



**UNIVERSITI PUTRA MALAYSIA**

**STATE INCOME DISPARITY IN RELATION TO  
NATIONAL DEVELOPMENT PLANS IN MALAYSIA**

**SIVABALASINGAM VEERASINGAM**

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UNIVERSITI PUTRA MALAYSIA**

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**STATE INCOME DISPARITY IN RELATION TO  
NATIONAL DEVELOPMENT PLANS IN MALAYSIA**

**By**

**SIVABALASINGAM VEERASINGAM**

**Thesis Submitted to the School of Graduate Studies, Universiti Putra Malaysia,  
in Fulfilment of the Requirements for the Degree of Doctor of Philosophy**

**June 2007**



## **DEDICATION**

This work is dedicated,

To the memories of my late brother, Dr V. Kulasingam who passed away while I was reading for this degree. I remain indebted and continue to miss him,

To my late parents for their love, wisdom and sacrifices,

To my beloved wife Thakshajini Panchanathan and loving daughter Tvisha. May the pursuit of goodness be their ultimate objective in life.

Abstract of thesis presented to the Senate of Universiti Putra Malaysia in fulfilment  
of the requirement for the degree of Doctor of Philosophy

**STATE INCOME DISPARITY IN RELATION TO  
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**June 2007**

**Chairman: Professor Muzafar Shah Habibullah, PhD**

**Faculty: Economics and Management**

Malaysia envisaged of bringing the low-income states to the general income level by 1985 (First Malaysia Plan, 1965). However, after 49 years of independence and equivalent years of economic planning, the national agenda of bridging the income divide across states in Malaysia remains an unresolved issue. This study is designed to address the question why for the last four decades and with nine National Development Planning programmes should substantial state income disparities be of great concern to the public, politicians and the academic circle.

In tandem with the general objective, we examined whether poor states in Malaysia are growing faster than rich states ( $\beta$ -convergence). In consonance with our comparative and non-parametric results, we find no econometric evidence to support  $\beta$ -convergence in Malaysia. In addition, an examination on sigma convergence, namely the tendency for cross-sectional dispersion of real per capita income to decline over time suggests that the dispersion in income across states in Malaysia has in fact widened. Our results also indicate that the strategies in the Third Malaysia

Plan were the most effective while the rest did not meet their intended target of reducing the income divide across states in Malaysia. We also find evidence to suggest that the rising income inequality is not a common phenomenon but mainly due to greater variation in real per capita income between Kelantan, Kedah, Perlis, Pahang and Sabah and the rest of the states in the country. A growth model based on the System Generalized Method of Moments technique suggest that investment has a positive impact, while agriculture sector and population growth rate has a negative impact on income growth.

Given these findings, we conclude that despite 49 years of independence and equivalent years of economic planning, the national agenda of bridging the income divide between the low and high-income states, in particular between Kelantan, Kedah, Perlis, Pahang and Sabah and the more developed states in the country did not materialise. This failure is largely associated to the ineffectiveness of the national regional policy. To mitigate the income divide across states in the country, greater industrial and investment activities are humbly recommended.

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Last but not least, I am very grateful to my wife, Thakshajini Panchanathan for her patience, especially for tolerating the vacuum I created during the period of this study. I thank her for enabling me to accomplish my life long dream.

## **DECLARATION**

I hereby declare that the thesis is based on my original work except for quotations and citations which have been duly acknowledged. I also declare that it has not been previously or concurrently submitted for any other degree at UPM or other institutions.

---

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## LIST OF ABBREVIATIONS

APEC	Asia Pacific Economic Cooperation
ARMA	Auto Regressive and Moving Average
ASEAN	Association of Southeast Asian Nations
BIMP-EAGA	Brunei Darussalam-Indonesia-Malaysia-Philippines East ASEAN Growth Area
BPMB	Bank Pembangunan Malaysia Berhad
COMECON	Council for Mutual Economic Assistance
CPI	Consumer Price Index
CSTCI	Country Specific Technical Change Index
EU	European Union
GDP	Gross Domestic Product
GLCs	Government Linked Companies
GMM	Generalized Method of Moments
GNI	Gross National Income
GNP	Gross National Product
GPP	Gross Provincial Product
HICOM	Heavy Industries Corporation of Malaysia Berhad
IMD	The Institute for Management Development
IMT-GT	Indonesia-Malaysia-Thailand Growth Triangle
JDS	Joint Development Strategy for Border Areas
KKMB	Kompleks Kewangan Malaysia Berhad
LAFTA	Latin American Free Trade Area
MARA	Majlis Amanah Rakyat
MEXPO	Malaysian Export Trade Centre

