of the higher incomes of rice producers as a result of the good harvest.

clothing. The government's program of supplying the weekly rations of rice at a controlled price appears to have been rather successful in preventing spectacular increases in the free market price of this basic staple.[39] This success was due in large part to a rise in the availability of rice for consumption from 816,000 metric tons in 1949 to 886,000 in 1950 and 958,000 in 1951 -- a situation resulting from higher output for which the government could claim little credit and higher imports in 1951 for which government policy was responsible.[40] Prices, however, of meat, fish, vegetables, milk, coconut oil and fresh fruit rose steadily to relatively

TABLE XIII.

Price Indices of Selected Consumer Commodities in the Federation of Malaya
(January-June 1950 = 100)

	Sept. 1950	Dec. 1950	March 1951	June 1951	Sept. 1951	Dec. 1951
Meat	114	130	141	153	157	162
Rice (free market)	103	100	106	110	113	116
Fresh vegetables	116	132	163	175	168	184
Men's clothing materials	107	137	148	151	145	143
Women's clothing materials	106	113	120	124	118	112

Source: Federation of Malaya Annual Reports, 1950 and 1951, pp. 39-40, respectively.

high levels during 1951. Textiles, on the other hand, were probably representative of a number of imported commodities in which prices reached their peak in mid-1951 and declined thereafter as greater supplies became available following the relaxation of import controls.

In summary, it appears that the Federation government's program of rationing rice and sugar and of price controlling bread, milk, and cigarettes was fairly successful in retarding price increases for the basic staples in the diet. The really sharp rises in prices came in fields of protein-rich foods, textiles, and doubtless other imported consumer goods.[41] Much of the inflation in the price of imported consumer goods can fairly be attributed to the six months' delay in relaxing restrictions on hard currency and semi-

39. This was also true of the sugar rationing program after its reintroduction in September 1950 but free market prices had risen 50 per cent before rationing was instituted.

40. Federation of Malaya Annual Report, 1951, p. 98.

41. Interestingly enough retained imports of artificial silk piece goods expanded 130 per cent between 1949 and 1951 while cotton piece goods imports expanded only 30 per cent. It is not unlikely that the shift in expenditure pattern during the boom period toward increased consumption of non-staples caused the cost of living indices to understate the increase in living costs which took place.

luxury imports. More effective restraint on the rising prices of domestically produced foods, whose supply was relatively inelastic in the short run, would have had to rely on siphoning off purchasing power through higher taxation. Government efforts to inaugurate modest policies in this direction were successfully modified by influential estate interests in such a wayeas to nullify their progressive character. However, without the considerable success achieved by the rubber estates in resisting and delaying substantial across-the-board wage increases until May 1951 and their concurrent accumulation of large profits which did not compete in the local market place for goods, the inflation of the general price level in Malaya would undoubtedly have been even greater. Inasmuch as the cost of living of laborers rose by December 1951 to some 40 to 50 per cent above levels prevailing in the six months preceding the Korean War, there seems to be grounds for wondering how significant were the gains in real income achieved by laborers -- as a whole and by occupation. As compared with smallholder and estate rubber producers, producers of food crops and those engaged in trade, laborers undoubtedly experienced a relative decline in incomes. The frequently observed unequal effects of inflation on the incomes of different groups were not missing in Malaya.

E. Response of the Government Budget

The export boom generated by the Korean War had an immediate salutary effect on Malaya's fiscal situation. Even with the existing low level of export duties, 1950 receipts from customs were up M$ 111 million over 1949 and M$ 122 million over the budget estimates. Duties on rubber and tin contributed 55 per cent and 15 per cent, respectively, of this increase.[42] Instead of a projected deficit of perhaps M$20-40 million (if one projects

TABLE XIV.

Federation of Malaya: Gross Revenues and Expenditures
(million of Malayan dollars)

	1949 actual	1950 budget estimates	1950 actual	1951 budget estimates	1951 actual	1952 budget estimates
Revenue	345	274	443	368	736	641
Expenditures	347	281	340	440	549	596
Surpluse(+) or Deficitse(-)	-2	-7	+103	-72	+187	+45

Sources: 1950-51 budget estimates from Minutes of Legislative Council of the Federation of Malaya, Third Session, pp. 619-23; 1952 estimates from Federation of Malaya Annual Report, 1952, (Kuala Lumpur, 1953), pp. 71-2; 1949-51 actuals from Economic Survey of Asia and the Far East, 1953, p. 100.

42. Direct budgetary contributions of the United Kingdom added another M$ 26 million. Note that this discussion excludes the Colony of Singapore.

receipts at the 1949 level and includes expenditures connected with the emergency), a healthy surplus of M$ 103 million was realized as outlays continued at 1949 levels because non-defense expenditures lagged.[43] Yet the existing government tax structure captured only a small part of the increase in incomes for while its receipts were rising 28 per cent between 1949 and 1950 it has been estimated that Malaya's Gross National Product was rising some 60 per cent.[44]

The quick change in the economic picture also made obsolete the 1951 budget estimates even at the time they were presented in November 1950, especially on the revenue side where estimates were kept at the 1949 realized level and no account was taken of the proposed increase in the rubber duty. Because of the continuation throughout 1951 of a high level of trade, higher company income taxes and the imposition of the sliding scale system of rubber export duties, government receipts were twice the estimates and 113 per cent larger than 1949. Of the M$ 293 million increase in revenues over 1950, rubber export duties accounted for 43 per cent, tin export duties for 8 per cent, import duties for 23 per cent, and income tax for 28 per cent.[45] The potential importance of a truly progressive tax on products experiencing booming demand can be seen in the fact that M$ 70 million of the M$ 125 million increase in revenue from the rubber export duty was attributable to the sliding scale rate introduced on January 1, 1951, while an additional M$ 50 million was collected and deposited in a special replanting fund.[46] The substantial rise in receipts from import duties and income taxes reflects the higher volume and value of imports, on the one hand, and on the other, the higher corporate and personal incomes in Malaya (and to an undetermined extent the rise in the company tax rate from 20 to 30 per cent).

Expenditures were also up 60 per cent (about M$ 200 million) over the 1949 and 1950 levels -- largely because of an increase between 1949 and 1951 of M$ 140 million in spending related to the emergency. Outlays incurred because of the emergency rose from 24 per cent of gross outlays in 1949 to 36 per cent in 1950 and 42 per cent in 1951.[47] The program of economic

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43. Expenditures on the emergency totaled some M$ 125 million compared with M$ 85 million in 1949.

44. Benham, _op. cit._, pp. 119 and 172. These figures understate the government's ultimate take from expanded incomes since company and income taxes on 1950 income were collected in 1951.

45. _Federation of Malaya Annual Reports, 1950 and 1951_, pp. 58 and 67-73, respectively. There was no contribution from the United Kingdom as there had been in the amount of M$ 26 million the year before. This accounts for the percentage increases in the revenue items listed adding to over 100 per cent.

46. The estimate that the new tax rates produced M$ 70 million more than the previous 5 per cent _ad valorem_ is based on the assumption that returns from the latter would have varied in proportion to the change in the value of gross rubber exports.

47. _Federation of Malaya Annual Reports, 1949, 1950, and 1951_, pp. 30-31, 54-55, and 68, respectively.

development envisioned by Malaya's Six Year Development Plan (1950) had to be revised to bear more directly on the security problem with the result that of the M$ 150 million labeled development expenditures by the Federation 27 per cent was for the resettlement of squatters, 37 per cent for railway and highway development, 6 per cent for telecommunications, and 15 per cent for electric power leaving 25 per cent for all other activities.[48] There seems to have been a conscious policy of trying to hold down expenditures in the face of rising costs. A substantial number of civilian and some military public works were cut back or postponed, for example, though the demands of the emergency caused total public works expenditures during the year to exceed the estimates by 50 per cent.[49] Nevertheless, despite the 60 per cent rise in expenditures, the year 1951 closed with the not inconsiderable surplus of M$ 187 million and the accumulated surplus of the Federation Government had been built up to over M$ 430 million which could be used to finance economic development in the days ahead.[50]