MIDA	Malaysian Industrial Development Authority
MIDFL	Malaysian Industrial Development Finance Limited
MITI	Ministry of International Trade and Industry
NEP	New Economic Policy
NGOs	Non-Governmental Organizations
OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
PERNAS	Perbadanan Nasional
PNB	Pelaburan Nasional Berhad
PPRT	Development Programs for the Poorest
R&D	Research and Development
SMEs	Small and Medium Size Industries
SPKR	Skim Pembangunan Kesejahteraan Rakyat
System GMM	System Generalized Method of Moments
TFP	Total Factor Productivity
UDA	Urban Development Authority
USA	United States of America

# CHAPTER 1

## INTRODUCTION

### 1.1 Background

Economic growth and equity remains an important issue in the economic agenda of many countries. Although different countries have different perception of what equitable is and how best to achieve it, by and large, there is a consensus that extreme inequality of income, wealth or opportunity is unfair and that efforts should be made to raise the income of the poorest members of society. Accordingly, in their quest to achieve both development and equity at the same time, policies and strategies are continuously being formulated and implemented across the globe. Malaysia, a Federation of thirteen states and three Federal Territories is no exception. The thirteen states in the Federation are Perlis, Kedah, Kelantan, Terengganu, Pulau Pinang, Perak, Pahang, Selangor, Negeri Sembilan, Melaka, Johor, Sabah and Sarawak while the Federal Territories are Kuala Lumpur and Putrajaya in West Malaysia and Labuan in East Malaysia. These states can be categorized into two, namely the more developed states<sup>1</sup> and the less developed states.

Recognizing the importance of achieving regional equality in Malaysia, the government instituted several policies and strategies since independence to close the gap between the states in Malaysia. These policies and strategies which are reported in nine volumes of the Five-Year Malaysia Plan, reflects the sincerity of the Malaysian government in eradicating if not alleviating the problem of regional imbalances.

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<sup>1</sup>The more developed states are Johor, Melaka, Negeri Sembilan, Perak, Pulau Pinang and Selangor. The less developed states are Kedah, Kelantan, Pahang, Perlis, Sabah, Sarawak and Terengganu. The Federal Territory of Kuala Lumpur and Putrajaya are categorized as more developed states, while the Federal Territory of Labuan is classified as a less developed state.



Malaysia as it is known today and as Malaya before independence is a nation with explicit social-economic goals. Well into the First Malaya Plan (1956-1960), on 31<sup>st</sup> August 1957, Malaya secured independence from Britain. While the Second Malaya Plan (1961-1965) was very much in progress, a new nation Malaysia was formed (September 1963) with the inclusion of the self-governing island of Singapore, and the British colonies of Sabah and Sarawak. While at the end of the Second Malaya Plan (August 1965), Singapore chose to separate itself from the Federation to form an independent state. Thereafter, Malaysia continued with the tradition of planning for the future. This led to the formulation and implementation of a series of five-year plans for the development of the Malaysian economy. These plans were guided by the development of the New Economic Policy (1970), the National Development Policy (1991), and the National Vision Policy (2001). More recent plans have been guided by a working paper presented by Tun Dr Mahathir Mohamad (former Prime Minister) in February 1991 entitled “Malaysia: The Way Forward”, also known as Vision 2020.

During the period between 1956 and 1960, output in Malaya grew at an average rate of 4%. The economic accomplishment of the Federation during the period was impressive as attested by a relatively high standard of living, financial stability and worldwide recognition of the strength of the economy (Federation of Malaya, Second Malaya Plan, 1961). Nevertheless, it was not an economy without problems. One of the major economic problems identified in the Second Malaya Plan was over-specialization and excessive dependence on rubber. At that time rubber accounted for over 25% of national income, nearly 30% of employment and about 60% of exports. The plan therefore saw a need for economic diversification. The other problems

identified were the high rate of population growth and the depressed condition of the rural areas.