Yet, the fiscal efforts of the Malayan government cannot be credited with containing the inflationary consequences of the export boom. Taking the balance on current account as a rough index of the magnitude of the primary inflationary pressure on incomes, then the anti-inflationary Federation budget surpluses of M$ 290 million over the two years 1950 and 1951 plus the rubber replanting fund of M$ 50 million, plus the Colony of Singapore surpluses of about M$ 66 million, were obviously inadequate to counter the inflationary forces coming from current account surpluses of approximately M$ 1,100 millions (U.S.$ 360 million) in both of those same years. As one has seen, the cost of living for Malay laborers rose 21 per cent between June and December 1950 and by December 1951 was 41 per cent above the pre-June 1950 level.[51] That the price inflation resulting from the huge export surplus was not even more marked was due primarily to the large profits transmitted abroad by non-Malayan companies (of the order, perhaps, of M$ 150 to 200 million in 1950 and M$ 400 million in 1951), the phenomenal outflow of private capital, and the use of earnings to provide the increased working capital necessitated by the higher volume and value of trade. Since the rise in government expenditures over the period should probably not be considered extraordinary in the light of the importance to present and future production of attaining greater internal security, fiscal policy could have achieved greater effectiveness as an anti-inflationary device chiefly through increasing tax receipts. This would have necessitated the application at a much earlier date of a

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48. Second Colombo Plan Report, op. cit., pp. 91-92. Spending related to the emergency and on economic development as here used are not mutually exclusive.

49. Federation of Malaya Financial Statements, 1951 (Kuala Lumpur, 1953), pp. 119-28. See also Economic Bulletin for Asia and the Far East, Vol. II, No. 2, p. 37.

50. Great Britain, Reports from Commissioners, 1951-52, IX, (London, 1954), First Annual Report of the Consultative Committee of the Colombo Plan, p. 41. The Colony of Singapore had an accumulated surplus of about M$ 70 million at the end of 1951.

51. The comparable increases were 17 and 46 per cent for Chinese laborers, 14 and 45 per cent for Indian laborers.

truly progressive export duty such as the government proposed in late 1950 and in mid-1951 but did not carry through. The government probably could also have tapped the secondary expansion in incomes through increasing corporation and individual income tax rates whose upper limit of 30 per cent could scarcely have been called excessive in such a boom though administrative limitations may have made such a rise difficult to enforce.[52]

Strong justification for progressive taxation of windfall profits from both exports and internal trade existed in the need for broadening the base of the nationės economy and expanding its output sufficiently to stay ahead of population growth estimated to be $2\frac{1}{2}$ per cent annually. Reserves could have been built up for financing an orderly and expanding development program when the boom disappeared. The sterling exchange standard imposes a considerable restraint on the Malayan government's freedom of action in development, restricting as it does the government's future budgetary deficits to its accumulated surplus and long-term borrowing.[53] Despite a number of steps hesitantly taken in the right direction Malaya lost an excellent opportunity during the boom. By 1953 the government of Malaya found that it could not bear alone the double burden of fighting Communist terrorism and of the social development without which the military effort would avail little.[54]

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52. It should be pointed out that the net anti-inflationary effect of such moves would have been lessened to the extent that the increased tax receipts were at the expense of profits which did not compete in the local market place for goods and services -- e.g., the profits remitted abroad.

53. Economic Survey for Asia and the Far East, 1953, p. 99.

54. Second Annual Colombo Plan Reporte op. cit., p. 84.

III. SUMMARY AND CONCLUSIONS

Malaya provides an outstanding example of the susceptibility of less developed, primary producing countries to wide fluctuations in their export proceeds and level of economic activity. Her export proceeds jumped from U.S.$ 734 million in 1949 to U.S.$ 1,985 million in 1951. National income doubled during the two year period.[1] The Malayan government responded after some delay by raising tax rates on rubber exports and on company profits, easing import controls and maintaining rationing and price control on basic food staples. As a result primarily of a higher level of trade and secondarily of the increased tax rates, government revenues rose faster than expenditures so that sizable budget surpluses were achieved over the two-year period. The rise in government outlays was held down by delaying or reducing anticipated spending on economic development, as it is generally conceived, in favor of concentrating resources on the improvement of internal security.