Between 1961 and 1965, the Federation experienced rapid economic growth with real Gross Domestic Product (GDP) averaging 6.4% and per capita income growth averaging 2.7%. During this period of rapid economic growth, the economy still depended heavily on agriculture and in particular, on the production of natural rubber (First Malaysia Plan, 1965). Between 1965 and 1970, GDP in real prices rose at an average rate of 5.5% (Second Malaysia Plan, 1971). Diversification not only in agriculture but also in other sectors, particularly in the manufacturing sector was also actively pursued. Consequently, the share of manufacturing to GDP rose from 8.5% in 1960 to 10.4% in 1965 and about 13% in 1970. Unemployment in West Malaysia in 1970 was estimated at 8% compared to 6.5% in 1965. For the period 1965 to 1970, per capita real income growth averaged 2.2%. Despite the significant progress made in improving the economic well-being of the poor, the problem of economic imbalance remained as large part of the population were engaged in low-income activities in the rural areas, particularly with the concentration of Malays and other indigenous people in the low-income activities. Thus the Second Malaysia Plan (1971-1975) adopted strategies to deal with the problems of poverty, unemployment and economic imbalance.

There on, seven other five-year plans were introduced and implemented and currently the Ninth Malaysia Plan for the period 2006 to 2010 is under way. Today as compared to the years in the foregoing paragraphs, Malaysia produces and exports a wide range of manufactured goods and primary commodities, including electronic

components and equipment, electrical machinery and appliances, chemicals, textiles, wood products, metal products, petroleum, liquefied natural gas, sawn timber, saw logs and tin. Malaysia is one of the world's largest exporters of semiconductors, air conditioners, rubber gloves, palm oil and rubber. This signifies the success of the diversification plan identified and pursued upon independence.

During the period between 1970 and 2005, Malaysia's GDP grew at an annual compounded rate of 6.9% from RM25,427 million to RM262,029 million in 2005. In the same reference period, Malaysia's per capita Gross National Income (GNI) in nominal prices recorded a compounded annual increase of 6.7% from RM788 to RM18,106. Other noticeable achievements include an increase in merchandise exports from RM2,182 million to RM533,790 million equivalent to an annual compounded increment of 12.1% and a surge in net official reserves from RM1,543 million to RM266,387 million during the 1957 to 2005 period which is equivalent to an annual compounded increment of 11.3%. The current account of Malaysia's balance of payments in 2005 totaled RM75,681 million compared to RM103 million in 1957. During post independence, rubber and tin dominated the export sector representing 62.3% and 53.8% in 1965 and 1970, respectively. Today manufacturing sector contributes 80.5% of Malaysian exports.

The foregoing paragraph illustrates that Malaysia was able to diversify quickly and grow very fast over the last few decades. Indeed, Malaysia has emerged as one of the most dynamic countries in the world. Between 1971-2005, Malaysia was among the fastest growing countries in the ASEAN-5 economies (Table 1.1). Malaysia's growth rate during this period was more than that of the world economy, even surpassing



that of the industrial economies (Table 1.2). Notably, the growth was accompanied by low unemployment and inflation rate. Despite population increasing at an annual compounded rate of 3.2% (between 1957 and 1992), Malaysia attained full employment in 1992 and continues to operate under such environment (Economic Report, 2004). On a regional comparison, Malaysia's unemployment rate remains low after 1990 (Table 1.3).

Likewise, inflation in Malaysia remains subdued and is among the lowest in the ASEAN-5 economies (Table 1.4). On an international benchmark, inflation rate in Malaysia is very much lower than that of the world (Table 1.5). More importantly, despite its richness in natural resources, the country continued to face the problems of poverty in the 60s (Second Malaysia Plan, 1971). Today poverty is more of an exception than a norm. The success of the Government in eradicating poverty is evident from the sharp decline in the incidence of total poverty from 52.4% in 1970 to 5.1% in 2002 (Economic Report, 2004) and declined further to 4.4% in 2004 (Ninth Malaysia Plan, 2006). Thus, it is not surprising that we hear calls for the USA and other western countries, which have also seen solid growth over the last 20 years but with little reduction in poverty rates to learn from the experience of the East Asian economies<sup>2</sup>.

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<sup>2</sup> Restoring the Asian Miracle", Wall Street Journal, Europe (3 February, 1998).