Broadly speaking, the government's measures proved "too little and too late." The tax structure at the time the Korean War broke out was not designed to tap the windfall profits it produced. Malaya's organized rubber growers successfully forestalled the imposition of a truly progressive export levy which could have struck at the root of the export inflation. Such a levy could have accumulated a development fund commensurate with the problems of rejuvenating the existing capital stock and diversifying the economy. The remission of profits and earnings abroad and the massive exodus of private capital were far more important than government budget surpluses during the boom in preventing the full impact of the export surplus from reaching the internal economy. Government rationing, procurement and price control were fairly successful in slowing down price rises for the basic staples in the diet, but the relaxation of import controls on non-basic consumers' goods seems to have followed rather than anticipated price rises. Inflation with its usual unevenness and inequalities was very much present in Malaya.

What lessons are to be drawn from Malayan experience during the boom phase of the boom-bust cycle which followed the outbreak of war in Korea? First, a sliding-scale system of taxes on exports of primary products seems to offer considerable promise as a means of cushioning the domestic economy against the full impact of an export boom and of building up reserves to sustain development activity during periods when current budgetary and foreign exchange receipts are depressed. The possibility of using excess profits taxes or special prosperity income tax levies during a boom to tap the secondary inflation of incomes also merits consideration but may be less feasible administratively in less developed countries. Such a program is all the more necessary where a rigid foreign exchange system restricts the authorities' use of the country's exchange reserves. It does not imply necessarily that investment decisions must be shifted from the private sector to the government. A portion of receipts from such taxes can be deposited in a separate fund, as in Malaya, for release to private producers for bona

1. Great Britain, Reports from Commissioners, 1951-52, IX, op. cit., p. 38.

fide investment when the boom has subsided. Diversification of the economy requires, however, that a substantial share of such receipts be channeled into other productive sectors. To achieve sustained development activity, administration of such a fund will require foresight and self-control on the part of governmental authorities to avoid raising, or attempting to raise, development expenditures during boom periods to the level of current receipts thereby precluding the accumulation of a development fund.

Second, the Malayan experience seems to indicate the importance of having a flexible tax system, capable of siphoning off a progressively larger share of a boom's windfall profits at the time the boom gets underway. Otherwise the time required to enact the required legislation will allow much of the windfall to escape. The resistance of producers to the enactment of such levies is also likely to be less before prices and profits boom.

Third, the relaxation of import controls and rationing of basic staples at stable prices can be very useful, in containing the price and cost inflation generated by the rise in incomes. It is probably more effective in view of administrative weakness usually present in less developed countries to concentrate government rationing, procurement and price control efforts on basic staples as was done with considerable success in Malaya than embarking on an all encompassing effort at controlling prices. The importance of promptness in allowing larger non-essential as well as basic consumer imports is demonstrated by the Malayan experience.

Finally, if economic development ranks high among a country's objectives, the governmental authorities can hardly permit a mass exodus of private capital such as occurred during 1950 and 1951 in Malaya -- a flow which cannot be relied upon to return when good times have passed. The accumulation, during a boom, of earning assets in world financial centers can give a tremendous lift to the continuity of a country's development efforts. However, it is difficult to see how a country as much in need of diversification and development as Malaya can afford to export over a two-year period private capital to other parts of the Sterling Area to the extent of U.S.$300 million -- almost half of its surplus on current account.[2] One can be a firm believer in the vital role to be played by private capital, foreign and domestic, in promoting economic growth in less developed areas and yet be skeptical whether permitting such unlimited capital flows is essential to private foreign investment. Nor does a rigid 100 per cent foreign exchange standard, requiring as it does the fairly prompt elimination of import surpluses and imposing a very conservative fiscal policy, seem the most appropriate for assisting economic growth. Colonial policy might be wiser to try to inculcate the principles of fiscal responsibility during the period of tutelage than to expose colonial investments to the dangers likely to follow an initial emotional junking of restrictive colonial measures after independence.

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2. Here the rise of private sterling assets of U.S.$ 60 million held with banks is taken to be an increase in working balances while the remaining U.S.$ 300 million is treated as a long-term capital outflow whose future reinvestment in Malaya cannot be relied upon.

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